

**Committee and Date**

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Item

Public

TREASURY MANAGEMENT UPDATE – QUARTER 3 2020/21

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1. Summary

- 1.1. The report outlines the treasury management activities of the Council in the last quarter. It highlights the economic environment in which treasury management decisions have been made and the interest rate forecasts of the Council's Treasury Advisor, Link Asset Services. It also updates Members on the internal treasury team's performance.
- 1.2. During the third quarter of 2020/21 the internal treasury team achieved a return of 0.23% on the Council's cash balances, outperforming the benchmark by 0.31%. This amounts to additional income of £145,850 during the quarter which is included within the Council's outturn position in the monthly revenue monitor. Following a decision by the Monetary Policy Committee in March 2020 to cut the Bank Rate to 0.1%, this has resulted in the 7 Day benchmark rate being a negative figure since the start of the financial year.

2. Recommendations

- 2.1. Members are asked to accept the position as set out in the report.

REPORT

3. Risk Assessment and Opportunities Appraisal

- 3.1. The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998.
- 3.2. There are no direct environmental, equalities or climate change consequences arising from this report.
- 3.3. Compliance with the CIPFA Code of Practice on Treasury Management, the Council's Treasury Policy Statement and Treasury Management Practices and the Prudential Code for Capital Finance together with the rigorous internal controls will enable the Council to manage the risk associated with Treasury Management activities and the potential for financial loss.

4. Financial Implications

- 4.1. The Council makes assumptions about the levels of borrowing and investment income over the financial year. Reduced borrowing as a result of capital receipt generation or delays in delivery of the capital programme will both have a positive impact of the council's cash position. Similarly, higher than benchmarked returns on available cash will also help the Council's financial position. For monitoring purposes, assumptions are made early in year about borrowing and returns based on the strategies agreed by Council in the preceding February. Performance outside of these assumptions results in increased or reduced income for the Council.
- 4.2. The Quarter 3 performance is above benchmark and has delivered additional income of £145,850 which is reflected in the Period 9 Revenue Monitor.
- 4.3. As at 31 December 2020 the Council held £170 million in investments as detailed in Appendix A and borrowing of £304 million at fixed interest rates.

5. Climate Change Appraisal

- 5.1. The Council's Financial Strategy includes proposals to deliver a reduced carbon footprint for the Council therefore the Treasury Team is working with the Council in order to achieve this. There are no climate change impacts arising from this report.

6. Background

- 6.1. The Council defines its treasury management activities as "the management of the authority's borrowing, investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks". The report informs Members of the treasury activities of the Council between 1 October 2020 and 31 December 2020.

7. Economic Background

- 7.1. It was agreed at the last meeting of the Bank of England Monetary Policy Committee to keep Bank Rate unchanged at 0.10%. However, it revised its economic forecasts to take account of a second national lockdown which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do a further tranche of quantitative easing (QE) of £150bn, to start in January when the current programme of £300bn of QE, announced in March to June, runs out. They announced these further asset purchases should now support the economy and help to ensure the unavoidable near-term slowdown in activity. Its forecasts appeared, at that time, to be rather optimistic in terms of three areas:
- The economy would recover to reach its pre-pandemic level in Q1 2022.
 - The Bank expected there to be excess demand in the economy by Q4 2022.
 - CPI inflation was therefore projected to be a bit above its 2% target by the start of 2023 and the inflation risks were judged to be balanced.

- 7.2. Significantly, there was no mention of negative interest rates in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. However, rather than saying that it stands ready to adjust monetary policy, the MPC this time said that it will take whatever additional action was necessary to achieve its remit. The latter seems stronger and wider and may indicate the Bank's willingness to embrace new tools.
- 7.3. The MPC does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably. That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. The Bank Rate forecast currently shows no increase, (or decrease), through to quarter 1 2024 but there could well be no increase during the next five years as it will take some years to eliminate spare capacity in the economy, and therefore for inflationary pressures to rise to cause the MPC concern. Inflation is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary factor and so not a concern.
- 7.4. We had been waiting expectantly for news that various COVID-19 vaccines would be cleared as being safe and effective for administering to the general public. The Pfizer announcement on 9th November was very encouraging as its 90% effectiveness was much higher than the 50-60% rate of effectiveness of flu vaccines which might otherwise have been expected. However, this vaccine has demanding cold storage requirements that impairs the speed of application to the general population. It has therefore been particularly welcome that the Oxford University/AstraZeneca vaccine has now also been approved which is much cheaper and only requires fridge temperatures for storage. The Government has 60 million doses on order and is aiming to vaccinate at a rate of 2 million people per week starting in January.
- 7.5. These announcements, plus expected further announcements that other vaccines could be approved soon, have enormously boosted confidence that life could largely return to normal during the second half of 2021, with activity in the still-depressed sectors like restaurants, travel and hotels returning to their pre-pandemic levels; this would help to bring the unemployment rate down. With the household saving rate having been exceptionally high since the first lockdown in March, there is plenty of demand and purchasing power stored up for these services. A comprehensive roll-out of vaccines might take into late 2021 to fully complete; but if these vaccines prove to be highly effective, then there is a possibility that restrictions could start to be eased, beginning possibly in Q2 2021 once vulnerable people and front-line workers have been vaccinated. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines would radically improve the economic outlook once they have been widely administered; it may allow GDP to rise to its pre-virus level a year earlier than otherwise and mean that the unemployment rate peaks at 7% in 2021 instead of 9%.

- 7.6. Overall, the pace of recovery was not expected to be rapid, but a more elongated and prolonged one. The initial recovery was sharp after quarter 1 saw negative growth at 3.0% followed by positive growth of 18.8% in quarter 2 and then a further positive upswing of 16.0% in quarter 3; this still left the economy 8.6% smaller than in Q4 2019. It is likely that the national lockdown that started on 5th November for a month, will have caused a further contraction of 8% in November so the economy may have then been 14% below its pre-crisis level.
- 7.7. In December 2020 / January 2021, there has been a reintroduction of restrictions due to the spread of a new mutation of the virus, and severe restrictions were imposed across all four nations. In January 2021, these restrictions were changed to national lockdowns of various initial lengths in each of the four nations, as the NHS was under extreme pressure. It is now likely that wide swathes of the UK will remain under these new restrictions for some months; this means that the near-term outlook for the economy is grim. However, the distribution of vaccines and the expected consequent removal of COVID-19 restrictions, should allow GDP to rebound rapidly in the second half of 2021 so that the economy could climb back to its pre-pandemic peak as soon as late in 2022. Provided that both monetary and fiscal policy are kept loose for a few years yet, then it is still possible that in the second half of this decade, the economy may be no smaller than it would have been if COVID-19 never happened. The significant caveat is if another mutation of COVID-19 appears that defeats the current batch of vaccines. However, now that science and technology have caught up with understanding this virus, new vaccines ought to be able to be developed more quickly to counter such a development and vaccine production facilities are being ramped up around the world.
- 7.8. The final Brexit agreement in December 2020 has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis.
- 7.9. In the US, the Democrats won the presidential election in November, and now that they have won two Senate seats in Georgia in early January, they have effective control of both the House of Representatives and the Senate, although power is more limited in the latter. This is likely to enable the Democrats to provide more fiscal stimulus to the economy and so help the speed of economic recovery.
- 7.10. The US economy had been recovering quite strongly from its contraction in 2020 of 10.2% due to the pandemic with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during quarter 4, to the highest level since mid-August, suggests that the US could be in the early stages of a fourth wave - impacting widely across the US this time. This latest upturn poses a threat that the recovery in the economy could stall. This is the single biggest downside risk to the short term outlook, a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, states might feel it necessary to return to more

draconian lockdowns. The restrictions imposed to control the spread of the virus are once again weighing on the economy with employment growth slowing sharply in November and retail sales dropping back. The economy is set for further weakness in December and into the spring. However, a \$900bn fiscal stimulus deal passed by Congress in late December will limit the downside. GDP growth is expected to rebound markedly from the second quarter of 2021 onwards as vaccines are rolled out on a widespread basis and restrictions are loosened.

- 7.11. The Federal Reserve's meeting on 16 December tweaked the guidance for its monthly asset quantitative easing purchases with the new language implying those purchases could continue for longer than previously believed. Nevertheless, with officials still projecting that inflation will only get back to 2.0% in 2023, the vast majority expect the fed funds rate to be still at near-zero until 2024 or later. Furthermore, officials think the balance of risks surrounding that median inflation forecast are firmly skewed to the downside. The key message is still that policy will remain unusually accommodative with near-zero rates and asset purchases continuing for several more years. This is likely to result in keeping Treasury yields low which will also have an influence on gilt yields in this country.
- 7.12. In early December, the Eurozone economy figures for Q3 GDP confirmed that the economy staged a rapid rebound from the first lockdowns. This provides grounds for optimism about growth prospects for next year. In Q2, GDP was 15% below its pre-pandemic level. But in Q3 the economy grew by 12.5% leaving GDP down by "only" 4.4%. That was much better than had been expected earlier in the year. However, growth is likely to stagnate during Q4 and in Q1 of 2021, as a second wave of the virus has affected many countries: it is likely to hit hardest those countries more dependent on tourism.
- 7.13. In China, after a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and then into Q3 and Q4; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth.

8. Economic Forecast

- 8.1. The Council receives its treasury advice from Link Asset Services. Their latest interest rate forecasts to 31 March 2024 are shown below:

Link Group Interest Rate View		9.11.20											
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20													
	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

8.2. The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to 0.25%, and then to 0.10%, it left Bank Rate unchanged at its last meeting, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31st March 2024 as economic recovery is expected to be only gradual.

8.3. Long term PWLB rates are expected to rise to 1.4% in June 2021 before increasing to reach 1.6% by June 2023.

9. Treasury Management Strategy

9.1. The Treasury Management Strategy (TMS) for 2020/21 was approved by Full Council on 27 February 2020. The Council's Annual Investment Strategy, which is incorporated in the TMS, outlines the Council's investment priorities as the security and liquidity of its capital.

9.2. The Council aims to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term (up to 1 year), and only invest with highly credit rated financial institutions using Link's suggested creditworthiness approach, including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Link. The Treasury Team continue to take a prudent approach keeping investments short term and with the most highly credit rated organisations.

9.3. In the third quarter of 2020/21 the internal treasury team outperformed its benchmark by 0.31%. The investment return was 0.23% compared to the benchmark of -0.08%. This amounts to additional income of £145,850 during the quarter which is included in the Council's outturn position in the monthly revenue monitor.

9.4. A full list of investments held as at 31 December 2020, compared to Link's counterparty list, and changes to Fitch, Moody's and Standard & Poor's credit ratings are shown in Appendix A. None of the approved limits within the

Annual Investment Strategy were breached during the third quarter of 2020/21. Officers continue to monitor the credit ratings of institutions on a daily basis. Delegated authority has been put in place to make any amendments to the approved lending list.

- 9.5. As illustrated in the economic forecast section above, investment rates available in the market for three months and longer have decreased significantly as a result of the decrease in Bank Rate in March 2020 to 0.1%. The average level of funds available for investment purposes in the third quarter of 2020/21 was £190 million.

10. Borrowing

- 10.1. It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy. A list of the approved limits is shown in Appendix B. The Prudential Indicators were not breached during the third quarter of 2020/21 and have not been previously breached. The schedule at Appendix C details the Prudential Borrowing approved and utilised to date.
- 10.2. In November 2020, the Chancellor announced the conclusion to the review of PWLB rates and subsequently all borrowing rates were reduced by 1%; but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. Link's target rate for new long-term borrowing (50 years) for the third quarter of 2020/21 was reduced to 2.14%. No new external borrowing has been undertaken to date in 2020/21. The low and high points during the quarter can be seen in the table below.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.65%	0.72%	1.00%	1.53%	1.32%
Date	29/12/2020	11/12/2020	11/12/2020	11/12/2020	11/12/2020
High	1.79%	1.90%	2.28%	2.86%	2.71%
Date	07/10/2020	11/11/2020	11/11/2020	11/11/2020	11/11/2020
Average	1.39%	1.43%	1.75%	2.31%	2.14%

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)

Cabinet, 7 September 2020, Treasury Management Update Quarter 1 2020/21

Cabinet, 14 December 2020, Treasury Management Update Quarter 2 2020/21

Council, 27 February 2020, Treasury Strategy 2020/21.

Cabinet Member:

David Minnery, Portfolio Holder for Finance

Local Member

N/A

Appendices

A. Investment Report as at 31 December 2020

B. Prudential Limits

C. Prudential Borrowing Schedule