TREASURY MANAGEMENT MID-YEAR UPDATE 2020/21

Cabinet – 10 December 2020

Report of: Deputy Chief Executive and Chief Officer - Finance & Trading

Status: For Decision

Key Decision: No

Executive Summary: This report gives details of treasury activity in the first half of the current financial year, recent developments in the financial markets and fulfils the reporting requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management.

This report supports the Key Aim of: Effective Management of Council Resources.

Portfolio Holder: Cllr. Matthew Dickins

Contact Officer: Roy Parsons, Principal Accountant - Ext 7204

Recommendation to Cabinet: It be RESOLVED that the Treasury Management Mid-Year Update for 2020/21 be approved.

Reason for recommendation: As required by both the Council's Financial Procedure Rules and the CIPFA Code, a mid-year report of treasury management activity is to be presented to Members for approval.

Background

1 Due to the Council's 2021/22 budget setting process being shortened, the Finance and Investment Advisory Committee meeting planned for November was brought forward to 21 October 2020. It was not possible to produce this report by the reporting deadline for the earlier date but the report has been circulated to Members of the Finance and Investment Advisory Committee and their comments will be reported to Cabinet.

Capital Strategy

2 In December 2017, the Chartered Institute of Public Finance and Accountancy (CIPFA) issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities have been required to prepare a Capital Strategy which is intended to provide the following:

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;

- an overview of how the associated risk is managed; and
- the implications for future financial sustainability

3 This Council's capital strategy for 2020/21 was considered by Members at the meeting of the Finance & Investment Advisory Committee on 23 January 2020 and by Cabinet on 4 February 2020.

Treasury management

4 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

5 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

6 Accordingly, treasury management is defined as:

"The management of the local 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."

Introduction

7 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017). The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities;
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives;
- Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review

Report and an Annual Report (stewardship report), covering activities during the previous year;

- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions; and

- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Finance & Investment Advisory Committee.

In addition, monthly reports from our treasury management advisors, Link Asset Services, are emailed to Members of the Finance & Investment Advisory Committee.

8 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2020/21 financial year;

- Interest rate forecasts;

- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;

- A review of the Council's investment portfolio for 2020/21;

- A review of the Council's borrowing strategy for 2020/21; and

- Any recent treasury management developments.

Economic update (as at 7 October 2020)

9 **UK.** As expected, the Bank of England's Monetary Policy Committee (MPC) kept Bank Rate unchanged on 6th August. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:

- The fall in GDP in the first half of 2020 was revised from 28% to 23% (subsequently revised to -21.8%). This is still one of the largest falls in output of any developed nation. However, it is only to be expected as the UK economy is heavily skewed towards consumer-facing services – an area which was particularly vulnerable to being damaged by lockdown.

- The peak in the unemployment rate was revised down from 9% in Q2 to 7½% by Q4 2020.

- It forecast that there would be excess demand in the economy by Q3 2022 causing CPI inflation to rise above the 2% target in Q3 2022, (based on market interest rate expectations for a further loosening in policy). Nevertheless, even if the Bank were to leave policy unchanged, inflation was still projected to be above 2% in 2023.

10 It also squashed any idea of using negative interest rates, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be less effective as a tool to stimulate the economy at this time when banks are worried about future loan losses. It also has other instruments available, including quantitative easing (QE) and the use of forward guidance.

11 The MPC expected the £300bn of QE purchases announced between its March and June meetings to continue until the turn of the year. This implies that the pace of purchases will slow further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.

12 In conclusion, this would indicate that the Bank could now just sit on its hands as the economy was recovering better than expected. However, the MPC acknowledged that the medium-term projections were a less informative guide than usual and the minutes had multiple references to downside risks, which were judged to persist both in the short and medium term. One has only to look at the way in which second waves of the virus are now impacting many countries, including Britain, to see the dangers. However, rather than a national lockdown, as in March, any spikes in virus infections are now likely to be dealt with by localised measures and this should limit the amount of economic damage caused. In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery. The wind down of the initial generous furlough scheme through to the end of October is another development that could cause the Bank to review the need for more support for the economy later in the year. Admittedly, the Chancellor announced in late September a second six month package from 1 November of government support for jobs whereby it will pay up to 22% of the costs of retaining an employee working a minimum of one third of their normal hours. There was further help for the self-employed, freelancers and the hospitality industry. However, this is a much less generous scheme than the furlough package and will inevitably mean there will be further job losses from the 11% of the workforce still on furlough in mid September.

13 Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one after a sharp recovery in June through to August which left the economy 11.7% smaller than in February. The last three months of 2020 are now likely to show no growth as consumers will probably remain cautious in spending and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind. If the Bank felt it did need to provide further support to recovery, then it is likely that the tool of choice would be more QE.

14 There will be some painful longer term adjustments. For example, office space and travel by planes, trains and buses may not recover to their

previous level of use for several years, or possibly ever. There is also likely to be a reversal of globalisation as this crisis has shown up how vulnerable long-distance supply chains are. On the other hand, one area that has already seen huge growth is digital services.

15 One key addition to the Bank's forward guidance was a new phrase in the policy statement, namely that it 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% target sustainably. That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, no action can be expected from the MPC to raise Bank Rate until they can clearly see that the level of inflation is going to be persistently above target if it takes no action to raise Bank Rate.

16 The Bank of England's Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the banking sector to somewhat less than £80bn. It stated that, in its assessment, banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection. The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

17 **USA.** The incoming sets of data during the first week of August were almost universally stronger than expected. With the number of new daily coronavirus infections beginning to abate, recovery from its contraction this year of 10.2% should continue over the coming months and employment growth should also pick up again. However, growth will be dampened by continuing outbreaks of the virus in some states leading to fresh localised restrictions. At its end of August meeting, the Federal Reserve (Fed) tweaked its inflation target from 2% to maintaining an average of 2% over an unspecified time period i.e.following periods when inflation has been running persistently below 2%, appropriate monetary policy will likely aim to achieve inflation moderately above 2% for some time. This change is aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary trap like in Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade so financial markets took note that higher levels of inflation are likely to be in the pipeline; long term bond yields duly rose after the meeting. The Fed also called on Congress to end its political disagreement over providing more support for the unemployed as there is a limit to what monetary policy can do compared to more directed central government fiscal policy. The Federal Open Market Committee (FOMC)'s updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least the end of 2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

18 **Eurozone.** The economy was recovering well towards the end of Q2 after a sharp drop in GDP, (e.g. France 18.9%, Italy 17.6%). However, the second wave of the virus affecting some countries could cause a significant slowdown in the pace of recovery, especially in countries more dependent on tourism. The fiscal support package, eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support and quickly enough to make an appreciable difference in weaker countries. The European Central Bank (ECB) has been struggling to get inflation up to its 2% target and it is therefore expected that it will have to provide more monetary policy support through more QE purchases of bonds in the absence of sufficient fiscal support.

19 **China.** After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and has enabled it to recover all of the contraction in Q1. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

20 **Japan.** There are some concerns that a second wave of the virus is gaining momentum and could dampen economic recovery from its contraction of 8.5% in GDP. It has been struggling to get out of a deflation trap for many years and to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. The resignation of Prime Minister Abe is not expected to result in any significant change in economic policy.

21 **World growth.** Latin America and India are currently hotspots for virus infections. World growth will be in recession this year. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

Interest rate forecasts (as at 7 October 2020)

22 The Council's treasury advisor, Link Asset Services, provided the following forecast on 11 August 2020. Public Works Loan Board (PWLB) rates are the certainty rates, gilt yields plus 180 bps):

Link Group Interest Rate View 11.8.20										
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month average earnings	0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 month average earnings	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 month average earnings	0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

23 The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its meeting on 6th August (and the subsequent September 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 QE 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 31 March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

24 **GILT YIELDS / PWLB RATES.** There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectation that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e.

shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

25 Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March. After gilt yields spiked up during the initial phases of the health crisis in March, we have seen these yields fall sharply to unprecedented lows as major western central banks took rapid action to deal with excessive stress in financial markets, and started massive quantitative easing purchases of government bonds. This also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in normal times would have caused bond yields to rise sharply. At the close of the day on 30th September, all gilt yields from 1 to 6 years were in negative territory, while even 25-year yields were at only 0.76% and 50-year at 0.60%.

26 From the local authority borrowing perspective, HM Treasury imposed two changes of margins over gilt yields for PWLB rates in 2019-20 without any prior warning. The first took place on 9 October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was then at least partially reversed for some forms of borrowing on 11 March 2020, but not for mainstream General Fund capital schemes, at the same time as the Government announced in the Budget a programme of increased infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins. This was to end on 4 June 2020, but that date was subsequently put back to 31 July 2020. It is clear that HM Treasury will no longer allow local authorities to borrow money from the PWLB to purchase commercial property if the aim is solely to generate an income stream (assets for yield).

27 Following the changes on 11 March 2020 in margins over gilt yields, the current situation is as follows: -

- PWLB Standard Rate is gilt plus 200 basis points (G+200bps)
- PWLB Certainty Rate is gilt plus 180 basis points (G+180bps)
- PWLB HRA Standard Rate is gilt plus 100 basis points (G+100bps)
- PWLB HRA Certainty Rate is gilt plus 80bps (G+80bps)
- Local Infrastructure Rate is gilt plus 60bps (G+60bps)

28 It is possible that the non-HRA Certainty Rate will be subject to revision downwards after the conclusion of the PWLB consultation. However, the timing of such a change is currently an unknown, although it would be likely to be within the current financial year.

29 As the interest forecast table for PWLB certainty rates (gilts plus 180bps) above shows, there is likely to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp

recession caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020/21.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably relatively even, but is subject to major uncertainty due to the virus.

- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields (and so PWLB rates) in the UK.

Downside risks to current forecasts for UK gilt yields and PWLB rates

- **UK** - second nationwide wave of virus infections requiring a national lockdown.

- **UK / EU trade negotiations** – if it were to cause significant economic disruption and a fresh major downturn in the rate of growth.

- **UK** - Bank of England takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth and increases in inflation to be weaker than we currently anticipate.

- **A resurgence of the Eurozone sovereign debt crisis** - The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for weaker countries. In addition, the EU recently agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next year or so. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to GDP and annual balanced budgets and southern EU countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.

- **Weak capitalisation of some European banks** - which could be undermined further depending on extent of credit losses resultant of the pandemic.

- **German minority government & general election in 2021** - In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in subsequent state elections but the SPD has done particularly badly. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until the general election in 2021. This then leaves a major question mark over who will be the major guiding hand and driver of EU unity when she steps down.

- **Other minority EU governments** - Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.

- **Austria, the Czech Republic, Poland and Hungary** - now form a strongly anti-immigration bloc within the EU. There has also been a rise in anti-immigration sentiment in Germany and France.

- **Geopolitical risks** - for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.

- **USA** – the Presidential election in 2020 could have repercussions for the US economy and China-US trade relations.

<u>Upside risks to current forecasts for UK gilt yields and PWLB rates</u>

- **UK** - stronger than currently expected recovery in UK economy.

- **Post-Brexit** – if an agreement was reached that removed the majority of threats of economic disruption between the EU and the UK.

- **Bank of England** - is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

Treasury Management Strategy and Annual Investment Strategy update

30 The Treasury Management Strategy Statement (TMSS) and Prudential Indicators for 2020/21 were approved by the Council on 25 February 2020. There are no policy changes to the TMSS thus far and the details in this report merely update the position in the light of the updated economic position.

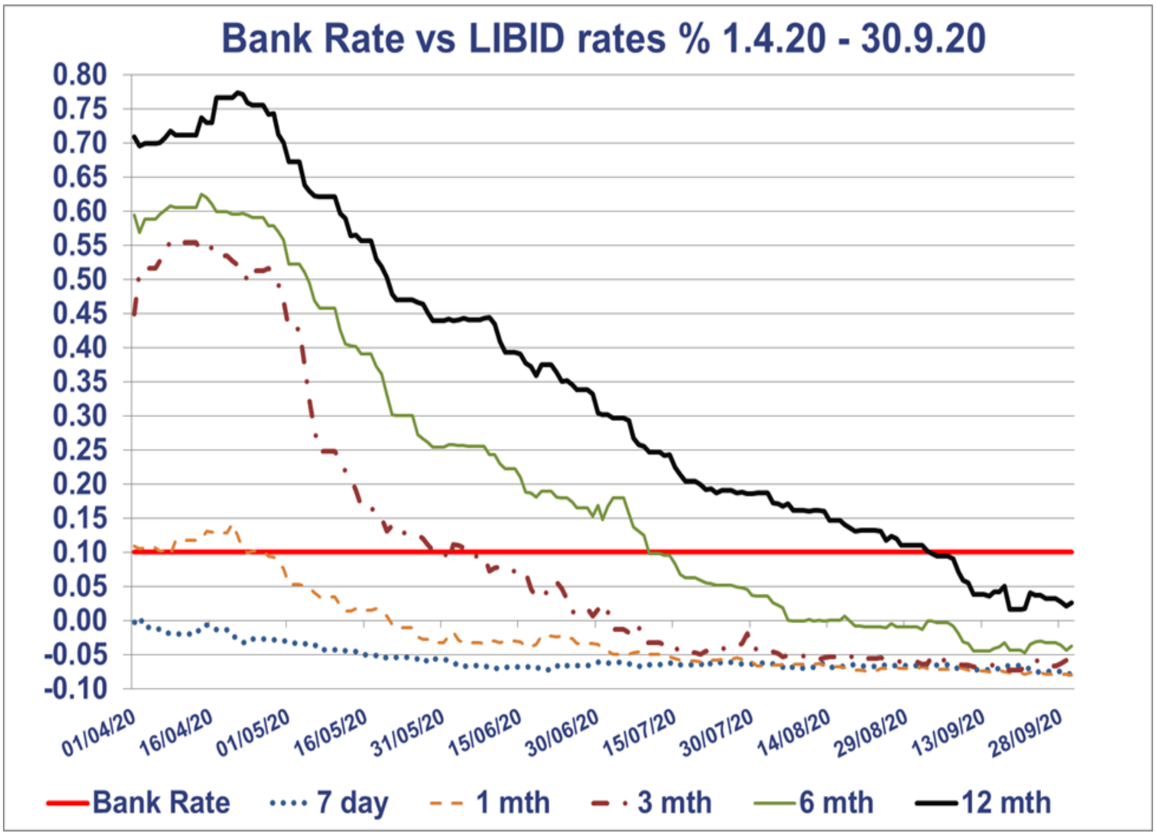
Investment portfolio 2020/21

31 In accordance with the Code, it is the Council’s priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council’s risk appetite. As described above, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.10% Bank Rate. The continuing potential for a re-emergence of a

Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

32 The Council held £18.662m of investments as at 30 September 2020 (£16.404m at 31 March 2020) and the investment portfolio yield for the first six months of the year is 0.47% against 7 Day and 3 Month LIBID benchmarks of -0.06% and 0.11% respectively. A full list of investments held as at 30 September 2020 appears in Appendix 1.

33 A comparison of Bank Rate and LIBID rates appears in the graph and table below.



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.10	0.00	0.14	0.56	0.62	0.77
High Date	01/04/2020	02/04/2020	20/04/2020	08/04/2020	14/04/2020	21/04/2020
Low	0.10	-0.07	-0.07	-0.06	-0.01	0.11
Low Date	01/04/2020	19/06/2020	21/08/2020	28/08/2020	25/08/2020	28/08/2020
Average	0.10	-0.05	-0.01	0.14	0.25	0.41
Spread	0.00	0.08	0.22	0.62	0.63	0.66

The levels shown above use the traditional market method for calculating LIBID rates i.e. LIBOR-0.125%. Given the ultra-low LIBOR levels through the first half of 2020/21 this produces negative rates at the short end of the money market yield curve.

34 The approved limits within the Annual Investment Strategy were not breached during the first six months of 2020/21. The current investment counterparty criteria approved in the Treasury Management Strategy Statement is currently meeting the requirements of the treasury management function.

35 The Council's budgeted investment return for 2020/21 is £300,000 and performance for the year to 30 September 2020 is approximately £92,000 below budget. This trend is likely to be maintained for the remainder of the financial year in the light of much reduced interest rates resulting from the coronavirus pandemic and lower than anticipated investment balances. The estimated shortfall at year-end is likely to be in the order of £210,000.

36 Members have previously expressed their desire to achieve returns closer to or exceeding the rate of inflation and investigations were commenced as to how this can best be realised within the context of the overarching treasury management tenet of "Security, Liquidity and then Yield". Appendix 2 shows our investment return compared with RPI & CPI in the current financial year.

37 The Treasury Management Strategy for 2020/21 was amended to allow for the use of alternative investment instruments such as Property, Bond, Equity or Multi-Asset Funds. These appear to achieve returns in excess of inflation, but are intended to be of a long-term nature (3 to 5 years) due to large swings in returns from month to month plus the question of entry and exit fees. As yet, a decision has not been reached as to their suitability. Since the start of the coronavirus pandemic, these types of fund are showing negative returns.

38 The budgeted investment return for 2020/21 also had an uplift built into it in anticipation of the use of the alternative investment instruments mentioned above.

Borrowing

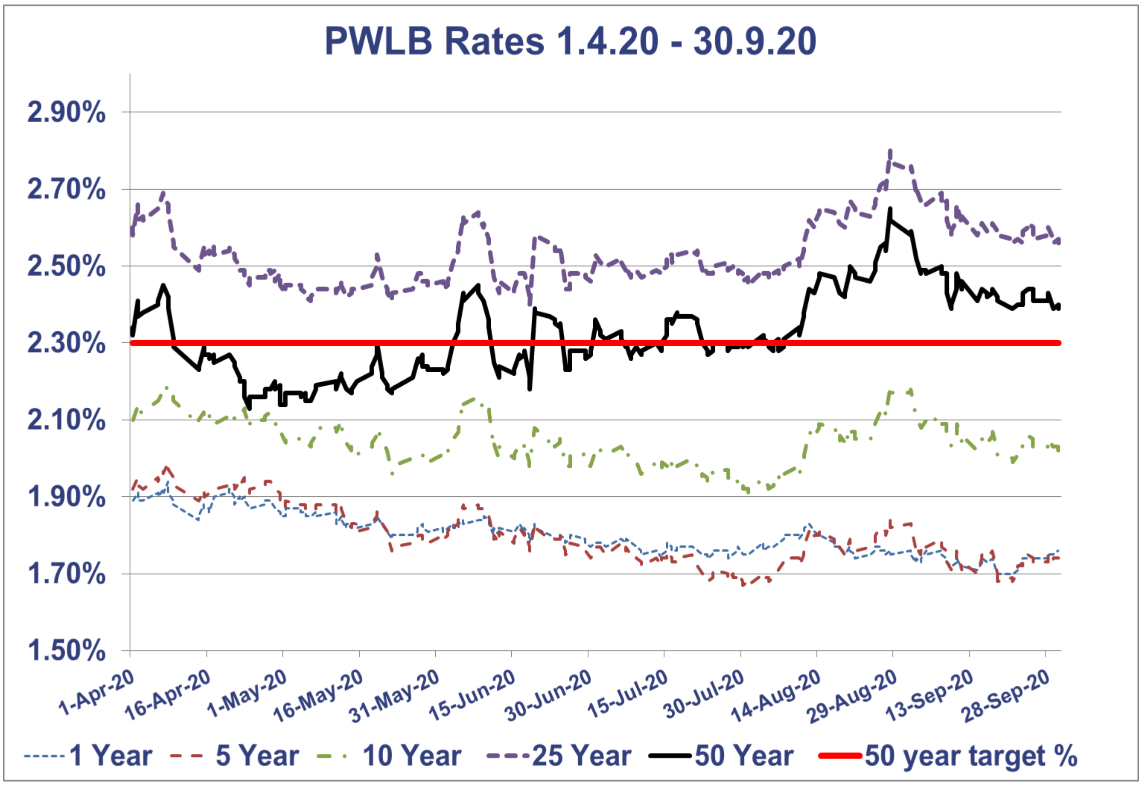
39 As at the end of September 2020 the Council had £4.954m of borrowing, comprising one loan from the Public Works Loan Board (PWLB) for 30 years at 2.66%.

40 It is anticipated that no further borrowing will be undertaken during this financial year.

41 The graph and table below show the movement in PWLB certainty rates for the first six months of the year to date. PWLB rates varied within a relatively narrow range between April and July but the longer end of the curve rose during August. This increase came in two periods; the first in the second week of the month was on the back of hopes for fresh US stimulus. This saw investors switch monies out of government bonds and into equities. The second shift higher at the longer end of the curve came in the latter stages of the month as investors reacted to the announcement of the tweak to the Fed's inflation target. Despite moves further out in the yield curve,

the short end remained anchored on the basis of no fundamental change to the interest rate outlook.

42 The 50-year PWLB target rate for new long-term borrowing was unchanged at 2.30%.



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.70%	1.67%	1.91%	2.40%	2.13%
Date	18/09/2020	30/07/2020	31/07/2020	18/06/2020	24/04/2020
High	1.94%	1.99%	2.19%	2.80%	2.65%
Date	08/04/2020	08/04/2020	08/04/2020	28/08/2020	28/08/2020
Average	1.80%	1.80%	2.04%	2.54%	2.33%

Recent treasury management developments

43 As shown by the interest rate forecasts above, it is now impossible to earn the level of interest rates commonly seen in previous decades as all investment rates are barely above zero now that Bank Rate is at 0.10%, while some entities, including more recently the Government's Debt Management Account Deposit Facility (DMADF), are offering negative rates of return in some shorter time periods. Given this risk environment and the fact that increases in Bank Rate are unlikely to occur before the end of the current forecast horizon of 31 March 2023, investment returns are expected to remain low.

44 While the Bank of England has said that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, some deposit accounts are

already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the Covid crisis; this has caused some local authorities to have sudden large increases in investment balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

45 As for money market funds (MMFs), yields have continued to drift lower. Some managers have suggested that they might resort to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a glut of money swilling around at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer nil or negative rates for very short term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions.

46 Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

Key Implications

Financial

The management of the Council's investment portfolio and cash-flow generated balances plays an important part in the financial planning of the authority. The security of its capital and liquidity of its investments is of paramount importance.

Legal Implications and Risk Assessment Statement

Under Section 151 of the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority, including securing effective arrangements for treasury management.

This annual review report fulfils the requirements of The Chartered Institute of Public Finance & Accountancy's Code of Practice on Treasury Management 2017.

Treasury management has two main risks:

- Fluctuations in interest rates can result in a reduction in income from investments; and
- A counterparty to which the Council has lent money fails to repay the loan at the required time.

Consideration of risk is integral in our approach to treasury management. However, this particular report has no specific risk implications as it is not proposing any new actions, but merely reporting performance over the last six months.

Equality Assessment

The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.

Conclusions

The overall return on the Council's investments up to the end of September 2020 is significantly below budget and the shortfall is forecast to increase further by the end of the financial year.

The reductions in Bank Rate during the coronavirus pandemic have had a consequent effect on the level of returns that can be achieved in the market.

The percentage yield on the portfolio is 0.47%, which exceeds the recognised benchmarks. However, as previously noted, inflation has historically outpaced investment returns and attempts are being made to address this.

The economic situation both globally and within the Eurozone remains volatile, and this will have consequences for the UK economy particularly as the Brexit process moves forward. Treasury management in the current and recent financial years has been conducted against this background and with a cautious investment approach.

Appendices

Appendix 1 - Investment portfolio at 30 September 2020

Appendix 2 – Investment returns vs RPI/CPI

Background Papers

Treasury Management Strategy for 2020/21 - Council 25 February 2020

Adrian Rowbotham

Deputy Chief Executive and Chief Officer - Finance & Trading