## TREASURY MANAGEMENT MID-YEAR UPDATE 2021/22

## Finance & Investment Advisory Committee – 4 November 2021

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

**Status:** For Decision

**Also considered by:**

- Cabinet – 11 November 2021

**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:** efficient management of the Council's resources.

**Portfolio Holder:** Cllr. Matthew Dickins

**Contact Officer:** Roy Parsons, Ext. 7204

**Recommendations to Finance & Investment Advisory Committee:**

a) that Cabinet be asked to approve the Treasury Management Mid-Year Update for 2021/22; and

b) provide comments to Cabinet regarding investment in Multi-Asset Funds in line with the approach laid out in Appendix C.

**Recommendations to Cabinet:**

a) that the Treasury Management Mid-Year Update for 2021/22 be approved.

b) that investment in Multi-Asset Funds be commenced in line with the approach laid out in Appendix C.

**Reason for recommendations:** 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**

Capital Strategy

1 In December 2017, the Chartered Institute of Public Finance and Accountancy (CIPFA) issued revised Prudential and Treasury Management Codes. These require all local authorities to prepare a Capital Strategy which is 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

2 This Council's capital strategy for 2021/22 was considered by Members at the meeting of the Finance & Investment Advisory Committee on 21 October 2020 (Capital Programme & Asset Maintenance 2021/24 report)and by Cabinet on 5 November 2020 (Budget Setting 2021/22 report).

Treasury management

3 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.

4 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.

5 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**

6 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.

7 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 2021/22 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 2021/22;

- A review of the Council's borrowing strategy for 2021/22; and

- Any recent treasury management developments.

**Economic update (as at 6 October 2021)**

8 **UK.** At its meeting on 24 September 2021, the Bank of England's Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures.

9 There was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August which had majored on indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in Bank Rate. In his press conference after the August MPC meeting, Governor Andrew Bailey said, "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures." In other words, it was flagging up a potential danger that labour shortages could push up wage growth by more than it expects and that, as a result, CPI inflation would stay above the 2% target for longer. It also discounted sharp increases in monthly inflation figures in the pipeline in late 2021 which were largely propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system: in other words, the MPC had been prepared to look through a temporary spike in inflation.

10 So, in August the country was just put on alert. However, this time the MPC's words indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October and due again next April, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected. Indeed, to emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement; this suggested that it was now willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year. This is a reversal of its priorities in August and a long way from words at earlier MPC meetings which indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. Indeed, whereas in August the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021, now its primary concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.

11 Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in February 2022, but this looks ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment once furlough ends at the end of September. At the MPC's meeting in February it will only have available the employment figures for November: to get a clearer picture of employment trends, it would need to wait until the May meeting when it would have data up until February. At its

May meeting, it will also have a clearer understanding of the likely peak of inflation.

12 The MPC's forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -

- Placing the focus on raising Bank Rate as "the active instrument in most circumstances".
- Raising Bank Rate to 0.50% before starting on reducing its holdings.
- Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
- Once Bank Rate had risen to at least 1%, it would start selling its holdings.

13 **Covid-19 vaccines.** These have been the game changer which has enormously boosted confidence that life in the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes implemented to contain their spread.

8 **USA.** The economic position is dealt with in the interest rate forecasts section of this report.

9 **Eurozone.** The slow roll out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction in GDP of -0.3% in Q1, Q2 came in with strong growth of 2%, which is likely to continue into Q3, though some countries more dependent on tourism may struggle. Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the ECB is likely to see these as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time.

10 Following the German general election in September, the CDU/CSU and SDP both having won around 24-26% of the vote, the composition of Germany's next coalition government may not be agreed by the end of 2021. An SDP-led coalition would probably pursue a slightly less restrictive fiscal policy, but any change of direction from a CDU/CSU led coalition government is likely to be small. However, with Angela Merkel standing down as Chancellor as soon as a coalition is formed, there will be a hole in overall EU leadership which will be difficult to fill.

11 **China.** After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of the year; this enabled China to recover all the initial contraction. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021. However, the pace of economic growth has now fallen back after this initial surge of recovery from the pandemic and China is now struggling to contain the spread of the Delta variant through sharp local lockdowns - which will also depress economic growth. There are also questions as to how effective Chinese vaccines are proving. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

12 **Japan.** 2021 has been a patchy year in combating Covid-19. However, after a slow start, nearly 50% of the population are now vaccinated and Covid-19 case numbers are falling. After a weak Q3 there is likely to be a strong recovery in Q4. The Bank of Japan is continuing its very loose monetary policy but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon: indeed, inflation was negative in July. New Prime Minister Kishida has promised a large fiscal stimulus package after the November general election – which his party is likely to win.

13 **World growth.** World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.

14 **Supply shortages.** The pandemic and extreme weather events have been highly disruptive of extended worldwide supply chains. At the current time there are major queues of ships unable to unload their goods at ports in New York, California and China. Such issues have led to mis-distribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves.

**Interest rate forecasts (as at 6 October 2021)**

15 The Council's treasury advisor, Link Asset Services, provided the following forecast on 29 September 2021. Public Works Loan Board (PWLB) rates are the certainty rates, gilt yields plus 180 bps):

| Link Group Interest Rate View 29.9.21 | 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 | 0.25 | 0.25 | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.75 |
| 3 month ave earnings | 0.10 | 0.10 | 0.20 | 0.20 | 0.30 | 0.40 | 0.50 | 0.50 | 0.60 | 0.70 |
| 6 month ave earnings | 0.20 | 0.20 | 0.30 | 0.30 | 0.40 | 0.50 | 0.60 | 0.60 | 0.70 | 0.80 |
| 12 month ave earnings | 0.30 | 0.40 | 0.50 | 0.50 | 0.50 | 0.60 | 0.70 | 0.80 | 0.90 | 1.00 |
| 5 yr PWLB | 1.40 | 1.40 | 1.50 | 1.50 | 1.60 | 1.60 | 1.60 | 1.70 | 1.70 | 1.70 |
| 10 yr PWLB | 1.80 | 1.80 | 1.90 | 1.90 | 2.00 | 2.00 | 2.00 | 2.10 | 2.10 | 2.10 |
| 25 yr PWLB | 2.20 | 2.20 | 2.30 | 2.30 | 2.40 | 2.40 | 2.40 | 2.50 | 2.50 | 2.60 |
| 50 yr PWLB | 2.00 | 2.00 | 2.10 | 2.20 | 2.20 | 2.20 | 2.20 | 2.30 | 2.30 | 2.40 |

16 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 0.10%, it left Bank Rate unchanged at its subsequent meetings.

17 As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 2 of 2022/23, a second increase to 0.50% in quarter 2 of 2023/24 and a third one to 0.75% in quarter 4 of 2023/24.

<u>Significant risks to the forecasts</u>

18 Significant risks to the forecasts include:-

- Covid-19 vaccines do not work to combat new mutations and/or new vaccines take longer than anticipated to be developed for successful implementation.
- The pandemic causes major long-term scarring of the economy.
- The Government implements an austerity programme that supresses GDP growth.
- The MPC tightens monetary policy too early – by raising Bank Rate or unwinding QE.
- The MPC tightens monetary policy too late to ward off building inflationary pressures.
- Major stock markets e.g. in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the "moral hazard" risks of having to buy shares and corporate bonds to reduce the impact of major financial market sell-offs on the general economy.
- Geo-political risks are widespread e.g. German general election in September 2021 produces an unstable coalition or minority government and a void in high-profile leadership in the EU when Angela Merkel steps down as Chancellor of Germany; on-going global power influence struggles between Russia/China/US.

The balance of risks to the UK economy

19 The overall balance of risks to economic growth in the UK is now to the downside, including residual risks from Covid-19 and its variants - both domestically and their potential effects worldwide.

Forecasts for Bank Rate

20 Bank Rate is not expected to go up fast after the initial rate rise as the supply potential of the economy has not generally taken a major hit during the pandemic, so should be able to cope well with meeting demand without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the surge to around 4% towards the end of 2021. Three increases in Bank rate are forecast in the period to March 2024, ending at 0.75%. However, these forecasts may well need changing within a relatively short time frame for the following reasons:-

- There are increasing grounds for viewing the economic recovery as running out of steam during the summer and now into the autumn. This could lead into stagflation which would create a dilemma for the MPC as to which way to face.

- Will some current key supply shortages e.g., petrol and diesel, spill over into causing economic activity in some sectors to take a significant hit?

- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation. Then we have the Government's upcoming budget in October, which could also end up in reducing consumer spending power.

- On the other hand, consumers are sitting on around £200bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?

- There are 1.6 million people coming off furlough at the end of September; how many of those will not have jobs on 1 October 2021 and will, therefore, be available to fill labour shortages in many sectors of the economy? So, supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months or so and alleviate the MPC's current concerns.

- There is a risk that there could be further nasty surprises on the Covid-19 front, on top of the flu season this winter, which could depress economic activity.

21 In summary, with the high level of uncertainty prevailing on several different fronts, it is likely that these forecasts will need to be revised again soon - in line with what the new news is.

22 It also needs to be borne in mind that Bank Rate being cut to 0.10% was an emergency measure to deal with the Covid-19 crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away that final emergency cut from 0.25% to 0.10% on the grounds of it no longer being warranted and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

Forecasts for PWLB rates and gilt and treasury yields

23 As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US.

24 There is likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields?
- Will the US Federal Reserve (Fed) take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures turn out to be in both the US and the UK and so impact treasury and gilt yields?
- How will central banks implement their new average or sustainable level inflation monetary policies?
- How well will central banks manage the withdrawal of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the “taper tantrums” in the US in 2013?

- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

25 The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within our forecasting period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China/North Korea and Iran, which have a major impact on international trade and world GDP growth.

Gilt and treasury yields

26 Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates. During the first part of the year, US President Biden's, and the Democratic party's determination to push through a $1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid-19 pandemic was what unsettled financial markets. However, this was in addition to the $900bn support package already passed in December 2020 under President Trump. This was then followed by additional Democratic ambition to spend further huge sums on infrastructure and an American families plan over the next decade which are caught up in Democrat/Republican haggling. Financial markets were alarmed that all this stimulus, which is much bigger than in other western economies, was happening at a time in the US when:-

- A fast vaccination programme has enabled a rapid opening up of the economy.
- The economy had already been growing strongly during 2021.
- It started from a position of little spare capacity due to less severe lockdown measures than in many other countries. A combination of shortage of labour and supply bottle necks is likely to stoke inflationary pressures more in the US than in other countries.
- The Fed was still providing monetary stimulus through monthly QE purchases.

27 These factors could cause an excess of demand in the economy which could then unleash stronger and more sustained inflationary pressures in the US than in other western countries. This could then force the Fed to take much earlier action to start tapering monthly QE purchases and/or increasing the Fed rate from near zero, despite their stated policy being to target average inflation. It is notable that some Fed members have moved forward their expectation of when the first increases in the Fed rate will occur in recent

Fed meetings. In addition, more recently, shortages of workers appear to be stoking underlying wage inflationary pressures which are likely to feed through into CPI inflation. A run of strong monthly jobs growth figures could be enough to meet the threshold set by the Fed of "substantial further progress towards the goal of reaching full employment". However, the weak growth in August, (announced 3 September 2021), has spiked anticipation that tapering of monthly QE purchases could start by the end of 2021. These purchases are currently acting as downward pressure on treasury yields. As the US financial markets are, by far, the biggest financial markets in the world, any trend upwards in the US will invariably impact and influence financial markets in other countries. However, during June and July, longer term yields fell sharply; even the large non-farm payroll increase in the first week of August seemed to cause the markets little concern, which is somewhat puzzling, particularly in the context of the concerns of many commentators that inflation may not be as transitory as the Fed is expecting it to be. Indeed, inflation pressures and erosion of surplus economic capacity look much stronger in the US than in the UK. As an average since 2011, there has been a 75% correlation between movements in 10 year treasury yields and 10 year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.

28 There are also possible downside risks from the huge sums of cash that the UK populace have saved during the pandemic; when savings accounts earn little interest, it is likely that some of this cash mountain could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will interplay with the Bank of England eventually getting round to not reinvesting maturing gilts and then later selling gilts, will be interesting to keep an eye on.

The balance of risks to medium to long term PWLB rates

29 There is a balance of upside risks to forecasts for medium to long term PWLB rates.

A new era – a fundamental shift in central bank monetary policy

30 One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the European Central Bank (ECB), to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum"

employment in its entirety' in the US before consideration would be given to increasing rates.

31 The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time. The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' and the ECB now has a similar policy.

32 For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.

33 Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes will all help to lower inflationary pressures.

34 Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

**Treasury Management Strategy and Annual Investment Strategy update**

35 The Treasury Management Strategy Statement (TMSS) and Prudential Indicators for 2021/22 were approved by the Council on 23 February 2021. 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 2021/22**

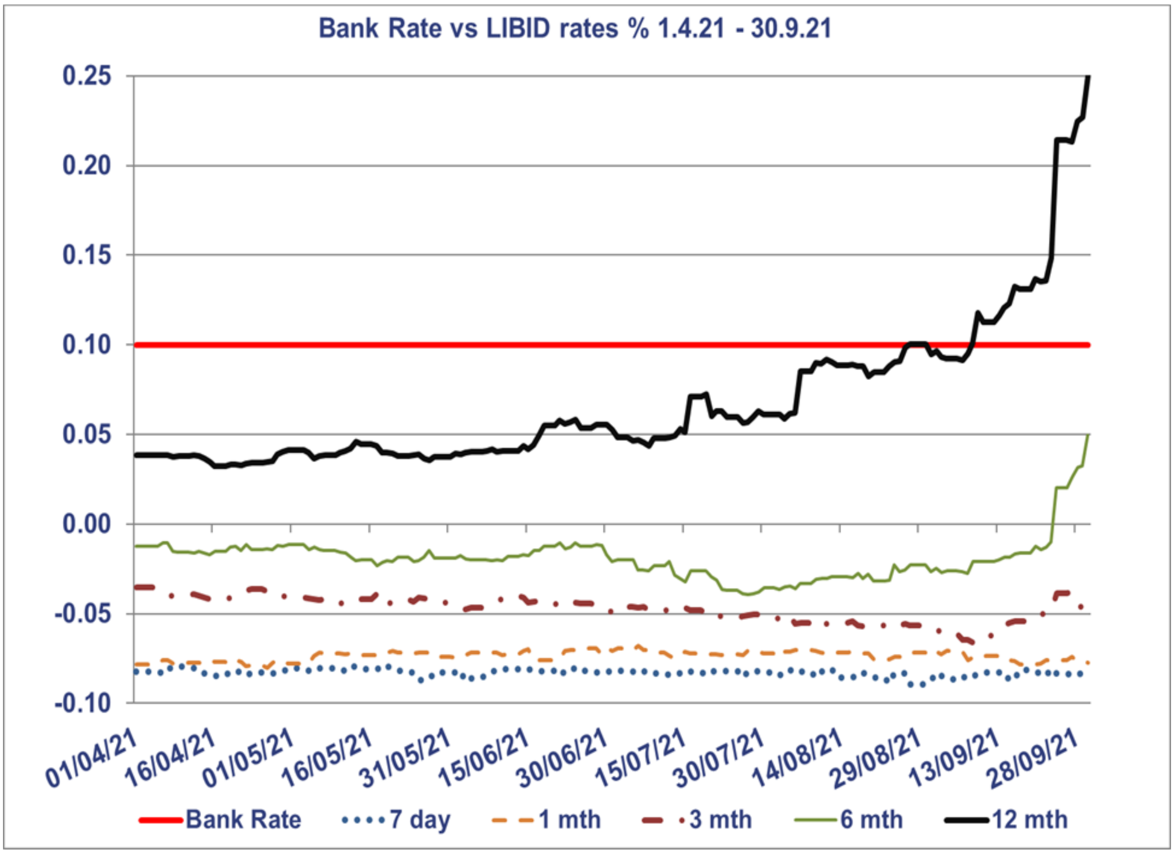
36 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the suggested creditworthiness approach supplied by Link Asset Services, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information. 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 short-term money market investment rates have only risen

weakly since Bank Rate was cut to 0.10% in March 2020 until the MPC meeting on 24 September 2021 when 6 and 12 month rates rose in anticipation of Bank Rate going up in 2022. Given this environment and the fact that Bank Rate may only rise marginally, or not at all, before mid-2023, investment returns are expected to remain low.

37 The Council held £27.6m of investments as at 30 September 2021 (£11.050m at 31 March 2021) and the investment portfolio yield for the first six months of the year is 0.11% against 7 Day and 3 Month LIBID benchmarks of -0.08% and -0.05% respectively. A full list of investments held as at 30 September 2021 appears in Appendix A.

38 A large proportion of these funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

39 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 | -0.08 | -0.07 | -0.04 | 0.05 | 0.25 |
| **High Date** | 01/04/2021 | 09/04/2021 | 06/07/2021 | 01/04/2021 | 30/09/2021 | 30/09/2021 |
| **Low** | 0.10 | -0.09 | -0.08 | -0.07 | -0.04 | 0.03 |
| **Low Date** | 01/04/2021 | 27/08/2021 | 26/04/2021 | 08/09/2021 | 27/07/2021 | 16/04/2021 |
| **Average** | 0.10 | -0.08 | -0.07 | -0.05 | -0.02 | 0.07 |
| **Spread** | 0.00 | 0.01 | 0.01 | 0.03 | 0.09 | 0.22 |

The levels shown above use the traditional market method for calculating LIBID rates i.e. LIBOR–0.125%. Given the ultra-low LIBOR levels this year, this produces negative rates across some periods.

40 The approved limits within the Annual Investment Strategy were not breached during the first six months of 2021/22. The current investment counterparty criteria approved in the Treasury Management Strategy Statement is currently meeting the requirements of the treasury management function.

41 The Council’s budgeted investment return for 2021/22 is £188,000 and performance for the year to 30 September 2021 is approximately £81,000 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 £166,000.

42 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 B shows our investment return compared with RPI & CPI in the current financial year.

43 The current Treasury Management Strategy allows 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 (5 years or longer) due to large swings in returns from month to month plus the question of entry and exit fees.

44 The budgeted investment return for 2021/22 also had an uplift built into it in anticipation of the use of the alternative investment instruments mentioned above.

45 Research has been undertaken in consultation with Link Asset Services and specific options have been assessed, as detailed in Appendix C. Members views on a preferred approach are now being sought. The recommendation is that investment into one or more Multi-Asset Funds up to a maximum of £5m in total is undertaken. In order to select the provider most closely aligned to the Council’s requirements, it is also recommended that Link Asset Services be engaged to carry out an assessment of Funds available.

46 The overriding principle when entering into such investments is that they will be of a long term nature. There is potential for negative returns during the life of the investments but, in the longer term, positive returns are more likely.

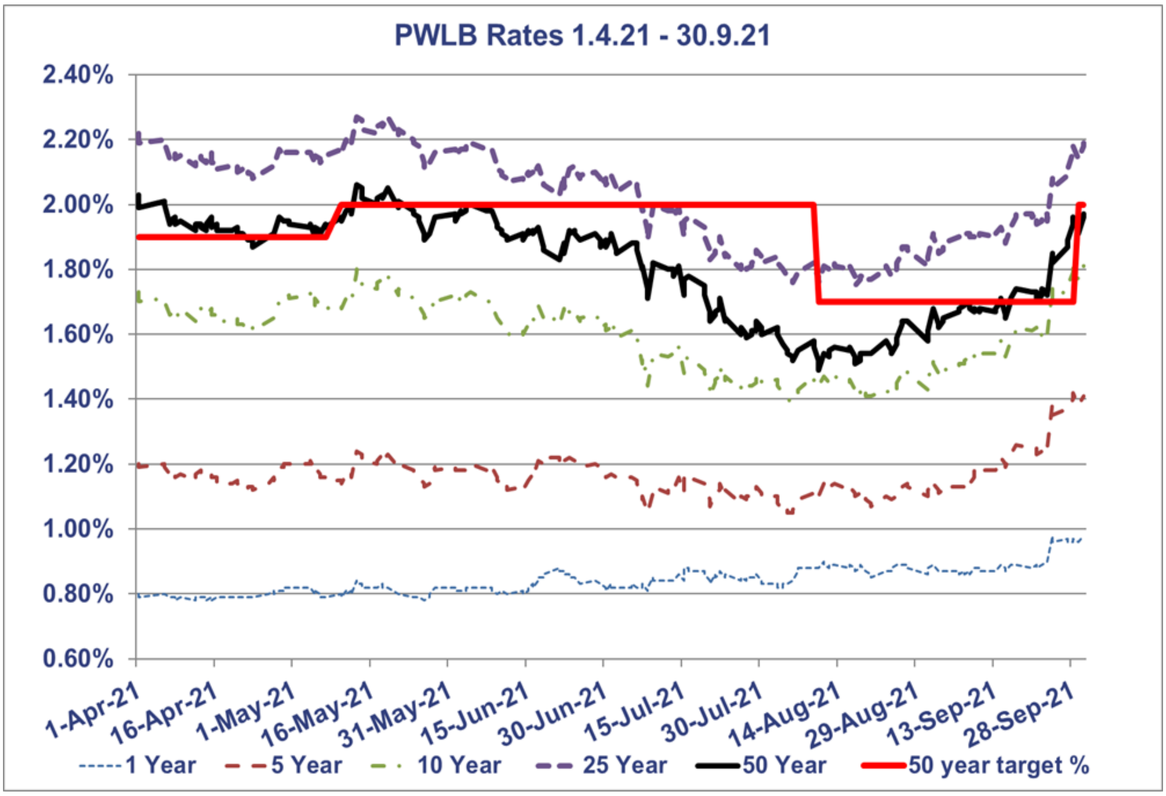
**Borrowing strategy 2021/22**

47 As at the end of September 2021 the Council had £4.829m of borrowing, comprising one loan from the Public Works Loan Board (PWLB) for 30 years at 2.66%.

48 It is anticipated that further borrowing may be undertaken during this financial year pending Member approval of additional capital schemes.

49 The graph and table below show the movement in PWLB certainty rates for the first six months of the year to date. Gilt yields and PWLB rates were on a falling trend between May and August. However, they rose sharply towards the end of September.

50 The 50 year PWLB target certainty rate for new long-term borrowing started 2021/22 at 1.90%, rose to 2.00% in May, fell to 1.70% in August and returned to 2.00% at the end of September after the MPC meeting of 24 September.




| | 1 Year | 5 Year | 10 Year | 25 Year | 50 Year |
|---|---|---|---|---|---|
| **Low** | 0.78% | 1.05% | 1.39% | 1.75% | 1.49% |
| **Date** | 08/04/2021 | 08/07/2021 | 05/08/2021 | 17/08/2021 | 10/08/2021 |
| **High** | 0.98% | 1.42% | 1.81% | 2.27% | 2.06% |
| **Date** | 24/09/2021 | 28/09/2021 | 28/09/2021 | 13/05/2021 | 13/05/2021 |
| **Average** | 0.84% | 1.16% | 1.60% | 2.02% | 1.81% |
| **Spread** | 0.20% | 0.37% | 0.42% | 0.52% | 0.57% |

**Recent treasury management developments**

51 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%. Given this risk environment and the fact that any significant 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.

52 As for money market funds (MMFs), yields continue to remain low. Some managers have trimmed 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 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.

53 Officers have engaged with the Municipal Bonds Agency with a view to having a borrowing facility in place should the need arise in the future.

**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 2021 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 0.11%, 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. Treasury management in the current and recent financial years has been conducted against this background and with a cautious investment approach.

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| **Appendices:** | Appendix A - Investment portfolio at 30 September 2021<br>Appendix B – Investment returns vs RPI/CPI<br>Appendix C – Proposal for future investment strategy |
| **Background Papers**: | Treasury Management Strategy for 2021/22 - Council 23 February 2021 |

**Adrian Rowbotham**
**Deputy Chief Executive and Chief Officer - Finance & Trading**