

Report of:	Head of Finance
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Key Decision:	No
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CABINET
30 JANUARY 2020
**TREASURY MANAGEMENT STRATEGY, MINIMUM REVENUE PROVISION
POLICY, ANNUAL INVESTMENT STRATEGY AND CAPITAL STRATEGY
2020/21**

1 Purpose of Report

1.1 This report is presented to obtain the Council's approval to:-

- Prudential and Treasury indicators - setting of indicators to ensure that the capital investment plans of the Council are affordable, prudent and sustainable;
- The Minimum Revenue Provision (MRP) Policy;
- Treasury Management Strategy Statement for 2020/21 - to set treasury limits for 2020/21 to 2022/23 and to provide a background to the latest economic forecasts of interest rates;
- Annual Investment Strategy 2020/21 - to set out the strategy of investment of surplus funds.

2 Recommendations

2.1 To approve:-

- (a) The Prudential and Treasury indicators;
- (b) The MRP Policy Statement;
- (c) The Treasury Management Policy;
- (d) The Annual Investment Strategy for 2020/21;

2.2 To note that indicators may change in accordance with the final recommendations from Cabinet to Council in relation to both the General Fund/ Housing Revenue Account Revenue Budgets and Capital Programmes.

3 Key Issues and Reasons for RecommendationsKey Issues

- 3.1 The Treasury Management Function essentially consists of:
- In the short term ensuring that the cash flow of a Balanced Revenue Budget is adequately planned with surplus monies invested in accordance with the risk appetite of the Council.
 - In the long term funding the capital plans of the authority and in particular managing the debt of the Council and any new borrowing requirement.
- 3.2 The Governance arrangements are detailed in the various policies and strategies as detailed in the report together with the setting of Indicators in accordance with the Capital Financing Prudential Code.

Reasons for Recommendations

- 3.3 The Council is required to approve its treasury management, investment and capital strategies to ensure that cash flow is adequately planned and that surplus monies are invested appropriately.

4 Relationship to Corporate Priorities

- 4.1 Treasury management and investment activity link in with all of the Council's priorities and their spending plans.

5 Report Detail**Background**

- 5.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.
- 5.2 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 that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.
- 5.3 The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the

ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

5.4 CIPFA defines treasury management 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.”

5.5 This authority has not engaged in any commercial investments and has no non-treasury investments.

Reporting Requirements

5.6 **Capital Strategy** - The CIPFA 2017 Prudential and Treasury Management Codes required all local authorities to prepare a capital strategy report which will provide the following:

- a high-level long term 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
- the implications for future financial sustainability

5.7 The aim of this capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

5.8 The capital strategy approved on the 7 February 2019 covers the period 2018/22 and is unchanged.

5.9 **Treasury Management reporting** - The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals:-

5.10 **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report covers:-

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an Investment Strategy (the parameters on how investments are to be managed).

- 5.11 **A mid year treasury management report** - This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.
- 5.12 **An annual treasury report** - This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.
- 5.13 **Scrutiny** - The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit and Governance Committee.
- 5.14 The Council has adopted the following reporting arrangements in accordance with the requirements of the CIPFA Code of Practice:-

Area of Responsibility	Council/Committee	Frequency
Treasury Management Strategy/ Annual Investment Strategy/ MRP policy	Full council	Annually in January/February each year
Treasury Management Strategy/ Annual Investment Strategy/ MRP policy/Monitoring of Prudential Indicators	Full council	Mid year
Treasury Management Strategy/ Annual Investment Strategy/ MRP policy – updates or revisions at other times	Full council	As required
Annual Treasury Outturn Report	Audit and Governance Committee and Council	Annually by 30 September after the end of the year
Scrutiny of treasury management strategy	Cabinet	Annually in January / February before the start of the year

Treasury Management Strategy for 2020/21

- 5.15 The strategy for 2020/21 covers two main areas:-

Capital issues

- the capital expenditure plans and the associated prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;

- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

5.16 These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, MHCLG MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

Training

5.17 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training for members is currently being reviewed and will be arranged as required.

5.18 The training needs of treasury management officers are periodically reviewed.

Treasury Management Consultants

5.19 The Council uses Link Asset Services, Treasury Solutions as its external treasury management advisors.

5.20 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

The Capital Prudential Indicators 2020/21 - 2022/23

5.21 The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

Capital expenditure

5.22 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts, which include a review of current schemes together with for growth bids, but to note these may change as part of the scrutiny process and finalisation of the Budget.

5.23 Any change to the forecast /growth bid will be separately identified in future Budget Reports and reflected in this indicator as reported to full council.

Capital expenditure	2018/19 Actual £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	Earmarked £'000
Corporate Improvement	438	72				452
Environment	391	362	126	118	90	406
Culture & Sport	450	156	1,223			2,121
Economic Development	526	318	243			5,745
Housing	661	427	1,452	926	926	296
Health & Wellbeing						
Town Centre Regeneration	441	85	219			
Leader of the Council						
Crime & Partnerships		45				67
Non –HRA	2,907	1,465	3,263	1,044	1,016	9,087
Non – HRA programme estimate			1,298	4,364	3,425	(9,087)
HRA	6,349	3,902	7,696	7,576	6,330	11,740
HRA programme estimate			293	5,800	5,647	(11,740)
Total	9,256	5,367	12,550	18,784	16,418	0

5.24 **Other long term liabilities.** The financing need excludes other long term liabilities, such leasing arrangements which already include borrowing instruments.

5.25 The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Capital expenditure	2018/19 Actual £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	Unallocated £'000
Total Spend	9,256	5,367	12,550	18,784	16,418	
Financed by:						
Capital Receipts	2,180	1,408	1,965	5,978	3,576	
Capital grants/ contributions	1,468	592	2,546	2,506	1,849	
Major Repairs	2,273	3,319	4,491	6,433	4,101	

Revenue	763	48	526	3,867	6,892	
Total Financing	6,684	5,367	9,528	18,784	16,418	
Net financing need for the year	2,571	0	3,022	0	0	

5.26 The capital financing of the programme will similarly be reviewed as part of the Budget process and any change will be separately identified in future Budget Reports and reflected in this indicator.

The Council's borrowing need (the Capital Financing Requirement)

5.27 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so it's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

5.28 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life and so charges the economic consumption of capital assets as they are used.

5.29 The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has £0.892 million of such schemes within the CFR.

5.30 The Council is asked to approve the following CFR projections, subject to any changes arising from the budget process:-

	2018/19 Actual £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
Capital Financing Requirement					
CFR – non housing	10,949	9,594	9,119	8,650	8,194
CFR - housing	82,504	82,496	85,509	85,501	85,492
Total CFR	93,453	92,090	94,628	94,151	93,686
Movement in CFR	(3,027)	(1,363)	2,538	(477)	(465)
Movement in CFR represented by					
Net financing need for the year	2,571	-	3,022	-	-
LAMS receipt	(2,000)	-	-	-	-
Repayment of borrowing	(1,500)	(875)	-	-	-

Less MRP and other financing movements	(2,098)	(488)	(484)	(477)	(465)
Movement in CFR	(3,027)	(1,363)	2,538	(477)	(465)

Core funds and expected investment balances

5.31 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed on the following page are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Year End Resources £m	2018/19 Actual £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
Earmarked Fund balances / reserves					
General Fund	10,835	11,300	10,169	9,949	9,312
General Fund working balance	2,916	2,689	2,689	2,596	2,012
HRA	5,225	7,578	9,297	7,898	3,382
HRA working balance	1,573	1,736	1,796	1,817	1,859
Sub Total	20,549	23,303	23,951	22,260	16,565
Capital receipts					
GF	7,371	6,232	6,454	3,304	262
HRA	1,006	1,567	1,711		
Sub Total	8,377	7,799	8,165	3,304	262
Provisions	3,238	3,238	1,500	200	200
Major Repairs Reserve	2,433	2,992	2,433		
Other - grants receipts in advance	664	780	1,105	1,105	1,105
Total core funds	35,261	38,112	37,154	26,869	18,132
Working Cashflow requirement	(2,717)	(3,000)	(3,000)	(3,000)	(3,000)
Under/over borrowing	10,956	9,811	10,425	10,176	9,934
Expected investments	27,022	31,301	29,729	19,693	11,198

*Working cashflow requirement shown are estimated year-end; based on previous year outturn.

Minimum revenue provision (MRP) policy statement

- 5.32 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP).
- 5.33 MHCLG Regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:-
- 5.34 The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/09, and will assess MRP for 2009/10 onwards in accordance with the recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.
- 5.35 Under powers delegated to the Section 151 Officer, the Council's annual MRP provision for expenditure incurred after 1 April 2008 and before 31 March 2017 will be based on the uniform rate of 4% of the Capital Financing Requirement. The Council's annual MRP provision for expenditure incurred on or after 1 April 2017 will be based on the asset life method i.e. the provision will be calculated with reference to the estimated life of the assets acquired, in accordance with the regulations.
- 5.36 MRP will be applicable from the year following that in which the asset is brought into operation.
- 5.37 Repayments included in annual PFI or finance leases are applied as MRP.
- 5.38 The Council are satisfied that the policy for calculating MRP set out in this policy statement will result in the Council continuing to make prudent provision for the repayment of debt, over a period that is on average reasonably commensurate with that over which the expenditure provides benefit.
- 5.39 The Section 151 Officer will, where it is prudent to do so, use discretion to review the overall financing of the Capital Programme and the opportunities afforded by the regulations, to maximise the benefit to the Council whilst ensuring the Council meets its duty to charge a prudent provision.
- 5.40 **MRP Overpayments** - A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. The Council has previously not made any MRP overpayments.

Affordability prudential indicators

- 5.41 The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:-

Ratio of financing costs to net revenue stream

- 5.42 This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Non HRA	2.8%	2.2%	1.9%	1.9%	1.6%
HRA	16.74%	16.92%	16.93%	16.53%	16.14%

HRA ratios

	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
HRA debt £'000	81,605	81,605	83,752	83,752	83,752
HRA revenues £'000	19,282	19,391	19,434	19,968	20,516
Ratio of debt to revenues	4.2	4.2	4.3	4.2	4.1
Number of HRA dwellings	5,146	5,129	5,103	5,099	5,073
Debt per dwelling £	15.86	15.91	16.41	16.43	16.51

Borrowing

- 5.43 The capital expenditure plans provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

Current portfolio position

- 5.44 The Council's forward projections for borrowing are summarised below. The table shows the actual external debt against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

	2018/19 Actual £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
External Debt					
PWLB debt at 1 April	81,605	81,605	81,605	83,752	83,752
Expected change in Debt			2,147		
Other long- term liabilities (OLTL)	1,105	892	674	451	223
Expected change in OLTL	(213)	(218)	(223)	(228)	(223)
Actual gross debt at 31 March	82,497	82,279	84,203	83,975	83,752
The Capital Financing Requirement	93,453	92,090	94,628	94,151	93,686
Under / (over) borrowing	10,956	9,811	10,425	10,176	9,934

- 5.45 Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2020/21 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.
- 5.46 The Head of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals contained in the Financial Plan for 2019/20 to 2022/23.

Treasury Indicators: limits to borrowing activity

- 5.47 **The operational boundary.** This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt. The operational boundary includes as in previous years a contingency borrowing provision of £2 million for future years.

Operational boundary £m	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
Debt	95,638	95,163	94,694	94,238
Other long term liabilities	674	1,451	1,223	1,000
Total	96,312	96,614	95,917	95,238

5.48 **The authorised limit for external debt.** This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

2. The Council is asked to approve the following authorised limit:-

Authorised limit £m	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
Debt	107,138	106,663	106,194	105,738
Other long term liabilities	674	1,451	1,223	1,000
Total	107,812	108,114	107,417	106,738

Prospects for interest rates

5.49 The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view.

Link Asset Services Interest Rate View														
	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.20	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

5.50 The above forecasts have been based on an assumption that there is an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU, at some point in time. The result of the general election has removed much uncertainty around this major assumption. However, it does not remove uncertainty around whether agreement can be reached with the EU on a trade deal within the short time to December 2020, as the prime minister has pledged.

- 5.51 It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit and the outcome of the general election. In its meeting on 7 November, the MPC became more dovish due to increased concerns over the outlook for the domestic economy if Brexit uncertainties were to become more entrenched, and for weak global economic growth: if those uncertainties were to materialise, then the MPC were likely to cut Bank Rate. However, if they were both to dissipate, then rates would need to rise at a “gradual pace and to a limited extent”. Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. There is still some residual risk that the MPC could cut Bank Rate as the UK economy is still likely to only grow weakly in 2020 due to continuing uncertainty over whether there could effectively be a no deal Brexit in December 2020 if agreement on a trade deal is not reached with the EU. Until that major uncertainty is removed, or the period for agreeing a deal is extended, it is unlikely that the MPC would raise Bank Rate.
- 5.52 **Bond yields / PWLB rates.** There has been much speculation during 2019 that the bond market has gone into a bubble, as evidenced by high bond prices and remarkably low yields. However, given the context that there have been heightened expectations that the US was heading for a recession in 2020, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty 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. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten-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. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.
- 5.53 During the first half of 2019-20 to 30 September, gilt yields plunged and caused a near halving of longer term PWLB rates to completely unprecedented historic low levels. There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts; at various times this correlation has been strong but at other times weak. However, forecasting the timing of this, and how strong the correlation is likely to be, is very difficult to forecast with any degree of confidence. Changes in UK Bank Rate will also impact on gilt yields.

- 5.54 One potential danger that may be lurking in investor minds is that Japan has become mired in a twenty-year bog of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that this condition might become contagious to other western economies.
- 5.55 Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt-fuelled boom that now makes it harder for central banks to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.
- 5.56 The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.
- 5.57 In addition, PWLB rates are subject to ad hoc decisions by H.M. Treasury to change the margin over gilt yields charged in PWLB rates: such changes could be up or down. It is not clear that if gilt yields were to rise back up again by over 100bps within the next year or so, whether H M Treasury would remove the extra 100 bps margin implemented on 9.10.19.
- 5.58 Economic and interest rate forecasting remains difficult with so many influences weighing on UK gilt yields and PWLB rates. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments

Investment and borrowing rates

- Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earnings.
- Borrowing interest rates were on a major falling trend during the first half of 2019-20 but then jumped up by 100 bps on 9.10.19. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. However, the unexpected increase of 100 bps in PWLB rates requires a major rethink of local authority treasury management strategy and risk management. Now that the gap between

longer term borrowing rates and investment rates has materially widened, and in the long term Bank Rate is not expected to rise above 2.5%.

- There will remain a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

Borrowing strategy

- 5.59 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.
- 5.60 Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. The Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:
- 5.61 Any decisions will be reported to members appropriately at the next available opportunity.

Treasury management limits on activity

- 5.62 There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance.

The indicators are:-

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

5.63 The Council is asked to approve the following treasury indicators and limits:-

£m	2020/21	2021/22	2022/23
Interest rate exposures			
	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	75%	75%	75%
Maturity structure of fixed interest rate borrowing 2020/21			
	Lower	Upper	
Under 12 months	0%	100%	
12 months to 2 years	0%	100%	
2 years to 5 years	0%	100%	
5 years to 10 years	0%	100%	
10 years and above	0%	100%	
Maturity structure of variable interest rate borrowing 2020/21			
	Lower	Upper	
Under 12 months	0%	75%	
12 months to 2 years	0%	75%	
2 years to 5 years	0%	75%	
5 years to 10 years	0%	75%	
10 years and above	0%	75%	

Policy on borrowing in advance of need

- 5.64 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.
- 5.65 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Debt rescheduling

- 5.66 Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

New financial institutions as a source of borrowing and / or types of borrowing

- 5.67 Following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100 bps to 180 basis points on loans lent to local authorities, consideration will also need to be given to sourcing funding at cheaper rates from the following:

- Local authorities (primarily shorter dated maturities)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of spot or forward dates)
- Municipal Bonds Agency (no issuance at present but there is potential)

5.68 The degree which any of these options proves cheaper than PWLB Certainty Rate is still evolving at the time of writing but our advisors will keep us informed.

Annual Investment Strategy

Investment policy – management of risk

5.69 The Council's investment policy has regard to the following: -

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

5.70 The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).

5.71 The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

5.72 In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

5.73 Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

5.74 Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

5.75 This authority has defined the list of types of investment instruments that the treasury management team are authorised to use, as per appendix 2.

- Specified investments are those with a high level of credit quality and subject to a maturity limit of one year.
- Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which

require greater consideration by members and officers before being authorised for use. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18 month deposit would still be non-specified even if it has only 11 months left until maturity.

- 5.76 **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being 50% of the total investment portfolio.
- 5.77 **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in the appendix 2.
- 5.78 **Transaction limits** are set for each type of investment in appendix 2.
- 5.79 This authority will set a limit for the amount of its investments which are invested for longer than 365 days.
- 5.80 Investments will only be placed with counterparties from countries with a specified minimum sovereign rating.
- 5.81 This authority has engaged external consultants, to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.
- 5.82 All investments will be denominated in sterling.
- 5.83 As a result of the change in accounting standards for 2019/20 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18.)
- 5.84 However, this authority will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

Creditworthiness policy

- 5.85 The Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:-
- credit watches and credit outlooks from credit rating agencies;
 - CDS spreads to give early warning of likely changes in credit ratings;

- sovereign ratings to select counterparties from only the most creditworthy countries.
- 5.86 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:-
- Yellow 5 years
 - Dark pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
 - Light pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
 - Purple 2 years
 - Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
 - Orange 1 year
 - Red 6 months
 - Green 100 days
 - No colour not to be used
- 5.87 The Link creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.
- 5.88 Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of short term rating F1 and a long term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.
- 5.89 All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of our creditworthiness service.
- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
 - in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.
- 5.90 Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, information on any external support for banks to help support its decision making process.
- 5.91 The Council has determined that it will only use approved counterparties from the UK and countries with a minimum sovereign credit rating of AA- from Fitch or

equivalent. The list of countries that qualify using this credit criteria as at the date of this report are shown in appendix 3. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

UK banks – ring fencing

- 5.92 The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as “ring-fencing”. Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.
- 5.93 Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and “riskier” activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity’s core activities are not adversely affected by the acts or omissions of other members of its group.
- 5.94 While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

Investment Strategy

- 5.95 Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.
- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
 - Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.
- 5.96 **Investment returns expectations.** On the assumption that the UK and EU agree a Brexit deal by the end of 2019 or soon after, then Bank Rate is forecast to increase only slowly over the next few years to reach 1.25% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

- Q1 2021 0.75%
- Q1 2022 1.00%
- Q1 2023 1.25%

5.97 The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

2019/20	0.75%
2020/21	1.00%
2021/22	1.00%
2022/23	1.50%
2023/24	1.50%
2024/25	1.75%
Later years	2.25%

5.98 The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture. The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside. In the event that a Brexit deal is agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

5.99 **Investment treasury indicator and limit** - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicator and limit:-

Maximum principal sums invested > 365 days			
	2020/21	2021/22	2022/23
Principal sums invested > 365 days	£10m	£10m	£10m

5.100 For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

Investment risk benchmarking

5.101 This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day, 1, 3, 6 or 12 month LIBID uncompounded.

End of year investment report

5.102 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

6 Implications**6.1 Financial**

Included in the report.

6.2 Legal

None.

6.3 Human Resources

None.

6.4 Section 17 (Crime Prevention)

None.

6.5 Human Rights Act

None.

6.6 Data Protection

None.

6.7 Risk Management

The Council regards security of the sums it invests to be the key objective of its treasury management activity. Close management of counterparty risk is therefore a key element of day to day management of treasury activity. The practices designed to ensure that risks are managed effectively are set out in the Treasury Management Practices available on the Council's website.

6.8 Equality and Diversity

The Council considers the effect of its actions on all sections of our community and has addressed all of the following Equality Strands in the production of this report, as appropriate:-

Age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex, sexual orientation.

6.9 Best Value

None.

7 Appendices to the Report

- Appendix 1: Economic Background.
- Appendix 2: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management.
- Appendix 3: Approved Countries for Investment.
- Appendix 4: Treasury Management Scheme of Delegation
- Appendix 5: The Treasury Management role of the Section 151 Officer

Previous Consideration –

None

Background Papers –

Available in Financial Services

ITEM NO. 10.

Economic Background

UK. Brexit. 2019 has been a year of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October 2019, with or without a deal. However, MPs blocked leaving on that date and the EU agreed an extension to 31 January 2020. In late October, MPs approved an outline of a Brexit deal to enable the UK to leave the EU on 31 January. Now that the Conservative Government has gained a large overall majority in the **general election** on 12 December, this outline deal will be passed by Parliament by that date. However, there will still be much uncertainty as the detail of a trade deal will need to be negotiated by the current end of the transition period in December 2020, which the Prime Minister has pledged he will not extend. This could prove to be an unrealistically short timetable for such major negotiations that leaves open two possibilities; one, the need for an extension of negotiations, probably two years, or, a no deal Brexit in December 2020.

GDP growth has taken a hit from Brexit uncertainty during 2019; quarter three 2019 surprised on the upside by coming in at +0.4% q/q, +1.1% y/y. However, the peak of Brexit uncertainty during the final quarter appears to have suppressed quarterly growth to probably around zero. The economy is likely to tread water in 2020, with tepid growth around about 1% until there is more certainty after the trade deal deadline is passed.

While the Bank of England went through the routine of producing another **quarterly Inflation Report**, (now renamed the Monetary Policy Report), on 7 November, it is very questionable how much all the writing and numbers were worth when faced with the uncertainties of where the UK will be after the general election. The Bank made a change in their Brexit assumptions to now include a deal being eventually passed. Possibly the biggest message that was worth taking note of from the Monetary Policy Report, was an increase in concerns among MPC members around weak global economic growth and the potential for Brexit uncertainties to become entrenched and so delay UK economic recovery. Consequently, the MPC voted 7-2 to maintain Bank Rate at 0.75% but two members were sufficiently concerned to vote for an immediate Bank Rate cut to 0.5%. The MPC warned that if global growth does not pick up or Brexit uncertainties intensify, then a rate cut was now more likely. Conversely, if risks do recede, then a more rapid recovery of growth will require gradual and limited rate rises. The speed of recovery will depend on the extent to which uncertainty dissipates over the final terms for trade between the UK and EU and by how much global growth rates pick up. The Bank revised its inflation forecasts down – to 1.25% in 2019, 1.5% in 2020, and 2.0% in 2021; hence, the MPC views inflation as causing little concern in the near future.

The **MPC meeting of 19 December** repeated the previous month's vote of 7-2 to keep Bank Rate on hold. Their key view was that there was currently 'no evidence about the extent to which policy uncertainties among companies and households had declined' i.e. they were going to sit on their hands and see how the economy goes in the next few months. The two members who voted for a cut were concerned that the labour market was faltering. On the other hand, there was a clear warning in the minutes that the MPC were concerned that "domestic unit labour costs have continued to grow at rates above those consistent with meeting the inflation target in the medium term".

If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with Bank Rate still only at 0.75%. It would therefore, probably suggest that it would be up to the Chancellor to provide help to support growth by way of a **fiscal boost** by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this direction and it made significant promises in its election manifesto to increase government spending by up to £20bn p.a., (this would add about 1% to GDP growth rates), by investing primarily in infrastructure. This is likely to be announced in the next Budget, probably in February 2020. The Chancellor has also amended the fiscal rules in November to allow for an increase in government expenditure.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell again in both October and November to a three-year low of 1.5%. It is likely to remain close to or under 2% over the next two years and so, it does not pose any immediate concern to the MPC at the current time. However, if there was a hard or no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

With regard to the **labour market**, growth in numbers employed has been quite resilient through 2019 until the three months to September where it fell by 58,000. However, there was an encouraging pick up again in the three months to October to growth of 24,000, which showed that the labour market was not about to head into a major downturn. The unemployment rate held steady at a 44-year low of 3.8% on the Independent Labour Organisation measure in October. Wage inflation has been steadily falling from a high point of 3.9% in July to 3.5% in October (3-month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.0%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The other message from the fall in wage growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of growth to a robust 2.9% y/y. **Growth** in 2019 has been falling after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2 and then 2.1% in quarter 3. The economy looks likely to have maintained a growth rate similar to quarter 3 into quarter 4; fears of a recession have largely dissipated. The strong growth in employment numbers during 2018 has weakened during 2019, indicating that the economy had been cooling, while inflationary pressures were also weakening. However, CPI inflation rose from 1.8% to 2.1% in November, a one year high, but this was singularly caused by a rise in gasoline prices.

The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not intended to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc.). It then cut rates by 0.25% again in September and by another 0.25% in its October meeting to 1.50 – 1.75%. At its September meeting it also said it was going to **start buying Treasuries again**, although this was not to be seen

as a resumption of quantitative easing but rather an exercise to relieve liquidity pressures in the repo market. Despite those protestations, this still means that the Fed is again expanding its balance sheet holdings of government debt. In the first month, it will buy \$60bn, whereas it had been reducing its balance sheet by \$50bn per month during 2019. As it will be buying only short-term (under 12 months) Treasury bills, it is technically correct that this is not quantitative easing (which is purchase of long term debt). The Fed left rates unchanged in December. However, the accompanying statement was more optimistic about the future course of the economy so this would indicate that further cuts are unlikely.

Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This **trade war** is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.

However, in November / December, progress has been made on agreeing a phase one deal between the US and China to roll back some of the tariffs; this gives some hope of resolving this dispute.

EUROZONE. Growth has been slowing from +1.8 % during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1, +0.2% q/q (+1.2% y/y) in quarter 2 and then +0.2% q/q, +1.1% in quarter 3; there appears to be little upside potential in the near future. German GDP growth has been struggling to stay in positive territory in 2019 and fell by -0.1% in quarter 2; industrial production was down 4% y/y in June with car production down 10% y/y. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars.

The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which then meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by quantitative easing purchases of debt. However, the downturn in EZ growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels "at least through the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a **third round of TLTROs**; this provides banks with cheap borrowing every three months from September 2019 until March 2021 that means that, although they will have only a two-year maturity, the Bank was making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum; at its meeting on 12 September it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a **resumption of quantitative easing purchases of debt for an unlimited period**. At its October meeting it said these purchases would start in November at €20bn per month - a relatively small amount compared to the previous buying programme. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have

much impact on growth and, unsurprisingly, the ECB stated that governments would need to help stimulate growth by 'growth friendly' fiscal policy.

There were no policy changes in the December meeting, which was chaired for the first time by the new President of the ECB, Christine Lagarde. However, the outlook continued to be down beat about the economy; this makes it likely there will be further monetary policy stimulus to come in 2020. She did also announce a thorough review of how the ECB conducts monetary policy, including the price stability target. This review is likely to take all of 2020.

On the political front, Austria, Spain and Italy have been in the throes of **forming coalition governments** with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The latest results of German state elections has put further pressure on the frail German CDU/SDP coalition government and on the current leadership of the CDU. The results of the Spanish general election in November have not helped the prospects of forming a stable coalition.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and shadow banking systems. In addition, there still needs to be a greater switch from investment in industrial capacity, property construction and infrastructure to consumer goods production.

JAPAN - has been struggling 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.

WORLD GROWTH. Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, 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. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation. **Central banks are, therefore, likely to come under more pressure to support growth by looser monetary policy measures and this will militate against central banks increasing interest rates.**

The trade war between the US and China is a major concern to **financial markets** due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns resulted in **government bond yields** in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been predicting a downturn in growth; this confirms investor sentiment that the outlook for growth during the year ahead is weak.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 3.3 are **predicated on an assumption of an agreement being reached on Brexit between the UK and the EU**. On this basis, while GDP growth is likely to be subdued in 2019 and 2020 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement on the detailed terms of a trade deal is likely to lead to a boost to the rate of growth in subsequent years. This could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an **orderly non-agreement exit in December 2020**, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.
- If there were a **disorderly Brexit**, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. Quantitative easing could also be restarted by the Bank of England. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably even, but dependent on a successful outcome of negotiations on a trade deal.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.
- In the event that a Brexit deal was agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although

central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **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**. In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new coalition based on an unlikely alliance of two very different parties will endure.
- Weak capitalisation of some **European banks**, particularly Italian banks.
- **German minority government**. 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 recent state elections but the SPD has done particularly badly and this has raised a major question mark over continuing to support the CDU. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until 2021.
- **Other minority EU governments**. Austria, Finland, Sweden, Spain, Portugal, Netherlands 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 rising anti-immigration sentiment in Germany and France.
- In October 2019, the IMF issued a report on the World Economic Outlook which flagged up a synchronised slowdown in world growth. However, it also flagged up that there was **potential for a rerun of the 2008 financial crisis**, but this time centred on the huge debt binge accumulated by corporations during the decade of low interest rates. This now means that there are corporates who would be unable to cover basic interest costs on **some \$19trn of corporate debt in major western economies**, if world growth was to dip further than just a minor cooling. This debt is mainly held by the shadow banking sector i.e. pension funds, insurers, hedge funds, asset managers etc., who, when there is \$15trn of corporate and government debt now yielding negative interest rates, have been searching for higher returns in riskier assets. Much of this debt is only marginally above investment grade so any rating downgrade could force some holders into a fire sale, which would then depress prices further and so set off a spiral down. The IMF's answer is to suggest imposing higher capital charges on lending to corporates and for central banks to regulate the investment operations of the shadow banking sector. In October 2019, the deputy Governor of the Bank of England also flagged up the dangers of banks and the shadow banking sector lending to corporates, especially highly leveraged corporates, which had risen back up to near pre-2008 levels.

- **Geopolitical risks**, for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

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

- **Brexit** – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- The **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.
- **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

ITEM NO. 10.

Treasury Management Practice (TMP1) - Credit and Counterparty Risk Management

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' quality criteria where applicable.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the specified investment criteria. A maximum of 50% will be held in aggregate in non-specified investments.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:-

	Minimum credit criteria / colour band	Max % of total investments/ £ limit per institution	Max. maturity period
DMADF – UK Government	N/A	100%	6 months
UK Government gilts	UK sovereign rating	£6 million	5 years
UK Government Treasury bills	UK sovereign rating	£6 million	12 months
Bonds issued by multilateral development banks	AAA	£6 million	5 years
Money Market Funds CNAV	AAA	100%	Liquid
Money Market Funds LNAV	AAA	100%	Liquid
Money Market Funds VNAV	AAA	100%	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	AAA	100%	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.5	AAA	100%	Liquid

	Minimum credit criteria / colour band	Max % of total investments/ £ limit per institution	Max. maturity period
Local authorities	N/A	100%	12 months
Call Accounts	N/A	£6 million	Liquid
Term deposits with housing associations	Blue Orange Red Green No Colour	£6 million	12 months 12 months 6 months 100 days Not for use
Term deposits with banks and building societies	Blue Orange Red Green No Colour	£6 million	12 months 12 months 6 months 100 days Not for use
CDs or corporate bonds with banks and building societies	Blue Orange Red Green No Colour	£6 million	12 months 12 months 6 months 100 days Not for use
Gilt funds	UK sovereign rating	£6 million	12 months

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

Approved Countries for Investment

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Hong Kong
- U.K.

AA-

- Belgium
- Qatar

TREASURY MANAGEMENT SCHEME OF DELEGATION

Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

Committees/Council

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

Body/person(s) with responsibility for scrutiny

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers;
- preparation of a capital strategy to include capital expenditure, capital financing, and treasury management, with a long term timeframe.