REPORT TO:	**GENERAL PURPOSES AND AUDIT COMMITTEE** **7 October 2020**
SUBJECT:	**Treasury Management Strategy Statement and Annual Investment Strategy** **End of Year Review 2019/2020**
LEAD OFFICER:	**Nigel Cook, Head of Treasury and Pensions**
CABINET MEMBER:	**Councillor Simon Hall** **Cabinet Member for Finance and Resources**
WARDS:	**All**

CORPORATE PRIORITY/POLICY CONTEXT:

Sound Financial Management. This Report details the Council's Treasury Management activities for the year 2019/2020 and its compliance with the 2017 Prudential Code for Capital Finance.

FINANCIAL SUMMARY:

This Report details the Council's Treasury Management activities for the year 2019/2020 and demonstrates its compliance with the 2017 Prudential Code for Capital Finance.

1. RECOMMENDATION

The Committee are recommended to:

1.1 Note the contents of this report.

2. EXECUTIVE SUMMARY

2.1 This Report is prepared in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) codes of practice in respect of capital finance and treasury management. The codes recommend that members are advised of the treasury management activities for the whole of each financial year and of compliance with various strategies and policies agreed by the Council. The report:

- Reviews compliance with the Treasury Management Strategy Statement, Capital Strategy and Annual Investment Strategy as agreed by full Council on 4 March 2019 (Minute A20/17 applies) and revised in part on 7 October 2019 (Minute 62/19 applies);
- Reviews treasury borrowing and investment activity for the period 1 April 2019 to 31 March 2020; and
- Demonstrates compliance with agreed Treasury and Prudential Indicators.

3 DETAIL

3.1 Background

3.1.1 In December 2017, CIPFA issued codes of practice as follows:

- The Prudential Code for Capital Finance in Local Authorities; and
- Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.

3.1.2 Under the Code of Practice, from 2019/2020, all local authorities are required 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.

3.1.3 As regards Treasury Management, the primary requirements of the Code are:

- 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 General Purposes and Audit Committee.

3.1.4 This year-end report has been prepared in compliance with the codes and covers the following:

- An economic update of the 2019/20 financial year (Section 3.2);
- A medium term interest rates forecast (Section 3.3);
- A review of the Council's Treasury Management Strategy Statement and Annual Investment Strategy (Section 3.4);
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators (Section 3.5);
- A review of the Council's borrowing strategy (Section 3.6);

- A review of the Council's investment strategy (Section 3.7);
- A review of any debt re-scheduling undertaken (Section 3.8);
- Compliance with Treasury and Prudential Limits (Section 3.9); and
- Treasury Outturn (Section 3.10).

3.2 Economic update

3.2.1 A commentary provided by the Council's independent treasury advisers, Link Asset Services (Link), in the first week of April 2020 is included as Appendix A1. In view of the impact of Covid 19 on so many aspects of the economy an updated version provided in the first week of September 2020 is included as Appendix A2.

3.3 Interest rate forecasts

3.3.1 Link provide the authority with forecasts of key interest rates on a regular basis and these are set out in Table 1 below. These forecasts will be updated during the remainder of 2020/2021 and will inform decisions as to the timing and duration of borrowing decisions

Table 1: Interest Rate Forecasts

Link Group Interest Rate View 11.8.20	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	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month average earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-
6 Month LIBID	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-
12 Month LIBID	0.20	0.20	0.20	0.20	0.20	0.20	0.20	-	-	-	-
5yr PWLB Rate	1.90	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

3.3.2 A commentary on these forecasts, also provided by Link, is included as Appendix B.

3.4 Treasury Management Strategy Statement and Annual Investment Strategy

3.4.1 The Treasury Management Strategy Statement and Annual Investment Strategy for 2019/2020 were approved by full Council on 4 March 2019 (Minute A20/17 applies). On 19 September 2019 Cabinet agreed to recommend to full Council revisions in borrowing limits arising from movements in the capital programme as discussed in Section 3.5 below and these were agreed on 7 October 2019 (Minute 62/19 applies).

3.5 Capital Strategy and Prudential Indicators

3.5.1 Table 2 shows the original capital budget as agreed by full Council on 4 March 2019 (Minute A19/17 applies), the revised outturn as reported in the Treasury Management Strategy Statement 2020/2021 as agreed by full Council on 2 March 2020 (Minute 87/20 applies) and the actual outturn.

Table 2: Capital Expenditure by Services

Capital Expenditure by Service	Original Estimate £m	Revised Outturn Estimate £m	Outturn £m
Health, Wellbeing and Adults		7.0	5.8
Children, Families and Education	35.6	31.1	16.4
Gateway, Strategy and Engagement	9.7		
Place	77.8	123.5	118.8
Resources.	60.4	74.9	39.4
HRA	38.4	42.2	51.4
Total	**221.9**	**278.7**	**231.8**

3.5.2 Table 3 details the funding sources of the capital programme. The borrowing element of the table increases the underlying need to borrow for capital purposes by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision).

Table 3: Financing of Capital Expenditure

Financing of Capital Expenditure	Original Estimate £m	Revised Outturn Estimate £m	Outturn £m
Capital receipts	2.5	20.8	19.0
Capital grants	33.8	29.7	25.8
Community Infrastructure Levy	8.0	8.0	6.5
Major Repairs Allowance	27.7		12.3
Capital reserves	7.0		
Revenue	3.7	10.0	10.0
Total financing	**82.7**	**68.5**	**73.6**
Borrowing requirement	**139.2**	**210.2**	**158.2**

3.5.3 The key controls over treasury management activity are prudential indicators and compliance with them ensures that, over the medium term, borrowing will only be for capital purposes. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2019/2020 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need as required. Table 4 shows changes in the CFR and borrowing over the year.

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Table 4: Capital Financing Requirement

	Original Estimate £m	Outturn Projection £m	Actual £m
Borrowing	1,351.1	1,536.6	1,445.0
Other long term liabilities	84.9	82.8	75.8
Total debt	1,436.0	1,619.4	1,520.8
CFR (year-end position)	1,465.4	1,573.3	1,465.0

3.5.4 The Prudential Indicators relevant to the capital programme and its borrowing implications are the Operational Boundary (the expected debt position) and the Authorised Limit (the limit beyond which borrowing is prohibited). Table 5 shows amendments which the full Council agreed on 7 October 2019 (Minute 62/19 applies).

Table 5: Key Prudential Indicators

	Original Estimate* £m	Outturn Projection** £m
Operational Boundary	1,436.0	1,655.3
Authorised Limit	1,486.0	1,705.3

*As agreed by full Council on 4 March 2019
**As agreed by full Council on 7 October 2019

3.5.5 The Authorised Limit includes a buffer of £50m to cover unexpected cash flow shortages.

3.6 Borrowing Strategy

3.6.1 During the first six months of 2019/2020 the Council was operating in accordance with the borrowing limits approved by full Council on 4 March 2019 (Minute 20/17 applies). For the remainder of the year the borrowing was in accordance with the Outturn Projection as shown in Table 5 above.

3.6.2 The level of the Council's borrowing, which is measured against the limits, was £1,357.0m on 1 April 2019 and £1,520.8m on 31 March 2020. At no point during the year was either the approved Operational Boundary or the Authorised Limit breached.

3.6.3 Table 6 shows the monthly movement of the actual debt during the year.

Table 6: Actual debt in 2019/20

End of Month	PWLB	Market debt	Temporary borrowing	PFI and other	TOTAL
	£'000	£'000	£'000	£'000	£'000
March (2019)	857,926	217,389	199,000	82,798	1,357,113
April	877,426	192,889	204,000	75,821	1,350,136
May	877,426	180,889	206,000	75,821	1,340,136
June	877,426	190,889	196,000	75,821	1,340,136
July	877,426	190,575	221,000	75,821	1,364,822
August	902,426	190,575	242,000	75,821	1,410,822
September	902,426	185,575	237,000	75,821	1,400,822
October	902,426	200,575	250,000	75,821	1,428,822
November	902,426	225,575	252,000	75,821	1,455,822

December	902,426	240,575	267,000	75,821	1,485,822
January	902,426	260,575	272,000	75,821	1,510,822
February	902,426	260,575	282,000	75,821	1,520,822
March (2020)	907,426	260,575	277,000	75,821	1,520,822

3.6.4 During the year, to take advantage of the low levels of short term rates, particularly from other local authorities, almost all new borrowing was taken for periods of up to two years; £59.5m was taken as long term PWLB debt. Of this £59.5m, £10m was to refinance maturing PWLB debt, £19.5m was used to refinance a LOBO in order to make savings on interest payments, £15m was borrowed by the HRA in order to purchase new properties and £15m was used to finance the ongoing capital programme.

3.6.5 Borrowing will be taken up as required based on a continuing analysis of actual and projected expenditure over the different components of the capital programme and interest rates forecasts. It is likely that the Council will use a mixture of long term borrowing from the PWLB and the wider market, short term borrowing from other local authorities and internal balances. Borrowing will be undertaken to fit into the Council's existing debt maturity profile to move towards a more even distribution of maturities. Appendix C shows the movements in PWLB interest rates for various loan periods during the last six months.

3.6.6 The Council's effective interest payable on long term debt currently stands at 2.68% with the maturity profile detailed in Appendix D

3.7 Investment Strategy

3.7.1 From time to time, under Section 15 (1) of the Local Government Act 2003 the Secretary of State issues statutory guidance on local government investments to which local authorities are required to "have regard." This guidance was taken into account in the investment policy parameters set within the Council's Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy as approved by full Council on 4 March 2019 Minute A20/17 applies).

3.7.2 The current guidance defines investments as "Specified" and "Non-specified"

3.7.3 An investment is a specified investment if all of the following apply:

- the investment and any associated payments or repayments are denominated in sterling;
- the investment has a maximum maturity of one year;
- the investment is not defined as capital expenditure; and
- the investment is made with a body or in an investment scheme described as high quality or with the UK Government, a UK local authority or a parish or community council.

3.7.4 A non-specified investment is any investment that does not meet all the conditions in paragraph 3.7.3 above.

3.7.5 All investments are managed in-house and it is the Council's priority when undertaking treasury activities to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. Investment instruments identified for use by the Council during

2019/2020 as included in the current Treasury Management Strategy are detailed in Appendix E.

3.7.6 During the year it was considered appropriate to keep investments short term to cover cashflow needs and to seek out value available in periods of up to twelve months. Investments were only made with highly credit rated financial institutions using the Link suggested creditworthiness approach including a minimum sovereign credit rating and Credit Default Swap overlay information.

3.7.7 Investment activity during 2019/2020 conformed to the approved strategy. The Council has experienced no liquidity issues with an average monthly balance of £121m being maintained in temporary investments. Part of this sum is made up of core balances such as provisions and reserves set aside and cash balances that can, if necessary, be invested for longer periods to take advantage of favourable interest rates and to limit exposure to the risk of future rate movements.

3.7.8 The Director of Finance, Investment and Risk, Section 151 Officer, confirms that the approved limits within the Annual Investment Strategy were not breached during the year.

3.7.9 As shown in Table 7 below, throughout the year the Treasury Management Team managed substantial balances with the month-end position only once being below £65m and on two occasions exceeding £180m. In aggregate, deposits totalling £1,458m were invested with the average monthly balance yielding an investment rate of return of 0.87% compared to the LIBID 7 day rate of 0.57% for the period. Total investments outstanding at 31 March 2020 were £109m invested as follows: £68m with UK local authorities, £31m with AAA rated Money Market Funds and £10m with overseas banks.

Table 7: Month end balances

Month	General Fund £m	Pension Fund £m	Total £m
April	110.00	10.90	120.90
May	107.30	10.70	118.00
June	79.05	10.05	89.10
July	73.00	6.80	79.80
August	75.70	15.00	90.70
September	41.40	23.40	64.80
October	67.60	28.60	96.20
November	82.10	82.22	164.32
December	96.70	86.32	183.02
January	95.30	87.72	183.02
February	74.00	84.85	158.85
March	27.70	81.32	109.02

3.8 Repayment of Debt and Debt Rescheduling

3.8.1 Debt rescheduling opportunities have been limited in the current economic climate. With high premiums being attached to the premature repayment of existing debt, opportunities for debt restructuring were minimal and none were taken.

3.9 Compliance with Treasury and Prudential Limits

3.9.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The approved Treasury and Prudential Indicators, (affordability limits), are included in the approved Treasury Management Strategy Statement. During the year the Council has operated within the treasury and prudential indicators as detailed in Appendix F.

3.10 Treasury Outturn

3.10.1 The Treasury outturn position is summarised in the table below.

Table 8: Borrowing costs and investment income

	Budget £m	Outturn £m	Variance £m
GENERAL FUND			
Borrowing costs	23.054	24.528	1.474
Investment income	-11.318	-15.330	-4.012
TOTAL	11.736	9.198	-2.538
HRA			
Borrowing costs	12.120	11.986	-0.134
Investment income	n/a	n/a	n/a
TOTAL	12.120	11.986	-0.134

4 FINANCIAL CONSIDERATIONS

4.1 There are no direct financial considerations arising from this report.

Approved by: Lisa Taylor, Director of Finance, Investment and Risk, S. 151 Officer.

5. OTHER CONSIDERATIONS

5.1 There are no Customer Focus, Equalities, Environment and Design, Crime and Disorder or Human Rights considerations arising from this report

6. HUMAN RESOURCES CONSIDERATIONS

6.1 There are no direct workforce implications arising from the recommendations within this report.

Approved by: Sue Moorman, Director of Human Resources

7. LEGAL CONSIDERATIONS

7.1 The Head of Litigation and Corporate Law comments on behalf of the Director of Law and Governance that there are no additional that there are no direct legal implications arising from the recommendations within this report.

Approved by: Sandra Herbert, Head of Litigation and Corporate Law on behalf of the Director of Law and Governance and Deputy Monitoring Officer.

8 FREEDOM OF INFORMATION

8.1 This report contains only information that can be publicly disclosed.

9 DATA PROTECTION IMPLICATIONS

9.1 Will the subject of the report involve the processing of 'personal data'?

No.

Has a data protection impact assessment (DPIA) been completed?

No. This report relates to matters relating to the administration of the LGPS and the Croydon Pension Fund.

Approved by: Lisa Taylor, Director of Finance, Investment and Risk, S151 Officer

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Resources Department, ext. 62552.

BACKGROUND DOCUMENTS: None

APPENDICES:

A1 and A2 Economic update
B - Interest rate forecast update
C - PWLB rates
D - Debt maturity profile
E - Investment Instruments
F - Treasury and Prudential Indicators

APPENDIX A1

Economic update (as prepared by Link Asset Services in the first week of April 2020)

UK. Economic growth in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 bouncing back up to +0.5% and quarter 4 flat at 0.0%, +1.1% y/y. 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election in December settled the Brexit issue. However, the three monthly GDP statistics in January were disappointing, being stuck at 0.0% growth. Since then, the whole world has changed as a result of the coronavirus outbreak. It now looks likely that the closedown of whole sections of the economy will result in a fall in GDP of at least 15% in quarter two. What is uncertain, however, is the extent of the damage that will be done to businesses by the end of the lock down period, when the end of the lock down will occur, whether there could be a second wave of the outbreak, how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover.

Although the UK left the EU on 31 January 2020, we still have much uncertainty as to whether there will be a reasonable trade deal achieved by the end of 2020. It is also unclear as to whether the coronavirus outbreak may yet impact on the deadline of agreeing a deal by then.

After the Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August 2018, Brexit uncertainty caused the MPC to sit on its hands and do nothing until March 2020; at this point it was abundantly clear that the coronavirus outbreak posed a huge threat to the economy of the UK. Two emergency cuts in Bank Rate from 0.75%, therefore, occurred in March, first to 0.25% and then to 0.10%. These cuts were accompanied by an increase in quantitative easing (QE), essentially the purchases of gilts (mainly) by the Bank of England of £200bn. The Government and the Bank were also very concerned to stop people losing their jobs during this lock down period. Accordingly, the Government has introduced various schemes to subsidise both employed and self-employed jobs for three months while the country is locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lock down period when some firms may have little or no income. However, at the time of writing, this leaves open a question as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services. This is a rapidly evolving situation so there may be further measures to come from the Bank and the Government. The measures to support jobs and businesses already taken by the Government will result in a huge increase in the annual budget deficit from about 2%, to nearly 11%. The ratio of debt to GDP is also likely to increase from around 80% to around 105%.

In the Budget in March, the Government also announced a large increase in spending on infrastructure; this will also help the economy to recover once the lock down is ended. Provided the coronavirus outbreak is brought under control relatively swiftly, and the lock down is eased, then it is hoped that there would be a sharp recovery, but one that would take a prolonged time to fully recover previous lost momentum.

Inflation is not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil which has fallen sharply in price. Other prices will also be under downward pressure; wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.

Employment had been growing healthily through the last year but it will obviously be heading for a big hit in the coming months. The good news over the last year is that wage inflation has been significantly higher than CPI inflation which means that consumer real spending power has been increasing and so will have provided support to GDP growth. However, while people cannot leave their homes to do non-food shopping, retail sales will also take a big hit.

USA. Growth in quarter 1 of 2019 was strong at 3.1% but growth fell back to 2.0% in quarter 2 and 2.1% in quarters 3 and 4. The slowdown in economic growth resulted in the Fed cutting rates from 2.25-2.50% by 0.25% in each of July, September and October. Once coronavirus started to impact the US in a big way, the Fed took decisive action by cutting rates twice by 0.50%, and then 1.00%, in March, all the way down to 0.00 – 0.25%. Near the end of March, Congress agreed a $2trn stimulus package (worth about 10% of GDP) and new lending facilities announced by the Fed which could channel up to $6trn in temporary financing to consumers and firms over the coming months. Nearly half of the first figure is made up of permanent fiscal transfers to households and firms, including cash payments of $1,200 to individuals.

The loans for small businesses, which convert into grants if firms use them to maintain their payroll, will cost $367bn and 100% of the cost of lost wages for four months will also be covered. In addition there will be $500bn of funding from the Treasury's Exchange Stabilization Fund which will provide loans for hard-hit industries, including $50bn for airlines.

However, all this will not stop the US falling into a sharp recession in quarter 2 of 2020; some estimates are that growth could fall by as much as 40%. The first two weeks in March of initial jobless claims have already hit a total of 10 million and look headed for a total of 15m by the end of March.

EUROZONE. The annual rate of growth has been steadily falling, from 1.8% in 2018 to only 0.9% y/y in quarter 4 in 2019. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which 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 purchases of debt. However, the downturn in EZ growth, 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%), prompted the ECB to take new measures to stimulate growth. At its March 2019 meeting it announced a third round of TLTROs [targeted longer-term refinancing operations]; this provides banks with cheap two year maturity borrowing every three months from September 2019 until March 2021. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting in September 2019, 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 to start in November at €20bn per month, a relatively small amount, plus more TLTRO measures. Once coronavirus started having a major impact in Europe, the ECB took action in March 2020 to expand its QE operations and other measures to help promote expansion of credit and economic growth. What is currently missing is a coordinated EU response of fiscal action by all national governments to protect jobs, support businesses directly and promote economic growth by expanding government expenditure on e.g. infrastructure; action is therefore likely to be patchy.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium-term risks have also been increasing. The major feature of 2019 was the trade war with the US. However, this has been eclipsed by being the first country to be hit by the coronavirus outbreak; this resulted in a lock down of the country and a major contraction of economic activity in February-March 2020. While it appears that China has put a lid on the virus by the end of March, these are still early days to be confident and it is clear that the economy is going to take some time to recover its previous rate of growth. Ongoing economic issues remain, in needing to make major progress to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. It also needs to address the level of non-performing loans in the banking and credit systems.

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. It appears to have missed much of the domestic impact from coronavirus in 2019-20 but the virus is at an early stage there.

WORLD GROWTH. The trade war between the US and China on tariffs was a major concern to financial markets and was depressing worldwide growth during 2019, as any downturn in China would spill over into impacting countries supplying raw materials to China. Concerns were particularly focused on the synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during 2019. In 2020, coronavirus is the big issue which is going to sweep around most countries in the world and have a major impact in causing a world recession in growth in 2020.

APPENDIX A2

Economic update (as prepared by Link Asset Services in the first week of September 2020)

- As expected, the Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 6th August. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:
    - The fall in **GDP** in the first half of 2020 was revised from 28% to 23%. This is still one of the largest falls in output of any developed nation. However, it is only to be expected as the UK economy is heavily skewed towards consumer-facing services – an area which was particularly vulnerable to being damaged by lockdown.
    - The peak in the **unemployment rate** was revised down from 9% in Q2 to 7½% by Q4 2020.
    - It forecast that there would be excess demand in the economy by Q3 2022 causing CPI **inflation** to rise above the 2% target in Q3 2022, (based on market interest rate expectations for a further loosening in policy). Nevertheless, even if the Bank were to leave policy unchanged, inflation was still projected to be above 2% in 2023.
- It also squashed any idea of using **negative interest rates**, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be "less effective as a tool to stimulate the economy" at this time when banks are worried about future loan losses. It also has "other instruments available", including QE and the use of forward guidance.
- The MPC still expects the £300bn of **quantitative easing** purchases announced between its March and June meetings to continue until the "turn of the year". This implies that the pace of purchases will slow further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.
- In conclusion, this would indicate that the Bank can now just *sit on its hands* as the economy is recovering better than expected. However, the MPC acknowledged that the "medium-term projections were a less informative guide than usual" and the minutes had multiple references to **downside risks,** which were judged to persist both in the short and medium term. One has only to look at the potential for a second wave of the virus to see the dangers. However, rather than a national lockdown, as in March, any spikes in virus infections are now likely to be dealt with by localised measures and this should limit the amount of economic damage caused. In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery. The wind down in the furlough scheme through to the end of October is another development that could cause the Bank to review the need for more support for the economy later in the year. If the Bank felt it did need to provide further support to recovery, then it is likely that the tool of choice would be more QE. Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. There will also be some painful longer term adjustments as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever. There is also likely to be a reversal of globalisation as this crisis has shown up how vulnerable long-distance supply chains are. On the other hand, digital services is one area that has already seen huge growth.

- One key addition to **forward guidance** was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate

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

- Overall, it is expected that there has been a strong pickup in economic growth during the back-end of quarter 2 of 2020. However, that pace is likely to fade as the furlough scheme ending in October will lead to many job losses during the second half of the year. Consumers will also probably remain cautious in spending and this will dampen growth. Uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind.

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

- **EU.** The economy was recovering well towards the end of Q2 after a sharp drop in GDP. However, there are growing fears of a second wave of the virus that could cause a significant slowdown in the pace of recovery, especially in countries more dependent on tourism. The fiscal support package, eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support and quickly enough to make an appreciable difference in weaker countries. The ECB has been struggling to get inflation up to its 2% target and it is therefore expected that it will have to provide more monetary policy support through more quantitative easing purchases of bonds in the absence of sufficient fiscal support.

- **China.** After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and has enabled it to recover all of the contraction in Q1. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.
- **Japan.** There are some concerns that a second wave of the virus is gaining momentum and could damage economic growth further. It has been struggling to get out of a deflation trap for many years and to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. The resignation of Prime Minister Abe is not expected to result in any significant change in economic policy.
- **World growth.** Latin America and India are currently hotspots for virus infections. World growth will be in recession this year. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

APPENDIX B

Interest rate forecast update (as prepared by Link Asset Services in the first week of September 2020)

- As LIBOR rates will cease from the end of 2021, there are no LIBID forecasts for 2022/23. Link will be continuing to look at market developments in this area and will monitor these with a view to communicating with clients when full financial market agreement is reached on how to replace LIBOR. This is likely to be an iteration of the overnight SONIA rate and the use of compounded rates and Overnight Index Swap (OIS) rates for forecasting purposes.
- Please note that we have made a slight change to our interest rate forecasts table above. Traditionally, we have used 3m LIBID forecasts, with the rate calculated using market convention of 1/8th (0.125%) taken off the LIBOR figure. Given that 3m LIBOR is currently running below 10bps, that would give a figure of around 0% to somewhere modestly into negative territory. However, the liquidity premium that is still in evidence at the short end of the curve means that 3m rates actually being achieved by local authority investors are still modestly in positive territory. While there are differences between counterparty offer rates, our analysis would suggest that an average rate of around 10bps should be achievable. *(Please note that the graph of investment rates in appendix 2 is based on market rates, i.e. actual LIBOR-related rates, not rates actually being achieved by local authorities.)*

The coronavirus outbreak has done huge economic damage to the UK and around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its last meeting on 6th August, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31st March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

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

Gilt yields had therefore already been on a falling trend during the year up until the coronavirus crisis hit western economies. Since then, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies and moved cash into safe haven assets i.e. government bonds. However, major western central banks started massive quantitative easing purchases of government bonds and this has acted to maintain downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance, in "normal" times would have caused bond yields to rise sharply. At the close of the day on 28th August, all gilt yields from 1 to 4 years were in negative territory, while even 25-year yields were at only 0.97% and 50 year at 0.82%. Meanwhile, equity markets have enjoyed a rebound since the lows of March as confidence has started to return among investors that the worst is over and recovery is now on the way.

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

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

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

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

As the interest forecast table for PWLB certainty rates, (gilts plus 180bps), above shows, there is likely to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020/21.

The balance of risks to the UK

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

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

- **UK -** second nationwide wave of virus infections requiring a national lockdown
- **UK / EU trade negotiations** – if it were to cause significant economic disruption and a fresh major downturn in the rate of growth.
- **UK - Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis.** The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for "weaker" countries. In addition, the EU recently agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next year or so. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.
- Weak capitalisation of some **European banks**, which could be undermined further depending on extent of credit losses resultant of the pandemic.
- **German minority government & general election in 2021.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in subsequent state elections but the SPD has done particularly badly. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until the general election in 2021. This then leaves a major question mark over who will be the major guiding hand and driver of EU unity when she steps down.
- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.

- **Geopolitical risks,** for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.
- **US – the Presidential election in 2020:** this could have repercussions for the US economy and SINO-US trade relations.

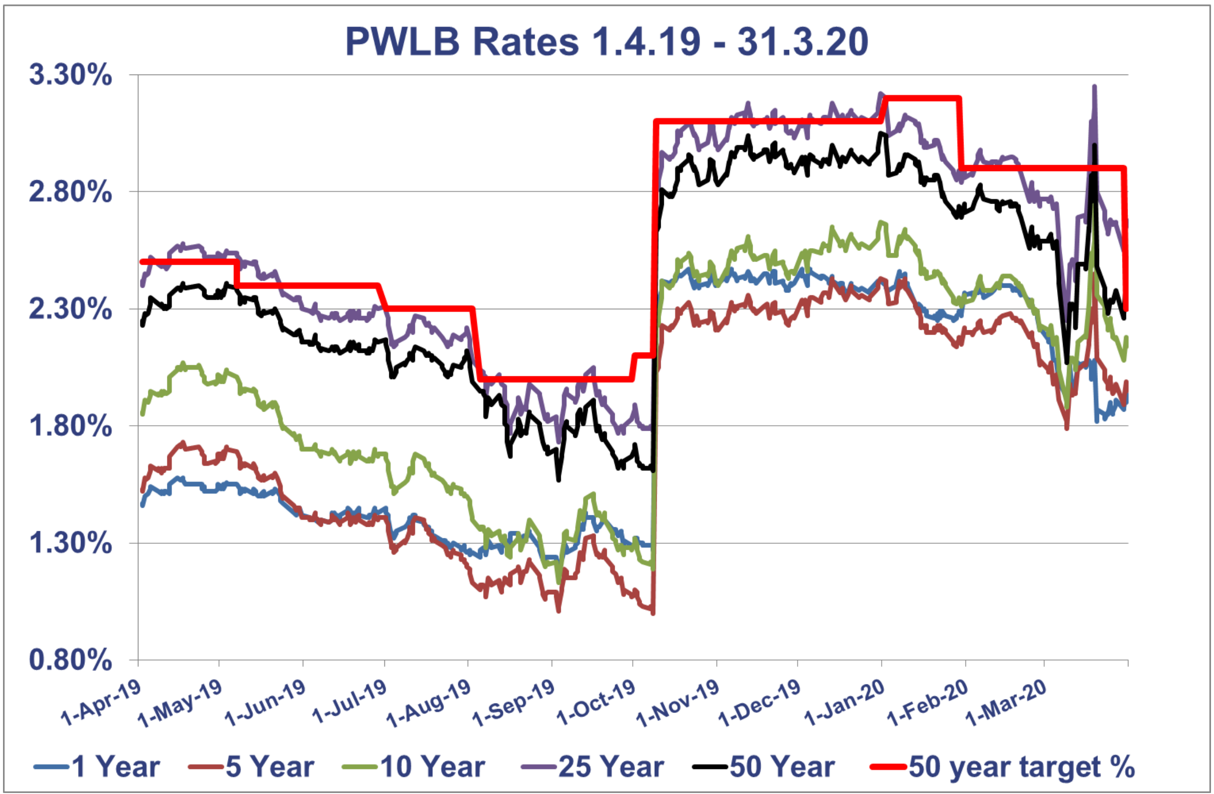
Upside risks to current forecasts for UK gilt yields and PWLB rates

- **UK -** stronger than currently expected recovery in UK economy.
- **Post-Brexit** – if an agreement was reached that removed the majority of threats of economic disruption between the EU and the UK.
- 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.

APPENDIX C

PWLB maturity certainty rates (gilts plus 180bps) year to date to 31 March 2020

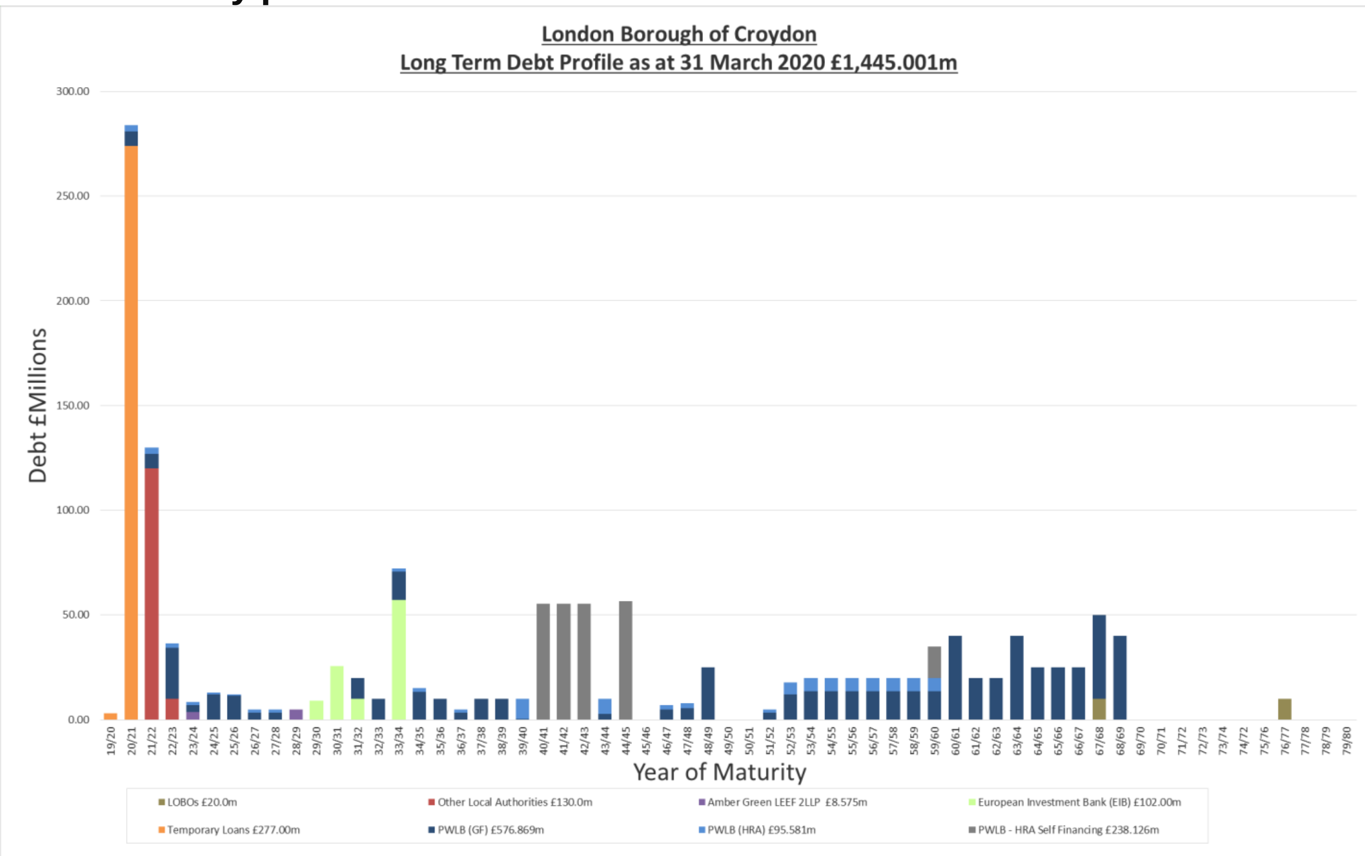
During the first six months PWLB rates were on a falling trend and longer rates reached historic lows. On 9 October, the Treasury increased the margin on PWLB rates by 100 bps (1%). Over the third quarter rates were on a rising trend but then fell sharply in the fourth quarter once the coronavirus outbreak hit the UK during March. The 50 year PWLB target rate for new long term borrowing started the year at 2.50%, fell to a low of 2.00% from August, and ended the year at 2.30% (including the additional 100bps margin imposed from 9 October).



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.17%	1.00%	1.13%	1.73%	1.57%
Date	03/09/2019	08/10/2019	03/09/2019	03/09/2019	03/09/2019
High	2.47%	2.45%	2.76%	3.25%	3.05%
Date	21/10/2019	19/03/2020	19/03/2020	19/03/2020	31/12/2019
Average	1.83%	1.77%	2.00%	2.56%	2.40%

APPENDIX D

Debt maturity profile



APPENDIX E

Investment instruments identified for use by the Council during 2019/20

Specified investments

AAA rated money market funds - limit £20m
Debt Management Office – no limit
Royal Bank of Scotland* – limit £25m
Duration of up to one year.

*Royal Bank of Scotland is included as a specified investment since it is the Council's banker and the UK Government holds a majority stake.

Non-specified investments

All institutions included on Link Asset Services' weekly "Suggested Credit List" – limit £10m
All UK local authorities – limit £10m
Duration to be determined by the "Suggested Credit List" from Link

APPENDIX F

Prudential and Treasury Indicators for 2019/20

Treasury Indicators	Treasury Management Strategy Statement £m	Actual £m
Authorised limit for external debt	1,486.0	1,705.3
Operational boundary for external debt	1,436.0	1,655.3
Gross external debt	1,436.0	1,520.8
Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	0-20%	19.0%
12 months to 2 years	0-20%	8.5%
2 years to 5 years	0-30%	4.6%
5 years to 10 years	0-30%	3.6%
10 years and above	0-100%	64.3%

Prudential Indicators	Treasury Management Strategy Statement £m	Actual £m
Capital expenditure		
General Fund	93.201	112.005
Commercial Activities / non-financial investments	90.273	68.377
HRA	38.451	51.375
TOTAL	221.925	231.757
Capital Financing Requirement (CFR)		
General Fund	1,126.663	1,126.069
HRA	338.688	338.924
TOTAL	1,465.351	1,464.993
Annual change in CFR		
General Fund	139.219	137.610
HRA		16.427
TOTAL	139.219	154.037
In year borrowing requirement	139.219	154.037