TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT STRATEGY MID-YEAR REVIEW REPORT 2020/21

Report of the Deputy Chief Executive (Section 151 Officer)

Key Highlights

1. Introduction and Purpose of the Report

This report provides Members with a mid-year review of the Council's Treasury Management Strategy Statement (TMSS) and Annual Investment Strategy (AIS) for 2020/21.

2. Interest Rate Forecast

- The Coronavirus outbreak has done enormous economic damage to the UK and economies around the world. The Bank of England took emergency action in March 2020 by cutting Bank rate to 0.25% and subsequently 0.10%, from where it has left the rate unchanged. Some forecasters have suggested that a cut into negative territory could happen, although the Bank of England has signalled that such a move may do more harm than good, and has since favoured quantitative easing as a tool to inject money into the economy to expand economic activity (£875bn as at November 2020).

- The summary forecasts for Bank Rate, LIBID (investment rates) and Public Works Loan Board (PWLB) rates are given in Section 8 of the main report. PWLB forecasts are based on the Certainty Rate (PWLB standard rate minus 20 basis points or 'bps') and show a generally rising trend over the longer-term.

- Gilt yields (on which PWLB rates are based) fell sharply to unprecedented lows during the first half of the financial year, as major western central banks took rapid action to deal with excessive stress in financial markets and started massive quantitative easing purchases of government bonds. This put downward pressure on government bond yields at a time when there was also extensive and fast expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in 'normal' times would have caused bond yields to rise sharply. At the close of the day on 30th September, all gilt yields from 1 to 6 years were in negative territory, while even 25-year yields were at only 0.76% and 50 year at 0.60%.

- 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 by the Coronavirus pandemic.

3. Treasury Management Activity 2020/21

- The overall treasury position at 30 September 2020 is given in the table below

AGENDA ITEM

Treasury Position	Financial Year 2020/21 (2 Pools)				Financial Year 2019/20 (2 Pools)			
	General Fund		HRA		General Fund		HRA	
	£000	%	£000	%	£000	%	£000	%
	as at 30.09.20		as at 30.09.20		as at 31.03.20		as at 31.03.20	
Fixed Rate Funding:								
PWLB	305,975	3.31%	75,494	4.76%	320,975	3.22%	75,494	4.76%
Market (LOBO)	10,942	4.26%	6,558	4.26%	10,942	4.26%	6,558	4.26%
Market (converted LOBOs)	37,517	3.89%	22,483	3.89%	37,517	3.89%	22,483	3.89%
Market (other long-term loans)	40,000	2.33%	0	0%	40,000	2.33%	0	0%
Market (other LAs +364 days)	17,500	1.00%	0	0%	7,500	1.00%	0	0%
Market (short-term)	140,000	1.00%	0	0%	128,000	1.00%	0	0%
Salix loans	2,829	0.00%	0	0%	3,212	0.00%	0	0%
Sub-total	554,763		104,535		548,146		104,535	
Variable Rate Funding:								
Market (short-term)	19	0.10%	0	0%	19	0.10%	0	0%
Sub-total	19		0	0%	19		0	0%
Total Debt	**554,782**	**2.62%**	**104,535**	**4.54%**	548,165	2.66%	104,535	4.54%
Total Investments	**57,150**	**0.25%**	**0**	**0%**	110,345	0.66%	0	0%
Net Debt	**497,632**		**104,535**		437,820		104,535	

4. Investment Portfolio

- Activity is in line with the Annual Investment Strategy (AIS) set out for 2020/21.

- Investment rates are barely above zero now that Bank Rate is at 0.10%,

- While the Bank of England has said that it is unlikely to introduce a negative Bank Rate, at least in the next 6-2 months, some deposit accounts are already offering negative rates for shorter periods and Money Market Funds (MMFs) yields have also continued to fall.

- Investor cash flow uncertainty and the need to maintain liquidity in these unprecedented times, has meant there is a glut of money circling around at the very short end of the market. This has seen a number of market participants, now including the DMADF[1], offer nil or negative rates for very short term maturities. This however is not universal and MMFs are still offering a marginally positive return, as are a number of financial institutions. Whether the heightened levels of liquidity in the market in the shorter periods will remain during the lead up to Christmas or year-end, when there is typically a market shortage, remains to be seen.

- The average level of funds available for investment purposes during the first half of 2020/21 was £76.096m. This higher level of investment balances has been maintained as a deliberate measure to protect the Council from any unforeseen liquidity in the market during 2020 as a result of the Coronavirus pandemic and also due to additional resources provided by central Government for Covid-19.

- The Council's return for the first half of 2020/21 was 0.48% on an average weighted investment duration of 39.18 days, which outperforms the 12 month LIBID benchmark by 0.13% despite being of much shorter duration (closer to 1 month that shows a negative return). The Council has achieved this return largely through

[1] Debt Management Account Deposit Facility (DMADF) - The DMO provides the DMADF as part of its cash management operations and in the context of a wider series of measures designed to support local authorities' cash management. The key objective of the DMADF is to provide users with a flexible and secure facility to supplement their existing range of investment options while saving interest costs for central government.

careful use of various notice accounts, bank deposits and money market funds. The Council does not however foresee being able to maintain this level of return in the second half of the financial year as investment opportunities are few and far between. The table above illustrates the falling return to 0.25% by the end of September 2020. Careful planning will be required to maintain a level of investment balances the Council feels is sufficient to counteract any unforeseen liquidity shortages, but not too high as returns earnt may be low or absent.

5. Borrowing Portfolio

- The revised estimate of the 2020/21 borrowing required to support prudential borrowing within the capital programme is circa £73.407m due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement, CFR). This includes £15.382m of current borrowing that has matured and requires replacing in 2020/21

- With short-term interest rates having been lower than long-term rates for some time, it has been cost effective for the Council to either use internal resources, or to borrow short-term rather than take long-term borrowing to fully fund its Capital Financing Requirement (CFR).

- Due to the increase in PWLB margins over gilt yields in October 2019 by HM Treasury, the Council has refrained from undertaking new long-term PWLB borrowing for the present. Requirements for borrowing during the financial year so far, have been met by using short-term market loans from other Councils. Opportunities to take long-term loans from alternative market participants seem to be absent at present, unless the Council were to look to bond issuance. However, given the recent reductions to PWLB borrowing rates, there is now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as current rates are at historic lows. Conversely, greater value can be obtained in borrowing for shorter maturity periods so the Council will assess its risk appetite in conjunction with budgetary pressures to reduce total interest costs. Longer-term borrowing could also be undertaken for the purpose of certainty, where that is desirable, or for flattening the maturity profile. In addition, the effect of Coronavirus on the capital programme objectives are being assessed.

- The Council’s borrowing strategy will be reviewed in the coming months to achieve optimum value in the long-term. It is however anticipated that long-term borrowing is less likely to be undertaken during this financial year and the Council will continue to rely on the short-term market and liquid investments.

6. Summary Economic Outlook

- 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. It may also be affected by what, if any, deal the UK agrees as part of Brexit.

- 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.

7. Conclusions and Recommendations

- The Council's Treasury Management Strategy remains relevant and effective at the half year point, with no significant changes required other than revisions to interest rate forecasts to reflect the current economic situation.

Cabinet is asked to recommend the following to the Council meeting:

- Note the report and the treasury activity in the first half of the financial year;
- Note the revised interest rate forecasts for PWLB rates over the short and medium term, which will drive the Council's long-term borrowing strategies going forward.

Meeting: 22 December 2020

TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT STRATEGY MID-YEAR REVIEW REPORT 2020/21

Report of the Deputy Chief Executive (Section 151 Officer)

FULL REPORT

1. INTRODUCTION AND PURPOSE OF REPORT

1.1 This report provides Cabinet with a mid-year review of the Council's Treasury Management Strategy Statement and Annual Investment Strategy for 2020/21, approved by Council on 27 February 2020, and has been prepared in accordance with the CIPFA Code of Practice for Treasury Management in the Public Services.

1.2 The Report provides an economic update for the first six months of 2020/21 and details how this impacts upon the interest rate predictions and outlook provided in the initial strategy. An overview is provided of more recent forecasts and developments in the financial markets and how these are affecting the Council's investment portfolio and borrowing strategies for the current financial year. A review is provided of the Council's capital expenditure prudential indicators and compliance with Treasury and Prudential Limits for 2020/21.

1.3 There are no key changes required to the Treasury Management and Capital strategies for 2020/21, which continue to be relevant and effective.

1.4 The main report is very detailed and provides a full picture of all the variables and circumstances impacting upon the Council's treasury management operation. Consequently, a 'key highlights' summary report containing all of the prevalent points has also been provided. This can be found immediately before this full report for quick reference.

2. BACKGROUND

2.1 The primary function of the treasury management operations is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

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

2.3 Accordingly, treasury management is defined as:
'The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective

control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.'

3. CIPFA REQUIREMENTS

3.1 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

3.2 The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by the full Council of an Annual Treasury Management Strategy Statement; including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- 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 Corporate, Resource and Governance Scrutiny Committee (CRMG).

4. MID-YEAR TREASURY MANAGEMENT STRATEGY REVIEW FOR 2020/21

The mid-year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- A review of the Council's investment portfolio for 2020/21;
- A review of the Council's borrowing strategy for 2020/21;
- A review of any debt rescheduling undertaken during 2020/21;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of compliance with Treasury and Prudential Limits for 2020/21;
- Any key changes required to the treasury management and capital strategies;
- An economic update for 2020/21;
- Information for Members on other prevalent issues.

5. TREASURY MANAGEMENT STRATEGY STATEMENT (TMSS) & ANNUAL INVESTMENT STRATEGY (AIS) UPDATE 2020/21

5.1 The Treasury Management Strategy Statement (TMSS) for 2020/21 was approved by this Council on 27 February 2020.

5.2 The underlying TMSS approved previously is still relevant and effective; the only revision required at the mid-year point of the financial year centres around adjusted interest rate forecasts (explained in Section 8) engendered by the current economic situation (given in Section 13) of the report, which will give rise to significant implications for the Council's investment returns and borrowing strategies.

6. TREASURY MANAGEMENT ADVISORS

6.1 The Council engages the services of Link Asset Services for its Treasury Management Advice contract.

6.2 Link Asset Services has worked with Stockport MBC for over a decade delivering a comprehensive range of Treasury Management Advisory Services. The core service includes specific advice in respect of an integrated approach to Treasury Management.

6.3 Oldham Council on behalf of a number of AGMA Authorities carried out a full compliant OJEU Open tender exercise as the current AGMA Framework agreement for treasury management advice expired in March 2019.

6.4 Link Asset Services were successful in winning the tender for this contract again which runs from April 2020 to 31 March 2022, with the option to extend for 12 months to March 2023.

7. TREASURY ACTIVITY 2020/21

7.1 The overall treasury position as at 30 September 2020 is given in the table below.

Treasury Position	**Financial Year 2020/21 (2 Pools)**				Financial Year 2019/20 (2 Pools)			
	General Fund		**HRA**		General Fund		HRA	
	£000	**%**	**£000**	**%**	£000	%	£000	%
	as at 30.09.20		**as at 30.09.20**		as at 31.03.20		as at 31.03.20	
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Variable Rate Funding:								
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Total Debt	**554,782**	**2.62%**	**104,535**	**4.54%**	548,165	2.66%	104,535	4.54%
Total Investments	**57,150**	**0.25%**	**0**	**0%**	110,345	0.66%	0	0%
Net Debt	**497,632**		**104,535**		437,820		104,535	

Note:

- This table excludes other long-term liabilities included in the tables in 12.4.3.

- The change in total borrowing between periods from £652.700m to £659.317m is small overall, but represents the repayment of a £15m PWLB loan that matured in April 2020 and an increase in short-term/over 364 day borrowing. This has resulted in a slight decrease in the overall borrowing rate from 3.18% to 2.93% representing the relative shift to cheaper short-term funding.
- Temporary investments have reduced between periods from £110.345m to £57.150m and have been used to finance cashflow shortages.

8. INTEREST RATE FORECAST UPDATE

8.1 The current interest rate forecast is provided in the table below to March 2023 and is the central forecast for PWLB[2] certainty rates[3]. Link provided the following forecasts on 11.08.20. However, following the conclusion of the review of PWLB margins over gilt yields on 25.11.20, all forecasts below have been reduced by 1%. These are forecasts for certainty rates, gilt yields plus 80bps

	Dec 2020 %	Mar 2021 %	June 2021 %	Sept 2021 %	Dec 2021 %	Mar 2022 %	June 2022 %	Sept 2022 %	Dec 2022 %	Mar 2023 %
Bank Rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
3 month ave earnings	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
6 month ave earnings	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
12 month ave earnings	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%
5yr PWLB	0.80%	0.80%	0.80%	0.80%	0.80%	0.90%	0.90%	0.90%	0.90%	0.90%
10yr PWLB	1.10%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.20%	1.20%
25yr PWLB	1.50%	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.70%
50yr PWLB	1.30%	1.30%	1.40%	1.40%	1.40%	1.40%	1.50%	1.50%	1.50%	1.50%

8.2 Please note that there is a slight change to the interest rate forecasts table above for forecasts for 3, 6 and 12 months. Traditionally, Link have used LIBID forecasts, with the rate calculated using market convention of 1/8th (0.125%) taken off the LIBOR figure. Given that all LIBOR rates up to 6 months are currently running below 0.1%, using that convention would give negative figures as forecasts for those periods. However, the liquidity premium that is still in evidence at the short end of the curve, means that the rates actually being achieved by local authority investors are still modestly in positive territory. While there are differences between counterparty offer rates, analysis would suggest that an average rate of around 0.05% is achievable for 3 months, 0.1% for 6 months and 0.15% for 12 months.

8.3 LIBOR and LIBID rates will cease from the end of 2021. Link will therefore be continuing to look at market developments in this area, particularly 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.

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[2] PWLB refers to the Public Works Loan Board. The **PWLB** is a statutory body operating within the United Kingdom Debt Management Office, a Cabinet Agency of HM Treasury. PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments

[3] The **PWLB certainty rate** is 20 basis points below the standard PWLB borrowing rate (gilt plus 100 basis points) across all loan types and maturities. This is available to Councils who outline their total proposed new long-term borrowing, as well as any borrowing planned to refinance existing loans, and the value of capital expenditure that will be financed by loans

8.4 The Coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged since, 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

8.5 Members will be aware that the PWLB on-lends Government borrowing from the capital markets to local authorities to deliver capital investment and this is offered at a fixed margin above the Government's cost of borrowing, as measured by the price/yield of gilts.

8.6 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.

8.7 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.

8.8 Gilt yields had therefore already been on a generally falling trend up until the Coronavirus crisis hit western economies during March. After gilt yields spiked up during the initial phases of the health crisis, we have seen these yields fall sharply to unprecedented lows as major western central banks took rapid action to deal with excessive stress in financial markets, and started massive quantitative easing purchases of government bonds. This also put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in 'normal' times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21.

8.9 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. However, also in March 2020, the Government started a consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure. (Please note that the Council has concerns over this approach, as the fundamental principle of local authority borrowing is that borrowing is a treasury management activity and individual sums that are borrowed are not linked to specific capital projects.)

8.10 The Government also introduced the following rates for borrowing for different types of capital expenditure:

- 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)

As a consequence of these increases in margins, many local authorities decided to refrain from PWLB borrowing unless it was for HRA or local infrastructure financing, until such time as the review of margins was concluded.

8.11 On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. Therefore the margins detailed in 8.10 above for various types of capital expenditure have been reduced by 1%.

8.12 As the interest forecast table for PWLB certainty rates, (gilts plus 80bps), 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.

8.13 The Balance of Risks to the UK

- The PWLB forecasts are based around a balance of risks. 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. It may also be affected by what, if any, deal the UK agrees as part of Brexit.

- 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.

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

- UK: further national lockdowns or severe regional restrictions in major conurbations during 2021.
- 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 a rise in anti-immigration sentiment in Germany and France;
- Geopolitical risks, for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows[4].

8.15 Upside risks, to current forecasts for UK gilt yields and PWLB rates include:

- 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

[4] This would drive a global flight to safety that would mean a rally in UK 'safe haven' bonds/gilts, pushing UK borrowing rates down. A country's sovereign debt is considered a 'safe' asset for investors. Gilt-edged securities are bonds issued by the UK Government.

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.

8.16 The Council's trigger rates at which to consider long-term borrowing at the present time are in line with the current PWLB forecasts (for the periods indicated above) for the second half of 2020/21. Target new long term borrowing rates to be considered in 2020/21 from alternative market lenders to the PWLB are at a margin of 40 basis points below the equivalent PWLB rate for the period.

9. ANNUAL INVESTMENT STRATEGY

INVESTMENT PORTFOLIO

9.1 The Treasury Management Strategy Statement (TMSS) for 2020/21, which includes the Annual Investment Strategy, was approved by the Council on 27 February 2020. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

9.2 The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

9.3 As shown by the interest rate forecasts in Section 8, it is now impossible to earn the level of interest rates commonly seen in previous decades as all investment rates are barely above zero now that Bank Rate is at 0.10%, while some entities, including more recently the Debt Management Account Deposit Facility (DMADF), are offering negative rates of return in some shorter time periods. Given this risk environment and the fact that increases in Bank Rate are unlikely to occur before the end of the current forecast horizon of 31st March 2023, investment returns are expected to remain low.

9.4 **Negative Interest Rates**

9.4.1 While the Bank of England has said that it is unlikely to introduce a negative Bank Rate, at least in the next 6-12 months, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the Covid-19 crisis; this has caused some local authorities to have sudden large increases in investment balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

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

9.4.3 Inter-local authority short-term lending and borrowing has also declined due to the surge in the levels of cash seeking a short-term home. This is at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government. However some local authorities with cash to lend for longer periods of 364 days and beyond are offering market loans to other authorities at levels way above market rates, i.e. 0.40% and higher, which raises question marks over whether this is an entirely fair or a reasonable course of action to take in the given circumstances. Whether the usual market shortages of cash will materialise around Christmas and year-end remains to be seen and if in fact those authorities will be able to continue to lend at such elevated levels.

9.5 **Creditworthiness**

9.5.1 Although the credit rating agencies changed their outlook on many UK banks from stable to negative outlook during the quarter ended 30 June 2020 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of UK banks. However, during Q1 and Q2 2020 banks made provisions for expected credit losses and the rating changes reflected these provisions.

9.5.2 As we move into the next quarters ahead, more information will emerge on actual levels of credit losses (quarterly performance is normally announced in the second half of the month following the end of the quarter.) This has the potential to cause rating agencies to revisit their initial rating adjustments earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that UK banks went into this pandemic with strong balance sheets. Indeed, the Financial Policy Committee (FPC) report on 6 August revised down their expected credit losses for the banking sector to 'somewhat less than £80bn'. They stated that in their 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%.

9.5.3 All three rating agencies have reviewed banks around the world with similar results in many countries of most banks being placed on negative watch, but with a small number of actual downgrades.

9.5.4 Link have conducted some stress testing on the Link credit methodology, to test for the results of a 1 notch downgrade to all Long Term Ratings from all agencies. Under such a scenario, only Commerzbank, Norddeutsche

Landesbank, NatWest Markets Plc (non-ring-fenced entity), Leeds, Skipton and Yorkshire Building Societies moved from Green (maximum 3 month investment) to No Colour (can no longer use). While there are a further 17 drops in other entities' suggested durations, in these instances, these entities still remain potentially available for use. (Note that this scenario excludes any additional impact from relative movement in CDS pricing.)

9.6 The current investment counterparty criteria selection approved in the TMSS in February 2020 is meeting the requirement of the treasury management function.

9.7 Although CDS prices, (these are market indicators of credit risk), for UK banks spiked upwards at the end of March/early April due to the liquidity crisis throughout financial markets, CDS prices have returned to more average levels since then, although they are still elevated compared to end-February. Pricing is likely to remain volatile as uncertainty continues. However, sentiment can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

9.8 **Investment Balances**

The average level of funds available for investment purposes during the first half of 2020/21 was £76.096m. This higher level of investment balances has been maintained as a deliberate measure to protect the Council from any unforeseen liquidity in the market during 2020 as a result of the Coronavirus pandemic and also due to additional resources provided by central Government for Covid-19. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

9.9 **Investment Performance**

Investment performance year to date as at 30th September 2020

Combined Investments 2020/21	**Council Performance**			
	Ave Balance Invested		**% Return**	**Weighted Time to Maturity (Days)**
	April 2020	£60.141m	0.70%	38.99
	May 2020	£81.124m	0.54%	47.29
	June 2020	£85.523m	0.46%	42.19
Average Q1		**£85.547m**	**0.57%**	**42.73**
	July 2020	£79.261m	0.38%	42.57
	Aug 2020	£65.469m	0.36%	32.61
	Sept 2020	£55.139m	0.32%	25.51
Average Q2		**£66.748m**	**0.36%**	**34.68**
Average year to date		**£76.096m**	**0.48%**	**39.18**

9.10 **Comparable LIBID Benchmarks**

Period	LIBID Benchmark
7 day	-0.06%
1 month	-0.02%
3 month	0.11%
6 month	0.21%
12 month	**0.35%**

9.11 As illustrated in the tables above the Council's return for the first half of 2020/21 was 0.48% on an average weighted investment duration of 39.18 days, which outperforms the 12 month LIBID benchmark by 0.13% despite being of much shorter duration (closer to the one month negative return). Much has been made earlier in the report of investment rates in the market now being low or close to zero. The Council has achieved this return largely through careful use of various notice accounts, bank deposits and money market funds. The Council does not however foresee being able to maintain this level of return in the second half of the financial year as investment opportunities are few and far between. Careful planning will be required to maintain a level of investment balances the Council feels is sufficient to counteract any unforeseen liquidity shortages, but not too high as returns earnt may be low or absent.

9.12 For 2020/21 the Council's Medium Term Financial Plan and Annual Investment Strategy budgeted for an expected investment return of 0.75% on new investments placed during 2020/21, assuming an average investment duration of three months. This was predicated on the Link interest rate forecasts in February 2020 which saw Bank rate remaining at 0.75% until March 2021 when it would rise to 1%. Of course this was prior to the Covid-19 pandemic which has actually seen the MPC cut Bank rate from 0.75% to 0.25% on 11 March 2020 and again on 19 March 2020 to its lowest level of 0.10%

9.13 The Deputy Chief Executive (Section 151 Officer), confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2020/21.

10. TREASURY MANAGEMENT STRATEGY STATEMENT (TMSS)

BORROWING STRATEGY

10.1 It is a statutory duty for the Council to determine and keep under review the 'Affordable Borrowing Limits'. Council's approved Prudential Indicators (affordability limits) are outlined in the approved TMSS.

10.2 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement (TMSS) and in compliance with the Council's Treasury Management Practices.

10.3 The Council's original Borrowing Requirement was £139.721m. The revised estimate of the 2020/21 borrowing required to support prudential borrowing within the capital programme is circa £73.407m due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement, CFR). This includes £15.382m of current borrowing that has matured and requires replacing in 2020/21. There has been some significant re-phasing of capital schemes during the first six months of the year. In spite of this, the borrowing that the Council will actually need will also take into account the level of investments held and will be greatly influenced by the amount of capital spending during 2020/21.

10.4 The Council's forecast closing capital financing requirement (CFR) for 2020/21 was £880.742m and this has reduced to £805.335m at this mid-year stage.

This is largely due to the re-phasing of capital schemes during the first half of the year. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The table in 12.4.3 shows the Council's internally borrowed position. This is a prudent and cost effective approach in the current economic climate but requires on-going monitoring in the event that upside risk to gilt yields prevails (current PWLB rates forecast to remain relatively flat), but more likely, this position becomes unmaintainable due to spent internal resources or limits to short-term market loans.

10.5 The table for PWLB certainty rates below shows for a selection of maturity periods, the range (high and low points) in rates, the average rates and individual rates over the first six months of the financial year.

	1 Year	5 Years	10 Years	25 Years	50 Years
High	1.94%	1.99%	2.19%	2.80%	2.65%
Date	08/04/20	08/04/20	08/04/20	28/08/20	28/08/20
Low	1.70%	1.67%	1.91%	2.40%	2.13%
Date	18/09/20	30/07/20	31/07/20	18/06/20	24/04/20
Average	1.80%	1.80%	2.04%	2.54%	2.33%

10.6 The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates having been lower than long-term rates for some time, it has been cost effective for the Council to either use internal resources, or to borrow short-term rather than take long-term borrowing to fully fund its Capital Financing Requirement (CFR). By doing so, the Council has been able to reduce net borrowing costs (and investment income forgone has been negligible due to enduring low short-term rates) and reduce overall treasury risk. This is called maintaining an 'internally borrowed position' and using the Council's cash reserves and balances to fund borrowing as a temporary measure. This strategy has been prudent as investment returns have been low and counterparty risk relatively high.

10.7 The strategy followed in the first half of 2020/21 has been to continue to borrow shorter-term cash from the market (other councils) and to draw back liquid investments to meet cashflow requirements. Years of maintaining an internal borrowing policy has given rise to the need for more significant temporary borrowing. Higher levels of temporary borrowing have also been used to boost short-term investments reserves to a higher level than is usual, aimed at negating the risk to the Council of market liquidity shortages due to the Coronavirus pandemic should this occur.

10.8 The Council continually assesses how much borrowing may be needed in the short to medium term, taking into account cashflows, level of investments or use of short-term borrowing, use of reserves and spend on the Capital Programme. The availability and type of borrowing likely to be available is also a key consideration.

10.9 The Council has an extensive three-year Capital Programme for the period 2020/21 to 2022/23. The programme is regularly reviewed and at this mid-year stage, there is a total of £393.088m planned expenditure on capital schemes over the next three years and a significant proportion of this, £202.054m, is to be financed by prudential borrowing.

10.10 Due to the increase in PWLB margins over gilt yields in October 2019 by HM Treasury, the Council has refrained from undertaking new long-term PWLB borrowing for the present. Requirements for borrowing during the financial year so far, have been met by using short-term market loans from other Councils. Opportunities to take long-term loans from alternative market participants seem to be absent at present, unless the Council were to look to bond issuance. However, given the recent reductions to PWLB borrowing rates, there is now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as current rates are at historic lows. Conversely, greater value can be obtained in borrowing for shorter maturity periods so the Council will assess its risk appetite in conjunction with budgetary pressures to reduce total interest costs. Longer-term borrowing could also be undertaken for the purpose of certainty, where that is desirable, or for flattening the maturity profile. In addition, the effect of Coronavirus on the capital programme objectives are being assessed.

10.11 The Council's borrowing strategy will be reviewed in the coming months to achieve optimum value in the long-term. It is however anticipated that long-term borrowing is less likely to be undertaken during this financial year and the Council will continue to rely on the short-term market and liquid investments.

10.12 Should the Council be in a position where it cannot continue to raise enough short-term loans and further borrowing is required, the Council will in the first instance borrow at the HRA Certainty Rate. There is currently £50.894m of prudential borrowing in the HRA three-year capital programme.

10.13 This Council has not borrowed in advance of need during the first half of the 2020/21 financial year.

11. DEBT RESCHEDULING

11.1 Debt rescheduling opportunities continue to be limited in the current economic climate and consequent structure of interest rates. No debt rescheduling was undertaken during the first six months of 2020/21.

12. THE COUNCIL'S CAPITAL POSITION (PRUDENTIAL INDICATORS)

12.1 This part of the report aims to update Members on:

- the Council's capital expenditure plans;
- how these plans are being financed;
- the impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- on compliance with the limits in place for borrowing activity.

Appendix 1 gives a full summary of the Prudential and Treasury indicators at the mid-year point.

12.2 Prudential Indicator for Capital Expenditure

12.2.1 This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed on 27 February 2020.

Capital Expenditure by Portfolio	2020/21 Original Estimate £m	2020/21 Current Estimate £m
Adult Care and Health	0.625	0.219
Children, Family Services and Education	0	0.024
Economy and Regeneration	48.166	51.778
Resources, Commissioning and Governance	73.127	35.987
Sustainable Stockport	96.897	48.258
Total Capital Expenditure	**218.815**	**136.266**
Non HRA	155.645	113.309
HRA	63.170	22.957

12.2.2 Officers regularly review the spending profiles of their capital schemes and schemes have been re-phased to reflect the latest information. Most notably, £40.140m has been re-phased from 2020/21 to 2020/21 for School and Asset Management Plan schemes and the forecast for the 2020/21 capital expenditure on HRA schemes has reduced by £40.213m. Changes in the Capital Programme during the financial year have been reflected in the revised CFR estimates below.

12.3 Changes to Financing of the Capital Programme

12.3.1 The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by the statutory charge to revenue for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2020/21 Non HRA Original Estimate £m	2020/21 HRA Original Estimate £m	2020/21 Total Original Estimate £m	2020/21 Non HRA Current Estimate £m	2020/21 HRA Current Estimate £m	2020/21 Total Current Estimate £m
Total Capital Expenditure	155.645	63.170	**218.815**	113.309	22.957	**136.266**
Financed By:						
Capital Grants	44.838	11.440	**56.278**	39.771	3.933	**43.704**
Capital Receipts	3.504	680	**4.184**	0.179	0.000	**0.179**
Capital Contributions	3.526	0	**3.526**	2.970	0.000	**2.970**
Revenue Contribution	2.323	12.783	**15.106**	3.290	12.376	**15.666**
Borrowing Requirement	**101.454**	**38.267**	**139.721**	**67.099**	**6.648**	**73.747**

12.4 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

12.4.1 The following tables show the CFR, which is the underlying external need to incur borrowing for a capital purpose and the expected debt position over the period. This is termed the Operational Boundary.

Prudential Indicator:

Capital Financing Requirement (CFR)	2020/21 Original Indicator £m	2020/21 Current Indicator £m
CFR General Fund (Non HRA)	697.306	654.788
CFR HRA	183.436	150.547
Total CFR	**880.742**	**805.335**

Prudential Indicator:

External Debt: Operational Boundary	2020/21 Original Indicator £m	2020/21 Current Indicator £m
Debt	905.300	905.300
Other Long-term Liabilities	13.700	13.700
Total	**919.000**	**919.000**

12.4.2 It should be noted that the CFR measures the Council's underlying need to borrow, i.e. the extent to which forecast capital expenditure has not been funded from resources such as capital receipts, grants etc. As indicated from the above, the CFR is much higher than the Council's actual borrowing, as previously reported it has been a treasury policy over recent years to incur capital expenditure in year, but temporarily fund this from the Council's own cash balances (i.e. balances and reserves) rather than external borrowing; often referred to as Internal Borrowing. The Capital Programme is regularly reviewed and during the first half of 2020/21 many schemes have been rephased to later years. As a result, the revised CFR has decreased significantly during the first half of the year to £805.335m and the impact of this reduction can be seen when comparing the mid-year position to the original gross borrowing estimates and limits. The level of internal borrowing indicates at some point in the financial year the Council may decide to convert some of this internal borrowing and externally borrow for this capital expenditure. However at the mid-year point in the financial year, spending on the capital programme is 64.6% and, is lower than expectations.

12.4.3 **Limits to Borrowing Activity**

i. 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 purposes. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

Gross Borrowing and the CFR	2020/21 Original Indicator £m	2020/21 Actual 30.09.20 £m
Gross Borrowing	784.757	659.317
Other Long-term Liabilities	13.700	13.700
Total	798.457	**673.017**
CFR	**880.742**	**805.335**

The Deputy Chief Executive (Section 151 Officer), reports that no difficulties are envisaged for the current or future years in complying with this prudential

indicator.

ii. A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised Limit and Overall Borrowing	**2020/21 Original Indicator £m**	**2020/21 Current Indicator £m**
Borrowing	925.300	925.300
Other Long-term Liabilities	13.700	13.700
Total	**939.000**	**939.000**

13. ECONOMIC UPDATE

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

13.2 Monthly gross domestic product (GDP) grew by 1.1% in September 2020 as lockdown measures continued to ease. This was the fifth consecutive monthly increase following a record fall of 19.5% in April 2020. September 2020 GDP is now 22.9% higher than its April 2020 low. However, it remains 8.2% below the levels seen in February 2020, before the full impact of the coronavirus (COVID-19) pandemic. There has also been a loss in momentum through Quarter 3 (July to Sept) 2020, which grew by 15.5%.

13.3 The Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 5th November. However, it revised its economic forecasts to take account of a second national lockdown from 5th November to 2nd December which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do a further tranche of quantitative easing (QE) of £150bn, to start in January 2021 when the current programme of £300bn of QE announced in March to June, runs out. It did this so that 'announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target'.

13.4 Its forecasts appear to be rather optimistic in terms of three areas:

- The economy would recover to reach its pre-pandemic level in Q1 2022;
- The Bank also expects there to be excess demand in the economy by Q4 2022;
- CPI inflation is therefore projected to be a bit above its 2% target by the start of 2023 and the 'inflation risks were judged to be balanced'.

13.5 The minutes did however contain several references to downside risks. The MPC reiterated that the ‘recovery would take time, and the risks around the GDP projection were judged to be skewed to the downside’. It also said ‘the risk of a more persistent period of elevated unemployment remained material’. Downside risks could well include severe restrictions remaining in place in some form during the rest of December and most of January too. That could involve some or all of the lockdown being extended beyond 2nd December, a temporary relaxation of restrictions over Christmas, a resumption of the lockdown in January and lots of regions being subject to Tier 3 restrictions when the lockdown ends. Hopefully, restrictions should progressively ease during the spring. It is only to be expected that some businesses that have barely survived the first lockdown, will fail to survive the second lockdown, especially those businesses that depend on a surge of business in the run up to Christmas each year. This will mean that there will be some level of further permanent loss of economic activity, although the extension of the furlough scheme to the end of 31st March will limit the degree of damage done.

13.6 As for upside risks, news to confirm that various vaccines have been cleared as being safe and effective for administering to the general public and there is always some possibility that the trade negotiations with the EU could turn out better than expected.

13.7 Significantly, there was no mention of negative interest rates in the minutes or Monetary Policy Report, suggesting that the MPC still remains some way from being persuaded of the case for such a policy, at least for the next 6-2 months. However, rather than saying that it ‘stands ready to adjust monetary policy’, the MPC this time said that it will take ‘whatever additional action was necessary to achieve its remit’. The latter seems stronger and wider and may indicate the Bank’s willingness to embrace new tools.

13.8 Public borrowing is now likely to increase by about £30bn to around £420bn (21.7% of GDP) as a result of the new lockdown. In normal times, such an increase in gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable. It is also quite possible that the Bank of England will do more QE in 2021 to support the economy, although negative interest rates could also be a usable tool in the tool box later on in 2021.

13.9 While the Bank Rate forecast contains no increase up to March 2024, it is quite possible that Bank Rate may not increase for some time further out than then as it is going to take a considerable time for the economy to recover lost capacity and momentum. It is not thought that inflation will pose a threat requiring increases in Bank Rate as there is likely to be spare capacity in the economy for a considerable time.

13.10 Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one after a sharp recovery in June through to August which left the economy 11.7% smaller than in

February. The last three months of 2020 are now likely to show no growth as consumers will probably remain cautious in spending and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind. If the Bank felt it did need to provide further support to recovery, then it is likely that the tool of choice would be more QE.

13.11 **USA.** The result of the November elections means that while the Democrats have gained the presidency and a majority in the House of Representatives, it looks as if the Republicans will still have a majority on the Senate. This means that the Democrats will not be able to do the large fiscal stimulus they had been hoping to do after the elections. This would have resulted in another surge of debt issuance and would have put upward pressure on debt yields, which could have also put upward pressure on gilt yields. Around the time of writing (9 Nov), financial markets have leapt on the first news of a successful vaccine, so that could cause a big shift in investor sentiment, i.e. a swing to sell out of government debt into equities and so cause debt prices to fall and yields to rise. It is too early yet to say how enduring this shift in market expectations will be or whether the Fed would feel it necessary to take action to suppress this jump up in debt yields. However, the next two years, and possibly four years in the US, could be a political stalemate where neither party can do anything radical.

13.12 **EU.** The economy was recovering well towards the end of Q2 after a sharp drop in GDP, (e.g. France 18.9%, Italy 17.6%). However, the second wave of the virus affecting some countries could cause a significant slowdown in the pace of recovery, especially in countries more dependent on tourism. The fiscal support package, eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support and quickly enough to make an appreciable difference in weaker countries. The 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.

13.13 **China.** After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and into Q3; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth. At the same time, China's economy has benefited from the shift towards online spending by consumers in developed markets. These factors help to explain its comparative outperformance compared to western economies.

13.14 **World growth.** While Latin America and India have, until recently, been hotspots for virus infections, infection rates have begun to stabilise. 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.

14. SCRUTINY MEMBER TRAINING

14.1 The CIPFA Treasury Management in Public Services Code of Practice places emphasis on the effective management and control of risk as the prime objective of the Council's treasury management activities. The Code also

cites the importance of reporting on treasury management strategy and performance and scrutiny of treasury management strategy and policy to a specific named body; the Council has accordingly delegated the role of ensuring effective scrutiny of its Treasury Management Strategy to the Corporate, Resource and Governance Scrutiny Committee.

14.2 In line with the Code, Cabinet and CRMG have received training each year since 2009/10. Further training is being arranged for 7 December 2020 to coincide with the consultation on next year's treasury strategy on 8 December 2020.

14.3 The session will provide a brief refresher of Members' and Officers' roles and responsibilities within the Treasury Management environment, and how to maintain effective scrutiny of the Treasury Management function. It will update Members on the current global economic position, particularly in the US, Europe and UK and provide up to date interest rate forecasts; possible scenarios for the economy in 2020/21 given current economic indicators and developments in the financial markets. Concentration will particularly be made on new and prevalent issues that will have a major impact on the Council's treasury strategy next year.

15. CONCLUSIONS AND RECOMMENDATIONS

15.1 Taking a view of the UK economy has seen economists raise concerns that recovery could be set back severely if the second lockdown action taken to contain COVID is coupled with a 'no deal' Brexit. The forecast potential is to the downside for GDP, which will force the Bank of England to add to its £875bn (£300bn for Coronavirus) of Quantitative Easing (QE) and maintain Bank Rate at current levels for a prolonged period. This scenario would likely ensure no material upside to gilt yields.

15.2 The economy has recovered in the main from the disastrous hit to GDP caused by the lockdown which was amplified in strong growth of 15.5% in Q3. However, the surge in infections and actions being taken to combat the spread will likely leave growth flat in Q4, and possibly Q1 2021. In turn, this could delay the return to pre-pandemic levels. Forecasters suggest that if the new restrictions are widened, tightened and last into 2021 in some form, and a narrow EU trade deal is achieved by year end, then the delay could push into 2022. Early easing of restrictions and availability of the vaccine recently announced should tip the balance to the upside, but the downside risks seem greater at present, particularly without any clear indication that a Brexit 'deal' is in the offing. It is hoped that the UK and EU will come to a compromise to avoid this, but a modest cooperative deal is still expected to see GDP fall by 1% next year, whereas a hard Brexit could result in a 2.5% hit to growth.

15.3 The Council's investments have outperformed market benchmarks during the first half of the financial year, but this scenario is unlikely to endure and we can expect to see investment returns fall in the second half of the financial year.

15.4 The Council has been maintaining a higher level of core investments during 2020/21 to manage liquidity than is usually the case, aimed at mitigating possible issues with market liquidity should they arise due to the Coronavirus pandemic. Finding adequate counterparties with whom to invest the Council's surplus cash and receive a reasonable return is also likely to become trickier

in the coming months, with the Council's use of Money Market Funds also likely to diminish. UK money market rates have been on a downward trajectory since March when the Coronavirus pandemic hit. Between market turmoil and falling bank rates worldwide, Money Market Funds (MMFs) have been grappling with how to best proceed in this prolonged low yield environment and the return on many funds is now very close to zero or even negative in some cases. The Council will need to find the best way of juggling an adequate but not excessive level of investments to manage cashflow requirements and at the same time also achieve a positive return.

15.5 Borrowing is being managed through the short-term markets and so far there is a greater level of liquidity, partly due to Government grants to local authorities for Covid-19 expenditure. Bank rate is predicted to remain at 0.10% for the whole of the forecast period.

15.6 Long-term Interest rate forecasts for PWLB certainty rates (gilts plus 80bps), indicate 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 due to Covid-19.

15.7 The Council's Treasury Management Strategy remains relevant and effective at the half year point, with no significant changes required other than revisions to interest rate forecasts to reflect the current economic situation.

15.8 Cabinet is asked to recommend the following to the Council meeting:

- Note the report and the treasury activity in the first half of the financial year;
- Note the revised interest rate forecasts for PWLB rates over the short and medium term which will drive the Council's long-term borrowing strategies going forward.

16. RECOMMENDATIONS TO THE SCRUTINY COMMITTEE

The Scrutiny Committee is invited to comment on the report.

BACKGROUND PAPERS

There are none

Anyone wishing to inspect the above background papers or requiring further information should contact Lorna Soufian on Tel: 0161 474 4026 or by email on lorna.soufian@stockport.gov.uk

APPENDIX 1

Prudential and Treasury Indicators 2020/21

Treasury Indicators

	2020/21 Budget £M	2020/21 Current/ Actual £M
Authorised limit for external debt	939.000	939.000
Operational boundary for external debt	919.000	919.000
Gross external debt	798.457	673.017

Maturity Structure of fixed rate borrowing upper and lower limits

Period	2020/21 Lower	2020/21 Upper
Under 12 months	0%	45%
12 months to 2 years	0%	45%
2 years to 5 years	0%	45%
5 years to 10 years	0%	45%
10 years and above	50%	100%

Interest rate limits

	2020/21 Budget %	2020/21 Actual %
Upper limit of fixed interest rates based on gross debt	100%	100%
Upper limit of variable interest rates based on gross debt	40%	0%

Principal Sums

	2020/21 Budget £M	2020/21 Actual £M
Upper limit for principal sums invested over 365 days	80	0

Capital Indicators

	Budget 2020/21 £000	Current 2020/21 £000
Capital expenditure	218.815	136.266
Capital Financing Requirement (CFR)	880.742	805.335
Annual change in CFR	123.872	58.025
In-year borrowing requirement (excluding MRP)	139.721	73.747
Ratio of financing costs to net revenue stream (non HRA)	8.98%	9.44%
Ratio of financing costs to net revenue stream (HRA)	10.79%	10.78%
Incremental impact of capital investment decisions:		
Increase in council tax (band change) per annum	£48.60	£26.85
Increase in average housing rent per week	£3.99	£0.61