ANNEX 1

TREASURY MANAGEMENT STRATEGY
2021/22
March 2021

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Section 1: CURRENT TREASURY POSITION

Current Portfolio Position

1.1 The overall treasury management portfolio at 31 March 2020 and the position at 31 December 2020 is shown below for both borrowing and investments.

Table 1: NET TREASURY INVESTMENTS	**Actual 31/03/2020 £000**	**Current 31/12/2020 £000**
Treasury Investments		
Cash at Bank	4,002	14,662
Building Societies - unrated	18,000	13,000
Building Societies - rated	0	0
Local Authorities	0	0
DMADF (HM. Treasury)	0	0
Money Market Funds	25,022	35,000
Certificates of Deposit		0
Total Managed In-House	**47,024**	**62,662**
Bond Funds	0	0
Property Funds	0	0
Total Managed Externally	**0**	**0**
Total Treasury Investments	**47,024**	**62,662**
Treasury External Borrowing		
Local Authorities	14,000	9,000
PWLB	0	0
Total External Borrowing	**14,000**	**9,000**
Net Treasury Investments / (Borrowing)	**33,024**	**53,662**

Expected Investment Balances

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

Table 2: EXPECTED BALANCES TO INVEST OR FUND CAPITAL	**2019/20 Actual £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**	**2023/24 Estimate £000**
General Fund Balance	7,939	3,246	3,246	3,246	3,246

Table 2: EXPECTED BALANCES TO INVEST OR FUND CAPITAL	2019/20 Actual £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
Earmarked Reserves	33,652	24,509	17,509	17,509	17,509
Capital Receipts/Grants	24,503	15,698	15,698	15,698	15,698
Provisions	181	181	181	181	181
Revenue Grants					
Total Core funds - General Fund	**66,275**	**43,634**	**36,634**	**36,634**	**36,634**
Working Capital	7,000	7,000	7,000	7,000	7,000
Under / Over Borrowing	16,924	16,924	16,924	16,924	16,924
Expected Investments	**42,351**	**19,710**	**12,710**	**12,710**	**12,710**

*Working capital balances shown are estimated year-end; these may be higher mid-year

Section 2: Prudential and Treasury Indicators 2021/22 – 2023/24

2.1 The Council's capital expenditure plans are the key driver of treasury management activity and these have been shown in the main document. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

Key Prudential Indicators

2.2 The two key prudential indicators are explained and presented in the main report and included here for completeness:

Table 3: PLANNED CAPITAL EXPENDITURE TO BE FINANCED	2019/20 Actual £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
People Services	1,595	17,163	11,575	11,525	1,525
Place Services	4,923	24,048	26,939	16,249	1,557
Organisation Services	1,385	4,890	2,767	2,293	2,019
Corporate Investment and Regeneration Activities	0	50,000	0	0	0
Loans to Wholly Owned Companies	10,219	0	0	0	0
Total	**18,122**	**96,100**	**41,280**	**30,067**	**5,101**

Table 4: FINANCING OF CAPITAL EXPENDITURE	2019/20 Actual £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
Grants/Contributions	2,513	1,843	1,600	1,187	1,187
Capital Receipts	2,099	8,805	24,488	26,778	0
Revenue	759	0	0	0	0
Reserves	304	10,000	7,000	0	0
External Funding	**5,675**	**20,649**	**33,089**	**27,965**	**1,187**
Net borrowing need - General Fund (Core)	2,228	25,451	8,192	2,101	3,913
Net borrowing need - General Fund (Regeneration)	10,219	50,000	0	0	0
Net financing need for the year	**12,447**	**75,451**	**8,192**	**2,101**	**3,913**

Affordability prudential indicators

Ratio of financing costs to Net Revenue Budget

2.3 The Medium Term Financial Plan has already been adopted and within it the Chief Finance Officer has highlighted that there are funding gaps in future years. The investment in corporate initiatives and regeneration is intended to make up part of that gap.

2.4 The table below highlights the risk to the net budget requirement of not achieving any planned income streams – the top line represents the increasing percentage of net budget requirement which would be needed to service debt if none of the existing investment income were received. The lower line represents the percentage of net budget requirement which would be needed to service debt even if existing investment income streams deliver as currently planned.

Table 5: RATIO OF FINANCING COSTS TO NET REVENUE BUDGET	2019/20 Actual %	2020/21 Estimate %	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %
Gross cost of borrowing as % of net budget requirement	1.8%	1.8%	8.7%	15.5%	16.5%
Net cost of borrowing including investment income as % of net budget requirement	(3.9)%	(3.9)%	1.7%	9.7%	10.6%

2.5 The estimates of financing costs include current commitments and the proposals in this budget report.

Table 6: EXTERNAL DEBT FOR COMMERCIAL AND REGENERATION ACTIVITIES	2019/20 Actual %	2020/21 Estimate %	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %
External Debt for corporate investment / regeneration activities					
Actual debt at 31 March - £m	10,219	60,219	60,219	60,219	60,219
Percentage of total external debt - %	72%	67%	63%	63%	62%

Maturity structure of borrowing

2.6 These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

2.7 The Council is relatively new to borrowing and has a very limited portfolio at present therefore in order to maximise the opportunity to achieve good

value for money and in the absence of any currently maturing loans, the Council is asked to approve the following treasury indicators and limits:

Table 7: MATURITY STRUCTURE OF FIXED INTEREST RATE BORROWING 2021/22		
	Lower	**Upper**
Under 12 months	0%	50%
12 months to 2 years	0%	100%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years to 20 years	0%	100%
20 years to 30 years	0%	100%
30 years to 40 years	0%	100%
40 years to 50 years	0%	100%
MATURITY STRUCTURE OF VARIABLE INTEREST RATE BORROWING 2021/22		
	Lower	Upper
Under 12 months	0%	100%
12 months to 2 years	0%	100%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years to 20 years	0%	100%
20 years to 30 years	0%	100%
30 years to 40 years	0%	100%
40 years to 50 years	0%	100%

External Debt

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

2.9 The introduction of IFRS16 may change some of the Prudential Indicators due to additional lease liabilities being recognised on the balance sheet under the heading ‘Other Long Term Liabilities’. In preparation for the potential adoption of the new standard in 2022/23, the capital financing requirement now includes the cost of operating leases. Once these have been reviewed, revised indicators will be provided to Members at the earliest opportunity.

Table 8: EXPECTED CHANGE IN EXTERNAL DEBT	**2019/20 Actual £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**	**2023/24 Estimate £000**
External Debt					
Debt at 1 April	12,000	14,000	89,130	95,961	95,829
Expected change in Debt	2,000	75,130	6,831	-132	1,560
Other long-term liabilities (OLTL)	181	181	181	181	181
Expected change in OLTL	0	0	0	0	0

Table 8: EXPECTED CHANGE IN EXTERNAL DEBT	2019/20 Actual £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
Actual Gross Debt at 31 March	**14,181**	**89,311**	**96,142**	**96,010**	**97,570**
CFR	31,105	106,235	113,066	112,934	114,494
Under / (over) Borrowing	**16,924**	**16,924**	**16,924**	**16,924**	**16,924**

Treasury Indicators: Limit To Borrowing Activity

2.10 Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.

2.11 The Chief Finance Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

2.12 **The Operational Boundary** Is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Table 9: OPERATIONAL BOUNDARY FOR BORROWING (MAX EXPECTED)	2019/20 Actual £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
Borrowing	20,000	35,735	42,566	42,434	43,994
Other long term liabilities		500	500	500	500
Commercial activities / regeneration activities	50,000	70,000	70,000	70,000	70,000
Total	**70,000**	**106,235**	**113,066**	**112,934**	**114,494**

2.13 **The authorised limit for external debt** is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs

to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

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

Table 10: AUTHORISED LIMITS FOR BORROWING	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24**
	Actual £000	**Estimate £000**	**Estimate £000**	**Estimate £000**	**Estimate £000**
Borrowing	30,000	115,735	122,566	122,434	123,994
Other long term liabilities		500	500	500	500
Total	**30,000**	**116,235**	**123,066**	**122,934**	**124,494**

Creditworthiness.

2.15 As advised by LINK: "*the credit rating agencies changed their outlook on many UK banks from Stable to Negative during the quarter ended 30.6.20 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 major financial institutions, including UK banks. However, during Q1 and Q2 2020, banks made provisions for expected credit losses and the rating changes reflected these provisions. As we move into future quarters, more information will emerge on actual levels of credit losses. (Quarterly earnings reports are 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 banks went into this pandemic with strong balance sheets. This is predominantly a result of regulatory changes imposed on banks following the Great Financial Crisis. Indeed, the Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the UK 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%. All three rating agencies have reviewed banks around the world with similar results in many countries of*

most banks being placed on Negative Outlook, but with a small number of actual downgrades."

Certificates of Deposit (CDS) prices

2.16 As advised by LINK: *"Although bank CDS prices, (these are market indicators of credit risk), spiked upwards at the end of March / early April 2020 due to the heightened market uncertainty and ensuing liquidity crisis that affected financial markets, they have returned to more average levels since then. Nevertheless, prices are still elevated compared to end-February 2020. Pricing is likely to remain volatile as uncertainty continues. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Council has access to this information via its Link-provided Passport portal."*

Other limits

2.17 Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors.

Non-specified treasury management investment limit

2.18 The Council has determined that it will limit the maximum total exposure of treasury management investments to non-specified treasury management investments as being 20% of the total treasury management investment portfolio.

Country limit.

2.19 The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 1, Section 5. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

Other limits.

2.20 In addition:

- no more than £10M will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

Section 3 Economic Background from LINK Advisory

UK.

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 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".

- *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".*
- *Significantly, there was no mention of **negative interest rates** in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 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.*
- *One key addition to **the Bank's forward guidance** in August 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. Our Bank Rate forecast currently shows no increase through to quarter 1 2024 but there could well be no increase during the next five years due to the slow rate of recovery of the economy and the need for the Government to see the burden of the elevated debt to GDP ratio falling significantly. **Inflation** is unlikely to pose a threat requiring increases in Bank Rate during this period as there is likely to be spare capacity in the economy for a considerable time. It is expected to briefly peak at around 2% towards the end of 2021, but this is a temporary short lived factor and so not a concern.*
- *However, the minutes did 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.

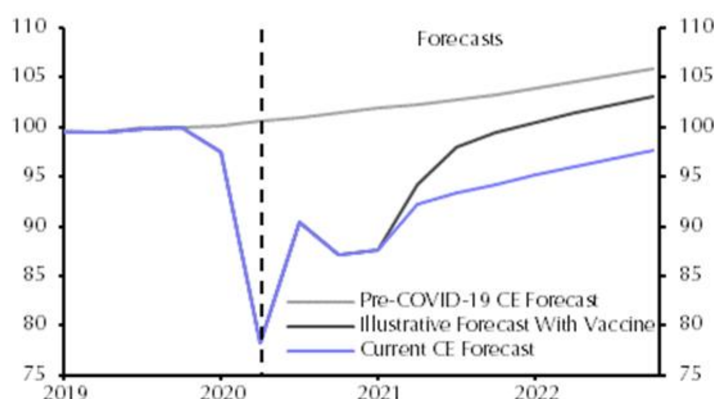
- *As for **upside risks**, we have been waiting expectantly for news that various **COVID19 vaccines** would be cleared as being safe and effective for administering to the general public. The Pfizer announcement on 9th November was very encouraging as its 90% effectiveness was much higher than the 50-60% rate of effectiveness of flu vaccines which might otherwise have been expected. However, their phase three trials are still only two-thirds complete. More data needs to be collected to make sure there are no serious side effects. We don't know exactly how long immunity will last or whether it is effective across all age groups. The Pfizer vaccine specifically also has demanding cold storage requirements of minus 70C that might make it more difficult to roll out. However, the logistics of production and deployment can surely be worked out over the next few months.*

- *What these vaccine results would mean is that **life could largely return to normal during 2021**, with activity in the still-depressed sectors like restaurants, travel and hotels returning to their pre-pandemic levels, which would help to bring the unemployment rate down. With the household saving rate currently being exceptionally high, there is plenty of pent-up demand and purchasing power stored up for these services. A large-scale roll-out of vaccines might take into late 2021 to fully complete; but if the vaccine really is that effective, then there is a possibility that restrictions could begin to be eased once vulnerable people and front-line workers had been vaccinated. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines would radically improve the economic outlook once they have been widely administered; it may allow GDP to rise to its pre-virus level a year earlier than otherwise and mean that the unemployment rate peaks at 7% next year instead of 9%. But while this would reduce the need for more QE and/or negative interest rates, increases in Bank Rate would still remain some years away. However, until there is clarity on these issues around the Pfizer vaccine, it would be premature to change the overall economic commentary and forecasting in this report. It also raises a potential question as to whether the relatively optimistic outlook of the Monetary Policy Report was swayed by making positive assumptions around effective vaccines being available soon. It should also be borne in mind that as effective vaccines will take time to administer, economic news could well get worse before it starts getting better.*

- ***Public borrowing** is now likely to increase by about £30bn to around £420bn (23% of GDP) as a result of the new lockdown. In normal times, such an increase in total 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.*

- *Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp but after a disappointing increase in GDP of only 2.1% in August, this left the economy still 9.2% smaller than in February; this suggested that the economic recovery was running out of steam after recovering 64% of its total fall during the crisis. The last three months of 2020 were originally expected to show zero growth due to the impact of widespread local lockdowns, consumers probably remaining cautious in spending, and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year also being a headwind. However, the new national lockdown for one month is now expected to depress GDP by 8% in November while the rebound in December is likely to be muted and vulnerable to the previously mentioned downside risks. Unemployment is also now expected to increase from 4.5% in August to a peak of 9% around the middle of 2021. Due to the number of adverse factors that have built up during the autumn, there is wide expectation that the Bank of England could resort to expanding quantitative easing by a further £100bn during 2021 to sustain momentum in the economy. Even so, it is now expected that the second national lockdown will push back recovery of GDP to pre pandemic levels by six months and into sometime during 2023. However, the graph below shows what Capital Economics forecast could happen if a successful vaccine was widely administered in the UK in the first half of 2021; this would cause a much quicker recovery.*

Level of real GDP (Q4 2019 = 100)



- *There will 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, even if vaccines are fully successful in overcoming the current virus. There is also likely to be a reversal of globalisation as this crisis has exposed how vulnerable long-distance supply chains are. On the other hand, digital services are one area that has already seen huge growth.*

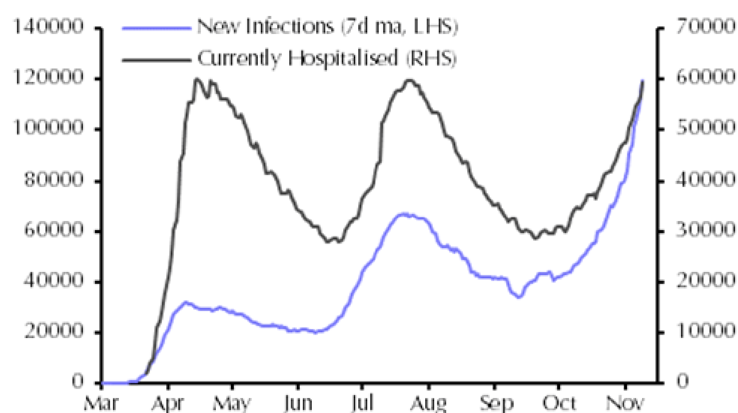
- *The **Financial Policy Committee** (FPC) report on 6th August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its assessment "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the 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%.*

***US.** 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 a massive fiscal stimulus, as they had been hoping to do after the elections, as they now have to get agreement from the Republicans. That would have resulted in another surge of debt issuance and would have put particular upward pressure on debt yields – which could have also put upward pressure on gilt yields. On the other hand, financial markets leapt up on 9th November 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.

The economy had been recovering quite strongly from its contraction in 2020 of 10.2% due to the ***pandemic*** *with GDP now only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during quarter 4, to the highest level since mid-August, suggests that the US could be in the early stages of a third wave. While the first wave in March and April was concentrated in the Northeast, and the second wave in the South and West, the latest wave has been driven by a growing outbreak in the Midwest. The latest upturn poses a threat that the recovery in the economy could stall. This is* ***the single biggest downside risk*** *to the outlook – a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, states might feel it necessary to return to more draconian lockdowns.*

COVID-19 New infections & hospitalisations



After Chair Jerome Powell unveiled the ***Fed's adoption of a flexible average inflation target*** *in his Jackson Hole speech in late August, the mid-September meeting of the Fed agreed by a majority to a toned down version of the new inflation target in his speech - that "it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 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, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. The Fed also called on Congress to end its political disagreement over providing more support for the unemployed as there is a limit to what monetary policy can do compared to more directed central government fiscal policy. The FOMC's updated economic and rate*

projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal. The Fed's meeting on 5 November was unremarkable - but at a politically sensitive time around the elections.

EU. *The economy was recovering well towards the end of Q2 and into Q3 after a sharp drop in GDP caused by the virus, (e.g. France 18.9%, Italy 17.6%). However, growth is likely to stagnate during Q4, and Q1 of 2021, as a second wave of the virus has affected many countries, and is likely to hit hardest those countries more dependent on tourism. The €750bn 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 the worst affected countries. With inflation expected to be unlikely to get much above 1% over the next two years, the ECB has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. 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 from governments. The current PEPP scheme of €1,350bn of QE which started in March 2020 is providing protection to the sovereign bond yields of weaker countries like Italy. There is therefore unlikely to be a euro crisis while the ECB is able to maintain this level of support. However, the PEPP scheme is regarded as being a temporary measure during this crisis so it may need to be increased once the first PEPP runs out during early 2021 - unless vaccines step in quickly enough to head off the need for more action by the ECB. It could also decide to focus on using the Asset Purchase Programme to make more monthly purchases, rather than the PEPP scheme, and it does have other monetary policy options.*

China. *After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and then into Q3 and Q4; 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.*

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 in the longer term. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

Japan. *Japan's success in containing the virus without imposing draconian restrictions on activity should enable a faster return to pre-virus levels of output than in many major economies. While the second wave of the virus has been abating, the economy has been continuing to recover at a reasonable pace from its earlier total contraction of 8.5% in GDP. However, there now appears to be the early stages of the start of a third wave. It has also 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. There has also been little progress on*

fundamental reform of the economy. The change of Prime Minister is not expected to result in any significant change in economic policy.

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.*

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

Summary

Central banks are, therefore, likely to come under more pressure to support growth by looser monetary policy measures and this is likely to result in more quantitative easing and keeping rates very low for longer. It will also put pressure on governments to provide more fiscal support for their economies.

If there is a huge surge in investor confidence as a result of successful vaccines which leads to a major switch out of government bonds into equities, which, in turn, causes government debt yields to rise, then there will be pressure on central banks to actively manage debt yields by further QE purchases of government debt; this would help to suppress the rise in debt yields and so keep the total interest bill on greatly expanded government debt portfolios within manageable parameters. It is also the main alternative to a programme of austerity.

The graph below as at 10th November, shows how the 10 year gilt yield in the UK spiked up after the Pfizer vaccine announcement on the previous day: -

Interest Rate Forecasts 2020-2024 from LINK Advisory

Link Group Interest Rate View	9.11.20													
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	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	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	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	0.20	0.20	0.20	0.20
5yr PWLB	1.80	1.80	1.80	1.80	1.80	1.90	1.90	1.90	1.90	1.90	2.00	2.00	2.00	2.00
10 yr PWLB	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30	2.30	2.30	2.30	2.30
25 yr PWLB	2.50	2.50	2.60	2.60	2.60	2.60	2.70	2.70	2.70	2.70	2.80	2.80	2.80	2.80
50 yr PWLB	2.30	2.30	2.40	2.40	2.40	2.40	2.50	2.50	2.50	2.50	2.60	2.60	2.60	2.60

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 5th November, 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 in the forecast table above as economic recovery is expected to be only gradual and, therefore, prolonged.

As the interest forecast table for PWLB certainty rates above shows, there is expected 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. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

Investment returns are likely to remain exceptionally low during 2021/22 with little increase in the following two years.

Borrowing interest rates fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England however, the unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps, required an initial major rethink of local authority treasury management strategy and risk management.

In March 2020, the Government started a consultation process for amending the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure. It 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)*
- ***Local Infrastructure Rate** is gilt plus 60bps (G+60bps)*

Borrowing not for infrastructure capital expenditure. As Link's long-term forecast for Bank Rate is 2.00%, and all PWLB non-HRA certainty rates (i.e. gilts plus 180bps), are close to or under 1% above 2.00%, there is little value in borrowing from the PWLB at present. Accordingly, the Council will reassess its risk appetite in terms of either seeking cheaper alternative sources of borrowing or switching to short term borrowing in the money markets until such time as the Government reconsiders the margins charged over gilt yields. Longer-term borrowing could also be undertaken for the purpose of certainty, where that is desirable, or for flattening the profile of a heavily unbalanced maturity profile.

Borrowing for infrastructure capital expenditure. As Link's long-term forecast for Bank Rate is 2.00%, and all PWLB HRA and infrastructure certainty rates are below 2.00%, there is value in borrowing from the PWLB, especially as current rates are at historic lows.

While this authority will not be able to avoid borrowing to finance new capital expenditure, to replace the rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

***Brexit.** The interest rate forecasts provided by Link in paragraph 3.3 are predicated on an assumption of a reasonable agreement being reached on trade negotiations between the UK and the EU by 31.12.20. However, as the differences between a Brexit deal and a no deal are not as big as they once were, the economic costs of a no deal have diminished. The bigger risk is that relations between the UK and the EU deteriorate to such an extent that both sides start to unravel the agreements already put in place. So what really matters now is not whether there is a deal or a no deal, but what type of no deal it could be.*

The differences between a deal and a no deal were much greater immediately after the EU Referendum in June 2016, and also just before the original Brexit deadline of 29.3.19. That's partly because leaving the EU's Single Market and Customs Union makes this Brexit a relatively "hard" one. But it's mostly because a lot of arrangements have already been put in place. Indeed, since the Withdrawal Agreement laid down the terms of the break-up, both the UK and the EU have made substantial progress in granting financial services equivalence and the UK has replicated the bulk of the trade deals it had with non-EU countries via the EU. In a no deal in these circumstances (a "cooperative no deal"), GDP in 2021 as a whole may be only 1.0% lower than if there were a deal. In this situation,

financial services equivalence would probably be granted during 2021 and, if necessary, the UK and the EU would probably rollover any temporary arrangements in the future.

The real risk is if the UK and the EU completely fall out. The UK could override part or all of the Withdrawal Agreement while the EU could respond by starting legal proceedings and few measures could be implemented to mitigate the disruption on 1.1.21. In such an "uncooperative no deal", GDP could be 2.5% lower in 2021 as a whole than if there was a deal. The acrimony would probably continue beyond 2021 too, which may lead to fewer agreements in the future and the expiry of any temporary measures.

Relative to the slump in GDP endured during the COVID crisis, any hit from a no deal would be small. But the pandemic does mean there is less scope for policy to respond. Even so, the Chancellor could loosen fiscal policy by about £10bn (0.5% of GDP) and target it at those sectors hit hardest. The Bank of England could also prop up demand, most likely through more gilt and corporate bond purchases rather than negative interest rates.

Brexit may reduce the economy's potential growth rate in the long run. However, much of that drag is now likely to be offset by an acceleration of productivity growth triggered by the digital revolution brought about by the COVID crisis.

So in summary there is not likely to be any change in Bank Rate in 20/21 – 21/22 due to whatever outcome there is from the trade negotiations and while there will probably be some movement in gilt yields / PWLB rates after the deadline date, there will probably be minimal enduring impact beyond the initial reaction.

The balance of risks to the UK

- *The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but is subject to major uncertainty due to the virus and how quickly successful vaccines may become available and widely administered to the population. 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.*

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 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 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.*

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

- ***UK -** stronger than currently expected recovery in UK economy, especially if effective vaccines are administered quickly to the UK population and lead to a resumption of normal life and a return to full economic activity across all sectors of the 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.*

Section 4: Treasury Management Practice 1 (TMP1) – Credit and Counter Party Risk Management

4.1 The MHCLG issued Investment Guidance in 2018, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

4.2 The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code and will apply its principles to all investment activity. In accordance with the Code, the Director of Finance has produced its treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual investment strategy

4.3 The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

4.4 The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified investments

4.5 These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. They also include investments which were originally classed as being non-specified investments, but which would have been classified as specified investments apart from originally being for a period longer than 12 months, once the remaining period to maturity falls to under twelve months. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

- The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
- Supranational bonds of less than one year's duration.
- A local authority, housing association, parish council or community council.
- Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's and / or Fitch rating agencies.
- A body that is considered of a high credit quality (such as a bank or building society).

4.6 The Council will operate to the following limits in relation to specified investments, where:

- Short Term – less than or equal to 12 months
- Medium Term – More than 12 months and up to and including 3 years
- Long Term – over 3 years and up to 5 years

Table 11: COUNTERPARTY LIST			**Credit Rating & Duration**			
			Fitch	**Standard & Poor**	**Moody's**	
The Council's own banker for day to day banking transactional purposes.	If the main bank maintains the following criteria	Short-Term	F1	A-1	P-1	• £20M with the bank or counterparties within their group
The Council's own banker for day to day banking transactional purposes.	If the main bank falls below the following criteria, in this case balances will be minimised in both monetary size and time invested.	Short-Term	F1	A-1	P-1	• £7m
UK Banks	Covers UK Retail & Clearing Banks	Short-Term	F1	A-1	P-1	• £10m with any individual counterparty
		Medium-Term	A+	A+	A1	• £10m with any individual counterparty
Part Nationalised UK Banks	These banks can be included provided they continue to be part nationalised or meet the ratings in UK Banks above.	Long-Term	AA-	AA-	Aa3	• £10m with any individual counterparty
Non-UK domiciled Banks	Non-UK Banks must be domiciled in a country which has a minimum sovereign Long-Term rating of 'AAA'	Short-Term	F1	A-1	P-1	• £5m with any individual counterparty
		Medium-Term	A+	A+	A1	• £5m with any individual counterparty

Table 11: COUNTERPARTY LIST			Credit Rating & Duration			
			Fitch	Standard & Poor	Moody's	
		Medium - Term	A+	A+	A1	• £10m
		Long- Term	AA-	AA-	Aa3	• £10m
Building societies	The Council will use all societies which meet the following criteria	Regulated by the Prudential Regulation Authority ***and*** has a minimum of a £1billion asset base				• £10m with any individual counterparty • Up to and incl. 3 years.
Money Market Funds (MMFs)	Constant Net Asset Value (CNAV)	Short- Term	AAA	AAA	Aaa	• £10m with any individual counterparty
Money Market Funds (MMFs)	Low-Volatility Net Asset Value (LVNAV)	Short- Term	AAA	AAA	Aaa	• £10m with any individual counterparty
Money Market Funds (MMFs)	Variable Net Asset value (VNAV)	Short- Term	AAA	AAA	Aaa	• £10m with any individual counterparty
UK Government (including gilts, Treasury Bills and the DMADF)	No credit rating - UK Government guarantee	N/A	N/A	N/A		• Unlimited • To maturity
Local authorities, parish councils etc.	No credit rating - UK government guarantee	N/A	N/A	N/A		• £10m with any individual counterparty • Up to and incl. 5 years
Supranational institutions (e.g. European Investment Bank or World Bank)	The Council will use supranational institutions which meet the following criteria:	Short- Term	F1	A-1	P-1	• £10m with any individual counterparty

Non-specified investments

4.7 These are any other type of investment (i.e. not defined as specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non-specified investments would include any sterling investments with:

- Supranational bonds greater than 1 year to maturity
- Multilateral development bank bonds
- A financial institution that is guaranteed by the UK Government e.g. UK Rail
- Gilt edged securities with a maturity of greater than 1 year
- The Council’s own banker if it fails to meet the basic credit criteria

- Building societies not meeting the basic security requirements under the specified investments

Monitoring of Investment Counterparties

4.8 The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from LINK as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Director of Finance, and if required new counterparties which meet the criteria will be added to the list.

Section 5 Approved Countries for Investment

5.1 This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link credit worthiness service.

Based on lowest available rating

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

AA+
- Canada
- Finland
- U.S.A.

AA
- Abu Dhabi (UAE)
- France

AA-
- Belgium
- Hong Kong
- Qatar
- U.K.

Section 6: Treasury Management Scheme of Delegation

(i) Council

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

(ii) Executive

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

(iii) Overview & Scrutiny Committee

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

Section 7: Treasury Management Role of the Section 151 Officer

The Section 151 Officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following : -
    - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*

- *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*

- *Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*

- *Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;*

- *Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.*