

REPORT TO EXECUTIVE
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PORTFOLIO	Resources and Performance Management
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2021/22 Treasury Management Mid-Year Report
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PURPOSE
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1. To report treasury management activity for the first half year of 2021/22 covering the period 1 April to 30 September 2021.

RECOMMENDATION
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2. The Executive is requested to;
  - Note the treasury management activities undertaken during the period 1 April to 30 September 2021, and;

Recommend that Full Council;

- Endorse the mid-year update on Treasury Management Strategy for 2021/22 in compliance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management.
- Approve the revised Operational Boundary and Authorised Limit for external debt as set out in Appendix 1 to this report.

REASONS FOR RECOMMENDATION
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3.
  - To inform members of the treasury management activity in the first half of 2021/22 and to fulfil statutory and regulatory requirements.

## SUMMARY OF KEY POINTS

### 4. **Background**

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. The first main function of 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.

The second main function of the treasury management service is to ensure 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 commitments. This management of longer term cash may involve arranging long or short term loans, or using cash flow surpluses, and, on occasions, any current debt may be restructured to meet Council risk or cost objectives.

Treasury management is defined as:

“The management of the Council'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.”

The monitoring requirements for treasury were set out in the report which included both the Treasury Management Strategy for 2021/22 and the Prudential and Treasury Indicators for 2021/22 – 2023/24, approved by Full Council on 24 February 2021.

### 5. **Introduction**

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

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Strategy which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by Full Council of an annual Treasury Management Strategy - 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.
4. 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.

5. 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 Scrutiny Committee.

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

- An economic update for the first six months of 2021/22;
- A review of the Treasury Management Strategy and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council's investment portfolio for 2021/22;
- A review of the Council's borrowing strategy for 2021/22;
- A review of any debt rescheduling undertaken during 2021/22;
- A review of compliance with Treasury and Prudential Limits for 2021/22.

## 6. **Economic Update (Provided by Link Asset Services)**

### **MPC meeting 24.9.21**

- The Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn.
- There was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August which had majored on indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in Bank Rate. In his press conference after the August MPC meeting, Governor Andrew Bailey said, "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures." In other words, it was flagging up a potential danger that labour shortages could push up wage growth by more than it expects and that, as a result, CPI inflation would stay above the 2% target for longer. It also discounted sharp increases in monthly inflation figures in the pipeline in late 2021 which were largely propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system: in other words, the MPC had been prepared to look through a temporary spike in inflation.
- So, in August the country was just put on alert. However, this time the MPC's words indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October and due again next April, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected. Indeed, to emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement; this suggested that it was now willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year. This is a reversal of its priorities in August and a long way from words at earlier MPC meetings which indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. Indeed, whereas in

August the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021, now its primary concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.

- Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in February 2022, but this looks ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment once furlough ends at the end of September.
- **COVID-19 vaccines.** These have been the game changer which have enormously boosted confidence that life in the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.
- **EU.** The slow roll out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction in GDP of -0.3% in Q1, Q2 came in with strong growth of 2%, which is likely to continue into Q3, though some countries more dependent on tourism may struggle. Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the ECB is likely to see these as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time.
- German general election. With the CDU/CSU and SPD both having won around 24-26% of the vote in the September general election, the composition of Germany's next coalition government may not be agreed by the end of 2021. An SPD-led coalition would probably pursue a slightly less restrictive fiscal policy, but any change of direction from a CDU/CSU led coalition government is likely to be small. However, with Angela Merkel standing down as Chancellor as soon as a coalition is formed, there will be a hole in overall EU leadership which will be difficult to fill.
- **China.** After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of the year; this enabled China to recover all the initial contraction. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021. However, the pace of economic growth has now fallen back after this initial surge of recovery from the pandemic and China is now struggling to contain the spread of the Delta variant through sharp local lockdowns - which will also depress economic growth. There are also questions as to how effective Chinese vaccines are proving. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

- **Japan.** 2021 has been a patchy year in combating Covid. However, after a slow start, nearly 50% of the population are now vaccinated and Covid case numbers are falling. After a weak Q3 there is likely to be a strong recovery in Q4. The Bank of Japan is continuing its very loose monetary policy but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon: indeed, inflation was negative in July. New Prime Minister Kishida has promised a large fiscal stimulus package after the November general election – which his party is likely to win.
- **World growth.** World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.
- **Supply shortages.** The pandemic and extreme weather events have been highly disruptive of extended worldwide supply chains. At the current time there are major queues of ships unable to unload their goods at ports in New York, California and China. Such issues have led to mis-distribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves.

## 7. **Interest Rate Forecast (Provided by Link Asset Services)**

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.

The latest forecast on 29<sup>th</sup> September is compared below to the previous forecast on 10<sup>th</sup> May. A comparison of these forecasts shows that some PWLB rates have increased marginally and there are now three increases in Bank Rate, to end at 0.75%, instead of one to only 0.25%. However, many PWLB rates were significantly lower than forecast during the earlier part of quarter 2.

Link Group Interest Rate View		29.9.21								
		Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
BANK RATE		0.10	0.10	0.25	0.25	0.25	0.25	0.50	0.50	0.50
3 month ave earnings		0.10	0.10	0.20	0.20	0.30	0.40	0.50	0.50	0.60
6 month ave earnings		0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.60	0.70
12 month ave earnings		0.30	0.40	0.50	0.50	0.50	0.60	0.70	0.80	0.90
5 yr PWLB		1.40	1.40	1.50	1.50	1.60	1.60	1.60	1.70	1.70
10 yr PWLB		1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10
25 yr PWLB		2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.50	2.50
50 yr PWLB		2.00	2.00	2.10	2.20	2.20	2.20	2.20	2.30	2.30

Link Group Interest Rate View		10.5.21											
		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	0.25	0.25	0.25
3 month ave earnings		0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.30	0.30	0.30
6 month ave earnings		0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.20	0.30	0.40	0.40	0.40
12 month ave earnings		0.20	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.40	0.50	0.50	0.50
5 yr PWLB		1.20	1.20	1.30	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50
10 yr PWLB		1.70	1.70	1.70	1.80	1.80	1.90	1.90	1.90	2.00	2.00	2.00	2.00
25 yr PWLB		2.20	2.20	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50	2.50	2.60
50 yr PWLB		2.00	2.00	2.10	2.20	2.20	2.20	2.30	2.30	2.30	2.30	2.30	2.40

The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings.

### Forecasts for Bank Rate

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

- There are increasing grounds for viewing the economic recovery as running out of steam during the summer and now into the autumn. This could lead into stagflation which would create a dilemma for the MPC as to which way to face.
- Will some current key supply shortages e.g., petrol and diesel, spill over into causing economic activity in some sectors to take a significant hit.
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation. Then we have the Government's upcoming budget in October, which could also end up in reducing consumer spending power.
- On the other hand, consumers are sitting on around £200bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?
- There are 1.6 million people coming off furlough at the end of September; how many of those will not have jobs on 1<sup>st</sup> October and will, therefore, be available to fill labour shortages in many sectors of the economy? So, supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months or so and alleviate the MPC's current concerns.
- There is a risk that there could be further nasty surprises on the Covid front, on top of the flu season this winter, which could depress economic activity.

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

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

8. **Treasury Management Strategy update**

The Treasury Management Strategy (TMS) for 2021/22, which includes the Annual Investment Strategy, was approved by this Council on 24 February 2021. The TMS requires revision in light of the increase to the capital programme during the year, and significantly the acquisition of Charter Walk. The changes to the Capital Financing Requirement (CFR) and both the Operational Boundary and Authorised Limits for external debt are set out in Appendix 1 to this report.

9. **The Council's Capital Position**

The table below shows the financing of the Original Capital Budget approved by Full Council on the 24 February 2021 and the latest Revised Capital Budget. The increase is due to a combination of in year budget monitoring adjustments, reprofiling of capital expenditure into future years and the acquisition of Charter Walk.

Capital	2021/22 Original Estimate £'000	2021/22 Revised Estimate £'000
<b>Total Budget</b>	<b>18,792</b>	<b>39,481</b>
Financed by:		
Capital receipts	1,834	2,080
Capital grants	7,792	5,923
Revenue	373	762
<b>Total financing</b>	<b>9,999</b>	<b>8,765</b>
<b>Borrowing need</b>	<b>8,793</b>	<b>30,716</b>

10. As shown by the interest rate forecasts in section 7, it is now impossible to earn the level of interest rates commonly seen in previous decades as all short-term money market investment rates have only risen weakly since Bank Rate was cut to 0.10% in March 2020. Given this environment, investment returns are expected to remain low.



The table below shows the maximum amount invested with any of the counterparties at any one time during the period April 2021 to 30 September 2021 against the maximum limits approved in the 2021/22 Treasury Management Strategy.

Counterparties	Maximum Limits £m	Highest level of Investment 2021/22 (£m)
HSBC	50.0	24.1
Moray Council	6.0	2.0
Santander	4.0	4.0
Goldman Sachs	4.0	2.0

#### 11. **Property Funds**

The council made 2 investments totalling £2m in property funds in 2018/19 for the purpose of increasing and diversifying our risk in investment income receivable and to help alleviate future revenue budget pressures. Dividends received in the 3 month period April to June 2021 amounted to £16,707, earning an average yield of 3.3%, compared to £14,523 received for the same period in 2020/21.

#### 12. **Borrowing**

The Council's capital financing requirement ( CFR) for 2021/22 is £71.367m. The CFR denotes the Council's underlying need to borrow for capital purposes. Below is a summary of the Councils' external indebtedness, as at 1 April 2021, and as at 30 September 2021.

Borrowing	1 Apr 21 £'000	30 Sept 21 £'000	Change Apr – Sept £'000
Public Works Loan Board	35,663	35,663	-
Temporary Market Loans	25	26	1
<b>Total</b>	<b>35,688</b>	<b>35,689</b>	<b>1</b>

**PWLB Loans** – There was no loan repayments during the period 1 April to 30 September 2021.

**Temporary Market Loans** – There has been a net movement of £1k in temporary market loans during the period 1 April 2021 to 30 September 2021.

#### 13. **Debt Rescheduling**

There have been no debt rescheduling opportunities in the current economic climate and consequent structure of interest rates. Therefore, no debt rescheduling was undertaken during the first six months of 2021/22.

#### 14. **Compliance with Treasury & Prudential Limits**

It is a statutory duty for the Council to determine and keep under review its affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy.



During the financial year to date the Council's treasury management activities operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy in compliance with the Council's Treasury Management Practices.

An extract of the Prudential and Treasury Indicators are shown in Appendix 1.

15. **Interest Payable on External Borrowing / Interest Receivable**

Provision is made in the revenue budget to meet the net interest payable on external borrowing. The figure in the original budget for 2021/22 was set at £1,306,716.

This budget has been revised down to £1,134,523 due to the council maintaining internal borrowing for its capital programme during the last financial year.

The total interest receivable on temporary deposits for the period 1 April 2021 to 30 September 2021 amounted to £19,430. An additional £16,707 was received in dividends on Property Funds for the period 1 April 2021 to 30 June 2021. The budget for the year for interest and dividend receipts was set at £270k. This has been revised down to £124k due to the delay in making the Burnley College investment and reduction of the amount from £4m to £2m.

<b>FINANCIAL IMPLICATIONS AND BUDGET PROVISION</b>
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16. None arising as a direct result of this report.

<b>POLICY IMPLICATIONS</b>
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17. Compliance with the revised CIPFA Code of Practice on Treasury Management.

<b>DETAILS OF CONSULTATION</b>
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18. Scrutiny Committee.

<b>BACKGROUND PAPERS</b>
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19. None.

<b>FURTHER INFORMATION</b>
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**PLEASE CONTACT:**

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and Property**