SOUTH HOLLAND DISTRICT COUNCIL

Report of:	**Executive Director Commercialisation (S151), Christine Marshall**
To:	**Governance and Audit Committee 30 July 2020** **Council 23 September 2020**
Author:	**Sean Howsam – Treasury & Investment Manager (PSPS)**
Subject:	**Annual Treasury Management Review 2019/20**
Purpose:	**To consider the Annual Treasury Management Review for 2019/20 prior to it being submitted to Council for approval.**

Recommendation(s):

1) That the Governance and Audit Committee scrutinise the Annual Treasury Management Review 2019/20 and make any comments for consideration by Council when they consider this document for approval at their meeting on 23 September 2020.

1.0 **BACKGROUND**

1.1 This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2019/20. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

For 2019/20 the following reports have been submitted:

- an annual treasury strategy in advance of the year (Council 27 February 2019);
- a mid year (minimum) treasury update report (Council 27 November 2019);
- An annual review following the end of the year describing the activity compared to the strategy (this report).

1.2 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is therefore important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

1.3 This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Governance and Audit Committee. Member training on treasury management issues was undertaken on 14 November 2019 in order to support the members' scrutiny role.

1.4 The Treasury Management function is administered by Public Sector Partnership Services Ltd on behalf of the Council.

1.5 The Council is currently in the process of producing its financial statements for the 2019/20 financial year and these will be subject to external audit. The figures in this report are therefore subject to change and any such changes will be reflected in the report submitted to Council.

2.0 **INTRODUCTION**

2.1 This report summarises the following :-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to its indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Borrowing and investment outturn positions;
- Economy and interest rates.

3.0 **THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING 2019/20**

3.1 The Council undertakes capital expenditure on long-term assets. These activities may either be:

- financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- if insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

3.2 The actual capital expenditure forms one of the required prudential indicators. The following tables show the actual capital expenditure and how this was financed.

£'000 General Fund	**2018/19 Actual**	**2019/20 Estimate**	**2019/20 Actual**
Capital expenditure	3,678	10,351	3,901
Financed in year	(2,072)	(5,885)	(2,786)
Unfinanced capital expenditure	1,606	4,466	1,115

£'000 Housing Revenue Account (HRA)	**2018/19 Actual**	**2019/20 Estimate**	**2019/20 Actual**
Capital expenditure	4,885	11,184	8,972
Financed in year	(4,885)	(11,184)	(8,972)
Unfinanced capital expenditure	-	-	-

4.0 **THE COUNCIL'S OVERALL BORROWING NEED**

4.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2019/20 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

4.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced by utilising temporary cash resources within the Council or through borrowing from external bodies (such as the Government, through the Public Works Loan Board (PWLB) or the money markets).

4.3 Reducing the CFR – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-HRA borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or

- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

4.4 The Council's 2019/20 MRP Policy as required by Ministry of Housing, Communities and Local Government (MHCLG) guidance was approved as part of the Treasury Management Strategy Report for 2019/20 on 27 February 2019.

4.5 The Council's CFR for the year is shown below, and represents a key prudential indicator:

CFR (£'000): General Fund	**31 March 2019 Actual**	**31 March 2020 Budget**	**31 March 2020 Actual**
Opening Balance	3,847	5,453	5,453
Add unfinanced capital expenditure (as above)	1,606	4,466	1,115
Closing Balance	**5,453**	**9,919**	**6,568**

CFR (£'000): HRA	31 March 2019 Actual	31 March 2020 Budget	31 March 2020 Actual
Opening Balance	68,439	68,439	68,439
Add unfinanced capital expenditure (as above)	-	-	-
Closing Balance	**68,439**	**68,439**	**68,439**

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

4.6 Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the CFR in the preceding year (2018/19) plus the estimates of any additional CFR for the current (2019/20) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2019/20. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2019 Actual (£'000)	31 March 2020 Budget (£'000)	31 March 2020 Actual (£'000)
Gross Borrowing Position	67,456	67,456	67,456
CFR	73,892	78,358	75,007

4.7 The authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The following table demonstrates that during 2019/20 the Council has maintained gross borrowing within its authorised limit.

The operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2019/20
Authorised limit	£91m
Maximum gross borrowing position	£67.456m
Operational boundary	£87m
Average gross borrowing position	£67.456m
Financing costs as a proportion of net revenue stream – Non HRA HRA	-2.59% 36.88%

5.0 **TREASURY POSITION AS AT 31 MARCH 2020**

5.1 The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. At the beginning and the end of 2019/20 the Council's treasury position including accrued interest was as follows:

	31/3/19 Amount £'000	**Rate/ Return %**	**Average Life**	**31/3/20 Amount £'000**	**Rate/ Return %**	**Average Life**
Fixed rate funding						
PWLB	67,456	3.48	43 years	67,456	3.48	42 years
Leases	-	n/a		-	n/a	
Total debt	**67,456**	**3.48**	**43 years**	**67,456**	**3.48**	**42 years**
CFR	73,892			75,007		
Over/(under) borrowing	(6,436)			(7,551)		
Cash and investments:						
long term equity and service loans	(5,605)	n/a	n/a	(7,034)	n/a	n/a
short term	(33,602)	1.07	173 days	(26,118)	0.97	138 days
instant access deposits	(4,977)	0.73	1 day	(11,192)	0.57	1 day
Total cash and investments	**(44,184)**	**1.02**	**150 days**	**(44,344)**	**0.85**	**97 days**
Net debt	**23,272**			**23,112**		

5.2 Investments and Cash and Cash Equivalents held as at 31 March 2020 including accrued interest were as follows:

INVESTMENT PORTFOLIO	**Actual 31/03/19 £000's**	**Actual 31/03/19 %**	**Actual 31/03/20 £000's**	**Actual 31/03/20 %**
Treasury Investments				
Banks	29,556	76	26,112	70
Building Societies	3,002	8	3,004	8
Local Authorities	3,019	8	2,001	5
Total managed in house	**35,577**	**92**	**31,117**	**83**
Money Market Funds	3,002	8	6,193	17
Total managed externally	**3,002**	**8**	**6,193**	**17**
Total Treasury Investments	**38,579**	**100**	**37,310**	**100**
Non-Treasury Investments (at fair value)				
Equity	2,725	49	3,664	52
Service Loans (long term debtors)	2,880	51	3,370	48
Total Non-Treasury Investments	**5,605**	**100**	**7,034**	**100**

SUMMARY	**Actual 31/03/19 £000's**	**Actual 31/03/19 %**	**Actual 31/03/20 £000's**	**Actual 31/03/20 %**
Total Treasury Investments	38,579	87	37,310	84
Total Non-Treasury Investments	5,605	13	7,034	16
Total of all Investments	**44,184**	**100**	**44,344**	**100**

The maturity structure of the investment portfolio was as follows:

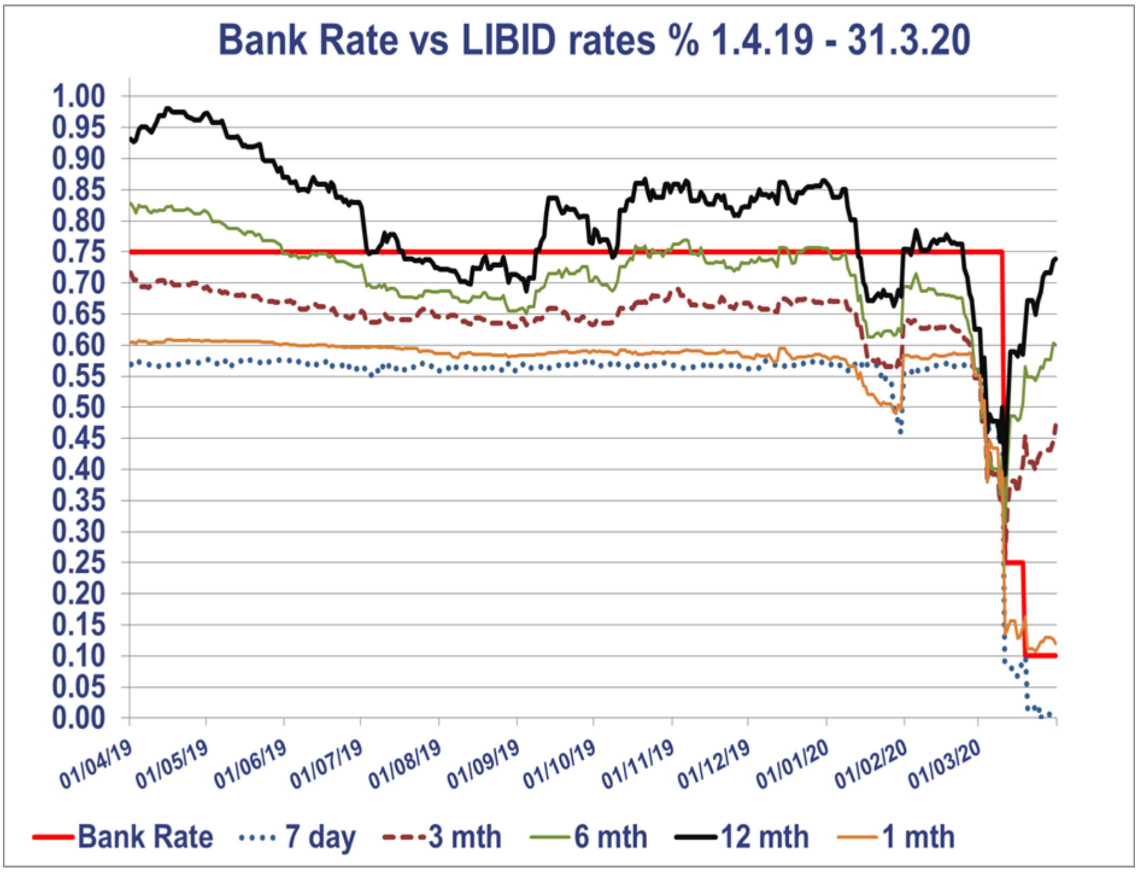
	2018/19 Actual £'000	**2019/20 Actual £'000**
Investments		
Longer than 1 year	5,605	7,034
Under 1 year	38,579	37,310
Total	44,184	44,344

The exposure to fixed and variable rates on investments was as follows:

	31/3/19 Actual £'000	31/3/20 Actual £'000
Fixed rate	36,482 (83%)	29,488 (66%)
Variable rate	7,702 (17%)	14,856 (34%)

6.0 **THE STRATEGY FOR 2019/20**

6.1 **Investment strategy and control of interest rate risk**



Investment returns remained low during 2019/20. The expectation for interest rates within the treasury management strategy for 2019/20 was that Bank Rate would stay at 0.75% during 2019/20 as it was not expected that the Monetary Policy Committee (MPC) would be able to deliver on an increase in Bank Rate until the Brexit issue was finally settled. However, there was an expectation that Bank Rate would rise after that issue was settled, but would only rise to 1.0% during 2020.

Rising concerns over the possibility that the UK could leave the European Union (EU) at the end of October 2019 caused longer term investment rates to be on a falling trend for most of April to September. They then rose after the end of October deadline was rejected by the Commons but fell back again in January before recovering again after the 31 January departure of the UK from the EU. When the coronavirus outbreak hit the UK in February/March, rates initially plunged but then rose sharply back up again due to a shortage of liquidity in financial markets. As longer term rates were significantly higher than shorter term rates during the year, value was therefore sought by placing longer term investments where cash balances were sufficient to allow this.

While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as illustrated in the charts shown above and below. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

6.2 **Borrowing strategy and control of interest rate risk**

During 2019/20, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. All current loan debt specifically relates to the HRA and the General Fund has no loan debt. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure.

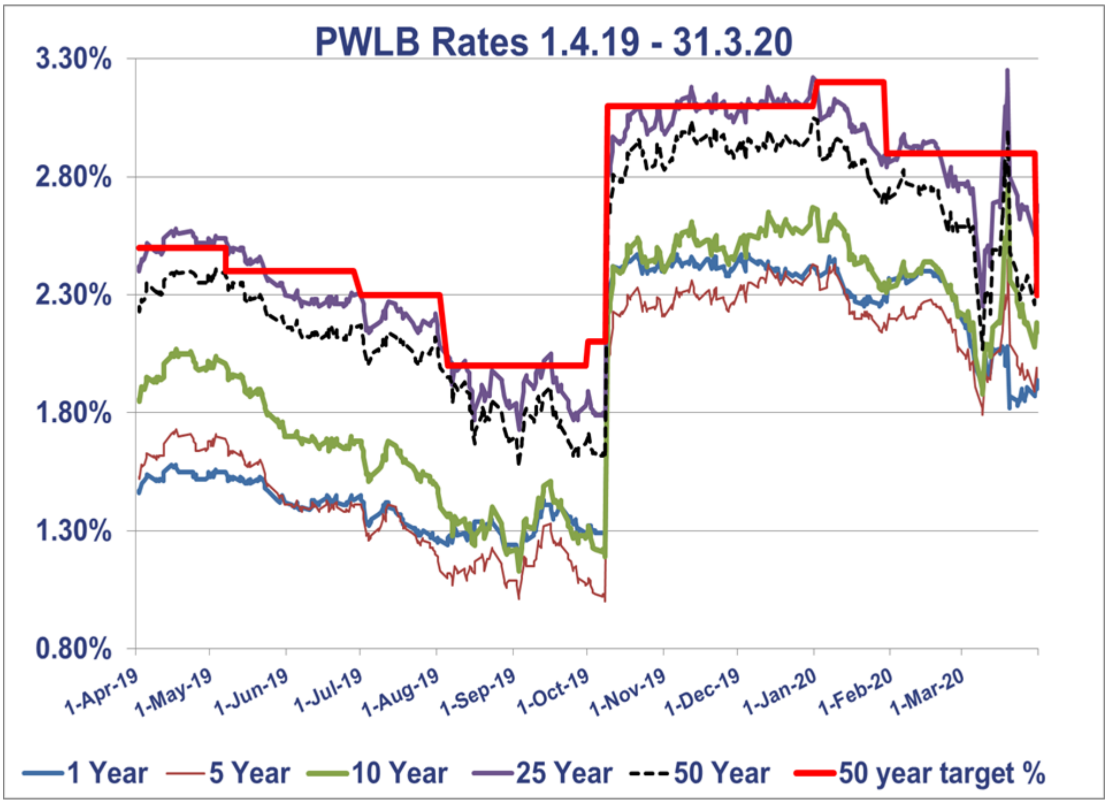
Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Section 151 Officer therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks:

- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed.

- if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2019/20 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

Link Asset Services Interest Rate View 5.8.19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	1.20	1.30	1.50	1.60	1.70	1.70	1.80	1.90	2.00	2.00	2.10
10yr PWLB Rate	1.50	1.60	1.80	1.90	2.00	2.00	2.10	2.20	2.30	2.30	2.40
25yr PWLB Rate	2.10	2.30	2.40	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00
50yr PWLB Rate	2.00	2.20	2.30	2.40	2.50	2.60	2.60	2.70	2.80	2.90	2.90



PWLB rates are based on, and are determined by, gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. 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, and a general background 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; these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have therefore seen, over the last year, many bond yields up to 10 years in the Eurozone turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

Gilt yields were on a generally falling trend during the last year up until the coronavirus crisis hit western economies. Since then, gilt yields have fallen sharply to unprecedented lows as investors have panicked in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks also started quantitative easing purchases of government bonds which will act to maintain downward pressure on government bond yields at a time when there is going to be a huge and quick expansion of government expenditure financed by issuing government bonds; (this would normally cause bond yields to rise). At the close of the day on 31 March, all gilt yields from 1 to 5 years were between 0.12 – 0.20% while even 25-year yields were at only 0.83%.

However, HM Treasury has imposed two changes in the margins over gilt yields for PWLB rates in 2019-20 without any prior warning; the first on 9 October 2019, added an additional 1% margin over gilts to all PWLB rates. That increase was then partially reversed for some forms of borrowing on 11 March 2020, at the same time as the Government announced in the Budget a programme of increased spending on infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins; this was due to end on 4 June but has been extended. It is clear that the Treasury intends to put a stop to local authorities borrowing money from the PWLB to purchase commercial property if the aim is solely to generate an income stream.

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

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

There is likely to be little upward movement in PWLB rates over the next two years as it will take national economies a prolonged period to recover all the momentum they will lose in the sharp recession that will be 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.

7.0 BORROWING OUTTURN FOR 2019/20

7.1 Due to investment concerns with both counterparty risk and low investment returns, no new borrowing was undertaken during the year.

7.2 No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

7.3 The Council’s external borrowing from the PWLB at 31 March 2020 remained at £67.456m at a fixed rate of 3.48% and matures on 28 March 2062.

8.0 **INVESTMENT OUTTURN FOR 2019/20**

8.1 **Investment Policy** – the Council's investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council on 27 February 2019. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.

8.2 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

8.3 Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources (£'000)	**31 March 2019**	**31 March 2020**
Balances	18,928	22,265
Earmarked reserves	8,902	8,213
Major Repairs Reserve	4,684	3,586
Capital Grants and Contributions	2,707	2,992
Usable capital receipts	4,959	3,061
Total	**40,180**	**40,117**

8.4 The Council held average treasury investment balances of £42.7m which were mainly internally managed and achieved an average rate of return of 0.949% compared with the average 3 Month London Interbank Bid (LIBID) rate of 0.634%.

The Council also held average non-treasury investment balances (excluding equity) of £3m. The Council has issued four loans totalling £3.23m to Welland Homes Limited, which is the Council's wholly owned Housing Development Company. These are service loans (classified as long term debtors) and the Council receives interest of 3.5% on these loans which is payable on a quarterly basis. Total interest earned during the year was £107,761.

The combined rate of return on all investments averaged 0.956%.

8.5 Actual investment interest earned during 2019/20 was £516k which was broadly in line with the original budget of £520k.

9.0 THE ECONOMY AND INTEREST RATES (commentary provided by Link Asset Services - external treasury advisors)

9.1 **UK. Brexit.** The main issue in 2019 was the repeated battles in the House of Commons to agree on one way forward for the UK over the issue of Brexit. This resulted in the resignation of Teresa May as the leader of the Conservative Government and the election of Boris Johnson as the new leader, on a platform of taking the UK out of the EU on 31 October 2019. The House of Commons duly frustrated that renewed effort and so a general election in December settled the matter once and for all by a decisive victory for the Conservative Party: that then enabled the UK to leave the EU on 31 January 2020. However, this still leaves much uncertainty as to whether there will be a reasonable trade deal achieved by the target deadline of the end of 2020. It is also unclear as to whether the coronavirus outbreak may yet impact on this deadline; however, the second and third rounds of negotiations have already had to be cancelled due to the virus.

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

After the Monetary Policy Committee raised **Bank Rate** from 0.5% to 0.75% in August 2018, due to Brexit uncertainty the MPC chose not to act until March 2020; at this point it was abundantly clear that the coronavirus outbreak posed a huge threat to the economy of the UK. Two emergency cuts in Bank Rate from 0.75% occurred in March, first to 0.25% and then to 0.10%. These cuts were accompanied by an increase in **quantitative easing** (QE), essentially the purchases of gilts (mainly) by the Bank of England of £200bn. The Government and the Bank were also very concerned to stop people losing their jobs during this lock down period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs for three months while the country was locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lock down period when some firms may have little or no income. However, at the time of writing, this leaves open a question as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services. At the time of writing, this is a rapidly evolving situation so there may be further measures to come from the Bank and the Government in April and beyond. The measures to support jobs and businesses already taken by the Government will result in a huge increase in the annual budget deficit in 2020/21 from 2%, to nearly 11%. The ratio of debt to GDP is also likely to increase from 80% to around 105%. In the Budget in March, the Government also announced a large increase in spending on infrastructure; this will also help the economy to recover once the lock down is ended. Provided the coronavirus outbreak is brought under control relatively swiftly, and the lock down is eased, then it is hoped that there would be a sharp recovery, but one that would take a prolonged time to fully recover previous lost momentum.

Inflation has posed little concern for the MPC during the last year, being mainly between 1.5 – 2.0%. It is also not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil which has fallen sharply in price. Other prices will also be under downward pressure while wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.

Employment had been growing healthily through the last year but it is obviously going to be adversely affected by the Coronavirus during 2020/21. The good news over the last year is that wage inflation has been significantly higher than Consumer Price Index (CPI) inflation which means that consumer real spending power had been increasing and so will have provided support to GDP growth. However, Coronavirus restrictions will have had a major impact on retail during the start of 2020/21.

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

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

However, all this will not stop the US falling into a sharp recession in quarter 2 of 2020.

9.3 **EUROZONE**. The annual rate of GDP growth has been steadily falling, from 1.8% in 2018 to only 0.9% y/y in quarter 4 in 2019. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in Eurozone (EZ) growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), prompted the ECB to take new measures to stimulate growth. At its March 2019 meeting it announced a third round of Targeted Longer-Term Refinancing Operations (TLTROs); this provided banks with cheap two year maturity borrowing every three months from September 2019 until March 2021. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting in September 2019, it cut its deposit rate further into negative territory, from -0.4% to -0.5% and announced a resumption of quantitative easing purchases of debt to start in November at €20bn per month, a relatively small amount, plus more TLTRO measures. Once coronavirus started having a major impact in Europe, the ECB took action in March 2020 to expand its QE operations and other measures to help promote expansion of credit and economic growth. What is currently missing is a coordinated EU response of fiscal action by all national governments to protect jobs, support businesses directly and promote economic growth by expanding government expenditure on e.g. infrastructure; action is therefore likely to be patchy.

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

9.5 **JAPAN** - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It appears to have missed much of the domestic impact from coronavirus in 2019/20 but the virus is at an early stage there.

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

10.0 OPTIONS

10.1 There are no alternative options presented.

11.0 REASONS FOR RECOMMENDATION

11.1 To comply with the Chartered Institute of Public Finance and Accountancy’s Code of Practice on Treasury Management 2017.

12.0 EXPECTED BENEFITS

12.1 The report provides Members with a summary of the economy, the effect it has had on financial markets and the treasury activity during 2019/20. The report requires scrutiny prior to submitting to Council for approval.

13.0 IMPLICATIONS

13.1 Constitution & Legal

13.1.1 This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2019/20. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

13.1.2 The Council’s financial strategy, capital financing and borrowing all form part of the Policy Framework and are therefore non-executive matters that fall within the remit of the full Council.

13.2 **Financial**

13.2.1 The report provides details of the treasury activity for the 2019/20 financial year to inform members on performance and to highlight any changes in the year.

13.2.2 Total interest received was £516k with £355k to the General Fund and £161k to the Housing Revenue Account. This was broadly in line with budget.

13.3 **Risk Management**

13.3.1 The Council's investment policy has regard to the MHCLG Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are security first, liquidity second, then return.

14.0 **WARDS/COMMUNITIES AFFECTED**

14.1 Due to budgetary considerations all wards are affected.

15.0 **ACRONYMS**

15.1 PSPS – Public Sector Partnership Services Ltd
15.2 CIPFA – Chartered Institute of Public Finance and Accountancy
15.3 HRA – Housing Revenue Account
15.4 CFR – Capital Financing Requirement
15.5 PWLB – Public Works Loan Board
15.6 MRP – Minimum Revenue Provision
15.7 VRP – Voluntary Revenue Provision
15.8 MHCLG – Ministry of Housing, Communities and Local Government
15.9 EU – European Union
15.10 GDP – Gross Domestic Product
15.11 MPC – Monetary Policy Committee
15.12 LIBID – London Interbank Bid Rate
15.13 QE - Quantitative Easing
15.13 CPI – Consumer Price Index
15.14 ECB – European Central Bank
15.15 EZ – Eurozone
15.16 TLTRO - Targeted Longer-Term Refinancing Operations

Background papers: - SHDC Treasury Management Strategy Statement 2019/20

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Key Decision: No

Exempt Decision: No

This report refers to a Mandatory Service

Appendices attached to this report: None