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AUDIT COMMITTEE

30 JULY 2020

TREASURY MANAGEMENT OUTTURN ANNUAL REPORT

Report from: Phil Watts, Chief Finance Officer
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Summary

This report gives an overview of treasury management activity during 2019/20. During 2019/20, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and treasury indicators	2018/19 Actual (restated) £000	2019/20 Per Strategy £000	2019/20 Actual £000
Capital expenditure			
• Non-HRA	46,106	52,641	76,602
• HRA	3,771	5,027	5,602
• Total	49,877	57,668	82,204
Capital Financing Requirement:			
• Non-HRA	289,271	278,046	344,522
• HRA	41,328	42,178	41,002
External debt (principal only)	250,320	299,082	287,660
Investments:			
• Longer than 1 year	0	n/a	0
• Property Funds (redemption value)	22,720	22,999	21,960
• Under 1 year	18,380	32,038	47,510
• Total	41,100	55,037	69,470
Net borrowing	209,220	244,045	218,190

Investments ‘per 19/20 strategy’ based on 15 November 2018 actual.
Capital Financing Requirement 18/19 restated following review by Link Asset Services.

Other prudential and treasury indicators are to be found in the main body of this report. The Chief Finance Officer also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit, (the authorised limit), was not breached. The financial year 2019/20 continued the challenging investment environment of previous years, namely low investment returns.

1. Budget and Policy Framework

1.1. The Council's treasury management strategy and policy are approved by Full Council following consideration by Cabinet and Audit Committee. The Audit Committee is responsible for approving the annual treasury outturn. In line with the Constitution an annual report must be taken to Cabinet detailing the Council's treasury management outturn within six months of the close of each financial year. The Cabinet considered this report on 7 July 2020.

2. Background

2.1. This Council is required by regulations issued under the Local Government Act 2003 to produce an annual review of treasury management 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).

2.2. During 2019/20 the minimum reporting requirements were that the full Council should receive the following reports:

- An annual treasury strategy in advance of the year (Council 21 February 2019).
- A mid-year treasury review report (Council 10 October 2019).

2.3. The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is 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.

2.4. This Council also confirms that it has complied with the requirements under the Code to give prior scrutiny to all of the above treasury management reports by the Audit Committee before they were reported to the full Council. Member training on treasury management issues was undertaken on 26 September 2019 in order to support members' scrutiny role.

2.5. This annual treasury outturn report summarises:

- 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 this indebtedness and the impact on investment balances
- Summary of interest rate movements in the year
- Detailed debt activity
- Detailed investment activity

3. The Council's Capital Expenditure and Financing

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 table below shows the actual capital expenditure all of which was financed during the year.

£m General Fund	2018/19 Actual £000's	2019/20 Per Strategy £000's	2019/20 Actual £000's
Capital expenditure	46,106	52,641	76,602
Financed in year (from receipts, grants, revenue contributions etc.)	27,925	10,677	21,351
Unfinanced (requiring borrowing)	**18,181**	**41,964**	**55,251**

£m HRA	2018/19 Actual £000's	2019/20 Per Strategy £000's	2019/20 Actual £000's
Capital expenditure	3,771	6,027	5,602
Financed in year	3,771	6,027	5,602
Unfinanced (requiring borrowing)	**0**	**0**	**0**

4. 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 of 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, treasury officers in Finance Strategy and Finance Operations organise 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 through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB], or the money markets), or utilising temporary cash resources within the Council.

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 broadly that capital assets are 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-Housing Revenue Account (HRA) borrowing need, (there is no statutory requirement to reduce the HRA CFR – though Medway's policy is to provide MRP on HRA borrowing). 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.

4.4. 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 Voluntary Revenue Provision (VRP).

4.5. The Council's 2019/20 MRP Policy (as required by MHCLG Guidance), was approved as part of the Treasury Management Strategy 2019/20 on 21 February 2019.

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

CFR (£m): General Fund (includes £20m designated for commercial activities/ non-financial investments)	31 March 2019 Actual (restated) £000	31 March 2020 Per Strategy £000	31 March 2020 Actual £000
Opening balance	272,658	239,780	289,271
Add unfinanced capital expenditure (as above)	18,182	41,964	55,251
Less MRP*	1,569	3,698	0
Closing balance	289,271	278,046	344,522

*MRP for 2019/20 was adjusted to just £1 based on a report by our treasury advisors, Link Asset Services; this identified historic errors in the calculation of CFR and therefore MRP provision. The reduction of MRP over the forthcoming years restores the correct position.

CFR (£m): HRA	31 March 2019 Actual £000	31 March 2020 Budget £000	31 March 2020 Actual £000
Opening balance	41,641	42,504	41,328
Add unfinanced capital expenditure (as above)	0	0	0
Less VRP	313	326	326
Closing balance	41,328	42,178	41,002

4.7. Borrowing activity is constrained by prudent indicators for gross borrowing and the CFR and by the authorised limit.

4.8. *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 capital financing requirement of the preceding year (2019/20) plus the estimates of any additional capital financing requirement for the current (2010/21) and the 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 needs. 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 Per Strategy £000**	**31 March 2020 Actual £000**
Gross borrowing position (principal)	250,320	299,083	287,660
CFR (General Fund)	289,271	320,244	344,522
Under- funding of CFR	38,951	21,161	56,862

4.9. *The authorised limit* – 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 table in 4.10 below demonstrates that during 2019/20 the Council has maintained gross borrowing within its authorised limit.

4.10. *The operational boundary* – 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 are acceptable subject to the authorised limit not being breached.

4.11. *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 £000
Authorised limit	462,797
Maximum gross borrowing position during the year	287,660
Operational boundary	420,724
Average gross borrowing position	290,703
Financing costs as a proportion of net revenue stream (General Fund)	4.02%
Financing costs as a proportion of net revenue stream (HRA)	14.49%

5. Treasury Position as at 31 March 2020

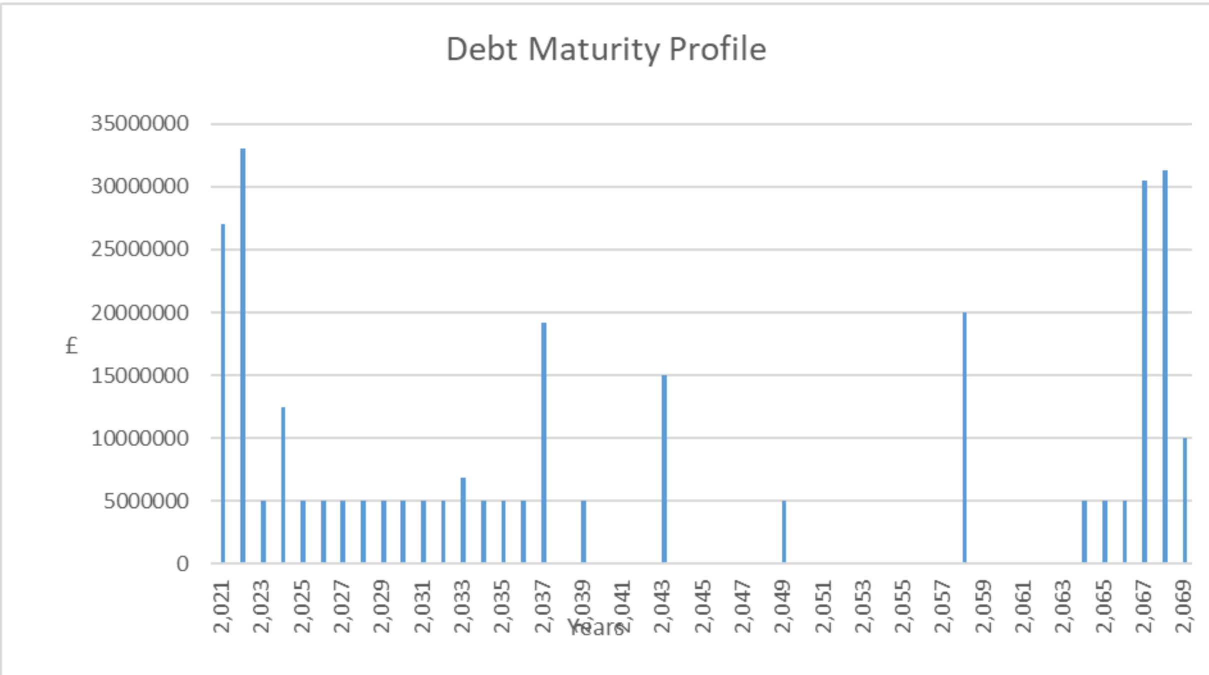
5.1. The Council's treasury management debt and investment position is organised by the treasury management officers in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2019/20 the Council's treasury, was as follows:

Borrowing and investment levels:

	31/03/19 £m	Rate	31/03/20 £m	Rate
Long Term Borrowing – PWLB/LOBO*	192.30	3.60%	230.3	3.39%
Long Term Borrowing – Other Local Authority	10.00	1.50%	30.00	1.58%
Long Term Borrowing – Growing Places/Salix/LEP	7.96		5.33	
Finance Leases	0.06		0.03	
Short Term Borrowing	40.00	0.89%	22.00	0.93%
Total Debt (Principal)	250.32		287.66	
Capital Financing Requirement (CFR)	289.27		344.52	
(Under)/Over Borrowing	*(38.95)*		*(56.86)*	
Less investments (exc. Property Funds)	18.38	1.22%	47.51	0.88%
Less Property Fund Investments **	22.72	5.88%	21.96	0.95%
Net borrowing	209.22		218.19	

* 31/3/18Includes £2m advanced in 2001 repaid in November 2019

** The return on the property fund investments includes the change in capital value.



5.2. The Ministry of Housing, Communities and Local Government (MHCLG) guidance since 2011 has been to show the maturity date for Lenders Options, Borrowers Options (LOBOs) as the next call date. The table does not follow this guidance because the rates payable on the Council's LOBOs far exceeds current market rates. As such it is considered extremely unlikely that lenders would exercise their rights to vary the interest rate and therefore the Council would not be afforded the opportunity to redeem. LOBOs have therefore been shown as maturing at their full term.

5.3. Upper limits for the proportion of debt maturing within various bands of years were set at the start of the year as shown below. There was no breach of these limits.

Maturity Structure of Fixed rate Borrowing during 2019/20	Upper Limit	Lower Limit
under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	0%

5.4. The investment portfolio is shown below. All investments were for up to one year. Balances at 31 March 2019 were usually high due to borrowing taken out at the start of the Covid-19 pandemic and substantial related government grant receipts.

INVESTMENT PORTFOLIO	Actual 31/03/19 £000	Actual 31/03/19 %	Actual 31/03/20 £000	Actual 31/03/20 %
Treasury investments				
Banks	1,295	3.16	40,665	58.45
Local authorities	10,000	24.44	0	0
Total managed in house	**11,295**	**27.60**	**40,665**	**58.45**
Property funds	22,720	55.52	21,960	31.56
Cash fund managers	6,909	16.88	6,953	9.99
Total managed externally	**29,629**	**72.4**	**28,913**	**41.55**
TOTAL TREASURY INVESTMENTS	**40,924**	**100%**	**69,578**	**100%**

5.5. Property fund investment and income are summarised below

	CCLA £000	Lothbury £000	Patriza £000	Total £000
Opening Value	12,606	4,940	5,177	22,723
Revaluation	(451)	(166)	(128)	(745)
Closing Value	12,155	4,774	5,049	21,978
Dividend Received	418	256	116	790
Accrued Dividend	135	0	38	173
Total Dividend	553	256	154	963
Overall Gain/ (Loss)	102	90	26	218

6. The Strategy for 2018/19

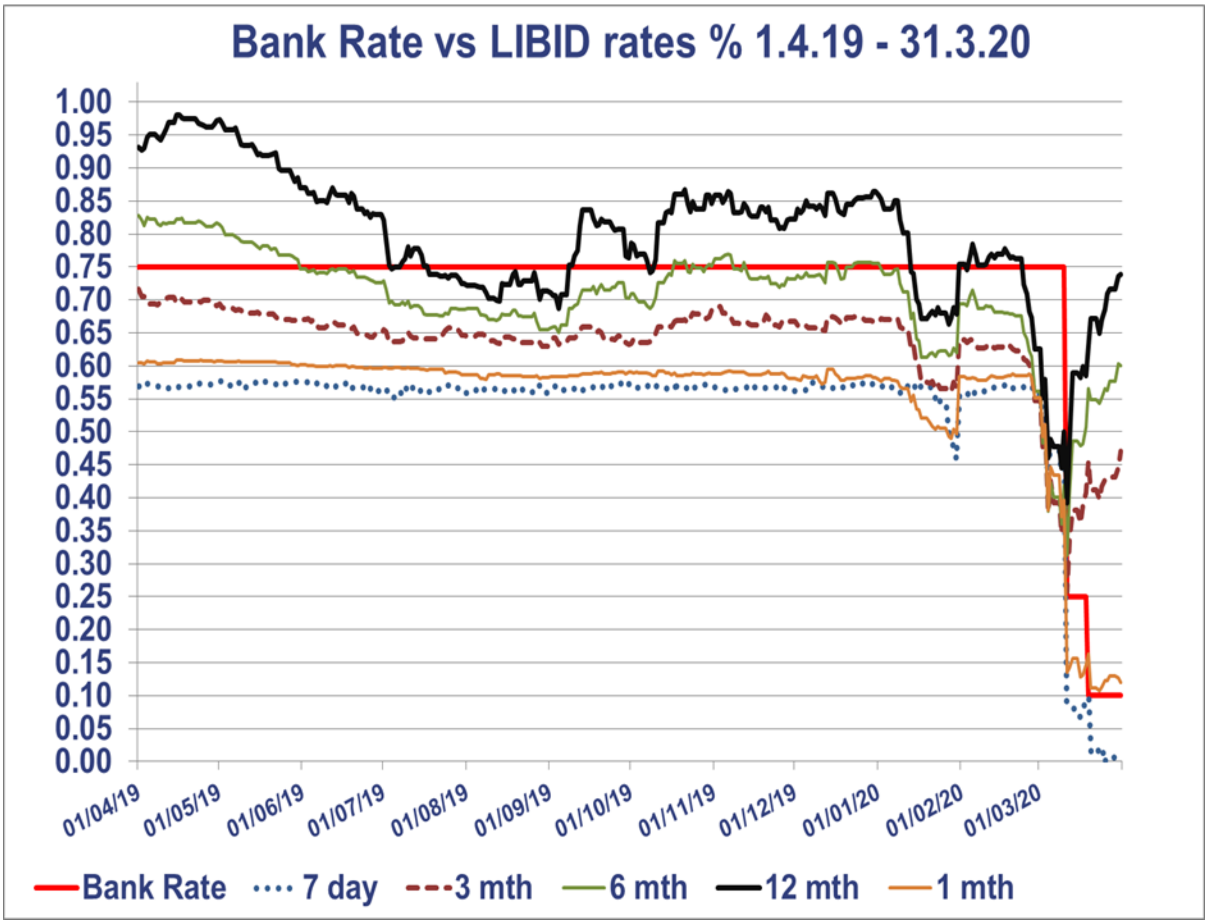
6.1. The strategy for 2018/19 as set out before the start of the year was to continue to use cash balances to meet funding requirements but where necessary to use short term borrowing to fund borrowing. However when drafting the strategy for 2019/20 emphasis was changed to reducing reliance on short term borrowing and for borrowing requirements to be met by taking longer term loans. At the same time long term borrowing would be structured so as to smooth out the maturity profile of debt. This process commenced towards the end of 2018/19 hence the increase in long term borrowing and reduction in short term loans.

6.2. **Investment strategy and control of interest rate risk**

6.2.1. 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 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. Shorter term investment interest rates were fairly flat during most of the year until the two cuts in Bank Rate in March 2020 caused investment rates to fall sharply.

6.2.2. Generally this authority does not have sufficient cash balances to be able to place deposits for more than a month so as to earn higher rates from longer deposits. 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.

6.2.3. Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing as far as possible, rather than borrowing externally from the financial markets. Higher 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.



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.75	0.58	0.61	0.72	0.83	0.98
High Date	01/04/2019	09/05/2019	15/04/2019	01/04/2019	01/04/2019	15/04/2019
Low	0.10	0.00	0.11	0.26	0.31	0.39
Low Date	19/03/2020	25/03/2020	23/03/2020	11/03/2020	11/03/2020	11/03/2020
Average	0.72	0.53	0.56	0.63	0.70	0.80
Spread	0.65	0.58	0.50	0.46	0.52	0.59

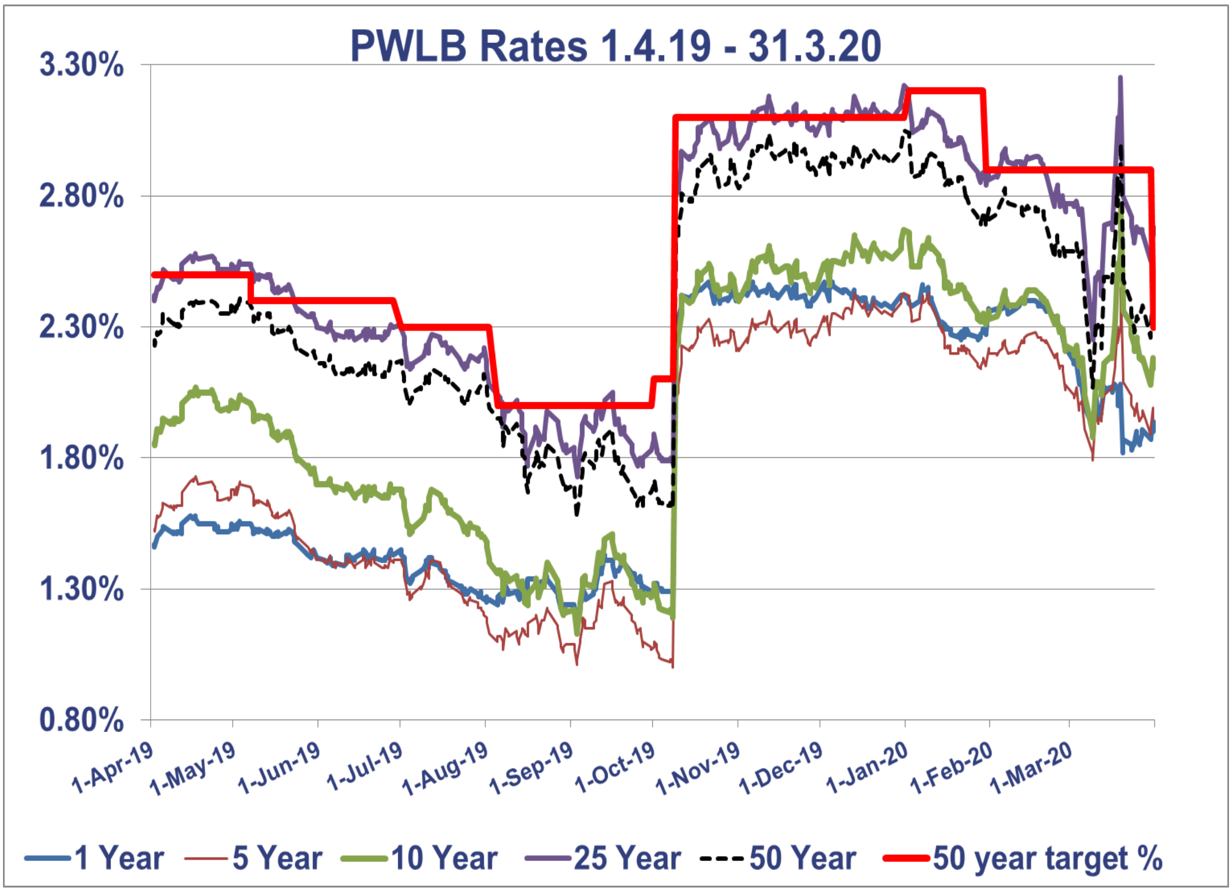
Link Asset Services Interest Rate View 31.3.20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month LIBID	0.45	0.40	0.35	0.30	0.30	0.30	0.30	0.30
6 Month LIBID	0.60	0.55	0.50	0.45	0.40	0.40	0.40	0.40
12 Month LIBID	0.75	0.70	0.65	0.60	0.55	0.55	0.55	0.55
5yr PWLB Rate	1.90	1.90	1.90	2.00	2.00	2.00	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50

6.3. Borrowing Strategy and control of interest rate risk

6.3.1. 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. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

6.3.2. 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.

6.3.3. The strategy for 2019/20 had been to take longer term loans to reduce interest rate exposure and to smooth the maturity profile of the debt portfolio. However a sudden and unexpected hike in PWLB rate policy on 9 October forced a reversal of this approach in the latter part of the year resulting in a higher proportion of debt maturing in the 2020/21 and 2021/22 than originally planned. (See table at 5.1 above). *P*WLB rates over the year were as follows:



7. Borrowing Outturn for 2019/20

7.1. The borrowing strategy for the Council confirmed the holding of £101.8 million in Lenders Options, Borrowers Options (LOBO) debt. These are debts that are subject to immediate repayment or variation of interest chargeable and the option to repay, on request from the lender on the review dates. However, the lender can only apply this clause once within the lifetime of the LOBO.

7.2. New long term PWLB loans totalling £40 million were taken out and a further £23 million from other local authorities.

7.3. The Council continued to use cash balances to finance new capital expenditure when possible so as to run down cash balances and minimise counterparty risk incurred on investments. This also maximised treasury management budget savings, as investment rates were much lower than most new borrowing rates. Details of the short term borrowing at 1 April 2019 is shown in the table below:

Lender	Amount Borrowed £m	Date Borrowed	Date Repaid	Annual Interest Rate (Inc. Brokerage)
North East Combined Authority	10.0	26/4/18	25/4/19	1.0%
Tees Valley Combined	5.0	28/6/18	27/6/18	0.85%
Gloucestershire County Council	5.0	28/6/18	27/6/19	0.85%
Middlesbrough Teeside Pension Fund	10.0	25/7/18	2/7/19	0.85%
London Borough of Bromley	10.0	2/11/18	1/11/19	1.19%
Total Short Term Borrowing at 1 April 2019	40.0			

7.4. New loans taken during 2018/19 but repaid before 31 March 2019 were:

Lender	Amount Borrowed £m	Date Borrowed	Repayment Date	Annual Interest Rate (inc brokerage)
Vale of Glamorgan Council	3.0	8/7/19	9/8/19	0.7%
Staffordshire Police & Crime Commissioner	5.0	26/7/19	27/8/19	0.71%
West Mercia Police & Crime Commissioner	2.0	5/7/19	27/9/19	0.69%
Wychavon District Council	5.0	31/10/19	17/3/20	0.79

7.5. The following short term loans taken out during 2018/19 were still outstanding at 31 March 2019:

Lender	Amount Borrowed £m	Date Borrowed	Repayment Date	Annual Interest Rate (inc brokerage)
Derbyshire County Pension Fund	5.0	20/3/20	20/4/20	1.05%
Cambridgeshire & Peterborough Combined Authority	5.0	23/9/19	21/9/20	0.85%
Trafford Council	3.0	14/10/19	12/10/20	1.35%
North Hertfordshire District Council	2.0	8/11/19	6/11/20	1.35%
London Borough of Merton	5.0	6/12/19	4/12/20	1.20%
Tewkesbury Borough Council	2.0	19/12/19	17/12/20	1.10%
Rugby Borough Council	5.0	16/3/20	16/3/21*	1.18%
Total Short Term Borrowing at 31 March 2019	27.0			

* part of a back to back loan arrangement. Loan renews on 16/3/21 for a further year at a rate of 1.86%

8. Debt Rescheduling

8.1. No debt restructuring was undertaken during 2019/20 as the average differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

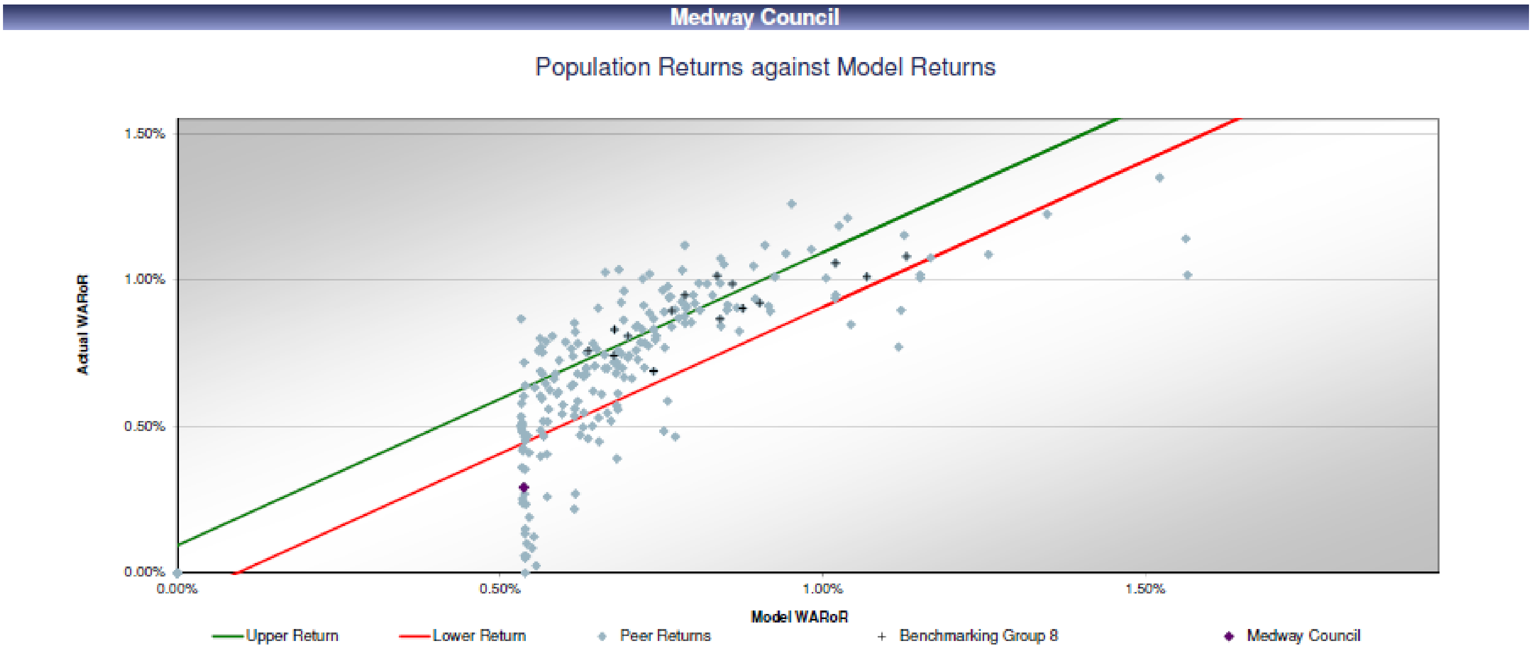
9. Investment Outturn for 2019/20

9.1. **Investment Policy** – the Council’s investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by the Council on 21 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 and credit default swaps).

9.2. The average balance held in bank accounts and money market funds during the year was £19.967m producing an overall return of 0.67%. This money is held primarily for cash flow purposes and therefore does not benefit from higher rates obtainable for longer term deposits.

9.3. The remaining longer term loans to other authorities were redeemed during the year. The average balance was £6.8m return on these funds for the whole year was 1.52%

9.4. The redemption of the long term loans has caused the Council’s performance relative to our peer group to fall as shown by the graph below which is a snapshot produced by Link Asset Services as at March 2020. Medway is the bold dot below the red line.



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Medway Council	0.29%	0.54%	-0.24%	0.44%	0.63%	Below

10. Compliance with Treasury Limits

10.1. There were no breaches of treasury limits in 2019-20.

11. Risk Management

11.1. Risk and the management thereof is a key feature throughout the strategy and in detail within the treasury management practices (TMP1) within the Treasury Strategy.

12. Financial Implications

12.1. Overall the Interest and Financing budget made a surplus over its targeted budget of £5,348,000.

12.2. A breakdown of the Interest and Financing budget is shown below:

Interest and Finance Budget against spend:

	Budget 2019/20 £000	**Actual 2019/20 £000**	**(Under)/ Overspend £000**
Interest Earned	(3,464)	(3,227)	237
Interest Paid	11,611	10,196	(1,415)
KCC Principal	1,361	1,361	0
MRP	4,107	0	(4,107)
Treasury Advice	70	178	107
Brexit Grant	(104)	(275)	(170)
Total	**13,581**	**8,233**	**(5348)**

12.3. The underspend on MRP follows a report by Link Asset Services which concluded that provision in previous years had been too high so just £1 has been charged as MRP in 2019/20 to redress the balance. The cost of the report has been charged to Treasury Advice, accounting for the overspend on that heading.

12.4. The underspend in interest paid is due to the timing and amounts of borrowing and also the increased use of intra-authority in recent months as a reaction to the hike in PWLB rates.

12.5. The body of the report outlines the significant financial implications. Any transactions undertaken on either investments or borrowings are governed by the London Code of Conduct, the Council's treasury policy statement, and the CIPFA Code of Practice on Treasury Management in Local Authorities.

13. Legal implications

13.1. For the financial year 2019/20 our investments were managed in compliance with the Codes of Practices, guidance and regulations made under the Local Government Act 2003.

14. Recommendation

14.1. The Committee is asked to approve this treasury management outturn annual report.

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Appendices

Appendix 1 Commentary by Link Asset Services on The Economy and Interest Rates
Appendix 2 Glossary of Terms

Background papers

None

Appendix 1

Commentary by Link Asset Services on The Economy & Interest Rates

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 minority 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 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, Brexit uncertainty caused the MPC to sit on its hands and to do nothing until March 2020; at this point it was abundantly clear that the coronavirus outbreak posed a huge threat to the economy of the UK. Two emergency cuts in Bank Rate from 0.75% 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 is locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lock down period when some firms may have little or no income. However, at the time of writing, this leaves open a question as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services. 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 heading for a big hit in March – April 2020. The good news over the last year is that wage inflation has been significantly higher than CPI inflation which means that consumer real spending power had been increasing and so will have provided support to GDP growth. However, while people cannot leave their homes to do non-food shopping, retail sales will also take a big hit.

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

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

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

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 EZ growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), prompted the ECB to take new measures to stimulate growth. At its March 2019 meeting it announced a third round of TLTROs; 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.

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

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

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

Appendix 2

Glossary of Terms

(not all of these abbreviations have been used in this report)

ALMO: an Arm's Length Management Organisation is a not-for-profit company that provides housing services on behalf of a local authority. Usually an ALMO is set up by the authority to manage and improve all or part of its housing stock.

LAS: Link Asset Services, Treasury solutions – the council's treasury management advisers.

CE: Capital Economics - is the economics consultancy that provides Link Asset Services, Treasury solutions, with independent economic forecasts, briefings and research.

CFR: capital financing requirement - the council's annual underlying borrowing need to finance capital expenditure and a measure of the council's total outstanding indebtedness.

CIPFA: Chartered Institute of Public Finance and Accountancy – the professional accounting body that oversees and sets standards in local authority finance and treasury management.

CPI: consumer price index – the official measure of inflation adopted as a common standard by countries in the EU. It is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them.

ECB: European Central Bank - the central bank for the Eurozone
EU: European Union
EZ: Eurozone -those countries in the EU which use the euro as their currency

Fed: the Federal Reserve System, often referred to simply as "the Fed," is the central bank of the United States. It was created by the Congress to provide the nation with a stable monetary and financial system.

FOMC: the Federal Open Market Committee – this is the branch of the Federal Reserve Board which determines monetary policy in the USA by setting interest rates and determining quantitative easing policy. It is composed of 12 members--the seven members of the Board of Governors and five of the 12 Reserve Bank presidents.

GDP: gross domestic product – a measure of the growth and total size of the economy.

G7: the group of seven countries that form an informal bloc of industrialised democracies--the United States, Canada, France, Germany, Italy, Japan, and the United Kingdom--that meets annually to discuss issues such as global economic governance, international security, and energy policy.

Gilts: gilts are bonds issued by the UK Government to borrow money on the financial markets. Interest paid by the Government on gilts is called a coupon and is at a rate that is fixed for the duration until maturity of the gilt, (unless a gilt is index linked to inflation); while the coupon rate is fixed, the yields will change inversely to the price of gilts i.e. a rise in the price of a gilt will mean that its yield will fall.

HRA: housing revenue account.

IMF: International Monetary Fund - the lender of last resort for national governments which get into financial difficulties.

LIBID: the London Interbank Bid Rate is the rate bid by banks on deposits i.e., the rate at which a bank is willing to borrow from other banks. It is the "other end" of the LIBOR (an offered, hence "ask" rate, the rate at which a bank will lend).

MHCLG: the Ministry of Housing, Communities and Local Government -the Government department that directs local authorities in England.

MPC: the Monetary Policy Committee is a committee of the Bank of England, which meets for one and a half days, eight times a year, to determine monetary policy by setting the official interest rate in the United Kingdom, (the Bank of England Base Rate, commonly called Bank Rate), and by making decisions on quantitative easing.

MRP: minimum revenue provision -a statutory annual minimum revenue charge to reduce the total outstanding CFR, (the total indebtedness of a local authority).

PFI: Private Finance Initiative – capital expenditure financed by the private sector i.e. not by direct borrowing by a local authority.

PWLB: Public Works Loan Board – this is the part of H.M. Treasury which provides loans to local authorities to finance capital expenditure.

QE: quantitative easing – is an unconventional form of monetary policy where a central bank creates new money electronically to buy financial assets, such as government bonds, (but may also include corporate bonds). This process aims to stimulate economic growth through increased private sector spending in the economy and also aims to return inflation to target. These purchases increase the supply of liquidity to the economy; this policy is employed when lowering interest rates has failed to stimulate economic growth to an acceptable level and to lift inflation to target. Once QE has achieved its objectives of stimulating growth and inflation, QE will be reversed by selling the bonds the central bank had previously purchased, or by not replacing debt that it held which matures. The aim of this reversal is to ensure that inflation does not exceed its target once the economy recovers from a sustained period of depressed growth and inflation. Economic growth, and increases in inflation, may threaten to gather too much momentum if action is not taken to ‘cool’ the economy.

RPI: the Retail Price Index is a measure of inflation that measures the change in the cost of a representative sample of retail goods and services. It was the UK standard for measurement of inflation until the UK changed to using the EU standard measure of inflation – CPI. The main differences between RPI and CPI is in the way that housing costs are treated and that the former is an arithmetical mean whereas the latter is a geometric mean. RPI is often higher than CPI for these reasons.

TMSS: the annual treasury management strategy statement reports that all local authorities are required to submit for approval by the full council before the start of each financial year.

VRP: a voluntary revenue provision to repay debt, in the annual budget, which is additional to the annual MRP charge, (see above definition).