

COUNCIL

8 OCTOBER 2020

TREASURY MANAGEMENT STRATEGY MID-YEAR REVIEW REPORT 2020/21

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Summary

This report gives an overview of treasury management activity since 1 April 2020 and presents a review of the Treasury Strategy approved by Council on 20 February 2020.

The key indicators are set out in the table below (further information is set out in section 10 of the report):

Indicator	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 onwards £000
Capital Expenditure*	109,260	145,743	118,108	55,570
Capital Financing Requirement (CFR) at year end**	383,353	486,277	536,240	530,238
External Borrowing	347,569	450,493	500,456	494,454
Underborrowing***	35,784	35,784	35,784	35,784

*Capital expenditure is as approved by Council up to July 2020

** CFR takes account of the MRP overprovision identified from previous years

*** External borrowing assumes that repayments are refinanced so the gap between external borrowing and CFR remains constant

1. Budget and Policy Framework

1.1 Audit Committee is responsible for the scrutiny of the Council's Treasury Management, Investment Strategy and Minimum Revenue Provision Policy Statement along with Treasury Management Practices and associated Schedules.

- 1.2 There needs to be, as a minimum, a mid-year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved.
- 1.3 This report has been considered by the Cabinet on 22 September 2020 and the Audit Committee on 24 September 2020.

2. Background

- 2.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensures this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially, before looking to maximise investment return.
- 2.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing requirements of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending liabilities. This management of longer-term cash may involve arranging long or short-term loans, or using long-term cash flow surpluses, and on occasion, debt previously incurred may be restructured to meet Council risk or cost objectives.
- 2.3 As a consequence treasury management is defined as:
"The management of the local authority's 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."
- 2.4 The principal requirements of the Code are as follows:
- (i) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities
 - (ii) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives
 - (iii) Receipt by full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities undertaken during the previous year
 - (iv) 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
 - (v) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific committee. For this Council the delegated body is the Audit Committee.

- 2.5 This mid year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy (Section 3)
 - A review of the Council's borrowing strategy for 2020/21 (Section 4)
 - A review of the Council's investment portfolio for 2020/21 (Section 5)
 - A review of any debt rescheduling undertaken during 2020/21 (Section 6)
 - A review of compliance with Treasury and Prudential Limits for 2020/21. (Section 7)
 - An economic update for the first part of 2020/21 (Appendix).

3. Treasury Management Strategy Statement and Annual Investment Strategy Update

- 3.1 Full Council approved the 2020/21 Treasury Management Annual Investment Strategy on the 20 February 2020.
- 3.2 The Strategy stated that officers would aim to smooth out the maturity profile and reduce reliance on short term debt. The current position is shown in the graph at 4.10. The decision by the Public Works Loan Board (PWLB) to increase borrowing rates by 1% in the autumn of 2019 has led to a resurgence in shorter term borrowing. It is hoped that following the government consultation of PWLB rates that these rates will be eased and further progress towards smoothing the profile can be made. However, borrowing for projects expected to generate capital receipts in a short timescale, such as those undertaken by Medway Development Company, will require shorter periods than that taken for other projects.

4. Borrowing & Borrowing Limits

- 4.1 The purpose of the Capital Financing Requirement (CFR) is to demonstrate that Council borrowing is undertaken to fund capital expenditure only. The CFR represents the long term assets of the Council that have not been funded from sources other than borrowing, such as grants and external contributions, capital receipts or revenue funding. External borrowing should not exceed the CFR over the medium term. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.
- 4.2 The CFR reported in the Treasury Outturn at the July 2020 Audit Committee was based on a value at 1 April 2020 of £385,525,000. The figure included in the Draft Statement of Accounts is £323,444,000. The Treasury Outturn figure was based on part of a report by advisors Link Asset Services. Following further discussions with Link, officers are satisfied that the higher figure arose from a mis-interpretation of the data in the report. The Council remained

under-borrowed even after this error was corrected. Furthermore, the error did not invalidate the report's conclusion that the Council had made past overprovision from revenue for the repayment of borrowing (MRP).

- 4.3 An updated estimate of the CFR and borrowing position compared with the estimate included in the Treasury Strategy is shown in the table below:

CFR Position	Per Strategy £000	Revised Estimate £000
CFR 31 March 2021*	451,571	383,353
External Debt**	399,288	347,569
Under-borrowing	52,283	34,784
Estimated In Year Borrowing Required**	92,459	59,909

*The downward revision in closing CFR arises mainly from the change in the opening value described in 4.2 above.

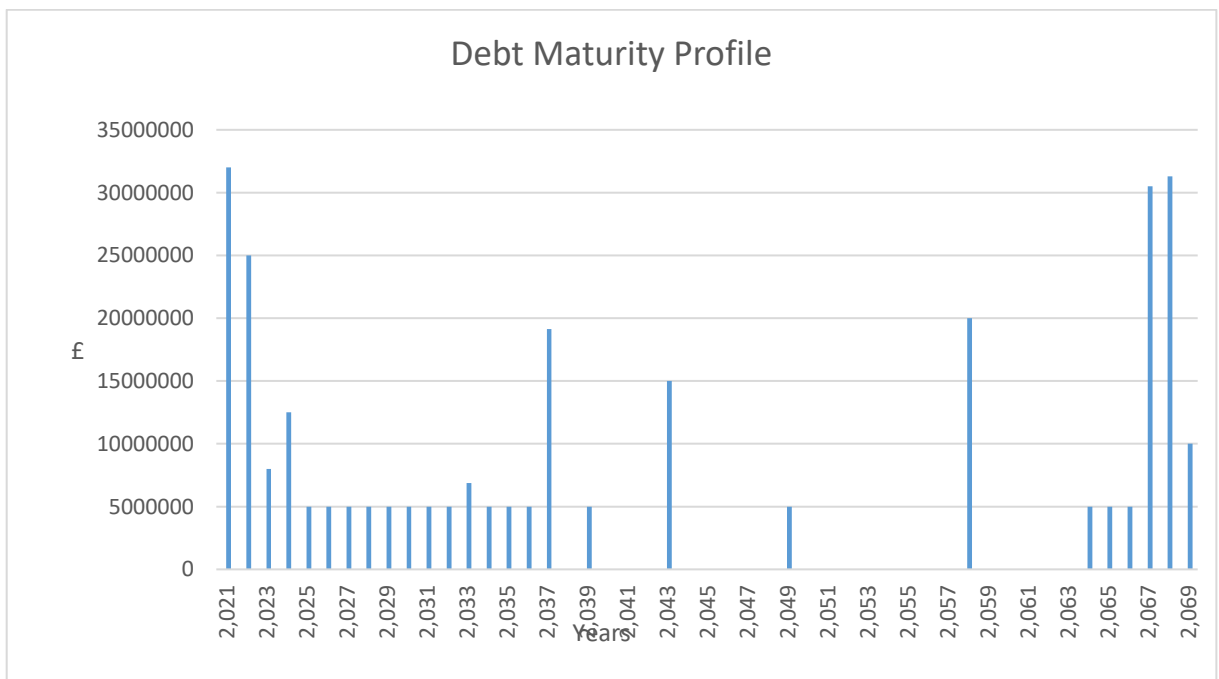
**The lower external debt and in-year borrowing requirement estimates arise from the evolution of the capital programme including changes to profiling and funding since the Strategy was formulated in late 2019.

- 4.4 The Chief Finance Officer reports that no difficulties are envisaged for the current or future years in ensuring that borrowing does not exceed CFR.
- 4.5 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit, which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in longer-term scenario. It is a forecast of maximum borrowing requirement with some capacity for unexpected movements. This is the statutory limit determined under section 3(1) of the Local Government Act 2003. The Council's authorised borrowing limit for 2020/21 is £607.278 million and it will not exceed this limit.
- 4.6 Recent strategy has been to reduce interest rate risk and smooth the borrowing repayment profile by taking out new borrowing for longer repayment terms. Progress towards this aim has been limited by the factors noted in 3.2 above.
- 4.7 Link's current forecast of interest rates are as follows:

	Sept 20	Dec 20	March 21	June 21	Sept 21	Dec 21	Mar 22	Jun 22
Bank rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
5 yr PWLB	1.90%	1.90%	2.00%	2.00%	2.00%	2.00%	2.00%	2.10%
10 yr PWLB	2.10%	2.10%	2.10%	2.10%	2.10%	2.20%	2.20%	2.20%
25 yr PWLB	2.50%	2.50%	2.50%	2.50%	2.60%	2.60%	2.60%	2.70%

50 Yr PWLB	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%
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- 4.8 One of the risks inherent within Treasury management is “Interest rate risk”. This risk is high where a large proportion of an organisation’s borrowing portfolio reach termination point at the same time. The organisation has then to re-finance a large proportion of their portfolio at a set point in time with the risk that interest rates may not be favourable.
- 4.9 In order to protect against this risk it is prudent to spread repayment dates over a number of years thereby reducing the risk of a large proportion of the portfolio being affected by adverse interest rates.
- 4.10 The graph in below shows the debt portfolio repayment profile as at 1 September 2020. All debts are being shown as repayable at term, although the LOBO’s (Lender Option Borrower Option) have a variety of “call” periods of between 6 months and every 5 years. The risk of a call occurring is currently low and therefore these have been shown as running to full term. Although £32m is due to be repaid by 31 March 2021 replacement borrowing of £20m has been arranged which itself will be due for repayment in 2021/22.



5. Investment Portfolio 2020/21

- 5.1 In accordance with the Code, it is the Council’s priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council’s risk appetite. As set out in Section 3, it is a very difficult investment market. Rates are very low and in line with the current 0.1% Bank Rate (as at 1 September 2020). Given the risk environment, investment returns are likely to remain low.
- 5.2 The investment portfolio yield on cash investments at 1 September 2020 ranges from 0.0% to about 0.13%.

5.3 A full list of in house investments held as at 1 September 2020 is shown below:

Investments: Core Investments (Local Authorities)	Principal 1 September 2020 £	Interest %
CCLA Property Fund (June 2020 market value)	11,672,005	n/a
Patrizia Hannover Property UT (June 2020 market value)	4,789,620	n/a
Lothbury Property Trust (June 2020 market value)	4,657,673	n/a
Total Core Investments	21,192,298	n/a

Investments: Liquid Investments	Principal 1 September 2020 £	Interest %
Svenska Handelsbanken	1,151	0.00%
Lloyds	24,336,157	0.05%
Barclays	4,285	0.00%
CCLA Public Sector Deposit Fund	25,169,432	Approx. 0.13%
Thurrock Council	10,000,000	0.28%
Total Liquid Investment	59,511,025	n/a

Investments	Principal 1 September 2020 £	Interest %
Total In house Investments	80,703,323	n/a

5.4 Due to exceptional cashflows arising from government and local response to the Covid-19 pandemic it has been difficult to manage cash balances within the counterparty limits set in the Treasury Strategy. Council therefore approved suspension of these limits up to 30 September 2020. Accordingly, cash balances in individual counterparties has from time to time exceeded Strategy limits. Officers are working to expanding the number of counterparties available, in particular the number of money market funds, to enable investments to revert to Strategy limits after 30 September.

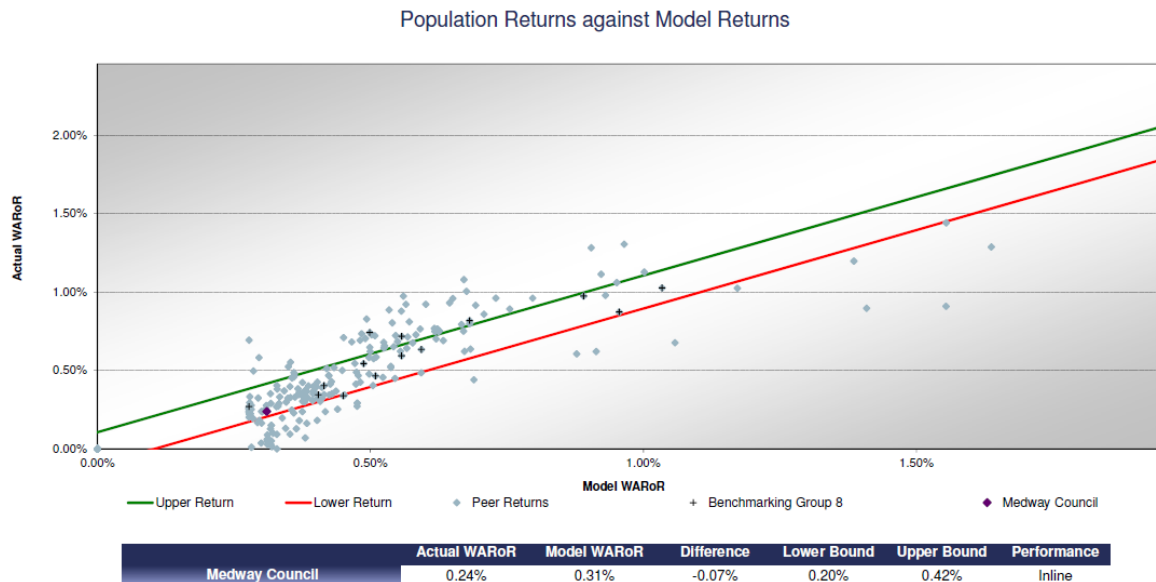
5.5 The Council's budgeted net interest payments for 2020/21 £7.6m are likely to be exceeded with the estimate at Round 1 standing at £7,9m.

5.6 Investment Counterparty Criteria

5.6.1 Subject to the comment in 5.4 above the current investment counterparty criteria selection approved in the Treasury Strategy is meeting the requirement of the treasury management function.

5.7 Benchmarking

5.7.1 The in-house Treasury team, contribute to the Link Asset Services benchmarking club which produces quarterly reports. Shown below is a graph showing Medway's performance to June.



5.7.2 The “x” axis of the graph shows the “Model Weighted Average Rate of Return”, this is easiest interpreted as the level of return we should expect for the level of risk that we are taking with our investment portfolio. This is then plotted against the “Actual Weighted Average Rate of Return” on the “y” scale, running diagonally upwards across the graph are two parallel lines, if a Council performance falls between these lines then they are deemed to be receiving a return as would be expected for their level of risk, below these two lines and performance is considered below that expected and above then the return being received is above that expected. As can be seen Medway's return fell in line with expectations for our level of risk. However, the data includes only at cash deposits and excludes property funds which currently yield dividends in excess of 3%.

5.7.3 In assessing the risk inherent in an Investment Portfolio for the benchmarking, three factors are taken into account,

- (i) The number of days to maturity of an investment. With a larger the number of days left to maturity the greater the risk that an adverse event could occur
- (ii) The total number of days that the investment was originally invested for, again the longer an authority is comfortable to invest for the greater the risk it is willing to take.
- (iii) The creditworthiness of the counterparties in which the authority invests.

5.7.4 The table below shows some detail from the June 2020 benchmarking data comparing Medway in-house performance against all participants of the benchmarking group; unitaries and other local councils.

Comparison of risk and returns table below:

Authority	Risk: Model Weighted Average Rate of Return	Risk: Weighted Average Maturity (Days)	Risk: Weighted Average Total Time (Days)	Risk: Weighted Average Credit Risk	Risk: Weighted Average Rate of Return
Medway	0.31%	5	14	1.80	0.24%
Average English Unitaries (23)	n/a	73	165	1.92	0.50%
Average Total Population (214)	n/a	64	137	2.49	0.49%
Average Local Benchmarking Group (15)	n/a	104	201	2.35	0.60%
Brighton & Hove CC	0.68%	163	279	1.80	0.82%
East Sussex CC	0.50%	153	195	2.64	0.74%
Sevenoaks DC	0.49%	52	131	2.56	0.54%
Tonbridge and Malling BC	0.34%	51	74	2.49	0.34%

6. Debt Rescheduling

6.1 Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. During the first six months of the year, no debt rescheduling was undertaken and it is not envisaged that any will occur before the end of the financial year. However, officers and the council's financial advisers, Link Asset Services, will continue to monitor the situation and opportunities will be carefully considered.

7. Compliance with Treasury and Prudential Limits

7.1 It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". Council's approved Treasury and Prudential Indicators (affordability limits) are outlined in the approved Treasury Management Strategy Statement.

7.2 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement as amended by the temporary relaxation of investment counterparty limits, as noted in 5.4 above, and in compliance with the Council's Treasury Management Practices.

8. Risk management

8.1 Risk and the management thereof is a feature throughout the Strategy and in detail within the Treasury Management Practices.

9. Cabinet – 22 September 2020

9.1 The Cabinet considered this report on 22 September 2020, noted its contents and agreed that comments on the report be passed to the Audit Committee as follows: With reference to the key indicators table included in the summary of the report on page 211 of the agenda, concern was expressed that the table was potentially confusing as capital expenditure and external borrowing had been included on a year basis, but the capital financing requirement had not been. It was requested that the table be revised accordingly ahead of the report being presented to the Audit Committee.

10. Audit Committee – 24 September 2020

10.1 The Audit Committee considered this report on 24 September 2020. An addendum report was tabled at the meeting to take account of the comments made by the Cabinet at paragraph 9.1 above.

10.2 The addendum report stated the Cabinet had requested an expansion in the detail of the Capital Financing Requirement (CFR) shown in the summary of the report. The table below provides that detail.

Capital Financing Requirement	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000
Opening Balance	323,444	383,353	486,277	536,240
In Year Borrowing Requirement	59,909	102,924	49,963	0
Minimum Revenue Provision	-4,976	-5,017	-4,918	-4,773
Less MRP Holiday	4,976	5,017	4,918	670
Closing CFR	383,353	486,277	536,240	532,137

10.3 At the meeting, the Finance Business Partner – Corporate Services advised the Committee of the key issues in the report, including an explanation as to the additional information in the addendum report, with particular reference to the capital financing requirement (CFR) which was shown as being £1,899,000 higher than shown in the main report; the table in the addendum report assumed that the recommendations of the Cabinet to Council on 8 October 2020 to fund £1,899,000 of the forecast overspend from borrowing would be approved, increasing the CFR accordingly.

10.4 Members then raised a number of questions and comments which included:

10.5 **Housing Infrastructure Funding (HIF)** – in response to a question on whether the HIF funds (£170M) would be included in the Council’s investment portfolio, the Chief Finance Officer confirmed that this funding would not be included in the investment portfolio. He explained that the Council would draw down funding following expenditure by the Council, which, overall would create an overall capitalised interest cost of approximately £400,000. Following discussion on this point, during which some concern was expressed, the Chief Finance Officer confirmed that the HIF Project Team were working to the overall funding taking account of this cost. In response to a question on the

Committee's request at the last meeting for a report on the process for how the HIF monies would be spent, the Chief Finance Officer undertook to check this.

- 10.6 **Short term borrowing** – in response to a question on the continued reliance of short term borrowing, the Finance Business Partner – Corporate Services advised that he hoped that the Government to normalise the Public Loans Work Board (PWLB) borrowing rates by the beginning of the next financial year. This would help to reduce the reliance on short term borrowing.
- 10.7 **Counterparty limits** – in response to a question on whether there was any benchmarking information on the suspension of counterparty limits and whether Members should be concerned as to the suspension of these limits, the Chief Finance Officer advised that such an exercise had not been undertaken. However, some other Local Authorities may have been in a similar position regarding cash flow given the injection of cash from the Government in the form of Covid-19 grants leading to a cash surplus. He further advised that subsequent funding from the Government to support Local Authorities during the pandemic now required the Council to claim funds back which could lead to a cash deficit.
- 10.8 **Investment portfolio** – in response to a question about dividend payments on property investments, which had been detailed in previous Committee reports but not detailed in this report, the Finance Business Partner – Corporate Services advised that the Council was still receiving such returns, however, they were much reduced compared to usual payments. He also advised that property values were currently uncertain and that some of the Council's property investments had been gated recently, the effect of which was to prevent the investors selling such investments in an attempt to maintain property values, although gating was ending on 30 September 2020 in respect of the fund that the Council had invested most.
- 10.9 **Capital Financing Requirement** – in response to a question as to what the £1.899M figure referenced in the addendum report represented, the Chief Finance Officer advised that this was likely to refer to an overspend on the Strood Riverside Scheme but that he would confirm this to the Committee after the meeting via email.
- 10.10 **Interest rates – Interest rates** – in response to a question about the effect of interest rates on the Council, particularly in a scenario where there might be negative interest rates, the Finance Business Partner – Corporate Services advised that, given the Council was a net borrower, it was beneficial for the Council that interest rates remain low.
- 10.11 The Committee noted the contents of the report.
- 10.12 Subsequent to the meeting, it has been confirmed that a report will be submitted to the next meeting of the Committee, with regards to the comments made in paragraph 10.5 above, which will outline the conditions attached to the HIF funding, the assurance process prescribed within those conditions and an explanation of the process the Council has in place to provide that assurance.

11. Financial and legal implications

11.1 The finance and legal implications are highlighted throughout this report. The Council has delegated responsibility for the execution and administration of treasury management decisions to the Chief Finance Officer, who will act in accordance with the Council's policy statement and Treasury Management Practices.

12. Recommendation

12.1 The Council is asked to note the report.

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Appendices

Appendix 1 – View of economic conditions

Background Papers

None

APPENDIX 1 - VIEW OF ECONOMIC CONDITIONS

This section has been prepared by the Authority's Treasury Advisors, Link.

1 ECONOMICS UPDATE

- 1.1 **UK. Economic growth** 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. The overall growth rate in quarter 1 was -2.2%, -1.7% y/y. However, the main fall in growth did not occur until April when it came in at -24.5% y/y after the closedown of whole sections of the economy. What is uncertain, however, is the extent of the damage that will have been done to businesses by the end of the lockdown period, how consumer confidence and behaviour may be impacted afterwards, 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 to what was formerly regarded as normality. However, some changes during lockdown are likely to be long lasting e.g. a shift to online purchasing, working from home, etc. The lockdown has also had a sharp effect in depressing expenditure by consumers which means their level of savings have increased and debt has fallen. This could provide fuel for a potential surge in consumer expenditure once some degree of normality returns.
- 1.2 Although the UK left the EU on 31 January 2020, we still have much uncertainty as to whether there will be a reasonable trade deal achieved by the end of 2020. At the end of June, the UK government rejected extending the transition period beyond 31 December 2020. This has increased the chances of a no-deal **Brexit**. However, the most likely outcome is expected to be a slim deal on trade in order to minimise as much disruption as possible. However, uncertainty is likely to prevail until the deadline date which will act as a drag on recovery
- 1.3 After the Monetary Policy Committee left **Bank Rate** unchanged at 0.75% in January 2020, the onset of the coronavirus epidemic in March forced it into making two emergency cuts in Bank Rate 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. In June, the MPC decided to add a further £100bn of QE purchases of gilts, but to be implemented over an extended period to the end of the year. The total stock of QE purchases will then amount to £745bn. It is not currently thought likely that the MPC would go as far as to cut Bank Rate into negative territory, although the Governor of the Bank of England has said all policy measures will be considered. The Governor also recently commented about an eventual tightening in monetary policy – namely that he favours unwinding QE before raising interest rates. Some forecasters think this could be as far away as five years.

- 1.4 The Government and the Bank were also very concerned to **stop people losing their jobs** during this lockdown period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs for three months to the end of June 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 lockdown 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. The furlough scheme was subsequently extended for another three months to October, but with employers having to take on graduated increases in paying for employees during that period. The Bank of England expects the unemployment rate to double to 8%.
- 1.5 The Government measures to support jobs and businesses will result in a huge increase in the annual budget deficit for the current year, from about 2% to nearly 17%. **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 lockdown is ended. Economic statistics during June were giving a preliminary indication that the economy was recovering faster than previously expected. However, it may be a considerable time before economic activity recovers fully to its previous level.
- 1.6 **Inflation.** The annual inflation rate dropped to 0.5% in May from 0.8% in April and could reach zero by the end of the year. Inflation rising over 2% is unlikely to be an issue for the MPC over the next two years as the world economy will be heading into a recession; this has caused a glut in the supply of oil which initially fell sharply in price, although the price has recovered somewhat more recently. Other UK domestic prices will also be under downward pressure; wage inflation was already on a downward path over the last half year and is likely to continue that trend in the current environment where unemployment will be rising significantly. In May's Monetary Policy Report, the Bank of England predicted that inflation would hit their 2% target by 2022. This was in the context of its forecast that GDP would rise by 3% in 2022 after a recovery during 2021. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.
- 1.7 **USA.** Growth in quarter 1 of 2020 fell by an annualised 5.0% and will fall sharply in quarter 2. 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.

- 1.8 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 was \$500bn of funding from the Treasury's Exchange Stabilization Fund which will provide loans for hard-hit industries, including \$50bn for airlines.
- 1.9 Non-farm payrolls unexpectedly increased by 2.5 million jobs in May, beating market expectations of an 8 million fall, and after declining by a record 20.7 million in April. The figures suggest that the economic recovery in the US may happen much faster than initially expected. Some states started reopening in mid-May after a two-month shutdown but a few have had to reimpose localised lockdowns since then.
- 1.10 EUROZONE. The Eurozone economy shrank by 3.6% on quarter in the first three months of 2020. So far, the ECB has been by far the most important institution in helping to contain the impact of coronavirus and the crisis on financial markets. Since 12th March, it has implemented a range of new policies including providing additional cheap loans for commercial banks and easing capital requirements for the banking sector. But most importantly, the ECB has stepped up and reformed its asset purchase programmes. So far, it has increased its planned asset purchases for this year by €1,470bn on top of the €20bn per month which it was already committed to. The new purchases consist of an additional €120bn within the existing Public Sector Purchase Programme (PSPP), and €1,350bn in the Pandemic Emergency Purchase Programme (PEPP). At its 4 June monetary policy meeting, the ECB Governing Council also committed to continue net asset purchases under the PEPP until at least the end of June 2021 and to continue to reinvest maturing principal payments under the PEPP until at least end-2022. It has also made clear that it would not hesitate to top up PEPP as much as needed to contain the risk of a crisis.
- 1.11 Just as important as the size of the PEPP is its flexibility. Whereas previous asset purchase programmes adhered to strict issuer limits, the PEPP was designed to be flexible across "time, asset classes and jurisdictions". This means that the ECB can act in the interests of the euro-zone as a whole rather than having to treat each national bond market equally. However, while this overall programme will provide protection over the next year or so, some vulnerable countries, particularly Italy, already started the crisis with a high level of debt to GDP and the crisis will make that level even worse at the same time as GDP growth prospects will have worsened. This leaves a big question over 'what happens after then when financial markets will be concerned that those debt levels are unsustainable?
- 1.12 What is currently missing is a major 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. The EU's recently-proposed rescue fund, (officially designated "Next Generation EU"), is a major first step towards financial integration in the EU. However, it is striking just how small this package is as the proposed €500 billion of grants amount to about 0.6% of average annual euro-zone GDP (over the seven-year budget period). It will therefore supply relatively little support to the weaker and more vulnerable countries within the EU. This has therefore left individual national governments to implement a patchwork of support measures within each country. This shows up how far away the EU is from being an effective fiscal union.

- 1.13 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 lockdown of the country and a major contraction of economic activity in February-March 2020. The Chinese economy shrank 6.8% y/y in Q1 2020, following 6% y/y growth in Q4 of 2019. 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. The post Covid government measures to stimulate more infrastructure investment are likely to result in an increase in inefficient low reward investment.
- 1.14 JAPAN has been struggling to stimulate consistent significant GDP growth for years 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. Japan appears to have escaped the worst effects of the virus - as yet.
- 1.15 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. This year, coronavirus is the inevitable big issue which is going to sweep around most countries in the world and have a major impact in causing a world recession in growth in 2020.