Audit and Governance Committee

PLYMOUTH CITY COUNCIL

Date of meeting:	21 September 2020
Title of Report:	**Treasury Management Update Report for Covid and the Financial Markets**
Lead Member:	Councillor Mark Lowry (Cabinet Member for Finance)
Lead Strategic Director:	Andrew Hardingham (Service Director for Finance)
Author:	Chris Flower (Finance Business Partner for Capital and Treasury Management)
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Your Reference:	Finance/CF
Key Decision:	No
Confidentiality:	Part I - Official

Purpose of Report

This report sets out a brief update on the effects caused by Covid19 on the Council's Treasury Management and the Financial Markets.

Recommendations and Reasons

1. . The Audit Committee notes the Treasury Management Update Report for Covid and the Financial Markets
2. The Audit Committee endorses the approach the council is taking to reduce its exposure to future interest rate increases

Alternative options considered and rejected

It is a statutory requirement under the Local Government Act 2003 and supporting regulations to set any changes to the treasury management strategy. The Council has adopted the CIPFA Code of Practice for Treasury Management.

Relevance to the Corporate Plan and/or the Plymouth Plan

Effective financial management is fundamental to the delivery of corporate improvement priorities. Treasury Management activity has a significant impact on the Council's activity both in revenue budget terms and capital investment and is a key factor in facilitating the delivery against a number of corporate priorities.

Implications for the Medium Term Financial Plan and Resource Implications:

Treasury Management affects the Council's budget in terms of borrowing costs and investment returns. The Treasury Management Strategy sets the authorised limits and operational boundaries within which investment and borrowing decisions are taken and risks managed. Effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

Carbon Footprint (Environmental) Implications:
There is no direct implications arising from this update

Other Implications: e.g. Health and Safety, Risk Management, Child Poverty:
** When considering these proposals members have a responsibility to ensure they give due regard to the Council's duty to promote equality of opportunity, eliminate unlawful discrimination and promote good relations between people who share protected characteristics under the Equalities Act and those who do not.*
A robust Treasury Management Strategy is key to ensuring a successful delivery of our Medium Term Financial Strategy and ensuring the Council can achieve its objectives to be a Pioneering, Growing Caring and Confident City.

Appendices
**Add rows as required to box below*

Ref.	Title of Appendix	**Exemption Paragraph Number** (if applicable) *If some/all of the information is confidential, you must indicate why it is not for publication by virtue of Part 1of Schedule 12A of the Local Government Act 1972 by ticking the relevant box.*						
		1	**2**	**3**	**4**	**5**	**6**	**7**
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Background papers:
**Add rows as required to box below*

Please list all unpublished, background papers relevant to the decision in the table below. Background papers are unpublished works, relied on to a material extent in preparing the report, which disclose facts or matters on which the report or an important part of the work is based.

Title of any background paper(s)	**Exemption Paragraph Number** (if applicable) *If some/all of the information is confidential, you must indicate why it is not for publication by virtue of Part 1of Schedule 12A of the Local Government Act 1972 by ticking the relevant box.*						
	1	**2**	**3**	**4**	**5**	**6**	**7**

Sign off:

Fin	pl.20.21.80	Leg	lt/353 09/08 0920	Mon Off	lt/353 09/08 0920	HR		Assets		Strat Proc	
Originating Senior Leadership Team member: Andrew Hardingham (Service Director for Finance)											
Please confirm the Strategic Director(s) has agreed the report? Yes Date agreed: 08/09/2020											
Cabinet Member approval: Cllr Mark Lowry approved by email Date approved: 11/09/2020											

Treasury Management Update Report the affects from Covid 19

September 2020

1. **Economic background:** The UK's exit from the European Union took a back seat during the first quarter of 2020/21 as the global economic impact from coronavirus took centre stage. Part of the measures taken to stop the spread of the pandemic included the government implementing a nationwide lockdown in late March which effectively shut down almost the entire UK economy. These measures continued throughout most of the quarter with only some easing of restrictions at the end of May and into June.

   Bank Rate was maintained at 0.1% despite some speculation that the Bank of England's Monetary Policy Committee (MPC) might cut further and some MPC members also suggesting that negative rates are part of the Bank's policy tools. In June the Bank increased the asset purchase scheme by £100 billion, taking the recent round of Quantitative Easing (QE) to £300bn and total QE to £745 billion.

   At the same time, the government also implemented a range of fiscal stimulus measures totalling over £300 billion which had been announced in March and designed to dampen the effect of the pandemic on the labour market.

   GDP growth contracted by 2.2% in Q1 (Jan-Mar) 2020 pushing the annual growth rate down to -1.6%. The lockdown only came into force on 23rd March, and the markets are braced for a dire set of growth data for Q2. In April UK GDP fell 20.4% month-on-month. On the back of the 5.8% month-on-month fall in March, this means economic output fell by 25% compared to its pre-coronavirus peak in February 2020.

   The headline rate of UK Consumer Price Inflation UK Consumer Price Inflation fell to 1.2% y/y in May, further below the Bank of England's 2% target.

   In the three months to June, labour market data remained largely unchanged on the previous quarter. This is likely due to the government's furlough scheme as more than a quarter of the UK workforce was estimated to be supported by it. The International Labour Organisation? (ILO) unemployment rate remained unchanged at 3.9% while the employment rate fell to 76.4%. However, employers will have to contribute towards furlough payments from August and the scheme is due to stop at the end of October; unemployment is expected to rise as a result.

   The US economy contracted at an annualised rate of 5.0% in Q1 2020. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% while the US government announced a $2 trillion fiscal stimulus package. Relations between the US and China, which had briefly improved when Phase 1 of the trade agreement was signed in January, deteriorated over the quarter.

   With little room to move on interest rates, the European Central Bank maintained interest rates at 0% and the rate on the deposit facility (which banks may use to make overnight deposits with the Eurosystem) at -0.5% and announced a further huge, open-ended commitment to buy €600bn of bonds under its Pandemic Emergency Purchase Programme (PEPP) which can be reinvested out to 2022. This lifted the ECB's total bond buying support package to €1.35trillion.

2. **Financial markets:** After selling off sharply in March, equity markets started recovering in April and while still down on their pre-crisis levels, the Dow Jones and FTSE 100 and 250 have made up around half of the losses. Measures implemented by central banks and governments continue to maintain some degree of general investor confidence, however volatility remains.

   Ultra-low interest rates and the flight to quality continued to keep gilts yields low over the period with the yield on some short-dated government bonds turning negative. The 5-year UK benchmark gilt yield dropped from 0.18% at the beginning of April 2020 to -0.06% on 30th June. The 10-year benchmark gilt yield fell from 0.31% to 0.14% over the same period, and the 20-year from 0.69% to 0.52%. 1-month, 3-month and 12-month bid rates averaged 0.04%, 0.28% and 0.44% respectively over the quarter.

   Over the quarter (April–June), the yield on 2-year US treasuries fell from 0.24% to 0.20% while that on yield on 10-year treasuries fell from 0.63% to 0.61%. German bund yields remain negative.

3. **Credit review:** After rising sharply in late March, credit default swap spreads slowly eased over the quarter but remained above their pre-crisis levels. Fitch downgraded the UK sovereign rating to AA- in March which was followed by a number of actions on UK and also non-UK banks from early April onwards. As the extent of the losses that banks and building societies will suffer due to the impact from the coronavirus epidemic remains the banks investment duration advice was restricted to a maximum of 35 days.

   The Covid-19 pandemic has changed the economic outlook for this year and beyond. In response to the spread of the virus and sharp increase in those infected, the government enforced lockdowns. Central banks and governments around the world cut interest rates and introduced massive stimulus packages in an attempt to reduce some of the negative economic impact to domestic and global growth.

   The Bank of England, which had held rates steady at 0.75% through most of 2019/20, moved in March to cut rates to 0.25% and then to the record low of 0.1%.

   Financial markets sold off sharply as the impact from the coronavirus worsened. After starting positively in 2020, the FTSE 100 fell over 30% at its worst point with stock markets in other countries seeing similar huge falls. In March sterling touch its lowest level against the dollar since 1985. The measures implemented by central banks and governments helped restore some confidence and financial markets have rebounded in recent weeks but remain extremely volatile.

4. **Hedging against Interest Rate Risk**

   With interest rates falling to their lowest on record there is a real risk that at some point in the future interest rates will rise. The Council has £465m short term borrowing from other local authorities at short term rates (usually 3-6 months) therefore if rates increase the Council will have to pay higher interest charges. The Council has been looking at innovative solutions to mitigate this risk through an interest Rate Swap.

   The Interest Rate Swap is a contact with a bank to fix the borrowing rates against SONIA (Sterling Over Night Index Average) (formerly LIBOR). If rates move about the agreed rate then the bank pays the Council. If rates move down below the agreed rate the Council pays the bank.

In April 2020 the Council agreed it first Interest Rate Swap of £75m which gives a fixed cost of borrowing of 0.56% for the next 20 years.

Other authorities are now taking out Interest rate swaps to hedge their own interest rate risk.

Since April the interest rates have fallen further and the Council has decided to take out a further £35m Interest Rate Swap to fixed borrowing rates for a period of 15 years.

5. Summary

Although the Council's returns from its investment have fallen it has been more than compensated by the savings made on its borrowing costs. The Council will continue to explore further innovative solutions to reduce the Council's exposure to future interest rate rises.

Recommendations and Reasons

1. The Audit Committee notes the Treasury Management Update Report for Covid and the Financial Markets
2. The Audit Committee endorses the approach the council is taking to reduce its exposure to future interest rate increases