Agenda Item No:8

TREASURY MANAGEMENT REPORT – QUARTER FOUR UPDATE 2019-20

To:	**General Purposes Committee**
Meeting Date:	**2 June 2020**
From:	**Chief Finance Officer**
Electoral division(s):	**All**
Forward Plan ref:	**Not applicable** *Key decision:* **No**
Outcome:	**To provide the quarterly update on the Treasury Management Strategy 2019/20, approved by Council in February 2019.**
Recommendation:	**The General Purposes Committee is recommended to:**

a) Note the Treasury Management Quarter Four Report for 2019-20 and forward to Full Council to note.

b) Permit the Chief Finance Officer to propose amendments to the Treasury Management Strategy to the July Full Council, in accordance with section 5.11 of this report and as selection of a multi-class credit fund manager progresses

	Officer contact:		***Member contacts:***
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1. BACKGROUND

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management recommends that Members be updated on treasury management activities regularly (annual, mid-year or quarterly reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

2. ECONOMIC CLIMATE

2.1 A current economic commentary is located in **Appendix 1**, which has been provided by Link Asset Services, the Council's treasury management advisers.

2.1 There was a mixed picture on economic growth throughout 2019/20, with year on year growth of 1.1%. The calendar year 2020 began with improved optimism emerging from business surveys pointing to an upswing in growth as some political uncertainty receded.

2.2 Since March 2020, however, the growth rate outlook has been transformed due to the impact of the global pandemic. The pandemic has had a substantial impact both on global financial markets and government intervention in the economy. It is fair to say since Q3 there has been seismic economic change as a result of Covid-19.

- On the 10th March, the Bank of England Monetary Policy Committee took decisive action to cut the interest rate from 0.75% to 0.25%.

- Just a few days later, the Bank of England cut interest rates even further to 0.10%.

- To mitigate the impact on unemployment, the Government introduced the Coronavirus Job Retention Scheme. This enabled employers to furlough staff by covering 80% of employees' normal monthly wages up to £2,500 per month, thereby reducing the number of redundancies.

- With "lockdown" announced by Government on 23rd March, most organisations have adopted a work from home policy; as such, there are wide ranging impacts on consumption within many areas of the economy.

- Oil prices have also tumbled sharply amidst the current pandemic.

3. INTEREST RATE FORECAST

3.1 The latest forecast for UK Bank Rate along with Public Works Loan Board (PWLB) borrowing rates (certainty rate) from the Council's treasury advisors is set out in Table 1 below.

3.2 Table 1 shows there is likely to be little upward movement in PWLB rates over the next two years as it will take 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 low, at least initially, during this period.

Table 1: Interest Rate Forecast (%)

Link Asset Services Interest Rate View								
	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

GILT YIELDS / PWLB RATES

3.3 HM Treasury has imposed changes of margins over gilt yields for PWLB rates in 2019/20. In October, an additional 1% margin over gilts was added to all PWLB rates. In March 2020, borrowing costs within Housing Revenue Account were reduced, however this does not benefit Cambridgeshire as a shire county without housing functions.

3.4 There is currently a consultation with local authorities on possibly further amending PWLB margins, ending on 31st July. Based on the consultation, the expectation is that steps are under consideration which provide disincentives to local authorities to borrow money from the PWLB to purchase commercial property if the aim is solely to generate an income stream.

3.5 The sharp increase in PWLB borrowing rates may provide an opportunity for the UK Municipal Bonds Agency (UKMBA) to kick start bond issuance on behalf of the sector, which would be seen as an alternative borrowing mechanism. The Council is an investor in the UKMBA. During Q4, it is understood that the agency successfully issued a 5-year, £350m bond on behalf of Lancashire County Council. The offer was substantially cheaper than PWLB and was significantly oversubscribed, partly reflecting prevailing market uncertainty. Lancashire County Council has a separate Moody's rating.

UKMBA is working with Councils to gauge interest for bond issues in the following categories:

- 10 years,
- 20-25 years
- 40-45 years

Prospective rates for such bond issues appear appealing from the Council's perspective in the current environment, the guarantee previously agreed for the bonds has been improved from the Council's perspective (to a "proportional" rather than “total” approach) and this may be a welcome opportunity to stimulate an additional borrowing option for the sector. Officers are monitoring this opportunity closely and will liaise further with Members, under existing policies and delegations, should a relatively quick decision be needed on whether to participate in a potential issuance.

3.6 ***INFRASTRUCTURE RATE***

3.6.1 To incentivise the construction of new infrastructure, in the Autumn Budget 2017 the government announced that it would make available £1bn of lending at the Local Infrastructure Rate of gilts + 60bps to English local authorities. The Council was successful during Q3 in bidding to HM Treasury for access to £60.8m of borrowing at the Local Infrastructure Rate for eight specified energy schemes.

3.6.2 This will enable the Council to borrow from the PWLB at a discount of 1.4% on normal rates, as the expenditure for those energy schemes comes forward in the coming years.

3.6.3 On March 27th 2020, the Council applied for the first tranche of the £60.8m – borrowing £8m from PWLB at a rate of 1.45%, maturing in 21 years.

4. SUMMARY PORTFOILIO POSITION

4.1. Net debt at 31st March 2020 stood at £593.6m, which was lower than the actual forecast set out in the Treasury Management Strategy in February 2019 of £755.0m. The changes were as a result of the slippage in the capital programme.

A comprehensive balance sheet review is due to be undertaken once the draft financial statement is produced, which will provide useful detailed analysis of the Council’s loans, investment and Capital Financing Requirement and reserves.

4.2 Further analysis on borrowing and investment is set out in the next two sections. A snapshot of the Council’s debt and investment position is shown in the table below.

	Actual as at 31 March 2019		Actual as at 31 March 2020		Change from Mar 2019 – Mar 2020
	£m	Rate %	£m	Rate %	£m
Borrowings					
Long term Borrowing (>12mth)	442.3	4.0	526.7	3.7	84.4
Short term Borrowing (<12mth)	156.0	1.0	242.2	1.4	86.2
Total Borrowings	**598.3**	**3.2**	**768.9**	**2.3**	**170.6**
Treasury Investment	29.6	0.7	69.7	0.4	40.1
Third Party Loans and Share Capital	95.4	3.0	106.2	3.2	10.8
TOTAL Net Debt/Borrowings	**473.3**	**-**	**593.0**	**-**	**119.7**

5. INVESTMENTS

5.1 The Treasury Management Strategy Statement (TMSS) for 2019/20, which includes the Annual Investment Strategy for financial assets, was approved by Council in February 2019. It sets out the Council's investment priorities as being:

1. Security of Capital;
2. Liquidity; and then
3. Yield

5.2 The Council will aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity.

5.3 At 31st March 2020 the Council's investment balances totalled £29.6m; the balance split between Money Market Funds, Call/Notice accounts and CCLA Property Fund. The balance excludes Third Party Loans and Share Capital. In Q4, the Council's investments held with CCLA Property Fund returned an average dividend of 4.35%. Any impact upon the latest budget projections for the financial year are reported through the Budget Monitoring process.

5.4 In November 2019, the Commercial & Investment (C&I) Investment Working Group reviewed a proposal to invest funds into the CCLA Diversified Income Fund under the Treasury Management Strategy; £2.1m was subsequently placed in this fund.

5.5 The diversified income fund is considered to be a medium-term investment, due to the facility to withdraw funds at shorter notice alongside the need to take a medium to longer-term view about changes in underlying capital values. The asset classes covered by the diversified income funds are split between assets and equity; please see Fig 1 & Fig 2, which shows the breakdown of Equity portfolio by sector and Asset allocation as at 31/03/2020.

Fig 1

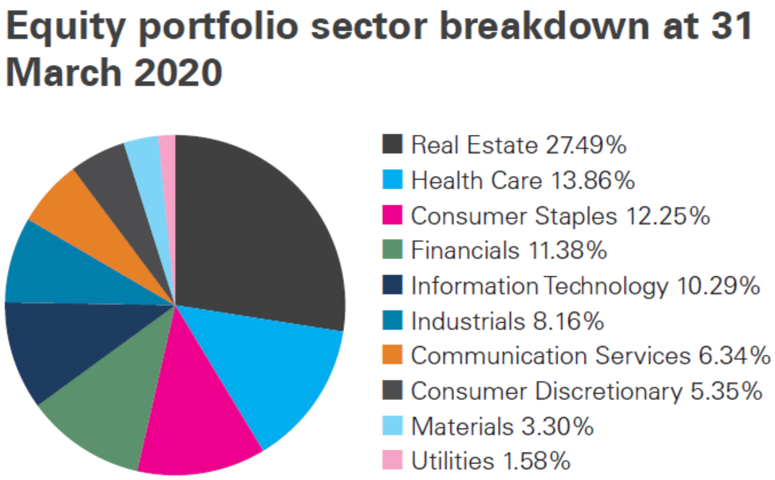
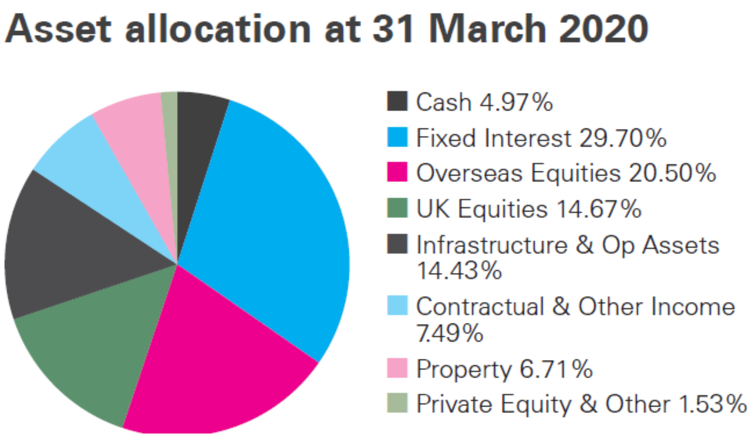


Fig 2



5.6 The overall average investment in Q4 was £86.0m. Fig 3 shows the investment by counterparty as at 31/03/2020.

Fig 3 CCC Investments allocation by Counterparty

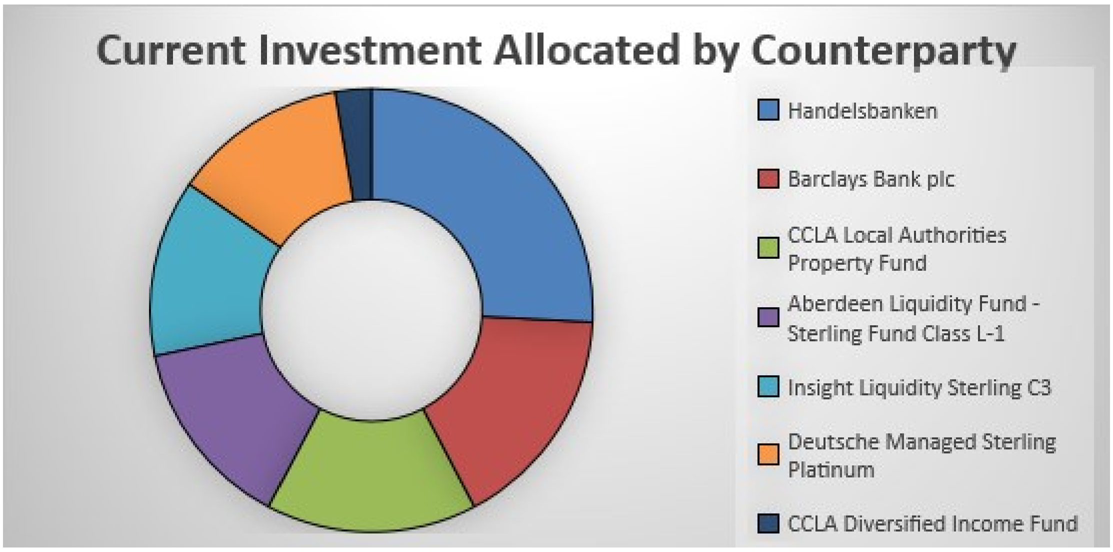


Table 2 below summarises the maturity profile of the Council's investment portfolio at the end of Q4 2019/20 (excluding Third Party Loans):

Table 2 – Investment maturity profile at end of Q4 2019/20

		Maturity Period					
		0d	**0-3m**	**3-6m**	**~5yrs**	**Total**	
Product	**Access Type**	**£m**	**£m**	**£m**	**£m**	**£m**	**%**
Money Market Funds	Same-Day	27.6				**27.6**	***39.6***
Bank Call Account	Instant Access	29.5				**29.5**	***42.3***
Certificate of Deposits	Fixed Term / Tradeable		0.00	0.0		**0.00**	***0.00***
Pooled Property Fund	Redemption Period Applies				10.8	**10.8**	***15.5***
Pooled Diversified Income Fund	Redemption – two days				1.8	**1.8**	***2.6***
	Total	**57.1**	**0.00**	**0.0**	**12.6**	**69.7**	***100.0***
	%	***81.9***	***0.00***	***0***	***18.1***	***100.0***	

5.7 Set out below are details of the amounts outstanding on loans and share capital investments classed as capital expenditure advanced to third party organisations at the end of Q4:

Table 3 - Loans/Equity holdings in This Land companies

Loan Summary	Amount (£m)	Repayment Year
Bridging Loan	7.656	2020/21
Loans for land acquired from third parties	2.040	2021/22
Construction & Development loans	8.161	2029/30
Loans for land acquired from CCC	78.915	2028/29
Equity holding	**3.951**	Continuous
Total Loans/Equity in This Land Ltd	**100.725**	

Table 4 - Third Party Loans

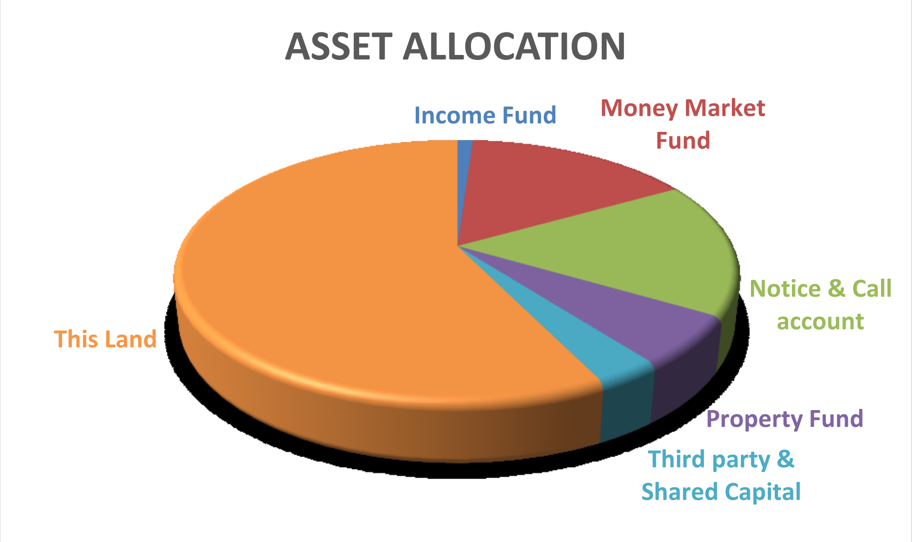
Loan Counterparty	Original Amount (£m)	Amount Outstanding (£m)	Repayment Year
Arthur Rank Hospice Charity	4.000	3.600	2042/43
Estover Playing Field 2015 CIC (Guaranteed by March Town Council)	0.350	0.277	2024/25
Wisbech Town Council	0.150	0.150	2043/44
VIVA Arts & Community Group	0.300	0.300	2043/44
Total Third Party Loans	**4.800**	**4.327**	

Table 5 – LGSS Law Ltd

Loan Counterparty	Type	Amount (£m)
LGSS Law Ltd	Cashflow loan	0.325
LGSS Law Ltd*	Equity	0.475
Total Loans/Equity in LGSS Law		**0.800**

5.8 *Cambridgeshire County Council (CCC), along with other shareholding authorities raised £1.425m in equity to LGSS Law Ltd, to enable the company to strengthen its balance sheet and to provide a sound financing basis for the company for the foreseeable future. The amount was advanced on March 12th, 2020. This in turn led to a £1m cash inflow from LGSS Law Ltd as exposure between shareholders was rebalanced and historic debts cleared.

Fig 4 Asset Allocation



5.9 Investment balances are forecast to reduce by the financial year end as internal resources from temporary positive cashflow surpluses are applied to fund expenditure demands in lieu of fully funding the borrowing requirement (internal borrowing) on a net basis. This process effectively reduces the cost of carrying additional borrowing at a higher cost than the income that could be generated through short term investment of those balances, as well as reducing investment counterparty credit risk.

Table 6: Average Benchmark Performance – Q4 2019/20

	Benchmark	Benchmark Return	Council Performance
Q1	**3m LIBID**	0.68%	1.31%
Q2	**3m LIBID**	0.64%	1.15%
Q3	**3m LIBID**	0.66%	2.52%
Q4	**3m LIBID**	0.55%	1.82%
Q1+2+3+4 (YTD)	**3m LIBID**	0.63%	1.70%

5.10 Leaving market conditions aside, the Council's return on investments is influenced by a number of factors, the largest contributors being the duration of investments and the credit quality of the institution or instrument:

- Credit risk is the consideration of the likelihood of default and is controlled through the creditworthiness policy approved by Council.
- The duration of an investment introduces liquidity risk; the risk that funds can't be accessed when required.
- Interest rate risk; the risk that arises from fluctuating market interest rates.

These factors and associated risks are actively managed by the Council's Finance team.

5.11 **Multi-class credit investment**

5.11.1 Following previous approval by the General Purposes Committee in January 2020, the Commercial & Investment Working Group have considered an updated proposal from the Council's appointed investment advisors, Redington Ltd, to invest funds into a pooled multi-class credit fund- a fund with a mixture of exposures to corporate and government debt, including sub-investment grade credit. The latest update takes account of the current global economic uncertainty and related risks.

5.11.2 The advantages of such an investment include diversifying the Council's investment portfolio, and the likelihood of an overall improved yield, as well as increasing the liquidity of funds invested on a medium term basis. The risks with such an approach are the depletion of the investments' capital values, heightened during a period of weakened company incomes and increased credit defaults. The Business Plan for 2020-21 includes improved financial returns as a result of making such an investment and a manager selection process is underway to put into effect the decision to invest.

5.11.3 Contingent on the outcome of the selection, it is likely that the investment will require amendment to the Treasury Management Strategy and a specific listed delegation to the manager to be appointed. Previously the Council had been proceeding on the basis that such an investment would be classified as capital expenditure, whereas further external advice on the nature of the likely fund and manager suggests this is treasury management activity. Should this be the case, once the leading fund is known, it is proposed that the Chief Finance Officer (CFO) be authorised to list any amendments required in the treasury report forwarded to Full Council from this meeting for its consideration in July, in consultation with the Chairmen of the General Purposes and Commercial & Investment Committees. The exact timing and phasing of the investment will need to be considered by the CFO, in line with the Treasury Management Strategy, and in view of prevailing economic conditions at that time, ahead of actually placing an investment.

5.11.4 The treasury management strategy, as approved by Full Council in February is available in full at: https://www.cambridgeshire.gov.uk/asset-library/Section-7-Treasury-Management-Strategy-2020-2021.pdf

The revisions required to enable such an investment include:

- Permitting an exception/individual consideration to the credit quality required of counterparties, such as an investment including "sub-investment grade" credit, as part of a multi-class credit mixed fund
- Listing a multi-class credit fund as a non-specified investment (and/or broadening the scope of bond investments that are permitted) and (potentially) listing this as an item exempt from treatment as capital expenditure
- Delegating the management of the funds to a named investment management firm (to be appointed)

In order for this to be allowable and necessary, the fund will need to be an authorised unit trust scheme carrying out a ‘home regulated’ investment business: Redington Ltd advise this is the likely outcome from the manager selection.

6. BORROWING

6.1 The Council can raise cash through borrowing in order to fund expenditure on its capital programme for the benefit of Cambridgeshire. The amount of new borrowing needed each year is determined by capital expenditure plans and projections of the Capital Financing Requirement, underlying borrowing requirement, forecast cash-backed reserves and both current and forecast economic conditions.

6.2 The Council will continue to utilise short to medium-term borrowing from other local authorities ‘and authorised brokers as the PWLB rate is not favourable at present. The Council intends to keep a proportion of the borrowing portfolio short-dated; in doing so, the Council will also be in the position to take up any funding opportunities that could arise in the near term.

6.3 In Q4, the Council repaid on maturity a total of £64.2m, of which £43.0m was short-term loans from other local authorities and £21.2m was longer-term loans from other authorities and PWLB. Loans raised during Q4 amounted to £73m, of which £15m related to short-dated loans borrowed to fund cashflow, with maturity within 1 to 20 days. The remaining £58m was split as follows: £7m short-term borrowing maturing within 1 year with an average rate of 1.03%, and £51m of fixed-term loans maturing within 2 years with an average rate of 1.59%.

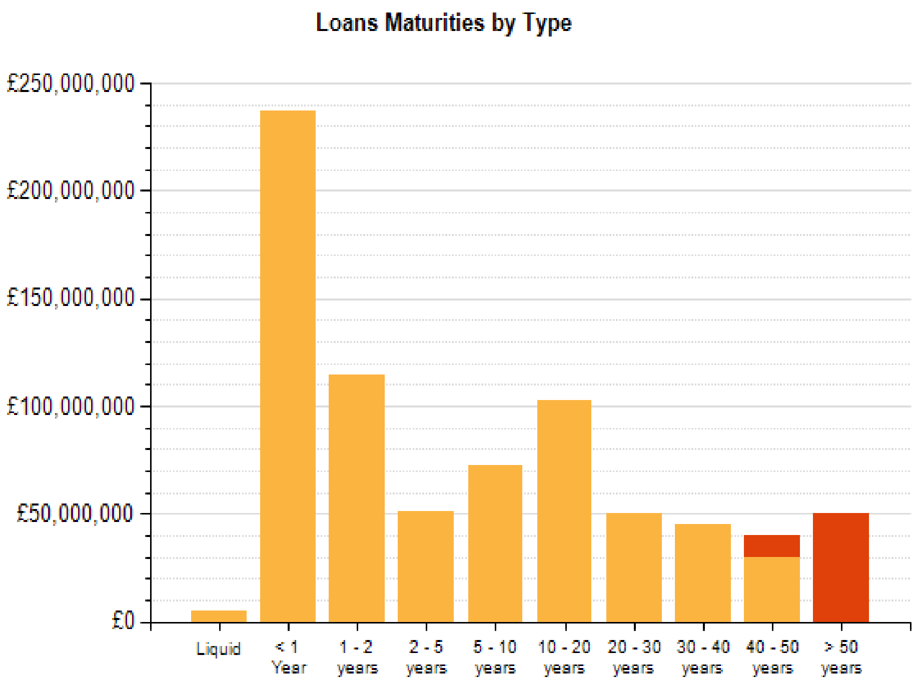
6.4 Therefore overall borrowing outstanding increased during Q4 compared to Q3 by £8.9m. At the end of Q4, the Council held £763.9m of borrowing of which £ 237.2m matures in less than 1 year.

6.5 Table 7 below sets out the maturity profile of the Council's borrowing portfolio at the end of Q4. £374.5m is held with the PWLB, £320m from other local authorities, £45m in market loans and £15.5m in a single market LOBO loan.

Table 7: Loan Maturity Profile – Q4 2019/20

Term remaining	Borrowing	
	£m	%
< 1 Year	£242,232,333	31.5
1 - 2 years	£114,365,333	14.9
2 - 5 years	£51,419,000	6.7
5 - 10 years	£72,683,667	9.5
10 - 20 years	£102,323,333	13.3
20 - 30 years	£50,406,667	6.5
30 - 40 years	£45,000,000	5.8
40 - 50 years	£40,000,000	5.2
> 50 years	£50,500,000	6.6
Total	**£768,930,333**	**100.0**

Fig 5 Loans Maturities by Type – Q4 2019/20



6.6 Market Lender Option Borrower Option (LOBO) loans are included in Table 7 at their final maturity rather than their next potential call date. In the current low interest rate environment the likelihood of lenders exercising their option to increase the interest rates on these loans - and so triggering the Council's option to repayment at par - is considered to be low.

6.7 The Council is in an internally borrowed cash position and balances will need to be replenished at some point in the future (subject to expenditure demands). This strategy is prudent while investment returns are lower than the cost of servicing debt and also serves to mitigate counterparty risk. The Council therefore plans to maintain this internal borrowing position but will closely monitor those reserves, balances and cashflows supporting this approach.

7. BORROWING RESTRUCTURING

7.1 No borrowing rescheduling was undertaken during Q4. Rescheduling opportunities are limited in the current economic climate. For PWLB loans, due to the spread between the carrying rate of existing borrowing and early redemption rates, substantial exit (premium) costs would be incurred. For market borrowing, the lender uses the certainty of the loans cashflow profile to hedge against forecast interest rate movements and so would pass the cost of unwinding these instruments onto the Council as an exit (premium) cost. Officers continue to monitor the position regularly.

8. TREASURY AND PRUDENTIAL INDICATORS

8.1 The Council's Treasury and Prudential Indicators (affordability limits) were approved alongside the TMSS. It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits.

8.2 During the financial year to date the Council has operated within the Treasury and Prudential Indicators set out in the Council's TMSS, shown in **Appendix 2**.

9. DEBT FINANCING BUDGET

9.1 This section summaries the 2019/20 debt financing budget, which is held as a central budget within Corporate Services, and complies with the reporting requirement in the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practices Treasury Management. The overall outturn position is an underspend of £1.284m, summarised in the table below.

Table 8: Debt Financing Budget – Q4 2019/20

	Budget £m	Outturn £m	Variance £m
Interest payable	15.669	15.103	(0.566)
Interest receivable	(0.574)	(0.743)	(0.169)
Capitalisation on interest cost	(2.406)	(1.736)	0.670
Technical & Other	0.590	0.567	(0.023)
MRP	14.278	13.082	(1.196)
Total	**27.557**	**27.273**	**(1.284)**

9.2 Interest payable was less than budgeted as fewer long term loans were raised during the year with more short term loans raised to need the Council's liquidity needs. Interest receivable increased as a direct result of investment into various Certificate of deposit schemes with a maturity of between 3-9 months. Minimum Revenue Provision (MRP) and Capitalisation of interest cost were less than budgeted as a result of reprofiling and alternative funding of capital expenditure.

10. ALIGNMENT WITH CORPORATE PRIORITIES

10.1 A good quality of life for everyone

There are no significant implications for this priority.

10.2 Thriving places for people to live

There are no significant implications for this priority.

10.3 The best start for Cambridgeshire's children

There are no significant implications for this priority.

10.4 Net zero carbon emissions for Cambridgeshire by 2050

There are no significant implications for this priority.

11. SIGNIFICANT IMPLICATIONS

11.1 Resource Implications

This report provides information on performance against the Treasury Management Strategy. Decisions on treasury management, which are driven by the capital programme and the Council's overall financial position, will impact the Debt Charges Budget and are reported through the Budget Monitoring process.

11.2 Procurement/Contractual/Council Contract Procedure Rules Implications

There are no significant implications for this category.

11.3 Statutory, Legal and Risk Implications

The Council continues to operate within the statutory requirements for borrowing and investments. Further details can be found within the Prudential Indicators in Appendix C.

11.4 Equality and Diversity Implications

There are no significant implications for this category.

11.5 **Engagement and Communications Implications**

There are no significant implications for this category.

11.6 **Localism and Local Member Involvement**

There are no significant implications for this category.

11.7 **Public Health Implications**

There are no significant implications for this category.

Implications	**Officer Clearance**
Have the resource implications been cleared by Finance?	Yes Name of Financial Officer: Tom Kelly
Have the procurement/contractual/ Council Contract Procedure Rules implications been cleared by the LGSS Head of Procurement?	Not applicable
Has the impact on statutory, legal and risk implications been cleared by LGSS Law?	Not applicable
Have the equality and diversity implications been cleared by your Service Contact?	Not applicable
Have any engagement and communication implications been cleared by Communications?	Not applicable
Have any localism and Local Member involvement issues been cleared by your Service Contact?	Not applicable
Have any Public Health implications been cleared by Public Health	Not applicable

Source Documents	**Location**
None	Not applicable

Appendix 1: Detailed economic commentary on developments during quarter ended 31 March 2020

This section has been provided by Capital Economics and therefore includes their views and opinions of future trends and events.

During the quarter ended 31 March 2020 ***(quarter 1 of 2020):***

- Lockdowns were put in place across much of the world to counteract the spread of the coronavirus;
- The UK government announced a fiscal package two-and-a-half times the size of that seen in 2008/09;
- Bank Rate was cut from 0.75% to 0.10% and the Bank of England restarted quantitative easing (QE);
- There was a significant tightening in financial conditions;
- Equity prices and sterling plunged;
- Unemployment benefit claims shot up;
- Disinflationary pressures intensified.

The policy response unveiled in response to the coronavirus crisis has been unprecedented in both its speed and scale. We estimate the UK government's fiscal package is now worth £119bn (5.3% of GDP), two-and-a-half times the size of that seen after the financial crisis in 2008/09.

The Bank of England has shown too that it is willing to do whatever it takes to support demand and to keep the financial markets functioning smoothly. In the space of a few weeks, it has slashed Bank Rate from 0.75% to its estimate of the effective lower bound of 0.10%, announced an increase in QE of £200bn, at least as large as the QE packages announced after the 2008 financial crisis. It has also unveiled three new measures to help firms struggling with cash flow problems. First, it launched a Term Funding Scheme with incentives for Small and Medium-sized Enterprises. Second, the Bank has reduced the so-called countercyclical capital buffer from 1% to 0% until at least March 2022. And third, it has set up a new Covid Corporate Financing Facility (CCFF), to provide unlimited liquidity for banks.

Taken together, this fiscal and monetary support gives us more confidence that the economy will recover reasonably quickly once the virus has been brought under control and that this economic and health crisis won't morph into a full-blown financial and banking crisis. Indeed, the actions of central banks around the world has helped to steady the mood in the markets this week, with the FTSE 100 – which was down by 34% between 31st December 2019 and 20th March – and other risky assets rallying. In the UK, banks have already borrowed a record £11bn for three months from the Bank of England via its Contingent Term Repo Facility.

So far, we have little evidence of the size of the likely slump in economic activity. But with the economy stagnating in Q4 and in January, we know that the economy headed into the crisis on a weak footing. The 0.0% m/m change in GDP in January was particularly worrying as we had expected the year to start on a strong note before the hits from the floods and coronavirus began to be felt.

And households' balance sheets looked fragile even before the coronavirus. The household saving ratio of 6.2% in Q4 2019 was still a long way below its average since 1997 of around 8%. Meanwhile, the underlying current account deficit, (excluding the non-monetary gold component), was still about 3% of GDP in Q4, which partly explains why the pound has been hit so hard recently, with the sterling trade-weighted index having fallen by 9.4% between the end of last year and March 20th. At least the 2.4% rise in profits in the year to Q4 suggests that businesses were reasonably healthy going into the crisis.

Meanwhile, the scale of the declines in the timelier indicators that we track means it's all but certain the economy is now contracting. The plunge in the composite PMI, from 53.0 in February to 37.1 in March, left the index at its lowest level since the series began in 1998. And this survey was conducted between 12th-20th March, even before the UK entered into a full lockdown on 23rd March. High frequency indicators such as restaurant bookings and cinema visits have since dropped to zero now that dine-in restaurants and cinemas have closed. And traffic volumes at peak time are just a fraction of their normal levels.

Following the enforced closure of almost all non-food stores, we now expect an eye-watering fall in retail sales in the region of 30% m/m in April. **And we have pencilled in a total fall in output of 15% q/q in GDP in Q2, which would be unprecedented in size and pace.**

As the economy heads into recession, disinflationary pressure is also likely to be rife. The collapse in economic activity, spike in unemployment and slump in oil prices look set to push CPI inflation down from 1.7% now to around 0.5% in August, with the risk that inflation falls to, or below zero. The initial fall will mostly be due to the more immediate energy effects linked to the plunge in oil prices. But as the hit to demand feeds through later in the year, core inflation (exc. energy, food, alcohol and tobacco) looks set to drop from 1.6% in February to about 1.0% by the start of 2021. **This means that even by 2021, there may be little pressure on the Bank of England to raise interest rates from the current all-time low of 0.10%.**

Of course, activity should rebound once the containment measures are lifted. In particular, the real estate sector and big-ticket durable goods producers should regain some lost ground, as those people who didn't lose their jobs and income during the recession make delayed purchases.

But even with these stimulus measures in place, we are sceptical we will see a perfect V-shaped recovery in the second half of the year for a few reasons. Overall, while we assume that GDP will recover reasonably quickly in the second half of 2020, it may be a few years before the economy reaches the level it would have done had the coronavirus shock not happened.

And there will of course be big economic and political questions that will need to be answered once the virus fades, including how the UK will tackle the increase in the debt burden. We estimate that the budget deficit will soar, probably from 2% of GDP now to almost 11% of GDP, higher than the 10.2% peak seen after the financial crisis. The government debt to GDP ratio will probably jump from 77% to about 105%, the highest since the 1960s. This has led the ratings agency Fitch to downgrade UK government debt from AA to AA-.

This is not an immediate problem as the markets' ability to absorb this debt won't need to be tested. In fact, the Bank of England's huge QE programme means that it will hoover up these new bonds. Further down the line, though, the government will be faced with an unenviable choice of whether to let debt be eroded only very gradually by economic growth, to try to inflate it away or to resort to more austerity.

Appendix 2: Treasury and Prudential Indicators

Prudential Indicator	**2019/20 Indicator**	**2019/20 Q4**
Authorised limit for external debt (Inc' loans raised to on-lend to Housing & Investment Company)	----- £1,088.0m -----	
Operational boundary for external debt (Inc' loans raised to on-lend to Housing & Investment Company)	----- £1,058.0m -----	
Capital Financing Requirement (CFR) *[Including PFI and Finance Lease Liabilities]*	£1,008.0m	£913.60m
Ratio of financing costs to net revenue streams	8.4%	9.0%
Upper limit of fixed interest rates based on net debt	150%	98%
Upper limit of variable interest rates based on net debt	65%	-5%
Principal sums invested over 365 days (exc' third party loans)	£50.0m	£12.5m
Maturity structure of borrowing limits:-		
Under 12 months	Max. 80% Min. 0%	31.5%
12 months to 2 years	Max. 50% Min. 0%	14.9%
2 years to 5 years	Max. 50% Min. 0%	6.7%
5 years to 10 years	Max. 50% Min. 0%	9.5%
10 years and above	Max. 100% Min. 0%	37.4%

- The Treasury Management Code of Practice guidance notes requires that maturity is determined by the earliest date on which the lender can trigger repayment, which in the case of LOBO loans is the next break/call point. This approach differs to Table 7 at paragraph 6.5 above, which instead shows the Council's LOBO loan at maturity date as the likelihood of the option being exercised is low.

Summary – Prudential and Treasury Indicators at 31st March 2020

Monitoring of Prudential and Treasury Indicators: approved by the Council in February 2019.

1. **Has the Council adopted CIPFA code of practice for Treasury Management in the Public Services?**

   The Council has adopted CIPFA's Treasury Management in the Public Services: Code of Practices and Cross sectoral Guidance Notes. This is a key element of the Treasury Strategy 2019-20, approved by the Council in February 2019.

2. **Limit for exposure to fixed and Variable rate of net borrowing (Borrowing less investments)**

	Limit	**Actual**
Fixed rate	150%	98%
Variable rate	65%	-5%

The interest rate exposure is calculated a percentage of net debt. Due to the mathematical calculation exposures could be greater than 100% of below zero (i.e. negative) depending on the component parts of the formula. The formulas are shown below:

$$\frac{\textit{Fixed rate borrowing – fixed rate investments}}{\textit{Total borrowing – total investments}}$$

* Defined as greater than 1 year to run

**Defined as less than 1 year to run or in the case of LOBO loan, the call date falling within the next 12 months.

3. **Total Principal sums invested for the periods longer than 364 days**

	2019-20 Limit £m	**Actual £m**
Investment longer than 354 days to run *	£20m	£12.69m

**Treasury Management Investment only*

4. **Limit for maturity structure of borrowing**

	Upper Limit	**Actual**
< 1 Year	80%	31.5%
1 - 2 years	50%	14.9%
2 - 5 years	50%	6.7%
5 - 10 years	50%	9.5%
>10 years	100%	37.4%

Note: The guidance for calculation of this indicator requires that LOBO loans are shown as maturing at the next possible call date rather than at final maturity.

5. **Ratio of financing cost to net revenue stream**

2019-20 Original Estimate %	2019-20 Outturn %	Difference %
8.4	6.4	-2

Prudence:

6. **Gross borrowing and the Capital Financing Requirement (estimated) borrowing liability excluding PFR.**

Original 2019-20 Capital Financing Requirement (CFR as of the 31 March 2020) £m	2019-20 CFR (as at 31 March 2020) £m	Actual Gross Borrowings (as at 31 March 2020) £m	Difference between actual borrowings and CFR (as at March 2020) £m
1,008.0	913.60	763.9	149.7

Capital Expenditure

7. **Estimates of Capital**

For the detail of capital expenditure and funding please refer to the capital outturn in the Integrated Finance Monitoring Report.

8. **External Debt**

Authorised limit for external debt

2019-20 Authorised Limit per TMSS £m	Actual Borrowings £m	Headroom compared to Authorised Limit £m
1,088.0	763.9	324.1

The Authorised limits the statutory limit on the Council's level of debt and must not be breached. This is the absolute maximum amount of debt the Council may have in the year.

9. Operational boundary for external debt

2019-20 Operational Boundary per Limit per TMSS £m	Actual Borrowings £m	Headroom compared to Operational Boundary £m
1,058.0	763.9	294.1

The operational boundary is set as a warning signal that debt has reached a level nearing the Authorised limit and must be monitored carefully.