

REPORT REFERENCE NO.	RC/21/15
MEETING	RESOURCES COMMITTEE
DATE OF MEETING	30 NOVEMBER 2021
SUBJECT OF REPORT	TREASURY MANAGEMENT PERFORMANCE 2021-22 – QUARTER 2
LEAD OFFICER	DIRECTOR OF FINANCE & RESOURCING (TREASURER)
RECOMMENDATIONS	<i>That the performance in relation to the treasury management activities of the Authority for 2021-22 (to September 2020) be noted.</i>
EXECUTIVE SUMMARY	The Chartered Institute of Public Finance and Accountancy (CIPFA) issued a Code of Practice for Treasury Management. The Code suggests that members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This report therefore ensures this Authority is embracing Best Practice in accordance with CIPFA's Code of Practice.
RESOURCE IMPLICATIONS	As indicated within the report.
EQUALITY IMPACT ASSESSMENT	An initial assessment has not identified any equality issues emanating from this report.
APPENDICES	Appendix A – Investments held as at 30 September 2021.
BACKGROUND PAPERS	Treasury Management Strategy (including Prudential and Treasury Indicators) as approved at the meeting of the Fire & Rescue Authority held on the 10 February 2021 – Minute DSFRA/69 refers.

1. **INTRODUCTION**

1.1 The Treasury Management Strategy for Devon and Somerset Fire & Rescue Authority has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in Public Services Code of Practice (the Code) and the CIPFA Prudential Code. The Code recommends that members be updated on treasury management activities regularly (TMSS, annual and mid-year reports). This report, therefore, ensures this Authority is implementing best practice in accordance with the Code and includes:

- The creation and maintenance of a Treasury Management Policy Statement, which sets out the policies and objectives of the Authority's treasury management activities;
- The creation and maintenance of Treasury Management Practices, which set out the manner in which the Authority will seek to achieve those policies and objectives;
- The receipt by the full Authority 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 during the previous year;
- The delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

1.2 Treasury management in this context is defined as:

“The management of the local authority's 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.”

1.3 The preparation of this report demonstrates that the Authority is implementing best practice in accordance with the code.

2. **ECONOMICS UPDATE**

2.1. The Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures.

2.2. There was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August which had majored on indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in Bank Rate.

- 2.3. In his press conference after the August 2021 MPC meeting, Governor Andrew Bailey said, “the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs” and that “the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures.” In other words, it was flagging up a potential danger that labour shortages could push up wage growth by more than it expects and that, as a result, Consumer Price Index (CPI) inflation would stay above the 2% target for longer. It also discounted sharp increases in monthly inflation figures in the pipeline in late 2021 which were largely propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system: in other words, the MPC had been prepared to look through a temporary spike in inflation.
- 2.4. In August 2021, the country was just put on alert. However, this time the MPC’s words indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October 2021 and due again in April 2022, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth. This would, in turn, increase the risk that price pressures would prove more persistent next year than previously expected. Indeed, to emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement. This suggested that it was now willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year. This is a reversal of its priorities in August 2021 and a long way from words at earlier MPC meetings which indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was ‘sustainably over 2%’. Indeed, whereas in August 2021 the MPC’s focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021, now its primary concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.
- 2.5. Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in February 2022, but this looks ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment once furlough ends at the end of September. At the MPC’s meeting in February it will only have available the employment figures for November: to get a clearer picture of employment trends, it would need to wait until the May meeting when it would have data up until February. At its May meeting, it will also have a clearer understanding of the likely peak of inflation.
- 2.6. The MPC’s forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows:
- Placing the focus on raising Bank Rate as “the active instrument in most circumstances”;
 - Raising Bank Rate to 0.50% before starting on reducing its holdings;
 - Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts and

- Once Bank Rate had risen to at least 1%, it would start selling its holdings.

- 2.7. **COVID-19 vaccines.** These have been the game changer which have enormously boosted confidence that life in the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.
- 2.8. **US.** See comments below on US treasury yields.
- 2.9. **EU.** The slow roll out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction in GDP of -0.3% in Q1, Q2 came in with strong growth of 2%, which is likely to continue into Q3, though some countries more dependent on tourism may struggle. Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the ECB is likely to see these as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time.
- 2.10. German general election. With the CDU/CSU and SPD both having won around 24-26% of the vote in the September general election, the composition of Germany's next coalition government may not be agreed by the end of 2021. An SPD-led coalition would probably pursue a slightly less restrictive fiscal policy, but any change of direction from a CDU/CSU led coalition government is likely to be small. However, with Angela Merkel standing down as Chancellor as soon as a coalition is formed, there will be a hole in overall EU leadership which will be difficult to fill.
- 2.11. **China.** After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of the year; this enabled China to recover all the initial contraction. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021. However, the pace of economic growth has now fallen back after this initial surge of recovery from the pandemic and China is now struggling to contain the spread of the Delta variant through sharp local lockdowns - which will also depress economic growth. There are also questions as to how effective Chinese vaccines are proving. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

- 2.12. **Japan.** 2021 has been a patchy year in combating Covid. However, after a slow start, nearly 50% of the population are now vaccinated and Covid case numbers are falling. After a weak Q3 there is likely to be a strong recovery in Q4. The Bank of Japan is continuing its very loose monetary policy but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon: indeed, inflation was negative in July. New Prime Minister Kishida has promised a large fiscal stimulus package after the November general election – which his party is likely to win.
- 2.13. **World growth.** World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is likely that we are heading into a period where there will be a reversal of **world globalisation** and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.
- 2.14. **Supply shortages.** The pandemic and extreme weather events have been highly disruptive of extended worldwide supply chains. At the current time there are major queues of ships unable to unload their goods at ports in New York, California and China. Such issues have led to mis-distribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves.

Interest Rate Forecasts

- 2.15. The Authority's treasury advisor, Link Group Ltd, has provided the following forecast:

Link Group Interest Rate View		29.9.21									
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	
BANK RATE	0.10	0.10	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75	
3 month ave earnings	0.10	0.10	0.20	0.20	0.30	0.40	0.50	0.50	0.60	0.70	
6 month ave earnings	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.60	0.70	0.80	
12 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.70	0.80	0.90	1.00	
5 yr PWLB	1.40	1.40	1.50	1.50	1.60	1.60	1.60	1.70	1.70	1.70	
10 yr PWLB	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	
25 yr PWLB	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.60	
50 yr PWLB	2.00	2.00	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.40	

- 2.16. The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings.

Forecasts for Bank Rate

- 2.17. Bank Rate is not expected to go up fast after the initial rate rise as the supply potential of the economy has not generally taken a major hit during the pandemic, so should be able to cope well with meeting demand without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the surge to around 4% towards the end of 2021. Three increases in Bank rate are forecast in the period to March 2024, ending at 0.75%. However, these forecasts may well need changing within a relatively short time frame for the following reasons:
- There are increasing grounds for viewing the economic recovery as running out of steam during the summer and now into the autumn. This could lead into stagflation which would create a dilemma for the MPC as to which way to face;
 - Will some current key supply shortages e.g., petrol and diesel, spill over into causing economic activity in some sectors to take a significant hit?
 - Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation. Then we have the Government's upcoming budget in October, which could also end up in reducing consumer spending power;
 - On the other hand, consumers are sitting on around £200bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?
 - There are 1.6 million people coming off furlough at the end of September; how many of those will not have jobs on 1st October and will, therefore, be available to fill labour shortages in many sectors of the economy? So, supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months or so and alleviate the MPC's current concerns; and
 - There is a risk that there could be further nasty surprises on the Covid front, on top of the flu season this winter, which could depress economic activity.
- 2.18. In summary, with the high level of uncertainty prevailing on several different fronts, it is likely that these forecasts will need to be revised again soon - in line with what the new news is.

- 2.19. It also needs to be borne in mind that Bank Rate being cut to 0.10% was an emergency measure to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away that final emergency cut from 0.25% to 0.10% on the grounds of it no longer being warranted and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

3. **TREASURY MANAGEMENT STRATEGY STATEMENT**

ANNUAL INVESTMENT STRATEGY

- 3.1. The Authority's Annual Investment Strategy, which is incorporated in the Treasury Management Strategy Statement (TMSS) was approved by the Authority on the 10 February 2021. It outlines the Authority's investment priorities as follows:

- Security of Capital
- Liquidity
- Yield

- 3.2. The Authority will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep a significant proportion of investments short term. This will not only cover short term cash flow needs but will also seek out value available in significantly higher rates in periods up to 12 months with highly credit rated financial institutions using the Link suggested creditworthiness matrices, including Credit Default Swap (CDS) overlay information provided by Link.

Creditworthiness

- 3.3. Significant levels of downgrades to Short and Long Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, as economies are beginning to reopen, there have been some instances of previous lowering of Outlooks being reversed.
- 3.4. A full list of investments held as at 30 September 2021 are shown in Appendix A.
- 3.5. The average level of funds available for investment purposes during the quarter was £51.0221m (£40.671m at Quarter 1). These funds were available on a temporary basis and the level of funds was dependent on the level of reserves, timing of precept payments, receipt of grants and progress on the Capital Programme.

Benchmark	Benchmark Return	Authority Performance	Investment interest to Quarter 1
3 Month LIBID	(0.05%)	0.15%	£0.023m.

- 3.6. As illustrated above, the Authority outperformed the 3 month LIBID benchmark by 0.20bp. It is currently anticipated that the actual investment return for the whole of 2021-22 will under recover the Authority's budgeted investment target of £0.100m by £0.015m.

BORROWING STRATEGY

Prudential Indicators:

- 3.7. It is a statutory duty for the Authority to determine and keep under review the "Affordable Borrowing Limits". The Authority's approved Prudential Indicators (affordability limits) are outlined in the approved TMSS.
- 3.8. A full list of the approved limits (as amended) are included in the Financial Performance Report 2021-22, considered elsewhere on the agenda, which confirms that no breaches of the Prudential Indicators were made in the period to September 2021 and that there are no concerns that they will be breached during the financial year.

Current external borrowing

- 3.9. The Authority has not taken any external loans since June 2012 and has been using cash resources to meet any capital expenditure. The amount of outstanding external borrowing as at 30 September 2021 was £24.804m, forecast to reduce to £24.757m by the end of the financial year as a result of standard loan repayments. All of this debt is at fixed rate with the remaining principal having an average rate of 4.25% and average life of 24.5 years.

Loan Rescheduling

- 3.10. No debt rescheduling was undertaken during the quarter. The Authority will continue to work closely with our treasury advisors to explore any opportunities to repay existing loans, however current Public Works Loan Board early repayment rates mean there is no financial benefit in undertaking premature loan repayment at this time.

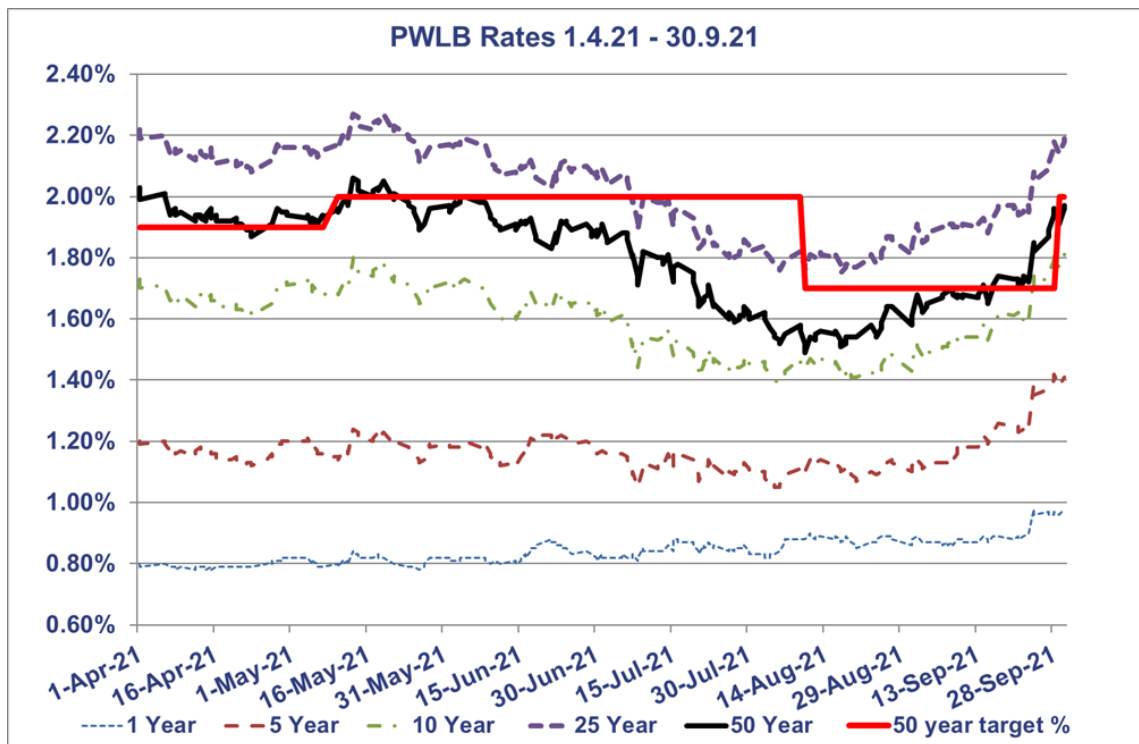
New Borrowing

- 3.11. Gilt yields and PWLB rates rose sharply during the first three months of 2021 but have lacked any consistent direction since then over the last three months to 30th September.
The 50 year PWLB target certainty rate for new long-term borrowing started at 1.49% in this quarter but then rose to 2.06% in August.
- 3.12. No new borrowing was undertaken during the quarter and none is planned during 2021-22 as a result of the Authority's adopted financial strategy to utilise revenue funds (revenue budget and reserves) to finance capital investment needs for the medium term.

PWLB rates quarter ended 30 September 2021

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.78%	1.05%	1.39%	1.75%	1.49%
Date	08/04/2021	08/07/2021	05/08/2021	17/08/2021	10/08/2021
High	0.98%	1.42%	1.81%	2.27%	2.06%
Date	24/09/2021	28/09/2021	28/09/2021	13/05/2021	13/05/2021
Average	0.84%	1.16%	1.60%	2.02%	1.81%
Spread	0.20%	0.37%	0.42%	0.52%	0.57%

3.13. Borrowing rates for this quarter are shown below.



Borrowing in Advance of Need

3.14. The Authority has not borrowed in advance of need during this quarter.

4. SUMMARY AND RECOMMENDATION

- 4.1. In compliance with the requirements of the Chartered Institute of Public Finance and Accountancy Code of Practice of Treasury Management, this report provides the Committee with the first quarter report on treasury management activities for 2021-22 to September 2021. As is indicated in this report, none of the Prudential Indicators have been breached, and a prudent approach has been taken in relation to investment decisions taken so far, with priority being given to liquidity and security over yield. Whilst investment returns are recovering as a result of the increase in interest rates, the Authority is still anticipating that investment returns will meet the budgeted target, as rates were forecast to rise when the budget was set.

SHAYNE SCOTT
Treasurer

APPENDIX A TO REPORT RC/21/15

Investments as at 30 September 2021					
Counterparty	Maximum to be invested	Amount Invested	Call or Term	Period invested	Interest rate(s)
	£m	£m			
Redcar & Cleveland Borough Council	7.000	-3.000	T	12 mths	0.30%
Staffordshire & Moorlands District Council	5.000	-1.500	T	18 mths	0.50%
Goldman Sachs	5.000	-3.000	T	6 mths	0.27%
Standard Chartered	5.000	-3.000	T	6 mths	0.12%
National Bank of Kuwait (International) PLC	5.000	-5.000	T	12 mths	0.21%
National Bank of Kuwait (International) PLC	5.000	-2.000	T	12 mths	0.20%
Lancashire County Council	5.000	-5.000	T	12 mths	0.10%
Standard Chartered	5.000	-4.000	T	6 mths	0.10%
Close Brothers	7.000	-5.000	T	6 mths	0.25%
Goldman Sachs	7.000	-2.000	T	6 mths	0.16%
Goldman Sachs	7.000	-2.000	T	6 mths	0.16%
Bayerische Landesbank	7.000	-7.000	T	6 mths	0.11%
Barclays Bank		-0.151	C	Instant Access	Variable
Aberdeen Standard	8.000	-3.090	C	Instant Access	Variable
Federated Cash Plus	8.000	-1.650	C	Instant Access	Variable
Total Amount Invested		-47.391			