Report for Decision: PCC 2020 / 004

Title: Treasury Management Strategy Statement 2020/21

Executive Summary:

This report presents the draft 2020/21 Treasury Management Strategy Statement for consideration and endorsement before it is presented to the PCC for approval at the Level 1 public meeting on 4th February 2020.

The draft Strategy Statement includes the proposed borrowing and investment strategies, and also sets out the prudential indicators and treasury management activity limits for the period 2020/21 to 2022/23 that provide the Office of the Police and Crime Commissioner's (OPCC) treasury service with an operational performance and control framework within which the relevant functions are undertaken.

The overall strategy is very similar to that adopted by the PCC in the current 2019/20 financial year.

The draft report was considered and endorsed by the Joint Independent Audit Committee at its recent meeting on 17th December 2019.

Recommendation:

The Police and Crime Commissioner is asked to consider and APPROVE the Treasury Management Strategy Statement for 2020/21 incorporating the Minimum Revenue Provision Policy Statement and the Annual Investment Strategy

Police and Crime Commissioner

I hereby approve the recommendation above.

Signature		**Date**	12·2·20.

PART 1 – NON-CONFIDENTIAL

1 Introduction and background

1.1 The PCC is required to operate a balanced budget which broadly means that cash income raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the PCC's low risk appetite, providing adequate liquidity initially before considering investment return.

1.2 The second main function of the treasury management service is the funding of the PCC's capital investment plans. These capital plans provide a guide to the PCC's borrowing need, especially the longer term cash flow planning to ensure that the PCC can meet his capital spending obligations.

2 Issues for consideration

2.1 The attached Treasury Management Strategy Statement and supporting documents will enable the PCC to fulfil and discharge the following primary legislative requirements to receive and adopt:

a) An over-arching annual **Treasury Management Strategy Statement** which sets out how the treasury service will support the PCC's capital investment decisions, the day to day treasury management and the limitations on activity through treasury prudential indicators.

b) A **Borrowing Strategy** which sets out the operational limits to borrowing activity, including the statutory Affordable Borrowing Limit, or **'Authorised Limit'.**

c) An **Investment Strategy** which sets out the PCC's criteria for choosing investment counterparties and limiting exposure to the risk of loss.

d) A **Minimum Revenue Provision (MRP) Policy Statement** which sets out how the PCC will pay for capital assets through revenue each year.

e) Treasury management **Prudential Indicators and Activity Limits,** setting out the operational performance parameters applicable to the PCC's capital finance and treasury management activities.

2.2 The above policies and parameters will also provide an approved framework within which officers will undertake and account for the PCC's day-to-day capital and treasury activities.

2.3 The PCC needs to be satisfied that the Strategy is relevant and appropriate since it will enable him to discharge his statutory obligations in this key policy and financial management area.

3 Financial comments

3.1 The attached Treasury Management Strategy Statement is fully consistent with the revenue budget for 2020/21, the medium term financial plan (2020/21 to 2022/23) and the medium term capital plan.

3.2 The individual capital prudential indicators and the treasury management activity limits are clearly set out in the Statement, as is the annual borrowing and investment strategy.

4 Legal comments

4.1 The PCC is required to approve an annual treasury management and investment strategy. Quarterly monitoring reports will be provided directly to the PCC.

5 Equality comments

5.1 No specific implications arising from this report

6 Background papers

Link Asset Services draft Treasury Management Strategy Statement

Public access to information Information in this form is subject to the Freedom of Information Act 2000 (FOIA) and other legislation. Part 1 of this form will be made available on the website within 1 working day of approval. Any facts and advice that should not be automatically available on request should not be included in Part 1 but instead on a separate Part 2 form. Deferment of publication is only applicable where release before that date would compromise the implementation of the decision being approved.
Is the publication of this form to be deferred? No
Is there a Part 2 form? No

Name & Role	Officer
Head of Unit This document is consistent with the draft annual revenue budget and draft capital programme. It also meets all the legal requirements set out below	PCC Chief Finance Officer
Legal Advice This document complies fully with the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG Minimum Revenue Provision guidance, the CIPFA Treasury Management Code of Practice and CLG Investment Guidance.	Chief Executive
Financial Advice The draft Treasury Management Strategy Statement is fully consistent with the draft revenue budget and draft capital programme. Quarterly monitoring reports will be prepared and presented to the PCC	PCC Chief Finance Officer
Equalities & Diversity No specific implications arising from this report	Chief Executive

PCC's STATUTORY OFFICERS' APPROVAL

We have been consulted about the proposal and confirm that financial and legal advice have been taken into account in the preparation of this report. We are satisfied that this is an appropriate request to be submitted to the Police and Crime Commissioner. Chief Executive   Date: 30 January 2020 Chief Finance Officer   Date: 30 January 2020

POLICE & CRIME COMMISSIONER
THAMES VALLEY

Treasury Management Strategy Statement 2020/21

incorporating the Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2020/21

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1 INTRODUCTION

1.1 Background

The Police and Crime Commissioner (PCC) is required to operate a balanced budget, which broadly means that cash income raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the PCC's low risk policy and appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the PCC's capital plans. These capital plans provide a guide to the PCC's borrowing need, essentially the longer term cash flow planning to ensure that the PCC can meet his capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet the PCC's risk or cost objectives.

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management 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."*

1.2 Reporting requirements

1.2.1 Capital strategy

The 2017 version of the CIPFA Prudential and Treasury Management Codes required all local authorities, including local policing bodies, to prepare a capital strategy report before the start of the 2019/20 financial year, to provide:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

The aim of this capital strategy is to ensure that the PCC fully understands the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

This capital strategy is reported separately from the Treasury Management Strategy Statement. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. The updated capital strategy for 2020/21 will be presented to the PCC at his budget setting meeting on 21st January 2020.

1.2.2 Treasury Management reporting

The PCC is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid-year treasury management report – This will update the PCC with progress on the capital position, amending prudential indicators as necessary, and will indicate whether the treasury operation is meeting the strategy or whether any policies require revision. In addition, this PCC will receive quarterly update reports in July and January.

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the PCC. As and when appropriate this role will be undertaken by the Joint Independent Audit Committee.

1.3 Treasury Management Strategy for 2020/21

The strategy for 2020/21 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) strategy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the PCC;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members (*sic*) with responsibility for treasury management receive adequate training in treasury management. This especially applies to members (*sic*) responsible for scrutiny.

The PCC and all five members of the Joint Independent Audit Committee have been provided with appropriate training. Further training will be provided as and when required.

The training needs of treasury management staff are reviewed periodically.

1.5 Treasury management consultants

The Office of the PCC uses Link Asset Services as its external treasury management advisors.

The PCC recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

The PCC also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The PCC will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2 THE CAPITAL PRUDENTIAL INDICATORS 2018/19 – 2023/24

The PCC's capital expenditure plans are the key driver of treasury management activity. The output from the capital expenditure plans are reflected in prudential indicators.

2.1 Capital expenditure and financing

The PCC is asked to approve the summary capital expenditure and financing projections. Any shortfall in resources results in a funding borrowing need. This forms the first prudential indicator.

Table 1	2018/19 Actual £m	2019/20 Revised Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Capital Expenditure	22.749	44.373	38.401	25.746	12.732	7.536
Financed by:						
Capital receipts	10.744	7.792	6.225	3.275	9.650	0.650
Capital grants	0.817	9.384	9.660	0.396	0.396	0.396
Revenue Reserves	5.203	0.000	0.000	0.000	0.000	0.000
Revenue contributions	5.693	10.270	9.582	11.082	11.082	11.082
3rd party contributions	0.292	0.150	0.150	0.150	0.150	0.150
Other Income	0.000	0.000	0.000	0.000	0.000	0.000
Capital Reserves	0.000	0.000	0.000	0.000	0.000	0.000
Improvement & Performance Reserve	0.000	0.050	1.145	0.680	0.000	0.000
Optimism Bias Reserve	0.000	3.407	4.639	0.845	0.028	0.000
Cashflow – timing issues[1]	0.000	0.000	0.000	9.318	-8.574	-4.742
Net financing need for the year	**0.000**	**13.320**	**7.000**	**0.000**	**0.000**	**0.000**

[1]. If all capital expenditure is incurred as scheduled in the Medium Term Capital Plan then we may not have sufficient capital resources in 2021/22 to cover the expenditure as it is incurred. Should this situation arise, which is unlikely, we would use general balances or general cashflow until the capital resources are received e.g. from the sale of assets.

2.2 The PCC's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the PCC's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the PCC's underlying borrowing need. Any capital expenditure included in the table above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life.

The CFR includes other long term liabilities such as PFI schemes and finance leases. Whilst these increase the CFR, and therefore the borrowing requirement, these types of scheme include a borrowing facility and so the PCC is not required to separately borrow for these schemes. The PCC currently [2019/20] has £5.195m of such schemes within the CFR.

The PCC is asked to approve the following CFR projections.

Table 2	2018/19 Actual £m	2019/20 Revised Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Opening CFR	**45.283**	**44.137**	**56.288**	**61.827**	**60.198**	**58.539**
Net financing need for the year (per Table 1 above)	0.000	13.320	7.000	0.000	0.000	0.000
Less MRP & VRP debt charged to accounts	-0.863	-0.862	-1.129	-1.269	-1.269	-1.269
Less Finance Lease Liability repayment	- 0.283	- 0.307	- 0.332	- 0.360	- 0.390	-0.422
Movement in CFR	**-1.146**	**12.151**	**5.539**	**-1.629**	**-1.659**	**-1.691**
Closing CFR	**44.137**	**56.288**	**61.827**	**60.198**	**58.539**	**56.848**

2.3 Minimum revenue provision (MRP) policy statement

The PCC is required to pay off an element of the accumulated capital spend each year (the CFR) and make a statutory charge to revenue for the repayment of debt, known as the minimum revenue provision (MRP). The MRP policy sets out how the PCC will pay for capital assets through revenue each year. The PCC is also allowed to make additional voluntary payments (voluntary revenue provision - VRP).

CLG regulations have been issued which require the PCC to approve an MRP Statement in advance of each year. A variety of options are provided, so long as there is a prudent provision.

The PCC is recommended to approve the following MRP Statement:

- For capital expenditure incurred before 1 April 2008, MRP will be based on the Regulatory Method. MRP will be written down over a fixed 50 year period
- For capital expenditure incurred from 1 April 2008, the MRP will be based on the 'Asset Life Method', whereby MRP will be based on the estimated life of the assets in accordance with the regulations.
- For finance leases, an 'MRP equivalent' sum will be paid off each year.

2.4 Core funds and expected investment balances

Investments will be made with reference to the core balances, future cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Table 3 below provides an estimate of the year end balances for each resource and anticipated day to day cash flow balances.

Table 3 Year End Resources	2018/19 Actual £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
General balances	18.705	16.387	15.402	14.697	14.227	14.227
Earmarked revenue reserves	24.456	19.008	11.173	4.871	4.193	3.543
Capital grants and reserves	18.191	7.154	-0.050	-9.368	-0.794	3.948
Insurance provision	8.627	8.627	8.627	8.627	8.627	8.627
Total core funds	**69.979**	**51.176**	**35.152**	**18.827**	**26.253**	**30.345**
Working capital*	2.530	2.530	2.530	2.530	2.530	2.530
Expected investments	**72.509**	**53.706**	**37.682**	**21.537**	**28.783**	**32.875**

* The working capital balance is the average difference between cash investments and core cash balances from the last 5 financial years. The actual figure will obviously vary from day to day according to circumstances.

2.5 Affordability prudential indicators

The previous sections cover the overall capital expenditure and control of borrowing prudential indicators but, within this framework, prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the PCC's overall finances. The PCC is asked to approve the following indicators:

2.6 Ratio of financing costs to net revenue stream.

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. The estimates of financing costs include current commitments and the proposals in this budget report.

Table 4 Ratio of Financing Costs to Net Revenue Stream	2018/19 Actual %	2019/20 Estimate %	202021 Estimate %	2021/22 Estimate %	2022/23 Estimate %
Ratio	0.34	0.38	0.55	0.60	0.60

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activities of the PCC. The treasury management function ensures that the PCC's cash is organised in accordance with the relevant professional codes so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The PCC's borrowing portfolio position at 31 March 2019, with forward projections, is summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement or CFR), highlighting any over or under borrowing.

Table 5 PCC Borrowing Portfolio	2018/19 Actual %	2019/20 Estimate %	2020/21 Estimate %	2021/22 Estimate %	2022/23 Estimate %
External Debt					
Debt at 1 April	22.478	27.478	51.798	52.798	52.798
Expected change in Debt	5.000	24.320	1.000	0.000	0.000
Other long-term liabilities (OLTL) at 1st April	5.478	5.195	4.888	4.556	4.196
Expected change in OLTL	-0.283	-0.307	-0.332	-0.360	-0.390
Actual gross debt at 31 March	**32.673**	**56.686**	**57.354**	**56.994**	**56.604**
The CFR	**44.137**	**56.288**	**61.827**	**60.198**	**58.539**
Under / (over) borrowing	**11.464**	**-0.398**	**4.473**	**3.204**	**1.935**

Within the prudential indicators there are a number of key indicators to ensure that the PCC operates their activities within well-defined limits. One of these is that the PCC needs to ensure that their gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Chief Finance Officer reports that the PCC has complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: limits to borrowing activity

The **operational boundary** for external debt is based on ‘probable’ debt during the year and is a benchmark guide, not a limit. Actual debt could vary around this boundary for short periods during the year. It should act as a monitoring indicator to initiate timely action to ensure the statutory mandatory indicator (the ‘Authorised Limit’, per Table 7 below) is not breached inadvertently.

Table 6 Operational boundary	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Debt	51.798	52.798	52.798	52.798
Other long term liabilities	5.195	4.888	4.556	4.196
Short Term liabilities	20.000	20.000	20.000	20.000
Total	**76.993**	**77.686**	**77.354**	**76.994**

The **authorised limit** for external debt is a key prudential indicator which provides control on the overall level of affordable borrowing. It represents a limit beyond which external debt is prohibited and needs to be set and/or revised by the PCC. It reflects the level of external debt which, whilst not necessarily desired, could be afforded in the short term, but is not sustainable in the longer term. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all local authority plans, or those of a specific authority (or PCC), although this power has not yet been exercised.

The PCC is asked to approve the following authorised limit:

Table 7 Authorised limit	2019/20	2020/21	2021/22	2022/23
Debt	71.798	72.798	72.798	72.798
Other long term liabilities	5.195	4.888	4.556	4.196
Short Term liabilities	20.000	20.000	20.000	20.000
Total	**96.993**	**97.686**	**97.354**	**96.994**

3.3 Prospects for interest rates[1]

The PCC has appointed Link Asset Services as his treasury advisor and part of their service is to assist the PCC to formulate a view on borrowing interest rates. The following table and subsequent paragraphs give the Link forecast view.

Table 8	Bank Rate	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
	%	%	%	%
Mar 2020	0.75	2.40	3.30	3.20
Jun 20120	0.75	2.40	3.40	3.30
Sep 2020	0.75	2.50	3.40	3.30
Dec 2020	0.75	2.50	3.50	3.40
Mar 2021	1.00	2.60	3.60	3.50
Jun 2021	1.00	2.70	3.70	3.60
Sep 2021	1.00	2.80	3.70	3.60
Dec 2021	1.00	2.90	3.80	3.70
Mar 2022	1.00	2.90	3.90	3.80
Jun 2022	1.25	3.00	4.00	3.90
Sep 2022	1.25	3.10	4.00	3.90
Dec 2022	1.25	3.20	4.10	4.00
Mar 2023	1.25	3.20	4.10	4.00

"The above interest rate forecasts have been based on an assumption that there is an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU, at some point in time. The result of the general election has removed much uncertainty around this major assumption. However, it does not remove uncertainty around whether agreement can be reached with the EU on a trade deal within the short time to December 2020, as the prime minister has pledged.

On this basis, while GDP growth is likely to be subdued in 2019 and 2020 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement on the detailed terms of a trade deal is likely to lead to a boost to the rate of growth in subsequent years. This could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an **orderly non-agreement exit in December 2020**, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.
- If there were a **disorderly Brexit**, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields

1. As of 7 January 2020

correspondingly. Quantitative easing could also be restarted by the Bank of England. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably even, but dependent on a successful outcome of negotiations on a trade deal.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.
- In the event that a Brexit deal was agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit and the outcome of the general election. In its meeting on 7 November, the MPC became more dovish due to increased concerns over the outlook for the domestic economy if Brexit uncertainties were to become more entrenched, and for weak global economic growth: if those uncertainties were to materialise, then the MPC were likely to cut Bank Rate. However, if they were both to dissipate, then rates would need to rise at a “gradual pace and to a limited extent”. Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. There is still some residual risk that the MPC could cut Bank Rate as the UK economy is still likely to only grow weakly in 2020 due to continuing uncertainty over whether there could effectively be a no deal Brexit in December 2020 if agreement on a trade deal is not reached with the EU. Until that major uncertainty is removed, or the period for agreeing a deal is extended, it is unlikely that the MPC would raise Bank Rate.

Bond yields / PWLB rates. There has been much speculation during 2019 that the bond market has gone into a bubble, as evidenced by high bond prices and remarkably low yields. However, given the context that there have been heightened expectations that the US was heading for a recession in 2020, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated, as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts; at various times this correlation has been strong but at other times weak. However, forecasting the timing of this, and how strong the correlation is likely to be, is very difficult to forecast with any degree of confidence. Changes in UK Bank Rate will also impact on gilt yields.

One potential danger that may be lurking in investor minds is that Japan has become mired in a twenty-year bog of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that this condition might become contagious to other western economies.

Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt-fuelled boom that now makes it harder for central banks to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

In addition, PWLB rates are subject to ad hoc decisions by H.M. Treasury to change the margin over gilt yields charged in PWLB rates: such changes could be up or down. It is not clear that if gilt yields were to rise back up again by over 100bps within the next year or so, whether H M Treasury would remove the extra 100 bps margin implemented on 9.10.19.

Economic and interest rate forecasting remains difficult with so many influences weighing on UK gilt yields and PWLB rates. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments."

Investment and borrowing rates

- Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earnings.

- Borrowing interest rates were on a major falling trend during the first half of 2019-20 but then jumped up by 100 bps on 9 October 2019. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. However, the unexpected increase of 100 bps in PWLB rates requires a major rethink of local authority treasury management strategy and risk management. Now that the gap between longer term borrowing rates and investment rates has materially widened, and in the long term Bank Rate is not expected to rise above 2.5%, it is unlikely that the PCC will do any further longer term borrowing over the next three years other than required to fund the Medium Term Financial Plan, or until such time as the extra 100 bps margin is removed.

3.4 Borrowing strategy

The PCC is currently in a marginally over-borrowed position. However, in 2020/21 we will return to under-borrowing position which means the capital borrowing need (the Capital Financing Requirement) has not been fully funded with loan debt as cash supporting the PCC's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as, currently, investment returns are low and counterparty risk is still an issue that needs to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances, e.g:

- *if it was felt that there was a significant risk of a sharp FALL in borrowing rates,* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then borrowing will be postponed.
- *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast,* perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any urgent decisions taken by the Chief Finance Officer will be reported to the PCC at the next available opportunity.

For budget planning purposes we have assumed that £0.750m of new borrowing will be taken in 2020/21 to help finance the Medium Term Capital Plan (MTCP). This is lower than shown in the MTCP report since £6m of the 2020/21 borrowing requirement has already been taken in 2019/20.

We will continue to minitor the forecast level of under-borrowing given the plans currently in place to utilise a significant proportion of the currently held revenue and capital reserves in coming years to help support one-off expenditure initiatives, including investment in new technology and change programmes.

Treasury management limits on activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies the maximum limit for variable interest rates for both borrowing and investments.
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the PCC's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The PCC is asked to approve the following treasury indicators and limits:

Table 9	**2020/21**	**2021/22**	**2022/23**
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates: • *Debt only* • *Investments only*	 *100%* *100%*	 *100%* *100%*	 *100%* *100%*
Limits on variable interest rates • *Debt only* • *Investments only*	 *50%* *100%*	 *50%* *100%*	 *50%* *100%*
Maturity structure of fixed interest rate borrowing 2020/21			
		Lower	**Upper**
Under 12 months		0%	50%
12 months to 2 years		0%	50%
2 years to 5 years		0%	50%
5 years to 10 years		0%	50%
10 years and above		0%	100%
Maturity structure of variable interest rate borrowing 2020/21			
		Lower	***Upper***
Under 12 months		*0%*	*100%*
12 months to 2 years		*0%*	*100%*
2 years to 5 years		*0%*	*100%*
5 years to 10 years		*0%*	*100%*
10 years and above		*0%*	*100%*

3.5 Policy on borrowing in advance of need

The PCC will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the PCC can ensure the security of such funds.

3.6 Debt rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Any rescheduling undertaken will be formally reported to the PCC in the next quarterly performance update.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments are covered in the Capital Strategy (a separate report).

The PCC's investment policy has regard to the following:

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code").
- CIPFA Treasury Management Guidance Notes 2018

The PCC's investment priorities will be security first, liquidity second, then return.

In accordance with the above guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the PCC applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the PCC will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

Investment instruments identified for use in the financial year are listed in appendix 5.2 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

4.2 Creditworthiness policy

The PCC applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the PCC to determine the suggested duration for investments. The PCC will therefore use counterparties within the following durational bands.

- Yellow 5 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

The Link Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the PCC uses will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored weekly. The PCC is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service:

- if a downgrade results in the counterparty / investment scheme no longer meeting the PCC's minimum criteria, its further use as a new investment will be withdrawn immediately.

- in addition to the use of credit ratings the PCC will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the PCC's lending list.

Sole reliance will not be placed on the use of this external service. In addition the PCC will also use market data and market information, information on any external support for banks to help support its decision making process.

UK banks – ring fencing

The largest UK banks (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits) are required by UK law to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The PCC will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

4.3 Country limits

The PCC has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.3. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

The UK is excluded from any stipulated minimum sovereign rating requirement.

4.4 Investment strategy

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). The majority of funds will be placed in call accounts, money market funds or short-term deposits. Alternatively, tradable certificates of deposit (CDs) will be acquired.

Investments of up to 2 years will also be allowed with the Royal Bank of Scotland Group. No material change in Government ownership is expected during that period. This policy will potentially enable the PCC to lock in investment returns whilst continuing to adopt a low risk approach.

On the assumption that the UK and EU agree a Brexit deal including the terms of trade by the end of 2020 or soon after, then Bank Rate is forecast to increase only slowly over the next few years to reach 1.25% by quarter 1 2023. Bank Rate forecasts for financial year ends (March) are:

- 2020/21 0.75%
- 2021/22 1.00%
- 2022/23 1.25%

The suggested budgeted investment earnings rates for returns on investments placed for periods of up to 3 months days during each financial year are as follows:

	Now
2019/20	0.75%
2020/21	0.75%
2021/22	1.00%
2022/23	1.25%
2023/24	1.50%
2024/25	1.75%
Later years	2.25%

- The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are broadly similar to the downside.
- In the event that a Brexit deal is agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

Investment treasury indicator and limit - total principal funds invested for greater than 364 days. These limits are set with regard to the PCC's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end. A limit of £20m is recommended in order to provide officers with flexibility to take advantage of time and cash limited offers, which sometimes exceed 364 days when initially offered, or to place deposits for up to 2 years in order to lock in investments returns whilst continuing to adopt a low risk approach.

The PCC is asked to approve the treasury indicator and limit:

Table 10 - Maximum principal sums invested > 364 days			
	2020/21	**2021/22**	**2022/23**
Principal sums invested	£20m	£20m	£20m

4.5 Investment risk benchmarking

The PCC has approved benchmarks for investment Security, Liquidity and Yield.

These benchmarks are simple guideline targets (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position, and amend the operational strategy depending on any changes.

The proposed benchmarking targets for 2020/21 are set out below:

a) **Security** - the PCC's maximum security risk benchmark for the current portfolio, when compared to historic default tables, is:
   - 0.25% historic risk of default when compared to the whole portfolio.

b) **Liquidity** – in respect of this area the OPCC seeks to maintain:
- Bank overdraft limit - £0.1m
- Liquid short term deposits - including the receipt of government grants, council tax precept income and use of short-term borrowing - of at least £5m available within one week.
- 'Weighted Average Life' benchmark - 9 months (270 days), with a maximum of 2 years.

c) **Yield** – performance target is to achieve:
- an average return above the weighted average 7 day, 3, 6 and 12 month LIBID rates (i.e. the bespoke TVP benchmark)

Any breach of the indicators or limits will be reported to the PCC, with supporting reasons, in the quarterly performance monitoring reports. Members of the Joint Independent Audit Committee will also be notified.

4.6 End of year investment report

At the end of the financial year the Chief Finance Officer will report on the investment activity as part of his Annual Treasury Report.

5 Appendices

5.1 Economic background (as provided by Link on 07.01.2020)

UK. Brexit. 2019 has been a year of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October 2019, with or without a deal. However, MPs blocked leaving on that date and the EU agreed an extension to 31 January 2020. In late October, MPs approved an outline of a Brexit deal to enable the UK to leave the EU on 31 January; however, even if a Conservative Government gains an overall majority in the general election on 12 December, there will still be much uncertainty as the detail of a trade deal will need to be negotiated by the current end of the transition period in December 2020.

GDP growth has taken a hit from Brexit uncertainty during 2019; quarter three 2019 surprised on the upside by coming in at +0.4% q/q, +1.1% y/y. However, the peak of Brexit uncertainty during the final quarter appears to have suppressed quarterly growth to probably around zero. The economy is likely to tread water in 2020, with tepid growth around about 1% until there is more certainty after the trade deal deadline is passed.

While the Bank of England went through the routine of producing another quarterly Inflation Report, (now renamed the Monetary Policy Report), on 7 November, it is very questionable how much all the writing and numbers are worth when faced with the uncertainties of where the UK will be after the general election. The Bank made a change in their Brexit assumptions to now include a deal being eventually passed. Possibly the biggest message that is worth taking note of from the Monetary Policy Report, was an increase in concerns among MPC members around weak global economic growth and the potential for Brexit uncertainties to become entrenched and so delay UK economic recovery. Consequently, the MPC voted 7-2 to maintain Bank Rate at 0.75% but two members were sufficiently concerned to vote for an immediate Bank Rate cut to 0.5%. The MPC warned that if global growth does not pick up or Brexit uncertainties intensify, then a rate cut was now more likely. Conversely, if risks do recede, then a more rapid recovery of growth will require gradual and limited rate rises. The speed of recovery will depend on the extent to which uncertainty dissipates over the final terms for trade between the UK and EU and by how much global growth rates pick up. The Bank revised its inflation forecasts down – to 1.25% in 2019, 1.5% in 2020, and 2.0% in 2021; hence the MPC views inflation as causing little concern in the near future.

The MPC meeting of 19 December repeated the previous month's vote of 7-2 to keep Bank Rate on hold. Their key view was that there was currently 'no evidence about the extent to which policy uncertainties among companies and households had declined' i.e. they were going to sit on their hands and see how the economy goes in the next few months. The two members who voted for a cut were concerned that the labour market was faltering. On the other hand, there was a clear warning in the minutes that the MPC were concerned that "domestic unit labour costs have continued to grow at rates above those consistent with meeting the inflation target in the medium term".

If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with Bank Rate still only at 0.75%. It would therefore, probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this direction and it made significant promises in its election manifesto to increase government spending by up to £20bn p.a., (this would add about 1% to GDP growth rates), by investing primarily in infrastructure. This is likely to be announced in the next Budget, probably in February 2020. The Chancellor has also amended the fiscal rules in November to allow for an increase in government expenditure.

As for inflation itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell again in both October and November to a three-year low of 1.5%. It is likely to remain close to or under 2% over the next two years and so, it does not pose any immediate concern to the MPC at the current time. However, if there was a hard or no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

With regard to the labour market, growth in numbers employed has been quite resilient through 2019 until the three months to September where it fell by 58,000. However, there was an encouraging pick up again in the three months to October to growth of 24,000, which showed that the labour market was not about to head into a major downturn. The unemployment rate held steady at a 44-year low of 3.8% on the Independent Labour Organisation measure in October. Wage inflation has been steadily falling from a high point of 3.9% in July to 3.5% in October (3-month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.0%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The other message from the fall in wage growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of growth to a robust 2.9% y/y. Growth in 2019 has been falling after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2 and then 2.1% in quarter 3. The economy looks likely to have maintained a growth rate similar to quarter 3 into quarter 4; fears of a recession have largely dissipated. The strong growth in employment numbers during 2018 has weakened during 2019, indicating that the economy had been cooling, while inflationary pressures were also weakening. However, CPI inflation rose from 1.8% to 2.1% in November, a one year high, but this was singularly caused by a rise in gasoline prices.

The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not intended to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc.). It then cut rates by 0.25% again in September and by another 0.25% in its October meeting to 1.50 – 1.75%. At its September meeting it also said it was going to start buying Treasuries again, although this was not to be seen as a resumption of quantitative easing but rather an exercise to relieve liquidity pressures in the repo market. Despite those protestations, this still means that the Fed is again expanding its balance sheet holdings of government debt. In the first month, it will buy $60bn, whereas it had been reducing its balance sheet by $50bn per month during 2019. As it will be buying only short-term (under 12 months) Treasury bills, it is technically correct that this is not quantitative easing (which is purchase of long term debt). The Fed left rates unchanged in December. However, the accompanying statement was more optimistic about the future course of the economy so this would indicate that further cuts are unlikely.

Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This **trade war** is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.
However, in November / December, progress has been made on agreeing a phase one deal between the US and China to roll back some of the tariffs; this gives some hope of resolving this dispute.

EUROZONE. Growth has been slowing from +1.8 % during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1, +0.2% q/q (+1.2% y/y) in quarter 2 and then +0.2% q/q, +1.1% in quarter 3; there appears to be little upside potential in the near future. German GDP growth has been struggling to stay in positive territory in 2019 and fell by -0.1% in quarter 2; industrial production was down 4% y/y in June with car production down 10% y/y. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars.

The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which then meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by quantitative easing purchases of debt. However, the downturn in EZ growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels "at least through the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a third round of TLTROs (Targeted longer-term refinancing operations); this provides banks with cheap borrowing every three months from September 2019 until March 2021 that means that, although they will have only a two-year maturity, the Bank was making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum; at its meeting on 12 September it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a **resumption of quantitative easing purchases of debt for an unlimited period.** At its October meeting it said these purchases would start in November at €20bn per month - a relatively small amount compared to the previous buying programme. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and, unsurprisingly, the ECB stated that governments would need to help stimulate growth by 'growth friendly' fiscal policy.

There were no policy changes in the December meeting, which was chaired for the first time by the new President of the ECB, Christine Lagarde. However, the outlook continued to be down beat about the economy; this makes it likely there will be further monetary policy stimulus to come in 2020. She did also announce a thorough review of how the ECB conducts monetary policy, including the price stability target. This review is likely to take all of 2020.

On the political front, Austria, Spain and Italy have been in the throes of **forming coalition governments** with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The latest results of German state elections has put further pressure on the frail German CDU/SDP coalition government and on the current leadership of the CDU. The results of the Spanish general election in November have not helped the prospects of forming a stable coalition.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and shadow banking systems. In addition, there still needs to be a greater switch from investment in industrial capacity, property construction and infrastructure to consumer goods production.

JAPAN - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

WORLD GROWTH. Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, 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. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation. Central banks are, therefore, likely to come under more pressure to support growth by looser monetary policy measures and this will militate against central banks increasing interest rates.

The trade war between the US and China is a major concern to financial markets due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns resulted in government bond yields in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been predicting a downturn in growth; this confirms investor sentiment that the outlook for growth during the year ahead is weak.

5.2 Credit and Counterparty Risk Management

Specified and Non-Specified Investments and Limits

Specified Investments

'Specified' investments are sterling investments of not more than one year maturity made with any institution meeting the minimum 'high' quality criteria where applicable

Non-Specified Investments

These are any investments which do not meet the specified investment criteria. A maximum of 50% will be held in aggregate in non-specified investment

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

Investments of up to 2 years will continue to be allowed with the Royal Bank of Scotland (RBS) Group, since no material change in Government ownership is expected during that period. This policy will potentially enable the PCC to lock in investment returns whilst continuing to adopt a low risk approach.

The proposed criteria for (a) Specified and (b) Non-Specified investments are presented below for approval.

a) Specified Investments

These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the PCC has the right to be repaid within 12 months if it wishes.

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	Minimum credit criteria / colour band	Maximum investment per institution	Maximum maturity period
The PCC's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.		Minimal	
DMADF – UK Government	N/A	No limit	6 months
Money Market Funds (MMF) – (Low Volatility Net Asset Value) & (Constant Net Asset Value)	AAA by at least 2 rating agencies and minimum asset base of £500m	£25m or 1% of total asset base per institution whichever is the lower figure	Liquid (instant access)
Local authorities	N/A	£10m	1 year
Term deposits with RFB banks and building societies	Blue Orange Red Green	£40m £30m £20m £15m	Up to 1 year Up to 1 year Up to 6 months Up to 100 days
CDs or corporate bonds with RFB banks and building societies	Blue Orange Red Green	£40m £30m £20m £15m	Up to 1 year Up to 1 year Up to 6 months Up to 100 days

b) Non-Specified Investments

Non-specified investments are any other type of investment (i.e. not defined as 'specified' above). The identification and rationale supporting the selection of these other investments, and the maximum limits to be applied, are set out below.

Non-specified investments would include any sterling investments with:

	Minimum credit criteria / colour band	Maximum investment per institution	Maximum maturity period
Local authorities	N/A	£10m	5 years
Term deposits with banks and building societies	Purple Blue (RBS)	£30m £20m	Up to 2 years Up to 2 years
CDs or corporate bonds with banks and building societies	Purple Blue (RBS)	£30m £40m	Up to 2 years Up to 2 years

5.3 Approved Countries for investments

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Hong Kong
- U.K.

AA-

- Belgium
- Qatar

THIS LIST IS AS AT 03.01.20