ITEM No …10….…….

REPORT TO: **PENSION SUB-COMMITTEE OF THE POLICY & RESOURCES COMMITTEE & PENSION BOARD – 13 DECEMBER 2021**

REPORT ON: **TREASURY MANAGEMENT ACTIVITY 2021/2022 (MID-YEAR REVIEW)**

REPORT BY: **EXECUTIVE DIRECTOR OF CORPORATE SERVICES**

REPORT NO: **346-2021**

1 PURPOSE OF REPORT

To review Tayside Pension Fund's Treasury Management activities for the period 1 April 2021 to 30 September 2021.

2 RECOMMENDATION

The Sub-Committee is asked to note the contents of the report.

3 FINANCIAL IMPLICATIONS

The Treasury Management activity during the first half of the current financial year indicates that investment income from cash balances held to pay pension benefits will be approximately £1,000 for 2021/2022.

4 BACKGROUND

Tayside Pension Fund is administered by Dundee City Council in accordance with Section 24 of its Financial Regulations. Investment policy and decisions (including those relating to Treasury Management) are delegated to the Pension Sub-Committee of the Policy and Resources Committee. The Pension Board assist the Sub-Committee with securing compliance to the regulations.

The primary objective of the Tayside Pension Fund is to provide for scheme members' pension and lump sum benefits on their retirement or for their dependants on death before or after retirement, on a defined benefits basis. There is limited discretion to vary these benefits.

Dundee City Council in its administering role, defines its treasury management activities as:

"The management of the 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."

It regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation and any financial instruments entered into to manage these risks.

It acknowledges that effective treasury management will provide support towards the achievement of its business and services objectives. It is therefore committed to the principles of achieving value for money in treasury management and to employing suitable performance measurement techniques, within the context of effective risk management.

All treasury management activities must comply with the appropriate regulations, codes and guidance as stated in the Treasury Management Policy Statement of Dundee City Council.

At its meeting on 8 March 2021, the Pension sub-committee of the Policy and Resources Committee and Pension Board approved the Fund's Treasury Policy Statement (Report no. 75-2021, article XI of minute refers) setting out the policies which would govern all lending transactions carried out by the Fund.

The Treasury Policy Statement requires that the Pension sub-committee of the Policy and Resources Committee and Pension Board will receive and consider the Treasury Management Strategy at the beginning of each new financial year.

On 8 March 2021, the Pension sub-committee of the Policy and Resources Committee and Pension Board approved the Fund's Treasury Management Strategy for 2021/2022 (Report no. 76-2021, article XII of minute refers).

This monitoring report covers the Treasury Management activity over the first six months of 2021/2022 financial year for cash held to pay pension benefits. Fund managers will also hold cash within custodian bank accounts, these amounts are excluded from this report.

5 ACTUAL LENDING

Variations in cash flow requirements mean that there will be surplus funds which will be invested for short periods (maximum of 364 days). Short term investments will be restricted only to those institutions identified in the Fund's Approved Counterparties list provided they have maintained a suitable credit rating.

An analysis of the lending position to 30 September 2021 shows:

Month	Lowest Amount Lent £m	Highest Amount Lent £m	End of month Amount Lent £m	Interest Rate Range % Min	Max
April 2021	2.900	23.000	8.000	0.01	0.01
May 2021	4.250	8.000	4.250	0.01	0.01
June 2021	2.750	9.750	9.750	0.01	0.01
July 2021	4.750	9.750	4.750	0.01	0.01
August 2021	2.750	9.750	9.750	0.01	0.01
September 2021	6.750	9.750	6.750	0.01	0.01

All cash investments were compliant with Treasury Policy Statement.

6 INTEREST RATE OUTLOOK 2021/2022

The Council's appointed treasury advisors (Link Group) assist the Council in formulating a view on interest rates. Link Group provided the following forecasts on 29th September 2021. These interest rate forecasts are for various terms, PWLB certainty rates are gilt yields plus 80bps:

	Dec-21	**Mar-22**	**Jun-22**	**Sep-22**	**Dec-22**	**Mar-23**
Bank Rate View	0.10%	0.10%	0.25%	0.25%	0.25%	0.25%
3m average earnings	0.10%	0.10%	0.20%	0.20%	0.30%	0.30%
6m average earnings	0.20%	0.20%	0.30%	0.30%	0.40%	0.40%
12m average earnings	0.30%	0.40%	0.50%	0.50%	0.50%	0.60%
5yr PWLB Rate	1.40%	1.40%	1.50%	1.50%	1.60%	1.60%
10yr PWLB Rate	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
25yr PWLB Rate	2.20%	2.20%	2.30%	2.30%	2.40%	2.40%
50yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.20%

	Jun-23	**Sep-23**	**Dec-23**	**Mar-24**
Bank Rate View	0.50%	0.50%	0.50%	0.50%
3m average earnings	0.50%	0.50%	0.50%	0.50%

6m average earnings	0.60%	0.60%	0.70%	0.80%
12m average earnings	0.70%	0.80%	0.90%	1.00%
5yr PWLB Rate	1.60%	1.70%	1.70%	1.70%
10yr PWLB Rate	2.00%	2.10%	2.10%	2.10%
25yr PWLB Rate	2.40%	2.50%	2.50%	2.60%
50yr PWLB Rate	2.20%	2.30%	2.30%	2.40%

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. As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 2 of 2022/23, a second increase to 0.50% in quarter 2 of 2023/24 and a third one to 0.75% in quarter 4 of 2023/24. A full Economic Update is available within appendix 1 of this report.

7 POLICY IMPLICATIONS

This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management. There are no major issues other than the risks noted in the Risk Register.

8 CONSULTATIONS

The Chief Executive and Head of Democratic and Legal Services have been consulted in the preparation of this report.

9 BACKGROUND PAPERS

None.

ROBERT EMMOTT
EXECUTIVE DIRECTOR OF CORPORATE SERVICES **03 DECEMBER 2021**

APPENDIX 1

ECONOMIC UPDATE AS AT 30 SEPTEMBER 2021

UK

Monetary Policy Committee Meeting 24.9.21

- 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 of the MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures.

- There was a major shift in the tone at this meeting from the previous meeting in August which had focussed 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. In his press conference after the August 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.” This flagged up a potential danger that labour shortages could push up wage growth by more than expected and that, as a result, 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.

- At the September meeting, 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 that will likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected. 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, 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%’. Whereas in August, 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.

- Following this, financial markets priced in a first increase in Bank Rate from 0.10% to 0.25% in February 2022, which looks ambitious considering that the MPC has stated that it wants to see what happens to the economy, and particularly employment once furlough ends at the end of September. At the MPC’s meeting in February 2022, it will only have employment figures for November available, therefore in order to get a clearer picture of employment trends, the MPC would need to wait until the May meeting when it would have data up until February 2022, and they will also have a clearer understanding of the likely peak of inflation.

- The MPC’s forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows:

    1. Placing the focus on raising Bank Rate as “the active instrument in most circumstances”.

    2. Raising Bank Rate to 0.50% before starting on reducing its holdings.

    3. Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.

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

COVID-19 vaccines

These 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 question remains 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.

Rest of World

US - During the first part of the year, markets were unsettled by President Biden's determination to push through a $1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from Covid. This was in addition to the $900bn support package already passed in December 2020 under President Trump. This was then followed by additional Democratic ambition to spend further huge sums on infrastructure and an American Families plan over the next decade. Financial markets were alarmed that all this stimulus was happening at a time in the US when the economy had already been growing strongly during 2021, and the vaccination programme has enabled a rapid opening up of the economy. Also, that the Fed was still providing monetary stimulus through monthly QE purchases, and that the shortage of labour and supply bottle necks is likely to stoke inflationary pressures more in the US than in other countries. This could then force the Fed to take much earlier action to start tapering monthly QE purchases and/or increasing the Fed rate from near zero, despite their stated policy being to target average inflation.

It is notable that some Fed members have moved forward their expectation of when the first increases in the Fed rate will occur in recent Fed meetings. In addition, more recently, shortages of workers appear to be stoking underlying wage inflationary pressures which are likely to feed through into CPI inflation. A run of strong monthly jobs growth figures could be enough to meet the threshold set by the Fed of "substantial further progress towards the goal of reaching full employment". However, the weak growth in August, (announced 3.9.21), has spiked anticipation that tapering of monthly QE purchases could start by the end of 2021. These purchases are currently acting as downward pressure on treasury yields. As the US financial markets are, by far, the biggest financial markets in the world, any trend upwards in the US will invariably impact and influence financial markets in other countries. However, during June and July, longer term yields fell sharply; even the large non-farm payroll increase in the first week of August seemed to cause the markets little concern, which is somewhat puzzling, particularly in the context of the concerns of many commentators that inflation may not be as transitory as the Fed is expecting it to be. Indeed, inflation pressures and erosion of surplus economic capacity look much stronger in the US than in the UK.

EU - The slow role 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.

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.

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.

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.

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.