# Buckinghamshire & Milton Keynes Fire Authority

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| **MEETING** | Fire Authority |
| **DATE OF MEETING** | 12 February 2020 |
| **OFFICER** | Mark Hemming, Director of Finance & Assets |
| **LEAD MEMBER** | Councillor David Hopkins |
| **SUBJECT OF THE REPORT** | **Treasury Management Strategy 2020/21** |
| **EXECUTIVE SUMMARY** | This report is being presented as the Fire Authority is required to approve the Treasury Management Policy Statement, Treasury Management Strategy Statement and the Annual Investment Strategy. These documents (Appendix A) all support the Medium Term Financial Plan.<br><br>The current strategy is operating effectively and outperforming the benchmark targets. There is no significant change from the previous strategy. The rationale for this is due to the current cashflow position with a considerable amount being spent on our capital programme which has resulted in a reduction of funds being available to invest in comparison to previous years. |
| **ACTION** | Decision |
| **RECOMMENDATIONS** | It is recommended that the Authority approve the Treasury Management Policy Statement, Treasury Management Strategy Statement and the Annual Investment Strategy for 2020/21 |
| **RISK MANAGEMENT** | Making investments in the Authority's own name means that the Authority bears the risk of any counterparty failure. This risk will be managed in accordance with the strategy and with advice from external treasury management advisors.<br><br>The Director of Finance and Assets will act in accordance with the Authority's policy statement; treasury management practices and CIPFA's Standard of Professional Practice on Treasury Management. There are no direct staffing implications. |
| **FINANCIAL IMPLICATIONS** | The proposed budget for 2020-21 is £150k. It is anticipated that the budget will be met. Detailed information is shown within Appendix. |
| **LEGAL IMPLICATIONS** | The Authority is required by section 15(1) of the Local |

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| | Government Act 2003 to have regard to the Department for Communities and Local Government Guidance on Local Government Investments; and by regulation 24 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146] to have regard to any prevailing CIPFA Treasury Management Code of Practice.<br>Under section 12 of the Local Government Act 2003 the Authority has the power to invest for "any purpose relevant to its functions" and "for the purposes of the prudent management of its financial affairs".<br>However it must exercise its investment power in accordance with its fiduciary duty, analogous to that of a trustee, owed to those who contribute to the funds of the Authority. |
| **CONSISTENCY WITH THE PRINCIPLES OF THE DUTY TO COLLABORATE** | No direct impact. |
| **HEALTH AND SAFETY** | No direct impact. |
| **EQUALITY AND DIVERSITY** | No direct impact. |
| **USE OF RESOURCES** | The projected income has been factored into the Medium Term Financial Plan. |
| **PROVENANCE SECTION**<br>**&**<br>**BACKGROUND PAPERS** | CIPFA Code of Practice for Treasury Management in the Public Services (CIPFA Code)<br>Department for Communities and Local Government Guidance on Local Government Investments (DCLG Guidance) |
| **APPENDICES** | Appendix A – Treasury Management Policy Statement, Treasury Management Strategy Statement and Annual Investment Strategy<br>Appendix B – Provisional Counterparty List<br>Appendix C – Prospects for Interest Rates |
| **TIME REQUIRED** | 15 minutes |
| **REPORT ORIGINATOR AND CONTACT** | Asif Hussain<br>ahussain@bucksfire.gov.uk<br>(01296) 744421 |

## Appendix A – Treasury Management Policy Statement, Treasury Management Strategy Statement and Annual Investment Strategy

### Treasury Management Policy Statement

This Authority 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.

This Authority 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.

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

The investment policy objective for this Authority is the prudent investment of its treasury balances. The Authority's investment priorities are the security of capital and liquidity of its investments so that funds are available for expenditure when needed. Both the CIPFA Code and DCLG guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The generation of investment income to support the provision of local authority services is an important, but secondary, objective.

The Authority's borrowing objectives are to minimise the revenue costs of debt whilst maintaining a balanced loan portfolio. The Authority will set an affordable borrowing limit each year in compliance with the Local Government Act 2003, and will have regard to the CIPFA Prudential Code for Capital Finance in Local Authorities when setting that limit.

### Treasury Management Strategy Statement

#### Current Portfolio Position

The Authority's treasury portfolio position as at 30 September 2019 comprised:

Borrowing

Fixed Rate Funding: £6.797m Average Rate: 4.62%

The last repayment of £585k was made in May 2018 with the next loan maturity not due until 2022.

Investments

£17,445m Average Rate 1 April 2019 to 30 September 2019: 1.00%

It is anticipated that a number of large payments will be made before the end of the year to fund our capital programme. Therefore, projected interest receivable has been modelled on an average fund balance of £15.0m against an average rate return of 1.00%.

**Prospects for Interest Rates**

For 2020/21, the Authority will continue with Link as its external treasury management advisor. Link's view of the prospects for interest rates can be seen in Appendix C.

Link advise that the current benchmark rate of return on investments should be Base Rate (currently 0.75%), although the rate may be higher if the Authority is able and willing to commit funds for longer durations (up to one year). The Authority will therefore set a benchmark rate of return based on the current average rate achieved, which would give a target rate of 1.00%. Based on this rate the Authority would achieve an annual return of circa £150k on a balance of £15.0m (the total current projected return for 2019/20 is in the region of £180k).

This overachievement can be partly attributed to the change in the TMS for the 2018/19. The Authority increased the maximum lending duration for UK based counterparties, increased the number of building societies and removed the restrictions for them to be rated. This has resulted in the Authority achieving returns in the excess of 0.75% anticipated by our treasury advisors.

For any type of investment there is a downside risk to the level of return we would obtain due to the uncertainty in the markets and the negative impact they have on the interest rates and therefore historical rates of return may not always provide a realistic indication of returns for the future. This will be closely monitored and reported to Members if the position changes from what we are currently projecting.

**Borrowing Strategy**

The Authority's borrowing objectives are:

- To minimise the revenue costs of debt whilst maintaining a balanced loan portfolio
- To manage the Authority's debt maturity profile, leaving no one future year with a disproportionate level of repayments

No additional borrowing is forecast to take place during the duration of the medium term financial plan.

**Investment Strategy**

This Authority maintains investments that are placed with reference to cash flow requirements. Investment of the Authority's funds is in accordance with the Annual Investment Strategy.

**Debt Rescheduling**

The potential for debt rescheduling is monitored in light of interest rate movements.

Any rescheduling will be in accordance with the borrowing strategy. The reasons for rescheduling include:

- The generation of cash savings at minimum risk

• Fulfilment of the borrowing strategy

• Enhancement of the maturity profile of the borrowing portfolio

The level of penalties on the early repayment of borrowing make it difficult to restructure debt effectively at current interest rates. It is recommended that further work be undertaken during the year to investigate debt restructuring, including the potential renegotiation of the early repayment charges.

## Annual Investment Strategy (AIS)

A prudent investment policy has two objectives (as defined by the DCLG guidance):

- achieving first of all security (protecting the capital sum from loss);
- and then liquidity (keeping the money readily available for expenditure when needed);
- only once proper levels of security and liquidity are determined, it will then be reasonable to consider what yield can be obtained consistent with those priorities.

### Investment Policy

In accordance with guidance from the DCLG and CIPFA, and in order to minimise the risk to investments, the Authority has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency. Using the Link ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support has had an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied have effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

As with previous practice, ratings will not be the sole determinant of the quality of an institution and that 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 Authority will engage with its advisors to maintain a monitor on market pricing such as credit default swaps (CDS) and overlay that information on top of the credit ratings. This is fully integrated into the credit methodology provided by the advisors, Link in producing its colour coding which show the varying degrees of suggested creditworthiness.

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.

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

The intention of the strategy is to provide security of investment and minimisation of risk.

**Creditworthiness Policy**

This Authority applies the creditworthiness service provided by Link. 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 have been used by the Authority to determine the suggested duration for investments. Itis recommended that the Authority continues to use Link's colour codes plus an additional six months for UK counterparties only. It would be beneficial if the Authority could lend to existing counterparties for a longer duration. This will increase the risk slightly but will offer increased returns. The Authority will therefore use counterparties within the following durational bands:

| **Colour Rating (UK Counterparties)** | **Colour Rating (Non UK Counterparties)** |
|---|---|
| Yellow - 5 Years and 6 Months | Yellow - 5 Years |
| Purple – 2 Years and 6 Months | Purple – 2 Years |
| Blue – 1 Year and 6 Months (only applies to nationalised or semi nationalised UK Banks) | Blue – 1 Year |
| Orange – 1 Year and 6 Months | Orange – 1 Year |
| Red – 1 Year | Red – 6 Months |

| **Colour Rating (UK Counterparties)** | **Colour Rating (Non UK Counterparties)** |
|---|---|

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|---|---|
| Green – 9 Months | Green – 3 Months |
| No colour not to be used (except for building societies on our counterparty list which the Authority can invest with for a maximum duration of 365 days limited to a maximum investment of £2 million per counterparty) | No colour not to be used |

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

Typically the minimum credit ratings criteria the Authority use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability 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 Authority is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service.

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

• in addition to the use of credit ratings the Authority will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Authority's lending list.

Sole reliance will not be placed on the use of this external service. In addition this Authority will also use market data and market information, information on government support for banks and the credit ratings of that supporting government.

## Country Limits

In 2017/18, the Authority determined that it would not only use approved counterparties based within the United Kingdom but allowed any counterparty (UK or non UK based) rated at least 'Green' by Link. Although no counterparty outside UK was used during 2019/20, these will remain on the lending list for 2020/21. The primary purpose of this is not to increase yield, but to provide additional diversity to the portfolio to effectively manage risk. A number of non-UK banks are ranked higher than some of the UK banks on the Authority's current counterparty list. Therefore the Authority proposes to limit the duration of all non UK investment in line with Link's recommended limits. A list of the proposed counterparties is shown in Appendix B.

## Counterparty Limits

As per the AIS, the Authority has determined that the maximum balance that can be invested with a single counterparty at any point in time will be no more than 30% of the portfolio, up to a limit of £5 million.

There are two exceptions to this limit in the AIS will continue to be Lloyds, where the maximum balance that can be invested will be a limit of £7.5 million. Of this £7.5 million, no more than £5 million will be invested in non-instant access (call) accounts.

The rationale for this is that Lloyds are the Authority's main banking provider, and as part of the contract will pay credit interest on all balances at a rate of Base Rate minus 0.10% (currently giving an effective rate of 0.65%). This means that:

- A higher rate can be achieved than on most other instant-access accounts
- The staff time taken to move money between our main bank account and other instant access account is reduced
- The banking charges associated with the movement of the money between accounts is reduced
- The additional risk exposure to the Authority is minimal as all amounts over the current £5 million limit would be available for withdrawal immediately should circumstances require

The other exception relates to non-rated building societies on our counterparty listing whereby the maximum balance that can be invested will be limited to £2 million for a maximum duration of 365 days.

### Investment Security

Investments are defined as being in one of two categories:

• Specified investments – these are investments with high security and high liquidity. All specified investments are in sterling and have a maturity of no more than one year. They will be with the UK government, a local authority, a parish council or with an investment scheme or body of "high credit quality" (as judged against the Creditworthiness Policy detailed earlier in this paper)

• Non-specified investments – any type of investment that does not meet the specified investment criteria. A maximum of £5 million will be held in aggregate in non-specified investments for longer than 364 days – up to a maximum of five years and 6 months as denoted by the yellow banding on the Link creditworthiness policy detailed earlier in this paper. In addition, property funds are also classified as non-specified investments and a maximum of £3 million will be held in aggregate.

### Investment Training

Relevant training and updates will be provided to relevant staff by the external treasury management advisors. This will be supplemented by additional training from CIPFA where necessary.

### Investment of Money Borrowed in Advance of Need

The Authority does not currently have any money that has been borrowed in advance of need. No further borrowing is planned over the medium term.

### Investment Liquidity

In consultation with external treasury advisors, the Authority will review its balance sheet position, level of reserves and cash requirements in order to determine the length of time for which investments can be prudently committed. Investments will be placed at a range of maturities, including having money on-call in order to maintain adequate liquidity.

## Appendix B – Provisional Counterparty List

This list is based on information provided by Link as at 27 December 2019. Please note that all colours indicated refer to Link's creditworthiness policy (see Appendix A):

UK Based Counterparties

| UK Based Counterparties | Counterparty | (as rated by Link) |
|---|---|---|
| UK | Abbey National Treasury Services | Red - 6 mths |
| UK | Bank of Scotland | Orange - 12 mths |
| UK | Barclays Bank plc (NRFB) | Red - 6 mths |
| UK | Barclays Bank plc (RFB) | Red - 6 mths |
| UK | Close Brothers | Red - 6 mths |
| UK | Clydesdale Bank | No colour - 0 mths |
| UK | Co-operative Bank Plc | No colour - 0 mths |
| UK | Goldman Sachs International | Red - 6 mths |
| UK | Handelsbanken Plc | Orange - 12 mths |
| UK | HSBC Bank plc (NRFB) | Orange - 12 mths |
| UK | HSBC Bank plc (RFB) | Orange - 12 mths |
| UK | Lloyds Bank Corporate Markets Plc (NRFB) | Red - 6 mths |
| UK | Lloyds Banking Group (RFB) | Orange - 12 mths |
| UK | Nat West Markets Plc (NRFB) | Green – 100 Days |
| UK | Santander UK PLC | Red - 6 mths |
| UK | Standard Chartered Bank | Red - 6 mths |
| UK | Sumitomo Mitsui Banking Corporation Europe Ltd | Red - 6 mths |
| UK | Debt Management Office | Yellow - 60 mths |
| UK | Other Local Authorities | Yellow - 60 mths |
| UK | Royal Bank of Scotland Group | Blue - 12 mths |
| UK | National Wesminster Bank | Blue - 12 mths |

*** This is the duration suggested by Link. As per the updated Creditworthiness Policy (see page 6) these will all be extended by six months, except for building societies rated 'Green', which will have a maximum duration of 12 months for up to £2m.**

The Authority will also have the ability to invest in AAA rated money market funds (MMFs) and enhanced money market funds.

Non-UK Based Counterparties

As noted in Appendix A, the duration of all non-UK investments will be in line with Links' duration limits.

| **Non-UK Based Counterparties** | **Country Counterparty** | **(as rated by Link)** |
|---|---|---|
| Australia | Australia and New Zealand Banking Group Ltd. | Orange - 12 mths |
| Australia | Commonwealth Bank of Australia | Orange - 12 mths |
| Australia | Macquarie Bank Ltd. | Red - 6 mths |
| Australia | National Australia Bank Ltd. | Orange - 12 mths |
| Australia | Westpac Banking Corp. | Orange - 12 mths |
| Belgium | BNP Paribas Fortis | Red - 6 mths |
| Belgium | KBC Bank N.V. | Orange - 12 mths |
| Canada | Bank of Montreal | Orange - 12 mths |
| Canada | Bank of Nova Scotia | Orange - 12 mths |
| Canada | Canadian Imperial Bank of Commerce | Orange - 12 mths |
| Canada | National Bank of Canada | Red - 6 mths |
| Canada | Royal Bank of Canada | Orange - 12 mths |
| Canada | Toronto-Dominion Bank | Orange - 12 mths |
| Denmark | Danske A/S | Red - 6 mths |
| Finland | Nordea Bank Abp | Orange - 12 mths |
| Finland | OP Corporate Bank plc | Orange - 12 mths |
| France | BNP Paribas | Orange - 12 mths |
| France | Credit Agricole Corporate and Investment Bank | Orange - 12 mths |
| France | Credit Agricole S.A. | Orange - 12 mths |
| France | Credit Industriel et Commercial | Red - 6 mths |
| France | Societe Generale | Red - 6 mths |
| Germany | BayernLB | Red - 6 mths |
| Germany | Commerzbank AG | Green – 100 Days |
| Germany | Deutsche Bank AG | No colour - 0 mths |
| Germany | DZ BANK AG Deutsche Zentral-Genossenschaftsbank | Orange - 12 mths |
| Germany | Landesbank Baden-Wuerttemberg | Red - 6 mths |
| Germany | Landesbank Berlin AG | Orange - 12 mths |
| Germany | Landesbank Hessen-Thueringen Girozentrale | Orange - 12 mths |
| Germany | Landwirtschaftliche Rentenbank | Purple - 24 mths |
| Germany | NRW.BANK | Purple - 24 mths |
| Netherlands | ABN AMRO Bank N.V. | Red - 6 mths |
| Netherlands | Bank Nederlandse Gemeenten N.V. | Purple - 24 mths |
| Netherlands | Cooperatieve Rabobank U.A. | Orange - 12 mths |
| Netherlands | ING Bank N.V. | Orange - 12 mths |
| Netherlands | Nederlandse Waterschapsbank N.V. | Purple - 24 mths |
| Qatar | Qatar National Bank | Red - 6 mths |
| Singapore | DBS Bank Ltd. | Orange - 12 mths |
| Singapore | Oversea-Chinese Banking Corp. Ltd. | Orange - 12 mths |
| Singapore | United Overseas Bank Ltd. | Orange - 12 mths |
| Sweden | Skandinaviska Enskilda Banken AB | Orange - 12 mths |
| Sweden | Svenska Handelsbanken AB | Orange - 12 mths |
| Sweden | Swedbank AB | Orange - 12 mths |

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|---|---|---|
| Switzerland | Credit Suisse AG | Red - 6 mths |
| Switzerland | UBS AG | Orange - 12 mths |
| United Arab Emirates | First Abu Dhabi Bank PJSC | Orange - 12 mths |
| United States | Bank of America N.A. | Orange - 12 mths |
| United States | Bank of New York Mellon, The | Purple - 24 mths |
| United States | Citibank N.A. | Orange - 12 mths |
| United States | JPMorgan Chase Bank N.A. | Orange - 12 mths |
| United States | Wells Fargo Bank, NA | Orange - 12 mths |

Counterparties Rated 'No Colour' by Link

As noted in Appendix A, sole reliance will not be placed on the use of Link ratings. The Authority will also use market data and market information, information on government support for banks and the credit ratings of that supporting government. The Authority added four building societies to its counterparty list in 2014/15, at which time they were all rated 'No Colour'. These are all now rated by Link and appear on our Provisional Counterparty Listing above. In 2018/19 the Authority increased the number of building societies in our counterparty list to ten. The top-ten building societies (by net assets) were added to the counterparty list. The duration of investment will continue to be limited to 365 days and the maximum amount invested with any non-rated building society at any point in time will not exceed £2 million.

| **UK Based Counterparties** | **Country Counterparty** | **(as rated by Link)** |
|---|---|---|
| UK | Coventry Building Society | Red - 6 mths |
| UK | Cumberland | No colour - 0 mths |
| UK | Leeds Building Society | Green - 100 days |
| UK | Nationwide BS | Red - 6 mths |
| UK | Newcastle | No colour - 0 mths |
| UK | Nottingham | No colour - 0 mths |
| UK | Principality | No colour - 0 mths |
| UK | Skipton Building Society | Green - 100 days |
| UK | West Bromwich | No colour - 0 mths |
| UK | Yorkshire Building Society | Green - 100 days |

## Appendix C – Prospects for Interest Rates

The following table gives the Link central view:

| Annual Average % | Bank Rate % | PWLB Borrowing Rates % (including certainty rate adjustment) | | |
|---|---|---|---|---|
| | | 5 year | 25 year | 50 year |
| Dec 2019 | 0.75 | 2.30 | 3.20 | 3.10 |
| Mar 2020 | 0.75 | 2.40 | 3.30 | 3.20 |
| Jun 2020 | 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 |

The following paragraphs provide Link's commentary on the current economic situation:

**Economic Background**

**UK**

General election December 2019 returned a large conservative majority on a platform of getting Brexit done. UK to leave the EU by 31 January 2020. There is still considerable uncertainty about whether the UK and EU will be able to agree the details of a **trade deal** by the deadline set by the prime minister of December 2020. This leaves open the potential risks of a no deal or a hard Brexit.

**GDP growth** has been weak in 2019 and is likely to be around only 1% in 2020. **November and December MPC meetings** were concerned about weak UK growth caused by the dampening effect of Brexit uncertainties and by weak global economic growth. There has been no change in Bank Rate in 2019.

**CPI inflation** 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.

**Labour market.** Employment growth 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%.

**Wage inflation** has been steadily falling from a high point of 3.9% in July 2019 to 3.5% in October 2019 (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.

## USA

**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; fears of a recession in 2020 have largely dissipated but growth is likely to be relatively weak. 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.

**The Fed** finished its series of increases in rates to 2.25 – 2.50% in December 2018. It has cut rates by 0.25% in July, September and October to end at 1.50 – 1.75%. In August it also ended its programme of **quantitative tightening**, (selling its holdings of treasuries etc. @ $50bn per month during 2019). 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. In the first month, it will buy $60bn.

**Trade war with China.** The trade war is 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. However, progress has been made in December 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 % in 2018 to around half of that at the end of 2019; there appears to be little upside potential in the near future. **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 during 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 various new measures to stimulate growth starting in March.

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.** These purchases would start in November at €20bn per month - a relatively small amount compared to the previous buying programme. It is doubtful whether the various monetary policy easing measures in 2019 will have much impact on growth and, unsurprisingly, the ECB has stated that governments would need to help stimulate growth by **'growth friendly' fiscal policy.**

Several EU countries have **coalition governments.** More recently, Austria, Spain and Italy have been in the throes of trying to form 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.

## 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

It 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 – reversal of globalisation

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 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.

**This weak global growth outlook for 2020 and beyond therefore means that central banks are likely to come under more pressure to support growth by looser monetary policy measures; this will militate against central banks increasing interest rates and reversing the distortions in financial markets caused by a decade of ultra-low interest rates.**

The trade war between the US and China has been 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 such fears have largely dissipated towards the end of 2019).

These concerns resulted in **government bond yields falling sharply in 2019** in the developed world. 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.