

Treasury Management Update

Quarter Ended 30 September 2016

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

1. Economic Background

UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were strong but 2015 was disappointing at 1.8%, though it still remained one of the leading rates among the G7 countries. Growth improved in quarter 4 of 2015 from +0.4% to 0.7% but fell back to +0.4% (2.0% y/y) in quarter 1 of 2016 before bouncing back again to +0.7% (2.1% y/y) in quarter 2. During most of 2015, the economy had faced headwinds for exporters from the appreciation during the year of sterling against the Euro, and weak growth in the EU, China and emerging markets, plus the dampening effect of the Government's continuing austerity programme. The referendum vote for Brexit in June this year delivered an immediate shock fall in confidence indicators and business surveys, pointing to an impending sharp slowdown in the economy. However, subsequent surveys have shown a sharp recovery in confidence and business surveys, though it is generally expected that although the economy will now avoid flat lining, growth will be weak through the second half of 2016 and in 2017.

The Bank of England meeting on August 4th addressed this expected slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to 0.25%. The Inflation Report included an unchanged forecast for growth for 2016 of 2.0% but cut the forecast for 2017 from 2.3% to just 0.8%. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting and suggested that the Government will need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation). The new Chancellor Phillip Hammond announced after the referendum result, that the target of achieving a budget surplus in 2020 will be eased in the Autumn Statement on November 23.

The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. CPI has started rising during 2016 as the falls in the price of oil and food twelve months ago fall out of the calculation during the year and, in addition, the post referendum 10% fall in the value of sterling on a trade weighted basis is likely to result in a 3% increase in CPI over a time period of 3-4 years. However, the MPC is expected to look thorough a one off upward blip from this devaluation of sterling in order to support economic growth, especially if pay increases continue to remain subdued and therefore pose little danger of stoking core inflationary price pressures within the UK economy.

The American economy had a patchy 2015 with sharp swings in the growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 disappointed at +0.8% on an annualised basis while quarter 2 improved, but only to a lacklustre +1.4%. However, forward indicators are pointing towards a pickup in growth in the rest of 2016. The Fed. embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international

scene and then the Brexit vote, have caused a delay in the timing of the second increase which is now strongly expected in December this year.

In the Eurozone, the ECB commenced in March 2015 its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month; this was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise from around zero towards the target of 2%. GDP growth rose by 0.6% in quarter 1 2016 (1.7% y/y) but slowed to +0.3% (+1.6% y/y) in quarter 2. This has added to comments from many forecasters that central banks around the world are running out of ammunition to stimulate economic growth and to boost inflation. They stress that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand in the their economies and economic growth.

Japan is still bogged down in anaemic growth and making little progress on fundamental reform of the economy while Chinese economic growth has been weakening and medium term risks have been increasing.

2. Interest Rate Forecast

The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Bank rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.25%	0.25%	0.25%	0.25%	0.50%
5yr PWLB rate	1.00%	1.00%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.20%	1.30%
10yr PWLB rate	1.50%	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.70%	1.80%
25yr PWLB rate	2.30%	2.30%	2.40%	2.40%	2.40%	2.40%	2.50%	2.50%	2.50%	2.50%	2.60%
50yr PWLB rate	2.10%	2.10%	2.20%	2.20%	2.20%	2.20%	2.30%	2.30%	2.30%	2.30%	2.40%

Capita Asset Services undertook a quarterly review of its interest rate forecasts after the MPC meeting of 4th August cut Bank Rate to 0.25% and gave forward guidance that it expected to cut Bank Rate again to near zero before the year end. The above forecast therefore includes a further cut to 0.10% in November this year and a first increase in May 2018, to 0.25%, but no further increase to 0.50% until a year later. Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual after they do start. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when the growth in average disposable income is still weak and could well turn negative when inflation rises during the next two years to exceed average pay increases.

3. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2016/17, which includes the Annual Investment Strategy, was approved by the Council on 02/03/2016. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield.

The Council will also aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with highly credit rated financial institutions, using our suggested creditworthiness approach, including a minimum sovereign credit rating, and Credit Default Swap (CDS) overlay information.

Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 30 September 2016.

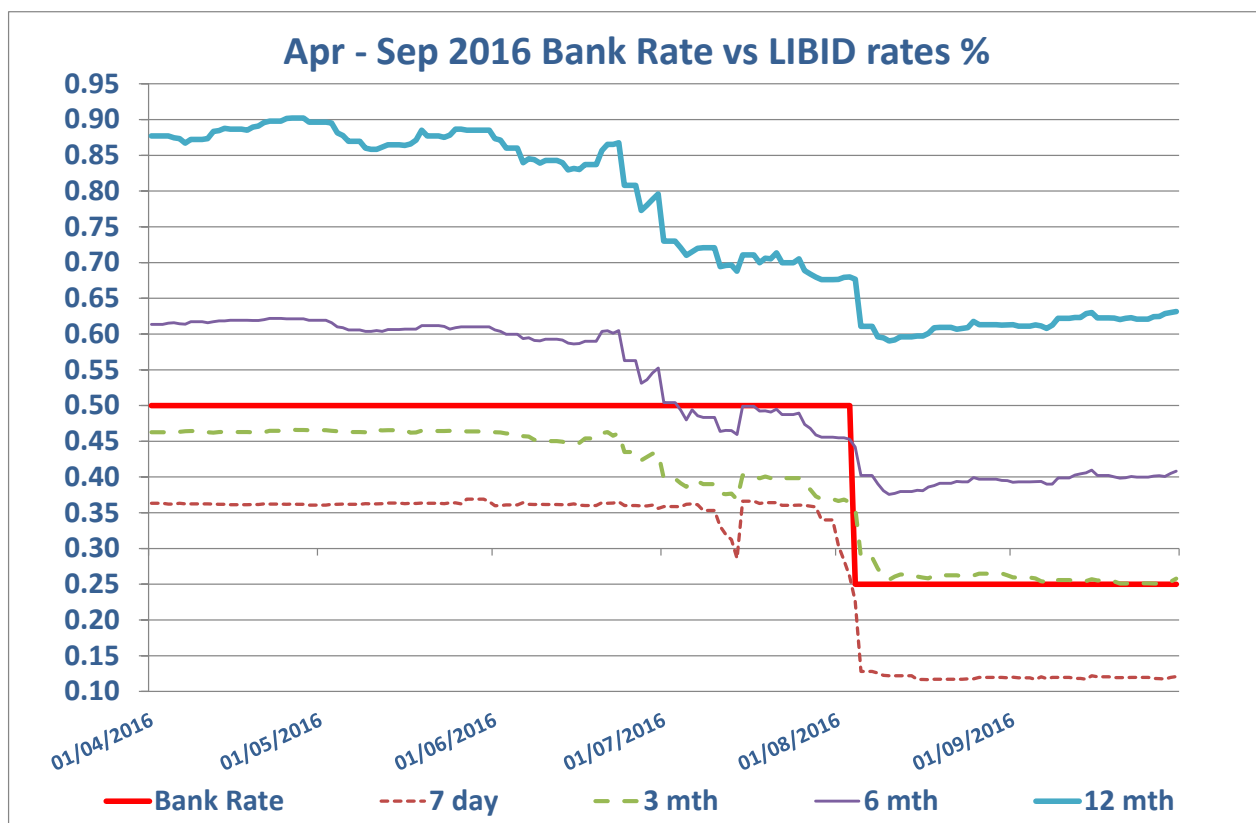
Investment rates available in the market were broadly stable during the first half of the quarter but then took a slight downward path in the second half concluding with a significant drop after the referendum on a sharp rise in expectations of an imminent cut in Bank Rate and "lower for longer" expectations thereafter.

The average level of funds available for investment purposes during the quarter following a review of cashflow needs was **£42.9m**. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme. The Council held **£44.6m** core cash balances for investment purposes at 30 September 2016 (i.e. funds available for more than one year).

Investment performance for the financial year to date as at 30th September 2016

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	0.28%	0.60%	£178k YTD

As illustrated, the Council outperformed the benchmark by 32 **bps**. The Council's budgeted investment return for 2016/17 is **£329k**, and performance for the year is estimated to be **£335k**, which is **£6k** above budget.



4. New Borrowing

There has been significant volatility in PWLB rates during quarter 1 culminating in a progressive fall in rates during the first three weeks in June as confidence rose that the polls were indicating an 'IN' result for the referendum, followed by a sharp rise in the run up to the referendum day as the polls swung the other way, followed by a sharp fall to the end of the month in anticipation that there is likely to be further quantitative easing purchases of gilts in the coming months.

During the year to date, the 50 year PWLB target (certainty) rate for new long term borrowing started at 3.10% and ended at 2.10%.

No borrowing was undertaken during the quarter. However, further borrowing may be undertaken during this financial year. Details of any specific borrowing will be advised to Members as part of the quarterly update reports when it is undertaken.

PWLB certainty rates for the financial year to 30th September 2016

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.81%	0.95%	1.42%	2.08%	1.87%
Date	07/09/2016	10/08/2016	10/08/2016	12/08/2016	30/08/2016
High	1.20%	1.80%	2.51%	3.28%	3.08%
Date	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016
Average	0.99%	1.33%	1.92%	2.69%	2.46%

Borrowing in advance of need

This Council has not borrowed in advance of need during the quarter ended 30 September 2016.

5. Debt Rescheduling

No debt rescheduling was undertaken during the quarter ended 30 September 2016.

6. Compliance with Treasury and Prudential Limits

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

During the financial year to date the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown after point (7) below.

7. Other

Treasury Management Strategy (TMS)

An update of the TMS was approved at Council on 28th September 2016, with a further version being considered by Cabinet and Council on 21st and 30th November respectively to increase borrowing limits for the purpose of property investment.

Changes in credit rating methodology

The recent post referendum change in the UK sovereign rating (downgraded from 'AA+' to 'AA' by Fitch) has no direct impact on the Council's ability to invest, as it has excluded the UK from its sovereign rating criteria overlay.

Prudential and Treasury Indicators as at 30 September 2016

Treasury Indicators	2016/17 Budget £'000	Quarter 2 (Jul-Sep) Actual £'000
Authorised limit for external debt ¹	113,500	138,500
Operational boundary for external debt ²	108,000	133,000

Maturity structure of fixed rate borrowing - budgeted/projected year-end position		
Under 12 months	2,154	2,154
12 months to 2 years	2,223	2,223
2 years to 5 years	7,104	7,104
5 years to 10 years	13,442	13,442
10 years and above	62,745	62,745

Prudential Indicators	2016/17 Budget £'000	Quarter 2 (Jul-Sep) Actual £'000
Capital expenditure	15,845	3,392
Capital Financing Requirement (CFR)	87,964	89,008

¹ Approval is being sought to increase the **authorised limit** to £338,500 in a further revision to the TMS, which goes before Cabinet and Council on 21st and 30th November 2016 respectively, to fund the new 'Property Investment Strategy' which itself goes to the same meetings for approval.

² Approval is also being sought to increase the **operational boundary for external debt** to £333,000 in the revised TMS, which goes to Cabinet and Council on 21st and 30th November respectively, for the same reason.