Treasury Management Update

Quarter Ended 31 December 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 rate 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 has been fairly robust at +0.6% q/q, +2.2% y/y in quarter 3 of 2016 to confound the pessimistic forecasts by the Bank of England in August and by other forecasters, which expected to see near zero growth during 2016 after the referendum. Prior to the referendum, the UK economy had been facing headwinds for exporters from the appreciation of sterling against the Euro plus weak growth in the EU, China and emerging markets, and 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, there was then a sharp recovery in confidence and business surveys and the fall in the value of sterling has had a positive effect in boosting manufacturing in the UK due to improved competitiveness in world markets.

The Bank of England meeting on 4th August addressed its forecast of a slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to 0.25%. The Inflation Report cut the forecast for growth in 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. While the MPC was prepared to cut Bank Rate again by the end of 2016, Carney also warned that the Bank could not do all the heavy lifting and suggested that the Government would 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 would be eased in the Autumn Statement on November 23 and which he duly delivered.

The robust growth in quarter 3 of +0.6%, plus forward indicating business surveys also being very positive on growth, caused the MPC in November to pull back from another cut in Bank Rate. The November Inflation Report also included a forecast for inflation to rise to around 2.7% in 2018 and 2019, well above its 2% target, due to a sharp rise in the cost of imports as a result of the sharp fall in the value of sterling after the referendum. 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%. Growth in quarter 1 of 2016 of +0.8% on an annualised basis, and quarter 2 at +1.4%, was disappointing. However, quarter 3 came in very strongly at +3.5% and forward indicators are pointing towards robust growth in 2017, especially if Trump's expansionary plans are put into effect.

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, caused a delay in the timing of the second increase of +0.25% until this December's meeting. Three or four further increases are now expected in both 2017 and 2018.

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 2015 and March 2016 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 2006 meeting, it also increased its monthly asset purchases to €80bn. In December 2016, it extended its QE programme; monthly purchases at €80bn will continue to March 2017 and then continue at €60bn until December 2017. 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 3 2016 (1.7% y/y) but forward surveys are, at last, positive about a modest upturn to growth while inflation has also started to increase significantly. There have been many comments from 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 has struggled for many years to boost anaemic growth despite massive fiscal and monetary stimulus, but quarter 3 came in at +2.7% y/y. 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:

	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling after early August. Consequently, Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth. During the two-year period 2017 – 2019, when the UK is negotiating the terms for

withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects, (i.e. by raising Bank Rate), which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

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.

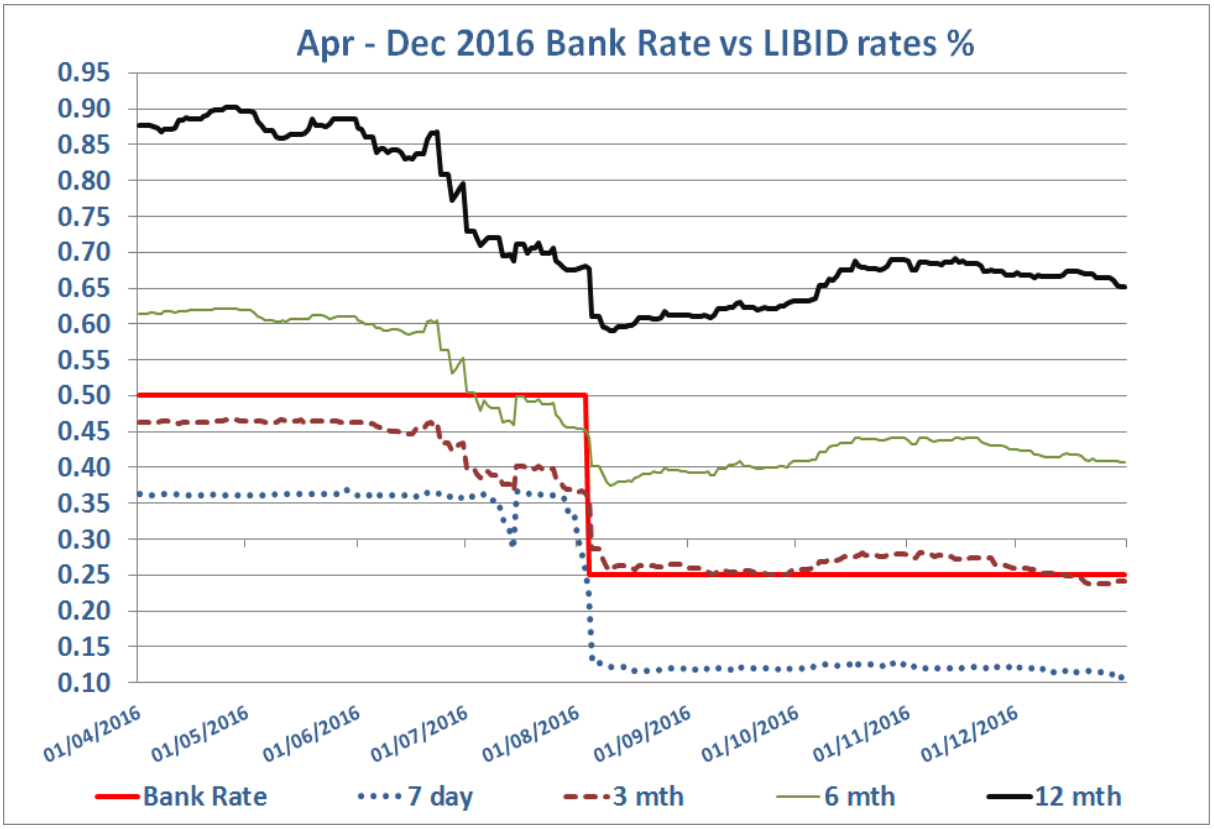
Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 31 December 2016.

The average level of funds available for investment purposes during the quarter was **£48.7m**. 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 holds **£52.7m** core cash balances for investment purposes at 31 December 2016 (i.e. funds typically available for more than one year), although some of this may be shorter term, as significant funds sitting in the Dover Regeneration and Economic Development Reserve are earmarked for spending during 2016/17 and 2017/18 on the new Dover leisure centre and town hall refurbishment (subject to project approvals).

Investment performance for the financial year to date as at 31st December 2016

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	0.23%	0.57%	£259k YTD

As illustrated, the Council outperformed the benchmark by 34 **bps**. The Council's budgeted investment return for 2016/17 is **£329k**, and performance for the year is estimated to be **£341k**, which is **£12k** above budget.



4. New Borrowing

There has been major volatility in PWLB rates during the current year with rates falling to historically very low levels during quarter 2 before rising significantly during quarter 3.

During the year to date ended 31 December 2016, the 50 year PWLB target (certainty) rate for new long term borrowing started at 3.0%, fell to a low of 2.10% in August, and then rose to 2.70% in November.

No borrowing was undertaken during the quarter.

PWLB certainty rates for the financial year to date as at 31 December 2016

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.76%	0.95%	1.42%	2.08%	1.87%
Date	20/12/2016	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	0.96%	1.36%	1.97%	2.71%	2.48%

Borrowing in advance of need

This Council has not borrowed in advance of need during the quarter ended 31 December 2016.

5. Debt Rescheduling

No debt rescheduling was undertaken during the quarter.

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 in after point (7) below.

7. Other

Treasury Management Strategy (TMS)

An update of the TMS was approved at Council on 30th November to increase borrowing limits for the purpose of property investment.

Changes in credit rating methodology.

The recent post referendum changes in the UK sovereign rating (downgraded from 'AA+' to 'AA' by Fitch) have 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 31 December 2016

Treasury Indicators	2016/17 Budget £'000	Quarter 3 (Oct-Dec) Actual £'000
Authorised limit for external debt[1]	113,500	338,500
Operational boundary for external debt[2]	108,000	333,000
Maturity structure of fixed rate borrowing - upper and lower limits		
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 3 (Oct-Dec) Actual £'000
Capital expenditure	13,765	4,358
Capital Financing Requirement (CFR)	87,964	89,008

[1] Approval was given to increase the **authorised limit** to £338,500 in a further revision to the TMS at Council on 30th November 2016, to fund the new 'Property Investment Strategy' which was itself approved at the same meeting.

[2] Approval was given to increase the **operational boundary for external debt** to £333,000 in the revised TMS at Council on 30th November, for the same reason.