Subject:	**TREASURY MANAGEMENT QUARTER ONE REPORT 2018/19**
Meeting and Date:	**Governance – 27 September 2018**
Report of:	**Mike Davis – Director of Finance, Housing & Community**
Portfolio Holder:	**Councillor Mike Connolly – Portfolio Holder for Corporate Resources and Performance**
Classification:	**Unrestricted**
Purpose of the report:	To provide details of the Council's treasury management for the quarter ended 30 June 2018 (Q1) and an update of activity to date.
Recommendation:	That the report is received

1. Summary

1.1 The Council's investment return for the June quarter was 1.96%, which outperformed the benchmark[1] by 1.41%. Interest and dividends income achieved for the quarter was £240k; the year-to-date (YTD) budget is £250k. The Council's projected investment return for 2018/19 is £1,018k, which is £20k better than the original budget estimate of £999k. This improvement is due to the pooled investment funds doing better than expected.

1.2 As at 30 June the Council's investment portfolio totalled £38.4m (see Appendix 2). Cashflow funds were higher than expected at £9.5m; this is due to a £5m investment that matured and was not reinvested until 18 July with Close Brothers. The Cashflow increased further at the end of August to £15.3m due to an investment of £7.5m maturing in July. We are in the process of opening a CCLA Diversified Income fund in which this income will be invested by the end of September. The Gilts (£1.9m) matured in July and the money was used to increase the investment in the Investec Diversified Income fund by a further £2m.

1.3 The Council remained within its Treasury Management and Prudential Code guidelines during the period.

2. Introduction and Background

2.1 CIPFA (the Chartered Institute of Public Finance and Accountancy) issued the revised Code of Practice for Treasury Management in November 2011; it recommends that members should be updated on treasury management activities at least twice a year, but preferably quarterly. This report therefore ensures this council is implementing best practice in accordance with the Code.

2.2 Council adopted the 2018/19 Treasury Management Strategy (TMS) on 7th March 2018 as part of the 2018/19 Budget and Medium Term Financial Plan.

[1] The "benchmark" is the interest rate against which performance is assessed. DDC use the London Inter-Bank Bid Rate or LIBID, as its benchmark.

2.3 In order to comply with the CIPFA code referred to above, a brief summary is provided below and Appendix 1 contains a full report from the Council's Treasury Management Advisors, Arlingclose.

2.4 Members are asked to note that in order to minimise the resource requirements in producing this report, Arlingclose's report has been taken verbatim. Treasury advisors generally use a more journalistic style than is used by our officers, but in order to avoid changing the meaning or sense of Arlingclose's work, this has not been edited out.

2.5 As at 30 June 2018, the Council's investment portfolio totalled £38.4m (see Appendix 2). However, some of this is shorter term, as significant funds sitting in the Dover Regeneration and Economic Development Reserve are earmarked for spending during 2018/19 and 2019/20 on the new Dover leisure centre, town hall refurbishment and other approved capital projects. After these approved commitments, there should be £20m - £25m underlying core funds available for longer term investment, while the remainder of funds will need to be kept in shorter term instruments and bank accounts for cash-flow requirements and future capital projects (subject to project appraisals).

3. Annual investment strategy

3.1 The investment portfolio, as at the end of June 2018, is attached at Appendix 2. Total balances held for investment and cash-flow purposes were £47.9m, rising to £48.3m at the end of August (see Appendix 4). The increase reflects normal cash-flow fluctuations arising from the timing of 'major preceptor' payments, which are made over twelve months, while the Council Tax receipts that fund them typically come in over the ten months to January and then decline. Additionally, there will be a further PWLB loan instalment to pay at the end of September 2018 of £2.35m.

3.2 Since the end of the June quarter, two fixed term deposits have matured totalling £10.5m. The Gilts (£1.9m) also reached their maturity. £5m has been deposited in a fixed term deposit with Close Brothers for 6 months at a rate of 0.80% and a further £2m has been deposited in the Investec Diversified Income fund.

3.3 All other funds are currently being held in money market funds. As a result, cash-flow funds increased from £3.1m at 31 March 2018 to £9.5m at 30 June 2018 (see Appendix 2), and then increased further to £15.3m by the end of August 2018 (see Appendix 4), although this will reduce due to approved capital spend in the coming weeks. Additionally, an investment is proposed in the CCLA Diversified Income fund, as per 1.2 above, and other options are subject to ongoing review within the scope of the treasury management strategy.

<u>Economic background</u>

3.4 The report attached (Appendix 1) contains information up to the end of June 2018; since then we have received an update from Arlingclose, included below. Please note that any of their references to quarters are based on *calendar* years:

Introduction

In line with our forecast and market expectations, the MPC voted to increase Bank Rate to 0.75% in August. There were, however, two surprises; the vote was unanimous and market expectations remained subdued despite this fact.

Our projected outlook for the UK economy means we maintain the significant downside risks to our interest rate forecast. The market's reaction to the rate hike suggests that investors expect both the relatively weak economic environment and political developments (Brexit negotiations and US trade relations) to limit the speed of rises in Bank Rate.

UK Data

The UK retail sector continues to take a battering as high street bellwether John Lewis reported a 99% drop in profits to £1.2m for the first half of 2018. Cutting margins to make good on their competitor price-matching promise was reported as one of the reasons, exacerbated by the greater number of discounting 'extravaganza days' offered by rivals.

There was some positive news on UK economic growth as the new monthly GDP estimate for July pointed to a 0.3% gain, pushing up the rolling three-month GDP figure to 0.6% from 0.4% in June and beating the consensus of 0.5%. Growth was driven by the services sector where output was up 0.3%. Construction, which has seen periods of weakness this year, was also a positive contributor. The recent hot weather caused utilities sector output to drag on growth.

There was also some good news from the labour market as annual regular earnings jumped from 2.8% to 3.1% in July, the fastest rate of growth for three years. This pushed the headline (3m y/y) excluding bonuses figure to 2.9% from 2.7%, reversing the recent declines. Employment growth softened slightly, rising 3,000 against the consensus expectation of 28,000, dragging the annual growth rate down to 0.8% from 1.0%. Within the detail, the number of full-time workers increased by 100,000 in the three months to July while part-time workers fell by 98,000.The unemployment rate held steady at 4.0%.

The Bank of England maintained Bank Rate at 0.75% (having raised it in August) while also maintaining the government and corporate bond asset purchases at existing levels.

Sticking with banks, albeit retail rather than central, and Royal Bank of Scotland's chairman admitted the government is unlikely to get back all of the £45.5bn it used to prop up the institution during the financial crisis. Over the 10 years since it was bailed out, RBS has lost over £130bn and incurred restructuring costs of £15bn, with the focus on the bank's survival serving to materially reduce its market value, taking it from the largest bank in the world to 29th largest.

US Data

Over in the US, producer prices came in weaker than expected in August at -0.1% versus +0.2% for the final demand reading, with the annual growth rate at 2.8% against 3.2% expected. This represented the first decline in well over a year as falls in the prices of food and trade services offset a rise in the cost of energy products. Consumer prices also rose by less than expected in August as gains in petrol prices and rents were dampened by declines in health care and clothing costs. On a monthly basis CPI was up 0.2%, the same rate as the previous month. The annual growth rate stood at 2.7%, down from 2.9% in July, while core inflation rose by 0.1% m/m. Despite the moderation, inflationary pressures continue to rise steadily as the labour market and economy continue to perform well, suggesting there is nothing in these reports that will halt the Fed from continuing to push up US interest rates.

Europe

Unlike Turkey's central bank which hiked rates by 6.25% to 24% today, the European Central Bank followed the Bank of England by maintaining the status quo. The main refinancing rate was kept at 0% and deposit rate at -0.4%. In subtle changes to the bank's guidance, the ECB announced plans to end bond purchases at the end of the year and maintain interest rates at their record low levels until at least through to the middle of 2019. It also confirmed it will cut bond purchases to €15bn per month from next month.

Interest rate forecast

The MPC continues to have a bias towards tighter monetary policy, talking up possible inflationary developments despite seeing little evidence in current data. We believe that MPC members consider both that: 1) ultra-low interest rates result in other economic problems, and 2) higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise and cuts become required.

*However, the MPC, and in particular Mark Carney, is reluctant to push interest rate expectations too strongly to avoid a sharper rise in yields. The Bank implied, using its new R*measure, that the long term neutral level of Bank Rate will be between 2% and 3%.*

The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in Q2 2018, but the quarterly annualised expansion of 1.6% remains below the long term average. As noted previously, the Bank believes that's lower economic growth of around 1.5% will be inflationary.

Our view is that the UK economy still faces a challenging outlook as the country exits the European Union. Central bank actions and geopolitical risks, such as prospective trade wars, have and will continue to produce significant volatility in financial markets, including bond markets.

The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon. Our central case is for Bank Rate to rise twice in 2019. The risks are weighted to the downside.

Gilt yields have remained at low levels. We expect some upward movement from current levels based on our interest rate projections and the strength of the US economy, but volatility arising from both economic and political events will continue to offer borrowing opportunities.

4. Net Borrowing

4.1 The Council's borrowing portfolio is attached at Appendix 3. No new borrowing was undertaken during the quarter.

5. Debt Rescheduling

5.1 At this time it is not of benefit to the Council to consider rescheduling of its long-term debt, as advised by Arlingclose.

6. Compliance with Treasury and Prudential Limits

6.1 The Council has operated within the treasury limits and Prudential Indicators, and in compliance with the Council's Treasury Management Practice.

7. Appendices

Appendix 1 – Arlingclose Treasury Management Report for Quarter One

Appendix 2 – Investment portfolio as at 30 June 2018

Appendix 3 – Borrowing portfolio as at 30 June 2018

Appendix 4 – Investment portfolio as at 31 August 2018

8. Background Papers

Medium Term Financial Plan 2018/19 – 2021/22

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Date: 18th September 2018