Subject:	**TREASURY MANAGEMENT QUARTER TWO REPORT**
Meeting and Date:	**Governance – 04 December 2014**
Report of:	**Mike Davis – Director of Finance, Housing & Community**
Portfolio Holder:	**Councillor Mike Connolly – Portfolio Holder for Corporate Resources and Performance**
Decision Type:	**Non-Key Decision**
Classification:	**Unrestricted**
Purpose of the report:	To provide details of the Council's treasury management for the quarter ended 30 September 2014 (Q2) and an update of activity to date.
Recommendation:	That the report is received

1. Summary

As at 30 September 2014, the Council's in-house investments (approximately £6m or 32% of total investments) and investments with the investment managers, Investec (approximately £12.9m or 68% of total investments) outperformed their benchmark[1]. The total interest received for the quarter was £69k (£143k year to date), which means that income for the year is projected to be £22k approx. better than the £264k budget.

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

2. Introduction and Background

CIPFA (the Chartered Institute of Public Finance and Accountancy) issued the revised Code of Practice for Treasury Management in November 2009: 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.

In order to comply with the CIPFA code referred to above, but minimise the resource requirements in producing this report, a brief summary is provided below, and Appendix 1 contains a full report from the Council's Treasury Management Advisers, Capita.

Council adopted the 2014/15 Treasury Management Strategy on 5 March 2014 as part of the 2014/15 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.

3. **Annual investment strategy**

The investment portfolio as at the end of September is attached at Appendix 2. Since the end of the quarter, the Investec deposit of £1.2m with Nordea Group (Sweden) matured and was then invested with Nationwide Building Society for three months.

A further update to the end of October is attached at Appendix 4. However, since the end of October, the Investec deposit of £2.4m with Standard Chartered Bank has matured and been re-invested with them for a further three months. Similarly, the in-house deposit of £1m with Bank of Scotland has matured and been re-invested with them for one year. A further £3m of cashflow money remains invested with the Nationwide Building Society until Feb 2015.

The investment manager, Investec, has returned lower rates than those achieved through in-house investments. Investec have continued to be used as they are able to offer a wider spread of our counter party risks and use of additional financial instruments (e.g. gilts). A review will be undertaken to assess whether to keep the same level of investments with Investec, transfer additional investments back in-house, or investigate alternative options.

4. **Economic background**

The report attached contains information up to the end of September 2014; since then we have received the following update from Capita (please note that their reference to quarters is based on *calendar* years):

Bank of England Inflation Report (November 2014)

The outlook for global growth weakened in the last quarter, as market interest rate expectations have fallen with the general consensus now being for a Q2 2015 rise. Declines in risky asset prices added to the gloomy outlook and caused considerable market volatility in October. Expectations for where interest rates will be in three years' time have dramatically dropped off, with rates now expected to remain below 2% in the UK over this period. Unemployment continued to fall at a quicker pace than expected in the previous Inflation Report. In the three months to August, the rate was 6.0%, with the Bank of England (BoE) forecasting this to drop to 5.4% by late 2015. In a similar vein, the BoE expect inflation to fall below 1.0% in the next six months, endorsing markets' view that the Bank will not raise interest rates until later next year. If inflation does dip below 1.0%, Governor Mark Carney will have to write a letter of explanation to the Chancellor, George Osborne.

UK GDP

Britain's rapid economic growth slowed slightly between July and September. Gross domestic product rose 0.7%, compared with 0.9% in the April-June period. A slowdown in services output and manufacturing expanding at its weakest pace in eighteen months held growth back. The UK still looks set to be the fastest growing advanced economy this year, confounding economists views that the growth seen since the start of 2013 could be sustained. This favours the ruling Conservative Party, with the General Election taking place in May 2015, hoping that voters will be influenced by this continued growth. The opposition, Labour, state that the effects of this recovery are not filtering through to the general public, as wage growth remains sluggish.

UK Inflation

British inflation slowed sharply in September to its lowest level in five years, further easing pressure on the BoE to raise interest rates, regardless of the aforementioned economic recovery. Consumer prices rose 1.2% on the year, affected by a fall in the prices of food and motor fuels, compared with a 1.5% rise in August. Wage growth remains below inflation, as it has since April of this year, but total pay, excluding bonuses rose 1.0% in the July to September period. As with the sustained gross domestic product, the signs of a pick-up in pay are likely to be embraced by the Conservative Government, as the opposition has pedalled the issue of stretched living standards at the centre of its message to voters in the lead up to the general election.

UK PMI Services

The UK's services sector was affected more than expected in October by mounting economic uncertainty. The sector, which accounts for a large amount of Britain's GDP, sank to a seventeen month low of 56.2, from 58.7 in September, according to the Purchasing Managers' Index. Despite the index remaining above the 50 threshold that separates growth from contraction, this was weaker than most economists' forecasts, and was tempered by worries about the Eurozone, the risk of a sharp slowdown in China amongst other geopolitical fears.

UK PMI Manufacturing

Weak demand from a struggling Eurozone sent manufacturing export orders tumbling at the fastest pace since January 2013 in October. Despite this, manufacturing activity expanded at its fastest rate in three months, rising to 53.2 from 51.5. Growth in new orders rose from September's seventeen month low to its highest since July, thanks to increased demand in the domestic market. Senior economist for PMI compiler, Markit, Rob Dobson, said "Although the pace of expansion remains below that seen at the start of the year... it is positive to see the sector break its recent sequence of slower growth".

US Non Farm/GDP

US job growth increased at a moderate pace in October as employers added 214,000 new jobs to their payrolls. Job growth has now exceeded 200,000 in each of the last nine months, which could provide sufficient strength to keep the economy on a higher growth path after it expanded at a 3.5% pace in Q3. The unemployment rate fell to a six year low of 5.8%, underscoring the economy's resilience in the face of slowing global demand. Despite the strengthening labour market picture, wage growth remained tepid in the US, suggesting that the Federal Reserve would be in no rush to raise their interest rates, similar to that of the BoE.

ECB

In September, the European Central Bank (ECB) cut their interest rates to 0.05%, with the deposit rate at -0.2%. This cut in rates was an attempt to spur economic growth and stave off the threat of deflation and is currently still in place. In the third quarter, gross domestic product rose at 0.2%. This was stronger than expected, with France beating market expectations and the bloc's largest economy, Germany, steering clear of a recession. Year on year, Eurozone growth was 0.8% higher in the third quarter.

5. **Interest Rates**

Capita has updated its interest rate forecast and now expects the base rate to increase in the second quarter of 2015 rather than the first quarter of 2015.

6. **New Borrowing**

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

7. **Debt Rescheduling**

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

8. **Compliance with Treasury and Prudential Limits**

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

Appendices

Appendix 1 – Capita treasury management report for quarter four

Appendix 2 – Investment portfolio as at 30 September 2014

Appendix 3 – Borrowing portfolio as at 30 September 2014

Appendix 4 – Investment portfolio as at 31 October 2014 (Investec) and 31 October 2014 (In-House)

Background Papers

Medium Term Financial Plan 2014/15 – 2016/17

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