

Treasury Management Update

Quarter Ended 31st December 2014

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

- After strong UK GDP growth in 2013 at an annual rate 2.7%, and then in 2014 0.7% in Q1, 0.9% in Q2 2014 (annual rate 3.2% in Q2), Q3 has seen growth fall back to 0.7% in the quarter and to an annual rate of 2.6%. It therefore appears that growth has eased since the surge in the first half of 2014 leading to a downward revision of forecasts for 2015 and 2016, albeit that growth will still remain strong by UK standards. For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster than expected. The MPC is now focusing on how quickly slack in the economy is being used up. It is also particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back significantly above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in wage growth at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.
- Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November, the lowest rate since September 2002. Forward indications are that inflation is likely to remain around or under 1% for the best part of a year. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed until November. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated.
- The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 and Q3 of 4.6% and 5.0% have been stunning and hold great promise for strong growth going forward. It is therefore confidently predicted that the first increase in the Fed. rate will occur by the middle of 2015.

- The Eurozone is facing an increasing threat from deflation. In November the inflation rate fell to 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB did take some rather limited action in June and September to loosen monetary policy in order to promote growth and is currently expected to embark on quantitative easing early in 2015 to counter this threat of deflation and to stimulate growth.

2. Interest Rate Forecast

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

	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
5yr PWLB rate	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
10yr PWLB rate	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
50yr PWLB rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%

Capita Asset Services undertook a review of its interest rate forecasts on 5 January 2015 after a proliferation of fears in financial markets around the plunge in the price of oil had caused a flight from equities into bonds and from exposure to the debt and equities of emerging market oil producing countries to safe havens in western countries. These flows were compounded by further fears that Greece could be heading towards an exit from the Euro after the general election on January 25 and financial flows generated by the increasing likelihood that the ECB would soon be starting on full blown quantitative easing (QE) purchase of Eurozone government debt. In addition, there has been a sharp increase in confidence that the US will start increasing the Fed. rate by the middle of 2015 due to the stunning surge in GDP growth in quarters 2 and 3 of 2014. This indicated that the US is now headed towards making a full recovery from the financial crisis of 2008.

The result of the combination of the above factors is that we have seen bond yields plunging to phenomenally low levels, especially in long term yields. These falls are unsustainable in the longer term but just how quickly these falls will unwind is hard to predict. In addition, positive or negative developments on the world political scene could have a major impact in either keeping yields low or prompting them to recover back up again. We also have a UK general election coming up in May 2015; it is very hard to predict what its likely result will be and the consequent impact on the UK economy, and how financial markets will react to those developments.

This latest forecast includes a move in the timing of the first increase in Bank Rate from quarter 2 of 2015 to quarter 4 of 2015 as a result of the sharp fall in inflation due to the fall in the price of oil and the cooling of the rate of GDP growth in the UK, albeit, that growth will remain strong by UK standards, but not as strong as was previously forecast. The Governor of the Bank of England, Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual. The MPC is

concerned about the impact of increases on many heavily indebted consumers, especially when average disposable income is only currently increasing marginally as a result of wage inflation now running slightly above the depressed rate of CPI inflation, though some consumers will not have seen that benefit come through for them. In addition, whatever party or coalition wins power in the next general election, will be faced with having to implement further major cuts in expenditure and / or increases in taxation in order to eradicate the annual public sector net borrowing deficit.

3. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2014/15, which includes the Annual Investment Strategy, was approved by the Council on **05/03/2014**. 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 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 sovereign credit rating and Credit Default Swap (CDS) overlay information.

Investment rates available in the market have been broadly stable during the quarter and have continued at historically low levels as a result of the ultra-low Bank Rate and other extraordinary measures such as the Funding for Lending Scheme. 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 £19m core cash balances for investment purposes (i.e. funds available for more than one year).

Year to Date Investment performance for period ended 31st December 2014

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	0.36%	0.73%	244k

As illustrated, the Council outperformed the benchmark by 37 bps. The Council’s budgeted investment return for 2014/15 is £264K, and performance for the year to date is projected to be £62k above budget.

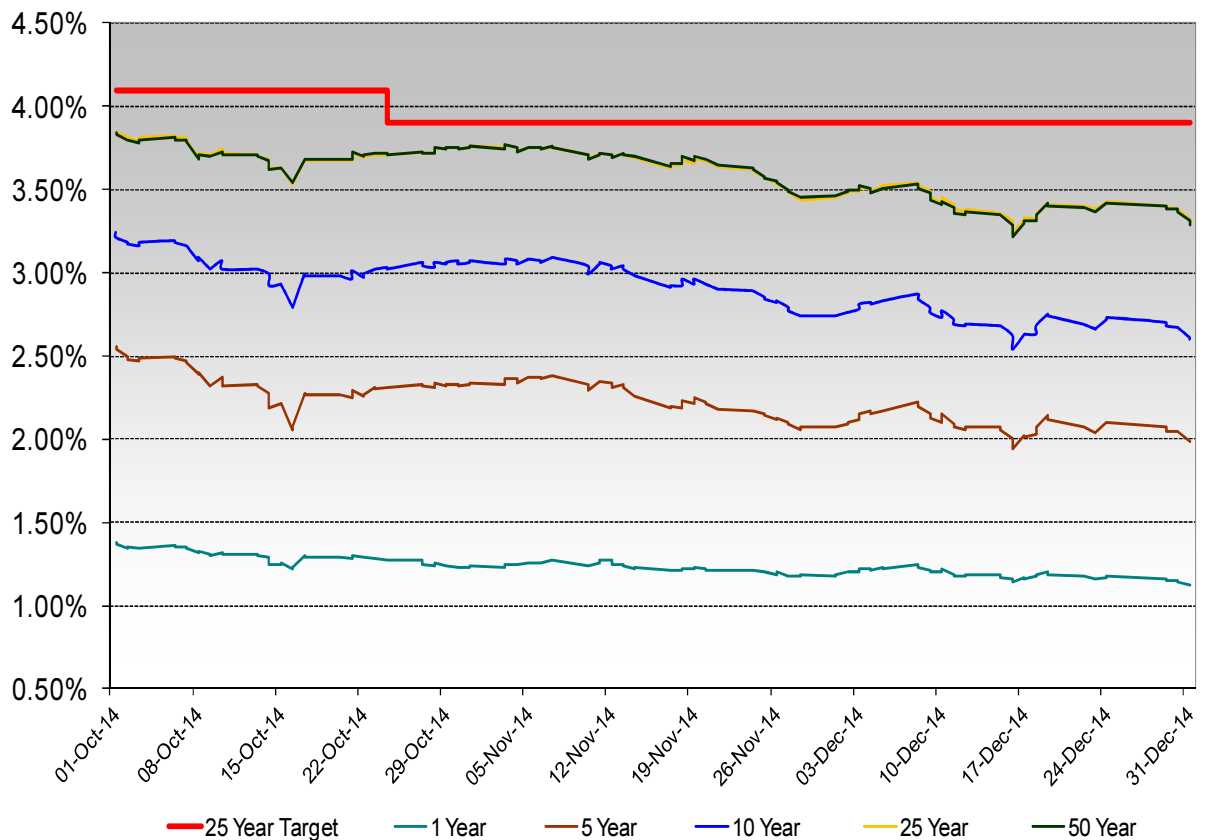
4. New Borrowing

The 25 year PWLB target (certainty) rate for new long term borrowing for the quarter fell from 4.10% to 3.9% in late October. No borrowing has been undertaken in the quarter.

PWLB certainty rates, quarter ended 31st December 2014

(Please note that the graph below is unable to show separate lines for 25 and 50 year rates as those rates were almost identical)

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.12%	1.94%	2.54%	3.24%	3.22%
Date	31/12/2014	16/12/2014	16/12/2014	16/12/2014	16/12/2014
High	1.38%	2.56%	3.24%	3.85%	3.84%
Date	01/10/2014	01/10/2014	01/10/2014	01/10/2014	01/10/2014
Average	1.24%	2.23%	2.91%	3.60%	3.60%



Borrowing in advance of need

This Council has not borrowed in advance of need during the quarter ended 31st December 2014 and has not borrowed in advance in all of 2014/15

5. Debt Rescheduling

No debt rescheduling was undertaken during the quarter ended 31st December 2014.

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 Annex 1 below.

ANNEX 1: Prudential and Treasury Indicators as at 31st December 2014

Treasury Indicators	2014/15 Budget £'000	Quarter 3 Actual £'000
Authorised limit for external debt	113,500	113,500
Operational boundary for external debt	108,000	108,000

Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	1,971	1,971
12 months to 2 years	3,070	3,070
2 years to 5 years	6,592	6,592
5 years to 10 years	12,467	12,467
10 years and above	69,753	69,753

Prudential Indicators	2014/15 Budget £'000	Quarter 3 Actual £'000
Capital expenditure *	15,758	5,025
Capital Financing Requirement (CFR) *	98,233	94,062