Treasury Management Update

Quarter Ended 31st March 2015

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. (Please note that the references to Q1, Q2, Q3 and Q4 in Appendix 1 are based on the *calendar* year, whereas the covering report is based on the financial year so that Q4 is the period ended 31st March 2015).

1. Economic Background

After strong UK GDP growth in 2013 at an annual rate of 2.7%, and then growth in 2014 of 0.6% in Q1, 0.8% Q2, 0.6% Q3 and 0.6% Q4 (annual rate for 2014 of 2.8% - the strongest rate since 2006), there are good grounds for optimism that the growth rate will increase further during 2015 as the positive effects from the fall in the price of oil feeds through to consumers and other parts of the economy. In its February quarterly Inflation Report, the Bank of England maintained its GDP forecast for 2015 at 2.9%, but revised up its forecasts for 2016 and 2017 to 2.9% and 2.7% respectively, from 2.6% in both years. The main source of upward revisions came from higher consumption growth, which is now expected to accelerate to 3.75% in 2015 due primarily to a 3.5% rise in real post-tax household income growth. Income growth is also supported by solid employment growth and a pick-up in average weekly pay growth of 3.5% in 2014 and 4.0% in 2016 and 2017. Unit labour cost growth is consequently forecast to be 2.0% in 2015 and 2.75% in 2016 which then pushes up the inflation forecast slightly in two years' time to 1.96%, while in three years' time it is forecast at 2.15%.

The American economy is well on track to making a full recovery from the financial crash. GDP quarterly growth rates (annualised) for Q2, Q3 and Q4 of 4.6%, 5.0% and 2.2%, (2.4% for 2014 as a whole), hold great promise for strong growth going forward and for further falls in unemployment. It is therefore confidently predicted that the Federal Open Market Committee will start on the first increase in the Fed funds rate during 2015 and is likely to be ahead of the UK in being the first major western country to raise rates.

As for the Eurozone, on 21 January 2015 the ECB fired its big bazooka in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is currently intended to run initially to September 2016. However, it remains to be seen whether this will have a significant enough effect in terms of boosting growth and employment, though the fall in the price of oil will provide additional support.

2. Interest Rate Forecast

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

	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%	1.25%	1.25%	1.50%	1.50%	1.75%	2.00%
5yr PWLB rate	2.20%	2.30%	2.50%	2.60%	2.70%	2.80%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%
10yr PWLB rate	2.80%	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%
25yr PWLB rate	3.40%	3.60%	3.80%	3.90%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%	4.70%
50yr PWLB rate	3.40%	3.60%	3.80%	3.90%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%	4.70%

Capita Asset Services undertook a review of its interest rate forecasts after the February Bank of England Inflation Report. On 21 January 2015 the ECB unleashed its €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This gave further impetus to the trend of a rise in bond prices and correspondingly, a fall in bond yields to phenomenally low levels. This trend had started earlier 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 elected a left wing anti austerity government.

In addition, there has been a sharp increase in confidence in this quarter that the US will start increasing the Fed funds rate by the end of 2015 due to strong GDP growth in 2014 and the rapidly falling unemployment rate. 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. This plunge in bond yields was partially reversed towards the end of the quarter. However, these very low levels 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.

This latest forecast includes a move in the timing of the first increase in Bank Rate from quarter 4 of 2015 to quarter 1 of 2016 as a result of the sharp fall in inflation due to the fall in the price of oil and the impact of that on core inflation. 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 starting to gradually increase as a result of wage inflation now running marginally 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. 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 **£22m** core cash balances for investment purposes (i.e. funds available for more than one year).

Investment performance for the financial year to 31st March 2015

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	0.35	0.54	£276k

As illustrated, the Council outperformed the benchmark by 19 bps. The Council's budgeted investment return for 2014/15 was £264K, and performance for the year was £12k above budget.

4. New Borrowing

The 25 year PWLB target (certainty) rate for new long term borrowing for the quarter fell from 3.90% to 3.40% in early January. This was revised down further to 3.30% after the February Bank of England Inflation report.

No borrowing was undertaken during the quarter.

PWLB certainty rates for the financial year to 31st March 2015

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.08%	1.71%	2.18%	2.85%	2.82%
Date	23/01/2015	02/02/2015	02/02/2015	02/02/2015	02/02/2015
High	1.49%	2.87%	3.66%	4.30%	4.28%
Date	16/07/2014	03/07/2014	20/06/2014	03/04/2014	02/04/2014
Average	1.27%	2.36%	3.08%	3.73%	3.72%

Borrowing in advance of need

This Council has not borrowed in advance of need during the year ended 31st March 2015 and has not borrowed in advance in all of 2014/15.

5. Debt Rescheduling

Debt rescheduling opportunities have been limited in the current economic climate and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010.

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 below.

7. Other

Shortly after the year-end, Investec announced that they were withdrawing from the segregated fund market at the end of June 2015. We were aware that this would create challenges, including requiring the Council to bring the funds held with Investec back in-house. Please refer to the Q1 TM Update 2015-16 for further information.

Prudential and Treasury Indicators as at 31st March 2015

Treasury Indicators	2014/15 Budget £'000	Quarter 4 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 4 Actual £'000
Capital expenditure *	15,758	9,648
Capital Financing Requirement (CFR) *	98,233	92,082