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# Treasury Management Update

## Quarter Ended 31st December 2013

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 growth of 0.7% in quarter 2 and 0.8% in quarter 3, it appears that UK GDP is likely to have grown at an even faster pace in quarter 4 of 2013. Forward surveys are also very encouraging in terms of strong growth and there are positive indications that recovery is broadening away from reliance on consumer spending and the housing market into construction, manufacturing, business investment and exporting. This strong growth has resulted in unemployment falling much faster towards the threshold of 7%, set by the MPC before it said it would consider any increases in Bank Rate, than it expected last August when that threshold was initially set. Accordingly, markets are expecting a first increase in early 2015 though recent comments from MPC members have emphasised they would want to see strong growth well established, and an increase in real incomes, before they would consider raising Bank Rate.
- Also encouraging has been a sharp fall in inflation (CPI) to 2.1% in November and forward indications are that inflation will continue to be subdued. The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the Autumn Statement, and fostered optimism for achieving a balance in the cyclically adjusted budget within five years, a year earlier than previously forecast.
- The big news in financial markets was that the Federal Reserve, in December, felt sufficiently confident that the premise for strong growth had been established in America that it could start to taper its asset purchases by reducing them by \$10bn per month from January 2014. These encouraging growth scenarios in the USA and UK led to a sharp jump up, in December, in short dated gilts; this, accordingly, impacted 5 and 10 year PWLB rates.

## 2. Interest Rate Forecast

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

	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.00%	1.25%
5yr PWLB rate	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.40%
10yr PWLB rate	3.60%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.30%	4.40%	4.50%
25yr PWLB rate	4.40%	4.50%	4.50%	4.60%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.10%
50yr PWLB rate	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.20%

Capita Asset Services undertook a review of its interest rate forecasts in late November, after the Bank of England's latest quarterly Inflation Report. This latest forecast now includes a first increase in Bank Rate in quarter 2 of 2016 (previously quarter 3) and reflects greater caution as to the speed with which the MPC will start increasing Bank Rate than the current expectations of financial markets.

### SUMMARY OUTLOOK

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are currently very positive in indicating that growth prospects are also strong for 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is very encouraging as there does need to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established. One drag on the economy is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. Labour productivity must improve significantly before increases in pay rates are warranted. With regard to the US, the main world economy, it faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although labour force participation rates remain lower than ideal.

As for the Eurozone, concerns have subsided considerably in 2013. However, sovereign debt difficulties have not gone away and major concerns could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed.

### 3. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2013/14, which includes the Annual Investment Strategy, was approved by the Council on 06/03/13. 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 cashflow 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.

Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 31st December 2013.

Investment rates available in the market have continued at historically low levels and have fallen further during the quarter as a result of the Funding for Lending Scheme. Additional 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).

#### Investment performance for quarter ended 31st December 2013

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	0.35%	0.69%	£59k

As illustrated, the Council outperformed the benchmark by 34 basis points. The Council's budgeted investment return for 2013/14 is £260k, and performance for the year to date is in line with the budget. However, this figure excludes unrealised losses of £60k at 31<sup>st</sup> December, mainly relating to gilts, which are subject to market fluctuations during the remainder of the year that may increase or reduce such potential losses, as well as realised losses of £5k.

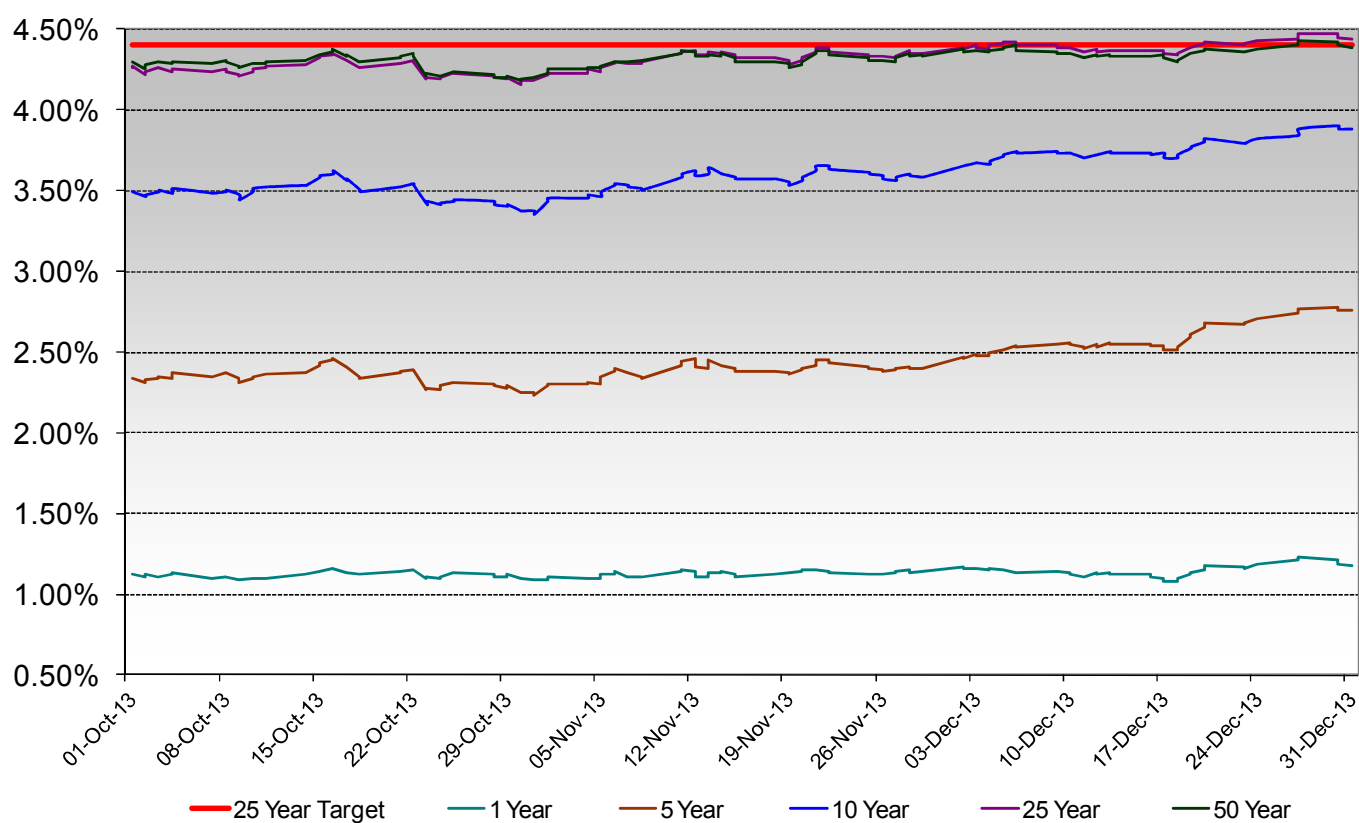
### 4. New Borrowing

No borrowing was undertaken during the quarter.

The 25 year PWLB target rate for new long term borrowing for the quarter remained at 4.40%, borrowing rates are detailed below.

## PWLB certainty rates, quarter ended 31st December 2013

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.08%	2.23%	3.35%	4.16%	4.18%
Date	17/12/2013	31/10/2013	31/10/2013	30/10/2013	30/10/2013
High	1.23%	2.78%	3.90%	4.47%	4.43%
Date	27/12/2013	30/12/2013	30/12/2013	27/12/2013	27/12/2013
Average	1.13%	2.43%	3.59%	4.32%	4.31%

**Borrowing in advance of need.**

This Council has not borrowed in advance of need during the quarter ended 31st December 2013 and has no intention to borrow in advance in 2013/14.

## 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 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.

### Prudential and Treasury Indicators as at 31st December 2013

Treasury Indicators	2013/14 Budget £'000	Quarter 3 Actual £'000
<b>Authorised limit for external debt</b>	113,500	113,500
<b>Operational boundary for external debt</b>	108,000	108,000
<b>Maturity structure of fixed rate borrowing - upper and lower limits</b>		
<b>Under 12 months</b>	2,100	2,100
<b>12 months to 2 years</b>	3,022	3,022
<b>2 years to 5 years</b>	6,489	6,489
<b>5 years to 10 years</b>	12,272	12,272
<b>10 years and above</b>	71,190	71,190
<b>Capital Expenditure</b>	10,035	3,526 (YTD)
<b>Capital Financing Requirement (CFR)</b>	98,223	98,223