

Treasury Management Update

Quarter Ended 31st March 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. (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 2014).

1. Economic Background

- After strong UK GDP growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, it appears that strong growth will continue into 2014 as forward surveys are very encouraging. There are also positive indications that recovery is starting to broaden 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 last August, before it said it would consider any increases in Bank Rate. In the February 2014 Inflation Report, the MPC therefore broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of indicators. Accordingly, markets are expecting a first increase around the end of 2014, though recent comments from MPC members have emphasised they would want to see strong growth well established, and an increase in labour productivity / real incomes, before they would consider raising Bank Rate.
- Also encouraging has been the sharp fall in inflation (CPI), reaching 1.7% in February: 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 by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19.
- The Federal Reserve has continued with its monthly \$10bn reductions in asset purchases which started in December; asset purchases have now fallen from \$85bn to \$55bn and are expected to stop by the end of 2014, providing strong economic growth continues this year.

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%	0.75%	0.75%	1.00%	1.25%	1.50%	1.75%
5yr PWLB rate	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%
10yr PWLB rate	3.70%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.50%
25yr PWLB rate	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.90%	5.00%	5.00%	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%	5.10%	5.10%	5.20%	5.20%

Capita Asset Services undertook a review of its interest rate forecasts in February, after the Bank of England's latest quarterly Inflation Report. This latest forecast now includes a first increase in Bank Rate in quarter 4 of 2015 (previously quarter 2 of 2016), 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 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 was that wage inflation had been significantly below CPI inflation, so disposable income and living standards were being eroded, (although income tax cuts had ameliorated this to some extent). However, the recent fall in inflation has narrowed the gap between wage increases and inflation and this gap could narrow even more during this year, especially if there is also a recovery in growth in labour productivity (leading to significant increases in pay rates). 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 subsided considerably during 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.

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 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 March 2014

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	0.34%	0.67%	£245k

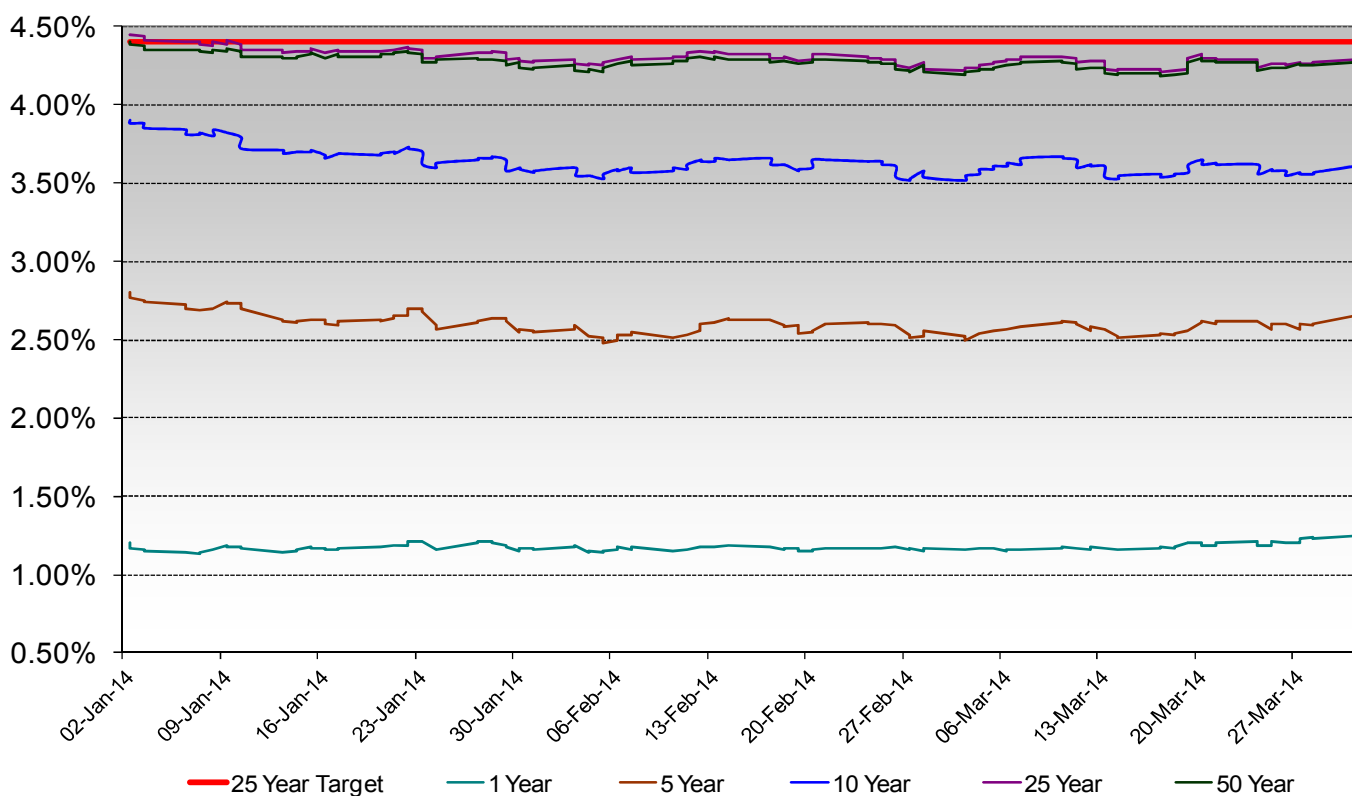
As illustrated, the Council outperformed the benchmark by 33 bps. The Council's budgeted investment return for 2013/14 was £235k, and performance achieved for the year was therefore £10k above budget.

4. New Borrowing

The 25 year PWLB target (certainty) rate for new long term borrowing for the quarter remained at 4.40%. No borrowing was undertaken during the quarter.

PWLB certainty rates, quarter ended 31st March 2014

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.13%	2.48%	3.52%	4.21%	4.18%
Date	07/01/2014	05/02/2014	27/02/2014	17/03/2014	17/03/2014
High	1.26%	2.80%	3.90%	4.45%	4.40%
Date	31/03/2014	02/01/2014	02/01/2014	02/01/2014	02/01/2014
Average	1.18%	2.60%	3.64%	4.31%	4.27%



Borrowing in advance of need.

This Council has not borrowed in advance of need during the quarter ended 31st March 2014 and has not borrowed in advance during the whole of 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 in the quarter.

6. Other

The Council sold the remaining balance of its Icelandic deposit in January 2014. It received 97% of the original deposit back.

7. 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 the Council 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 March 2014

Treasury Indicators	2013/14 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	2,100	2,100
12 months to 2 years	3,022	3,022
2 years to 5 years	6,489	6,489
5 years to 10 years	12,272	12,272
10 years and above	71,190	71,190

Prudential Indicators	2013/14 Budget £'000	Quarter 4 Actual £'000
Capital expenditure *	10,035	6,075
Capital Financing Requirement (CFR) *	98,223	98,223