Committee and Date
Cabinet
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TREASURY MANAGEMENT UPDATE – QUARTER 4 2015/16

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1. Summary

1.1. The report outlines the treasury management activities of the Council in the last quarter. It highlights the economic environment in which treasury management decisions have been made and the interest rate forecasts of the Council's Treasury Advisor, Capita Asset Services. It also updates Members on the internal treasury team's performance.

1.2. During the fourth quarter of 2015/16 the internal treasury team achieved a return of 0.68% on the Council's cash balances, outperforming the benchmark by 0.32%. This amounts to additional income of £127,000 during the quarter which is included within the Council's projected outturn position in the monthly revenue monitor.

2. Recommendations

2.1. Members are asked to accept the position as set out in the report.

REPORT

3. Risk Assessment and Opportunities Appraisal

3.1. The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998.

3.2. There are no direct environmental, equalities or climate change consequences arising from this report.

3.3. Compliance with the CIPFA Code of Practice on Treasury Management, the Council's Treasury Policy Statement and Treasury Management Practices and the Prudential Code for Capital Finance together with the rigorous internal controls will enable the Council to manage the risk associated with Treasury Management activities and the potential for financial loss.

4. Financial Implications

4.1. The Council makes assumptions about the levels of borrowing and investment income over the financial year. Reduced borrowing as a result of capital receipt generation or delays in delivery of the capital programme will both have a positive impact of the council's cash position. Similarly, higher than benchmarked returns on available cash will also help the Council's financial position. For monitoring purposes, assumptions are made early in year about borrowing and returns based on the strategies agreed by Council in the preceding February. Performance outside of these assumptions results in increased or reduced income for the Council.

4.2. The Quarter 4 performance is above benchmark and has delivered additional income of £127,000 which will be reflected in the Period 12 Revenue Monitor.

4.3. The Council currently has £134 million held in investments as detailed in Appendix A and borrowing of £329 million at fixed interest rates.

5. Background

5.1. The Council defines its treasury management activities as "the management of the authority's investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks". The report informs Members of the treasury activities of the Council between 1 January 2016 and 31 March 2016.

6. Economic Background

6.1. The economic recovery had a little more momentum than previously thought, with real GDP growth revised upwards from 0.4% in the third quarter to 0.6% in the fourth quarter. The Bank of England February Inflation Report included a forecast for growth for 2016 of 2.2% and 2.3% for 2017, down from 2.5% and 2.6% respectively. Nevertheless, this is still a reasonable rate of growth which is being driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a limited recovery in wage inflation and falls in many prices, especially fuel, which has seen CPI inflation fall to, or near to, zero over the last quarter.

6.2. The price of Brent crude has weakened further this year, dipping below £23 per barrel, which has helped to keep inflation low. Despite rising to 0.3% so far this year from an average of 0.1% in the previous quarter, CPI inflation is still far below the Bank of England's 2% target. Price cuts announced by four major gas suppliers will also start to weigh on inflation in March and April. Inflation is forecast to pick up later this year as last year's sharp falls in oil and food prices drop out of the annual comparison, and the effect of sterling's appreciation between 2013 and 2015 fades. The bigger picture is that it is likely to return to target only very slowly.

6.3. The Monetary Policy Committee (MPC) voted to keep official interest rates on hold at 0.5% during the quarter. Weak inflationary pressures including

renewed falls in the oil price are reinforcing the case to keep rates on hold for a while yet.

6.4. The US economy made a strong comeback during the year to post an annual growth rate of 2.4% for 2015. Following the Federal Reserve's decision to increase interest rates in December 2015, more downbeat news on the international scene has caused a re-emergence of caution over the timing and pace of further increases.

6.5. In the Eurozone, the European Central Bank (ECB) announced a massive €1.1 trillion programme of quantitative easing in January 2015 to buy up high credit quality government and other debt of selected Eurozone countries. This programme of €60 billion of monthly purchases started in March 2015 and following the ECB's December meeting was extended to March 2017. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth which rose by 0.3% in the fourth quarter. The ECB is also struggling to get inflation up from around or below zero towards its target of 2%.

7. Economic Forecast

7.1. The Council receives its treasury advice from Capita Asset Services. Their latest interest rate forecasts to 31 March 2019 are shown below:

	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%
5yr PWLB rate	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%
10yr PWLB rate	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.30%	3.40%	3.50%	3.60%
25yr PWLB rate	3.20%	3.30%	3.30%	3.50%	3.50%	3.60%	3.60%	3.70%	3.70%	3.70%	3.80%	3.80%
50yr PWLB rate	3.00%	3.10%	3.10%	3.30%	3.30%	3.40%	3.40%	3.50%	3.60%	3.60%	3.70%	3.70%

7.2. Capita Asset Services undertook an early quarterly review of its interest rate forecasts on 20 January 2016, before the quarterly Bank of England Inflation Report was issued, due to the run of recent downbeat UK and world economic news and the extreme volatility in financial markets. However, a further revised forecast was then done on 12 February 2016 due to a further resurgence of various fears and renewed extreme volatility in markets. This latest forecast shows a change in the timing of the first increase in Bank Rate as being March 2017.

7.3. With CPI inflation now expected to be between 0% and 1% during the whole of 2016, it is likely to be very difficult for the MPC to make a start on

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-

increasing Bank Rate in 2016. The Inflation Report forecast was also notably subdued with inflation barely getting back up to the 2% target within the 2-3 year time horizon.

7.4. In addition, average weekly earnings excluding bonuses were weak at only 2.2% in the three months to January 2016 and so this is unlikely to provide ammunition for the MPC to take action to dampen inflationary pressures as labour productivity growth would mean that net labour unit costs are still not rising by the significantly more than 2% level which the MPC wants to see before starting to raise Bank Rate.

7.5. The Governor of the Bank of England, Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual after they do start. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when the growth in average disposable income is still weak and for some consumers, who have had no increases in pay, could be non-existent (other than through some falls in prices).

7.6. Long term PWLB rates are expected to rise to 3.3% in March 2017 before steadily increasing over time to reach 3.7% by December 2018.

7.7. As the threat of potential risks from a number of sources still remains, caution must be exercised in respect of all interest rate forecasts at the current time. Economic forecasting remains difficult with so many influences weighing on the UK. Capita's bank rate forecasts will be liable to further amendment depending on how economic data transpires over 2016.

8. Treasury Management Strategy

8.1. The Treasury Management Strategy (TMS) for 2015/16 was approved by Full Council on 26 February 2015. The Council's Annual Investment Strategy, which is incorporated in the TMS, outlines the Council's investment priorities as the security and liquidity of its capital.

8.2. The Council aims to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term (up to 1 year), and only invest with highly credit rated financial institutions using the Capita's suggested creditworthiness approach, including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Capita. The Treasury Team continue to take a prudent approach keeping investments short term and with the most highly credit rated organisations. This approach has been endorsed by our external advisors, Capita.

8.3. In the fourth quarter of 2015/16 the internal treasury team outperformed its benchmark by 0.32%. The investment return was 0.68% compared to the benchmark of 0.36%. This amounts to additional income of £127,000 during the quarter which is included in the Council's projected outturn position in the monthly revenue monitor.

8.4. A full list of investments held as at 31 March 2016, compared to Capita's counterparty list, and changes to Fitch, Moody's and Standard & Poor's

credit ratings are shown in Appendix A. None of the approved limits within the Annual Investment Strategy were breached during the fourth quarter of 2015/16. Officers continue to monitor the credit ratings of institutions on a daily basis. Delegated authority has been put in place to make any amendments to the approved lending list.

8.5. The Council's interest receivable/payable budgets are currently projecting a surplus of £1.518 million due to no General Fund borrowing being undertaken during the year and the average investment balances and average interest rates earned being higher than estimated. The final outturn position will be reported in the Annual Treasury Report.

9. Borrowing

9.1. 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 Treasury Management Strategy. A list of the approved limits is shown in Appendix B. The Prudential Indicators were not breached during the fourth quarter of 2015/16 and have not been previously breached. The schedule at Appendix C details the Prudential Borrowing approved and utilised to date.

9.2. Capita's target rate for new long term borrowing (50 years) for the fourth quarter of 2015/16 fell from 3.5% to 3.0%. No new external borrowing was required in 2015/16 due to a review of the Capital Programme. As outlined below, borrowing rates fell during the quarter. The low and high points during the quarter can be seen in the table below.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.02%	1.51%	2.14%	3.01%	2.85%
Date	11/02/2016	11/02/2016	11/02/2016	11/02/2016	11/02/2016
High	1.18%	2.12%	2.74%	3.44%	3.27%
Date	04/01/2016	04/01/2016	04/01/2016	04/01/2016	04/01/2016
Average	1.10%	1.72%	2.39%	3.20%	3.02%

List of Background Papers (This MUST be completed for all reports, but does

not include items containing exempt or confidential information) Cabinet, 29 July 2015, Treasury Management Update Quarter 1 2015/16 Cabinet, 9 December 2015, Treasury Management Update Quarter 2 2015/16 Cabinet, 10 February 2016, Treasury Management Update Quarter 3 2015/16 Council, 26 February 2015, Treasury Strategy 2015/16.
Cabinet Member: Malcolm Pate, Leader
Local Member N/A
Appendices A. Investment Report as at 31 March 2016 B. Prudential Limits C. Prudential Borrowing Schedule