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TREASURY MANAGEMENT UPDATE – QUARTER 1 2016/17

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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 first quarter of 2016/17 the internal treasury team achieved a return of 0.64% on the Council's cash balances, outperforming the benchmark by 0.28%. This amounts to additional income of £125,730 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 1 performance is above benchmark and has delivered additional income of £125,730 which will be reflected in the Period 3 Revenue Monitor.

4.3. The Council currently has £173 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 April 2016 and 30 June 2016.

6. Economic Background

6.1. The economic recovery lost a little momentum in the quarter, with real GDP growth revised downwards from 0.6% in the fourth quarter of 2015 to 0.4% in the first quarter of 2016. The Bank of England May Inflation Report included a forecast for growth for 2016 of 2.0% and 2.3% for 2017 on the assumption that the referendum result was a vote to remain.

6.2. In his 30 June & 1 July speeches, the Governor of the Bank of England has indicated that the Monetary Policy Committee (MPC) would be likely to cut Bank Rate and would consider doing further quantitative easing purchasing of gilts, in order to support growth. He also suggested that the Government will need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation).

6.3. Since its peak in November 2015, sterling has fallen against the Euro by 14% which will help to make British goods & services much more competitive and will increase the value of overseas earnings by multinational companies based in the UK. In addition, the Chancellor has announced that the target of achieving a budget surplus in 2020 will have to be eased in order to help the economy recover from the expected slowing of growth during the second half of 2016.

6.4. Inflation has been very subdued in the months preceding the EU referendum. CPI inflation has stood at just 0.3% every month so far this year, but price

pressures are likely to pick up in the months ahead. The difference between headline inflation and the Bank of England's 2% target is largely due to low food and energy price inflation. But the dampening influence of food and energy prices is set to wane as last year's sharp falls drop out of the annual comparison. Together with the recent fall in the value of sterling, this should eventually feed through to higher inflation, which is expected to rise above the Bank of England's 2% target in the first half of next year

6.5. The US economy posted growth of 1.1% in the first quarter of 2016 but forward indicators are pointing towards a pickup in growth for the rest of 2016. Following the Federal Reserve's decision to increase interest rates in December 2015, more downbeat news on the international scene and then the Brexit vote has caused a re-emergence of caution over the timing and pace of further increases. It is likely there will now be only one more increase in 2016.

6.6. In the Eurozone, growth rose by 0.6% in the first quarter of 2016 and is expected to continue growing at a modest pace. The European Central Bank (ECB) is expected to respond to the economic damage generated by the UK's vote to leave the European Union by accelerating the pace of its asset purchases and possibly with another small cut in interest rates. The ECB is also struggling to get inflation up from near 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 30 June 2019 are shown below:

	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.50%	0.50%	0.50%
5yr PWLB rate	1.00%	1.10%	1.10%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.30%	1.30%
10yr PWLB rate	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.70%	1.80%	1.80%	1.80%	1.80%	1.90%
25yr PWLB rate	2.40%	2.40%	2.40%	2.50%	2.50%	2.50%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%
50yr PWLB rate	2.20%	2.20%	2.20%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%

7.2. Capita Asset Services undertook a quarterly review of its interest rate forecasts on 4 July 2016 after letting markets settle down somewhat after the Brexit result of the referendum on 23 June. It is generally agreed that this outcome will result in a slowing in growth in the second half of 2016 at a time when the Bank of England has only limited ammunition in its armoury to promote growth by using monetary policy.

7.3. It was expected that the Bank Rate would be cut by 0.25% at the 14 July MPC meeting. This did not happen, but it is still possible a cut may be made at the MPC's quarterly Inflation Report meeting on 4 August when it has a greater opportunity to report in depth on its research and findings. The Bank Rate could even be cut to 0% or 0.10%. The MPC are not expected to take any further action on Bank Rate in 2016 or 2017 as the pace of recovery of growth is expected to be weak during a period of great uncertainty as to the final agreement between the UK and the EU on arrangements after Brexit.

7.4. The MPC may also consider renewing a programme of quantitative easing. The prospect of further purchases of gilts in this way has already resulted in 10 year gilt yields falling below 1% for the first time ever.

7.5. Bank Rate is not expected to start rising until the second quarter of 2018 and any further increases are likely to be implemented at a slower pace than before. The Governor of the Bank of England 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 2.3% in June 2017 before steadily increasing over time to reach 2.5% by March 2019.

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 2016/17 was approved by Full Council on 25 February 2016. 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. Following the outcome of EU referendum vote, the UK's sovereign rating has fallen to AA from AAA, however, this is still above the minimum sovereign credit rating of AA- approved in the 2016/17 Treasury Management Strategy. Individual UK financial institution ratings have been slightly affected by the decision to leave the EU and Capita suggested investment durations have been decreased from six months to three months for two banks.

8.4. In the first quarter of 2016/17 the internal treasury team outperformed its benchmark by 0.28%. The investment return was 0.64% compared to the benchmark of 0.36%. This amounts to additional income of £125,730 during the quarter which is included in the Council's projected outturn position in the monthly revenue monitor.

7.4. A full list of investments held as at 30 June 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 first quarter of 2016/17. 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.

7.5. As illustrated in the economic background section above, investment rates available in the market are at an historical low point. The average level of funds available for investment purposes in the first quarter of 2016/17 was £178 million.

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 first quarter of 2016/17 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 first quarter of 2016/17 remained at 3.0%. However, the target rate was cut to 2.20% on 4 July 2016 due to a sharp fall in gilt yields after the referendum. No new external borrowing is currently required in 2016/17 due to a review of the Capital Programme. 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	0.89%	1.21%	1.85%	2.63%	2.33%
Date	27/6/16	27/6/16	27/6/16	29/6/16	30/6/16
High	1.20%	1.80%	2.51%	3.28%	3.08%
Date	27/4/16	27/4/16	27/4/16	27/4/16	27/4/16
Average	1.11%	1.59%	2.25%	3.05%	2.83%

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)
Cabinet, 27 July 2016, Treasury Management Update Quarter 4 2015/16
Council, 25 February 2016, Treasury Strategy 2016/17.

Cabinet Member: Malcolm Pate, Leader
Local Member N/A
Appendices A. Investment Report as at 30 June 2016 B. Prudential Limits C. Prudential Borrowing Schedule