Committee and Date
Cabinet
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TREASURY MANAGEMENT UPDATE – QUARTER 3 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 third quarter of 2016/17 the internal treasury team achieved a return of 0.47% on the Council's cash balances, outperforming the benchmark by 0.35%. This amounts to additional income of £168,200 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 3 performance is above benchmark and has delivered additional income of £168,200 which will be reflected in the Period 9 Revenue Monitor.

4.3. The Council currently has £181 million held in investments as detailed in Appendix A and borrowing of £324 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 October 2016 and 31 December 2016.

6. Economic Background

6.1. The Bank of England meeting on 4th August addressed its forecast of a slowdown in growth by cutting the Bank Rate from 0.50% to 0.25%. The August inflation report cut the forecast for growth in 2017 from 2.3% to just 0.8%. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access to the EU single market.

6.2. However, the robust growth in the third quarter of 0.6%, plus forward indicating business surveys also being very positive on growth, caused the Monetary Policy Committee (MPC) in November to pull back from another cut in Bank Rate. The November Inflation Report also included a forecast for Inflation to rise to around 2.7% in 2018 and 2019, well above its 2% target, due to a sharp rise in the cost of imports as a result of a sharp fall in sterling after the referendum.

6.3. For now at least, the MPC do not appear to be too fazed by this overshoot of the 2% inflation target. Given the uncertainty about the economic outlook and especially the impact from the two year window for Brexit negotiations from March 2017, interest rates look set to remain on hold for a long while yet.

6.4. The US economy grew strongly during the quarter and forward indicators are pointing towards robust growth in 2017, especially if Donald Trump's expansionary plans are put into effect. The Federal Reserve embarked on its long anticipated first increase in interest rates back in December 2015. At that point confidence was high and four more increases were expected to be implemented in 2016. Since then more downbeat news on the international scene and then the Brexit vote caused a delay in the timing of the second increase of 0.25% until December 2016. Further increases are now expected in both 2017 and 2018.

6.5. In the Eurozone, the European Central Bank extended its Quantitative easing programme in December 2016 but these measures have struggled to make a significant impact in boosting economic growth and helping inflation to rise from around zero towards the 2% target. There have been many comments from forecasters that central banks around the world are running out of ammunition to stimulate economic growth and to boost inflation. They stress that national governments will need to do more by way of structural reforms, fiscal measures and direct investment to support demand in their economies and economic growth.

6.6. Japan has been struggling to gain consistent significant growth but has achieved an annualised rate of 2.7% in the third quarter. It has also been struggling to put deflation firmly behind it and to get inflation up to reasonable levels, despite huge monetary and fiscal stimulus. Japan has been making little progress on fundamental reform of the economy.

7. Economic Forecast

7.1. The Council receives its treasury advice from Capita Asset Services. Their latest interest rate forecasts to 31 March 2020 are shown below:

	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

7.2. The MPC had previously given a strong steer that it was likely to cut the Bank Rate again from its current level of 0.25% and this was likely to be in November or December 2016. However, economic data since the last cut in August has indicated much stronger growth than had been forecast. Inflation forecasts have also risen substantially as a result of a continuation of the sharp fall in the value of Sterling after early August. Consequently, the Bank Rate was not cut again in November or December and on current trends it now appears unlikely that there will be another cut although this cannot be completely ruled out if there was a significant fall in economic growth.

7.3. During the two year period 2017 – 2019, when the UK is negotiating the terms of the withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects (i.e. by raising Bank Rate), which will already be adversely impacted by the uncertainties of what form Brexit will eventually take.

7.4. Capita Asset Services have recently undertaken a review of its interest rate forecasts and they now expect the Bank Rate to remain at 0.25% until June 2019 when it is expected to rise to 0.50% after these negotiations have been completed.

7.5. Long term PWLB rates are expected to rise from 2.70% in March 2017 to 3% in March 2019 before steadily increasing over time to reach 3.2% by March 2020.

7.6. 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 2017.

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 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 third quarter of 2016/17 the internal treasury team outperformed its benchmark by 0.35%. The investment return was 0.47% compared to the benchmark of 0.12%. This amounts to additional income of £168,200 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 31 December 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 third 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 forecast 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 third quarter of 2016/17 was £193 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 third 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 third quarter of 2016/17 started at 2.1% and ended at 2.70%. 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	0.76%	1.04%	1.56%	2.32%	2.15%
Date	28/12/16	03/10/16	03/10/16	03/10/16	04/10/16
High	0.99%	1.58%	2.34%	2.97%	2.72%
Date	26/10/16	14/11/16	12/12/16	12/12/16	12/12/16
Average	0.88%	1.40%	2.09%	2.74%	2.51%

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 1 2016/17
Cabinet, 21 December 2016, Treasury Management Update Quarter 2 2016/17
Council, 25 February 2016, Treasury Strategy 2016/17.

Cabinet Member:
Malcolm Pate, Leader

Local Member
N/A

Appendices
A. Investment Report as at 31 December 2016
B. Prudential Limits
C. Prudential Borrowing Schedule