CAPITA

Treasury solutions

Asset Services

Shropshire Council

Monthly Investment Analysis Review

September 2017

Monthly Economic Summary

General Economy

Changing interest rate expectations were to the fore in September, with investors reining in their expectations following the Bank of England's Monetary Policy Committee (MPC) meeting. This suggested that a rate hike could be appropriate in the coming months, possibly as soon as November.

The month started with the release of the Markit/CIPS Manufacturing Purchasing Manager's Index (PMI), which defied expectations of a small fall to 55.0 and instead rose to 56.3 for August from the 55.3 figure reported for July. The headline reading was supported by increases in both the output and new orders balance, suggesting the recent strength of the survey will be maintained. This raised expectation that, after a disappointing start to the year, the sector could provide a decent boost to GDP in the second half of the year. A rise in the number of total new orders reflected stronger domestic demand as the export orders balance edged down – suggesting we might start to see import growth ease as UK firms and consumers substitute domestic goods for imports.

However, August's Services PMI suggests the economy is struggling to pick up much pace in the third quarter. The headline business activity index fell to 52.3 from 53.8 in July, a greater fall than expected. Adding to that, the UK Construction PMI continued last month's disappointment and fell further to a twelve month low of 51.1. While still indicating "expansion", it is drifting close to the 50 dividing line between growth and contraction. Retail sales, on the other hand, brought good news and suggested consumers are faring well and showing resilience in the face of the real pay squeeze. Volumes rose by a hefty 1.0% for August – beating the consensus expectation of a 0.2% rise – along with July's figure being upwardly revised to 0.6% from 0.3%. While retail sales are very volatile on a month-by-month basis, and high-street spending growth has eased this year, the latest data suggests households are continuing to provide some support to the overall economy.

Inflation day brought something of a surprise with the Consumer Price Index (CPI) hitting its joint highest (with May) figure in more than 5 years of 2.9% for August as households paid more for fuel and clothing, which jumped by 4.6% y/y. Wage growth, however, yielded a 2.1% y/y rise, giving little change from previous month's growth rates. The stagnant wage growth paired with both higher than expected inflation and low unemployment – which unexpectedly fell further this month to its lowest since 1975 during the three months to July at 4.3% – came just ahead of the Bank of England's MPC meeting.

Whilst the MPC voted 7-2 in favour of keeping policy unchanged in September, the minutes stated that *"some withdrawal of monetary stimulus is likely to be appropriate over the coming months"*. The day after the meeting, the 'arch dove' of the MPC, Gertjan Vlieghe, gave a surprise at the annual conference of the Society of Business Economists in London by adding his voice to the calls for an end to a decade of historically low interest rates. He paired the rise in inflation with the tightening labour market and remarked *"…we are approaching the moment when the Bank Rate may need to rise"*. These further comments caused the pound to leap above the $1.36 mark as traders and investors positioned themselves in anticipation of a potential interest rate rise at the MPC's next meeting in November. Markets currently price the probability of a rate rise in November at around 70%.

Moving on to the public finances, the UK posted its smallest budget deficit for any August since 2007 – boosted by record sales tax revenues for the month. The deficit was reported at £5.7bn, down 18% compared with August 2016. Forecasts had expected a much larger deficit of £7.1bn. August's surprisingly strong performance followed July's unexpected budget surplus – a benefit for Chancellor Philip Hammond who is under pressure to relax austerity measures when he announces budget plans in November.

The final reading of second quarter growth figures saw the annual rate revised down to 1.5% from the 1.7% previously recorded, resulting in the weakest y/y growth since 2013. However, some analysts were quick to point out that the revision was due to an uplift in 2016 growth, rather than a weakening in more recent times. The quarterly growth figure remained unchanged at 0.3%. There was also a bit of positive news in terms of the composition of growth in the second quarter, which showed bigger contributions from business investment and exports than previously thought.

On the other side of "the pond", the US non-farm payrolls increased by a softer 165,000 last month, marginally below the consensus forecast of 179,000. Additionally, the gains in the preceding two months were revised down modestly and the unemployment rate edged back up to 4.4% from 4.3%. Even though the hurricane season did cause some temporary disruption, third quarter GDP growth is still predicted to be between 2.5%-3.0% annualised, with the final estimate for Q2 GDP revised marginally upwards to 3.1% from 3.0%. August showed consumer prices accelerated amid a jump in the cost of gasoline and rents. The month-on-month figure rose to 0.4%, while the annual rate increased from 1.7% to 1.9%. This sign of firming inflation provided further evidence that the Federal Reserve may tighten policy rates again before the year is out. This view gained more credence on the back of the actual policy meeting, where the updated individual economic and interest rate projections saw 11 out of 16 members expecting one more rate hike before the year is out. In addition, the central bank announced its plans for trimming its balance sheet. The plan was that, come October, it would begin to reduce its $4.2 trillion in holdings of US treasury bonds and mortgage backed securities by cutting $10 billion each month from the amount of maturing securities it reinvests. This level would then increase by $10bn per quarter until it reached $50bn in October 2018.

A little closer to home, the European Central Bank said it expects key interest rates to remain at their present levels for an extended period of time, and they confirmed asset purchases of €60bn per month are set to run until the end of this year or beyond, if necessary. However, the Bank is widely expected to announce its own plans for tapering its purchase programme at its next meeting in late October. On the data front, Eurozone Q2 GDP growth was confirmed at 0.6%, with annual growth revised upward to 2.3% from 2.2%. Unemployment is currently at 9.1%, with the Czech Republic having the lowest rate at 2.9% followed by Germany with 3.6%.

Housing

Nationwide reported that house prices in London have fallen for the first time since 2009, whilst prices across Britain overall rose at their slowest pace in more than four years for the month of September. Annually, house prices in London fell by 0.6% whilst nationally house prices rose by 2.0%, only a slightly weaker figure than the 2.1% growth reported for August. This national figure is, however, still the weakest figure since June 2013. Conversely, Halifax reported monthly house prices hit an eight month high in August of 1.1%, adding to signs the housing market has regained some strength after its post-Brexit slow down. Annual house price growth picked up to 2.6% from 2.1% in July. The Bank of England also commented that mortgage approvals were much stronger than expected in July.

Forecast

Capita Asset Services (CAS) has not changed their forecasts this month. While market interest rate expectations have changed sharply through September, the Interest Rate Strategy Group are awaiting the outcome of the next MPC meeting on 2nd November before making any changes to its current view. Key here is whether the Bank signals that any move is a one off reversal of the emergency action in August 2016, or the start of a more sustained, albeit gradual shift higher. Capital Economics (CE), however, have changed their forecast. They now expect the Bank Rate to increase to 0.5% in Q4 2017, with further rises of 25 basis points in Q2 2018, Q3 2018, Q4 2018, Q2 2019 and Q4 2019.

Bank Rate	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Capita Asset Services	0.25%	0.25%	0.25%	0.25%	0.25%
Capital Economics	0.50%	0.50%	0.75%	1.00%	1.25%

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Current Investment List

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest Long Term Rating	Historic Risk of Default
HSBC Bank Plc	20,000,000	0.55%		Call	AA-	0.000%
MMF Standard Life	7,620,000	0.21%		MMF	AAA	0.000%
MMF Insight	850,000	0.19%		MMF	AAA	0.000%
Slough Borough Council	5,000,000	0.28%	21/07/2017	23/10/2017	AA	0.001%
Lloyds Bank Plc	5,000,000	0.55%	28/04/2017	27/10/2017	A	0.004%
Barclays Bank Plc	5,000,000	0.32%		Call32	A-	0.005%
Lloyds Bank Plc	3,500,000	0.55%	08/05/2017	08/11/2017	A	0.006%
Glasgow City Council	5,000,000	0.25%	04/08/2017	08/11/2017	AA	0.002%
Lloyds Bank Plc	3,680,000	0.55%	09/05/2017	09/11/2017	A	0.006%
Lloyds Bank Plc	1,400,000	0.55%	11/05/2017	10/11/2017	A	0.006%
Goldman Sachs International Bank	5,000,000	0.65%	07/06/2017	07/12/2017	A	0.010%
Lloyds Bank Plc	5,000,000	0.55%	07/06/2017	07/12/2017	A	0.010%
Lloyds Bank Plc	8,100,000	0.55%	14/06/2017	14/12/2017	A	0.012%
Lloyds Bank Plc	2,420,000	0.55%	16/06/2017	15/12/2017	A	0.012%
North Tyneside Metropolitan Borough Council	7,000,000	0.50%	20/12/2016	19/12/2017	AA	0.005%
Lloyds Bank Plc	900,000	0.36%	21/06/2017	21/12/2017	A	0.013%
Santander UK Plc	15,000,000	0.40%		Call95	A	0.015%
Barclays Bank Plc	2,800,000	0.34%	13/07/2017	15/01/2018	A-	0.017%
Barclays Bank Plc	5,450,000	0.34%	14/07/2017	15/01/2018	A-	0.017%
Barclays Bank Plc	1,750,000	0.34%	17/07/2017	17/01/2018	A-	0.017%
Coventry Building Society	5,000,000	0.30%	17/07/2017	17/01/2018	A	0.017%
Nationwide Building Society	5,000,000	0.32%	17/07/2017	17/01/2018	A	0.017%
Dundee City Council	5,000,000	0.50%	23/01/2017	22/01/2018	AA	0.007%
Nationwide Building Society	5,000,000	0.32%	28/07/2017	26/01/2018	A	0.018%
Fife Council	5,000,000	0.35%	03/08/2017	02/02/2018	AA	0.008%
Goldman Sachs International Bank	5,000,000	0.58%	08/08/2017	08/02/2018	A	0.020%
Northamptonshire County Council	5,000,000	0.35%	15/08/2017	15/02/2018	AA	0.009%
Lancashire County Council	5,000,000	0.61%	15/05/2017	14/05/2018	AA	0.014%
Total Investments	**£150,470,000**	**0.44%**				0.009%

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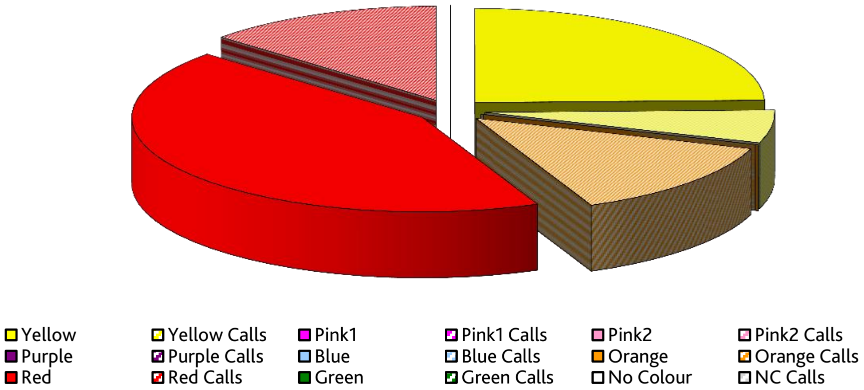
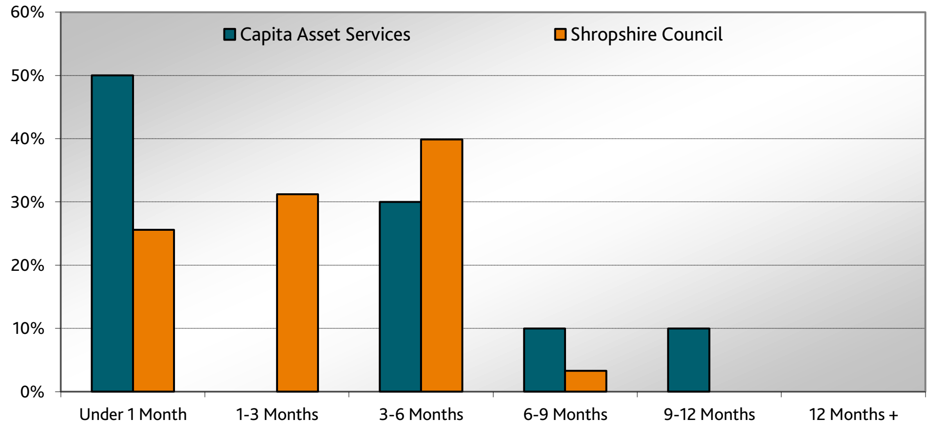
Portfolio Composition by Capita Asset Services' Suggested Lending Criteria





Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

Portfolios weighted average risk number = 3.66

WARoR = Weighted Average Rate of Return
WAM = Weighted Average Time to Maturity

	% of Portfolio	Amount	% of Colour in Calls	Amount of Colour in Calls	% of Call in Portfolio	WARoR	WAM	WAM at Execution	Excluding Calls/MMFs/USDBFs WAM	Excluding Calls/MMFs/USDBFs WAM at Execution
Yellow	30.22%	£45,470,000	18.63%	£8,470,000	5.63%	0.37%	85	197	105	243
Pink1	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Pink2	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Purple	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Blue	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Orange	13.29%	£20,000,000	100.00%	£20,000,000	13.29%	0.55%	0	0	0	0
Red	56.49%	£85,000,000	23.53%	£20,000,000	13.29%	0.45%	83	159	84	183
Green	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
No Colour	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
	100.00%	**£150,470,000**	**32.21%**	**£48,470,000**	**32.21%**	**0.44%**	**72**	**149**	**91**	**205**

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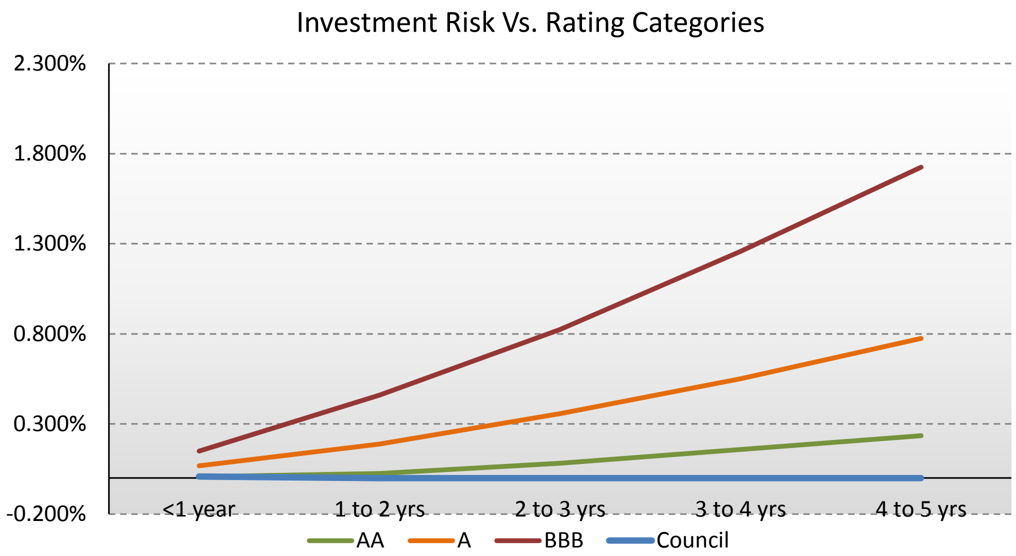
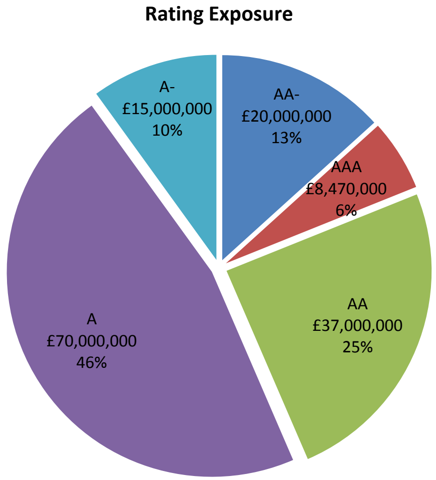
Investment Risk and Rating Exposure





Historic Risk of Default

Rating/Years	<1 year	1 to 2 yrs	2 to 3 yrs	3 to 4 yrs	4 to 5 yrs
AA	0.007%	0.024%	0.081%	0.158%	0.234%
A	0.067%	0.189%	0.356%	0.551%	0.775%
BBB	0.150%	0.460%	0.824%	1.257%	1.726%
Council	0.009%	0.000%	0.000%	0.000%	0.000%

Historic Risk of Default

This is a proxy for the average % risk for each investment based on over 30 years of data provided by Fitch, Moody's and S&P. It simply provides a calculation of the possibility of average default against the historical default rates, adjusted for the time period within each year according to the maturity of the investment.

Chart Relative Risk

This is the authority's risk weightings compared to the average % risk of default for “AA”, “A” and “BBB” rated investments.

Rating Exposures

This pie chart provides a clear view of your investment exposures to particular ratings.

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Monthly Credit Rating Changes

FITCH

Date	Update Number	Institution	Country	Rating Action
04/09/2017	1549	Co-operative Bank Plc	UK	Long Term Rating was affirmed at 'B-', Outlook changed to Stable and was removed from Evolving Watch. Short Term Rating was affirmed at 'B', removed from Negative Watch. Viability Rating downgraded to 'f' from 'c'.
07/09/2017	1551	Clydesdale Bank	UK	Long Term Rating affirmed at 'BBB+', removed from Negative Watch and placed on Stable Outlook. Short Term Rating was affirmed at 'F2'.
08/09/2017	1552	Co-operative Bank Plc	UK	Long Term Rating affirmed at 'B-', Stable Outlook. Short Term Rating affirmed at 'B'. Viability Rating upgraded to 'b-' from 'f'.
29/09/2017	1560	Barclays Bank Plc	UK	Long Term Rating 'A', removed from Stable Outlook and placed on Positive Watch. Short Term Rating was affirmed at 'F1'.
29/09/2017	1561	Deutsche Bank AG	Germany	Long Term Rating downgraded to 'BBB+' from 'A-', Outlook changed to Stable from Negative. Short Term Rating downgraded to 'F2' from 'F1'. Viability Rating downgraded to 'bbb+' from 'a-'.
29/09/2017	1562	National Westminster Bank Plc	UK	Long Term Rating 'BBB+', removed from Stable Outlook and placed on Positive Watch. Short Term Rating affirmed at 'F2' and Viability Rating affirmed at 'bbb+'.
29/09/2017	1562	The Royal Bank of Scotland	UK	Long Term Rating affirmed at 'BBB+', Stable Outlook. Support Rating was placed on Positive Watch and at the same time all other ratings were affirmed.

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Monthly Credit Rating Changes

MOODY'S

Date	Update Number	Institution	Country	Rating Action
07/09/2017	1550	Co-operative Bank Plc	UK	Long Term Rating affirmed at 'Caa2', Short Term Rating affirmed at 'NP'. Outlook changed to Positive from Evolving Watch.
13/09/2017	1554	Bank of America, N.A.	USA	Long Term Rating 'A1', removed from Positive Outlook and placed on Positive Watch. Short Term Rating affirmed at 'P-1'.
18/09/2017	1556	Clydesdale Bank	UK	Long Term Rating 'Baa2', removed from Stable Outlook and placed on Positive Watch. Short Term Rating 'P-2', placed on Positive Watch.
25/09/2017	1557	United Kingdom Sovereign	UK	Sovereign Rating downgraded to 'Aa2' from 'Aa1', Outlook changed to Stable from Negative.
28/09/2017	1558	Bank of Scotland Plc	UK	Long Term Rating upgraded to 'Aa3' from 'A1', removed from Positive Watch and placed on Stable Outlook. Short Term Rating affirmed at 'P-1'.
28/09/2017	1558	HSBC Bank Plc	UK	Long Term Rating downgraded to 'Aa3' from 'Aa2', Negative Outlook. Short Term Rating was affirmed at 'P-1'.
28/09/2017	1558	Lloyds Bank Plc	UK	Long Term Rating upgraded to 'Aa3' from 'A1', removed from Positive Watch and placed on Stable Outlook. Short Term Rating affirmed at 'P-1'.
28/09/2017	1558	National Westminister Bank Plc	UK	Long Term Rating affirmed at 'A2', Outlook changed to Positive from Stable. Short Term Rating affirmed at 'P-1'.
28/09/2017	1558	The Royal Bank of Scotland	UK	Long Term Rating affirmed at 'A2', Outlook changed to Negative from Stable. Short Term Rating affirmed at 'P-1'.
28/09/2017	1559	BNP Paribas	France	Long Term Rating upgraded to 'Aa3' from 'A1', Stable Outlook. Short Term Rating affirmed at 'P-1'.
28/09/2017	1559	ING Bank NV	France	Long Term Rating upgraded to 'Aa3' from 'A1', Outlook changed to Stable from Positive. Short Term Rating affirmed at 'P-1'.

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Monthly Credit Rating Changes

S&P

Date	Update Number	Institution	Country	Rating Action
12/09/20117	1553	Qatar National Bank	Qatar	Affirmed at 'A', removed from Negative Watch and placed on Negative Outlook. Short Term Rating affirmed at 'A-1', removed from Negative Watch.
18/09/2017	1555	ABN AMRO Bank N.V.	Netherlands	Long Term Rating affirmed at 'A', Outlook changed to Positive from Stable. Short Term Rating affirmed at 'A-1'.
18/09/2017	1555	Cooperative Rabobank U.A.	Netherlands	Long Term Rating affirmed at 'A+', Outlook changed to Positive from Stable. Short Term Rating affirmed at 'A-1'.