CAPITA

Treasury solutions

Asset Services

Appendix A

Shropshire Council

Monthly Investment Analysis Review

September 2014

Shropshire Council

Monthly Economic Summary

General Economy

September was dominated by great volatility in the markets due to the much anticipated Scottish Referendum result which was 55.3% ‘No’ to independence. Following the result, sterling appreciated due to greater confidence within financial markets, alongside risk premium unwinding (with the focus returning to the strength of Britain’s recovery). This caused the pound to strengthen against the euro to a two year high, which may cause the BoE to slow down the pace of interest rates hikes to help to rebalance the economy. Essentially, dovish policymakers are concerned with the weakness of exports with Britain relying heavily upon domestic demand to maintain the momentum of economic recovery. There is therefore increasing divergence between the euro and pound, with the ECB cutting interest rates to fight deflation which could potentially disrupt financial markets and pose downside risks to the UK.

The MPC minutes this month further reiterated the split in their decision to keep rates on hold, with two hawkish policymakers voting to raise rates to 0.75% for a second successive month. Nonetheless, the consensus decision still remains in favour of holding interest rates at their historic low of 0.5%, citing reasons such as declines in manufacturing, exports and housing activity, in conjunction with weaknesses within the Eurozone.

The Markit/CIPS purchasing managers' index (PMI) for construction has continued to rise, demonstrating its biggest monthly growth in the six months to July, increasing to 64.0 in August from 62.4 in July. These figures have been mainly driven by growth in housing, commercial and civil engineering markets. Similarly, Britain’s dominant services sector, the major driving force of the UK economy, expanded at its fastest pace in a year increasing to 60.5 in August, largely exceeding market expectations. However, the services industry has been hit by turbulence stemming from the Ukraine crisis. This could create future threats in terms of slowing down the services and construction sector. This impact can already be seen in new orders and employment diminishing cumulatively across all three sectors this month. The manufacturing Markit PMI survey declined to 52.5 in August, the slowest rate in 14 months. Nonetheless, this is still above the 50 point threshold denoting growth.During Q2 2014, UK GDP grew 0.9% on the previous quarter (3.2% y/y), increasing from 0.7% in Q1.

Britain’s trade deficit in goods rose for a successive month to £10.186 billion, the highest figure since April 2012, due to a considerable decline in export orders, stemming from a poor Eurozone performance, UK’s largest trading partner.

The unemployment rate in Britain has demonstrated substantial improvement, with the ONS quoting the number of people in employment rising to a record high to 30.609 million in the three months through July; however, pay growth was weak. Nonetheless, despite this lack of wage growth, income tax receipts and social security payments have risen 1.6% from a year earlier. Subsequently, this data provides a positive indication that consumer activity should remain optimistic throughout the year despite the lack of wage growth. However, pay growth is still lagging behind inflation, which declined to 1.5% in July, a 5 year low. Although this indicates that the BoE will be unlikely to change their projections, Governor Mark Carney stated that, dependent upon the labour markets recovery, the central bank may decide to raise interest rates earlier than anticipated. Nonetheless, the current eight month run of consumer price inflation remains below the 2% target and this remains key to the BoE deciding to hold off raising rates.

British Retail Sales in September were reported to have grown at a relatively slower pace in comparison with August, with surveys signalling a decline in consumer confidence. The Confederation of British Industry’s distributive trade’s survey’s retail balance fell to +31, down from +37 high in August, which may dampen the current rate of UK economic growth. Despite this, solid growth was still demonstrated in actual sales on the high street with the strongest growth demonstrated since April, retail sales volumes rising by 0.4% on the month despite real pay pressures and looming interest rate hikes. Nevertheless, wage growth remains remarkably weak which has become crucial to the BoE’s decision of holding Britain’s record low interest rates.

Public sector net borrowing in August was £11.6bn, up 6.1% from the previous year. This means that it will be much harder to hit the budgeted 10% reduction in borrowing this year after successive months this year with similar overshoots. The Government may, therefore, have to consider greater austerity measures to reduce the budget deficit if this situation does not improve during the rest of the year. This will be a key issue with the upcoming general election with deficit reduction becoming central to the economic policy of the Conservative led coalition.

Finally, in the US, the economy grew at a relatively optimistic pace in Q2, expanding at 4.6% annually, previously reported at 4.2%. This has been reflected somewhat during Q3, with strong growth seen in manufacturing, trade and housing and domestic demand. However; slow job growth can be accounted for during August with the unemployment rate falling to 6.1% due to more Americans giving up the search for work. However, robust job gains are indicative of strong labour market performance, deriving from a surge in gross domestic income. Nonfarm payrolls increased by 142,000 last month, the smallest increase in 8 months. In their recent meeting this September, the US Federal Reserve revised its economic forecast and individual interest rate expectations. With no change to expected employment and inflation, this would appear to justify a higher rate outlook with the first rise likely to be in Q1 next year.

Housing Market

In the earlier part of the year, Governor Mark Carney stated that housing was the biggest domestic threat to Britain’s economic recovery, with many borrowers taking on more debt beyond their means. However, the BBA quoted mortgage approvals for house purchases have fallen to their lowest level in 12 months during August (down to 64,212), but were still up 5.2% compared to the previous year, so the housing market has slowed marginally over recent months. According to mortgage lender Nationwide, house prices fell to an eight month low, declining by 0.2% in September, after positive growth recorded at 0.8% in August. Nonetheless, the housing market should remain stable as increases to interest rates are likely to be fairly gradual over the next few years.

Forecast

Capita Asset Services kept its Bank Rate forecast unchanged this month, expecting the first increase in Q1 2015. Capital Economics did not alter their forecast this month.

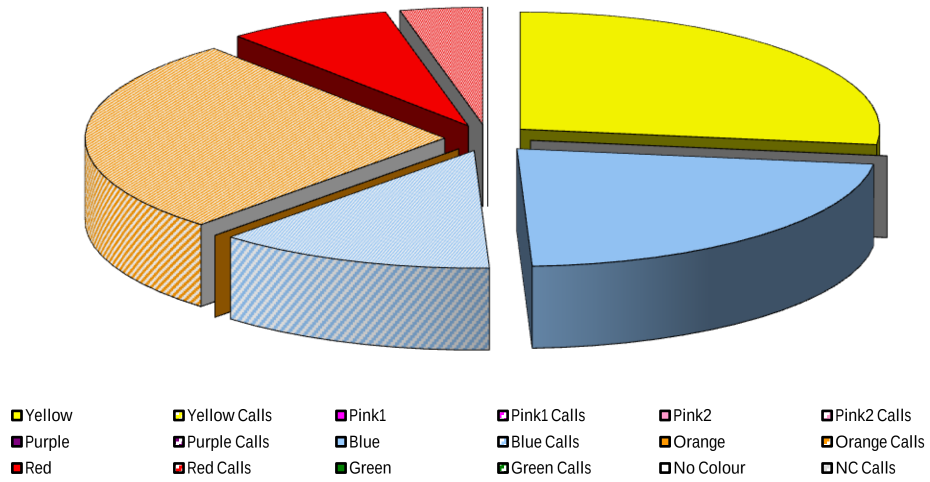
Bank Rate	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Capita Asset Services	0.50%	0.75%	0.75%	1.00%	1.00%
Capital Economics	0.50%	0.75%	0.75%	1.00%	1.00%

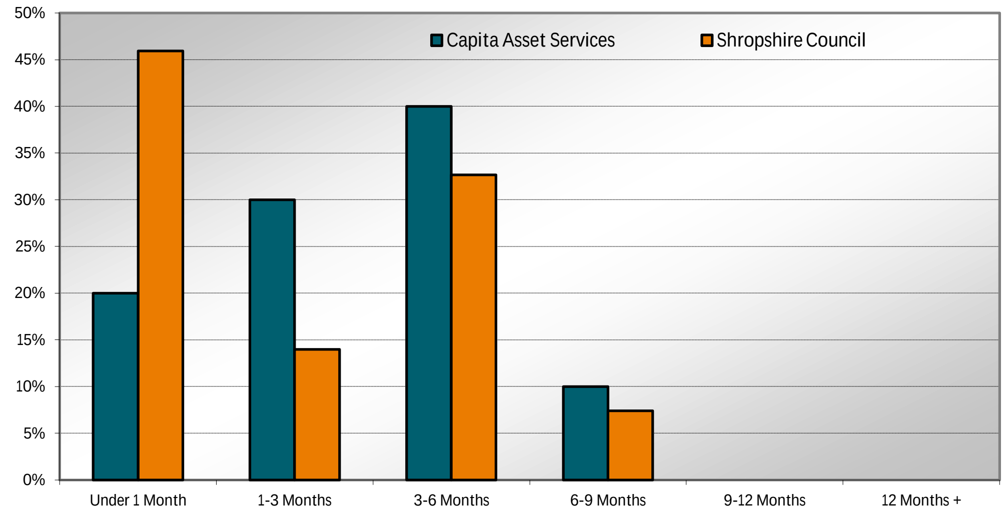
Shropshire Council

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	0.80%		Call	AA-	0.000%
Svenska Handelsbanken AB	16,550,000	0.55%		Call	AA-	0.000%
National Westminster Bank Plc	1,880,000	0.25%		Call	BBB+	0.001%
Blaenau Gwent County Borough Council	2,000,000	0.32%	11/08/2014	03/10/2014	AA+	0.000%
Lloyds Bank Plc	3,600,000	0.57%	04/07/2014	06/10/2014	A	0.001%
Nationwide Building Society	2,100,000	0.45%	19/08/2014	10/10/2014	A	0.002%
Stockport Metropolitan Borough Council	3,000,000	0.33%	19/08/2014	13/10/2014	AA+	0.001%
Salford City Council	5,000,000	0.33%	14/07/2014	14/10/2014	AA+	0.001%
Nationwide Building Society	4,000,000	0.44%	03/09/2014	20/10/2014	A	0.005%
Nationwide Building Society	2,470,000	0.45%	08/09/2014	29/10/2014	A	0.007%
Nationwide Building Society	1,430,000	0.45%	10/09/2014	29/10/2014	A	0.007%
Barclays Bank Plc	5,000,000	0.55%		Call35	A	0.008%
Blaenau Gwent County Borough Council	2,000,000	0.33%	22/08/2014	05/11/2014	AA+	0.002%
Birmingham City Council	5,000,000	0.35%	06/08/2014	06/11/2014	AA+	0.002%
Lloyds Bank Plc	1,400,000	0.60%	07/07/2014	07/11/2014	A	0.009%
Lloyds Bank Plc	900,000	0.57%	07/08/2014	10/11/2014	A	0.010%
Blaenau Gwent County Borough Council	2,000,000	0.35%	20/08/2014	20/11/2014	AA+	0.002%
Salford City Council	2,600,000	0.35%	01/09/2014	02/12/2014	AA+	0.003%
National Westminster Bank Plc	15,000,000	0.30%		Call95	BBB+	0.052%
Lloyds Bank Plc	4,320,000	0.95%	09/01/2014	08/01/2015	A	0.024%
Lancashire County Council	5,000,000	0.50%	22/07/2014	22/01/2015	AA+	0.005%
Lloyds Bank Plc	1,520,000	0.95%	13/02/2014	12/02/2015	A	0.032%
Birmingham City Council	5,000,000	0.45%	15/08/2014	16/02/2015	AA+	0.006%
Cornwall Council	5,000,000	0.45%	03/09/2014	03/03/2015	AA+	0.007%
Lloyds Bank Plc	5,000,000	0.95%	07/03/2014	06/03/2015	A	0.037%
Lloyds Bank Plc	3,260,000	0.95%	02/04/2014	01/04/2015	A	0.043%
Lloyds Bank Plc	5,000,000	0.95%	09/04/2014	08/04/2015	A	0.045%
Lloyds Bank Plc	5,000,000	0.95%	17/04/2014	16/04/2015	A	0.047%
Total Investments	**£135,030,000**	**0.58%**				0.015%

Portfolio Breakdown 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

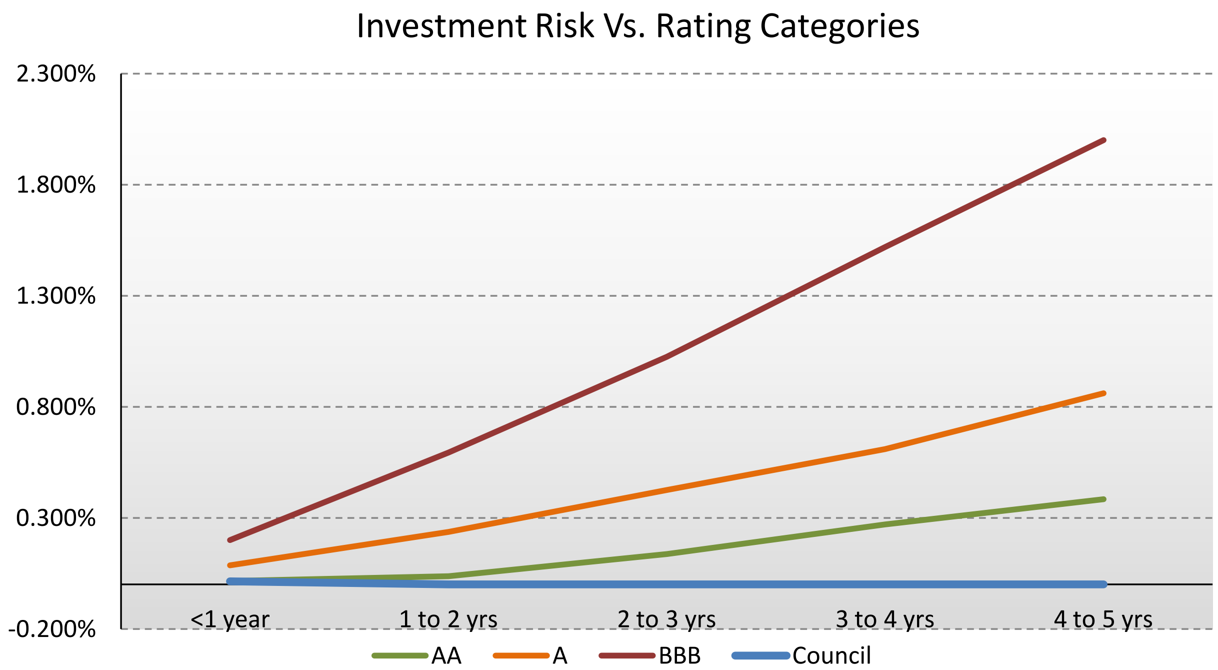
Portfolios weighted average risk number = 2.95

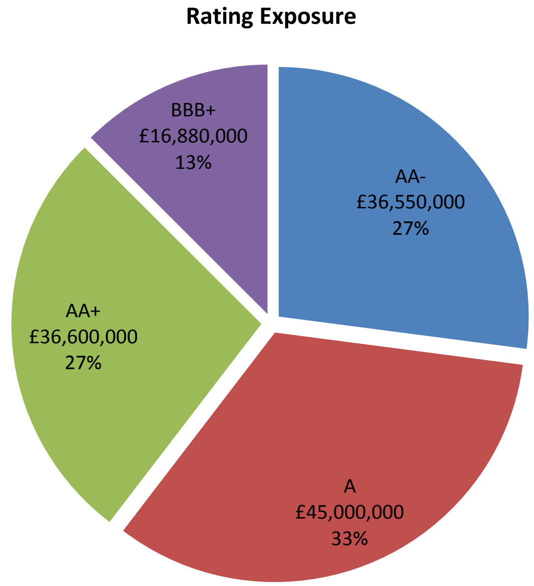
WARoR = Weighted Average Rate of Return
WAM = Weighted Average Time to Maturity

			% of Colour	Amount of	% of Call				Excluding Calls/MMFs/EMMFs	
	% of Portfolio	Amount	in Calls	Colour in Calls	in Portfolio	WARoR	WAM	WAM at Execution	WAM	WAM at Execution
Yellow	27.11%	£36,600,000	0.00%	£0	0.00%	0.39%	73	123	73	123
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	34.72%	£46,880,000	36.01%	£16,880,000	12.50%	0.67%	117	230	136	312
Orange	27.07%	£36,550,000	100.00%	£36,550,000	27.07%	0.69%	0	0	0	0
Red	11.11%	£15,000,000	33.33%	£5,000,000	3.70%	0.48%	26	45	21	49
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%	**£135,030,000**	**43.27%**	**£58,430,000**	**43.27%**	**0.58%**	**63**	**118**	**91**	**188**

Shropshire Council

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	0.017%	0.038%	0.137%	0.271%	0.384%
A	0.087%	0.237%	0.425%	0.610%	0.861%
BBB	0.201%	0.595%	1.025%	1.519%	2.000%
Council	0.015%	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.

Shropshire Council

Monthly Credit Rating Changes

FITCH

Date	Update Number	Institution	Country	Rating Action
24/09/2014	1299	Yorkshire Building Society	UK	Long Term Rating was upgraded to 'A-' from 'BBB+' placed on a Stable Outlook. Short Term Rating upgraded to 'F1' from 'F2'. Viability Rating upgraded to 'a' from 'bbb+'. Support Rating was affirmed at '5'.
24/09/2014	1299	Skipton Building Society	UK	Long Term Rating was upgraded to 'BBB' from 'BBB-', Outlook changed from Positive from Stable. Short Term Rating was Upgraded to 'F2' from 'F3'. Viability Rating was upgraded to 'bbb' from 'bbb-'. Support Rating was affirmed at '5'.
24/09/2014	1299	Leeds Building Society	UK	Long Term Rating was affirmed at 'A', placed on a Stable Outlook. Short Term Rating was upgraded to 'F1' from 'F2'. Viability Rating was affirmed at 'a-'. Support Rating was affirmed at '5'.

Shropshire Council

Monthly Credit Rating Changes

MOODY'S

Date	Update Number	Institution	Country	Rating Action

Monthly Credit Rating Changes

S&P

Date	Update Number	Institution	Country	Rating Action