Shropshire Council	**Committee and Date** Cabinet 10 June 2015 12.30 pm	**Item** **9** Public

TREASURY MANAGEMENT UPDATE – QUARTER 4 2014/15

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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 Councils Treasury Advisor, Capita Asset Services. It also updates Members on the internal treasury team's performance.

1.2. During the fourth quarter of 2014/15 the internal treasury team achieved a return of 0.58% on the Council's cash balances outperforming the benchmark by 0.26%. This amounts to additional income of £83,062 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 result in increased or reduced income for the Council.

4.2. The Quarter 4 performance is above benchmark and has delivered additional income of £83,062 which will be reflected in the Period 12 Revenue Monitor.

4.3. The Council currently has £110 million held in investments as detailed in Appendix A and borrowing of £338 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 2015 and 31 March 2015.

6. Economic Background

6.1. After strong UK Gross Domestic Product (GDP) growth in 2013 at an annual rate of 2.7% and strong growth for 2014 at an annual rate of 2.8% which is the strongest rate since 2006, there are good grounds for optimism that the growth rate will increase further during 2015 as the positive effects from the fall in the price of oil feeds through to consumers and other parts of the economy. In its February quarterly Inflation Report, the Bank of England maintained its GDP forecast for 2015 at 2.9%, but revised up its forecasts for 2016 and 2017 to 2.9% and 2.7% respectively, from 2.6% in both years.

6.2. Also encouraging has been the sharp fall in Inflationary pressures. Consumer Price Inflation (CPI) fell all the way to 0% in February, its lowest level since 1960. Whilst lower petrol and utility prices pushed the headline rate down, the main driver of the fall was a drop in core inflation. This perhaps reflects the delayed effect of the fall in oil prices seen over the past six months, starting to feed through into lower prices for other goods. Forward indications are that the UK looks set to experience a brief period of negative inflation soon, when the cut in gas prices announced by British Gas (the utility company with the biggest market share) will show up in the inflation figures for the first time.

6.3. The Monetary Policy Committee (MPC) voted to keep official interest rates on hold at 0.5% during the quarter and voted not to increase its programme of asset purchases under the Bank's quantitative easing (QE) programme at its March meeting. The present low level of inflation raised concerns among some members of the MPC, most notably the Bank of England's Chief Economist Andy Haldane, who recently said that he believes that the next move in Bank Rate is just as likely to be a rate cut than a rate increase. Not all MPC members share his pessimism, Mark Carney recently stated that it would be foolish to fight the current period of low inflation by injecting more monetary stimulus into the economy, and re-iterated that the most likely next move in interest rates is likely to be up.

6.4. The US economy is well on track to making a full recovery from the financial crash. Growth of 2.4% for 2014 hold great promise for strong growth going forward and for further falls in unemployment. It is therefore confidently predicted that the first increase in US interest rates will be in 2015 and is likely to be ahead of the UK in being the first major western country to raise rates.

6.5. As for the Eurozone, on 21 January 2015 the European Central Bank (ECB) unleashed a massive €1.1 trillion programme of quantitative easing 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 it is currently intended to run initially to September 2016. However, it remains to be seen whether this will have a significant enough effect in terms of boosting growth and employment, though the fall in the price of oil will provide additional support.

7. Economic Forecast

7.1. The Council receives its treasury advice from Capita Asset Services. Their latest interest rate forecasts to 31 March 2018 are shown below:

	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.00%
5yr PWLB rate	2.20%	2.30%	2.50%	2.60%	2.70%	2.80%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%
10yr PWLB rate	2.80%	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%
25yr PWLB rate	3.40%	3.60%	3.80%	3.90%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%	4.70%
50yr PWLB rate	3.40%	3.60%	3.80%	3.90%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%	4.70%

7.2. Capita undertook a review of its interest rate forecasts after the February Bank of England Inflation Report and following the announcement from the ECB on its €1.1 trillion programme of quantitative easing. This gave further impetus to the trend of a rise in bond prices and correspondingly, a fall in bond yields to phenomenally low levels. This trend had started earlier after a proliferation of fears in financial markets around the plunge in the price of oil had caused a flight from equities into bonds and from exposure to the debt and equities of emerging market oil producing countries to safe havens in western countries. These flows were compounded by further fears that Greece could be heading towards an exit from the Euro after the general election. The result of the combination of the above factors is that we have seen bond yields plunging to phenomenally low levels, especially in long term yields although the fall in bond yields was partially reversed towards the end of the quarter. These falls are unsustainable in the longer term but how quickly these falls will unwind is hard to predict. Their latest forecast now includes a first increase in Bank Rate to be in the first quarter of 2016 instead of the last quarter of 2015 as previously reported as a result of the sharp fall in inflation. The Governor of the Bank of England, Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual.

7.3. Long term PWLB rates are expected to rise from their current low levels to 3.9% in March 2016 before steadily increasing over time to reach 4.7% by 31 March 2018 due to the high volume of gilt issuance in the UK, and the bond issuance in other major western countries.

7.4. Positive or negative developments on the world political scene could have a major impact in either keeping yields low or prompting them to recover back up again. We also have a UK general election coming up in May 2015 which is very hard to predict what its likely result will be and the consequent impact on the UK economy, and how financial markets will react to those developments. 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. We are experiencing exceptional levels of volatility which are highly correlated to geo-political and sovereign debt crisis developments meaning PWLB rates and bond yields are so unpredictable at present. This high level of volatility in PWLB rates is expected to continue in 2015 meaning economic forecasting remains difficult with so many external influences weighing on the UK.

8. Treasury Management Strategy

8.1. The Treasury Management Strategy (TMS) for 2014/15 was approved by Full Council on 27 February 2014. 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 2014/15 the internal treasury team outperformed its benchmark by 0.26%. The investment return was 0.58% compared to the benchmark of 0.32%. This amounts to additional income of £83,062 during the quarter which is included in the Council's projected outturn position in the monthly revenue monitor. The Internal Treasury team made loans totalling

£85.4 million during the quarter and £87.4 million was repaid during the quarter.

8.4. A full list of investments held as at 31 March 2015, 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 2014/15. 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. 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 fourth quarter of 2014/15 was £127.8 million.

8.6. The Council's interest receivable/payable budgets are currently projecting a surplus of £0.673 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 2014/15 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 (25 years) for the fourth quarter of 2014/15 fell from 3.9% to 3.4% in early January. This was revised down further to 3.3% after the February Bank of England Inflation report. As outlined below, borrowing rates rose during the quarter. The low and high points during the quarter can be seen in the table below. No new external borrowing was undertaken in 2014/15.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.08%	1.71%	2.18%	2.85%	2.82%
Date	23/01/2015	02/02/2015	02/02/2015	02/02/2015	02/02/2015
High	1.20%	2.20%	2.81%	3.47%	3.46%
Date	03/03/2015	09/03/2015	09/03/2015	09/03/2015	09/03/2015
Average	1.14%	1.92%	2.49%	3.16%	3.14%

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)
Cabinet, 30 July 2014, Treasury Management Update Quarter 1 2014/15
Cabinet, 10 December 2014, Treasury Management Update Quarter 2 2014/15
Cabinet, 11 February 2015, Treasury Management Update Quarter 3 2014/15
Council, 27 February 2014, Treasury Strategy 2014/15.

Cabinet Member:
Mike Owen, Portfolio Holder

Local Member
N/A

Appendices
A. Investment Report as at 31 March 2015
B. Prudential Limits
C. Prudential Borrowing Schedule