Shropshire Council

Committee and Date
Cabinet
10 February 2016

TREASURY MANAGEMENT UPDATE – QUARTER 3 2015/16

Responsible Officer James Walton
e-mail: james.walton@shropshire.gov.uk Tel: (01743) 255011

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 2015/16 the internal treasury team achieved a return of 0.67% on the Council's cash balances, outperforming the benchmark by 0.31%. This amounts to additional income of £130,090 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 £130,090 which will be reflected in the Period 9 Revenue Monitor.

4.3. The Council currently has £140 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 October 2015 and 31 December 2015.

6. Economic Background

6.1. The economic recovery was shown to have slowed by more than previously thought, with real GDP growth falling from an estimated 0.7% in the second quarter to 0.4% in the third quarter. In its November quarterly inflation report, the Bank of England included a forecast for growth over the three years of 2015, 2016 and 2017 to be around 2.7%, 2.5% and 2.6% respectively, although statistics since then would indicate that an actual outturn for 2015 is more likely to be around 2.2%. Nevertheless, this is still moderately strong growth which is being driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero over the last quarter.

6.2. The sterling price of Brent Crude oil fell below £24 per barrel in December, and wholesale gas and electricity prices fell further too. While it looks like the UK's brief period of deflation in 2015 came to an end in November with CPI inflation nudging back into positive territory at 0.1%, inflation will remain below target for a long while yet. Despite these disinflationary pressures, inflation will pick up in coming months as the previous sharper falls in oil prices will drop out of the calculation of the annual figure.

6.3. The Monetary Policy Committee (MPC) voted to keep official interest rates on hold at 0.5% during the quarter. Weak inflationary pressures from the labour market have been compounded by renewed falls in the energy prices in reinforcing the case to keep rates on hold for a while yet.

6.4. The US economy made a strong comeback after a weak first quarter's growth at 0.6% (annualised), to grow by no less than 3.9% in the second quarter of 2015 before easing back to 2.0% in the third quarter. While there had been confident expectations that the US Federal Reserve could start increasing rates at its meeting in September, downbeat news during the summer about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the decision to pull back from making that start. However, since then concerns on both the domestic and international scene have abated and so the Federal Reserve made its long anticipated start in raising rates at its December meeting.

6.5. In the Eurozone, the European Central Bank (ECB) announced a massive €1.1 trillion programme of quantitative easing in January 2015 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 following the ECB's December meeting was extended to March 2017. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth which rose by 0.3% in the third quarter.

7. Economic Forecast

7.1. The Council receives its treasury advice from Capita Asset Services. Their latest interest rate forecasts to 31 March 2019 are shown below:

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
5yr PWLB rate	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
10yr PWLB rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
25yr PWLB rate	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
50yr PWLB rate	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%

7.2. Capita Asset Services undertook a review of its interest rate forecasts on 9 November after the August Bank of England Inflation Report was issued. Since this report was issued, most worldwide economic statistics have been weak and financial markets have been particularly volatile. The November Inflation report flagged up particular concerns for the potential impact of these factors on the UK. This latest forecast shows a change in the timing of the first increase in Bank Rate as being December 2016.

7.3. With CPI inflation now likely to be at or near zero into early 2016, it is currently very difficult for the MPC to make a start on increasing Bank Rate. In addition, the Inflation Report forecast was also notably subdued with inflation barely getting back up to the 2% target within the 2-3 year time horizon.

7.4. The Governor of the Bank of England, Mark Carney, 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 average disposable income is only just starting a significant recovery as a result of recent increases in the rate of wage inflation, though some consumers will not have seen that benefit come through for them.

7.5. Long term PWLB rates are expected to rise to 3.5% in March 2017 before steadily increasing over time to reach 4% by September 2018.

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 2016.

8. Treasury Management Strategy

8.2. The Treasury Management Strategy (TMS) for 2015/16 was approved by Full Council on 26 February 2015. 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.

8.3. 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.

8.4. In the third quarter of 2015/16 the internal treasury team outperformed its benchmark by 0.31%. The investment return was 0.67% compared to the benchmark of 0.36%. This amounts to additional income of £130,090 during the quarter which is included in the Council's projected outturn position in the monthly revenue monitor.

8.5. A full list of investments held as at 31December 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 third quarter of 2015/16. 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.

8.6. 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 third quarter of 2015/16 was £167.9 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 2015/16 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 2015/16 fell slightly from 3.6% to 3.5% after the November Bank of England Inflation report. No new external borrowing is currently required in 2015/16 due to a review of the Capital Programme. As outlined below, borrowing rates generally fell during the quarter. 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	1.17%	1.90%	2.55%	3.28%	3.10%
Date	23/10/2015	15/10/2015	05/10/2015	02/10/2015	03/12/2015
High	1.33%	2.23%	2.88%	3.57%	3.43%
Date	09/11/2015	09/11/2015	09/11/2015	09/11/2015	09/11/2015
Average	1.23%	2.05%	2.69%	3.41%	3.27%

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)
Cabinet, 29 July 2015, Treasury Management Update Quarter 1 2015/16
Cabinet, 9 December 2015, Treasury Management Update Quarter 2 2015/16
Council, 26 February 2015, Treasury Strategy 2015/16.

Cabinet Member:
Malcolm Pate – Portfolio Holder

Local Member
N/A

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