Committee and Date
Cabinet
21 December 2016

TREASURY MANAGEMENT UPDATE – QUARTER 2 2016/17

Responsible Officer James Walton
e-mail: james.walton@shropshire.gov.uk Tel: (01743) 258915

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 second quarter of 2016/17 the internal treasury team achieved a return of 0.56% on the Council's cash balances, outperforming the benchmark by 0.36%. This amounts to additional income of £169,150 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 2 performance is above benchmark and has delivered additional income of £169,150 which will be reflected in the Period 6 Revenue Monitor.

4.3. The Council currently has £175 million held in investments as detailed in Appendix A and borrowing of £326 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 July 2016 and 30 September 2016.

6. Economic Background

6.1. The referendum vote for Brexit in June this year delivered an immediate shock fall in confidence indicators and business surveys, pointing to an impending sharp slowdown in the economy. However, subsequent surveys have shown a sharp recovery in confidence and business surveys, though it is generally expected that although the economy will now avoid flat lining, growth will be weak through the second half of 2016 and in 2017.

6.2. The economic recovery regained some momentum in the quarter, with real GDP growth revised upwards from 0.4% in the first quarter of 2016 to 0.7% in the second quarter of 2016. The Bank of England August Inflation Report included an unchanged forecast for growth for 2016 of 2.0% but cut the forecast for 2017 from 2.3% to just 0.8%.

6.3. The Governor of the Bank of England 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, (i.e. without tariffs), to the EU single market. He also suggested that the Government will need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation).

6.4. The new Chancellor Phillip Hammond announced after the referendum result that the target of achieving a budget surplus in 2020 will be eased in the Autumn Statement on 23rd November.

6.5. After months of subdued price growth, inflation picked up during the quarter. Headline Consumer Price Inflation stood at 0.6% in July and August, driven by a rise in food and fuel inflation. There are signs that price pressures are building at the start of the production pipeline, with producer input costs rising by an annual 7.6% in August. This will feed through to higher prices in shops in time. As such, inflation is expected to break through the Monetary Policy Committee's (MPC) 2% target by mid-2017. The MPC revised up its inflation forecasts in the August Inflation Report to show inflation remaining above the target from the latter half of 2017 onwards.

6.6. The US economy posted a slightly improved growth rate of 1.4% (annualised) in the second quarter of 2016 when compared to the first quarter. Forward indicators are pointing towards a pickup in growth for the rest of 2016. Following the Federal Reserve's decision to increase interest rates in December 2015, more downbeat news on the international scene and then the Brexit vote have caused a delay in the timing of the second increase, which is now strongly expected in December this year.

6.7. In the Eurozone, growth slowed from 0.6% in the first quarter of 2016 to 0.3% in the second quarter. This has added to comments from many 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 expenditure to support demand in their economies and economic growth

6.8. Japan is still bogged down in anaemic growth and making little progress on fundamental reform of the economy while Chinese economic growth has been weakening and medium term risks have been increasing.

7. Economic Forecast

7.1. The Council receives its treasury advice from Capita Asset Services. Their latest interest rate forecasts to 30 June 2019 are shown below:

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Bank rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.25%	0.25%	0.25%	0.25%	0.50%
5yr PWLB rate	1.00%	1.00%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.20%	1.30%
10yr PWLB rate	1.50%	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.70%	1.80%
25yr PWLB rate	2.30%	2.30%	2.40%	2.40%	2.40%	2.40%	2.50%	2.50%	2.50%	2.50%	2.60%
50yr PWLB rate	2.10%	2.10%	2.20%	2.20%	2.20%	2.20%	2.30%	2.30%	2.30%	2.30%	2.40%

7.2. Capita Asset Services undertook a quarterly review of its interest rate forecasts after the MPC meeting of 4th August cut Bank Rate to 0.25%, and gave forward guidance that it expected to cut Bank Rate again to near zero before the year end. The above forecast therefore includes a further cut to 0.10% in November 2016 and a first increase in May 2018, to 0.25%, but no further increase to 0.50% until a year later.

7.3. The Governor of the Bank of England 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 the growth in average disposable income is still weak and could well turn negative when inflation rises during the next two years to exceed average pay increases.

7.4. Long term PWLB rates are expected to rise to 2.2% in June 2017 before steadily increasing over time to reach 2.4% by June 2019.

7.5. 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

8.1. 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 second quarter of 2016/17 the internal treasury team outperformed its benchmark by 0.36%. The investment return was 0.56% compared to the benchmark of 0.20%. This amounts to additional income of £169,150 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 30 September 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 second 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 second quarter of 2016/17 was £190 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 second 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 second quarter of 2016/17 started at 3.0% and ended at 2.10%. The sharp fall is in anticipation that there is likely to be further quantitative easing purchases of gilts in the coming months. 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	0.81%	0.95%	1.42%	2.08%	1.87%
Date	7/9/16	10/8/16	10/8/16	12/8/16	30/8/16
High	0.94%	1.22%	1.78%	2.60%	2.34%
Date	2/8/16	21/7/16	4/7/16	21/7/16	21/7/16
Average	0.88%	1.09%	1.60%	2.34%	2.11%

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
Council, 25 February 2016, Treasury Strategy 2016/17.

Cabinet Member:
Malcolm Pate, Leader

Local Member
N/A

Appendices
A. Investment Report as at 30 September 2016
B. Prudential Limits
C. Prudential Borrowing Schedule