Committee and Date
Cabinet
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TREASURY MANAGEMENT UPDATE – QUARTER 1 2017/18

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

1.2. During the first quarter of 2017/18 the internal treasury team achieved a return of 0.46% on the Council's cash balances, outperforming the benchmark by 0.35%. This amounts to additional income of £136,920 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 1 performance is above benchmark and has delivered additional income of £136,920 which will be reflected in the Period 3 Revenue Monitor.

4.3. The Council currently has £151 million held in investments as detailed in Appendix A and borrowing of £324 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 April 2017 and 30 June 2017.

6. Economic Background

6.1. The UK GDP annual growth rates in each calendar year 2013 – 2016 have all been the top rate, or near the top rate, of any of the G7 countries in every year. It is particularly notable that this UK performance was repeated in 2016, a year in which the Bank of England had forecast in August that growth would be near to zero in the second half of the year due to the economic shock it expected from the result of the Brexit referendum in June.

6.2. However, following its February and May 2017 Inflation Reports, the Bank of England upgraded its forecasts for growth in 2017, 2018 and 2019 to 1.9%. Over this three year period, it also expects inflation to accelerate towards nearly 3% as increases in costs as a result of the fall in the value of sterling since the referendum, gradually feeds through into the economy, though it should fall back to 2.2% in 2019. Provided those cost pressures do not feed through into significantly higher domestically generated inflation within the UK, the MPC is expected to look through this one off blip upwards in Inflation. There is, though, a potential risk that the Monetary Policy Committee might muster a majority to reverse the emergency 0.25% rate cut before embarking on a progressive trend of increases in Bank Rate at a later time.

6.3. The US GDP growth has been highly volatile in 2016 but overall mediocre, at an average of 1.6% for the year. Quarter 1 in 2017 has also been mediocre at 1.4% but current indications are that growth could rebound strongly in

quarter 2. The disappointment so far has been the lack of decisive action from President Trump to make progress with his promised fiscal stimulus package. The Fed has, therefore, started raising rates now that the economy is at or around full employment and inflationary pressures have been building to exceed its 2% target. It has raised rates four times, with the last three following quickly on one another in December 2016, March 2017 and June 2017. One or two more increases are expected in 2017 and possibly four in 2018.

6.4. In the Eurozone, growth has improved in 2016 to 1.7% after the European Central Bank cut rates into negative territory and embarked on massive quantitative easing during the year. The ECB is now forecasting growth of 1.9% in 2017, 1.8% in 2018 and 1.7% in 2019. It has committed to continuing major monthly quantitative easing, though in April 2017 it reduced the rate from €80 billion to €60 billion per month, throughout the whole of 2017 in order to stimulate growth and to get inflation up to its 2% target.

6.5. There are major concerns about the various stresses within the EU. The Dutch and French elections passed off without creating any waves for the EU and the German national election due in October 2017 is not currently expected to cause any significant change. What could be more problematic is the Austrian general election due in October 2017 and a risk of a snap general election in Italy before the final end date of May 2018. A continuing major stress is dealing with the unsustainable level of national debt in Greece in the face of implacable opposition from Germany to any further bail out. The EU will also have to deal with the Brexit negotiations with the UK.

6.6. China is expected to continue with reasonably strong growth of 6.5% in 2017 although medium term risks are increasing. Japan has only achieved 1% growth in 2016 and is struggling to get inflation to move from around 0%, despite massive fiscal stimulus and monetary policy action by the Bank of Japan.

7. Economic Forecast

7.1. The Council receives its treasury advice from Capita Asset Services. Their latest interest rate forecasts to 31 March 2020 are shown below:

	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%
50yr PWLB rate	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%

7.2. The Monetary Policy Committee (MPC) cut the Bank rate from 0.50% to 0.25% on 4 August 2016 in order to counteract what it forecast was going to

be a sharp slowdown in growth in the second half of 2016. However, since then, growth has been robust until dipping in quarter 1 of 2017 to 0.2%.

7.3. CPI inflation has risen substantially as a result of the sharp fall in the value of sterling since the referendum. Consequently, Bank Rate has not been cut again, and market concern has switched to whether the MPC could get together a majority to reverse the August 0.25% rate cut before embarking on a progressive trend of increases in Bank Rate at a later time when the economic and political/Brexit situation is more robust to withstand such increases.

7.4. There is much uncertainty at this time over the slender majority the Conservative Government has, which is dependent on DUP support, and also over what form of Brexit will transpire and how difficult the EU could be in setting terms. Therefore there are a many uncertainties at the current time and depending on how things transpire, then this will materially influence MPC decision making as to when Bank Rate will rise.

7.5. Capita Asset Services have recently undertaken a review of its interest rate forecasts and they expect the Bank Rate to remain at 0.25% until June 2019 when it is expected to rise to 0.50% after these negotiations have been completed.

7.6. Long term PWLB rates are expected to rise from 2.6% in September 2017 to 2.9% in March 2019 before steadily increasing over time to reach 3.1% by March 2020.

7.7. 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 2017.

8. Treasury Management Strategy

8.1. The Treasury Management Strategy (TMS) for 2017/18 was approved by Full Council on 23 February 2017. 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 first quarter of 2017/18 the internal treasury team outperformed its benchmark by 0.35%. The investment return was 0.46% compared to the benchmark of 0.11%. This amounts to additional income of £136,920 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 June 2017, 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 first quarter of 2017/18. 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 first quarter of 2017/18 was £155 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 first quarter of 2017/18 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 first quarter of 2017/18 was 2.5%. No new external borrowing has currently been undertaken in 2017/18. 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	0.80%	1.14%	1.78%	2.53%	2.27%
Date	03/05/2017	15/06/2017	15/06/2017	13/04/2017	13/04/2017
High	1.08%	1.44%	2.08%	2.75%	2.48%
Date	30/06/2017	30/06/2017	30/06/2017	30/06/2017	09/05/2017
Average	0.87%	1.23%	1.89%	2.60%	2.34%

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)

Cabinet, 12 July 2017, Treasury Management Update Quarter 4 2016/17 Council, 23 February 2017, Treasury Strategy 2017/18.
Cabinet Member: Peter Nutting, Leader
Local Member N/A
Appendices A. Investment Report as at 30 June 2017 B. Prudential Limits C. Prudential Borrowing Schedule