CAPITA
Treasury solutions

Asset Services

Shropshire Council

Monthly Investment Analysis Review

June 2017

Monthly Economic Summary

General Economy

‘A strong and stable Britain’, a phrase commonly used by Prime Minister Theresa May during her general election campaign which can only be described as an antonym of the UK’s current economic state. The outcome of the election revealed that the Conservative’s failed to secure a majority, having detrimental affects on the UK’s negotiating position on Brexit – the one thing Theresa May wanted the election to secure. The dissatisfaction with living standards is widely seen as a key factor behind Theresa May's election result however, a deal with the Democratic Unionist Party (DUP) towards close of the month resulted in her remaining as UK Prime Minister. Prior to this deal, Brexit negotiations started at the beginning of the month leaving the UK’s negotiation stance at an all-time low after the shock election result. Having said that, economists anticipate a softer form of Brexit as a result of the recent deal with the DUP as having open borders with Ireland after the UK leaves the EU is believed to be a key part of the deal with the Conservative party. Elsewhere the Monetary Policy Committee (MPC) came its closest to voting for a rate hike since 2007 as it was voted 5 to 3 to keep rates at 0.25%, with Bank of England Governor Mark Carney, voting to leave the rate unchanged. Nevertheless, shortly after this outcome Carney had, on the face of it, a very different tone when speaking at the European Central Bank’s conference in Portugal as he suggested that economic activity and the outcome of Brexit are factors which would trigger a change in interest rates, although it is still ‘too early’ to decide.

The initial economic tone for the UK economy for the month was set by the Purchasing Managers Index (PMI) figures for May. They continued to reveal how the post-Brexit and snap-election uncertainty has affected the Services, Construction and Manufacturing sectors. Manufacturing fell slightly to 56.7 in May from April’s three-year high of 57.3, as a result of higher raw material costs for factories, although orders grew at the second fastest rate in three year’s. Likewise, Britain’s dominant Services sector, fell to a three-month low of 53.8 last month from 55.8 in April, as uncertainty surrounding the general election made businesses put off any investment decisions and inflationary pressure continued to squeeze household income. On the other hand, the Construction industry expanded at its fastest rate since 2015, up to 56.0 from 53.1 in April. This jump is believed to be due to a sudden pick-up in housebuilding, allowing builders to recover from a quiet start to the year. However, it is widely expected that, as Brexit discussions advance, the UK economy will experience a slowdown as rising inflation will continue to eat into household disposable income as a result of high costs and weaker relative wage growth.

UK inflation jumped to its highest level in nearly four years in May as the Consumer Price Index rose by 2.9% year-on-year, above the forecasted rise of 2.7%. An increase in the cost of holidays abroad for British tourists, due to the Brexit-related depreciation in Sterling, was one of the main contributors to this sudden pick-up in inflation. Retail Price Inflation also rose in May to 3.7%, its highest rate since February 2012. As a result, consumer expenditure is set to be sluggish over the coming months as rising inflation continues to tighten the squeeze on household disposable income. Elsewhere, data on Britain’s labour market continued to be somewhat mixed. The unemployment rate held steady at a more than four-decade low of 4.6% in the three months to April, with the employment figure rising to 31.954million in the same period. However, worker’s “real” earnings (ie after inflation) contracted at its fastest pace since 2014 by 0.4% in the three months to April, underlining the impact on household finances. The Bank of England have announced that they are watching wage growth closely with it expecting wages to rise by 2% this year before picking up further in 2018 and 2019. In terms of growth, the final estimates showed Britain’s economy slowed sharply in the first three months of 2017 as quarter-on-quarter Q1 GDP came in at 0.2% from 0.7% recorded in Q4. Conversely, the year-on-year figure rose to 2.0% in Q1, from 1.9% previously.

Meanwhile, UK retail sales continued to show how the economy has been affected by the rising inflation since the Brexit vote. On the month figures showed a contraction of 1.2% in May with the year-on-year figure also dropping from 4.2% in April to 0.9% in May. Both falls came after the unexpected surge in figures in April; data which economists believe to be an anomaly and broadly related to the timing of Easter. Increased retail prices across all sectors are believed to be a key factor in this slowdown in growth, strengthening the common view among economists that inflationary pressure is continuing to squeeze consumer expenditure. The UK GfK consumer confidence reading also echoed this view as it slumped to -10 in June from -5 in May as weakening wage growth, rising inflation and political uncertainty took its toll on consumer’s economic outlook.

The UK’s budget deficit was down nearly 5% when compared with May’s figure last year as it came in at £6.7bn, providing Chancellor Philip Hammond some relief ahead of an expected increase in borrowing later this year. This narrowing in the deficit was largely due to the biggest intake of value-added tax receipts recorded in May. Despite the unexpected outcome of the general election and uncertainty surrounding Brexit negotiations, Hammond has stated that he currently has no reason not to stick to the fiscal rules he set out late last year. Therefore as of now, the UK Economy is still committed to a balanced budget by the first half of the 2020s.

Across the pond US unemployment growth fell to a 16-year low of 4.3% in May from 4.4% in the previous month. This came in despite non-farm payrolls rising by just 138,000, down from the revised figure of 174,000 for April, leading some to question whether the US labour market is starting to lose momentum. As published in the Federal Reserve's Beige Book, there is growing evidence of companies struggling to find qualified workers, something clearly highlighted by the fact employment in manufacturing, government and retail sectors fell again in May. This struggle to fill posts would add to the view that the lack of slack in the labour market should translate to rising wages in the coming months. The Fed raised interest rates by 25bps in their June meeting to a range target of 1.00% to 1.25% as they continue to focus strong economic growth and strengthening of the labour market – key policies on Trump's administration's economic agenda. Later in the month, the final estimates of US Q1 2017 GDP showed the annual rate dropped to 1.4% from the 2.1% seen in Q4 2016. This was largely due to consumer expenditure growing at its slowest pace since 2013 showing a relatively weak start to the year for the US economy. It must be said that US Q1 GDP figures have tended to be disappointing in recent years, therefore, the proposed stimulus package by Trump's administration by cutting the taxation rate and implementing deregulation, is likely to help boost the US economy as the year progresses…if and when it finally materialises.

Amidst the potential internal turbulence caused by the official start of Brexit negotiations, data for the Eurozone came in rather positive. Employment levels in the region were up 0.4% for the first three-months of this year resulting in a year-on-year change of 1.5%, providing a clear picture of current labor market conditions. Final figures for Q1 GDP 2017 showed quarterly growth at 0.6% and annual growth rose to 1.9% from 1.8% recorded in Q4 2016. In their June meeting, the European Central Bank (ECB) kept with the status quo, maintaining both its main refinancing rate and deposit rate steady at 0% and -0.40% respectively. In addition, the ECB confirmed that the net asset purchases are intended to run until the end of December, or beyond if necessary, at the new monthly pace of €60bn. However, speaking at the recent ECB's conference in Portugal President of the ECB, Mario Draghi, hinted that the ECB policymakers are ready to reduce monetary stimulus in the area in order to focus on reflation, thus a possible change in policy in the Eurozone could be on the horizon.

Looking ahead, all eyes will be on the UK economy as Brexit negotiations begin to advance amongst all the political uncertainty surrounding the UK economy and household's real income continue to feel the strain from rising inflation. Monetary policy is set to be thrown in the limelight across the UK, US and Eurozone economies as Mark Carney, Janet Yellen and Mario Draghi have all hinted at possible tightening to current policy in order to meet desired economic targets.

Housing

The month began by Halifax reporting that house price growth showed a significant slowdown in May as annual house price growth hit a 4-year low at 3.3%, down from the 3.8% rise recorded in April. In monthly terms, price were up 0.4% although, house prices should be supported over the coming months as a result of a shortage in existing properties for sale as well as weak supply of new homes being built. Towards the close of the month, Nationwide published relatively upbeat data for the housing market as house prices rose 1.1% in June, bouncing back from the 0.2% fall in May; although monthly growth rates can be highly volatile so the data may not represent an underlying improvement in demand. However, the annual figure showed a rise of 3.1% in June from the 2.1% recorded in May, pointing to modest price gains over recent months.

Forecast

Neither Capita Asset Services (CAS) nor Capital Economics (CE) altered their forecasts this month. It is forecasted by CAS that a rate hike to 0.50% will occur in Q2 2019 followed by a further hike to 0.75% in Q4 2019. CE expects a hike in the bank rate to occur in Q2 2018 to 0.50% with further hikes forecasted in Q4 2018 to 0.75% and in Q2 2019 to 1.00%.

Bank Rate	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
Capita Asset Services	0.25%	0.25%	0.25%	0.25%	0.25%
Capital Economics	0.25%	0.25%	0.25%	0.50%	0.50%

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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	0.55%		Call	AA-	0.000%
Svenska Handelsbanken AB	2,620,000	0.20%		Call	AA-	0.000%
MMF Standard Life	15,000,000	0.24%		MMF	AAA	0.000%
MMF Insight	9,010,000	0.21%		MMF	AAA	0.000%
Nationwide building society	5,000,000	0.42%	03/01/2017	03/07/2017	A	0.000%
Leeds Building Society	2,000,000	0.35%	11/01/2017	11/07/2017	A-	0.002%
Barclays Bank Plc	2,800,000	0.42%	13/01/2017	13/07/2017	A-	0.002%
Barclays Bank Plc	5,450,000	0.42%	16/01/2017	14/07/2017	A-	0.002%
Eastleigh Borough Council	5,000,000	0.40%	16/01/2017	17/07/2017	AA	0.001%
Barclays Bank Plc	1,750,000	0.42%	17/01/2017	17/07/2017	A-	0.003%
Barclays Bank Plc	5,000,000	0.32%		Call32	A-	0.005%
Fife Council	5,000,000	0.40%	03/02/2017	03/08/2017	AA	0.002%
Goldman Sachs International Bank	5,000,000	0.75%	08/02/2017	08/08/2017	A	0.006%
Santander UK Plc	15,000,000	0.65%		Call95	A	0.015%
Lloyds Bank Plc	5,000,000	0.55%	28/04/2017	27/10/2017	A	0.018%
Lloyds Bank Plc	3,500,000	0.55%	08/05/2017	08/11/2017	A	0.020%
Lloyds Bank Plc	3,680,000	0.55%	09/05/2017	09/11/2017	A	0.020%
Lloyds Bank Plc	1,400,000	0.55%	11/05/2017	10/11/2017	A	0.021%
Goldman Sachs International Bank	5,000,000	0.65%	07/06/2017	07/12/2017	A	0.025%
Lloyds Bank Plc	5,000,000	0.55%	07/06/2017	07/12/2017	A	0.025%
Lloyds Bank Plc	8,100,000	0.55%	14/06/2017	14/12/2017	A	0.026%
Lloyds Bank Plc	2,420,000	0.55%	16/06/2017	15/12/2017	A	0.026%
North Tyneside Metropolitan Borough Council	7,000,000	0.50%	20/12/2016	19/12/2017	AA	0.011%
Lloyds Bank Plc	900,000	0.55%	21/06/2017	21/12/2017	A	0.027%
Dundee City Council	5,000,000	0.50%	23/01/2017	22/01/2018	AA	0.013%
Lancashire County Council	5,000,000	0.61%	15/05/2017	14/05/2018	AA	0.020%
Total Investments	**£150,630,000**	**0.48%**				0.009%

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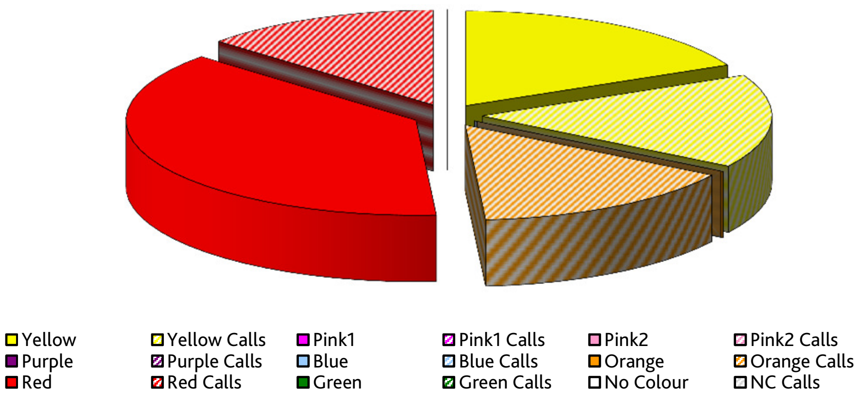
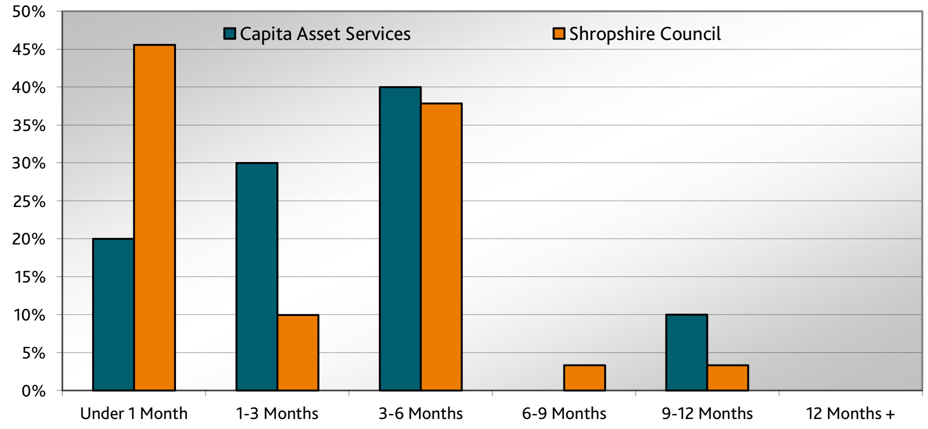
Portfolio Composition by Capita Asset Services' Suggested Lending Criteria





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 = 3.50

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

	% of Portfolio	Amount	% of Colour in Calls	Amount of Colour in Calls	% of Call in Portfolio	WARoR	WAM	WAM at Execution	Excluding Calls/MMFs/USDBFs WAM	Excluding Calls/MMFs/USDBFs WAM at Execution
Yellow	33.86%	£51,010,000	47.07%	£24,010,000	15.94%	0.36%	80	157	151	296
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	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Orange	15.02%	£22,620,000	100.00%	£22,620,000	15.02%	0.51%	0	0	0	0
Red	51.12%	£77,000,000	25.97%	£20,000,000	13.28%	0.54%	94	155	99	182
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%	**£150,630,000**	**44.23%**	**£66,630,000**	**44.23%**	**0.48%**	**75**	**133**	**115**	**219**

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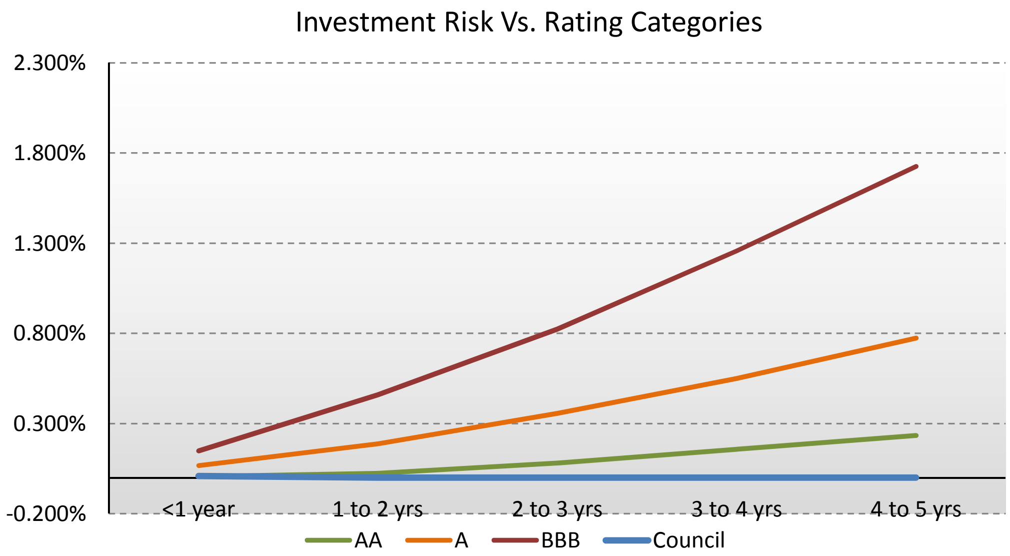
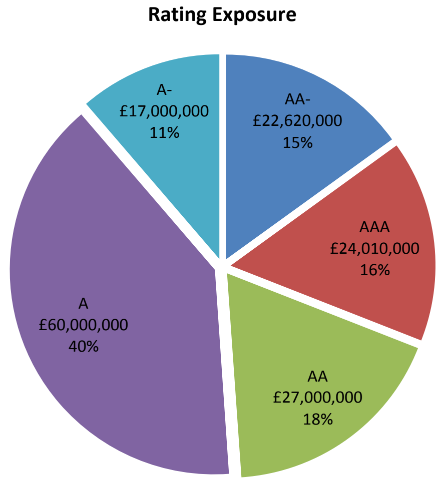
Investment Risk and Rating Exposure





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	0.007%	0.024%	0.081%	0.158%	0.234%
A	0.067%	0.189%	0.356%	0.551%	0.775%
BBB	0.150%	0.460%	0.824%	1.257%	1.726%
Council	0.009%	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.

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Monthly Credit Rating Changes

FITCH

Date	Update Number	Institution	Country	Rating Action
12/06/2017	1530	Qatar Sovereign Rating	Qatar	Sovereign Rating removed from Stable Outlook and placed on Negative Watch, affirmed at 'AA'.
21/06/2017	1533	Qatar National Bank	Qatar	Long Term Rating removed from Stable Outlook and placed on Negative Watch, affirmed at 'AA-'. Short Term Rating placed on Negative Watch, affirmed at 'F1+'. Viability Rating placed on Negative Watch, affirmed at 'bbb+'. Support Rating placed on Negative Watch, affirmed at '1'.
30/06/2017	1535	Co-operative Bank Plc	United Kingdom	Long Term Rating affirmed at 'B-', Evolving Watch. Short Term Rating changed to Negative Watch from Evolving Watch, affirmed at 'B'. Viability Rating downgraded to 'c' from 'cc'. Support Rating removed from Positive Watch, affirmed at '5'.

Shropshire Council

Monthly Credit Rating Changes

MOODY'S

Date	Update Number	Institution	Country	Rating Action
16/06/2017	1531	Royal Bank of Scotland Group Plc	United Kingdom	Long Term Rating upgraded to 'Baa3' from 'Ba1', Outlook changed to Stable from Negative. Short Term Rating upgraded to 'P-3' from 'NP'
16/06/2017	1531	National Westminster Bank Plc	United Kingdom	Long Term Rating upgraded to 'A2' from 'A3', Outlook changed to Stable from Negative. Short Term Rating upgraded to 'P-1' from 'P-2'.
16/06/2017	1531	The Royal Bank of Scotland Plc	United Kingdom	Long Term Rating upgraded to 'A2' from 'A3', Outlook changed to Stable from Negative. Short Term Rating upgraded to 'P-1' from 'P-2'.
19/06/2017	1532	Australia and New Zealand Banking Group Ltd	Australia	Long Term Rating downgraded to 'Aa3' from 'Aa2', Outlook changed to Stable from Negative. Short Term Rating affirmed at 'P-1'.
19/06/2017	1532	Commonwealth Bank of Australia	Australia	Long Term Rating downgraded to 'Aa3' from 'Aa2', Outlook changed to Stable from Negative. Short Term Rating affirmed at 'P-1'.
19/06/2017	1532	National Australia Bank Ltd	Australia	Long Term Rating downgraded to 'Aa3' from 'Aa2', Outlook changed to Stable from Negative. Short Term Rating affirmed at 'P-1'.
19/06/2017	1532	Westpac Banking Corporation	Australia	Long Term Rating downgraded to 'Aa3' from 'Aa2', Outlook changed to Stable from Negative. Short Term Rating affirmed at 'P-1'.
23/06/2017	1534	Ulster Bank Ltd	United Kingdom	Long Term Rating upgraded to 'A2' from 'A3', Outlook changed to Stable from Positive. Short Term Rating upgraded to 'P-1' from 'P-2'.

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Monthly Credit Rating Changes

S&P

Date	Update Number	Institution	Country	Rating Action
08/06/2017	1528	Qatar Sovereign Rating	Qatar	Sovereign Rating downgraded to 'AA-' from 'AA', removed from Negative Outlook and placed on Negative Watch.
09/06/2017	1529	Qatar National Bank	Qatar	Long Term Rating downgraded to 'A' from 'A+', removed from Negative Outlook and placed on Negative Watch. Short Term Rating placed on Negative Watch and affirmed at 'A-1'.