| Committee and Date |
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| Cabinet |
| 17 September 2018 |

# TREASURY MANAGEMENT UPDATE – QUARTER 1 2018/19

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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, Link Asset Services. It also updates Members on the internal treasury team's performance.

1.2. During the first quarter of 2018/19 the internal treasury team achieved a return of 0.64% on the Council's cash balances, outperforming the benchmark by 0.28%. This amounts to additional income of £74,260 during the quarter which is included within the Council's 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 £74,260 which is reflected in the Period 3 Revenue Monitor.

4.3. As at 30 June 2018 the Council held £107 million in investments as detailed in Appendix A and borrowing of £318 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 2018 and 30 June 2018.

## 6. Economic Background

6.1. UK economic growth was disappointingly weak in the first half of 2017 but picked up to 0.5% in quarter 3 and 0.4% in quarter 4. Growth in quarter 1 2018 was again disappointing, although on the first revision the rate improved from 0.1 to 0.2% to allay fears that the economy may have started a prolonged period of very weak growth. Initial indications in quarter 2 are that growth may have picked up to around 0.4%. The main reason for weak growth during 2017 and 2018 has been that inflation has been exceeding pay growth until recently, meaning that there has been negative growth in consumer disposable income when consumer expenditure is the biggest driver of the services sector which accounts for about 75% of GDP.

6.2. The manufacturing sector has been the positive sector in the economy in 2017 in terms of strong growth but quarter 1 was the weakest quarter for one and a half years and forward indicators do not suggest a return to strong growth is likely. However, the manufacturing sector only accounts for around 11% of GDP so weaker growth in this sector will have a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

6.3. During January and February financial markets were viewing a Bank Rate increase at the May Monetary Policy Committee (MPC) meeting as likely to be a near certainty after strong growth in the second half of 2017. However, the ensuing weeks before the meeting saw opinion turn right around and the MPC did not disappoint by leaving rates unchanged due to concerns as to whether the weak growth in quarter 1 was indicative of the start of a prolonged slow down or just a temporary blip, to which bad weather had been just one contributor. Since May, opinion has again turned to suggest that an August Bank Rate increase is likely. However, there remains much uncertainty around Brexit negotiations, consumer spending levels and business investment, so it is still far too early to be confident about how strong growth and inflationary pressures will be over the next two years and therefore the pace of any rate increases.

6.4. CPI inflation has fallen back from 3.0% in quarter 4 to 2.4% in May, as the inflationary impact of sterling's past depreciation has eased. However, rising oil prices over the past few months in response to concerns about supply disruptions, has put upward pressure on costs. The utility price hikes announced by the largest energy firms will probably cause inflation to pick up temporarily in the coming months. It is still felt that inflation will fall back this year given the offsetting downward pressure from easing food price and imported goods inflation.

6.5. Economic growth in the EU had been lack lustre for several years after the financial crisis despite the European Central Bank eventually cutting its main rate to minus 0.4% and embarking on a massive programme of Quantitative Easing. However, growth picked up in 2016 and 2017 but this looks likely to weaken somewhat going forward. Despite providing massive monetary stimulus, the ECB has been struggling to get inflation up to its 2% target. However, in April the headline Eurozone rate jumped up from 1.4% to 1.9% although the core inflation rate was still subdued in rising from 0.7% to 1.1%. At its June meeting, the ECB announced it would halve its monthly quantitative easing purchases from €30bn to €15bn, and then end all purchases after December. It is unlikely to make a start on increasing rates until late in 2019.

6.6. Growth in the US economy was volatile in 2015, 2016 and 2017 during each year, with quarter 1 being particularly weak. The annual rate of GDP growth for 2017 was 2.3%. Quarter 1 in 2018 came in at 2.0%, down from 2.9% in the previous quarter. The Trump $1.5 trillion income tax cut package coming into effect in January 2018, is likely to boost growth to the Trump administration's 3% target. However, it is also likely to boost inflation at a time when spare capacity in the economy is minimal and unemployment, in particular, has fallen to the lowest level for 17 years, reaching 3.8% in May. The Federal Reserve started on an upswing in rates with seven increases since the first one in December 2015, the latest one being in June 2018 to increase the central rate to 1.75 - 2.0%. There could be a further two or more increases in 2018.

6.7. Chinese economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus and medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property.

6.8. Japan has seen the best economic run of positive growth for the last eight quarters since the 1980s but this came to an end in quarter 1 and was blamed on weak exports. Japan is still struggling to get inflation up to its target rate of 2% despite huge monetary and fiscal stimulus, with inflation falling to only 0.4% in May. It is also making little progress on fundamental reform of the economy.

## 7. Economic Forecast

7.1. The Council receives its treasury advice from Link Asset Services. Their latest interest rate forecasts to 31 March 2021 are shown below:

| | Sep-18 | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank Rate | 0.50% | 0.75% | 0.75% | 0.75% | 1.00% | 1.00% | 1.00% | 1.25% | 1.25% | 1.50% | 1.50% |
| 5yr PWLB Rate | 2.00% | 2.00% | 2.10% | 2.20% | 2.20% | 2.30% | 2.30% | 2.40% | 2.40% | 2.50% | 2.50% |
| 10yr PWLB View | 2.40% | 2.50% | 2.60% | 2.60% | 2.70% | 2.80% | 2.80% | 2.90% | 2.90% | 3.00% | 3.00% |
| 25yr PWLB View | 2.80% | 2.90% | 3.00% | 3.10% | 3.20% | 3.30% | 3.30% | 3.40% | 3.40% | 3.50% | 3.50% |
| 50yr PWLB Rate | 2.50% | 2.60% | 2.70% | 2.80% | 2.90% | 3.00% | 3.00% | 3.10% | 3.10% | 3.20% | 3.20% |

7.2. Link Asset Services undertook its last review of interest rate forecasts in May after the quarterly Bank of England Inflation Report and MPC meeting at which the MPC kept Bank Rate unchanged at 0.5%.The MPC minutes indicated they wanted to see whether the slowdown in growth in quarter 1 had been a temporary blip or a potential first sign of a prolonged period of weak growth.

7.3. Link Asset Services has pushed back the expected first Bank Rate increase to November 2018 to be followed by further increases in September 2019, June 2020 and November 2020. This is based on a central assumption that the UK will make progress with concluding a satisfactory outcome over the Brexit negotiations with the EU by March 2019. Following the Bank Rate rise to 0.75% in August, Link are currently reviewing and updating their forecasts.

7.4. Long term PWLB rates are expected to rise from 2.50% in September 2018 to 2.7% in March 2019 before steadily increasing over time to reach 3.2% by December 2020.

7.2. The overall balance of risks to economic recovery in the UK is probably even. However, given the uncertainties around Brexit in particular, but also other uncertainties, there is a wide diversity of possible outcomes for the strength of economic growth and inflation, and the corresponding speed with which Bank Rate could go up.

## 8. Treasury Management Strategy

8.1. The Treasury Management Strategy (TMS) for 2018/19 was approved by Full Council on 22 February 2018. 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 Link's suggested creditworthiness approach, including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Link. 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, Link.

8.3. In the first quarter of 2018/19 the internal treasury team outperformed its benchmark by 0.28%. The investment return was 0.64% compared to the benchmark of 0.36%. This amounts to additional income of £74,260 during the quarter which is included in the Council's outturn position in the monthly revenue monitor.

7.4. A full list of investments held as at 30 June 2018, compared to Link'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 2018/19. 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 for three months and longer have come down slightly after April when expectations collapsed that the MPC would raise Bank Rate at its May meeting. The average level of funds available for investment purposes in the first quarter of 2018/19 was £106 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 2018/19 and have not been previously breached. The schedule at Appendix C details the Prudential Borrowing approved and utilised to date.

9.2. Link's target rate for new long term borrowing (50 years) for the first quarter of 2018/19 was marginally reduced to 2.4%. No new external borrowing has been undertaken to date in 2018/19. 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 | 1.28% | 1.67% | 2.10% | 2.52% | 2.25% |
| Date | 01/06/2018 | 29/05/2018 | 29/05/2018 | 29/05/2018 | 29/05/2018 |
| High | 1.57% | 1.98% | 2.43% | 2.79% | 2.53% |
| Date | 17/04/2018 | 25/04/2018 | 25/04/2018 | 25/04/2018 | 25/04/2018 |
| Average | 1.44% | 1.86% | 2.29% | 2.66% | 2.40% |

**List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)**
Cabinet, 25 July 2018, Treasury Management Update Quarter 4 2017/18
Council, 22 February 2018, Treasury Strategy 2018/19.

**Cabinet Member:**
David Minnery, Portfolio Holder for Finance

**Local Member**
N/A

**Appendices**
A. Investment Report as at 30 June 2018
B. Prudential Limits
C. Prudential Borrowing Schedule