Committee and Date	Item
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TREASURY MANAGEMENT UPDATE – QUARTER 3 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 third quarter of 2018/19 the internal treasury team achieved a return of 0.84% on the Council's cash balances, outperforming the benchmark by 0.26%. This amounts to additional income of £91,510 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 3 performance is above benchmark and has delivered additional income of £91,510 which is reflected in the Period 9 Revenue Monitor.

4.3. As at 31 December 2018 the Council held £130 million in investments as detailed in Appendix A and borrowing of £312 million at fixed interest rates.

5. Background

5.1. The Council defines its treasury management activities as “the management of the authority’s borrowing, 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 2018 and 31 December 2018.

6. Economic Background

6.1. After weak economic growth of only 0.1% in quarter one, growth picked up to 0.4% in quarter 2 and to 0.6% in quarter 3. However, uncertainties over Brexit look likely to cause growth to have weakened again in quarter four. After the Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the MPC until the uncertainties over Brexit clear. In the event of a disorderly exit, the MPC have said that rates could go up or down, though it is probably much more likely to be down so as to support growth. Nevertheless, the MPC does have concerns over the trend in wage inflation which peaked at a new post financial crisis high of 3.3%, (excluding bonuses), in the three months to October. The main issue causing this is a lack of suitably skilled people due to the continuing increase in total employment and unemployment being near to 43 year lows. Correspondingly, the total level of vacancies has risen to new highs.

6.2. CPI inflation has been on a falling trend, reaching 2.3% in November. However, in the November Bank of England Inflation Report, the latest forecast for inflation over the two year time horizon was raised to being marginally above the MPC’s target of 2%, indicating a slight build up in inflationary pressures.

6.3. The rise in wage inflation and fall in CPI inflation is good news for consumers as their spending power is improving in this scenario as the difference between to two figures in now around 1%, i.e. a real terms increase. Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months.

6.4. There is a risk that the current government may be unable to secure a majority in the Commons over Brexit. However, Link's central position is that the government will endure, despite various setbacks, along the route to Brexit in March 2019. If, however, the UK faces a general election in 2019, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

6.5. President Trump's easing of fiscal policy is fuelling a temporary boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2% in quarter 1 to 4.2% in quarter 2 and 3.5% in quarter 3. The strong growth in employment numbers has fed through to an upturn in wage inflation which hit 3.1% in November. However, CPI inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Federal Reserve's (Fed's) target of 2% during 2019. The Fed increased rates another 0.25% in December to between 2.25% and 2.50%, this being the fifth increase in 2018 and the ninth in this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the rate and level of increases in rates and that it is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world plunging under the weight of fears around the Fed's actions, the trade war between the US and China, an expectation that world growth will slow, Brexit etc.

6.6. Growth in the Eurozone fell in quarter 3 to 0.2% from 0.4% in quarter 2 but this is likely to be a one off blip caused primarily by a one off fall in car production. The ECB forecast growth in 2018 to be 1.9% falling to 1.7% in 2020. The ECB ended its programme of quantitative easing purchases of debt in December, which now means that the central banks in the US, UK and EU have all now ended the phase of post financial crisis expansion of liquidity supporting world financial markets

6.7. Chinese economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

6.8. Japan has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental economy reform.

7. Economic Forecast

7.1. The Council receives its treasury advice from Link Asset Services. Their latest interest rate forecasts to 31 March 2022 are shown below:

Link Asset Services Interest Rate View	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

7.2. After the August increase in Bank Rate to 0.75%, the first above 0.5% since the financial crash, the MPC has since then put any further action on hold, probably until such time as the fog of Brexit clears and there is some degree of certainty of what the UK will be heading into. It is particularly unlikely that the MPC would increase Bank Rate in February 2019 ahead of the deadline in March for Brexit, if no agreement on Brexit has been reached by then. The above forecast, and other comments in this report, are based on a central assumption that there is an agreement on a reasonable form of Brexit. In that case, then we think that the MPC could return to increasing Bank Rate in May 2019 but then hold fire again until February 2020. However, this is obviously based on making huge assumptions which could be confounded. In the event of a disorderly Brexit, then cuts in Bank Rate could well be the next move.

7.3. The overall balance of risks to economic growth in the UK is probably neutral. The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

7.4. Long term PWLB rates are expected to rise to 2.8% in June 2019 before steadily increasing over time to reach 3.3% by June 2021.

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.

8.3. In the third quarter of 2018/19 the internal treasury team outperformed its benchmark by 0.26%. The investment return was 0.84% compared to the benchmark of 0.58%. This amounts to additional income of £91,510 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 31 December 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 third 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 increased slightly as a result of the increase in Bank Rate in August. The average level of funds available for investment purposes in the third quarter of 2018/19 was £141 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 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 third quarter of 2018/19 was unchanged at 2.70%. 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	50 year target
1-Oct-18	1.59%	1.97%	2.38%	2.78%	2.60%	2.60%
31-Dec-18	1.53%	1.70%	2.08%	2.65%	2.50%	2.70%
Low	1.47%	1.63%	2.00%	2.56%	2.39%	2.60%
Date	19/11/2018	12/12/2018	12/12/2018	11/12/2018	11/12/2018	-
High	1.64%	2.07%	2.50%	2.93%	2.79%	2.70%
Date	10/10/2018	10/10/2018	10/10/2018	10/10/2018	12/10/2018	-
Average	1.54%	1.81%	2.22%	2.75%	2.61%	2.68%

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information) Cabinet, 17 September 2018, Treasury Management Update Quarter 1 2018/19 Cabinet, 12 December 2018, Treasury Management Update Quarter 2 2018/19 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 31 December 2018 B. Prudential Limits C. Prudential Borrowing Schedule