



<u>Committee and Date</u>	<u>Item</u>
Cabinet 03 July 2019	
	<u>Public</u>

TREASURY MANAGEMENT UPDATE – QUARTER 4 2018/19

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, Link Asset Services. It also updates Members on the internal treasury team's performance.
- 1.2. During the fourth quarter of 2018/19 the internal treasury team achieved a return of 0.90% on the Council's cash balances, outperforming the benchmark by 0.33%. This amounts to additional income of £119,820 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 4 performance is above benchmark and has delivered additional income of £119,820 which is reflected in the Period 12 Revenue Monitor.
- 4.3. As at 31 March 2019 the Council held £127 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 January 2019 and 31 March 2019.

6. Economic Background

- 6.1. UK economic growth was particularly strong in the third quarter of 2018/19 before cooling off in the final quarter of the financial year. Given all the uncertainties over Brexit, this weak growth in the final quarter was as to be expected. However, some recovery in the rate of growth is expected going forward. The annual growth in Quarter 4 came in at 1.4% year on year confirming that the UK was the third fastest growing individual country in the G7. After the Monetary Policy Committee (MPC) raised Bank Rate from 0.5% to 0.75% in August 2018, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further increases from the MPC until the uncertainties over Brexit clear. If there were a disorderly exit, it is likely that Bank Rate would be cut 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 3.5%, in the three months to December before falling marginally to 3.4% in the three months to January. British employers ramped up their hiring at the fastest pace in more than three years in the three months to January as the country's labour market defied the broader weakness in the overall economy as Brexit approached. The number of people in work surged by 222,000, helping to push down the unemployment rate to 3.9%, its lowest rate since 1975. Correspondingly, the total level of vacancies has risen to new highs.
- 6.2. CPI inflation has been on a falling trend, reaching 1.8% in January before rising marginally to 1.9% in February. However, in the February Bank of

England Inflation Report, the latest forecast for inflation over both the two and three-year time horizons remained marginally above the MPC's target of 2%.

- 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 the two figures is now around 1.5%, 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. The government has so far been unable to muster a majority in the Commons over its Brexit deal. If another form of Brexit, other than the current deal, does get a majority, then it is likely there will need to be a long delay to Brexit to allow time for negotiations with the EU. It appears unlikely that there will be a Commons majority which would support a disorderly Brexit or revoking article 50. There would also need to be a long delay if there is no majority for any form of Brexit. If that were to happen, then it increases the chances of 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. Further updates on Brexit will be provided in next quarter's report.
- 6.5. President Trump's easing of fiscal policy in 2018 fuelled a temporary boost in consumption in 2018 which generated an upturn in the strong rate of growth. The annual rate came in at 2.9% for 2018, just below President Trump's 3% growth target. The strong growth in employment numbers has fed through to an upturn in wage inflation which hit 3.4% in February, a decade high point. However, CPI inflation overall fell to 1.5% in February, a two and a half year low, and looks to be likely to stay around that number in 2019 which is below the Fed's target of 2%. 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 the current rate rising cycle. However, the Fed now appears to be edging towards a change of direction and admitting there may be a need to switch to taking action to cut rates over the next two years. Financial markets are now predicting two cuts of 0.25% by the end of 2020.
- 6.6. Growth in the Eurozone has been weak at 0.4% in quarter 2, 0.2% in quarter 3, 0.2% in quarter 4 and likely to be 0.1% in quarter 1 of 2019. The annual rate of growth for 2018 was 1.8% but is expected to fall to possibly around half that rate in 2019. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which means that the central banks in the US, UK and EU have all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range, has prompted the ECB to take new measures to stimulate growth. However, with its refinancing rate already at 0% and the deposit rate at -0.4%, it has probably reached the bottom of its rate cutting cycle. At its March meeting it said that it expects to leave interest rates at their present levels "at least through the end of 2019", but that is of little help to boosting growth in the near term.
- 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 fundamentally reforming the economy.

6.9. Global equity markets are currently concerned about the synchronised general weakening of growth in the major economies of the world. They fear there could even be a recession looming up in the US, though the fear is probably overstated. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries with the exception of the US. There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks.

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												
	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%	2.00%
3 Month LIBID	0.80%	1.00%	1.10%	1.20%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	0.90%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.10%	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	1.90%	2.00%	2.10%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
10yr PWLB Rate	2.30%	2.40%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.00%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%

7.2. After the August 2018 increase in Bank Rate to 0.75%, the first above 0.5% since the financial crash, the MPC has put any further action on hold, probably until such time as the fog of Brexit might clear and there is some degree of certainty of what the UK will be heading into. *The above forecast, and other comments in this report, were based on a central assumption that there will be an agreement on a reasonable form of Brexit.* In view of the current, lack of any majority in the House of Commons for one option for Brexit, the above forecasts will probably need revision to take account of the current impasse if that were to continue. This could mean that the start of increases in Bank Rate may need to be pushed back.

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 December 2019 before steadily increasing over time to reach 3.3% by September 2021.

8. Treasury Management Strategy

8.1. The Treasury Management Strategy (TMS) for 2019/20 was approved by Full Council on 28 February 2019. 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 fourth quarter of 2018/19 the internal treasury team outperformed its benchmark by 0.33%. The investment return was 0.90% compared to the benchmark of 0.57%. This amounts to additional income of £119,820 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 March 2019, 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 fourth 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 fourth quarter of 2018/19 was £145 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 fourth 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 fourth quarter of 2018/19 was marginally reduced to 2.40%. No new external borrowing was undertaken during 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
01/01/2019	1.49%	1.70%	2.08%	2.65%	2.50%
29/03/2019	1.48%	1.55%	1.85%	2.40%	2.23%
Low	1.44%	1.50%	1.80%	2.33%	2.16%
Date	28/03/2019	26/03/2019	28/03/2019	26/03/2019	26/03/2019
High	1.61%	1.82%	2.19%	2.72%	2.56%
Date	17/01/2019	18/01/2019	18/01/2019	18/01/2019	18/01/2019
Average	1.54%	1.68%	2.03%	2.56%	2.41%

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
 Cabinet, 13 February 2019, Treasury Management Update Quarter 3 2018/19
 Council, 28 February 2019, Treasury Strategy 2019/20.

Cabinet Member:

David Minnery, Portfolio Holder for Finance

Local Member

N/A

Appendices

A. Investment Report as at 31 March 2019
 B. Prudential Limits
 C. Prudential Borrowing Schedule