Committee and Date	Item
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TREASURY MANAGEMENT UPDATE – QUARTER 1 2015/16

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

1.2. During the first quarter of 2015/16 the internal treasury team achieved a return of 0.58% on the Council's cash balances outperforming the benchmark by 0.22%. This amounts to additional income of £84,150 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 result in increased or reduced income for the Council.

4.2. The Quarter 1 performance is above benchmark and has delivered additional income of £84,150 which will be reflected in the Period 3 Revenue Monitor.

4.3. The Council currently has £152 million held in investments as detailed in Appendix A and borrowing of £337 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 2015 and 30 June 2015.

6. Economic Background

6.1. After strong UK Gross Domestic Product (GDP) growth in 2013 at an annual rate of 2.7% and 3.0% in 2014, quarter 1 of 2015 was disappointing at only 0.4%, though subsequent data indicates that this could well be revised up further down the line and also indicates a return to stronger growth in the second quarter. In its May quarterly inflation report, the Bank of England reduced its GDP forecast for 2015 from 2.9% to 2.5% and from 2.9% to 2.7% in 2016, while increasing its forecast for 2017 from 2.4% to 2.7%.

6.2. The latest Consumer Price Inflation (CPI) figures showed that deflation lasted just one month. CPI inflation rose from -0.1% in April to +0.1% in May, reflecting the slower pace of falls in food prices and a rebound in petrol prices. Inflation looks set to remain just above zero for the next six months, but it wouldn't take much during that period, perhaps a renewed 10% fall in the oil price, for the UK to be tipped back into deflation.

6.3. The Monetary Policy Committee (MPC) voted to keep official interest rates on hold at 0.5% during the quarter and voted not to increase its programme of asset purchases under the Bank's quantitative easing (QE) programme at its June meeting. With inflation close to zero, the first budget of the next parliament due to be published in July, and the situation in Greece becoming increasingly troubling, it looks unlikely that the MPC will increase rates this year.

6.4. As for the American economy, confidence has improved markedly in this quarter that the US will start increasing interest rates by the end of 2015 due to a return to strong economic GDP growth of 2.4% in 2014.

6.5. In the Eurozone, the European Central Bank (ECB) announced a massive €1.1 trillion programme of quantitative easing in January 2015 to buy up high credit quality government and other debt of selected Eurozone countries. This programme of €60 billion of monthly purchases started in March 2015 and is intended to run initially to September 2016. This already appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth, though it remains to be seen whether this will have an enduring effect as strong as the recovery in the US and UK.

6.6. The major development over the past quarter has been the deterioration of the situation in Greece. Currently the country is still a member of the Eurozone, but its future as part of the single currency has become increasingly uncertain. Greece urgently needs financial assistance in order to meet its debt repayments, but is unwilling to accept the reforms which creditors demand in exchange for funds. The situation is so severe that emergency capital controls have been imposed in order for the Greek banking system from collapsing. If a last minute deal is struck this is only likely to offer a short term solution and Greece will need to undertake substantial debt restructuring or outright default if it is to return its public finances to a sustainable position in the long run. Whilst the UK's economic and financial exposures to Greece are small, there could be an adverse impact on the UK's economy from a wider fallout and a period of general financial market instability that would be likely to prevail if a Greek exit were to occur.

7. Economic Forecast

7.1. The Council receives its treasury advice from Capita Asset Services. Their latest interest rate forecasts to 31 March 2018 are shown below:

	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%
5yr PWLB rate	2.30%	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%
10yr PWLB rate	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%
25yr PWLB rate	3.60%	3.70%	3.80%	4.00%	4.10%	4.20%	4.30%	4.40%	4.40%	4.50%	4.60%
50yr PWLB rate	3.60%	3.70%	3.80%	4.00%	4.10%	4.20%	4.30%	4.40%	4.40%	4.50%	4.60%

7.2. Capita undertook a review of its interest rate forecasts following the issue of the latest Bank of England Inflation Report in May 2015. The ECB's quantitative easing programme to buy up Eurozone debt caused an initial widespread rise in bond prices and, correspondingly, a fall in bond yields to phenomenally low levels, including the debt of some European countries plunging into negative yields. Since then, fears about recession in the

Eurozone, and around the risks of deflation, have abated and so there has been an unwinding of this initial phase with bond yields rising back to more normal, though still historically low yields.

7.3. This latest forecast includes a move in the timing of the first increase in Bank Rate from the first quarter of 2016 to the second quarter of 2016 as a result primarily of poor growth in quarter 1, weak wage inflation and the recent sharp fall in inflation due to the fall in the price of oil. The Governor of the Bank of England, Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual.

7.4. Long term PWLB rates are expected to rise to 4% in June 2016 before steadily increasing over time to reach 4.6% by 31 March 2018. It is expected that there will be a high level of volatility in PWLB rates over 2015, depending on how long it takes to decide what will happen in Greece and as other factors impinge on market and investor sentiment.

7.5. 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 2015. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or safe haven of bonds. The overall longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the bond issuance in other major western countries.

8. Treasury Management Strategy

8.1. The Treasury Management Strategy (TMS) for 2015/16 was approved by Full Council on 26 February 2015. 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 the 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 2015/16 the internal treasury team outperformed its benchmark by 0.22%. The investment return was 0.58% compared to the benchmark of 0.36%. This amounts to additional income of £84,150 during the quarter which is included in the Council's projected outturn position in the monthly revenue monitor.

8.4. A full list of investments held as at 30 June 2015, 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 2015/16. 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.

8.5. As illustrated in the economic background 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 2015/16 was £153 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 2015/16 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 (25 years) for the first quarter of 2015/16 rose slightly from 3.4% to 3.5% after the May Bank of England Inflation report. No new external borrowing is currently required in 2015/16 due to a review of the Capital Programme. As outlined below, borrowing rates generally rose during the quarter. 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	1.11%	1.82%	2.40%	3.06%	3.01%
Date	02/04/2015	02/04/2015	02/04/2015	02/04/2015	02/04/2015
High	1.33%	2.32%	3.04%	3.65%	3.55%
Date	25/06/2015	25/06/2015	10/06/2015	24/06/2015	04/06/2015
Average	1.23%	2.09%	2.75%	3.37%	3.29%

List of Background Papers (This MUST be completed for all reports, but does

not include items containing exempt or confidential information)
Cabinet, 10 June 2015, Treasury Management Update Quarter 4 2014/15
Council, 26 February 2015, Treasury Strategy 2015/16.

Cabinet Member:
Mike Owen, Portfolio Holder

Local Member
N/A

Appendices
A. Investment Report as at 30 June 2015
B. Prudential Limits
C. Prudential Borrowing Schedule