Committee and Date

Cabinet

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TREASURY MANAGEMENT UPDATE – QUARTER 4 2017/18

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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 fourth quarter of 2017/18 the internal treasury team achieved a return of 0.52% on the Council's cash balances, outperforming the benchmark by 0.16%. This amounts to additional income of £52,010 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 £52,010 which is reflected in the Period 12 Revenue Monitor.

4.3. As at 31 March 2018 the Council held £92 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 January 2018 and 31 March 2018.

6. Economic Background

6.1. UK economic growth was disappointingly weak in the first half of 2017; quarter 1 came in at only 0.3% and quarter 2 was also 0.3%, which meant that growth in the first half of 2017 was the slowest for the first half of any year since 2012. The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 75% of GDP, has seen weak growth as consumers cut back on their expenditure.

6.2. However, growth picked up in quarter 3 to 0.5% before dipping back to 0.4% in quarter 4. Annual growth for 2017, therefore, came in at an overall figure of 1.8%, the same as the upwardly revised figure in 2016.

6.3. The manufacturing sector has been the positive sector in the economy, seeing stronger growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, the manufacturing sector only accounts for around 11% of GDP so expansion in this sector will have a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

6.4. CPI inflation duly peaked at 3.1% in November 2017 as the Monetary Policy Committee (MPC) had forecast, but the February 2018 MPC forecast still sees CPI above its target rate of 2% in two years' time. The primary reason why the MPC has become more aggressive with its wording around the pace of increases in Bank Rate is due to an emerging view that with unemployment falling to 4.3%, the lowest level since 1975, and improvements in productivity being so weak, the amount of spare capacity in the economy has also significantly diminished. In particular, the MPC has also been concerned at building pressure on rising average wage rates. It was, therefore, no surprise that the MPC increased Bank Rate by 0.25% to 0.5% in November.

6.5. Their forward guidance of two more increases of 0.25% by 2020 was viewed as being less than markets had expected. Unsurprisingly then, at their February 2018 meeting, the wording became more aggressive still and indicated that Bank Rate would be going up faster than had previously been indicated to the markets. Nevertheless, while there remains so much uncertainty around the Brexit negotiations, consumer spending levels and business investment, 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.

6.6. 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 now looks to have gathered ongoing substantial strength and momentum thanks to this stimulus, with an overall GDP figure for 2017 being 2.5%. Nevertheless, despite providing massive monetary stimulus, the ECB is still struggling to get inflation up to its 2% target and in March, inflation was only 1.4%. It is, therefore, unlikely to start an upswing in rates until possibly towards the end of 2019.

6.7. Growth in the US economy was volatile in 2015 and 2016. 2017 followed that path again with quarter 1 at 1.2%, quarter 2 at 3.1%, quarter 3 at 3.2% and quarter 4 coming in at 2.9%. The annual rate of GDP growth for 2017 was 2.3%. Unemployment in the US has also fallen to the lowest level for 17 years, reaching 4.1% in October to February, while wage inflation pressures, and inflationary pressures in general, have been building. The Federal Reserve has started on an upswing in rates with six increases since the first one in December 2015 to lift the central rate to 1.50 – 1.75%. There could be a further two or more increases in 2018. In October 2017, the Federal Reserve became the first major western central bank to make a start on unwinding Quantitative Easing by phasing in a gradual reduction in respect of reinvesting maturing debt.

6.8. 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.

6.9. GDP growth has been improving during 2017 to reach an annual figure of 2.1% in quarter 4. However, it is still struggling to get inflation up to its target rate of 2% despite huge monetary and fiscal stimulus, although inflation has risen in 2018 to reach 1.5% in February. 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:

	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank rate	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.50%
5yr PWLB rate	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%
10yr PWLB rate	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
25yr PWLB rate	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB rate	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

7.2. Link Asset Services undertook a review of its interest rate forecasts in February after the quarterly Bank of England Inflation Report and MPC meeting at which the MPC kept Bank Rate unchanged at 0.5%.The MPC also gave forward guidance that they were likely to increase Bank Rate at a slightly faster rate than they had anticipated at the previous quarterly Inflation Report meeting.

7.3. A recent further review of interest rate forecasts by Link Asset Services has seen them push back the expected first Bank Rate increase from May 2018 to November 2018. This follows on from a sharp downturn of economic data since mid-February which has resulted in an initial estimate of 0.1% GDP growth in quarter 1.

7.4. Long term PWLB rates are expected to rise from 2.70% in June 2018 to 3.0% in March 2019 before steadily increasing over time to reach 3.4% 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 2017/18 was approved by Full Council on 23 February 2017. 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 fourth quarter of 2017/18 the internal treasury team outperformed its benchmark by 0.16%. The investment return was 0.52% compared to the benchmark of 0.36%. This amounts to additional income of £52,010 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 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 fourth quarter of 2017/18. 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 have improved slightly during the quarter following the 0.25% increase in bank base rate in November 2017. The average level of funds available for investment purposes in the fourth quarter of 2017/18 was £129 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 2017/18 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 2017/18 was 2.6%. No new external borrowing has been undertaken in 2017/18. 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	1.20%	1.58%	2.08%	2.56%	2.27%
Date	02/01/2018	05/01/2018	05/01/2018	28/03/2018	27/03/2018
High	1.50%	2.00%	2.51%	2.90%	2.61%
Date	26/03/2018	15/02/2018	15/02/2018	15/02/2018	15/02/2018
Average	1.36%	1.83%	2.30%	2.73%	2.44%

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

not include items containing exempt or confidential information) Cabinet, 6 September 2017, Treasury Management Update Quarter 1 2017/18 Cabinet, 6 December 2017, Treasury Management Update Quarter 2 2017/18 Cabinet, 14 February 2018, Treasury Management Update Quarter 3 2017/18 Council, 23 February 2017, Treasury Strategy 2017/18.
Cabinet Member: David Minnery, Portfolio Holder for Finance
Local Member N/A
Appendices A. Investment Report as at 31 March 2018 B. Prudential Limits C. Prudential Borrowing Schedule