CAPITA

Asset Services

Treasury solutions

Treasury Management Update
Quarter Ended 30 June 2016

FAR COMMITTEE (22.9.16)

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The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (TMSS, annual and midyear reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

1. Economic Background

UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country. However, the 2015 growth rate finally came in at a disappointing 1.8% so this shows that growth had slowed down, though it still remained one of the leading rates among the G7 countries. Growth improved in quarter 4 of 2015 from +0.4% to 0.7% but fell back again to +0.4% (2.0% y/y) in quarter 1 of 2016. During most of 2015, the economy had faced headwinds for exporters from the appreciation during the year of sterling against the Euro, and weak growth in the EU, China and emerging markets, plus the dampening effect of the Government's continuing austerity programme and uncertainty created by the Brexit referendum. However, since the peak in November 2015, sterling has fallen against the Euro by 14% which will help to make British goods and services much more competitive and will increase the value of overseas earnings by multinational companies based in the UK. In addition, the Chancellor has announced that the target of achieving a budget surplus in 2020 will have to be eased in order to help the economy recover from the expected slowing of growth during the second half of 2016.

The Bank of England May Inflation Report included a forecast for growth for 2016 of 2.0% and 2.3% for 2017 on the assumption that the referendum result was a vote to remain. The Governor of the Bank of England, Mark Carney, warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. In his 30 June and 1 July speeches, Carney indicated that the Monetary Policy Committee (MPC), would be likely to cut Bank Rate and would consider doing further quantitative easing purchasing of gilts, in order to support growth. However, he did also warn that the Bank cannot do all the heavy lifting and suggested that the Government will need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation).

The May Bank of England Inflation Report forecast was notably subdued with inflation barely getting back up to the 2% target within the 2-3 year time horizon. However, the falls in the price of oil and food twelve months ago will be falling out of the calculation of CPI during 2016 and in addition, the recent 10% fall in the value of sterling is likely to result in a 3% increase in CPI over a time period of 3-4 years. There is therefore likely to be an acceleration in the pace of increase in inflation which could make life interesting for an MPC which wants to help promote growth in the economy by keeping Bank Rate low.

The American economy had a patchy 2015 – quarter 1 0.6% (annualised), 3.9% in quarter 2, 2.0% in quarter 3 and 1.4% in quarter 4, leaving growth in 2015 as a whole at 2.4%. Quarter 1 of 2016 came in at +1.1% but forward indicators are pointing towards a pickup in growth in the rest of 2016. The Fed embarked on its long anticipated first increase in rates at its December meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene and then the Brexit vote, has caused a re-emergence of caution over the timing and pace of further increases. It is likely there will now be only one more increase in 2016.

In the Eurozone, the ECB commenced in March 2015 its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month; this was intended to run initially to September 2016. In response to a continuation of weak growth, at the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. At its December and March meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. GDP growth rose by 0.6% in quarter 1 2016 (1.7% y/y) and is expected to continue growing but at only a modest pace. The ECB is also struggling to get inflation up from near zero towards its target of 2%.

2. Interest Rate Forecast

The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.50%	0.50%	0.50%
5yr PWLB rate	1.00%	1.10%	1.10%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.30%	1.30%
10yr PWLB rate	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.70%	1.80%	1.80%	1.80%	1.80%	1.90%
25yr PWLB rate	2.40%	2.40%	2.40%	2.50%	2.50%	2.50%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%
50yr PWLB rate	2.20%	2.20%	2.20%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%

Capita Asset Services undertook a quarterly review of its interest rate forecasts on 4 July 2016 after letting markets settle down somewhat after the Brexit result of the referendum on 23 June. It is generally agreed that this outcome will result in a slowing in growth in the second half of 2016 at a time when the Bank of England has only limited ammunition in its armoury to promote growth by using monetary policy. We therefore expect that Bank Rate will be cut by 0.25%, probably at the 14 July MPC meeting but possibly at its quarterly Inflation Report meeting on 4 August when it has a greater opportunity to report in depth on its research and findings. Bank Rate could even be cut to 0% or 0.10% over this period. Thereafter, we do not expect the MPC to take any further action on Bank Rate in 2016 or 2017 as we expect the pace of recovery of growth to be weak during a period of great uncertainty as to the final agreement between the UK and the EU on arrangements after Brexit. However, the MPC may also consider renewing a programme of quantitative easing; the prospect of further purchases of gilts in this way has already resulted in 10 year gilt yields falling below 1% for the first time ever. We do not expect Bank Rate to start rising until quarter 2 2018 and for further increases then to be at a slower pace than before. The Governor of the Bank of England, Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual after they do start. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when the growth in average disposable income is still weak and for some consumers, who have had no increases in pay, could be non-existent (other than through some falls in prices).

3. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2016/17, which includes the Annual Investment Strategy, was approved by the Council on 11 February 2016. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield.

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in higher rates in periods up to 24 months.

Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 30 June 2016.

Investment rates available in the market were broadly stable during the first half of the quarter but then took a slight downward path in the second half concluding with a significant drop after the referendum on a sharp rise in expectations of an imminent cut in Bank Rate and lower for longer expectations thereafter.

The average level of funds available for investment purposes in house during the quarter was £18.5m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme. The Council holds £28.5m core cash balances for investment purposes (i.e. funds available for more than one year). The investment portfolio yield for the first 3 months of the year is 0.93%.

Investments at 30th June 2016

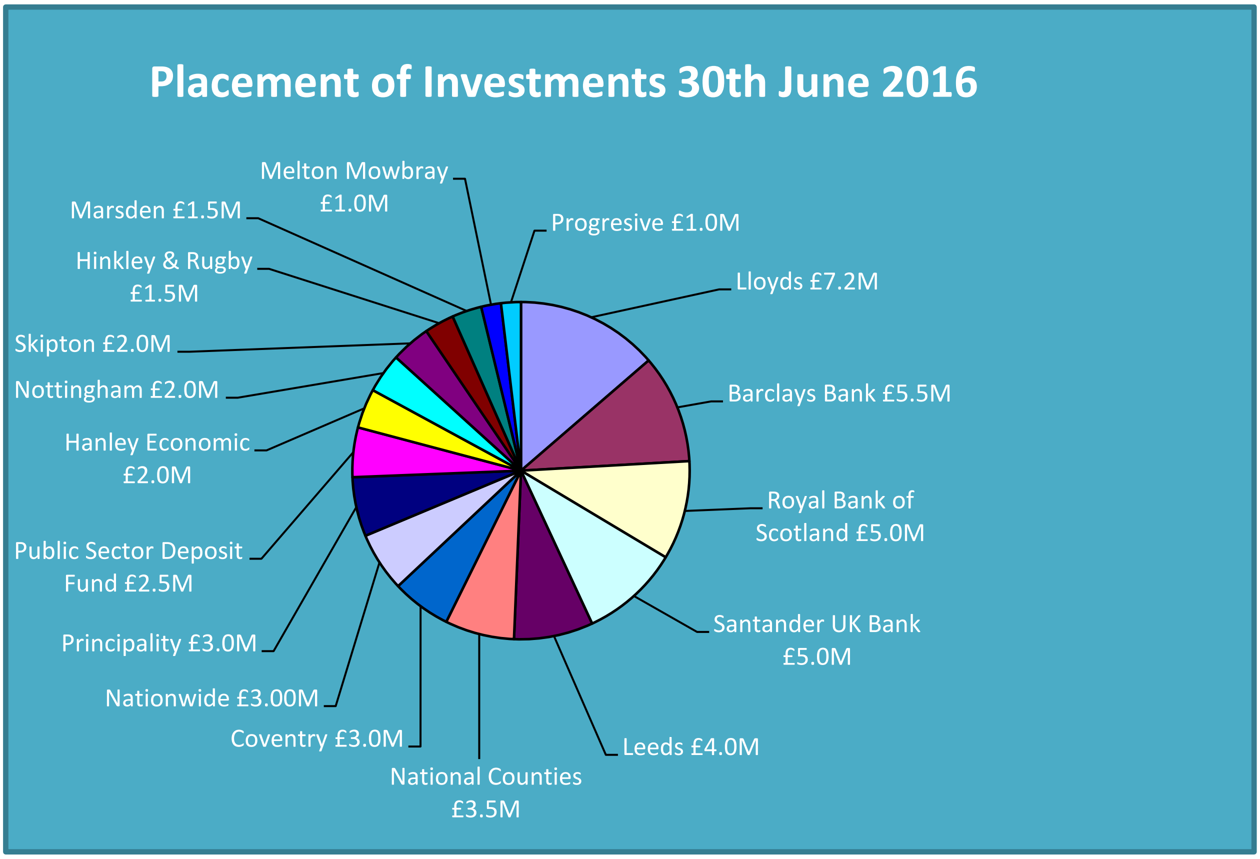
	Amount £	Average Interest Rate %
Managed By NHDC		
Banks	14,700,000	0.73
Building Societies	7,000,000	0.62
Money Market Fund	2,500,000	0.57
NHDC To Total	**24,200,000**	**0.69**
Managed by Tradition		
Banks	8,000,000	1.22
Building Societies	20,500,000	1.26
Tradition Total	**28,500,000**	**1.25**
TOTAL	**52,700,000**	**1.16**

In percentage terms, this equates to:

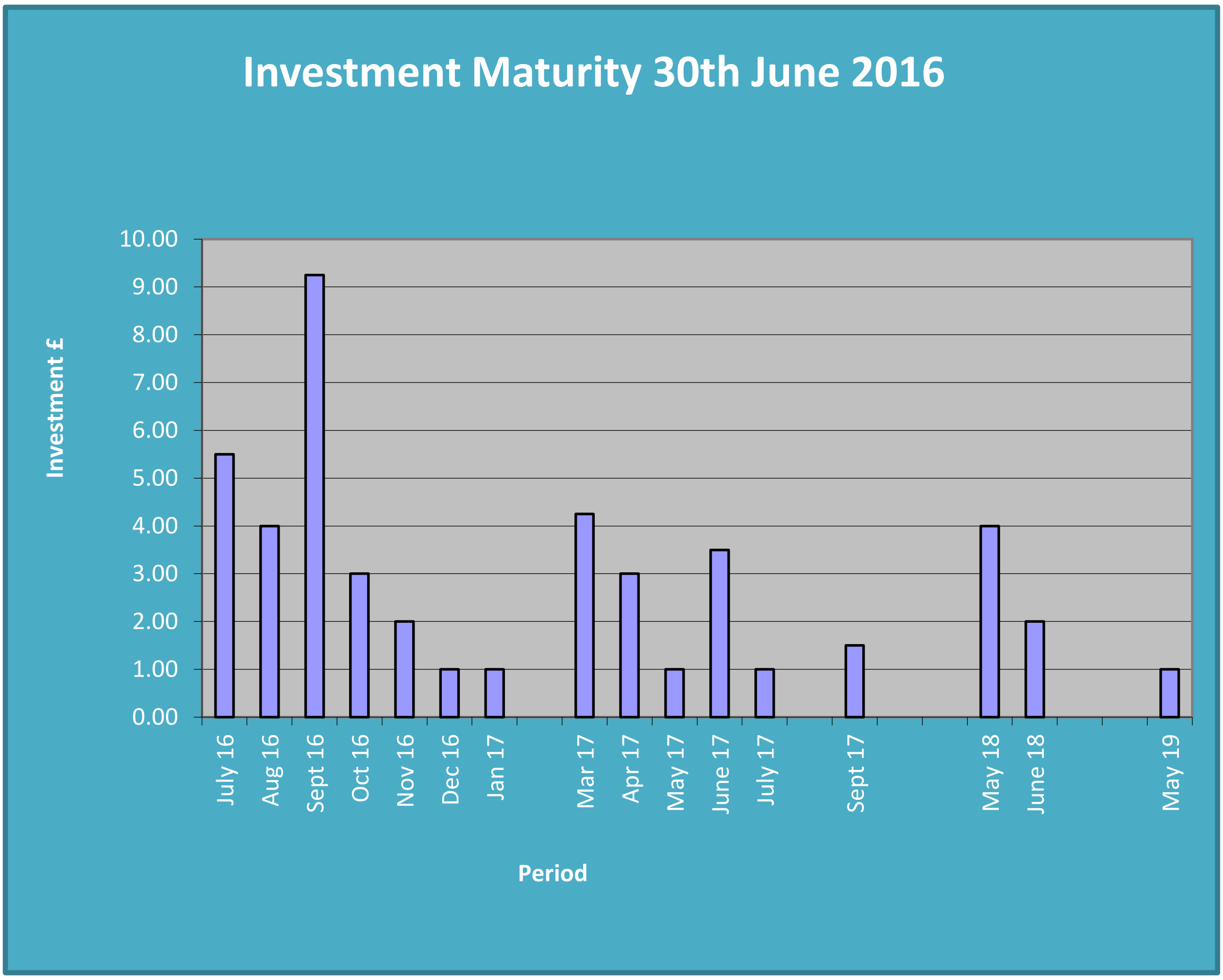
	Percentage
Money Market Funds	4.74
Banks	43.07
Building Societies	52.19

The approved 16/17 strategy is that no more than 75% of investments should be placed with Building Societies.

The pie chart below shows the spread of investment balances as at 30 June 2016. This is a snapshot in time that demonstrates the diversification of investments.

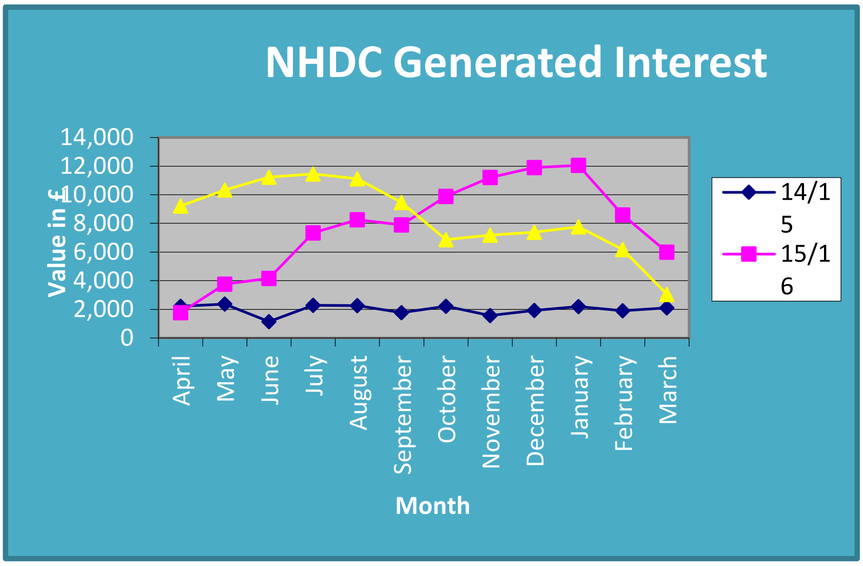


The chart below shows the Council's investment maturity profile. (This does not include the £2.5M held in the Public Sector Deposit Fund Money Market account or £3.2M held in the Lloyds current account which can be called back on any day). Tradition placed eight new deals in the first quarter, three of which were for longer than a year. Two were two year deals with interest rates of 1.2% and the third was a three year deal at 1.6%. The final outstanding investment placed by Sterling matured in June and was reinvested by Tradition.



The Council's Original budgeted investment return for 2016/17 was £0.371M. The projection at the first quarter is £0.427M which is an increase of approximately £0.056M. The increase is mainly due to the three long term deals placed by Tradition and in house investments being placed for longer periods.

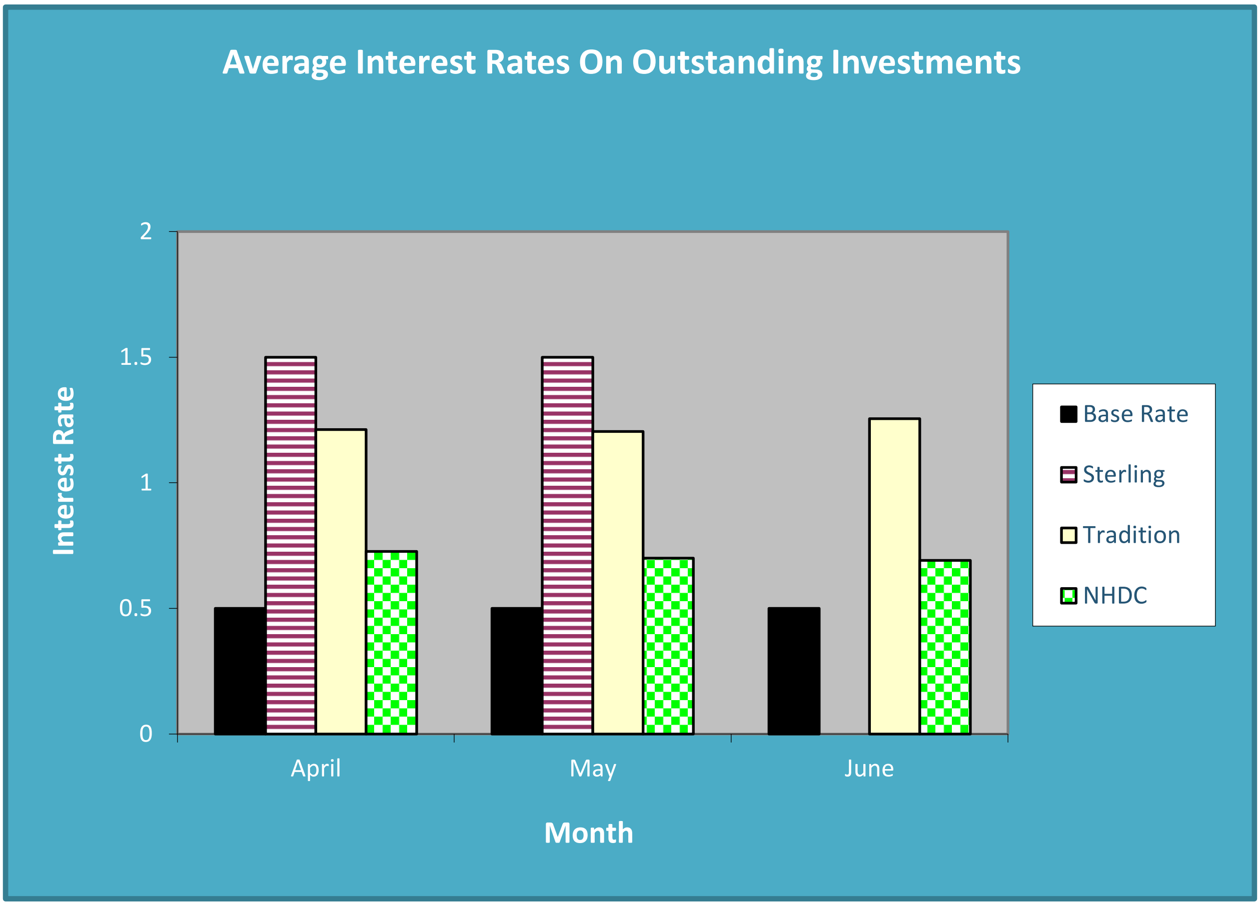
The graph below shows the level of interest expected to be generated from the cash available in-house over the year which is maintained to ensure adequate cash flow. Cash balances have historically reduced over January to March each year as there were no Council tax receipts in February and March.



The table below shows the average rates achieved on investments made during the first quarter.

	Ave Interest Rate on Deals made in the 1st Qrt
NHDC	0.67%
Tradition	1.27%

Base rate started the year at 0.5% and remained constant through out the first quarter. (Base rate reduced to 0.25% on 4th August). The graph below shows the average rate of interest on outstanding investments at 30th June.



As can be seen from the graph, the average rate of interest on outstanding investments for NHDC (cash managed internally) is consistently lower than that of the Cash Managers. This is because the investments made by NHDC during the year are to meet cash flow requirements and are therefore made for short periods. At present, rates in the shorter periods are lower than the longer periods. The Cash Managers have more long term investments and the turnover of investments is small in comparison to NHDC.

The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first quarter of 2016/17.

4. New Borrowing

No borrowing was undertaken during the quarter.

The Council's capital financing requirement (CFR) for 2016/17 is -£18.8m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The CFR is negative as the Council has more cash investments than borrowing. The balance of external and internal borrowing is generally driven by market conditions.

It is anticipated that long term borrowing will not be undertaken during this financial year.

PWLB certainty rates quarter ended 30 June 2016

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.89%	1.21%	1.85%	2.63%	2.33%
Date	27/6/16	27/6/16	27/6/16	29/6/16	30/6/16
High	1.20%	1.80%	2.51%	3.28%	3.08%
Date	27/4/16	27/4/16	27/4/16	27/4/16	27/4/16
Average	1.11%	1.59%	2.25%	3.05%	2.83%

Loans Outstanding at 30 June 2016

	Amount	Average Interest Rate	Cumulative Rate
	£	%	%
Public Works Loans Board	515,290	9.2126	8.85
Lender Option Borrower Option	1,000,000	10.125	10.10
	1,540,539	9.7511	8.5485

5. Debt Rescheduling

No debt rescheduling was undertaken during the quarter.

6. Compliance with Treasury and Prudential Limits

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 TMSS.

During the financial year to date the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown in Appendix A.

APPENDIX A: Prudential and Treasury Indicators as at 30 June 2016

Treasury Indicators	2016/17 Budget £'000	Quarter 1 (Apr-Jun) Actual £'000
Authorised limit for external debt	7,000	1,515
Operational boundary for external debt	5,000	1,515
Gross external debt	3,515	1,515
Investments	(34,000)	(52,700)
Net borrowing	(30,485)	(51,185)

Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	1,035	1,035
12 months to 2 years	25	25
2 years to 5 years	51	51
5 years to 10 years	79	79
10 years and above	325	325

Upper limit of fixed Investment interest rates	70% - 100%	92.4%
Upper limit of variable Investment interest rates	0% - 30%	7.6%

Upper limit for principal sums invested over 364 days	Max 40%	22%

Prudential Indicators	2016/17 Budget £'000	Quarter 1 (Apr-Jun) Actual £'000
Capital expenditure	16,040	740
Capital Financing Requirement (CFR)	(18,827)	(18,827)
In year borrowing requirement	0	0