Treasury Management Update

Quarter Ended 31 December 2017

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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 (annual, midyear/quarterly reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

1. Economic Background

UK. After the UK economy surprised on the upside with strong growth in 2016, growth in 2017 was disappointingly weak in the first half of the year; quarter 1 came in at only +0.3% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y), 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.

However, growth picked up in quarter 3 to 0.4% and in quarter 4 there have been encouraging statistics from the manufacturing sector which is seeing strong 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, this 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. Growth in quarter 4 is expected to be around 0.4% again which would see annual growth in 2017 coming in at around 1.7 – 1.8%, almost as strong as the recently upwardly revised figure for 2016 of 1.8%, (which meant that the UK was equal to Germany as having the strongest GDP growth figure for the G7 countries in 2016).

The Monetary Policy Committee (MPC) meeting of 14 September 2017 surprised markets and forecasters by suddenly switching to a much more aggressive tone in its words warning that Bank Rate will need to rise. Recent Bank of England Inflation Reports have flagged up that they expected CPI inflation to peak at just over 3% in late 2017, before falling back to near to its target rate of 2% in two years' time. Inflation actually came in at 3.1% in November. The reason why the MPC became so aggressive with its wording in September and November around increasing Bank Rate was due to an emerging view that with unemployment falling to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of increasing globalisation. This effectively means that the UK labour faces competition from overseas labour e.g. in outsourcing work to third world countries, and this therefore depresses the negotiating power of UK labour. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so would be inflationary over the next few years.

It was therefore no surprise that the MPC increased Bank Rate by 0.25% to 0.5% in November. However, their forward guidance of two more increases of 0.25% by 2020 was viewed as being more dovish than markets had expected. However, some forecasters are flagging up that they expect growth to improve significantly in 2018, as the fall in inflation will bring to an end the negative impact on consumer spending power while a strong export performance will compensate for weaker services sector growth. If this scenario were to materialise, then the MPC would have added reason to embark on more than one increase in Bank Rate during 2018. While there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two years will pan out.

EU. Economic growth in the EU, (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and now looks to have gathered ongoing substantial strength and momentum thanks to this stimulus. GDP growth was 0.6% in quarter 1 (2.1% y/y), 0.7% in quarter 2 (2.4% y/y) and 0.6% in quarter 3 (2.6% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in November inflation was only 1.2%. It is therefore unlikely to start on an upswing in rates until possibly towards the end of 2019.

USA. Growth in the American economy has been volatile in 2015 and 2016. 2017 followed that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1% and quarter 3 coming in at 3.2%, the first time since 2014 that two successive quarters have been over 3%. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.1% in November, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on an upswing in rates with four increases since December 2016 to lift the central rate to 1.25 – 1.50%. There could then be another four more increases in 2018. In October, the Fed became the first major western central bank to make a start on unwinding quantitative easing by phasing in a start to a gradual reduction of reinvesting maturing debt.

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, and to address the level of non-performing loans in the banking and credit systems.

Japan. GDP growth has been gradually improving during 2017 to reach an annual figure of 2.1% in quarter 3. However, it is still struggling to get inflation anywhere near to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

2. Interest Rate Forecast

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

Link Asset Services Interest Rate View													
	Mar-18	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	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB rate	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB rate	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB rate	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

Link Asset Services undertook its last review of interest rate forecasts on 7 November after the quarterly Bank of England Inflation Report and MPC meeting. As expected, the MPC policy raised Bank Rate by 0.25% to 0.50%. The MPC also gave forward guidance that they expected to raise Bank Rate by 0.25% only twice more in the next two years to reach 1.0% by 2020. This was very much in line with previous guidance that Bank Rate would only go up very gradually and to a limited extent.

The overall balance of risks to economic recovery in the UK is probably currently to the downside due to the uncertainties around Brexit; however, given those 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.

3. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2017/18, which includes the Annual Investment Strategy, was approved by the Council on 9th February 2017. It sets out the Council's investment priorities as being:

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

The Council will also 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

Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 31 December 2017.

The average level of funds available for investment purposes I house during the quarter was **£14.5m**. 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 9 months of the year is 0.78%.

Investments at 30th December 2017

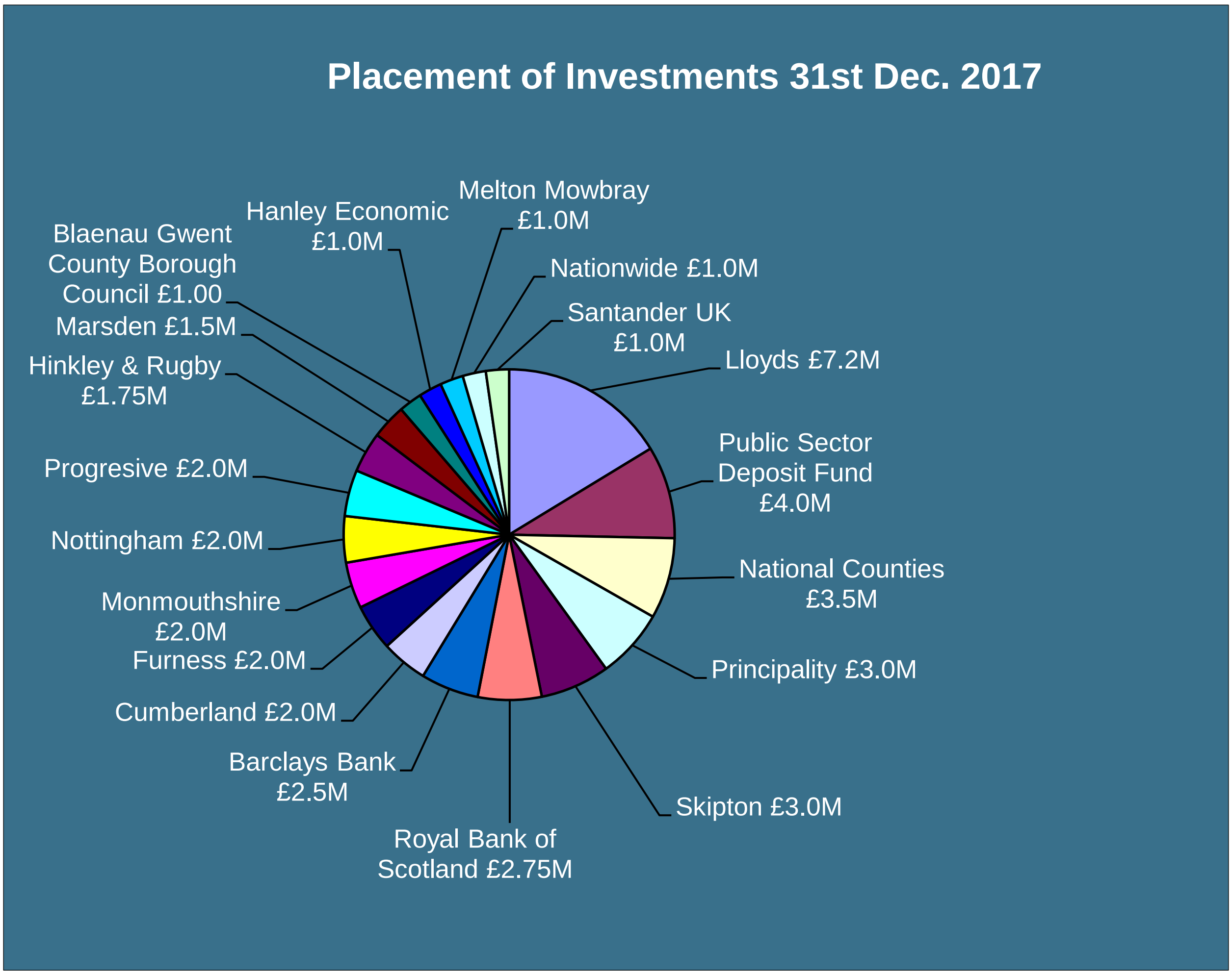
	Amount £	Average Interest Rate %
Managed By NHDC		
Banks	10,700,000	0.49
Local Authorities	1,000,000	0.37
Money Market Fund	4,000,000	0.44
NHDC To Total	**15,700,000**	**0.47**
Managed by Tradition		
Banks	2,750,000	0.58
Building Societies	25,750,000	1.09
Tradition Total	**28,500,000**	**1.05**
TOTAL	**44,200,000**	**1.00**

In percentage terms, this equates to:

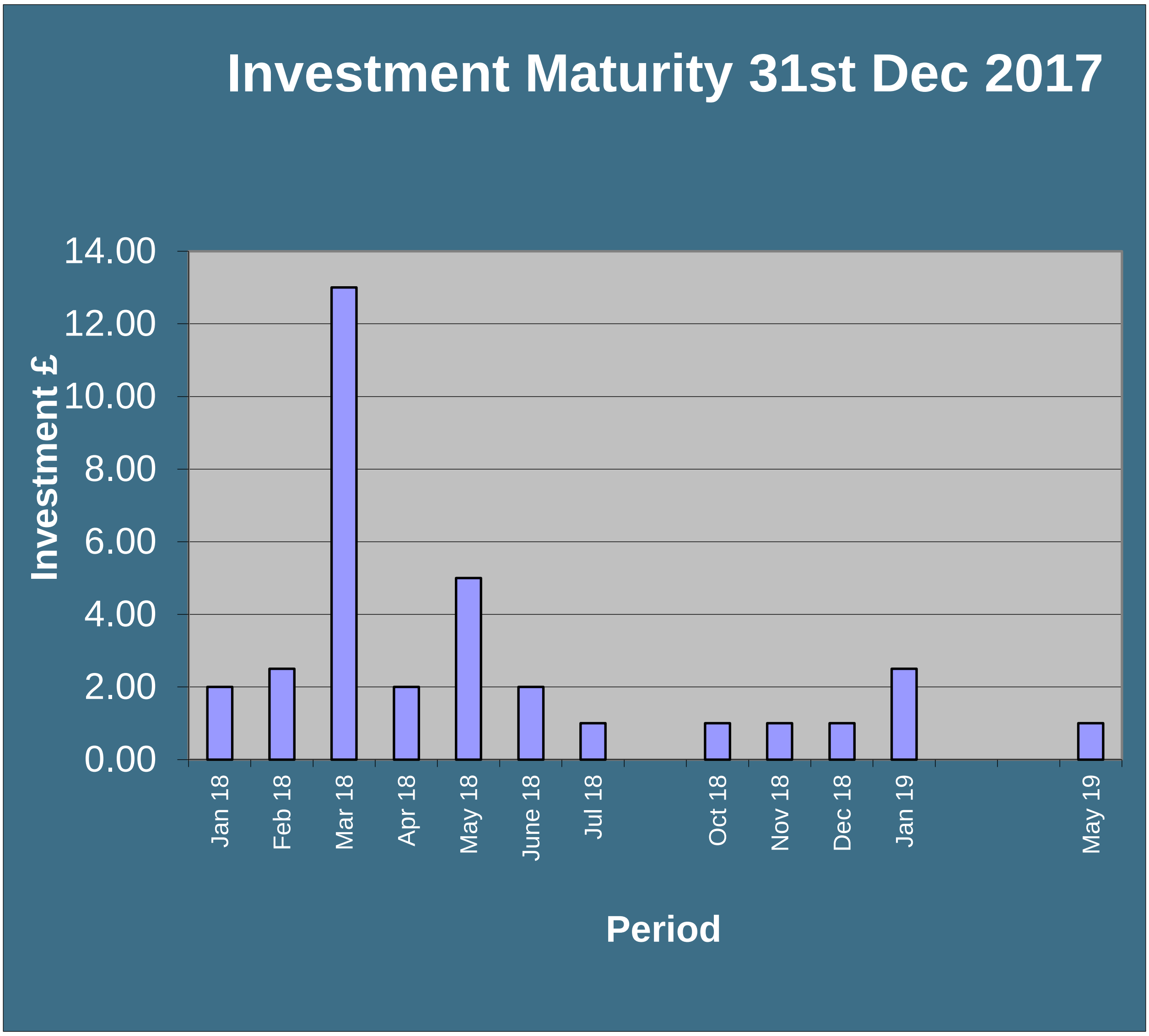
	Percentage
Local Authorities	2.26
Money Market Funds	9.05
Banks	30.43
Building Societies	58.26

The approved 17/18 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 December 2017. This is a snapshot in time that demonstrates the diversification of investments.

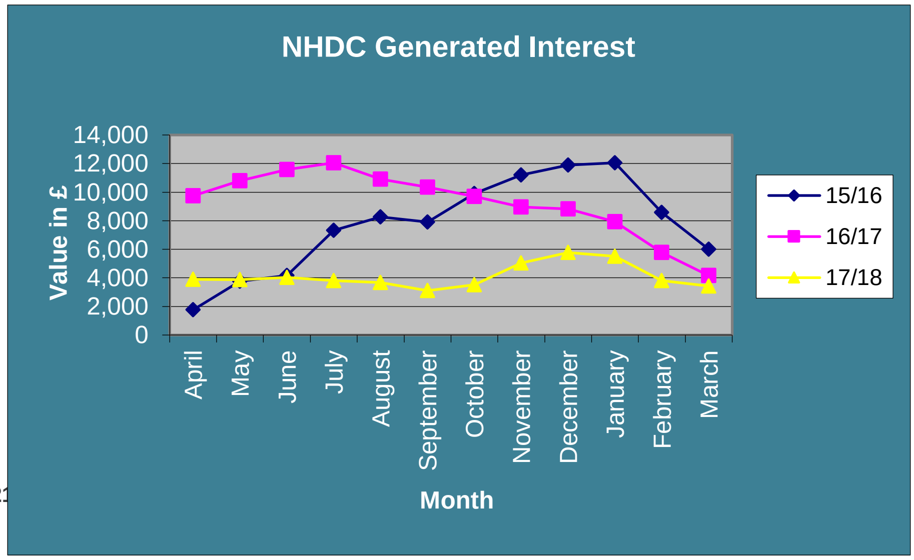


The chart below shows the Council's investment maturity profile. (This does not include the £4.0M held in the Public Sector Deposit Fund Money Market account or £5.2M held in the Lloyds current account which can be called back on any day). There were no new Tradition deals in the third quarter.



The Council's Original budgeted investment return for 2017/18 was £0.267M. The projection at the second quarter was £0.320M which was an increase of £0.053M on the Original budget. The projection at the third quarter is slightly higher at £0.324M. The increase is mainly due to a higher level of balances.

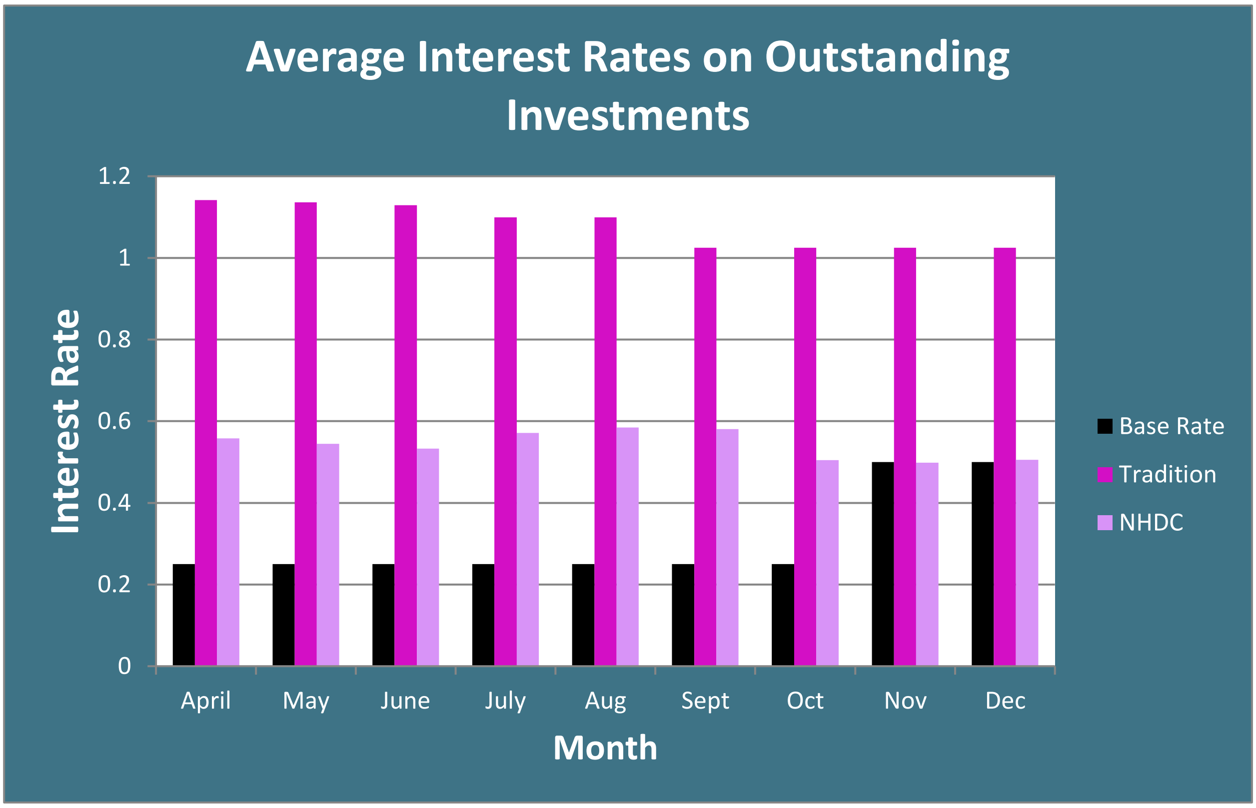
The graph below shows the level of interest expected to be generated from the cash available in-house over the year which is maintained to ensure adequate cash flow. Cash balances have historically reduced over January to March each year as there are less Council tax receipts in February and March.



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

	Ave Interest Rate on Deals made in the 3rd Qrt
NHDC	0.36%
Tradition	N/A

The graph below shows the average rate of interest on outstanding investments at 30th December.



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 third quarter of 2017/18.

4. New Borrowing

No borrowing was undertaken during the quarter.

The Council's capital financing requirement (CFR) for 2017/18 is expected to be -£10.7m (-£16.6m at the end of 16/17). 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 for the financial year to 31 December 2017

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.80%	1.19%	1.80%	2.52%	2.25%
Date	03/05/2017	13/04/2017	21/06/2017	08/09/2017	08/09/2017
High	1.27%	1.67%	2.25%	2.85%	2.59%
Date	08/12/2017	25/10/2017	25/10/2017	06/10/2017	06/10/2017
Average	1.02%	1.39%	2.01%	2.68%	2.41%

Loans Outstanding at 31 December 2017

	Amount	Average Interest Rate	Cumulative Rate
	£	%	%
Public Works Loans Board	466,109	9.5265	8.8541
Lender Option Borrower Option	0		
	466,109	9.5265	8.8541

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 quarter ended 31 December 2017, 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 1.

APPENDIX 1: Prudential and Treasury Indicators for 2017-18 as at 31 December 2017

Treasury Indicators	2017/18 Budget £'000	Quarter 3 (Oct - Dec) Actual £'000
Authorised limit for external debt The maximum level of borrowing set by Council which can not be exceeded.	6,000	466
Operational boundary for external debt The limit beyond which external debt is not normally expected to exceed, based on gross external debt	4,000	466
Gross external debt Based on current level of debt, plus an allowance for additional debt if it was required	3,480	466
Investments Level of cash investments, expect actuals to exceed this early in the year as linked to capital spend during the year.	(31,500)	(44,200)
Net borrowing Investments less Gross external debt	(28,020)	(43,734)

Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	25	11
12 months to 2 years	16	16
2 years to 5 years	53	53
5 years to 10 years	96	96
10 years to 20 years *1	40	40
20 years to 30 years *1	250	250
The budget represents the structure of borrowing that was in place at the start of the year. No new borrowing has been taken out so the position is still in line with budget.		

Upper limit of fixed interest rates based on net debt At least 70% of investments should be at fixed rates. Currently only the Money Market Fund investment is at a variable rate.	70% - 100%	91%
Upper limit of variable interest rates based on net debt See above.	0% - 30%	9%
Upper limit for principal sums invested over 364 days Up to 40% of investments (by value) can be for more than one year.	Max 40%	7.9%

Prudential Indicators	2017/18 Budget £'000	Quarter 3 (Oct - Dec) Actual £'000
Capital expenditure The budget is the expected capital expenditure during the year. The actual total is spend to date. Only at the end of the year will actuals get close to the budget.	20,590	7,548
Capital Financing Requirement (CFR) The total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. The year end position reflects the budgeted capital spend during the year. A negative total means that there is no borrowing requirement.	(2,286)	(10,716)
In year borrowing requirement	0	0
Ratio of financing costs to net revenue stream Net expenditure/ (income) from borrowing and investments, as a % of the Council's net revenue. This is negative as the Council is currently receiving a net income from investments.	-1.6	-2.0
Incremental impact of capital investment decisions on Band D Council Tax This reflects the expected impact of the net change in financing costs/ income compared to the previous year. This is represented by the theoretical change in Band D Council Tax that would be required to fund this change.	1.13%	1.13%