

Treasury Management Update

Quarter Ended 31 December 2018

This report is intended for the use and assistance of customers of Link Asset Services. It should not be regarded as a substitute for the exercise by the recipient of its own judgement. Link Asset Services exists to provide its clients with advice primarily on borrowing and investment. We are not legal experts and we have not obtained legal advice in giving our opinions and interpretations in this paper. Clients are advised to seek expert legal advice before taking action as a result of any advice given in this paper. Whilst Link Asset Services makes every effort to ensure that all information provided by it is accurate and complete, it does not guarantee the correctness or the due receipt of such information and will not be held responsible for any errors therein or omissions arising there from. Furthermore, Link Asset Services shall not be held liable in contract, tort or otherwise for any loss or damage (whether direct, or indirect or consequential) resulting from negligence, delay or failure on the part of Link Asset Services or its officers, employees or agents in procuring, presenting, communicating or otherwise providing information or advice whether sustained by Link Asset Services customer or any third party directly or indirectly making use of such information or advice, including but not limited to any loss or damage resulting as a consequence of inaccuracy or errors in such information or advice. All information supplied by Link Asset Services should only be used as a factor to assist in the making of a business decision and should not be used as a sole basis for any decision.

Link Asset Services is a trading name of Link Treasury Services Limited (registered in England and Wales No. 2652033). Link Treasury Services Limited is authorised and regulated by the Financial Conduct Authority only for conducting advisory and arranging activities in the UK as part of its Treasury Management Service, FCA register number 150403. Registered office: 6th Floor, 65 Gresham Street, London, EC2V 7NQ.

Contents

1.	Economic Background.....	3
2.	Interest Rate Forecast	4
3.	Annual Investment Strategy	5
4.	New Borrowing	10
5.	Debt Rescheduling	10
6.	Compliance with Treasury and Prudential Limits	10
	APPENDIX 1: Prudential and Treasury Indicators as at 31 December 2018.....	11

Treasury Management Update

Quarter Ended 31 December 2018

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, mid-year or quarterly reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

1. Economic Background

UK. After weak **economic growth** of only 0.1% in quarter one, growth picked up to 0.4% in quarter 2 and to 0.6% in quarter 3. However, uncertainties over Brexit look likely to cause growth to have weakened again in quarter four. After the Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the MPC until the uncertainties over Brexit clear. In the event of a disorderly exit, the MPC have said that rates could go up or down, though it is probably much more likely to be down so as 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 3.3%, (excluding bonuses), in the three months to October. The main issue causing this is a lack of suitably skilled people due to the continuing increase in total employment and unemployment being near to 43 year lows. Correspondingly, the total level of vacancies has risen to new highs.

As for **CPI inflation** itself, this has been on a falling trend, reaching 2.3% in November. However, in the November Bank of England Inflation Report, the latest forecast for inflation over the two year time horizon was raised to being marginally above the MPC's target of 2%, indicating a slight build up in inflationary pressures.

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%, 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.

In the **political arena**, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to Brexit in March 2019. If, however, the UK faces 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.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a (temporary) boost in consumption in 2018 which generated an upturn in the strong rate of growth; this rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5% in quarter 3. The strong growth in employment numbers has fed through to an upturn in wage inflation which hit 3.1% in November,

However, CPI inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Fed's target of 2% during 2019. 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 this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the rate and level of increases in rates and that it is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world plunging under the weight of fears around the Fed's actions, the trade war between the US and China, an expectation that world growth will slow, Brexit etc.

EUROZONE. Growth fell in quarter 3 to 0.2% from 0.4% in quarter 2 but this is likely to be a one off blip caused primarily by a one off fall in car production. The ECB forecast growth in 2018 to be 1.9% falling to 1.7% in 2020. The ECB ended its programme of quantitative easing purchases of debt in December, which now means that the central banks in the US, UK and EU have all now ended the phase of post financial crisis expansion of liquidity supporting world financial markets.

CHINA. 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.

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 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-19	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%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	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	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

After the August increase in Bank Rate to 0.75%, the first above 0.5% since the financial crash, the MPC has since then put any further action on hold, probably until such time as the fog of Brexit clears and there is some degree of certainty of what the UK will be heading into. It is particularly unlikely that the MPC would increase Bank Rate in February 2019 ahead of the

deadline in March for Brexit, if no agreement on Brexit has been reached by then. ***The above forecast, and other comments in this report, are based on a central assumption that there is an agreement on a reasonable form of Brexit.*** In that case, then we think that the MPC could return to increasing Bank Rate in May 2019 but then hold fire again until February 2020. However, this is obviously based on making huge assumptions which could be confounded. In the event of a disorderly Brexit, then cuts in Bank Rate could well be the next move.

The balance of risks to the UK

- 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.

3. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2018/19, which includes the Annual Investment Strategy, was approved by the Council on 8th February 2018. 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 31 December 2018.

The average level of funds available for investment purposes during the quarter was **£38.8m**. The Council holds **£22.0m** core cash balances for investment purposes (i.e. funds available for more than one year). The investment portfolio yield for the third quarter of the year is 0.91%.

Investments at 31st December 2018

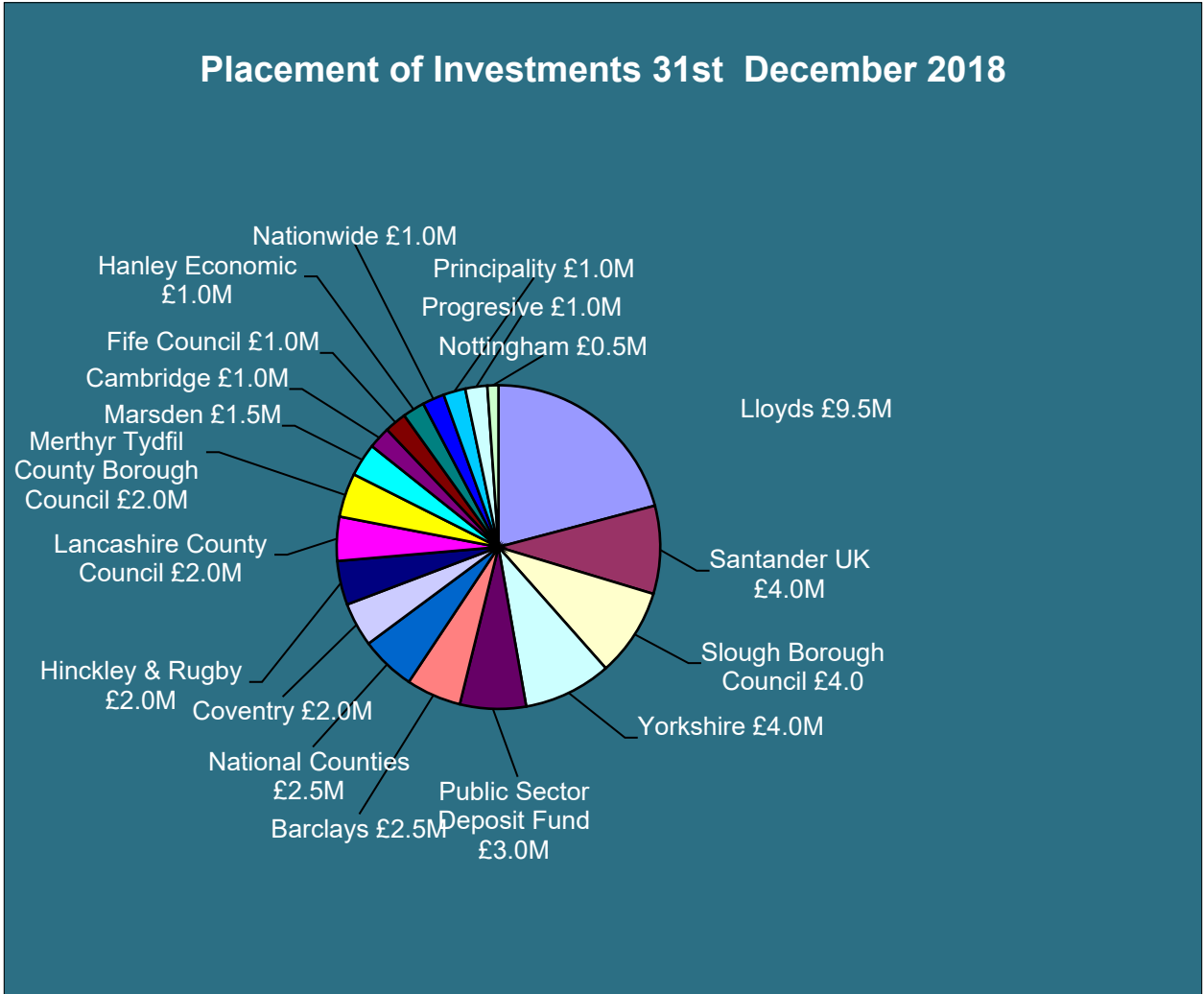
	Amount	Average
	£	Interest Rate %
Managed By NHDC		
Banks	16,000,000	0.89
Building Societies	7,500,000	0.74
Local Authorities	9,000,000	0.98
Money Market Fund	3,000,000	0.82
NHDC To Total	35,500,000	0.88
Managed by Tradition		
Building Societies	10,000,000	1.15
Tradition Total	10,000,000	1.15
TOTAL	45,500,000	1.00

In percentage terms, this equates to:

	Percentage
Money Market Funds	7
Local Authorities	20
Banks	35
Building Societies	38

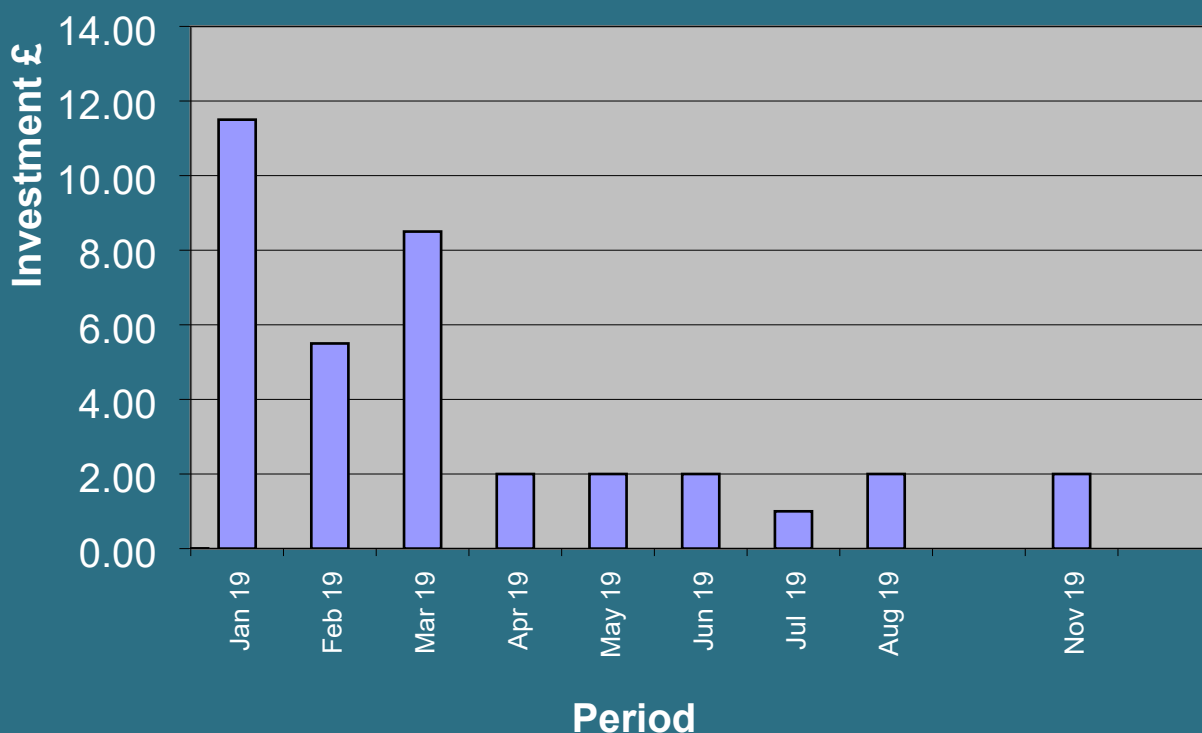
The approved 18/19 strategy is that no more than 75% of investments should be placed with Building Societies.

The pie chart below shows the spread of investment balances as at 31 December 2018. This is a snapshot in time that demonstrates the diversification of investments.



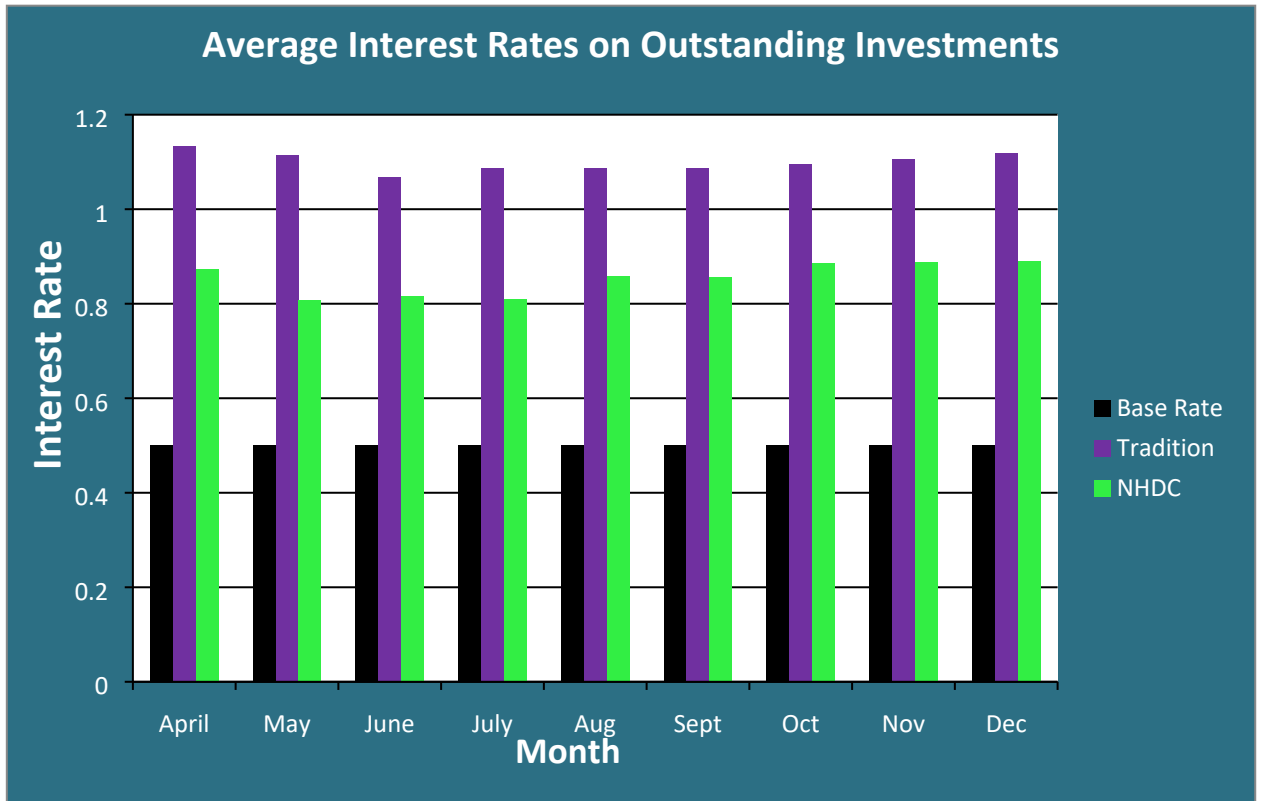
The chart below shows the Council's investment maturity profile. (This does not include the £3.0M held in the Public Sector Deposit Fund Money Market account or £6.0M held in the Lloyds current account which can be called back on any day).

Investment Maturity 31st December 2018



The Council's Original budgeted investment return for 2018/19 was £0.167M. The projection at the second quarter was £0.320M. The projection at the third quarter is now £0.358M. The increase is mainly due to a higher level of balances which means investments can be made for longer periods and achieve a higher interest rate.

The graph below shows the average rate of interest on outstanding investments at 31st December.



The higher rates achieved through Tradition reflect that these are longer-term investments. In general, the Council can currently achieve similar rates for the same length of investment. The Council only undertakes new investments through Tradition where the rate achieved (after fees) are greater than what the Council could achieve for a similar investment.

The Service Director - Resources confirms that the approved limits within the Annual Investment Strategy were not breached during the third quarter of 2018/19.

4. New Borrowing

No borrowing was undertaken during the quarter.

The Council's capital financing requirement (CFR) for 2018/19 is expected to be -£4.7m (-£10.3m at the end of 17/18). 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 (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.

Loans Outstanding at 31 December 2018

	Amount	Average Interest Rate
	£	%
Public Works Loans Board	£448k	9.65

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 31.12.18, 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 2018-19 as at 31 December 2018

Treasury Indicators	2018/19 Budget £'000	31.12.18 Actual £'000
Authorised limit for external debt	15,000	448
Operational boundary for external debt	5,000	448
Gross external debt	3,456	448

Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	16	16
12 months to 2 years	17	17
2 years to 5 years	56	56
5 years to 10 years	92	92
10 years to 20 years	25	25
20 years to 30 years	250	250

Prudential Indicators	2018/19 Budget £'000	31.12.18 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.	7,211	994
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.	(0.010)	(9.734)
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.	-0.73	-2.21

