REPORT TO:	Executive Board
DATE:	19 July 2018
REPORTING OFFICER:	Operational Director – Finance
PORTFOLIO:	Resources
TITLE:	Treasury Management Annual Report 2017-18
WARDS:	Borough-wide

1.0 PURPOSE OF REPORT

1.1 The purpose of the report is to provide an update regarding investment and borrowing activities undertaken during 2017/18, as required by the Council's Treasury Management Policy.

2.0 RECOMMENDED: That the report be noted.

3.0 SUPPORTING INFORMATION

Economic Outlook

3.1 The following analysis of the UK economic situation has been provided by Link Asset Services, the Council's treasury management advisors.

3.2 During the six months up until 31st March 2018;

- The UK economy maintained a mediocre pace
- Employment fell and the tightness in the labour market fed through to higher wage growth
- Headline inflation reached its highest level since March 2012 and the Bank of England's Monetary Policy Committee (MPC) signalled its intention to bring Consumer Price Index (CPI) inflation back to target over a shorter time horizon
- The MPC increased the bank rate for the first time in a decade and a further increase expected in 2018/19
- The Chancellor provided a larger than expected budget "giveaway"
- The European Commission gave the green light to progress to the second phase of Brexit negotiations

3.3 After the UK economy surprised analysts with strong growth in 2016, the growth in 2017 was disappointingly weak in the first half of the year. Quarter 1 came in at +0.3% (+1.7% year on year) and quarter 2 was +0.3% (+1.5% year on year), 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 EU referendum, feeding increases into 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 Gross Domestic Product (GDP), has seen weak growth as consumers cut back on their expenditure.

3.4 Growth did pick 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 for 2016, (which meant the UK was equal to Germany in having the strongest GDP growth figure of the G7 countries in 2016).

3.5 The manufacturing sector has been the bright spot 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.

3.6 The MPC meeting minutes of 14 September 2017 surprised markets and forecasters by using a much more aggressive tone in its words, warning that bank rate would need to rise shortly. CPI inflation duly peaked at 3.1% in November 2017 as the 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 in, and since September, 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 the bank rate by 0.25% to 0.5% in November 2017.

3.7 At their February 2018 meeting, the MPC's wording became more aggressive still and indicated that the 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.

3.8 Economic growth in the EU, (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis, despite the European Central Bank (ECB) eventually cutting its main rate to -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 likely to be around 2.5%. Nevertheless, despite providing massive monetary stimulus, the ECB is still struggling to get inflation up to its 2% target and in March 2018, inflation was only 1.4%. It is, therefore, unlikely to start an upswing in rates until possibly towards the end of 2019.

3.9 Growth in the American 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 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 Bank has started on an upswing in rates with six increases since the first one in December 2015 to lift the central rate to 1.75%. There could be a further two or more increases in 2018. In October 2017, the Federal Bank 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.

Interest Rate Forecast

3.10 The following forecast has been provided by Link Asset Services.

	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%

Short Term Borrowing Rates

3.11 The bank base rate increased to 0.5% on 2nd November 2017.

	Sep	Oct	Nov	Dec	Jan	Feb	Mar
	%	%	%	%	%	%	%
Call Money (Market)	0.22	0.22	0.47	0.47	0.47	0.47	0.47
1 Month (Market)	0.25	0.40	0.49	0.50	0.49	0.50	0.51
3 Month (Market)	0.34	0.44	0.52	0.52	0.52	0.58	0.71

Longer Term Borrowing Rates

	Sep	Oct	Nov	Dec	Jan	Feb	Mar
	%	%	%	%	%	%	%
1 Year (Market)	1.14	1.17	1.23	1.16	1.33	1.38	1.47
10 Year (PWLB)	2.23	2.22	2.25	2.11	2.34	2.41	2.26
25 Year (PWLB)	2.79	2.77	2.77	2.65	2.75	2.77	2.57

3.12 Market rates are based on LIBOR rates and PWLB rates are for new loans based on principal repayable at maturity. The rates are shown for the end of each month.

Borrowing and Investments

Turnover During the Period

	No of deals	Turnover £m
Short Term Borrowing	-	-
Short Term Investments	20	167

Position at Month End

	Sep £m	Oct £m	Nov £m	Dec £m	Jan £m	Feb £m	Mar £m
Total Borrowing	143	172	172	172	172	172	172
Total Investments	(68)	(54)	(70)	(75)	(70)	(65)	(65)
Call Account Balance	(31)	(24)	(18)	(20)	(25)	(25)	(16)

Investment Benchmarking

Benchmark	Benchmark Return %	Performance Oct - Mar %	Investment Interest Earned £000
7 day	0.32	0.25	30
1 month	0.34	0.30	2
3 month	0.40	0.38	34
6 month	0.49	0.66	176
12 month	0.69	0.76	14
Over 12 months		0.72	44
Property Fund		4.22	106
Total			**406**

3.13 This shows the Council has not reached the benchmarks for very short term investments, but has over achieved on 6 months and above. It is intended to use Money Market Funds more often during 2018/19 to achieve an increased yield on short term investments.

3.14 At 31st March 2018 the Council held £5m in the CCLA Local Authority Property Fund, for which there is no benchmark available.

Budget Monitoring

	Net Interest at 31st March 2018				
	Budget Year to Date £000	**Actual Year to Date £000**	**Variance (o/spend) £000**		**Actual inc M Gateway £000**
Investment	(406)	(534)	128		(689)
Borrowing	1,141	1,124	17		5,845
Total	**735**	**590**	**145**		**5,156**

3.15 As the borrowing and investments in relation to the Mersey Gateway have no effect on the Council's revenue budget they been excluded from the budget monitoring figures above.

New Long Term Borrowing

3.16 The Council borrowed £29m from the Public Works Loan Board (PWLB) on 26th October 2017 at a rate of 2.73% to fund the final major capital spend on the Mersey Gateway. The interest on Mersey Gateway borrowing is funded from toll income so has no impact on the Council's revenue budget.

Policy Guidelines

3.17 The Treasury Management Strategy Statement (TMSS) for 2017/18, which includes the Annual Investment Strategy, was approved by the Council on 23 February 2017. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield

3.18 The Council will also aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate and the heightened credit concerns it is considered appropriate to keep the majority of investments short term and to ensure all investments are in in line with Link Asset Services' credit rating methodology.

Treasury Management Indicators

3.19 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 were set out in the Treasury Management Strategy Statement and are reviewed in Appendix 1.

Debt Rescheduling

3.20 No debt rescheduling was undertaken during the year.

4.0 POLICY IMPLICATIONS

4.1 None.

5.0 FINANCIAL IMPLICATIONS

5.1 The financial implications are as set out in the report.

6.0 IMPLICATIONS FOR THE COUNCIL'S PRIORITIES

6.1 There are no direct implications, however, the revenue budget and capital programme support the delivery and achievement of all the Council's priorities.

7.0 RISK ANALYSIS

7.1 The main risks with Treasury Management are security of investment and volatility of return. To combat this, the Authority operates within a clearly defined Treasury Management Policy and annual borrowing and investment strategy, which sets out the control framework

8.0 EQUALITY AND DIVERSITY ISSUES

8.1 None.

9.0 LIST OF BACKGROUND PAPERS UNDER SECTION 100D OF THE LOCAL GOVERNMENT ACT 1972

9.1 There are no background papers under the meaning of the Act.

Appendix 1

Treasury and Prudential Indicators – 2017/18

Prudential Indicators	2016/17 Full Year Actual £000	2017/18 Original Estimate £000	2017/18 Full Year Actual £000
Capital Expenditure	84,747	82,013	104,665
Net Financing Need for the Year *(Borrowing Requirement)*	58,759	60,177	85,208
Increase / (Decrease) in CFR *(Capital Financing Requirement)*	56,369	57,744	722,947
Ratio of Financing Costs to Net Revenue Stream *(Proportion of cost of borrowing to Council's net revenue)*	2.1%	2.0%	1.9%
Incremental Impact on band D Council Tax (£) *(net cost of borrowing compared to tax base)*	2.42	2.44	2.17
External Debt	153,000	173,000	172,000
Operational Boundary *(Limit of which external debit is not epected to exceed)*	252,600	254,164	254,164
Authorised Limit *(Limit beyound which external debit is prohibited)*	270,000	270,000	270,000

Upper Limit for Interest Rate Exposure	Exposure Limit %	2016/17 Actual %	2017/18 Actual %
Fixed Rate	100	100	100
Variable Rate	30	-	-

Maturity Structure of Fixed Rate Borrowing	Exposure Limit %	2016/17 Actual %	2017/18 Actual %
Under 12 months	40	7	0
12 months to 24 months	40	0	0
24 months to 5 years	40	0	0
5 years to 10 years	40	0	0
10 years and above	100	93	100

Maximum Principal invested > 365 days	Investment Limit £000	2016/17 Actual £000	2017/18 Actual £000
Principal Sums Invested over 365 days	30,000	5,000	10,000