REPORT TO:	Executive Board
DATE:	15 November 2018
REPORTING OFFICER:	Operational Director – Finance
PORTFOLIO:	Resources
TITLE:	Treasury Management Half Year Report 2018-19
WARDS:	Borough-wide

1.0 PURPOSE OF REPORT

1.1 The purpose of this report is to provide an update regarding activities undertaken on the money market as required by the Treasury Management Policy.

2.0 RECOMMENDED: That

1) Council be recommended to adopt the updated Operational Boundary and Authorised Limits as detailed in paragraph 3.18; and

2) the report be noted.

3.0 SUPPORTING INFORMATION

Economic Outlook

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

3.2 During the six months ended 30th September 2018:

- The economy showed signs of regaining momentum after the slowdown in the previous quarter
- A tight labour market put upward pressure on wage growth
- Consumer price inflation rose unexpectedly
- Base rate increased in August to 0.75%
- Brexit negotiations remained at an impasse

3.3 The first half of 2018/19 has seen UK economic growth post a modest performance, but sufficiently robust for the Monetary Policy Committee, (MPC), to unanimously (9-0) vote to increase Bank Rate on 02 August 2018 from 0.5% to 0.75%. Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019

3.4 Some Monetary Policy Committee (MPC) members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components, but is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate. The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

3.5 As for the labour market, unemployment has continued at a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 2.9%, (3 month average regular pay, excluding bonuses) and to a one month figure in July of 3.1%. This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 0.4%, near to the joint high of 0.5% since 2009. (The previous high point was in July 2015.) 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. This tends to confirm that the MPC were right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy. However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit.

3.6 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, it appears the Government will endure, despite various setbacks, along the route to Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, 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.

3.7 In the USA President Trump's massive easing of fiscal policy is fuelling a (temporary) boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2, but also an upturn in inflationary pressures. With inflation moving towards 3%, the Federal Bank increased rates another 0.25% in September to between 2.00% and 2.25%, this being four increases in 2018, and indicated they expected to increase rates four more times by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US, (China in particular), could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Federal Bank in the second half of 2019

3.8 In the Eurozone growth was unchanged at 0.4% in quarter 2, but has undershot early forecasts for a stronger economic performance in 2018. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of 2% for 2018, the horizon is less clear than it seemed just a short while ago.

Interest Rate Forecast

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

Link Asset Services Interest Rate View	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

Short Term Borrowing Rates

3.10 The bank base rate increased from 0.50% to 0.75% on the 2nd August 2018.

	Mar	Apr	May	Jun	Jul	Aug	Sep
	%	%	%	%	%	%	%
Call Money (Market)	0.47	0.47	0.47	0.47	0.46	0.71	0.70
1 Month (Market)	0.51	0.51	0.50	0.50	0.68	0.72	0.72
3 Month (Market)	0.72	0.71	0.61	0.67	0.80	0.80	0.80

Longer Term Borrowing Rates

	Mar	Apr	May	Jun	Jul	Aug	Sep
	%	%	%	%	%	%	%
1 Year (Market)	1.01	0.97	0.89	0.96	1.05	1.05	1.06
10 Year (PWLB)	2.26	2.35	2.20	2.21	2.27	2.25	2.37
25 Year (PWLB)	2.57	2.69	2.56	2.57	2.63	2.63	2.74

3.11 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

<u>Turnover During the Period</u>

	No of deals	Turnover £m
Short Term Borrowing	-	-
Short Term Investments	18	200

<u>Position at Month End</u>

	Mar £m	Apr £m	May £m	Jun £m	Jul £m	Aug £m	Sep £m
Total Borrowing	172	153	153	153	143	143	143
Total Investments	(65)	(95)	(95)	(95)	(95)	(100)	(100)
Call Account Balance	(16)	(19)	(18)	(25)	(25)	(15)	(20)

Investment Benchmarking

Benchmark	Benchmark Return %	Performance Apr - Sep %	Investment Interest Earned £000
7 day	0.40	0.52	70
1 month	0.43	0.00	-
3 months	0.58	0.84	67
6 months	0.69	0.80	213
12 months	0.89	0.92	89
Over 12 months		1.30	65
Property Fund		4.07	102
Total			**606**

3.12 This shows the Council has over achieved on all benchmarks for the first 6 months of the year. There are no benchmarks available for the Council's investment in the CCLA property fund, or for investments held over 12 months.

Budget Monitoring

	Net Interest at 31st March 2018		
	Budget Year to Date £000	**Actual Year to Date £000**	**Variance (o/spend) £000**
Investment	(300)	(606)	306
Borrowing	1,099	1,099	-
Total	**799**	**493**	**306**

New Long Term Borrowing

3.13 No new long term borrowing has been taken in this period.

Policy Guidelines

3.14 The Treasury Management Strategy Statement (TMSS) for 2018/19, which includes the Annual Investment Strategy, was approved by the Council on 07 March 2018. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield

3.15 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 Sector's credit rating methodology.

Change to the Authorised Limit and Operational Boundary

3.16 One of the key Treasury Indicators set by the Council as part of the Treasury Management Strategy is the Operational Boundary (the limit beyond which external debt is normally expected to exceed) and the Authorised Limit (the limit beyond which external debt is prohibited).

3.17 Due to the valuation of the Mersey Gateway Bridge being required to be included during the preparation of the 2017/18 Statement of Accounts, an additional £644m was added to the Council's Capital Financing Requirement. This represents the capital element of the future Unitary Payments the Council are due to make over the next thirty years, funded from toll income. It should be noted that this is a purely accounting adjustment and doesn't reflect any additional borrowing over and above what is already taken.

3.18 It is therefore proposed that £644m is added to the Operation Boundary and Authorised Limit as shown below:

	Treasury Strategy £000	Updated Limits £000	Increase £000
Operational Boundary	212,500	856,312	643,812
Authorised Limit	282,500	926,312	643,812

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 quarter.

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 – 2018/19 – Quarter 2

Prudential Indicators	2017/18 Full Year Actual £000	2018/19 Original Estimate £000	2018/19 Quarter 2 Estimate £000
Capital Expenditure	104,663	36,253	48,146
Net Financing Need for the Year *(Borrowing Requirement)*	85,206	21,161	17,841
Increase / (Decrease) in CFR *(Capital Financing Requirement)*	79,134	18,274	15,575
Ratio of Financing Costs to Net Revenue Stream *(Proportion of cost of borrowing to Council's net revenue)*	2.5%	2.4%	2.0%
Incremental Impact on band D Council Tax (£) *(net cost of borrowing compared to tax base)*	17.30	2.50	27.63
External Debt	172,000	172,000	172,000
Operational Boundary *(Limit of which external debit is not epected to exceed)*	254,164	212,500	856,312
Authorised Limit *(Limit beyound which external debit is prohibited)*	270,000	282,500	926,312

Upper Limit for Interest Rate Exposure	Exposure Limit %	2017/18 Actual %	2018/19 Estimate %
Fixed Rate	100	100	100
Variable Rate	30	-	-

Maturity Structure of Fixed Rate Borrowing	Exposure Limit %	2017/18 Actual %	2018/19 Estiamte %
Under 12 months	40	0	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	100	100

Maximum Principal invested > 365 days	Investment Limit £000	2017/18 Actual £000	2018/19 Estimate £000
Principal Sums Invested over 365 days	30,000	10,000	20,000