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| **REPORT TO:** | Executive Board |
| **DATE:** | 20 November 2014 |
| **REPORTING OFFICER:** | Operational Director – Finance |
| **PORTFOLIO:** | Resources |
| **TITLE:** | Treasury Management<br>2nd Quarter: July-Sept 2014 |
| **WARDS:** | All Wards |

**1.0 PURPOSE OF REPORT**

1.1 The purpose of this report is to provide an update regarding investment and borrowing activities undertaken during the 2nd quarter of 2014/15 as required by the Treasury Management Policy.

**2.0 RECOMMENDED: That the report be noted.**

**3.0 SUPPORTING INFORMATION**

**3.1** Supporting information has been provided by Capita Asset Services, the Council's treasury management advisors

During the quarter ended 30th September:

- Indicators pointed to another robust quarter of GDP growth
- Further healthy increases in household spending
- A slowdown in jobs growth
- CPI inflation eased further below the 2% target
- Dovish signals from the MPC
- Low tax receipts put the fiscal tightening slightly off track
- Further loosening of monetary policy in the Eurozone

After strong UK GDP quarterly growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), and 0.7% in Q1 and 0.9% in Q2 2014 (annual rate 3.2% in Q2), it appears very likely that strong growth will continue through 2014 and into 2015 as forward surveys for the services and construction sectors, are very encouraging and business investment is also strongly recovering. The manufacturing sector has also been encouraging though the latest figures indicate a weakening in the future trend rate of growth. However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

Also encouraging has been the sharp fall in inflation (CPI), reaching 1.5% in July, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly 1%. The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed so far this year.

In September, the U.S. Federal Reserve continued with its monthly $10bn reductions in asset purchases, which started in December 2014. Asset purchases have now fallen from $85bn to $15bn and are expected to stop in October 2014, providing strong economic growth continues. First quarter GDP figures were depressed by exceptionally bad winter weather, but quarter 2 rebounded strongly to 4.6%.

The Eurozone is facing an increasing threat from deflation. In September, the inflation rate fell further, to reach 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation.

Accordingly, the ECB did take some rather limited action in June and September to loosen monetary policy in order to promote growth.

## 3.2 Interest Rate Forecast

The following forecast has been provided by Capita Asset Services::

| | Dec-14 | Mar-15 | Jun-15 | Sep-15 | Dec-15 | Mar-16 | Jun-16 | Sep-16 | Dec-16 | Mar-17 | Jun-17 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank rate | 0.50% | 0.75% | 0.75% | 1.00% | 1.00% | 1.25% | 1.25% | 1.50% | 1.75% | 2.00% | 2.00% |
| 5yr PWLB rate | 2.70% | 2.80% | 2.90% | 3.00% | 3.00% | 3.10% | 3.20% | 3.30% | 3.40% | 3.50% | 3.50% |
| 10yr PWLB rate | 3.50% | 3.60% | 3.70% | 3.80% | 3.90% | 4.00% | 4.10% | 4.10% | 4.20% | 4.30% | 4.30% |
| 25yr PWLB rate | 4.10% | 4.20% | 4.30% | 4.40% | 4.50% | 4.60% | 4.70% | 4.80% | 4.80% | 4.90% | 4.90% |
| 50yr PWLB rate | 4.10% | 4.20% | 4.30% | 4.40% | 4.50% | 4.60% | 4.70% | 4.80% | 4.80% | 4.90% | 4.90% |

Capita Asset Services undertook a review of its interest rate forecasts in mid-August, after the Bank of England's Inflation Report. By the beginning of September, a further rise in geopolitical concerns, principally over Ukraine but also over the Middle East, had caused a further flight into safe havens like gilts and depressed PWLB rates further. However, there is much volatility in rates as news ebbs and flows in negative or positive ways.

## 3.3 Short Term Borrowing Rates

The bank base rate remained at 0.50% throughout the quarter.

| | | Jul | | Aug | | Sep | |
|---|---|---|---|---|---|---|---|
| | Start | Mid | End | Mid | End | Mid | End |
| | % | % | % | % | % | % | % |
| Call Money (Market) | 0.47 | 0.47 | 0.48 | 0.47 | 0.47 | 0.48 | 0.47 |
| 1 Month (Market) | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.51 |
| 3 Month (Market) | 0.55 | 0.56 | 0.56 | 0.56 | 0.56 | 0.56 | 0.57 |

## 3.4 Longer Term Borrowing Rates

| | | Jul | | Aug | | Sep | |
|---|---|---|---|---|---|---|---|
| | Start | Mid | End | Mid | End | Mid | End |
| | % | % | % | % | % | % | % |
| 1 Year (Market) | 1.05 | 1.07 | 1.07 | 1.04 | 1.05 | 1.05 | 1.06 |
| 10 Year (PWLB) | 3.62 | 3.55 | 3.55 | 3.37 | 3.23 | 3.39 | 3.30 |
| 25 Year (PWLB) | 4.11 | 4.14 | 4.08 | 3.92 | 3.76 | 3.97 | 3.85 |

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

3.5 Borrowing/Investments

Turnover during period

| | No of deals | Turnover £m |
|---|---|---|
| Short Term Borrowing | 0 | 0.0 |
| Short Term Investments | 16 | 133.0 |

Position at Month End

| | Jul £m | Aug £m | Sep £m |
|---|---|---|---|
| Total Borrowing | 70.0 | 70.0 | 183.0 |
| Total Investments | 85.0 | 80.0 | 188.0 |
| Call Account Balance | 14.7 | 16.0 | 20.0 |

Investment Benchmarking

| Benchmark | Benchmark Return % | Performance % | Investment Intrest Earned £000 |
|---|---|---|---|
| 7 day | 0.35 | 0.45 | 27 |
| 1 month | 0.37 | 0.00 | 0 |
| 3 month | 0.43 | 0.51 | 18 |
| 6 month | 0.58 | 0.62 | 46 |
| 12 month | 0.92 | 0.81 | 114 |
| Total | | | 205 |

This shows that the Council has over achieved the benchmark for most maturities. Due to the Council's strict treasury management guidelines only Counterparties with a very high credit score can be used for 12 months investments. For this reason the returns are not as high as the benchmark return given.

Budget Monitoring

| | Net Interest at 31st September 2014 | | |
|---|---|---|---|
| | Budget £000 | Actual £000 | Variance £000 |
| Investments | -205 | -311 | -106 |
| Borrowings | 810 | 990 | 180 |
| Sub Total | 605 | 679 | 74 |
| Rechage to Capital | | -137 | -137 |
| Net Interest Cost | 605 | 542 | -63 |

The net position is shown as underspent against budget at the end of quarter 2, a net nil position is estimated at year end. It should be noted that the investment position is very volatile as is dependent of levels of interest payable by our counterparties.

3.6 New Long Term Borrowing

Two loans were taken from the PWLB in this quarter, the first for £55m, and the second for £58m. These loans have been taken for the future funding of the Mersey Gateway project to take advantage of historically low PWLB rates. This borrowing will be invested until needed to fund the project. As the net interest cost will be capitalised for these loans, the net interest costs have been removed from the budget monitoring figures above.

3.7 Policy Guidelines

The Treasury Management Strategy Statement (TMSS) for 2014/15, which includes the Annual Investment Strategy, was approved by the Council on 5th March 2014 with an updated Annual Investment Strategy being approved by the Council on 16th July 2014. 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 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 investments short term with a maximum duration of 12 months in accordance with Sector's credit rating methodology.

To enable the Council to take advantage of low interest rates given by the PWLB, a special council meeting was held on 15th September 2014 to increase the Operational Boundary and Authorised Limit for 2014/15. This enabled the Council to borrow the funds discussed in 3.6 above.

3.8 Treasury Management Indicators

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 are included in the approved Treasury Management Strategy Statement.

## 4.0 DEBT RESCHEDULING

4.1 No debt rescheduling was undertaken during the quarter.

## 5.0 IMPLICATIONS FOR THE COUNCIL'S PRIORITIES

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

## 6.0 RISK ANALYSIS

6.1 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

## 7.0 EQUALITY AND DIVERSITY ISSUES

7.1 There are no issues under this heading.

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

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