REPORT TO:	Executive Board
DATE:	12 February 2015
REPORTING OFFICER:	Operational Director – Finance
PORTFOLIO:	Resources
TITLE:	Treasury Management 2014/15 3rd Quarter: October-December
WARDS:	All Wards

1.0 PURPOSE OF REPORT

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

2.0 RECOMMENDED: That the report be noted.

3.0 SUPPORTING INFORMATION

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

3.1.1 During the quarter ended 31st December:

- Indicators pointed to another quarter of strong GDP growth
- Further robust increases in household spending;
- Jobs growth and real wages picked up;
- CPI inflation fell to 1%;
- The ECB was still struggling to stimulate demand in the euro-zone.

3.1.2 After strong UK GDP growth in 2013 at an annual rate 2.7%, and then in 2014 0.7% in Q1, 0.9% in Q2 2014, Q3 has seen growth fall back to 0.7% in the quarter and to an annual rate of 2.6%. It therefore appears that growth has eased since the surge in the first half of 2014 leading to a downward revision of forecasts for 2015 and 2016, albeit that growth will still remain strong by UK standards.

3.1.3 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 than expected.

3.1.4 The MPC is now focusing on how quickly slack in the economy is being used up. It is also particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back significantly 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.

3.1.5 Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in wage growth 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.

3.1.6 Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November, the lowest rate since September 2002. Forward indications are that inflation is likely to remain around or under 1% for the best part of a year. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed until November. The Autumn Statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated.

3.1.7 The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 and Q3 of 4.6% and 5.0% have been stunning and hold great promise for strong growth going forward. It is therefore confidently predicted that the first increase in the Fed. rate will occur by the middle of 2015.

3.1.8 The Eurozone is facing an increasing threat from deflation. In November the inflation rate fell to 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 and is currently expected to embark on quantitative easing early in 2015 to counter this threat of deflation and to stimulate growth.

3.2 Interest Rate Forecast

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

	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
5yr PWLB rate	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
10yr PWLB rate	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
50yr PWLB rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%

3.2.1 Capita Asset Services undertook a review of its interest rate forecasts on 5 January 2015 after a proliferation of fears in financial markets around the plunge in the price of oil had caused a flight from equities into bonds and from exposure to the debt and equities of emerging market oil producing countries to safe havens in western countries.

3.2.2 These flows were compounded by further fears that Greece could be heading towards an exit from the Euro after the general election on January 25 and financial flows generated by the increasing likelihood that the ECB would soon be starting on full blown quantitative easing (QE) purchase of Eurozone government debt. In addition, there has been a sharp increase in confidence that the US will start increasing the Fed. rate by the middle of 2015 due to the stunning surge in GDP growth in quarters 2 and 3 of 2014. This indicated that the US is now headed towards making a full recovery from the financial crisis of 2008.

3.2.3 The result of the combination of the above factors is that we have seen bond yields plunging to phenomenally low levels, especially in long term yields. These falls are unsustainable in the longer term but just how quickly these falls will unwind is hard to predict. In addition, positive or negative developments on the world political scene could have a major impact in either keeping yields low or prompting them to recover back up again. We also have a UK general election coming up in May 2015; it is very hard to predict what its likely result will be and the consequent impact on the UK economy, and how financial markets will react to those developments.

3.2.4 This latest forecast includes a move in the timing of the first increase in Bank Rate from quarter 2 of 2015 to quarter 4 of 2015 as a result of the sharp fall in inflation due to the fall in the price of oil and the cooling of the rate of GDP growth in the UK, albeit, that growth will remain strong by UK standards, but not as strong as was previously forecast. The Governor of the Bank of

England, Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual.

3.2.5 The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when average disposable income is only currently increasing marginally as a result of wage inflation now running slightly above the depressed rate of CPI inflation, though some consumers will not have seen that benefit come through for them. In addition, whatever party or coalition wins power in the next general election, will be faced with having to implement further major cuts in expenditure and / or increases in taxation in order to eradicate the annual public sector net borrowing deficit.

3.3 Short Term Borrowing Rates

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

		Oct		**Nov**		**Dec**	
	Start	**Mid**	**End**	**Mid**	**End**	**Mid**	**End**
	%	%	%	%	%	%	%
Call Money (Market)	0.47	0.47	0.47	0.47	0.47	0.47	0.45
1 Month (Market)	0.51	0.51	0.51	0.51	0.50	0.50	0.50
3 Month (Market)	0.56	0.56	0.55	0.56	0.55	0.56	0.56

3.4 Longer Term Borrowing Rates

		Oct		**Nov**		**Dec**	
	Start	**Mid**	**End**	**Mid**	**End**	**Mid**	**End**
	%	%	%	%	%	%	%
1 Year (Market)	1.06	1.00	1.01	0.98	0.97	0.98	0.98
10 Year (PWLB)	3.29	2.98	3.12	2.96	2.58	2.72	2.64
25 Year (PWLB)	3.86	3.64	3.77	3.64	3.45	3.37	3.30

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 and Investments

3.5.1 Turnover during period

	No of deals	**Turnover £m**
Short Term Borrowing	-	-
Short Term Investments	5	30

3.5.2 Position at Month End

	Oct £m	Nov £m	Dec £m
Total Borrowing	183	183	183
Total Investments	188	188	183
Call Account Balance	23	21	20

3.5.3 Investment Benchmarking – Quarter 3 Only

Benchmark	Benchmark Return %	Performance %	Investment Interest Earned £000
7 day	0.36	0.45	60
1 month	0.38	0.00	-
3 month	0.43	0.47	23
6 month	0.56	0.61	101
12 month	0.87	0.83	211
Total			**395**

This shows that the Council has over achieved the benchmark interest rate return for most investment periods during quarter 3. Due to the Council's strict treasury management guidelines only Counterparties with a very high credit score can be used for 12 months investments, therefore the actual return for 12 months is marginally lower than the benchmark return.

3.5.4 Budget Monitoring

	Net Interest at 31st December 2014				
	Budget Year to Date £000	**Actual Year to Date £000**	**Variance (o/spend) £000**		**Actual inc M Gateway £000**
Investment	(308)	(471)	163		(706)
Borrowing	1,698	1,234	464		2,022
Total	**1,390**	**763**	**627**		**1,316**

The net investment and borrowing position is below the budget to date at the end of quarter 3. It should be noted however that the investment position is very volatile, as is dependent upon interest rates payable by our counterparties.

As the borrowing and investments in relation to the Mersey Gateway scheme are to be funded from future toll revenue and will have no effect upon the Council's revenue budget, they have been excluded from the budget monitoring figures above.

3.6 New Long Term Borrowing

No new loans have been taken in this quarter.

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 for its contribution towards the Mersey Gateway project.

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.