BOROUGH COUNCIL OF WELLINGBOROUGH **AGENDA ITEM 6**

Resources Committee **1 November 2017**

Report of the Section 151 Officer

2017-18 MID YEAR REPORT ON TREASURY MANAGEMENT

1 Purpose of Report

This report aims to keep members informed of treasury management activity, in line with the Treasury Management Strategy Statement (TMSS) which was approved by this Committee on 15 March 2017.

2 Executive Summary

2.1 This report combines the actual performance and investments held as at 30 September 2017 with an overall outline of expected performance for the remainder of the financial year.

2.2 It also includes as an appendix an update on the current UK economy and the forecast for interest rates going forwards. The market and economy are key factors in the level of returns that can be expected from investments and this information should help members understand the wider economic picture and its influences over the rate of return achieved.

3 Appendices

Appendix 1 - Summary of Investment transactions at 30 September 2017

Appendix 2 – Summary of economic background and interest forecast at 30 September 2017

4. **Proposed action: The resources committee is invited to RESOLVE to:**

4.1 **Note the Mid-Year Report on Treasury Management**

5. Background

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management and the Council's treasury management policy requires periodic reports on the routine activity of the treasury management function and operations to be reported to Committee, which includes a mid-year update report. This report fulfils that requirement.

6 Discussion

Annual Investment Strategy:

6.1 The Treasury Management Strategy Statement (TMSS) for 2017-18 was approved by Council on 15 March 2017. The Council's Annual Investment

Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

- Security of Capital
- Liquidity of investments

6.2 The Council also aims to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity.

6.3 The Council has historically invested mainly in Building Societies, which do not necessarily have high credit ratings as defined by the recognised credit rating agencies e.g. Fitch and Moody's. However, at the present time Building Societies are continuing to provide better rates of return, with a good history of credit and as such the credit risk of investing with them is considered acceptable within the parameters outlined in the TMSS. However these do need to be monitored carefully.

6.4 The Treasury Management Strategy allows for up to 25% of available funds (if we exclude our current banking provider) to be invested in individually specified domestic banks and a total of £25m in the larger domestic building societies. Wellingborough's portfolio of investments currently comprises of £6.5m with the domestic Banks and £19m with domestic building societies.

6.5 As illustrated in the economic background in Appendix 2, investment rates available in the market are still historically low, but are likely to start increasing slowly within the next half year.

6.6 The level of funds available for investment purposes in the first half of 2017-18, as reported above, was £25.5m. Many of these funds were non-reserve backed working capital balances and as such were temporary in nature. The level of funds was dependent on the timing of precept and NNDR payments, as well as the receipt of various grants. Progress on the capital programme also influences the level of funds available for investment purposes

2017-18 Performance to date

6.7 Appendix 1 shows a detailed list of the investments held at 30 September 2017. These totalled £25.5m which includes £4.5m in call accounts, with estimated interest receivable for the first 6 months amounting to £138k.

6.8 The profiling and the maturity of these investment are summarised in the following charts:

Chart 1:

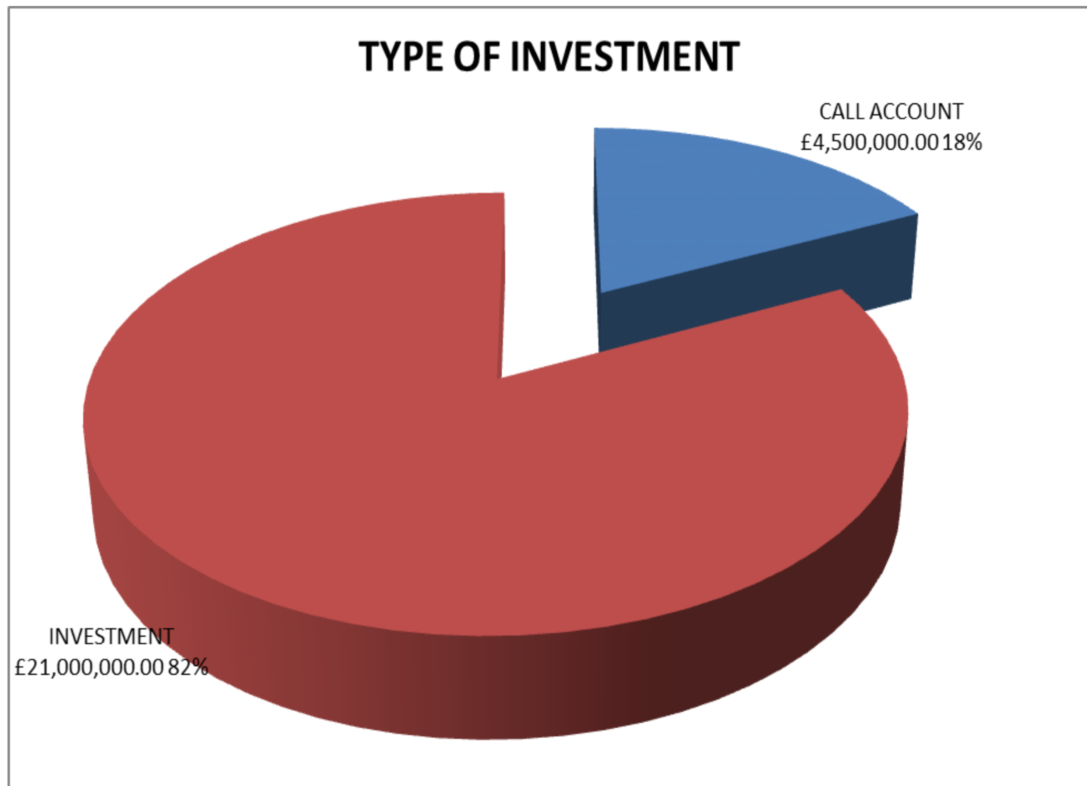
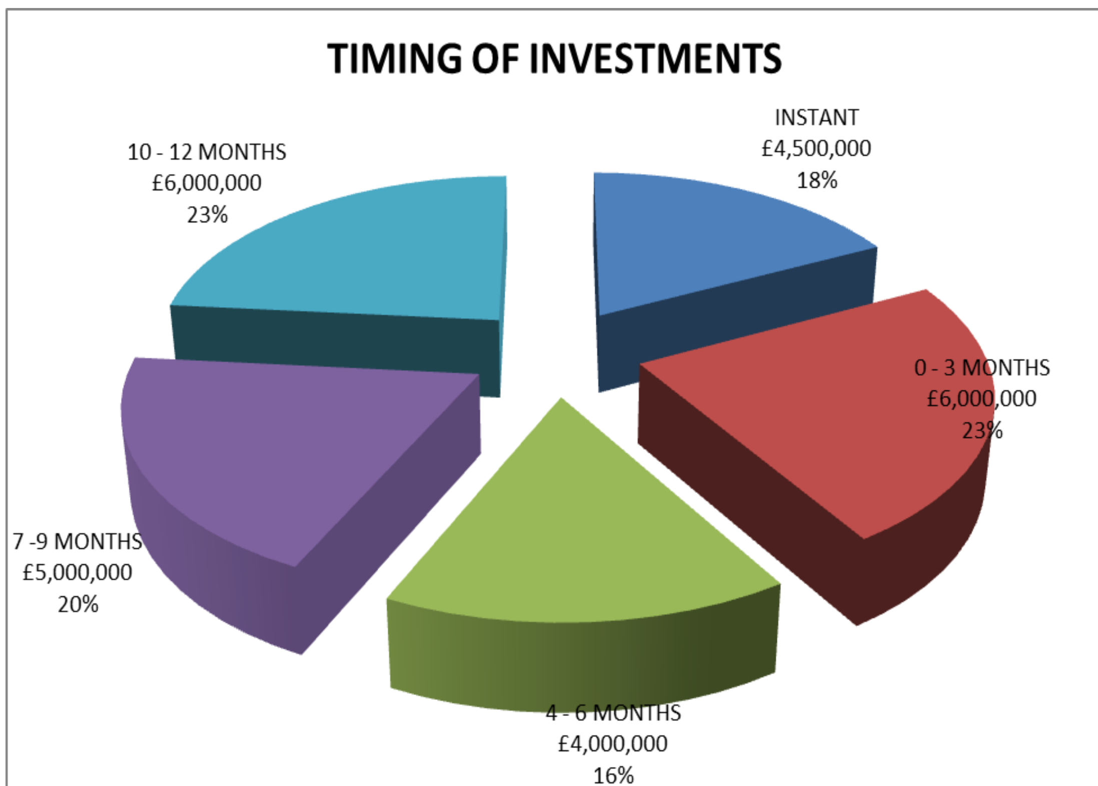


Chart 2:



6.9 The average rate of return, the council has achieved, for the first six month period is 0.77%, compared to the average three months LIBID (London

Interbank Bid Rate) interest rate for the same period of 0.32%.

6.10 The estimated interest receivable for the year is £205k, based on an average annual interest rate of 0.68%, the 2017-18 budget was set at £237k assuming an average rate of return of 0.95%, therefore anticipated performance for the year is approximately £32k below budget and the pressure on the budget for Investment income will be reported as part of the Revenue Monitoring for the year.

6.11 Capita, the Council's treasury management advisers have provided an overview of the current economic climate and this is provided at Appendix 2, as it helps to set the scene within which the Council's treasury management function operates.

6.12 Interest rates are predicted to increase in the near future, as detailed in Appendix 2. The anticipated increase is minor and therefore will only have a minimal impact on our investment interest returns. It is prudent that we continue to forecast our investment interest returns at the current level but amend the 2018-19 budget to reflect any interest rate changes.

6.13 During the first 6 months of 2017-18 there have been two breaches of the Annual Investment Strategy. On both occasions the breaches of the overnight balance had been anticipated and were carefully managed to mitigate any risk to the Council.

6.14 The Chief Financial Officer confirms that the remaining approved limits within the Annual Investment Strategy were not breached during the first six months of 2017-18.

6.15 Other that the issues discussed in 6.13, the Council has complied fully with the requirements of its approved Treasury Management Strategy during the period including use of approved counterparties and investment limits.

7 Legal Powers

Local Government Act 2003.

8 Financial and Value For Money Implications

As stated in the report.

9 Risk Analysis

Nature of risk	Consequences if realised	Likelihood of occurrence	Control measures
Fall in interest rates	Reduced income	Medium	Maintaining as high an average interest rate as possible through a mix of short and longer term fixed and variable rate investments.

Nature of risk	Consequences if realised	Likelihood of occurrence	Control measures
Less funds available for investment	Reduced income	Medium	Regular budget monitoring, allowing for remedial action to be taken.
Loss of capital	Reduced funds available for both capital and revenue purposes	Low	Financial ratings of counterparties and limits on amounts invested. Review of Council's lending policies.

10 Implications for Resources

No direct implications for staffing or property.

11 Implications for Stronger and Safer Communities

No direct implications.

12 Implications for Equalities

No direct implications.

13 Author and Contact Officer

Tracey Cave, Service Accountant

14 Consultees

Liz Elliott, Managing Director

Samantha Knowles, Assistant Director

Julie O'Connell, Accountancy Team Leader

15 Background Papers

Treasury Management Strategy statement 2017-18

Appendix 1

Summary of Investment transactions at 30 September 2017

Loans Investment Number	Borrower	Interest Rate %	Period of Loan	Value of Investment £	Maturity Date
I 3385	Progressive Building Society	0.85	364	2,000,000	27/10/2017
I 3386	Skipton Building Society	0.65	364	1,000,000	31/10/2017
I 3388	Nationwide Building Society	0.59	336	1,000,000	09/10/2017
I 3389	Skipton Building Society	0.65	364	2,000,000	08/12/2017
I 3391	National Counties Building Society	0.78	364	1,000,000	02/01/2018
I 3394	Progressive Building Society	0.76	364	1,000,000	04/04/2018
I 3395	Principality Building Society	0.64	306	1,000,000	06/02/2018
I 3396	Nottingham Building Society	0.68	335	1,000,000	12/03/2018
I 3399	Santander Bank	0.85	364	2,000,000	29/05/2018
I 3400	Principality Building Society	0.76	364	2,000,000	12/06/2018
I 3401	Newcastle Building Society	0.80	364	1,000,000	05/07/2018
I 3402	National Counties Building Society	0.82	364	2,000,000	25/07/2018
I 3406	Newcastle Building Society	0.82	364	2,000,000	02/08/2018
I 3407	Nottingham Building Society	0.53	184	1,000,000	15/02/2018
I 3408	Nottingham Building Society	0.77	364	1,000,000	12/09/2018
I 3393	Bank of Scotland	0.15	CALL	1,500,000	CALL
I 3398	Bank of Scotland	0.15	CALL	1,000,000	CALL
I 3403	Bank of Scotland	0.15	CALL	250,000	CALL
I 3404	Bank of Scotland	0.15	CALL	250,000	CALL
I 3405	Bank of Scotland	0.15	CALL	1,500,000	CALL
	Total			25,500,000	

Appendix 2

Summary of Economic Background and Outlook at 30 September 2017

UK. After the UK economy surprised on the upside with strong growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.3% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y) 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 referendum, feeding increases in 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 GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong 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, this 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.

The Monetary Policy Committee (MPC) meeting of 14 September 2017 surprised markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise. The Bank of England Inflation Reports during 2017 have clearly flagged up that they expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years time. Inflation actually came in at 2.9% in August, (this data was released on 12 September), and so the Bank revised its forecast for the peak to over 3% at the 14 September meeting MPC. This marginal revision can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment falling to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of increasing globalisation. This effectively means that the UK labour faces competition from overseas labour e.g. in outsourcing work to third world countries, and this therefore depresses the negotiating power of UK labour. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so would be inflationary over the next few years.

It therefore looks very likely that the MPC will increase Bank Rate to 0.5% in November or, if not, in February 2018. The big question after that will be whether this will be a one off increase or the start of a slow, but regular, increase in Bank Rate. As at the start of October, short sterling rates are indicating that financial markets do not expect a second increase until May 2018 with a third increase in November 2019. However, some forecasters are flagging up that they expect growth to improve significantly in 2017 and into 2018, as the fall in inflation will bring to an end the negative impact on consumer spending power while a strong export performance will compensate for weak services sector growth. If this scenario were to materialise, then the MPC would have added reason to embark on a series of slow but gradual increases in Bank Rate during 2018. While there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two years will pan out.

EU. Economic growth in the EU, (the UK's biggest trading partner), has been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and now looks to have gathered ongoing substantial strength and momentum thanks to this stimulus. GDP growth was 0.5% in quarter 1 (2.0% y/y) and 0.6% in quarter (2.3% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in August inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019.

USA. Growth in the American economy has been volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1%, resulting in an overall annualised figure of 2.1% for the first half year. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.4%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with three increases since December 2016; and there could be one more rate rise in 2017 which would then lift the central rate to 1.25 – 1.50%. There could then be another four more increases in 2018. At its June meeting, the Fed strongly hinted that it would soon begin to unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

Chinese 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 is struggling to stimulate consistent significant 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.

Interest rate forecasts

The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.50%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%
50yr PWLB rate	2.70%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%

Capita Asset Services undertook its last review of interest rate forecasts on 9 August after the quarterly Bank of England Inflation Report. There was no change in MPC policy at that meeting. However, the MPC meeting of 14 September revealed a sharp change in sentiment whereby a majority of MPC members said they would be voting for an increase in Bank Rate "over the coming months". It is therefore possible that there will be an increase to 0.5% at the November MPC meeting. If that happens, the question will then be as to whether the MPC will stop at just withdrawing the emergency Bank Rate cut of 0.25% in August 2016, after the result of the EU withdrawal referendum, or whether they will embark on a series of further increases in Bank Rate during 2018.