BOROUGH COUNCIL OF WELLINGBOROUG **AGENDA ITEM 6**

Resources Committee **31 October 2018**

Report of the Section 151 Officer

2018-19 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 21 March 2018.

2 Executive Summary

2.1 This report combines the actual performance and investments held as at 30 September 2018 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 2018

Appendix 2 – Summary of economic background and interest forecast at 30 September 2018

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 2018-19 was approved by council on 21 March 2018. 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
- Yield from its investments

6.2 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. All potential investees are monitored carefully and on a regular basis.

6.3 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 totals £24m, comprised of £8m with three domestic banks and £16m with nine domestic building societies.

6.4 As illustrated in the economic background in appendix 2, investment rates are expected to continue at low levels in the medium-term, but have nonetheless increased over recent months, driven by the rise in the Bank of England's base rate by 0.25%, from 0.50% to 0.75%, at the beginning of August 2018. Although the increase is only modest in absolute terms, it is proportionately large and has meant that current investments are being entered into at significantly higher rates than those previously available.

6.5 The level of funds available for investment purposes in the first half of 2018-19, as reported above, was £24m. 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

2018-19 Performance to date

6.6 Appendix 1 shows a detailed list of the investments held at 30 September 2018. These totalled £24m which includes £4m in call accounts, with estimated interest receivable for the first 6 months amounting to £108k.

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

Chart 1:

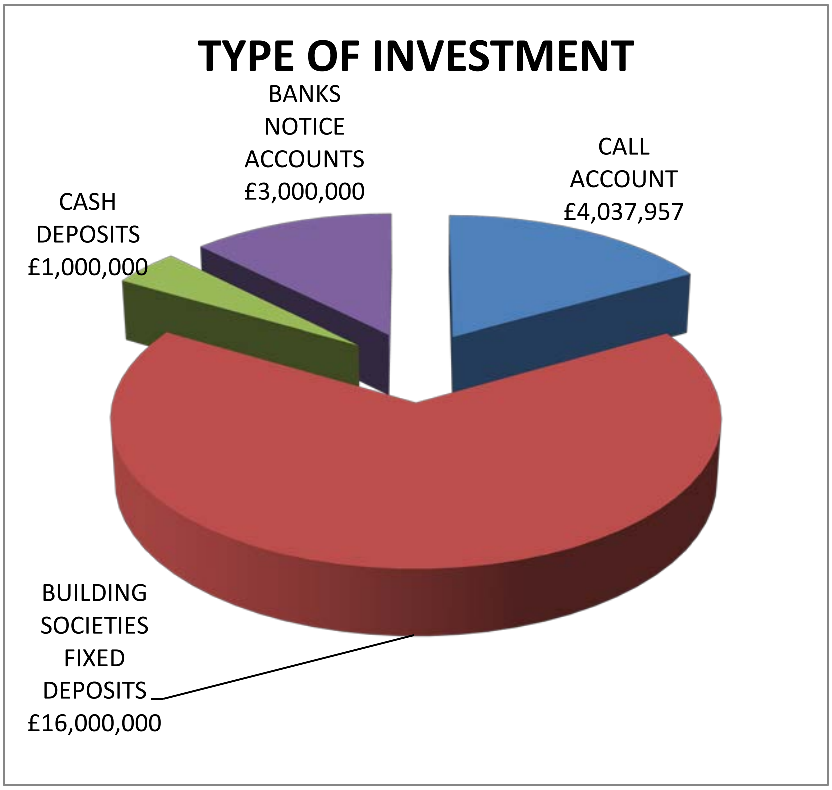
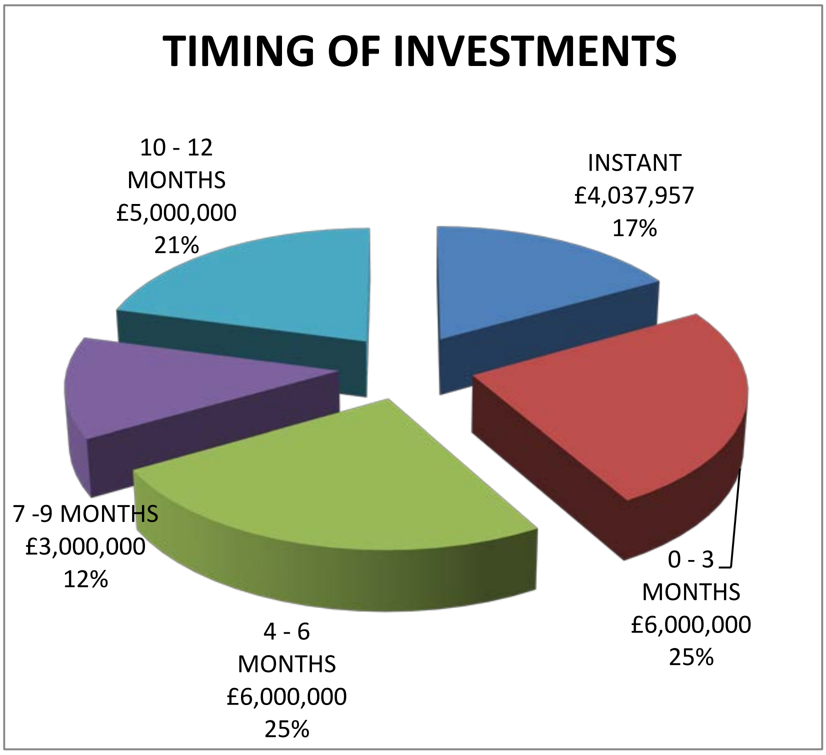


Chart 2:



6.8 The average rate of return that the council has achieved for the first six month period is 0.97%, compared to the average three months LIBID (London Interbank Bid Rate) interest rate for the same period of 0.75%.

6.9 The estimated interest receivable for the year is £226k, based on an average annual interest rate of 0.83%. The 2018-19 budget was set at £205k assuming an average rate of return of 0.78%, therefore anticipated performance for the year is approximately £21k above budget and the surplus on the budget for investment income will be reported as part of the revenue monitoring process for the year.

6.10 Link Asset Services, the council's treasury management advisers, have provided an overview of the current economic climate and this is set out at appendix 2, as it helps to set the scene within which the Council's treasury management function operates.

6.11 The table in appendix 2 predicts that the Bank of England base rates are likely to remain stable for the rest of the current financial year, before beginning to rise steadily again in the middle of 2019-20, .However the investment rates are slowly increasing in anticipation of future increases. This will produce significant effect on future investment interest returns. The projected impact of this will be incorporated into the 2019-20 budget and medium-term forecasts for the following years.

6.12 The chief financial officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2018-19.

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.
Less funds available for investment	Reduced income	Medium	Regular budget monitoring, allowing for remedial action to be

Nature of risk	Consequences if realised	Likelihood of occurrence	Control measures
			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 S151 Officer

Tony Furber, Interim Deputy S151 Officer

Julie O'Connell, Finance Manager

15 Background Papers

Treasury Management Strategy Statement 2018-19

Appendix 1

Summary of Investment transactions at 30 September 2018

Loans Investment Number	Borrower	Interest Rate %	Period of Loan	Value of Investment £	Maturity Date
I 3409	West Bromwich Building Society	0.82	364	1,000,000	08/10/2018
I 3412	Saffron Building Society	0.80	365	1,000,000	01/11/2018
I 3413	Progressive Building Society	0.88	364	1,000,000	06/11/2018
I 3416	West Bromwich Building Society	0.90	364	1,000,000	07/12/2018
I 3419	National Counties Building Society	0.90	364	1,000,000	08/01/2019
I 3420	Saffron Building Society	0.93	364	1,000,000	13/02/2019
I 3423	Nottingham Building Society	0.96	364	1,000,000	15/03/2019
I 3428	Saffron Building Society	1.03	364	1,000,000	15/04/2019
I 3429	Nottingham Building Society	1.00	364	1,000,000	15/04/2019
I 3433	Santander Bank	0.95	365	1,000,000	31/05/2019
I 3434	West Bromwich Building Society	0.74	183	1,000,000	12/12/2018
I 3435	Furness Building Society	0.78	184	1,000,000	03/01/2019
I 3436	Newcastle Building Society	0.92	364	1,000,000	04/07/2019
I 3437	National Counties Building Society	1.02	359	2,000,000	19/07/2019
I 3438	National Westminster PLC	0.90	186	1,000,000	04/02/2019
I 3439	Santander Bank	1.10	194	1,000,000	12/02/2019
I 3440	Monmouthshire Building Society	1.03	364	1,000,000	16/08/2019
I 3441	Santander Bank	1.00	95	1,000,000	19/11/2018
I 3442	Progressive Building Society	1.05	364	1,000,000	11/09/2019
	Bank Of Scotland Call Account	0.65	CALL	4,037,957	
	Total			24,037,957	

Appendix 2

Summary of Economic Background and Outlook at 30 September 2018

UK. 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 2nd August 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.

Some 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.

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.

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, our central position is that Prime Minister May's 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.

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 Fed 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 Fed in the second half of 2019.

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.

CHINA. 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 - has been struggling to stimulate consistent significant GDP 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 Forecast

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

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%

The flow of generally positive economic statistics after the end of the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, to 0.75%. However, the MPC emphasised again, that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a medium term forecast. We do not think that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. We also feel that the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.