ANNEX C

TREASURY MANAGEMENT POSITION 2019/20 – QUARTER 1

1.0 LEGISLATIVE REQUIREMENT:

1.1 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (Treasury Management Strategy Statement, Annual and Mid-year reports, as well as quarterly updates). This report therefore ensures this Council is implementing best practice in accordance with the Code.

1.2 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This Quarter 1 report therefore updates Members on the current treasury management position and is presented to Cabinet and also Audit, Governance and Standards Committee.

1.3 The Council's treasury management position is based on its requirement to fund the capital programme and it's operational cash flow need. The Council looks to balance the requirement to borrow from external sources with the surplus funds that are available.

1.4 During 2018/19 the Council supported its Capital Expenditure by capital receipts, reserves, revenue contribution, long term borrowing , as wells as short term borrowing and the use of surplus funds for cash flow purposes. The short term borrowing was taken and repaid in Quarter 1 of 2019/20. The council continues to have an underlying need to borrow for capital purposes and has three long term external borrowing loans totalling £12,700,000 these were undertaken from the Public Works Loan Board (PWLB).

1.5 The capital financing requirement in 2019/20, which is the amount of borrowing required to support the capital expenditure programme, is set at £77,665,383. The capital expenditure of the Council is mainly supported by grants, contributions and reserves. The capital financing requirement refers to the amount of borrowing that could be taken to support the capital expenditure programme.

1.6 The following table shows the treasury management position as at 30 June 2019:-

	30 June 19 £000's	Rate %
Capital Financing Requirement	77,665	
Borrowing	12,700	2.39
Investments	330	0.73

Table 1: Borrowing and Investment position at 30 June 2019

1.7 The table shows that changes in the capital expenditure programme only affects the treasury management position through the surplus funds that are available to the Council to invest, to earn investment income.

2.0 THE ECONOMY, INTEREST RATES AND TREASURY MANAGEMENT STRATEGY:

2.1 The economic background and interest rate forecast, which sets the environment in which the Council's treasury management operates, is attached at Annex D.

3.0 ANNUAL INVESTMENT STRATEGY 2019/20 – QUARTER 1:

3.1 The Treasury Management Strategy Statement (TMSS) for 2019/20 which includes the Annual Investments Strategy, was approved by the Council on 26 February 2019. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity;
- Yield

3.2 The Council's priority is security of its surplus funds when investing with financial institutions. However the Council will always aim to achieve the optimum return (yield) on investments in line with its risk appetite and which is commensurate with proper levels of liquidity and security. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months. Investments are placed with highly credit rated financial institutions, using the Council's treasury Management advisers – Link Asset Services - suggested creditworthiness approach including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Link Asset Services.

3.3 The average level of funds available for investment purposes during Quarter 1 – 30 June 2019 - was £4,613 187. The level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme. The Council held £330,000 cash flow movement balances at the end of Quarter 1.

3.4

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	0.56%	0.73%	£8,408

Table 2: Investment performance for quarter 1 at 30 June 2019

3.5 The table shows that the Council monitors its cash flow investments against the 7 day rate. The Council outperformed the 7 day benchmark by 0.17%.

3.6 The Council's budgeted investment return for 2019/20 was approved at £35,000 for cashflow investment interest and £1,459,600 for Capital Interest, the Quarter 1 monitoring report will report increased income from capital investments of £15,160 resulting in a new budget of £1,474,760.

4.0 BORROWING 2019/20 – QUARTER 1

4.1 The Council had short term borrowing of £2,000,000 and long term borrowing of £12,700,000 at the beginning of 2019/20. The short term borrowing was repaid in the first quarter of 2019/20. The long term borrowing consists of three loans with the Public Works Loan Board (PWLB). One loan has an interest rate of 1.05% and will be repaid on 5th September 2021. £9,000,000 is due to be repaid on 7th March 2069 and has a rate of 2.45% and £2,500,000 has a maturity date of 25th March 2064 and has a rate of 2.24%.

4.2 The Council's budgeted borrowing expenditure interest for 2019/20 was approved at £280,670, the Quarter 1 monitoring report will request increased expenditure on interest from borrowing by £12,430 due to higher than budgeted Public Loans Work Board (PWLB) interest rates resulting in a new budget of £293,100. At Quarter 1 £72,574 of interest was paid on the loans previously taken.

4.3 Public Works Loan Board (PWLB) rates have been on a general falling trend during most of this quarter to reach lows during June. This fall has been largely caused by a fall in US Treasury yields as investors have become increasingly concerned that the US economy is heading towards a sharp fall in GDP growth. The 50 year PWLB target (certainty) rate for new long term borrowing started at 2.50% and fell to 2.40%.

4.4 The table below shows the Public Works Loans Board interest rates which were available for loans during Quarter 1 of 2019/20. The Public Works Loans Board is the mechanism by which the Government allows local authorities to borrow at slightly lower interest rates than are available to other institutions. Certainty rates, as detailed in the table, are interest rates available to local authorities if they inform the Government of their borrowing requirements at the beginning of the financial year and are 0.02% (or 20 basis points) below Public Works Loans Board rates. This was introduced by the Government in October 2012.

	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2019	1.46%	1.52%	1.84%	2.41%	2.24%
30/06/2019	1.43%	1.41%	1.68%	2.30%	2.16%
Low	1.39%	1.38%	1.64%	2.25%	2.11%
Date	06/06/2019	07/06/2019	18/06/2019	07/06/2019	14/06/2019
High	1.58%	1.73%	2.07%	2.58%	2.41%
Date	15/04/2019	17/04/2019	17/04/2019	17/04/2019	17/04/2019
Average	1.49%	1.55%	1.86%	2.42%	2.26%

Table 3: Public Works Loan Board (PWLB) certainty rates, quarter ended 30 June 2019

4.5 **Treasury Borrowing**: Due to the overall financial position and the underlying need to borrow for capital purposes, external borrowing of £12,700,000 has been taken by the Council from the Public Works Loan Board (PWLB), a breakdown of the total borrowing can be seen at 4.1.

4.6 It is anticipated that more borrowing will be required during the financial year 2019/20 to support the overall Capital Programme and for cash flow purposes. The Council will remain under the affordable borrowing limit of £81,000,000 set in the Treasury Management Strategy 2019/20 on 12 February 2019.

4.7 **Rescheduling of Borrowing**: the Council did not reschedule any of the long term loans.

4.8 **Repayment of Borrowing**: the Council repaid a short term loan from 2018/19 of £2,000,000 in Quarter 1 of 2019/20. The Council took a short term loan of £1,000,000 during Quarter 1 from a Local Authority on 24 May 2019 at a rate of 0.90% for cash flow purposes. This was repaid on 3 June 2019.

5.0 <u>COMPLIANCE WITH PRUDENTIAL AND TREASURY INDICATORS</u>:

5.1 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 (affordability limits) were approved in the Treasury Management Strategy Statement by Council on 26 February 2019 and are in compliance with the Council's Treasury Management Practices.

5.2 During the financial year to date the Council has operated within the Treasury and Prudential Indicators approved which are attached at Annex E.

5.3 Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the Quarter ended 30 June 2018.

ANNEX D

Economic Update

1.1 ECONOMIC BACKGROUND:

United Kingdom

After only tepid annual economic growth of 1.4% in 2018, growth in quarter 1 was unexpectedly strong at 0.5%. However, this was boosted by stock building ahead of the original March Brexit deadline so quarter 2 is now expected to be zero or slightly negative.

After the Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August 2018, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the Monetary Policy Committee until the uncertainties over Brexit clear. If there were a no deal exit, it is likely that Bank Rate would be cut in order to support growth. Nevertheless, the Monetary Policy Committee does have concerns over the trend in wage inflation which peaked at a new post financial crisis high of 3.5%, (excluding bonuses), in the three months to December before falling marginally to 3.4% more recently. Growth in employment fell to only 32,000 in the three months to April, well below the 2018 average, while the unemployment rate remained at 3.8 percent, its lowest rate since 1975. Correspondingly, the total level of vacancies has risen to new highs.

As for Consumer Price Index inflation itself, this rose slightly to 2.1% in April before falling back again to 2.0% in May, and is likely to remain around this level over the next two years. If there was a no deal Brexit though, it could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.

The rise in wage inflation and fall in Consumer Price Index inflation is good news for consumers as their spending power is improving in this scenario as the difference between the two figures is now around 1.3%, i.e. a real terms increase. 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.

USA

President Trump's massive easing of fiscal policy in 2018 fuelled a (temporary) boost in consumption in 2018 which generated an upturn in the rate of growth to 2.9% for 2018, just below his target of 3%. Growth in quarter 1 of 2019 was a strong 3.1% but current expectations are for this to weaken considerably in quarter 2. The strong growth in employment numbers during 2018 has faded more recently, indicating that the economy is cooling, while inflationary pressures are also weakening. After the Fed increased rates by 0.25% in December to between 2.25% and 2.50%, market expectations have swung to now expecting the Fed to cut rates by 1.0% - 1.25% in total to counter the expected downturn in growth. Financial markets have priced in a first cut of 0.25% for July.

Eurozone

The annual rate of growth for 2018 was 1.8% but is expected to fall to possibly around half that rate in 2019. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the European Central Bank to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels "at least through the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a third round of Targeted Longer-Term Refinancing Operations (TLTROs); this provides banks with cheap borrowing every three months from September 2019 until March 2021 which means that, although they will have only a two-year maturity, the Bank is making funds available until 2023, two years later than under its previous policy. As with the last round, the new Targeted Longer-Term Refinancing Operations (TLTROs) will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans. However, the downturn now appears to be gathering momentum so market expectations have moved on to expecting possibly a small increase in the deposit rate from -0.4% to -0.5% and a resumption of quantitative easing, but possibly more focused on purchases of corporate debt than government debt.

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 Gross Domestic Product 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.

World Growth

The trade war between the US and China on tariffs is a major concern not only to financial markets and China itself, but also for world growth, as any downturn in China will spill over into impacting countries supplying raw materials to China. Concerns are focused on the synchronised general weakening of growth in the major economies of the world compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns have resulted in government bond yields in the developed world falling significantly during 2019, which has then caused equity prices to rise. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US), and there are concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks.

1.2 INTEREST RATE FORECAST:

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

	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate	0.75	0.75	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.50
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.20	1.30	1.40	1.40	1.40
6 Month LIBID	0.80	0.90	0.80	0.90	1.00	1.20	1.40	1.50	1.60	1.60	1.60
12 Month LIBID	1.00	1.00	1.10	1.20	1.30	1.40	1.50	1.60	1.70	1.80	1.80
5yr PWLB Rate	1.50	1.60	1.70	1.80	1.90	2.00	2.10	2.10	2.20	2.30	2.40
10yr PWLB Rate	1.80	1.90	2.00	2.10	2.20	2.30	2.40	2.50	2.60	2.60	2.70
25yr PWLB Rate	2.40	2.50	2.60	2.70	2.80	2.90	3.00	3.00	3.10	3.20	3.30
50yr PWLB Rate	2.30	2.40	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20

After the August 2018 increase in Bank Rate to 0.75%, the first above 0.5% since the financial crash, the Monetary Policy Committee has put any further action on hold, probably until such time as the fog of Brexit might clear and there is some degree of certainty of what the UK will be heading into. The above forecast, is based on a central assumption that there will be some form of muddle through agreement on a reasonable form of Brexit. Bank Rate forecasts will have to change if this assumption does not materialise e.g. a no deal Brexit on 31 October could well prompt the Monetary Policy Committee to do an immediate cut of 0.5% in Bank Rate back to 0.25%. All other forecasts for investment and borrowing rates would also have to change.

The balance of risks to the UK

- The overall balance of risks to economic growth in the United Kingdom is probably to the downside due to the weight of all the uncertainties over Brexit.
- The balance of risks to increases in Bank Rate and shorter term Public Works Loan Board rates are broadly similarly to the downside.