TREASURY MANAGEMENT UPDATE FOR THE QUARTER ENDED 31 DECEMBER 2014

To:	**Governance & Audit Committee – 17 March 2015**
Main Portfolio Area:	**Finance**
By:	**Section 151 Officer**
Classification:	**Unrestricted**

Summary: **To Update the Governance & Audit Committee on Treasury Activity during the Quarter ended 31 December 2014**

For Information

1.0 Introduction and Background

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 (TMSS), annual and mid-year reports). This report therefore ensures this Council is implementing best practice in accordance with the Code.

2.0 Capita's Economic Background (issued by the Council's treasury advisor, Capita Asset Services, on 6 January 2015)

2.1 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 (annual rate 3.2% in Q2), 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. 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. The Monetary Policy Committee (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. 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.

2.2 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.

2.3 The U.S. Federal Reserve (Fed) ended its monthly asset purchases in October 2014. U.S. 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.

2.4 The Eurozone (EZ) 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 European Central Bank (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.

3.0 Capita's Interest Rate Forecast (issued by Capita on 6 January 2015)

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

	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 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. 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 US 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.

3.3 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.

3.4 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. 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.

4.0 Annual Investment Strategy

4.1 The Treasury Management Strategy Statement (TMSS) and revised TMSS for 2014/15, which includes the Annual Investment Strategy, were approved by the Council on 6 February 2014 and 2 October 2014 respectively. They set out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield

4.2 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 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 370 days, with highly credit rated financial institutions, using the suggested Capita Credit List (which includes sovereign credit rating and Credit Default Swap (CDS) overlay information).

4.3 Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 31st December 2014.

4.4 Investment rates available in the market have been broadly stable during the quarter and have continued at historically low levels as a result of the ultra-low Bank Rate and other extraordinary measures such as the Funding for Lending Scheme. The average level of funds available for investment purposes during the quarter was £40.213m. These funds were available on a temporary basis, and 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 does not invest funds for over 370 days.

4.5 The yield on deposits for the quarter ended 31 December 2013 was 0.50% against a benchmark (average 7-day LIBID rate) of 0.36%. The Council's budgeted deposit return for 2014/15 is £0.148m, and performance for the year to date is above budget at £0.162m.

5.0 Borrowing

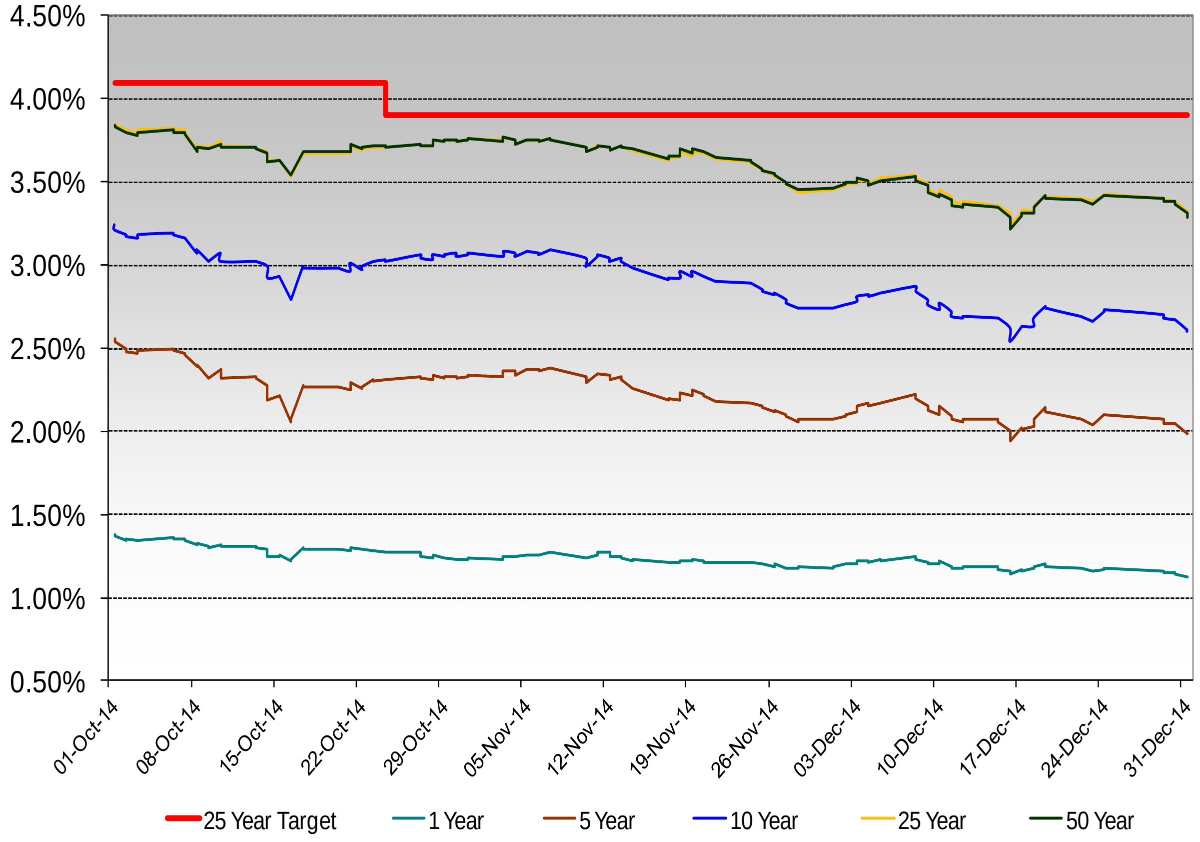
5.1 Capita's 25 year PWLB target (certainty) rate for new long term borrowing fell from 4.10% to 3.90% in late October. Due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement - CFR), new external borrowing was undertaken in Q3 2014/15 from the PWLB as shown below:

- £1,800,000 advanced on 23 October 2014 and repayable by equal instalments of principal over 21 years at 3.08% pa.

5.2 PWLB certainty rates, quarter ended 31st December 2014

(Please note that the graph below is unable to show separate lines for 25 and 50 year rates as those rates were almost identical)

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.12%	1.94%	2.54%	3.24%	3.22%
Date	31/12/2014	16/12/2014	16/12/2014	16/12/2014	16/12/2014
High	1.38%	2.56%	3.24%	3.85%	3.84%
Date	01/10/2014	01/10/2014	01/10/2014	01/10/2014	01/10/2014
Average	1.24%	2.23%	2.91%	3.60%	3.60%



5.3 Debt rescheduling opportunities have been limited in the current economic climate and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. During the quarter ended 31st December 2014 no debt rescheduling was undertaken.

6.0 Compliance with Treasury and Prudential Limits

6.1 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) are included in the approved TMSS.

6.2 During the financial year to date the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

7.0 Options

That the Governance & Audit Committee approves this report.

8.0 Corporate Implications

8.1 Financial and VAT

8.1.1 There are no financial or VAT implications arising directly from this report.

8.2 Legal

8.2.1 It is best practice that this report is brought before the Governance & Audit Committee for approval, under the CIPFA Treasury Management Code of Practice.

8.3 Corporate

8.3.1 This report evidences that the Council continues to carefully manage the risk associated with its treasury management activities.

8.4 Equity and Equalities

8.4.1 There are no equity or equality issues arising from this report.

9.0 Recommendation(s)

9.1 That the Governance & Audit Committee approves this report.

10.0 Decision Making Process

10.1 This report is presented to the 17 March 2015 Governance & Audit Committee meeting for approval.

11.0 Disclaimer

11.1 This report is a technical document focussing on public sector investments and borrowings and, as such, readers should not use the information contained within the report to inform personal investment or borrowing decisions. Neither Thanet District Council nor any of its officers or employees makes any representation or warranty, express or implied, as to the accuracy or completeness of the information contained herein (such information being subject to change without notice) and shall not be in any way responsible or liable for the contents hereof and no reliance should be placed on the accuracy, fairness or completeness of the information contained in this document. Any opinions, forecasts or estimates herein constitute a judgement and there can be no assurance that they will be consistent with future results or events. No person accepts any liability whatsoever for any loss howsoever arising from any use of this document or its contents or otherwise in connection therewith.

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Annex List

N/A	

Corporate Consultation Undertaken

Finance	N/A
Legal	N/A