Treasury Management Mid-year Report for 2016/17

SUMMARY **Report to advise members of the Treasury Management Service performance for 2016/17 as at 30th September 2016 and to illustrate the compliance to-date with the Prudential Indicators for 2016/17.**

PORTFOLIO – Finance (Councillor Richard Brooks) **Date signed off: 16/11/16**	
WARDS AFFECTED	**All**

RECOMMENDATION **(i) The Executive is advised to NOTE and COMMENT on the report;**

1. Executive Summary

1.1 This report sets out the performance of the Council's investments and borrowing for the first six months of the year. It is also intended to demonstrate that the Council is complying with the Prudential Indicators set by Full Council as part of the Treasury Strategy.

1.2 The Council is exceeding its budgeted treasury income by £32k or 20% and is complying with all the Prudential Indicators set for 2016/17 as at the 30th September 2016

2. Key Issues

Background

2.1 The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end).

2.2 The Authority's Treasury Management Strategy for 2016/17 was approved by Executive on 13th January 2016.

2.3 The Authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risk.

Local Context

2.4 At 31/3/2016 the Authority's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £18.1m, while usable reserves and working capital which are the underlying resources available for investment were £20.4m on an accruals basis. The Authority had £17.9m of external borrowing and £27.7m of investments.

2.5 The Authority is predicted to have an increasing CFR over the next 3 years due to the capital programme however this could increase significantly if further investment in property is undertaken.

Changes since the 30th September 2016

2.6 The Council approved an increase in its borrowing limit of £35m to fund property purchases together with changes to its Prudential Indicators on the 9th November 2016. As this report covers the first 6 months of the year only those changes are not reflected within it.

3. Treasury Performance

Borrowing Activity to 30th September 2016

3.1 At 30/9/2016 the Authority held £17.3m of borrowing, (a decrease of £0.6m on 31/3/2016), as part of its strategy for funding previous years' capital programmes.

3.2 At the 30th September 2016 the Council expected to borrow up to £122m with an upper limit of £132m. However subsequent to this in order to fund further property investment the limit was raised in November 2016 to £167m with an expectation that £157m would be borrowed.

3.3 The Authority's chief objective when borrowing continues to be striking an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

3.4 Affordability remained an important influence on the Authority's borrowing strategy particularly as interest rates are currently low.

3.5 Post referendum, the fall in yields and PWLB rates was more pronounced as evidenced in Tables 2 and 3 in Appendix 2.

Borrowing Activity to the 30th September 2016

	Balance	Maturin	Debt	New	Balance	Avg Rate

	on 01/04/2016 £m	g Debt £m	Prematurely Repaid £m	Borrowing £m	on 30/09/2016 £m	% and Avg Life (yrs)
CFR	18.1				17.6	
Short Term Borrowing[1]						
Long Term Borrowing - PWLB - Local Authorities - Commercial Lenders		(0.5)			(0.5)	2.90% - 28 years
TOTAL BORROWING	18.1	(0.5)			17.6	
Other Long Term Liabilities						
TOTAL EXTERNAL DEBT	18.1	(0.5)			17.6	
Increase/ (Decrease) in Borrowing £m					(0.5)	

[1] Loans with maturities less than 1 year.

Investment Activity to 30th September 2016

3.6 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held.

3.7 The Guidance on Local Government Investments in England gives priority to security and liquidity and the Authority's aim is to achieve a yield commensurate with these principles.

3.8 The transposition of European Union directives into UK legislation places the burden of rescuing failing EU banks disproportionately onto unsecured local authority investors through potential bail-in of unsecured bank deposits including certificates of deposit.

3.9 Given the increasing risk and continued low returns from short-term unsecured bank investments, it is the Authority's aim to diversify into more secure and/or higher yielding asset classes. This is especially the case for the estimated £8m that is available for longer-term investment. The majority of the Authority's surplus cash is invested in short-term unsecured bank deposits, and money market funds.

Investment Activity in 2016/17

Investment Counterparty	Balance on 01/04/16	Investments Made	Maturities/ Investments Sold	Balance on 30/09/16	Average Rate at 30/09/16
	£000s	£000s	£000s	£000s	%
UK Central Government - Short Term - Long Term	**0**	19,500	-19,500	**0**	0.15
UK Local Authorities - Short Term - Long Term	**5,500** **2,000**		-1,500	**4,000** **2,000**	0.93 1.30
Banks, Building Societies & Other Organisations - Short Term - Long Term	**5,259**	38,703	-34,126	**9,835**	0.31
AAA-rated Money Market Funds - Short Term Cash Equivalents - Long Term	**6,973** **7,962**	19,524 449	-16,500	**9,996** **8,411**	0.48 8.79
Total Investments	**27,694**	**78,176**	**-71,627**	**34,243**	**3.84**

3.10 Security of capital has remained the Authority's main investment objective. This has been maintained by following the Authority's counterparty policy as set out in its Treasury Management Strategy Statement for 2016/17.

3.11 Counterparty credit quality was assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating for institutions defined as having "high credit quality" is A- across rating agencies Fitch, S&P and Moody's); credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

Credit Risk

3.12 The table below shows counterparty credit quality as measured by credit ratings and the percentage of the in-house investment portfolio exposed to bail-in risk.

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating	Investments exposed to bail-in risk
31/03/2016	4.26	AA-	2.35	AA+	50%
31/06/2016	4.84	A+	3.35	AA	65%
30/09/2016	4.69	A+	3.12	AA	67%

<u>Scoring:</u>
-Value weighted average reflects the credit quality of investments according to the size of the deposit

-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

3.13 The Council has sought to balance risk against return by diversifying across a wide range of banks, building societies, local authorities and money market funds. The poor returns offered by banks linked to the Bank of England base Rate being so low has meant that the Council has moved investments into property, corporate bond and equity managed funds. These provide better returns but are subject to the volatility of the underlying investments hence any investment needs to be made for the longer term. This policy of diversified investment should mean that the Council will exceed the budgeted interest earned for 2016/17 depending on financial markets .

Counterparty Update

3.14 Various indicators of credit risk reacted negatively to the result of the referendum on the UK's membership of the European Union. UK bank credit default swaps saw a modest rise but bank share prices fell sharply, on average by 20%, with UK-focused banks experiencing the largest falls. Non-UK bank share prices were not immune although the fall in their share prices was less pronounced.

3.15 Fitch downgraded the UK's sovereign rating by one notch to AA from AA+, and Standard & Poor's downgraded its corresponding rating by two notches to AA from AAA. Fitch, S&P and Moody's have a negative outlook on the UK. S&P took similar actions on rail company bonds guaranteed by the UK Government. S&P also downgraded the long-term ratings of the local authorities to which it assigns ratings as well as the long-term rating of the EU from AA+ to AA, the latter on the agency's view that it lowers the union's fiscal flexibility and weakens its political cohesion.

3.16 Moody's affirmed the ratings of nine UK banks and building societies but revised the outlook to negative for those that it perceived to be exposed to a more challenging operating environment arising from the 'leave' outcome.

3.17 There was no immediate change to Arlingclose's credit advice on UK banks and building societies as a result of the referendum result. Our advisor believes there is a risk that the uncertainty over the UK's future trading prospects will bring forward the timing of the next UK recession.

3.18 The European Banking Authority released the results of its 2016 round of stress tests on the single market's 51 largest banks after markets closed on Friday 29th July. The stress tests gave a rather limited insight into how large banks might fare under a particular economic scenario. When the tests were designed earlier this year, a 1.7% fall in GDP over three years must have seemed like an outside risk. Their base case of 5.4% growth now looks exceptionally optimistic and the stressed case could be closer to reality. No bank was said to have failed the tests. The Royal Bank of Scotland made headline news as one of the worst performers as its ratios fell by some of the largest amounts, but from a relatively high base. Barclays Bank and Deutsche Bank ended the test with Common Equity Tier 1 (CET1) ratios below the 8% threshold, and would be required to raise more capital should the stressed scenario be realised. The tests support our cautious approach on these banks.

3.19 In July Arlingclose completed a review of unrated building societies' annual financial statements. Cumberland, Harpenden and Vernon Building Society were removed from Arlingclose's advised list, following deterioration in credit indicators. The maximum advised maturity was also lowered for eleven societies from 6 months to 100 days due to the uncertainty facing the UK property market following the EU referendum.

Budgeted Income and Outturn

3.20 The average cash balances were £34m during the half year. The UK Bank Rate had been maintained at 0.5% since March 2009 until August 2016, when it was cut to 0.25%. It is now forecast to fall further towards zero but not go negative. Short-term money market rates have remained at relatively low levels (see Table 1 in Appendix 2). Following the reduction in Bank Rate, rates for very short-dated periods (overnight – 1 month) fell to between 0.1% and 0.2%. Debt Management Account Deposit Facility (DMADF) rates fell to 0.15% for periods up to 3 months and to 0.10% for 4 – 6 month deposits.

3.21 New investments on an unsecured basis with banks and building societies over the 6-month period were made at an average rate of 0.54%. Short-term money market rates have remained at relatively low levels.

3.22 The Authority's budgeted investment income for the year is estimated at £300k of which £182k has been received in the first six months..

3.23 The Bank Rate is expected to be cut further towards zero in the coming months, which will in turn lower the rates short-dated money market investments with banks and building societies. As the majority of the Authority's surplus cash continues to be invested in short-dated money market instruments, it will most likely result in a fall in investment income over the year.

Update on Investments with Icelandic Banks

3.24 The Council originally had £4m at risk in Iceland due to the collapse of the Icelandic banks in 2008. Over the intervening years this money was repaid in instalments however at the 31st March 2016 a balance of ISK135bn, which represented the remainder of the Council's claim against Glitnir Bank, remained due to Icelandic currency controls. In June 2016 the Icelandic Government announced that they would allow foreign deposits in ISK to be exchanged for one last time in a currency auction. If this opportunity was not taken then the money could remain trapped for several years and indeed be subject to a steep exit payment. On the advice of the Council's professional advisors the decision was taken to take advantage of this offer and the final balance held in Iceland was repaid as Euro712k. This is currently being held on deposit with the Council's bankers.

3.25 As a consequence of this there is no more money held in Iceland and the Council has received slightly more than the £4m originally deposited.

Compliance with Prudential Indicators

3.26 The Authority confirms compliance with its Prudential Indicators for 2016/17, which were set in January 2016 as part of the Authority's Treasury Management Strategy Statement. Details of treasury-related Prudential Indicators can be found in Appendix 1.

Economic Review and Outlook for the remainder of the year

3.27 The Council's advisors Arlingclose have provided an Economic Review of the year so far and an outlook for Qtrs 3 and 4. This is included in Annex D

4. Resource Implications

4.1 None directly as a result of this paper, but the investment income is used to support the current revenue expenditure.

5. Options

5.1 The Executive is asked to note on comment on the report as appropriate.

6. Proposals

6.1 It is proposed that the Executive NOTE and COMMENT on the report;

7. Corporate Objectives and Key Priorities

7.1 The Treasury Management processes support the Council's objective of 'Delivering services efficiently, effectively and economically'.

8. Policy Framework

8.1 The Council fully complies with the requirements of the CIPFA Code of Practice on
Treasury Management. The current relevant criteria and constraints incorporated
into the Treasury Management Policy Statement are:

- New borrowing is to be contained within the limits approved by the Council, in accordance with the CIPFA Prudential Code for Capital Finance in Local Authorities, and the Council's prudential indicators.

- Investments to be made in accordance with the CLG guidance on Local Authority Investments, on the basis of Fitch, Moody's and Standard & Poors credit ratings and as detailed in the Treasury Management Policy statement and approved schedules and practices.

- Sufficient funds to be available to meet the Council's estimated outgoings for any day.

- Investment objectives are to maximise the return to the Council balanced against the risks to protect reserves.

9. Legal Issues

9.1 The report demonstrates that the Council is complying with the Prudential Framework.

10. Risk Management

10.1 Weak returns on investments could lead to a reduction in income required to support the revenue budget.

10.2 The limits in this report in respect to counterparties and investments are the overall limits for agreement by Council. However from time to time these may be tightened temporarily by the Head of Corporate Finance in consultation with the portfolio holder for Resources to reflect increased uncertainty and increase in perceived risk in financial institutions and the economy. This will usually be at the cost of lower returns.

10.3 The Council has taken and acted on advice from its advisors in relation to increasing returns albeit at increased risk. These investments may go up or down in value and the full capital sum is not protected

10.4 The investments ratings provided by credit ratings agencies are only a guide and do not give 100% security. There is always a risk that an institution may be unable to repay its loans whatever the credit rating.

11. Officer Comments

11.1 None other than within the report.

ANNEXES	**Annex A – Investments as at 30th September 2014** **Annex B – Treasury Management Performance Indicators**
BACKGROUND PAPERS	**CIPFA code on Treasury Management**

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HEAD OF SERVICE	Kelvin Menon – Executive Head of Finance

Consultations, Implications and Issues Addressed

	Required	Consulted	Date
Resources			
Revenue	✓		
Capital			
Human Resources			
Asset Management			
IT			
Other Issues			
Corporate Objectives & Key Priorities	✓		
Policy Framework			
Legal			
Governance			
Sustainability			
Risk Management			
Equalities Impact Assessment			
Community Safety			
Human Rights			
Consultation			
P R & Marketing			

INVESTMENTS as at 30th September 2016

	£	Maturity Date	
Lloyds Bank Call Account	3,001,510	Instant Access	A+
Goldman Sachs Bank	2,000,000		A
Total Banks	**5,001,510**		
National Counties Building Society	1,000,000	12-Jan-17	
Nationwide Building Society	2,000,000	07-Oct-16	A
Total Building Society	**3,000,000**		
Debt Management Office	0		
Total Banks, Building Societies and DMO	**8,001,510**		
Glasgow City Council	2,000,000	30-Oct-18	Unrated
Greater London Authority	2,000,000	28-Oct-16	AA+
The London Borough of Islington	2,000,000	28-Oct-16	Unrated
Total Local Authorities	**6,000,000**		
AAA Rated MM Fund - Aberdeen (SWIP)	2,983,927	N/A	AAA
AAA Rated MM Fund - Blackrock	2,000,431	N/A	AAA
AAA Rated MM Fund - CCLA	1,000,000	N/A	AAA
AAA Rated MM Fund - Insight	1,011,732	N/A	AAA
AAA Rated MM Fund - Standard Life (Ignis)	3,000,000	N/A	AAA
Total Money Market Funds	**9,996,090**		
CCLA Property Fund	2,042,540	N/A	None
M & G Investments - Global Dividend Fund	1,095,671	N/A	None
M & G Investments - Strategic Corp Bond Fund	2,097,168	N/A	None
Threadneedle - Global Equity Income Fund	1,170,465	N/A	None
Threadneedle - Strategic Bond Fund	2,005,317	N/A	None
Total Longer Term Investments	**8,411,160**		
Total Invested (excluding the NatWest SIBA)	**32,408,760**		
NatWest SIBA	1,216,980	Instant Access	BBB+
NatWest International Account	616,910		
Total Invested (including NatWest SIBA)	**£34,242,650**		

The Council’s advisors Arlingclose have provided an Economic Review of the year so far and an outlook for Qtrs 3 and 4. This is included in Annex D

Treasury Management Indicators as at the 30th September 2016

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as an amount of net principal borrowed will be:

	2016/17	2017/18	2018/19
Upper limit on fixed interest rate exposure	£132m	£132m	£132m
Actual	£0.2m		
Upper limit on variable interest rate exposure	£132m	£132m	£132m
Actual	-£0.2m		

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower	Actual
Under 12 months	100%	0%	2%
12 months and within 24 months	100%	0%	2%
24 months and within 5 years	100%	0%	17%
5 years and within 10 years	100%	0%	4%
10 years and within 20 years	100%	0%	11%
20 years and within 30 years	100%	0%	15%
30 years and within 40 years	100%	0%	21%
Over 40 years	100%	0%	27%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than 364 days: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2016/17	**2017/18**	**2018/19**
Limit on principal invested beyond year end	£15m	£15m	£15m
Actual	£2m	£8m	£0m

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average [credit rating] or [credit score] of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target	**Actual 30/09/2016**
Portfolio average credit rating	A	A+

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	Target	**Actual 30/09/2016**
Total cash available within 3 months	£5m	£14m

1) Outlook for the remainder of 2016/17

The economic outlook for the UK has immeasurably altered following the popular vote to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU, particularly with regard to Single Market access.

The short to medium-term outlook as been more downbeat due to the uncertainty generated by the result and the forthcoming negotiations. Economic and political uncertainty will likely dampen or delay investment intentions, prompting lower activity levels and potentially a rise in unemployment. The downward trend in growth apparent on the run up to the referendum may continue through the second half of 2016, although some economic data has held up better than was initially expected, perhaps suggesting a less severe slowdown than feared.

Arlingclose has changed its central case for the path of Bank Rate over the next three years. Arlingclose believes any currency-driven inflationary pressure will be looked through by Bank of England policymakers. Arlingclose's central case is for Bank Rate to remain at 0.25%, but there is a 40% possibility of a drop to close to zero, with a small chance of a reduction below zero.

Gilt yields are forecast to be broadly flat from current levels, albeit experiencing short-term volatility.

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

Global interest rate expectations have been pared back considerably. There remains a possibility that the Federal Reserve will wait until after November's presidential election, and probably hike interest rates in in December 2016 but only if economic conditions warrant.

In addition, Arlingclose believes that the Government and the Bank of England have both the tools and the willingness to use them to prevent market-wide problems leading to bank insolvencies. The cautious approach to credit advice means that the banks currently on the Authority's counterparty list have sufficient equity buffers to deal with any localised problems in the short term.

Appendix 1

Prudential Indicators as at the 30th September 2016

The Local Government Act 2003 requires the Authority to have regard to CIPFA's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure: The Authority's planned capital expenditure and financing may be summarised as follows. Further detail is provided in the capital programme outturn..

Capital Expenditure and Financing	**2015/16 Actual £m**	**2016/17 Estimate £m**	**2017/18 Estimate £m**	**2018/19 Estimate £m**
Capital Programme	18	**107**	4	1
Total Expenditure	**18**	**107**	**4**	**1**
Capital Receipts	1	0	0	0
Government Grants	0	1	0	0
Borrowing	17	106	4	0
Total Financing	**18**	**107**	**4**	**1**

Estimates of Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose.

Capital Financing Requirement	**31.03.16 Actual £m**	**31.03.17 Estimate £m**	**31.03.18 Estimate £m**	**31.03.19 Estimate £m**
Total CFR	**18**	**139**	**142**	**142**

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt	**31.03.16 Actual**	**31.03.17**	**31.03.18 Estimate**	**31.03.19 Estimate**

	£m	Estimat e £m	£m	£m
Borrowing	18	124	127	127
Total Debt	**18**	**124**	**127**	**127**

The figures above could increase significantly if the council decides to invest in more property.

The actual debt levels are monitored against the Operational Boundary and Authorised Limit for External Debt, below.

Operational Boundary for External Debt: The Operational Boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.

Operational Boundary	2016/17 £m	2017/18 £m	2018/19 £m
Borrowing	122	122	122
Total Debt	**122**	**122**	**122**

The Authority confirms that during 2016/17, the Operational Boundary was not breached.
In November 2016, the Council increased the Operational Boundary to £157m and the Authorised Limit to £167m.

Authorised Limit for External Debt: The Authorised Limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2016/17 £m	2017/18 £m	2018/19 £m
Borrowing	132	132	132
Total Debt	132	132	132

Total debt at 30/09/2016 was £17.2m. The Authority confirms that during 2016/17 the Authorised Limit was not breached at any time.

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %
General Fund	-15	-36	-37

Incremental Impact of Capital Investment Decisions: This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed earlier in this report.

Incremental Impact of Capital Investment Decisions	2016/17 Estimate £	2017/18 Estimate £	2018/19 Estimate £
General Fund - increase in annual Band D Council Tax	-15.49	-34.58	-69.46

Adoption of the CIPFA Treasury Management Code: The Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services at its meeting on 26th February 2014.*

Appendix 2

Economic Review provide by the Council's Treasury advisors Arlingclose

1) The preliminary estimate of Q2 2016 GDP showed reasonably strong growth as the economy grew 0.7% quarter-on-quarter, as compared to 0.4% in Q1 and year/year growth running at a healthy pace of 2.2%. However the UK economic outlook changed significantly on 23rd June 2016. The surprise result of the referendum on EU membership prompted forecasters to rip up previous projections and dust off worst-case scenarios. Growth forecasts had already been downgraded as 2016 progressed, as the very existence of the referendum dampened business investment, but the crystallisation of the risks and the subsequent political turmoil prompted a sharp decline in household, business and investor sentiment.

2) The repercussions of this plunge in sentiment on economic growth were judged by the Bank of England to be severe, prompting the Monetary Policy Committee to initiate substantial monetary policy easing at its August meeting to mitigate the worst of the downside risks. This included a cut in Bank Rate to 0.25%, further gilt and corporate bond purchases (QE) and cheap funding for banks (Term Funding Scheme) to maintain the supply of credit to the economy. The minutes of the August meeting also suggested that many members of the Committee supported a further cut in Bank Rate to near-zero levels (the Bank, however, does not appear keen to follow peers into negative rate territory) and more QE should the economic outlook worsen.

3) In response to the Bank of England's policy announcement, money market rates and bond yields declined to new record lows. Since the onset of the financial crisis over eight years ago, Arlingclose's rate outlook has progressed from 'lower for longer' to 'even lower for even longer' to, now, 'even lower for the indeterminable future'.

4) The new members of the UK government, particularly the Prime Minister and Chancellor, are likely to follow the example set by the Bank of England. After six years of fiscal consolidation, the Autumn Statement on 23rd November is likely to witness fiscal initiatives to support economic activity and confidence, most likely infrastructure investment. Tax cuts or something similar cannot be ruled out.

5) Whilst the economic growth consequences of BREXIT remain speculative, there is uniformity in expectations that uncertainty over the UK's future trade relations with the EU and the rest of the world will weigh on economic activity and business investment, dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment. These effects will dampen economic growth through the second half of 2016 and in 2017.

6) Meanwhile, inflation is expected to pick up due to a rise in import prices, dampening real wage growth and real investment returns. The August Quarterly *Inflation Report* from the Bank of England forecasts a rise in CPI to 0.9% by the end of calendar 2016 and thereafter a rise closer to the Bank's 2% target over

the coming year, as previous rises in commodity prices and the sharp depreciation in sterling begin to drive up imported material costs for companies.

7) The rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes, concentrating instead on the negative effects of Brexit on economic activity and, ultimately, inflation.

8) Market reaction: Following the referendum result gilt yields fell sharply across the maturity spectrum on the view that Bank Rate would remain extremely low for the foreseeable future. The yield on the 10-year gilt fell from 1.37% on 23rd June to a low of 0.52% in August, a quarter of what it was at the start of 2016. The 10-year gilt yield has since risen to 0.69% at the end of September. The yield on 2- and 3-year gilts briefly dipped into negative territory intra-day on 10th August to -0.1% as prices were driven higher by the Bank of England's bond repurchase programme. However both yields have since recovered to 0.07% and 0.08% respectively. The fall in gilt yields was reflected in the fall in PWLB borrowing rates, as evidenced in Tables 2 and 3 in Appendix 2.

9) On the other hand, after an initial sharp drop, equity markets appeared to have shrugged off the result of the referendum and bounced back despite warnings from the IMF on the impact on growth from 'Brexit' as investors counted on QE-generated liquidity to drive risk assets.

10) The most noticeable fall in money market rates was for very short-dated periods (overnight to 1 month) where rates fell to between 0.1% and 0.2%

<u>Appendix 2</u>

Money Market Data and PWLB Rates

The average, low and high rates correspond to the rates during the financial year rather than those in the tables below.

Please note that the PWLB rates below are <u>Standard Rates</u>. Authorities eligible for the Certainty Rate can borrow at a 0.20% reduction. Borrowing eligible for the project rate can be undertaken at a 0.40% reduction.

Table 1: Bank Rate, Money Market Rates

Date		**Bank Rate**		**O/N LIBID**	**7-day LIBID**	**1-month LIBID**	**3-month LIBID**	**6-month LIBID**	**12-month LIBID**	**2-yr SWAP Bid**	**3-yr SWAP Bid**	**5-yr SWAP Bid**
01/4/2016		0.50		0.36	0.36	0.39	0.46	0.61	0.88	0.78	0.83	0.98
30/4/2016		0.50		0.36	0.36	0.38	0.47	0.62	0.90	0.86	0.95	1.13
31/5/2016		0.50		0.35	0.37	0.39	0.46	0.61	0.89	0.82	0.92	1.09
30/6/2016		0.50		0.35	0.36	0.39	0.43	0.55	0.80	0.49	0.49	0.60
31/7/2016		0.50		0.15	0.45	0.42	0.52	0.64	0.77	0.47	0.47	0.54
31/8/2016		0.25		0.11	0.18	0.18	0.38	0.54	0.69	0.42	0.42	0.48
30/9/2016		0.25		0.10	0.25	0.45	0.51	0.61	0.74	0.43	0.42	0.47
Minimum		0.25		0.02	0.15	0.18	0.30	0.50	0.66	0.38	0.37	0.42
Average		0.43		0.26	0.37	0.42	0.52	0.66	0.83	0.61	0.64	0.75
Maximum		0.50		0.43	0.55	0.61	0.72	0.83	1.04	0.88	0.99	1.20
Spread		0.25		0.41	0.40	0.43	0.42	0.33	0.38	0.51	0.62	0.78

Table 2: PWLB Borrowing Rates – Fixed Rate, Maturity Loans (Standard Rate)

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/4/2016	125/16	1.33	1.82	2.51	3.24	3.33	3.19	3.15
30/4/2016	165/16	1.37	1.95	2.65	3.34	3.40	3.25	3.21
31/5/2016	205/16	1.36	1.93	2.56	3.22	3.27	3.11	3.07
30/6/2016	249/16	1.17	1.48	2.09	2.79	2.82	2.61	2.57
31/7/2016	292/16	1.07	1.31	1.84	2.57	2.65	2.48	2.44
31/8/2016	336/16	1.09	1.23	1.65	2.22	2.29	2.12	2.08
30/9/2016	380/16	1.02	1.20	1.70	2.34	2.43	2.29	2.27
	Low	1.01	1.15	1.62	2.20	2.27	2.10	2.07
	Average	1.20	1.54	2.12	2.81	2.87	2.70	2.67
	High	1.40	2.00	2.71	3.40	3.46	3.31	3.28

Table 3: PWLB Borrowing Rates – Fixed Rate, Equal Instalment of Principal (EIP) Loans (Standard Rate)

Change Date	Notice No	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/4/2016	125/16	1.50	1.86	2.54	2.99	3.25	3.34
30/4/2016	165/16	1.59	1.99	2.68	3.11	3.34	3.42
31/5/2016	205/16	1.58	1.97	2.58	2.99	3.23	3.30
30/6/2016	249/16	1.24	1.51	2.11	2.55	2.79	2.86
31/7/2016	292/16	1.13	1.34	1.87	2.31	2.58	2.67
31/8/2016	336/16	1.12	1.25	1.67	2.02	2.23	2.31
30/9/2016	380/16	1.05	1.22	1.72	2.13	2.36	2.44
	Low	1.03	1.17	1.64	2.00	2.20	2.28
	Average	1.30	1.57	2.15	2.58	2.82	2.89
	High	1.63	2.04	2.73	3.17	3.41	3.48

Table 4: PWLB Variable Rates (standard rate)

	1-M Rate	3-M Rate	6-M Rate	1-M Rate	3-M Rate	6-M Rate
	Pre-CSR	Pre-CSR	Pre-CSR	Post-CSR	Post-CSR	Post-CSR
1/4/2016	0.61	0.65	0.67	1.51	1.55	1.57
30/4/2016	0.61	0.65	0.67	1.51	1.55	1.57
31/5/2016	0.65	0.66	0.70	1.55	1.56	1.60
30/6/2016	0.64	0.62	0.62	1.54	1.52	1.52
31/7/2016	0.55	0.48	0.45	1.45	1.38	1.35
31/8/2016	0.38	0.41	0.48	2.18	1.31	1.38
30/9/2016	0.38	0.40	0.48	1.28	1.30	1.38

Please note PWLB rates are standard rates