REPORT TO:	Executive Board
DATE:	16 November 2017
REPORTING OFFICER:	Operational Director, Finance
PORTFOLIO:	Resources
TITLE:	Treasury Management Half Year Report 2017-18
WARDS:	Borough-wide

1.0 PURPOSE OF REPORT

1.1 The purpose of this report is to provide an update regarding activities undertaken on the money market as required by the Treasury Management Policy.

2.0 RECOMMENDED: That the report be noted.

3.0 SUPPORTING INFORMATION

Economic Outlook

3.1 The following analysis of the economic situation has been provided by Capita Asset Services, the Council's treasury management advisors.

3.2 During the six months ended 30 September 2017:

- The economy struggled to pick up much pace;
- There was an intensifying squeeze on households' real earnings;
- The labour market tightened further, but underlying wage pressures remained weak;
- The MPC took a more hawkish turn;
- A snap General Election delivered a hung Parliament;
- Face-to-face negotiations with the EU began but have lacked "significant progress;
- The public finance performed better than expected;
- Headline inflation picked up further.

3.3 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% and quarter 2 was +0.3% 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

3.4 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 MPC meeting. 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 force faces competition from overseas labour e.g. in outsourcing work to developing economies, 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.

3.5 The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. CPI has started rising during 2017 as the falls in the price of oil and food twelve months ago fall out of the calculation during the year and, in addition, the post referendum 10% fall in the value of sterling on a trade weighted basis is likely to result in a 3% increase in CPI over a time period of 3-4 years. However, the Monetary Policy Committee is expected to look through a one off upward blip from this devaluation of sterling in order to support economic growth, especially if pay increases continue to remain subdued and therefore pose little danger of stoking core inflationary price pressures within the UK economy.

3.6 It therefore looks very likely that the MPC will increase the 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.

3.7 Economic growth in the EU, (the UK's biggest trading partner), has been lack lustre for several years after the financial crisis despite the European Central Bank (ECB) eventually cutting its main rate to -0.4% and embarking on a massive programme of quantitative easing (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 and 0.6% in quarter. 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.

3.8 Japan is still bogged down in anaemic growth and making little progress on fundamental reform of the economy while Chinese economic growth has been weakening and medium term risks have been increasing.

3.9 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 1.50%.

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.

3.10 Interest Rate Forecast

The following forecast has been provided by Capita Asset Services.

	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%

3.11 Short Term Borrowing Rates

The bank base rate remained at 0.25% between April and September 2017.

	Mar	Apr	May	Jun	Jul	Aug	Sep
	%	%	%	%	%	%	%
Call Money (Market)	0.22	0.22	0.22	0.21	0.22	0.22	0.22
1 Month (Market)	0.25	0.26	0.25	0.25	0.25	0.25	0.25
3 Month (Market)	0.34	0.33	0.29	0.31	0.29	0.28	0.34

3.12 Longer Term Borrowing Rates

	Mar	Apr	May	Jun	Jul	Aug	Sep
	%	%	%	%	%	%	%
1 Year (Market)	0.83	0.82	0.85	1.08	0.98	0.90	1.14
10 Year (PWLB)	1.97	1.97	1.87	2.12	2.08	1.91	2.23
25 Year (PWLB)	2.60	2.63	2.54	2.73	2.72	2.58	2.79

Market rates are based on LIBOR rates and PWLB rates are for new loans based on principal repayable at maturity. The rates are shown for the end of each month.

3.13 **Borrowing and Investments**

Turnover During the Period

	No of deals	Turnover £m
Short Term Borrowing	2	5
Short Term Investments	17	158

Position at Month End

	Mar £m	Apr £m	May £m	Jun £m	Jul £m	Aug £m	Sep £m
Total Borrowing	153	153	153	153	143	143	143
Total Investments	(103)	(103)	(93)	(68)	(68)	(68)	(68)
Call Account Balance	(18)	(19)	(26)	(17)	(9)	(14)	(31)

Investment Benchmarking

Benchmark	Benchmark Return %	Performance Apr - Sep %	Investment Interest Earned £000
7 day	0.12	0.23	24
1 month	0.14	0.17	9
3 month	0.24	0.34	29
6 month	0.40	0.62	60
12 month	0.63	0.62	47
Property Fund		5.12	114
Total			**283**

This shows the Council has over achieved or almost matched all benchmarks for the first 6 months of the year.

At 30 September 2017 Halton Borough Council hold £5m in the CCLA Local Authority Property Fund. There is no benchmark available for this income.

New Long Term Borrowing

3.14 No new long term borrowing has been taken in this period.

Policy Guidelines

3.15 The Treasury Management Strategy Statement (TMSS) for 2017/18, which includes the Annual Investment Strategy, was approved by the Council on 08 March 2017. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield

3.16 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 and the heightened credit concerns it is considered appropriate to keep the majority of investments short term and to ensure all investments are in in line with Sector's credit rating methodology.

Treasury Management Indicators

3.17 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 were set out in the Treasury Management Strategy Statement and are reviewed in Appendix 1.

Debt Rescheduling

3.18 No debt rescheduling was undertaken during the quarter.

4.0 POLICY IMPLICATIONS

4.1 None.

5.0 FINANCIAL IMPLICATIONS

5.1 The financial implications are as set out in the report.

6.0 IMPLICATIONS FOR THE COUNCIL'S PRIORITIES

6.1 There are no direct implications, however, the revenue budget and capital programme support the delivery and achievement of all the Council's priorities.

7.0 RISK ANALYSIS

7.1 The main risks with Treasury Management are security of investment and volatility of return. To combat this, the Authority operates within a clearly defined Treasury Management Policy and annual borrowing and investment strategy, which sets out the control framework

8.0 EQUALITY AND DIVERSITY ISSUES

8.1 None.

9.0 LIST OF BACKGROUND PAPERS UNDER SECTION 100D OF THE LOCAL GOVERNMENT ACT 1972

9.1 There are no background papers under the meaning of the Act.

Appendix 1

Treasury and Prudential Indicators – 2017/18 – Quarter 2

	2016/17	2017/18	
Prudential Indicators	**Full Year Actual £000**	**Original Estimate £000**	**Quarter 2 Estimate £000**
Capital Expenditure	78,511	82,013	129,841
Net Financing Need for the Year *(Borrowing Requirement)*	52,523	60,177	100,588
Increase / (Decrease) in CFR *(Capital Financing Requirement)*	56,369	57,744	98,046
Ratio of Financing Costs to Net Revenue Stream *(Proportion of cost of borrowing to Council's net revenue)*	2.1%	2.0%	2.0%
Incremental Impact on band D Council Tax (£) *(net cost of borrowing compared to tax base)*	2.00	2.44	1.53
External Debt	153,000	173,000	182,000
Operational Boundary *(Limit of which external debit is not epected to exceed)*	252,600	254,164	254,164
Authorised Limit *(Limit beyound which external debit is prohibited)*	270,000	270,000	270,000

Upper Limit for Interest Rate Exposure	**Exposure Limit %**	**2016/17 Actual %**	**2017/18 Estimate %**
Fixed Rate	100	100	100
Variable Rate	30	-	-

Maturity Structure of Fixed Rate Borrowing	**Exposure Limit %**	**2016/17 Actual %**	**2017/18 Estiamte %**
Under 12 months	40	7	0
12 months to 24 months	40	0	0
24 months to 5 years	40	0	0
5 years to 10 years	40	0	0
10 years and above	100	93	100

Maximum Principal invested > 365 days	Investment Limit £000	2016/17 Actual £000	2017/18 Estimate £000
Principal Sums Invested over 365 days	30,000	5,000	0