Appendix A

2018/19 Treasury Management Mid Year Review: Six Months Ended 30 September 2018

1. CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice on Treasury Management (revised 2017) recommends that members be updated on treasury management activities regularly (TMSS, annual and midyear reports). This report therefore ensures this Council is implementing best practice in accordance with the Code.

2. Economic update

- 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.

3. 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.

4. Annual Investment Strategy and Investment Portfolio 2018/19

The Treasury Management Strategy Statement (TMSS) for 2018/19, which includes the Annual Investment Strategy, was approved by the Council on 26 February 2018. It sets out the Council's investment priorities as being:

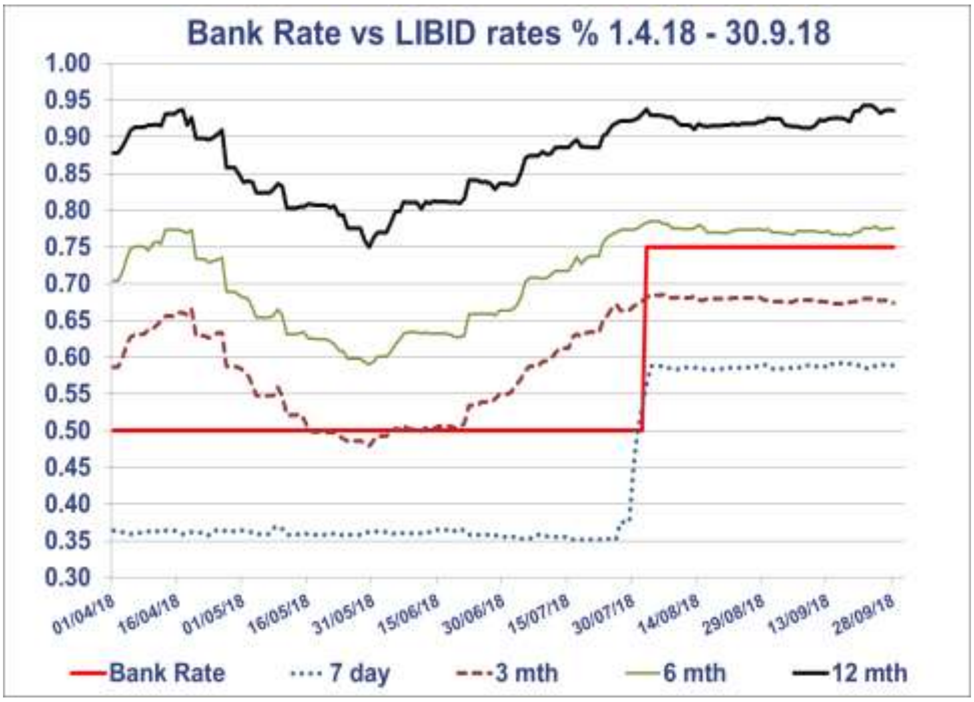
- Security of capital;
- Liquidity; and
- Yield.

The Council will also aim to achieve the optimum return (yield) on its 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 12 months with highly credit rated financial institutions, using our suggested creditworthiness approach.

The Council held £35.1m of investments as at 30 September 2018 (£25.7m at 31 March 2018). The Section 151 Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2018/19.

The Council's budgeted investment return for 2018/19 is £96k, and performance for the year to date is currently above budget achieving an average rate of return of 0.70% compared against a benchmark of the 7 day LIBID rate of 0.59%.

The current investment counterparty criteria selection, approved in the TMSS is meeting the requirement of the treasury management function.



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.75	0.59	0.60	0.68	0.78	0.94
High Date	02/08/2018	14/09/2018	18/09/2018	06/08/2018	03/08/2018	21/09/2018
Low	0.50	0.35	0.37	0.48	0.59	0.75
Low Date	01/04/2018	19/07/2018	30/05/2018	30/05/2018	30/05/2018	30/05/2018
Average	0.58	0.43	0.47	0.61	0.71	0.87
Spread	0.25	0.24	0.23	0.21	0.19	0.19

5. Borrowing

No borrowing was undertaken during the first six months of the year. Based on the current level of investments it is anticipated that further borrowing will not be undertaken during this financial year.

The graph and table below show the movement in PWLB certainty rates for the first six months of the year to date, PWLB rates have not been on any consistent trend during this period. The 50 year PWLB target (certainty) rate for new long term borrowing varied between 2.40% and 2.70% during this period.

	1 Year	5 Year	10 Year	25 Year	50 Year
3.4.18	1.48%	1.84%	2.22%	2.55%	2.27%
30.9.18	1.55%	1.93%	2.33%	2.74%	2.56%
Low	1.28%	1.67%	2.09%	2.50%	2.25%
Date	01/06/2018	29/05/2018	20/07/2018	20/07/2018	29/05/2018
High	1.57%	1.99%	2.43%	2.83%	2.64%
Date	17/04/2018	25/09/2018	25/04/2018	25/09/2018	25/09/2018
Average	1.46%	1.84%	2.25%	2.64%	2.41%

6. Debt Rescheduling

No debt rescheduling has been undertaken to date in the current financial year.

7. Compliance with Treasury and Prudential Limits

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 are included in the approved TMSS.

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. The prudential and treasury Indicators are detailed at the end of this appendix.

8. Other

(a) UK banks – ring fencing

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

(b) IFRS9 accounting standard

This accounting standard came into effect from 1st April 2018. It means that the category of investments valued under the available for sale category will be removed and any potential fluctuations in market valuations may impact onto the Surplus or Deficit on the Provision of Services, rather than being held on the balance sheet. This change is unlikely to materially affect the commonly used types of treasury management investments but more specialist types of investments, (e.g. pooled funds, third party loans, commercial investments), are likely to be impacted.

The Ministry of Housing, Communities and Local Government (MHCLG), are currently conducting a consultation for a temporary override to allow English local authorities time to adjust their portfolio of investments. Members will be updated when the result of this consultation is known.

(c) Changes in risk appetite

The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy should be brought to members' attention in treasury management update reports.

(d) Addition to Minimum Revenue Policy

Where the Council is investing in assets solely with the intention of generating a capital receipt on completion it will defer the charging of MRP until the loan is repaid through receipt of capital receipts. This will be evidenced through explicit setting aside of future Capital Receipts for this purpose at project inception.

9. Prudential and Treasury Indicators as at 30 September 2018

Treasury Indicators	2018-19 Budget £'000	30.09.18 Actual £'000
Authorised limit for external debt	14,000	14,000
Operational boundary for external debt	13,000	13,000
Gross external debt	7,259	1,506
Investments	20,000	35,110
Net borrowing	(12,741)	(33,604)

Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	0%	0%
12 months to 2 years	10%	1.7%
2 years to 5 years	20%	1.5%

5 years to 10 years	30%	0%
10 years to 20 years	100%	0%
20 years to 30 years	100%	0%
30 years to 40 years	100%	96.8%

Upper limit for principal sums invested for over 365 days	6,000	0

Prudential Indicators	2018/19 Budget £'000	30.09.18 Actual £'000
Capital expenditure	9,925	400
Capital Financing Requirement (CFR)	8,921	5,460
Annual change in CFR	2,979	(481)
In year borrowing requirement	3,604	148
Ratio of financing costs to net revenue stream	10.99%	6.29%

10. Investment Portfolio

Investments held as a 30th September 2018:

Institution		Amount	Investment Period: Lend date	Investment Period: Repay date	Terms	Interest Rate %
Money Market / Direct Dealing						
14	Santander UK plc	2,000,000	04/07/2018	18/10/2018	Fixed	0.66%
16	Nottingham Building Society	1,000,000	04/07/2018	12/10/2018	Fixed	0.51%
24	Nationwide Building Society	3,000,000	17/07/2018	18/10/2018	Fixed	0.64%
25	Coventry Building Society	2,000,000	27/07/2018	22/10/2018	Fixed	0.60%
26	National Counties Building Society	2,000,000	01/08/2018	22/10/2018	Fixed	0.64%
5	Santander UK plc	2,000,000	08/08/2018	19/11/2018	Fixed	0.75%
27	Cumberland Building Society	2,000,000	15/08/2018	19/11/2018	Fixed	0.78%
9	Santander UK plc	2,000,000	20/08/2018	20/11/2018	Fixed	0.76%
11	Newcastle Building Society	2,000,000	20/08/2018	20/11/2018	Fixed	0.73%
13	Nottingham Building Society	2,000,000	30/08/2018	20/11/2018	Fixed	0.70%
20	Nottingham Building Society	2,000,000	07/09/2018	14/12/2018	Fixed	0.73%
19	Bank of Scotland	1,000,000	12/09/2018	21/01/2019	Fixed	0.80%
23	Principality Building Society	1,500,000	12/09/2018	19/12/2018	Fixed	0.72%
28	Nottingham Building Society	1,000,000	13/09/2018	19/12/2018	Fixed	0.73%
3	Principality Building Society	1,500,000	19/09/2018	19/12/2018	Fixed	0.74%
Bank of Scotland 95 day notice account		5,000,000			Fixed	0.80%
HSBC Money Market		3,110,000			Fixed	0.38%
		£35,110,000				