Treasury Management Financial Outlook and Quarterly Benchmarking

Financial Review and Outlook for 2018/19

The UK economy still faces a challenging outlook as the government continues to negotiate the country's exit from the European Union. The current soft UK economic environment prompted the MPC not to tighten policy in May. The economic data since then has been mixed, but suggests that GDP growth will recover somewhat in Q2 2018 after the weak expansion in Q1.

Central bank actions and geopolitical risks, such as prospective trade wars, have and will continue to produce significant volatility in financial markets, including bond markets.

The above interest forecast are set against the following background:

- The MPC has maintained expectations of a rise in interest rates this year.
- Our central case is for Bank Rate is to rise once in 2018 and twice more in 2019. The risks are weighted to the downside (0.25% increase reported in August 2018).
- Gilt yields have been volatile, but remain historically low. We expect some upward movement from current levels based on our interest rate projections and the strength of the US economy, but volatility arising from both economic and political events will continue to offer borrowing opportunities.

Credit background:

UK bank credit default swaps rose marginally over the quarter, but the overall level was still low against historic averages.

There were a few credit rating changes during the quarter. Moody's downgraded Barclays Bank Plc's long-term rating to A2 from A1 after the banking group completed its restructure to be compliant with UK bank ring-fencing requirements which come into effect in 2019. The agency also downgraded Royal Bank of Scotland plc's (RBS plc) long-term ratings to Baa2 from A3 on its view that the credit metrics of RBS plc, which will become the non-ring-fenced NatWest Markets plc, will become weaker and less diversified and the main functions of the bank would be in higher risk activities. Moody's and Fitch upgraded the long-term ratings of NatWest Bank and Ulster Bank on the view that their credit profiles are expected to improve following ring-fencing.

Investment Performance

The council's advisors undertake quarterly investment benchmarking across its client base. As reported previously our portfolio was more diversified and at higher interest rates than the average as a result of moving into the bond programme earlier than most clients, but there is now more competition for bonds from both government bodies and other local authorities, so opportunities to replace maturing bonds are limited and we will see a fall in suitable instruments. With this in mind, and following discussions with our advisors, it was decided to move more into property funds, which are a longer term investment, and to restrict temporary borrowing and therefore run our short term investments down.

During the last quarter our investments in bonds has reduced to £13.7M due to maturities and we have maintained the property funds at £27M, with all other cash being placed in either Money Market Funds (MMF), instant access bank accounts and a rolling £3M in a 180 notice account. As a result we had 43% (£31M) of our overall investment in Money Market which is in line with other Unitary Authorities for this time of year but this is expected to fall during the year.

Due to earlier investment decisions our income return on investments managed internally is 0.93% which is higher than the average of 0.60% whilst still maintaining a higher than unitary average credit rating of AA-. Total income return at 2.35% is also higher than the average for both unitary (1.23%) and LA's (1.13%). Our total investment return at 3.34% is again higher than both the both unitary (1.61%) and LA's (1.27%) across Arlingclose's client base and is mainly due to the investments made in property funds but as previously reported the value of the funds are more volatile and can go down as well as up but are less risky than buying individual properties and do not constitute capital spend and it is the income return at 4.63% that is the driver to invest.