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.

In August the MPC voted 9-0 to increase the Bank Rate by 0.25% to 0.75% and maintain the asset purchase programme at £435bn and the corporate bond purchase programme at £10bn. The Bank of England cited very limited slack in the UK economy and a tightening in the labour market as reason for increase. The Bank sees CPI at 2% by Q4 2020 and holding steady there throughout 2021.

Our treasury advisor Arlingclose, latest interest forecast is for a further increase in March 2019 to 1% and again in September to 1.25% with it remaining so until 2021. The interest forecast are set against the following background:

- The MPC has maintained expectations of a slow rise in interest rates in the medium term.

- 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:

There were a few credit rating changes during the quarter, none of which have impacted on our investment strategy.

The ringfencing of the big four UK banks (Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc) is complete and the transfer of their business lines into retail (ringfenced) and investment banking (non-ringfenced) is progressing and will need to be completed by the end of 2018. Following this our treasury advisor will provide ratings which are specific to wholesale deposits including certificates of deposit, rather than provide general issuer credit ratings. Non-preferred senior unsecured debt and senior bonds are at higher risk of bail-in than deposit products, either through contractual terms, national law, or resolution authorities' flexibility during bail-in, their creditworthiness advice will continue to include unsecured bank deposits and CDs but not senior unsecured bonds issued by commercial banks.

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 £7.62M 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 £2M 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 1.05% which is higher than the average of 0.76% whilst still maintaining a higher than unitary average credit rating of AA-. Total income return at 2.38% is also higher than the average for both unitary (1.31%) and LA's (1.17%). Our total investment return at 3.56% is again higher than both the both unitary (1.49%) and LA's (1.25%) 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 4.23% that is the driver to invest.