Leicestershire County Council

CORPORATE GOVERNANCE COMMITTEE – 10 MAY 2019

QUARTERLY TREASURY MANAGEMENT REPORT

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

Purpose of the Report

1. To update the Committee on the actions taken in respect of treasury management for the quarter ending 31 March 2019 (Quarter 4).

Background

2. Treasury Management is defined as:-

   "The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

3. A quarterly report is produced for the Committee to provide an update on any significant events in the area of treasury management.

Economic Background

4. In the UK, Gross Domestic Product (GDP) slowed slightly to 0.3% in the rolling 3 months to February. This continues the downward trend since the strong growth recorded in the summer months. GDP growth was driven mainly by the services (0.4%) and production sectors (0.2%). Construction output for the rolling three months was -0.6%, although it should be noted the construction sector grew by 0.4% in February – driven by private housing and infrastructure.

5. Inflation in the UK (as measured by the Consumer Price Index) eased to 1.8% in January, although this was in line with the Bank of England's expectations it was the first sub 2% reading in two years. This easing was driven by weaker energy inflation as the utility price cap weighed along with lower fuel prices. Going forwards, Ofgem's decision to increase the utility price cap from 1st April should add to inflation and coupled with increasing food inflation (driven by rising agricultural commodity and domestic producer prices), analysts suggest inflation will push back through the 2% level and could hit 2.5% by April.

6. On 21st March, the Bank of England's Monetary Policy Committee (MPC) voted unanimously to keep the base rate on hold at 0.75%. Brexit continues to tie the Bank's hands; most observers believe the Bank wishes to start to move interest rates higher but has found itself stymied by politics. The Council's treasury advisers suggest the chances of a near term rate hike are slim at best and the prospect of a move towards the end of the year is only 50%.

7. The US economy continues to show signs of cooling down, Q4 GDP forecasts have been revised lower in light of the weak retail sales data in December. A figure of around 2.5% is favored, but less optimistic revisions suggest this could be as low as 1.5%. Having had four interest rate rises last year expectations, following recent communications from the Fed, are that there will now be no rate hikes in 2019.

8. Eurozone growth continues to be weak; GDP growth quarter on quarter is still running at 0.2%. This slowdown since 2017 has resulted from net exports swinging from a driver of economic growth to being a lag. The four main economies in the eurozone continue to exhibit differing levels of performance; on the one hand Italy is experiencing a small contraction and Germany only marginally avoided a technical recession in the first quarter of 2019. France and Spain, on the other hand, continue to enjoy healthy growth.

Action Taken during Quarter 4 to March 2019

9. The March MPC meeting delivered the expected no change vote with a unanimous 9-0 vote. Indications are that rates will remain on hold at least until after the UK exits the European Union, and probably until the implications of the exit are better understood. The result is that loans for short dated rates out to six months are not overly attractive when compared to those of longer duration. Opportunities will be sought to extend the maturity profile and improve returns.

10. During the quarter the balance of the investment portfolio increased from £228.7m to £247.5m. Within the portfolio £33.7m of loans matured at an average rate of 0.91% and £52.5m of new loans were placed, at an average rate of 1.08%.

11. The loan portfolio at the end of December was invested with the counterparties shown in the list below, shown by original investment date.

	£m	Maturity Date
Instant Access		
Money Market Funds	2.5	April 2019
6 Months		
Goldman Sachs	10.0	April 2019
National Bank of Canada	10.0	May 2019
Goldman Sachs	10.0	June 2019
Nationwide Building Society	10.0	July 2019
Santander	20.0	September 2019
Close Brothers Ltd	20.0	September 2019
12 Months		
Lloyds (Bank of Scotland)	10.0	May 2019
Australia & New Zealand Bank	15.0	May 2019
National Westminster Bank Plc	10.0	May 2019
National Westminster Bank Plc	20.0	July 2019
National Westminster Bank Plc	20.0	August 2019
Toronto Dominion Bank	15.0	October 2019
Landesbank Hessen Thuringen	15.0	October 2019
Commonwealth Bank of Australia	10.0	November 2019
Lloyds (Bank of Scotland)	20.0	November 2019
Beyond 12 Months		
Partners Group (Private Debt)	20.0	Estimated 2024
Danske Bank	10.0	September 2027
Total Portfolio Balance at 31st March 2019	**247.5**	

Loans to counterparties that breached authorised lending list

12. There were no loans active during the period that breached the authorised counterparty list at the time that the loan was made, and none that had already been placed to a counterparty that subsequently fell below the threshold that would have been acceptable for the remaining period of the loan following a credit-rating downgrade.

Ring-Fenced and Non-Ring-Fenced Banks

13. From 1st January 2019 the largest UK banks, those with more than £25bn of retail deposits, have been required by legislation to separate core domestic retail banking activities from international and investment banking activities. This structural reform is known as ring fencing. As such, the largest UK banks

now effectively have two separate entities, each with their own credit rating, to which the Council can lend.

14. Appendix A shows a comparison of how the credit ratings of the Ring-Fenced Banks (RFB) compare with those of the Non-Ring-Fenced Banks (NRFB) and also to other institutions on the Council's suggested counterparty list.

15. It should be noted that the Councils suggested counter party list and suggested loan duration is determined by a combination of short term and long-term credit ratings, as well as Credit Defaults Swap (CDS) price. The CDS price is essentially the cost of insuring against the bank defaulting on its debt which is an indication of its creditworthiness. This means, on rare occasions, an institution can have a lower long-term credit rating than another, but still be deemed a safer counterparty.

16. Another factor that influences creditworthiness is the nationalised status of a Bank. For example, National Westminster Bank and Royal Bank of Scotland (Ring Fenced Banks) have a credit rating of A-, lower than a number of other institutions, but are still considered the safest counterparty on our list due to their part nationalised status.

Resource Implications

17. The interest earned on revenue balances and the interest paid on external debt will impact directly onto the resources available to the Council.

Equality and Human Rights Implications

18. There are no discernible equality and human rights implications.

Recommendation

19. The Committee is asked to note this report.

Background Papers

20. None

Circulation under the Local Issues Alert Procedure

None

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Appendices

Appendix A - Comparison of credit ratings of Ring-Fenced and Non-Ring-Fenced Banks

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