

Appendix A: Background, Economy and Outlook

1. Background

- 1.1 Both Councils' Treasury Management Strategies for 2015/16 is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.
- 1.2 The Code also recommends that Members are informed of Treasury Management activities at least twice a year. This report therefore ensures the Councils are embracing best practice in accordance with CIPFA's recommendations.
- 1.3 Treasury management is defined as: "The management of the local authority'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."
- 1.4 In addition to reporting on risk management related to treasury activities, the Treasury Management Code also requires the Councils to report on any financial instruments entered into to manage treasury risks.
- 1.5 The instruments and the limits with individual counterparties approved in the 2015/16 Treasury Management Strategy (as amended in July 2015) of each Council are aligned and are as follows:

Type of instrument	BDC and MSDC limit
Deposits with banks and building societies	£1m
AAA rated money market funds	£2m
Deposits with other local authorities	£1m
Treasury bills	No limit
Debt Management Account Deposit Facility	No limit
Pooled Funds	£5m
Registered Providers	£1m
Corporates	£1m

1.6 The total limits for non-specified investments are shown in the table below:-

Non – Specified Investment Limits	BDC and MSDC limit
Total investments without credit ratings	£10m
Total non – specified investments	£10m
Total loans to unrated corporates	£1m

1.7 In terms of which banks and building societies are included on the Councils' counterparty list, the advice of our treasury management advisors Arlingclose is used. As market conditions and credit ratings change during the year, institutions are either taken off or put on the list of counterparties that we are happy to lend money to.

1.8 In practice, the Councils do not have the size of deposit that interests the major banks and building societies, so on a daily basis it is usually money market funds, short-term deposits and call accounts that are used to make short term investments.

2. UK Economy

2.1 The economy has remained resilient over the last six months. Although economic growth slowed in Q1 2015 to 0.4%, year/year growth to March 2015 was a relatively healthy 2.9%. Q2 2015 GDP growth bounced back and was confirmed at 0.7%, with year/year growth showing slight signs of slowing, decreasing to 2.6%. GDP has now increased for ten consecutive quarters, breaking a pattern of slow and erratic growth from 2009. The annual rate for consumer price inflation (CPI) briefly turned negative in April, falling to 0.1%, before returning to 0.1%, 0.0% and 0.1% in May, June and July respectively. In the August Quarterly Inflation Report, the Bank of England projected that GDP growth will continue around its average rate since 2013. The Bank of England's projections for inflation remained largely unchanged from the May report with them expecting inflation to gradually increase to around 2% over the next 18 months and then remain there in the near future. Further improvement in the labour market saw the ILO unemployment rate for the three months to April fall to 5.5%, although this ticked back up to 5.6% in subsequent months. In the August report, average earnings excluding bonuses for the three months to June rose 2.8% year/year.

2.2 The outcome of the UK general election, largely fought over the parties' approach to dealing with the consequences of the structural deficit and the pace of its removal, saw some very big shifts in the political landscape and put the key issue of the UK's relationship with the EU at the heart of future politics.

2.3 The US economy slowed to 0.6% in Q1 2015 due to bad weather, spending cuts by energy firms and the effects of a strong dollar. However, Q2 GDP showed a large improvement at a revised 3.7% (annualised). This was largely due to a broad recovery in corporate investment alongside a stronger performance from consumer and government spending and exports. With the Fed's decision on US interest rate dependent upon data, GDP is clearly supportive. However it is not as simple as that and the Fed are keen to see inflation rise alongside its headline economic growth and also its labour markets. Markets remained split between predicting a rate rise in September or December.

3. Market Reaction

- 3.1 Equity markets initially reacted positively to the pickup in the expectations of global economic conditions, but were tempered by the breakdown of creditor negotiations in Greece. China led stock market turmoil around the globe in August, with the FTSE 100 falling by around 8% overnight on 'Black Monday'. Indices have not recovered to their previous levels but some improvement has been seen. Government bond markets were quite volatile with yields rising (i.e. prices falling) initially as the risks of deflation seemingly abated. Thereafter yields fell on the outcome of the UK general election and assisted by reappraisal of deflationary factors, before rising again. Concerns around China saw bond yields dropping again through August. Bond markets were also distorted by the size of the European Central Bank's QE programme, so large that it created illiquidity in the very markets in which it needed to acquire these bonds, notably German government bonds (bunds) where yields were in negative territory.