**ITEM No …7………..**

**REPORT TO:** **PENSION SUB-COMMITTEE OF THE POLICY & RESOURCES COMMITTEE & PENSION BOARD – 3 DECEMBER 2018**

**REPORT ON:** **TREASURY MANAGEMENT ACTIVITY 2018/2019 (MID-YEAR REVIEW)**

**REPORT BY:** **EXECUTIVE DIRECTOR OF CORPORATE SERVICES**

**REPORT NO:** **385-2018**

## 1 PURPOSE OF REPORT

To review Tayside Pension Fund's Treasury Management activities for the period 1 April 2018 to 30 September 2018.

## 2 RECOMMENDATION

The Committee is asked to note the contents of the report.

## 3 FINANCIAL IMPLICATIONS

The Treasury Management activity during the first half of the current financial year indicates that investment income from cash balances held to pay pension benefits will be approximately £24,000 for 2018/2019.

## 4 BACKGROUND

Tayside Pension Fund is administered by Dundee City Council in accordance with Section 24 of its Financial Regulations. Investment policy and decisions (including those relating to Treasury Management) are delegated to the Pension Sub-Committee of the Policy and Resources Committee. The Pension Board assist the Sub-Committee with securing compliance to the regulations.

The primary objective of the Tayside Pension Fund is to provide for scheme members' pension and lump sum benefits on their retirement or for their dependants on death before or after retirement, on a defined benefits basis. There is limited discretion to vary these benefits.

Dundee City Council in its administering role, defines its treasury management activities as:

"The management of the 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."

It regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation and any financial instruments entered into to manage these risks.

It acknowledges that effective treasury management will provide support towards the achievement of its business and services objectives. It is therefore committed to the principles of achieving value for money in treasury management and to employing suitable performance measurement techniques, within the context of effective risk management.

All treasury management activities must comply with the appropriate regulations, codes and guidance as stated in the Treasury Management Policy Statement of Dundee City Council.

At its meeting on 5th March 2018, the Pension sub-committee of the Policy and Resources Committee and Pension Board approved the Fund's Treasury Policy Statement (Report no. 85-2018, article IX of minute refers) setting out the policies which would govern all lending transactions carried out by the Fund.

The Treasury Policy Statement requires that the Pension sub-committee of the Policy and Resources Committee and Pension Board will receive and consider the Treasury Management Strategy at the beginning of each new financial year.

On 5th March 2018, the Pension sub-committee of the Policy and Resources Committee and Pension Board approved the Fund's Treasury Management Strategy for 2018/2019 (Report no. 86-2018, article X of minute refers).

This monitoring report covers the Treasury Management activity over the first six months of 2018/2019 financial year for cash held to pay pension benefits. Fund managers will also hold cash within custodian bank accounts, these amounts are excluded from this report but will be included in future.

## 5 ACTUAL LENDING

Variations in cash flow requirements mean that there will be surplus funds which will be invested for short periods (maximum of 364 days). Short term investments will be restricted only to those institutions identified in the Fund's Approved Counterparties list provided they have maintained a suitable credit rating.

An analysis of the lending position to 30 September 2018 shows:

| Month | Lowest Amount Lent £m | Highest Amount Lent £m | End of month Amount Lent £m | Interest Rate Range % | |
|---|---|---|---|---|---|
| | | | | Min | Max |
| April 2018 | 2.1 | 9.6 | 2.1 | 0.40 | 0.46 |
| May 2018 | 1.4 | 6.5 | 3.3 | 0.46 | 0.49 |
| June 2018 | 2.2 | 10.5 | 2.2 | 0.40 | 0.51 |
| July 2018 | 1.0 | 8.5 | 1.0 | 0.40 | 0.53 |
| August 2018 | 0.9 | 9.1 | 3.6 | 0.53 | 0.64 |
| September 2018 | 1.5 | 9.5 | 1.5 | 0.64 | 0.67 |

All of these investments were in compliance with the Treasury Policy Statement.

## 6 OUTLOOK FOR THE SECOND HALF OF 2018/2019

The Council's treasury advisor, Link Asset Services, interest rate forecasts are provided in the table below. The forecasts are predicated on an assumption that there is no break-up of the Eurozone or EU (apart from the departure of the UK) within the forecasting time period, and that there is no further unrest in international relations which would have major impact on international trade and world GDP growth.

Link do not currently believe that the Monetary Policy Committee (MPC) of the Bank of England will increase the bank rate in February 2019, ahead of March Brexit deadline. However, in view of the hawkish stance of the MPC, on 6th November 2018 they moved forward their first forecast of increase in bank rate from August 2019 to May 2019, with following increases in February and November 2020, ending up at 2.0% in February 2022. See Appendix 1 for an economic review.

| Link Asset Services Interest Rate View | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank Rate View | 0.75% | 0.75% | 1.00% | 1.00% | 1.00% | 1.25% | 1.25% | 1.25% | 1.50% | 1.50% | 1.75% | 1.75% | 1.75% | 2.00% |
| 3 Month LIBID | 0.80% | 0.90% | 1.00% | 1.10% | 1.20% | 1.30% | 1.40% | 1.50% | 1.50% | 1.60% | 1.70% | 1.80% | 1.90% | 2.00% |
| 6 Month LIBID | 0.90% | 1.00% | 1.20% | 1.30% | 1.40% | 1.50% | 1.60% | 1.70% | 1.70% | 1.80% | 1.90% | 2.00% | 2.10% | 2.20% |
| 12 Month LIBID | 1.10% | 1.20% | 1.30% | 1.40% | 1.50% | 1.60% | 1.70% | 1.80% | 1.90% | 2.00% | 2.10% | 2.20% | 2.30% | 2.40% |
| 5yr PWLB Rate | 2.00% | 2.10% | 2.20% | 2.20% | 2.30% | 2.30% | 2.40% | 2.50% | 2.50% | 2.60% | 2.60% | 2.70% | 2.80% | 2.80% |
| 10yr PWLB Rate | 2.50% | 2.50% | 2.60% | 2.60% | 2.70% | 2.80% | 2.90% | 2.90% | 3.00% | 3.00% | 3.10% | 3.10% | 3.20% | 3.20% |
| 25yr PWLB Rate | 2.90% | 2.90% | 3.00% | 3.10% | 3.10% | 3.20% | 3.30% | 3.30% | 3.40% | 3.40% | 3.50% | 3.50% | 3.60% | 3.60% |
| 50yr PWLB Rate | 2.70% | 2.70% | 2.80% | 2.90% | 2.90% | 3.00% | 3.10% | 3.10% | 3.20% | 3.20% | 3.30% | 3.30% | 3.40% | 3.40% |

The key changes to Link's forecasts are highlighted below:

| BANK RATE | now | previously |
|---|---|---|
| Q1 2019 | 0.75% | 0.75% |
| Q1 2020 | 1.25% | 1.00% |
| Q1 2021 | 1.50% | 1.50% |

## 7 POLICY IMPLICATIONS

This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management. There are no major issues other than the risks noted in the Risk Register.

## 8 CONSULTATIONS

The Chief Executive and Head of Democratic and Legal Services have been consulted in the preparation of this report.

## 9 BACKGROUND PAPERS

None.

**GREGORY COLGAN**
**EXECUTIVE DIRECTOR OF CORPORATE SERVICES** **26 NOVEMBER 2018**

**APPENDIX 1**

## ECONOMIC BACKGROUND

**GLOBAL OUTLOOK. World growth** has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China, overall world growth is likely to weaken.

Inflation has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to a marked acceleration of wage inflation which is likely to prompt central banks into a series of increases in central rates. The EU is probably about a year behind in a similar progression.

**KEY RISKS - Central Bank Monetary Policy Measures**

The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation is coming towards its close and a new period has already started in the US, and more recently in the UK, on reversing those measures i.e. by raising central rates and, (for the US), reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of an on-going reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets.

**UK -** The first half of 2018/19 has seen UK economic growth post only a modest performance. However, growth has been recovering pace and the latest 3 month rolling average came in at a healthy 0.7%. The positive run of economic statistics was 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 overall 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 came in at 2.4% in September and is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate.

As for the labour market, unemployment has continued at a 43 year low of 4% on the Independent Labour Organisation measure. Given that 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. However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit.

**USA -** The Federal has had four increases in 2018, and indicated they expected to increase rates four more times by the end of 2019.

**Eurozone -** Growth was unchanged at 0.4% in quarter 2, but has undershot early forecasts for a stronger economic performance in 2018. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank has indicated it is likely to end all further purchases in December 2018. Inflationary pressures are starting to build gently so it is expected that the ECB will start to increase rates towards the end of 2019.

**China -** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. There are concerns that official economic statistics are inflating the published rate of growth.

**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. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.