ITEM No …7………..

REPORT TO: **PENSION SUB-COMMITTEE OF THE POLICY & RESOURCES COMMITTEE & PENSION BOARD – 4 DECEMBER 2017**

REPORT ON: **TREASURY MANAGEMENT ACTIVITY 2017/2018 (MID-YEAR REVIEW)**

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

REPORT NO: **412-2017**

1 PURPOSE OF REPORT

To review Tayside Pension Fund's Treasury Management activities for the period 1 April 2017 to 30 September 2017.

2 RECOMMENDATION

The Committee is asked to note the information contained herein.

3 FINANCIAL IMPLICATIONS

The Treasury Management activity during the first half of the current financial year indicates that investment income will be around £10,000 for 2017/2018 from cash held to pay pension benefits.

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 6th March 2017, the Pension sub-committee of the Policy and Resources Committee and Pension Board approved the Fund's Treasury Policy Statement (Report no. 92-2017, article IV 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 6th March 2017, the Pension sub-committee of the Policy and Resources Committee and Pension Board approved the Fund's Treasury Management Strategy for 2017/2018 (Report no. 93-2017, article V of minute refers).

This monitoring report covers the Treasury Management activity over the first six months of 2017/2018 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 2017 shows:

Month 2017	Lowest Amount Lent £m	Highest Amount Lent £m	End of month Amount Lent £m	Interest Rate Range %	
				Min	Max
April	4.4	12.2	4.4	0.01	0.15
May	3.6	7.1	3.6	0.15	0.24
June	3.1	10.0	3.1	0.15	0.22
July	3.2	9.7	3.3	0.19	0.21
August	1.8	4.2	1.8	0.20	0.21
September	1.4	7.6	5.5	0.18	0.20

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

6 OUTLOOK FOR THE SECOND HALF OF 2016/2017

The Council's treasury advisor, Capita Asset Services (CAS), has provided the following base interest rate forecast:-

Quarter ending	Bank Rate Forecast %
Dec-17	0.25
Mar-18	0.25
Jun-18	0.25
Sep-18	0.25
Dec-18	0.25

Quarter ending	Bank Rate Forecast %
Mar-19	0.25
Jun-19	0.50
Sep-19	0.50
Dec-19	0.75
Mar-20	0.75

CAS undertook last reviewed interest rate forecasts on 9th August after the quarterly Bank of England Inflation Report where there was no change in MPC policy. However, the MPC meeting of 14th September revealed a sharp change in sentiment whereby a majority of MPC members said they would be voting for an increase in Bank Rate "over the coming months". It is therefore possible that there will be an increase to 0.5% at the November MPC meeting. If that happens, the question will then be as to whether the MPC will stop at just withdrawing the emergency Bank Rate cut of 0.25% in August 2016, after the result of the EU withdrawal referendum, or whether they will embark on a series of further increases in Bank Rate during 2018. See Appendix 1 for full economic review.

7 <u>MIFID II</u>

The EU has now set a deadline of 3 January 2018 for the introduction of regulations under MIFID II. These regulations will govern the relationship that financial institutions conducting lending and borrowing transactions will have with local authorities from that date. This will have little effect on this authority apart from the completion of forms sent by each institution dealing with this authority and for each type of investment instrument we use apart from for cash deposits with banks requesting professional client opt-up status. A separate report (289-2017) on this subject was considered by the Sub-Committee on 4 September 2017.

8 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.

9 CONSULTATIONS

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

10 BACKGROUND PAPERS

None.

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EXECUTIVE DIRECTOR OF CORPORATE SERVICES **24 NOVEMBER 2017**

APPENDIX 1

ECONOMIC REVIEW

1. Economics update

1.1. **UK**. After the UK economy surprised on the upside with strong growth in 2016, growth in 2017 has been disappointingly weak. The first half of 2017 was the slowest growth for the first half of any year since 2012. The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 75% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there has been encouraging statistics from the manufacturing sector which is seeing stronger growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, this sector only accounts for around 11% of GDP so expansion in this sector will have a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

The Monetary Policy Committee (MPC) meeting of 14 September 2017 surprised markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise. The Bank of England Inflation Reports during 2017 have clearly flagged up that they expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. Inflation actually came in at 2.9% in August, (data released on 12 September), and so the Bank revised its forecast for the peak to over 3% at the 14 September meeting MPC. The MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of increasing globalisation. This effectively means that the UK labour faces competition from overseas labour e.g. in outsourcing work to third world countries, and this therefore depresses the negotiating power of UK labour. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so would be inflationary over the next few years.

There is increasing likelihood that the MPC may increase Bank Rate to 0.5% in November or, if not, in February 2018. The big question after that will be whether this will be a one off increase or the start of a slow, but regular, increase in Bank Rate. As at the start of October, short sterling rates are indicating that financial markets do not expect a second increase until May 2018 with a third increase in November 2019. However, some forecasters are flagging up that they expect growth to improve significantly in 2017 and into 2018, as the fall in inflation will bring to an end the negative impact on consumer spending power while a strong export performance will compensate for weak services sector growth. If this scenario were to materialise, then the MPC would have added reason to embark on a series of slow but gradual increases in Bank Rate during 2018. While there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two years will pan out.

1.2. **EU.** GDP growth was 0.5% in quarter 1 0.6% in quarter 2. However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in August inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019.

1.3. **USA.** Growth in the American economy remains volatile in 2017 with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1%. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.4%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with three increases since December 2016; and there could be one more rate rise in 2017, lifting their central rate to 1.50%. There could then be another four more increases in 2018, and the Fed have strongly hinted that it will soon begin to unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

1.4. **Others.** Chinese economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

Japan is struggling to stimulate consistent significant 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.

2. Potential Up and Downside Risks

The overall balance of risks to economic recovery in the UK is currently to the downside but huge variables over the coming few years include just what final form Brexit will take, when finally agreed with the EU, and when.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK’s main trading partners - the EU and US.
- Geopolitical risks in Europe, the Middle East and Asia, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis.
- Weak capitalisation of some European banks.
- Monetary policy action failing to stimulate sustainable growth and to get inflation up consistently to around monetary policy target levels.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include:

- The pace and timing of increases in the Fed. Funds Rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels causing an increase in the inflation premium inherent to gilt yields.