PLYMOUTH CITY COUNCIL

Subject:	Treasury Management 'Brexit' Report
Committee:	Audit Committee
Date:	15 September 2016
Cabinet Member:	Councillor Darcy
CMT Member:	Andrew Hardingham (Assistant Director for Finance)
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Ref:	FIN/CF
Key Decision:	No
Part:	I

Purpose of the report:

The report is to provide a commentary on the effects on Treasury Management caused by the UK's decision to leave the European Union.
The report gives a general update on the changes in the economy and the markets and how these have affected the Council's Treasury Management.

The Corporate Plan 2013/14 - 2016/17:

The Council's expenditure forms the basis on which the Corporate Plan can be delivered.

Implications for Medium Term Financial Plan and Resource Implications: Including finance, human, IT and land

The changes in Treasury Management will have implications on Treasury Management budget. The income on the Council's investment has fallen but this will be partially compensated by the falling cost of borrowing.

Other Implications: e.g. Child Poverty, Community Safety, Health and Safety and Risk Management:

N/A

Equality and Diversity

Has an Equality Impact Assessment been undertaken? No

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1) Recommendations and Reasons for recommended action:

The Audit Committee to note the report.

Alternative options considered and rejected:

None

Published work / information:

Background papers: None

None

Sign off:

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Originating SMT Member – Andrew Hardingham													
Has the Cabinet Member(s) agreed the contents of the report? Yes													

Treasury Management Brexit Report – September 2016

1. Executive summary

1.1 Economic and credit outlook since the 'Brexit' outcome of the EU referendum vote:

- Safe haven (UK, US, German etc.) government bond yields have continued to fall.
- Equity markets have recovered and risen above pre-vote levels.
- General measure of volatility has stabilised.
- Currency devalued significantly (although there has been a recent small rise in rates)
- Consumer confidence fallen.
- Property fund values have fallen.
- Bank Rate cut by MPC to 0.25% on expectation of economic slowdown.
- Inflation is currently at low levels but expected to rise, mainly due to the currency weakness. Economic growth is expected to fall, possibly to recessionary levels, although little data is available for the post-vote period so the real impact is not yet known. MPC have signalled the potential for a further rate cut to almost 0%. This is likely to mean interest rates staying even lower for even longer.
- Overall, credit conditions have been fairly stable. Certificates of Deposit (CDs) rose on Brexit vote but have since eased.

1.2 Investments:

Since the cut in the Bank of England interest rate we have seen all financial institutions drop their investment interest rates and some are offering close to zero interest rates. The Council will have a fall in its investment income but it is looking into other investment opportunities in order to maintain its investment income.

The Council has investments in the CCLA Property fund (exclusively for local authorities) and the fund has seen a small fall in its value but the returns are expected to be maintained at their higher position.

1.3 Borrowing

The Council has fixed rate borrowing (LOBOs and PWLB) so it is tied into paying the higher rates. However, the Council has circa £100m in short term borrowing and it will benefit from the fall in the interest rate.

1.4 Summary

The overall effect of the decisions to leave the EU on the Council's Treasury Management is quite stable. The Council's officers are continually monitoring and reviewing the financial markets. The officers have regular meetings with its Treasury Management advisors and are investigating other investment opportunities to help maintain their Treasury Management income.

2. Underlying assumptions:

2.1 The economic trajectory for the UK has been immeasurably altered following the vote to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries.

2.2 The short to medium-term outlook is somewhat more down beat due to the uncertainty generated by the result and the forth coming negotiations (not with standing the Olympic and summer feel-good effects). The rapid installation of a new prime minister and cabinet lessened the political uncertainty, and the government/Bank of England has been proactive in tackling the economic uncertainty.

2.3 Purchasing Managers' Index data and consumer and business confidence surveys published for July showed a significant down turn in business activity. An overreaction was always expected due to the unexpected result and confidence indicators, particularly consumer confidence, have experienced a limited recovery.

2.4 Over the medium term, economic and political uncertainty will likely dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment. These effects will dampen economic growth through the second half of 2016.

2.5 UK Consumer Price Inflation (currently 0.6% year/year) will rise close to target over the coming year as previous rises in commodity prices and the sharp depreciation in sterling begin to drive up imported material costs for companies:-

2.6 The rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policy makers looking through import-led CPI spikes to the negative effects of Brexit on economic activity and, ultimately, inflation.

2.7 There is a debatable benefit to further interest rate cuts (particularly with regard to financial stability). Negative Bank Rate is currently perceived by policy makers to be counterproductive, but there is a possibility of close-to-zero Bank Rate. QE will be used to limit the upward movement in bond yields.

2.8 Following significant global fiscal and monetary stimulus, the short term outlook for the global economy is somewhat brighter than a few months ago. However, financial market volatility is likely at various points because the stimulus has only delayed the fallout from the build-up of public and private sector debt (particularly in developing economies, e.g. China).

- Globally, the outlook is uncertain and risks remain weighted to the downside. The UK domestic outlook is uncertain, but likely to be weaker in the short term than previous expected.
- Any currency-driven inflationary pressure will be looked through by Bank of England policy makers.
- The likely path for Bank Rate is weighted to the downside with a possibility of a drop to close to zero.
- Gilt yields will be broadly flat from current levels.