

## **Economic Update and interest rates as at July 2014**

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- A1. The UK returned to strong growth during 2013/14 and indications are this will continue through 2014/15.
- A2. Inflation has fallen sharply and expectations are that inflation will continue to be subdued. However, real incomes are still having an affect on households as wages have not risen with inflation. The squeeze on households' income will remain a critical factor in the economy over the next few years. The slow recovery has meant that social security payments remain high and tax income is low.
- A3. Deflation is now a threat in the Eurozone. The ECB took some action in June 2014 to loosen monetary policy in order to promote growth.
- A4. The government's Funding for Lending Scheme (FLS) has been introduced to improve access to mortgages at lower rates. This has reduced lenders need to borrow and money market rates have fallen considerably as a result. There will be a need to increase interest rates and reverse the government bond purchases at some stage, but it is unlikely that the latter will happen in the next 12 to 24 months.
- A5. Investor demand in UK gilts as a 'safe haven' continues to keep yield increases down. Long term rates will eventually rise, mainly due to the fact that high volumes of gilts have been issued already in the UK and also in other major western countries.
- A6. Following comments from the MPC and Mark Carney, along with the prospect of good economic recovery in 2014, interest rates are forecast to rise from 2015.
- A7. Concerns over investment counterparty risk remain because of the volatile economic conditions. However the council's current treasury management policy manages this risk down to a low level.

### **Interest rates**

- A8. The Bank of England Inflation report upgraded its growth predictions to 3.4% in 2014 and 2.9% in 2015.
- A9. Bank rate remained unchanged at 0.5% throughout 2013/14. The earlier forecast of a rate rise in Q4 of 2016 has been revised to Q1 in 2015. This follows comments from the MPC and the fact economic recovery is likely to be robust.
- A10. Investment rates have remained flat with a range between 0.5 per cent to around 1.0 per cent for up to a year's maturity. This has dropped significantly as banks and building societies were offered further cheap cash supply via the FLS. The short term rates from one month to six months offer very little differential with six month rates ranging between 0.37 per cent and 0.55 per cent.

A11. Capita Asset Services' forecast of the expected movement in medium term interest rates: Agenda Item 6

	NOW	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
BANK RATE	0.50	0.50	0.50	0.75	0.75	1.00	1.00
3 month LIBID	0.50	0.50	0.60	0.80	0.80	1.10	1.10
6 month LIBID	0.58	0.60	0.80	0.90	1.00	1.15	1.20
12 month LIBID	0.80	0.80	1.00	1.00	1.20	1.30	1.40
5 yr PWLB	2.70	2.70	2.80	2.90	3.00	3.00	3.10
10 yr PWLB	3.50	3.70	3.70	3.80	3.90	4.00	4.00
25 yr PWLB	4.10	4.40	4.40	4.50	4.60	4.70	4.70
50 yr PWLB	4.10	4.40	4.40	4.50	4.60	4.70	4.70
	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
BANK RATE	1.25	1.25	1.50	1.75	2.00	2.00	2.00
3 month LIBID	1.30	1.40	1.60	1.90	2.10	2.25	2.25
6 month LIBID	1.40	1.50	1.80	2.00	2.20	2.30	2.30
12 month LIBID	1.70	1.80	2.10	2.20	2.30	2.40	2.40
5 yr PWLB	3.20	3.30	3.30	3.40	3.50	3.60	3.60
10 yr PWLB	4.10	4.20	4.20	4.30	4.40	4.40	4.40
25 yr PWLB	4.80	4.80	4.90	4.90	4.90	5.00	5.00
50 yr PWLB	4.80	4.80	4.90	4.90	4.90	5.00	5.00

Counterparty	Deposit type	Maturity Date	Principal	Rate
Kingston upon Hull City Council	Fixed	Jun-15	1,000,000	1.90%
Barclays Bank plc	Fixed	Dec-14	2,000,000	3.75%
HSBC	Fixed	Feb-17	2,000,000	1.90%
West Bromwich Building Society	Fixed	May-14	2,000,000	1.05%
Skipton Building Society	Fixed	May-14	2,000,000	0.86%
West Bromwich Building Society	Fixed	Jun-14	3,000,000	0.95%
Bank of Scotland	Fixed	Jul-14	5,000,000	1.01%
West Bromwich Building Society	Fixed	Jul-14	1,000,000	0.93%
National Counties Building Society	Fixed	Jun-14	1,500,000	1.00%
Kingston upon Hull City Council	Fixed	Aug-20	3,500,000	2.70%
Kingston upon Hull City Council	Fixed	Aug-20	1,500,000	2.70%
National Counties Building Society	Fixed	Jun-14	2,000,000	1.00%
West Bromwich Building Society	Fixed	Sep-14	3,000,000	1.05%
National Counties Building Society	Fixed	Jul-14	2,000,000	1.00%
Blaenau Gwent County Borough Council	Fixed	Apr-16	3,000,000	1.38%
West Bromwich Building Society	Fixed	Oct-14	2,000,000	1.00%
Manchester Building Society	Fixed	Jul-14	1,000,000	0.90%
National Counties Building Society	Fixed	Aug-14	2,000,000	0.95%
Progressive Building Society	Fixed	Aug-14	1,000,000	0.85%
Progressive Building Society	Fixed	Aug-14	1,000,000	0.85%
Progressive Building Society	Fixed	Sep-14	2,000,000	0.92%
Close Brothers	Fixed	Nov-14	2,500,000	1.15%
Furness Building Society	Fixed	Sep-14	2,000,000	0.85%
Newcastle Building Society	Fixed	Oct-14	2,000,000	0.85%
Furness Building Society	Fixed	Sep-14	2,000,000	0.88%
Progressive Building Society	Fixed	Oct-14	1,000,000	0.85%
Close Brothers	Fixed	Dec-14	3,000,000	1.00%
Skipton Building Society	Fixed	Dec-14	2,000,000	0.88%
National Counties Building Society	Fixed	Nov-14	2,500,000	1.00%
Manchester Building Society	Fixed	Oct-14	2,000,000	0.90%
Kingston upon Hull City Council	Fixed	Jan-21	2,000,000	2.50%
Manchester Building Society	Fixed	Oct-14	2,000,000	0.90%
Newcastle Building Society	Fixed	Jan-15	2,000,000	0.90%
Newcastle Building Society	Fixed	Jan-15	2,000,000	0.90%
Santander	Call		10,030,219	0.90%
Royal Bank of Scotland	Call		2,320	0.85%
Royal Bank of Scotland	Call		480,000	0.80%
Goldman Sachs	MMF		170,000	Variable
Deutsche Bank	MMF		265,000	Variable
Blackrock	MMF		490,000	Variable
L&G Equities	Unit trust		12,509,147	Variable
Royal Bank of Scotland	Corporate bond		1,626,000	9.63%
Santander	Corporate bond		321,395	11.50%
CCLA - property fund	Property fund		5,000,000	4.65%
<b>GRAND TOTAL</b>			<b>101,394,080</b>	

<b>Prudential indicators as at 31 March 2014</b>		
	<b>2013/14 Original estimate £m</b>	<b>31.03.2014 Position £m</b>
<b>Authorised limit for external debt</b>		
Borrowing	5	0
Other long term liabilities	5	0
	<b>10</b>	<b>0</b>
<b>Operational boundary for external debt</b>		
Borrowing	2	0
Other long term liabilities	3	0
	<b>5</b>	<b>0</b>
<b>Investments</b>		
<b>Interest rate exposures</b>		
Limits on fixed interest rates	100	100
Limits on variable interest rates	30	30
<b>Maximum principal sums invested &gt; 364 days</b>		
Upper limit for principal sums invested > 364 days	70	17
Limit to be placed on investments to maturity		
1 - 2 years	70	5
2 - 5 years	50	10
5 years +	50	2
<b>Investment portfolio spread</b>		
Supranational bonds	15	0
Gilts	15	0
Equities*	10	13
Corporate bonds	10	4
Money market funds	20	4
Pooled bond fund	5	0
Property - direct investments	30	16
Property related pooled funds	10	5
External fund manager	20	0
Cash and certificates of deposit	85%	80%
Debt management account deposit facility	100%	0%

\*Limit at time of purchase - Equities include accumulated dividends

GLOSSARY OF TERMS

<b>Basis Point (BP)</b>	1/100th of 1%, i.e. 0.01%
<b>Base Rate</b>	Minimum lending rate of a bank or financial institution in the UK.
<b>Benchmark</b>	A measure against which the investment policy or performance of a fund manager can be compared.
<b>Bill of Exchange</b>	A non-interest-bearing written order used primarily in international trade that binds one party to pay a fixed sum of money to another party at a predetermined future date.
<b>Callable Deposit</b>	A deposit placed with a bank or building society at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre agreed dates, before maturity. This decision is based on how market rates have moved since the deal was agreed. If rates have fallen the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower.
<b>[Cash] Fund Management</b>	Fund management is the management of an investment portfolio of cash on behalf of a private client or an institution, the receipts and distribution of dividends and interest, and all other administrative work in connection with the portfolio.
<b>Certificate of Deposit (CD)</b>	Evidence of a deposit with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before the maturity of the CD.
<b>Commercial Paper</b>	Short-term obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing.
<b>Corporate Bond</b>	Strictly speaking, corporate bonds are those issued by companies. However, the term is used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.
<b>Counterparty</b>	Another (or the other) party to an agreement or other market contract (e.g. lender/borrower/writer of a swap/etc.)
<b>Credit Default Swap (CDS)</b>	A swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap.

<b>Capital Financing Requirement (CFR)</b>	The amount the council has to borrow to fund its capital commitments.
<b>CIPFA</b>	Chartered Institute of Public Finance and Accountancy.
<b>CLG</b>	[Department for] Communities and Local Government.
<b>Derivative</b>	A contract whose value is based on the performance of an underlying financial asset, index or other investment, e.g. an option is a derivative because its value changes in relation to the performance of an underlying stock.
<b>Debt Management Account Deposit Facility (DMADF)</b>	Deposit Account offered by the Debt Management Office, guaranteed by the UK government
<b>European Central Bank (ECB)</b>	European Central Bank – sets the central interest rates in the EMU area. The ECB determines the targets itself for its interest rate setting policy; this is the keep inflation within a band of 0 to 2%. It does not accept that monetary policy is to be used to manage fluctuations in unemployment and growth caused by the business cycle.
<b>European and Monetary Union (EMU)</b>	The Economic and Monetary Union (EMU) is an umbrella term for the group of policies aimed at converging the economies of all member states of the European Union.
<b>Equity</b>	A share in a company with limited liability. It generally enables the holder to share in the profitability of the company through dividend payments and capital appreciation. Equity values can decrease as well as increase.
<b>Forward Deal</b>	The act of agreeing today to deposit funds with an institution for an agreed time limit, on an agreed future date, at an agreed rate.
<b>Forward Deposits</b>	Same as forward dealing (above).
<b>Fiscal Policy</b>	The government policy on taxation and welfare payments.
<b>GDP</b>	Gross Domestic Product.
<b>[UK] Gilt</b>	Registered UK government securities giving the investor an absolute commitment from the government to honour the debt that those securities represent.
<b>LIBID</b>	London inter-bank bid rate
<b>LIBOR</b>	London inter-bank offered rate.

<b>Money Market Fund</b>	A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short-term instruments. It is very similar to a unit trust, however in a MMF.
<b>Monetary Policy Committee (MPC)</b>	Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1% of a central target of 2.5% in two years time from the date of the monthly meeting of the committee. Their secondary target is to support the government in maintaining high and stable levels of growth and employment.
<b>Other Bond Funds</b>	Pooled funds investing in a wide range of bonds.
<b>PWLB</b>	Public Works Loan Board.
<b>QE</b>	Quantitative Easing.
<b>Retail Price Index</b>	Measurement of the monthly change in the average level of prices at the retail level weighted by the average expenditure pattern of the average person.
<b>Sovereign Issues (excl UK Gilts)</b>	Bonds issued or guaranteed by nation states, but excluding UK government bonds.
<b>Supranational Bonds</b>	Bonds issued by supranational bodies, e.g. European Investment Bank. The bonds – also known as Multilateral Development Bank bonds – are generally AAA rated and behave similarly to gilts, but pay a higher yield (“spread”) given their relative illiquidity when compared with gilts.
<b>Treasury Bill</b>	Treasury bills are short-term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final redemption value.

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