

Lincolnshire County Council

Monthly Investment Analysis Review

September 2016



Lincolnshire County Council

Monthly Economic Summary

General Economy

This month there was still a focus on the UK's decision to leave the European Union. The hard data released however, was more positive than many expected. Nevertheless, the path to Brexit is a long one and while the initial impact may be less than feared, it does not mean that issues will not materialise over the medium term. Furthermore, the active stance taken by the Monetary Policy Committee last month, including cutting interest rates to 0.25%, will also have likely supported the recent rebound in activity.

A boost to exports and more than a 10% fall in the value of the pound helped the PMI manufacturing activity survey recover from initial Brexit impacts and rise to a 10 month high. In August activity in the sector jumped to 53.3, from 48.2 in July. Export orders flowed at their fastest rate for two years whilst factories increased output by the highest amount since January. Construction activity also recovered in August, with the PMI headline reading rising to 49.2 from 45.9 in July, suggesting the economy is stabilising post the referendum vote. However, activity in the sector still remains slightly below 50, the level that divides "expansion" from "contraction". Economists now fear the construction industry will face further issues in the face of strong inflation pressures with raw material prices rising by their fastest pace in five years. Completing the set, service sector activity had the biggest one month gain in the PMI survey's history as it soared to 52.9 in August from 47.4 in July. This boosted the composite PMI activity reading to a five month high of 53.2. If the uplift in sentiment transfers to "hard" economic output data then it would suggest that an imminent recession will be avoided and puts the possibility of a second rate cut before the end of the year more in the balance.

The Bank of England met in September and voted unanimously to keep interest rates at a record low of 0.25% whilst also leaving the bond buying schemes unchanged. Furthermore, they improved their Q3 growth forecast, predicting that growth will be closer to 0.3% as opposed the 0.1% they originally forecast. Nevertheless, the Bank said they are still likely to cut interest rates again this year with a further cut of 0.1basis points expected when they next meet in November.

British inflation held firm remaining at an annual rate of 0.6% in August, slightly below the 0.7% forecast. Clothing and hotels had lower prices, counteracting the price rise in fuel prices, food and airfares. In terms of growth, the service sector exceeded initial estimates in Q2 and this resulted in final UK Q2 GDP growth being revised to 0.7% from 0.6%.

In the three months to August employment rose by 174,000 showing there has not yet been any post Brexit shedding. Unemployment is still expected to rise, however, as companies wait for greater clarity on the UK's exit deal from the European Union. Growth in workers' wages slowed in August, signalling a tough period ahead as British households are likely to face higher inflation as a result of the weaker pound.

UK Public Sector Net Borrowing for August registered a deficit of £10.55bn, but lower than the £11.47bn figure recorded for the same period last year. However, it failed to meet the forecast of just £10bn. The Office for National Statistics stated there was little impact from the Brexit vote as Income and Corporation Tax receipts rose strongly.

Retail sales calmed in August, falling -0.2% after strong growth in July of 1.9%. Despite the slight fall there is still a pattern of strong growth in the sector on an annual basis as sales volumes are up 6.2% compared with last year and higher than the forecast of 5.4%. John Lewis has mentioned they have noticed little impact of the Brexit vote, but they suggested that the full impact has not yet become clear.

Adding to the positive tone to data releases was figures for UK's trade balance in July. The deficit in the UK's goods balance improved to -£11.764bn in July from a revised -£12.920bn in June. Conversely, the services balance fell slightly to £7.262bn in July from £7.347bn in June.

Q2 GDP growth was also published for the Eurozone this month. GDP was up 0.3% in the euro area and by 0.4% in the EU28, with annual growth rates of 1.6% and 1.8% respectively. Exports were a leading factor in this growth, increasing by 1.1% in both areas. At the individual level, Germany grew at 1.7% and France at 1.4% but Romania (5.9%) and Slovakia (3.7%) published the highest growth rates. With regards employment across the region, the unemployment rate remained at its lowest level since July 2011 at 10.1%, down from 10.7% in August a year ago. The EU 28 also remained stable at 8.6%, down from 9.3% in August 2015. The lowest unemployment rates were recorded in the Czech Republic (3.9%) and Germany (4.2%), whilst Spain remained as one of the highest, at 19.5%.

Across the Atlantic, non-farm payrolls improved by 151,000 in August, with the unemployment rate holding steady at 4.9%. This was less than the expected rise of 180,000 and a slowdown from the previous two months which had a combined rise of 546,000. Average hourly earnings only increased by a 0.1% and Americans worked fewer hours last month with average weekly hours dipping to 34.3. These figures have reignited the debate as to whether another interest rate hike before the end of the year will benefit the US economy. The final Q2 estimate for US GDP was upwardly revised this month, increasing from initial estimates of 1.1% to a 1.4% annualised growth rate. This rise was due to business' pumping more money into research and development and exports growing strongly.

Housing

Halifax house prices fell a further 0.2% in August, after falling 1.1% in July. The second consecutive month of falling house prices has caused the annual growth rate to decline to 6.9%, its lowest level in more than a year. This slowdown is supported by the British Bankers Association survey. According to the survey the number of mortgages approved fell to 36,997 in August, its lowest point since January 2015 and 21% lower than this time last year. Nationwide House prices reflect this slowdown has continued into September. While prices rose by 0.3% on the month, this was below that seen in August (0.6%) and pulled the annual rate down to 5.3% from 5.6% previously.

Forecast

Neither Capita Asset Services (CAS) nor Capital Economics altered their forecasts this month. It is mutually anticipated that another rate cut will occur in the last quarter of this year with CAS forecasting a potential hike occurring in the second quarter of 2018.

Bank Rate	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
Capita Asset Services	0.10%	0.10%	0.10%	0.10%	0.10%
Capital Economics	0.10%	0.10%	0.10%	0.10%	0.10%

Lincolnshire County Council

Current Investment List

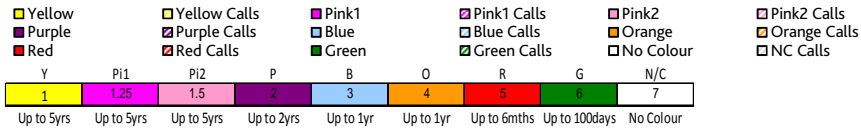
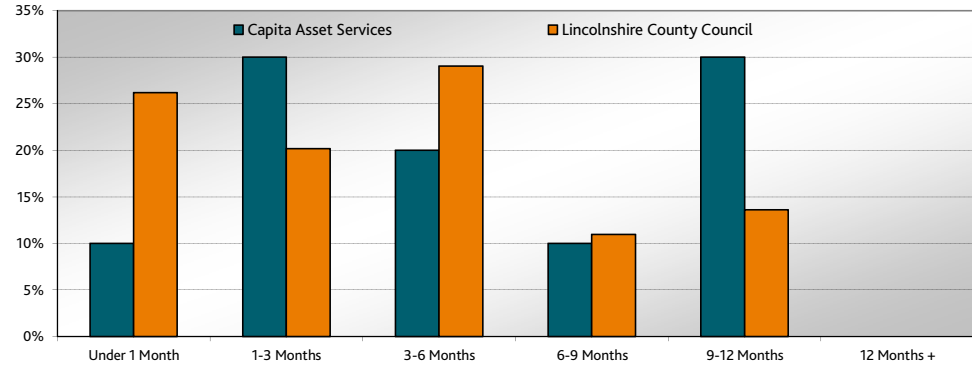
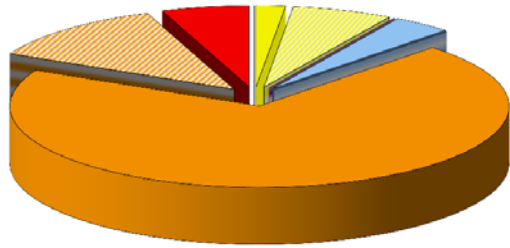
Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest Long Term Rating	Historic Risk of Default
MMF Standard Life	1,875,000	0.37%		MMF	AAA	0.000%
MMF Aberdeen	15,315,000	0.38%		MMF	AAA	0.000%
Svenska Handelsbanken AB	8,000,000	0.50%	05/07/2016	05/10/2016	AA-	0.000%
Landesbank Hessen-Thuringen Girozentrale	6,725,000	0.76%	13/04/2016	13/10/2016	A	0.002%
Toronto Dominion Bank	5,000,000	0.80%	16/10/2015	14/10/2016	AA-	0.000%
Toronto Dominion Bank	5,000,000	0.81%	16/10/2015	14/10/2016	AA-	0.000%
Credit Industriel et Commercial	8,950,000	0.75%	18/04/2016	18/10/2016	A	0.003%
Toronto Dominion Bank	8,500,000	0.90%	29/10/2015	27/10/2016	AA-	0.000%
HSBC Bank Plc	10,000,000	0.37%		Call30	AA-	0.001%
United Overseas Bank Ltd	6,775,000	0.80%	04/11/2015	02/11/2016	AA-	0.001%
Svenska Handelsbanken AB	12,000,000	0.35%		Call35	AA-	0.001%
Toronto Dominion Bank	1,500,000	0.89%	06/11/2015	04/11/2016	AA-	0.001%
DZ Bank AG (Deutsche Zentral-Genossenschaf	7,079,000	0.63%	19/05/2016	21/11/2016	AA-	0.001%
DBS Bank Ltd	5,000,000	0.63%	31/05/2016	30/11/2016	AA-	0.001%
Credit Industriel et Commercial	6,050,000	0.70%	03/06/2016	05/12/2016	A	0.012%
North Tyneside Metropolitan Borough Council	5,000,000	0.75%	23/12/2015	21/12/2016	AA	0.001%
HSBC Bank Plc	10,000,000	0.62%		Call90	AA-	0.002%
United Overseas Bank Ltd	4,675,000	0.58%	01/07/2016	03/01/2017	AA-	0.002%
Commonwealth Bank of Australia	5,000,000	0.85%	07/01/2016	05/01/2017	AA-	0.002%
Bank of Montreal	5,000,000	0.85%	19/01/2016	17/01/2017	A+	0.020%
Landesbank Hessen-Thuringen Girozentrale	8,400,000	0.90%	22/04/2016	23/01/2017	A	0.021%
Landesbank Hessen-Thuringen Girozentrale	4,800,000	0.93%	25/04/2016	25/01/2017	A	0.021%
National Australia Bank Ltd	5,450,000	0.80%	03/02/2016	01/02/2017	AA-	0.002%
Nordea Bank AB	5,000,000	0.68%	08/06/2016	08/02/2017	AA-	0.002%
Bank of Montreal	10,000,000	0.80%	12/02/2016	10/02/2017	A+	0.024%
Swedbank AB	5,000,000	0.44%	18/08/2016	17/02/2017	AA-	0.003%
Commonwealth Bank of Australia	10,000,000	0.90%	11/03/2016	10/03/2017	AA-	0.003%
United Overseas Bank Ltd	8,550,000	0.75%	11/05/2016	13/03/2017	AA-	0.003%
Commonwealth Bank of Australia	5,000,000	0.97%	31/03/2016	30/03/2017	AA-	0.003%
Cooperatieve Rabobank U.A.	3,925,000	0.55%	05/07/2016	05/04/2017	A+	0.034%

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Current Investment List

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest Long Term Rating	Historic Risk of Default
The Royal Bank of Scotland Plc	3,446,000	0.97%	19/05/2016	17/05/2017	BBB+	0.094%
The Royal Bank of Scotland Plc	1,000,000	1.12%	08/07/2016	17/05/2017	BBB+	0.094%
The Royal Bank of Scotland Plc	499,000	1.12%	08/07/2016	17/05/2017	BBB+	0.094%
The Royal Bank of Scotland Plc	2,037,000	0.78%	22/07/2016	17/05/2017	BBB+	0.094%
The Royal Bank of Scotland Plc	3,150,000	0.82%	27/07/2016	17/05/2017	BBB+	0.094%
Bank of Montreal	5,000,000	0.80%	27/05/2016	26/05/2017	A+	0.044%
DBS Bank Ltd	5,000,000	0.77%	27/05/2016	26/05/2017	AA-	0.004%
DBS Bank Ltd	5,000,000	0.80%	23/06/2016	22/06/2017	AA-	0.005%
Skandinaviska Enskilda Banken AB	5,000,000	0.58%	21/07/2016	20/07/2017	A+	0.054%
Skandinaviska Enskilda Banken AB	10,000,000	0.50%	05/08/2016	04/08/2017	A+	0.057%
Cooperatieve Rabobank U.A.	6,075,000	0.50%	08/08/2016	07/08/2017	A+	0.057%
DBS Bank Ltd	5,000,000	0.50%	26/08/2016	25/08/2017	AA-	0.006%
Cooperatieve Rabobank U.A.	10,000,000	0.57%	16/09/2016	15/09/2017	A+	0.064%
Total Investments	£264,776,000	0.67%				0.016%

Portfolio Composition by Capita Asset Services' Suggested Lending Criteria



Portfolios weighted average risk number =

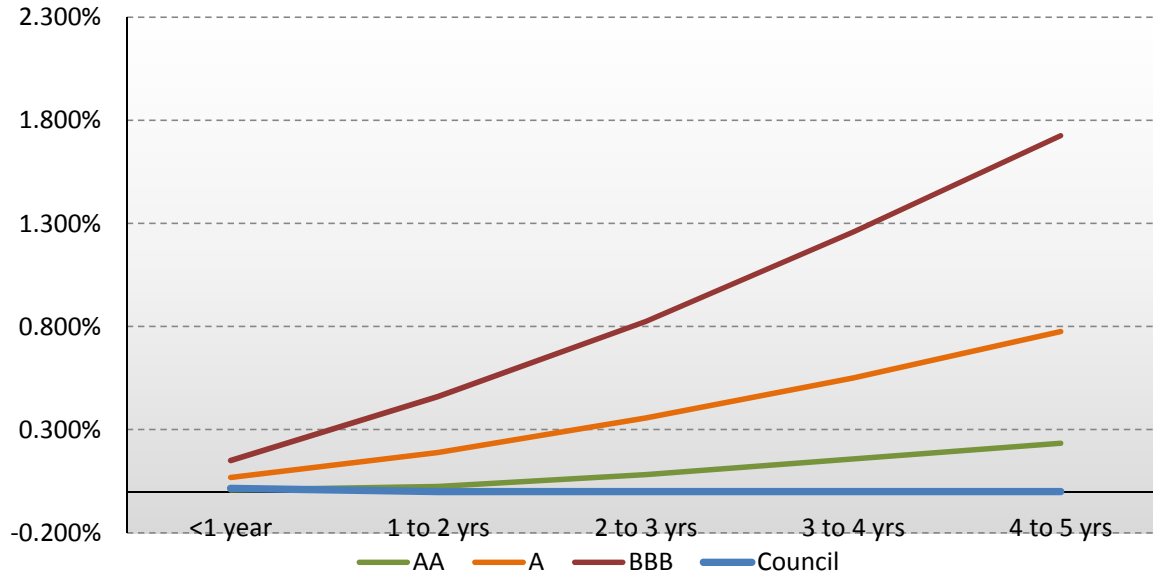
3.77

WARoR = Weighted Average Rate of Return
 WAM = Weighted Average Time to Maturity
 Excluding Calls/MMFs/ECFs

	% of Portfolio	Amount	% of Colour in Calls	Amount of Colour in Calls	% of Call in Portfolio	WARoR	WAM	WAM at Execution	WAM	WAM at Execution
Yellow	8.38%	£22,190,000	77.47%	£17,190,000	6.49%	0.47%	18	82	82	364
Pink1	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Pink2	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Purple	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Blue	3.83%	£10,132,000	0.00%	£0	0.00%	0.91%	229	321	229	321
Orange	82.13%	£217,454,000	14.72%	£32,000,000	12.09%	0.68%	135	272	150	311
Red	5.67%	£15,000,000	0.00%	£0	0.00%	0.73%	37	184	37	184
Green	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
No Colour	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Total	100.00%	£264,776,000	18.58%	£49,190,000	18.58%	0.67%	123	253	144	304

Investment Risk and Rating Exposure

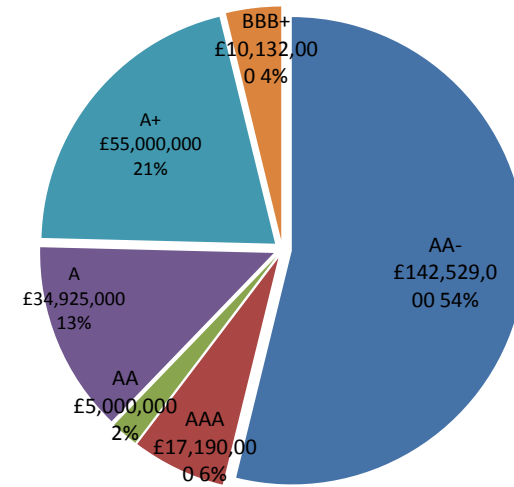
Investment Risk Vs. Rating Categories



Historic Risk of Default

Rating/Years	<1 year	1 to 2 yrs	2 to 3 yrs	3 to 4 yrs	4 to 5 yrs
AA	0.007%	0.024%	0.081%	0.158%	0.234%
A	0.067%	0.189%	0.356%	0.551%	0.775%
BBB	0.150%	0.460%	0.824%	1.257%	1.726%
Council	0.016%	0.000%	0.000%	0.000%	0.000%

Rating Exposure



Historic Risk of Default

This is a proxy for the average % risk for each investment based on over 30 years of data provided by Fitch, Moody's and S&P. It simply provides a calculation of the possibility of average default against the historical default rates, adjusted for the time period within each year according to the maturity of the investment.

Chart Relative Risk

This is the authority's risk weightings compared to the average % risk of default for "AA", "A" and "BBB" rated investments.

Rating Exposures

This pie chart provides a clear view of your investment exposures to particular ratings.

Monthly Credit Rating Changes
FITCH

Date	Update Number	Institution	Country	Rating Action
07/09/2016	1472	Newcastle Building Society	U.K.	Affirmed and withdrew the ratings of Newcastle Building Society. Long Term Rating affirmed at 'BB+', 'Stable Outlook', Rating Withdrawn. Short Term Rating affirmed at 'B', Rating Withdrawn.

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Monthly Credit Rating Changes
MOODY'S

Date	Update Number	Institution	Country	Rating Action
16/09/2016	1473	Norddeutsche Landesbank Girozentrale	Germany	Long Term Rating downgraded to 'A3' from 'A2', removed from 'Negative Watch' and placed on 'Negative Outlook'. Short Term Rating downgraded to 'P-2' from 'P-1', removed from 'Negative Watch'.

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Monthly Credit Rating Changes
S&P

Date	Update Number	Institution	Country	Rating Action
19/09/216	1474	Finland Sovereign Rating	Finland	Affirmed at 'AA+', Outlook changed to 'Stable' from 'Negative'.

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