REPORT TO:	Executive Board Sub-Committee
DATE:	10th February 2011
REPORTING OFFICER:	Operational Director – Finance
TITLE:	Treasury Management 2010/11 3rd Quarter: October - December

1.0 PURPOSE OF REPORT

1.1 The purpose of the report is to update the Sub-Committee about activities undertaken on the money market as required by the Treasury Management Policy.

2.0 RECOMMENDED: That the report be noted

3.0 SUPPORTING INFORMATION

3.1 Economic Background

The following has been provided by Sector, the Council's Treasury Management advisors (reports from 25/01/2011 show the inherent difficulty in projecting economic data)

The third quarter of 2010/11 saw

- Indicative figures initially showed activity had strengthened, suggesting that the recovery still had a reasonable amount of momentum. These activity indicators have since been revised and actual data shows a 0.5% contraction in the third quarter.
- Spending on the high street continued to recover.
- Conditions in the labour market deteriorated further.
- House prices continued to fall with some regional exceptions.
- Public finances deteriorated, questioning whether the government could meet its fiscal forecasts.
- The UK's trade deficit widened further, pouring cold water on hopes of an export-led recovery.
- CPI inflation increased and pipeline price pressures continued to build.
- The Monetary Policy Committee shied away from doing more quantitative easing.
- UK equities surged and gilt yields increased.
- Economic growth picked up strongly in the US and maintained pace in the euro-zone.

Activity indicators suggested that the recovery still has a reasonable amount of momentum. The CIPS/Markit surveys improved in the third quarter and are now consistent again with modest growth, having briefly pointed to a double-dip in prior months. The surveys suggested that the recovery weakened in the construction sector, but strengthened in the larger manufacturing sector. GDP (Gross Domestic Product) expanded by 0.7%q/q in the third quarter of 2010. As reported, actual data has now confirmed that the economy contracted by 0.5% in the third quarter.

There were signs that consumer spending improved during the quarter. Retail sales volumes rose by a solid 0.7% and 0.3% in October and November respectively. Survey evidence has suggested that December's heavy snowfall has not had too much of a negative effect on retail spending over the festive period as a whole, with consumers making up for weaker spending in early December during the post-Christmas "sales" period.

The resilience of consumer spending during the quarter was in sharp contrast to the renewed deterioration of conditions in the labour market. Employment on the Labour Force Survey (LFS) measure fell by 33,000 in the three months to October, which was far less than the large rises seen a few months ago. As a result, ILO unemployment rose by 35,000 over the same period.

House prices have also continued to fall during the quarter. The Nationwide measure fell by 0.7% m/m in October and 0.3%m/m in November, before rising by 0.4%m/m in December. The Halifax house price measure rose by 1.9% m/m in October, this only offset around half of the fall in September. The measure subsequently posted a small 0.1% m/m drop in November but a fall of 1.3% in December.

Public finances appear to have deteriorated during the quarter. Borrowing on the PSNB ex. measure was in line with 2009/10's figure in October but was £6bn higher than a year before in November. The figures therefore cast doubt on whether the Government will be able to meet its borrowing forecast of £149bn this year, some £7bn lower than last year's total. Elsewhere, there are still few signs that the external sector has begun to support the overall recovery. The trade in goods deficit widened again from £8.4bn to £8.5bn in October, while the overall deficit also grew from £3.8bn to £3.9bn. While export goods volumes rose by 2.2% m/m in October, import goods volumes rose by a larger 2.6%.

CPI (consumer price inflation) inflation edged up from 3.1% to 3.2% in October and then to 3.3% in November. Part of the rise may have reflected retailers pushing up their prices ahead of the VAT rise in January 2011. The rise also seems to have reflected the surge in commodity prices during the quarter and earlier in the year. If these commodities hold onto their recent price gains, then their inflationary effects will build over the next few months.

Encouraging activity data and strong inflation data prevented the Monetary Policy Committee (MPC) from following the Fed in sanctioning more quantitative easing (QE) at its November meeting.

The majority of members on the MPC have continued to vote for official interest rates to remain on hold at 0.5%; the minutes to their meetings suggested that most members thought that the risks that CPI inflation would overshoot the 2% target in two years time had grown. Some members also expressed concern about the recent rise in households' inflation expectations.

3.2 Economic Forecast

The following forecast has been provided by Sector:

	Mar11	Jun11	Sep11	Dec11	Mar12	Jun12	Sep12	Dec12	Mar13	Jun13	Sep13	Dec13
Sectors Bank Rate View	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.25%	2.75%	3.00%	3.25%
5yr PWLB	3.30%	3.30%	3.40%	3.50%	3.60%	3.80%	3.90%	4.10%	4.30%	4.60%	4.80%	4.90%
10yr PWLB	4.40%	4.40%	4.40%	4.50%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%	5.40%
25yr PWLB	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.40%	5.40%	5.50%	5.50%	5.60%	5.70%
50yr PWLB	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.40%	5.40%	5.50%	5.50%	5.60%	5.70%

The data suggests that Bank rate will remain largely at 0.50% throughout 2011, rising to 0.75% in December 2011 and continuing to rise to 3.25% by December 2013.

5 year and 25 year PWLB rates will begin to rise in September 2011 increasing steadily to 4.90% and 5.40% respectively by December 2013.

In the UK, sentiment has shifted in terms of concerns around the build up of inflationary pressures and there is an increase in concern as to the credibility of the MPC when inflation has been so much above its 2% target for such a long time. The MPC will be particularly concerned that the public's inflation expectations could become unhinged. There is a risk that the MPC may feel they will need to take action earlier than Q4, i.e. Q3, in order to do a damage limitation exercise to its credibility.

In line with widespread comment that the Bank of England's previous forecasts for growth were on the optimistic side, the November Inflation Report did downgrade the forecast for 2011 to about 2.3%. However, the Bank then slightly upgraded its forecast for growth in 2012 to around 3%, helped by the continuation of strong monetary policy stimulus through an exceptionally low Bank Rate and the current level of QE.

However, inherent in this optimistic forward looking view are major assumptions around a continuation of healthy world growth rates. This dependency is due to a combination of negative factors that are likely to dampen the UK growth rate: -

- the public sector will be a negative contributor to the UK growth rate;
- personal expenditure growth rates are likely to be weak;
- many corporates and people will be focused on cutting back over-borrowing in the years of easy and cheap credit;
- corporate and personal borrowing by borrowers seeking credit will be held back by banks caution in expanding credit when banks are faced with having to refinance huge sums of wholesale funding maturing over the next few years plus repaying all loans made by the Bank of England under the SLS scheme, which closes in early 2012.

There are significant potential downside risks to these forecasts and to the pace of both UK and world recovery, authorities should remain cautious when setting their investment budgets.

Any forecasts beyond a one year time horizon will be increasingly subject to being significantly amended as and when world events and financial markets change.

3.3 Short Term Rates

The bank base rate remained at 0.5% throughout the quarter.

		October		November		December	
	Start	Mid	End	Mid	End	Mid	End
	%	%	%	%	%	%	%
Call Money (Market)	0.55	0.56	0.56	0.56	0.56	0.56	0.57
1 Month (Market)	0.57	0.57	0.57	0.57	0.58	0.58	0.59
3 Month (Market)	0.73	0.74	0.74	0.74	0.74	0.75	0.76

3.3 Longer Term Rates

During October, 10 and 25 year PWLB rates increased on average by 1% following the CSR announcement. This has a significant impact on the cost of new borrowings from the PWLB.

		October		November		December	
	Start	Mid	End	Mid	End	Mid	End
	%	%	%	%	%	%	%
1 Year (Market)	1.47	1.47	1.48	1.49	1.49	1.50	1.51
10 Year (PWLB)	3.22	3.24	4.32	4.44	4.49	4.82	4.65
25 Year (PWLB)	3.96	4.13	5.17	5.27	5.25	5.47	5.23

Market rates are based on LIBOR rates published at the middle and end of each month. PWLB rates are for new loans in the “lower quota” entitlements.

3.5 Temporary Borrowing/Investments

Turnover during period

	No. Of Deals Struck	Turnover £m
Short Term Borrowing	2	3.50
Short Term Investments	36	66.65

Position at Month End

	October £m	November £m	December £m
Short Term Borrowing	0.00	0.00	0.00
Short Term Investments	24.65	21.25	22.55

Investment Income Forecast

The forecast income and outturn for the quarter is as follows:

	Cumulative Budget £'000	Cumulative Actual £'000	Cumulative Target Rate %	Cumulative Actual Rate %
Quarter 1	175	192	0.42	3.01
Quarter 2	251	344	0.42	2.46
Quarter 3	273	426	0.43	2.17
Quarter 4	275			

The Actual rate exceeds the benchmark rate reflecting previous actions taken, to lock in a large proportion of the investment portfolio into longer dated fixed rate investments. When these investments unwind, the Council will not generate the same amount of income it has experienced in previous years.

Delays in the capital programme have resulted in investments being held at current levels as opposed to being run down to finance capital expenditure.

The target rate is based on the 7-day LIBID rate. For comparison purposes the 1 month average rate was 0.43%, 3 month rate was 0.62% and the 6 month rate was 0.91%.

3.6 Policy Guidelines

Interest Rate Exposure – complied with.
Borrowing Instruments – complied with.

Prudential Indicators – complied with:
- Operational Boundary for external debt;
- Upper limit on interest rate exposure on fixed rate debt;
- Upper limit on interest rate exposure on variable rate debt;

- Maturity structure of borrowing as a percentage of fixed rate borrowing;
- Total principal sums invested for periods longer than 364 days;
- Maturity structure of new fixed rate borrowing

3.7 It is pleasing to report that Mike Lloyd, who manages the treasury function on a day to day basis, has completed the Certificate in International Treasury Management Public Finance (CertITM-PF). This helps to keep the relevant skills and knowledge up to date in a highly technical and important area that has generated considerable budget savings over many years.

4.0 INVESTMENT LIMITS

4.1 As part of the preparation for the Treasury Management Strategy 2011/12, Executive Board will review the approved counterparty list and investment limits held with each counterparty at this afternoons meeting.

The table below shows the current and proposed maximum amounts to be placed in different types of investment instruments:

Organisation	Criteria	Current Limit	Proposed Limit
Deposit with Banks	Minimum F1, A-1 or P-1 short term backed up by an 'A' long term credit rating and support ratings of 1, 2 or 3	£10m	£20m
Deposit Building Societies	Minimum F1, A-1 or P-1 short term back up by an 'A' long term credit rating and support ratings of 1, 2 or 3	£10m	£15m
UK Local Authorities		£10m	£10m
Institutions which are not credit rated	Building Society by asset size	£5m/£2.5m	£5m/2.5m

The Council continues to prioritise Security and Liquidity of investments over Yield. Therefore, as part of the Treasury Management Strategy 2011/12, it is proposed to increase the limits of investments held with counterparties whom it considers to be of high credit quality. It is proposed to remove a number of Building Societies from the counterparty list.

5.0 POLICY IMPLICATIONS

6.0 OTHER IMPLICATIONS

7.0 IMPLICATIONS FOR THE COUNCIL'S PRIORITIES

7.1 **Children and Young People in Halton**

None

7.2 **Employment, Learning and Skills in Halton**

None

7.3 **A Healthy Halton**

None

7.4 **A Safer Halton**

None

7.5 **Halton's Urban Renewal**

None

8.0 RISK ANALYSIS

8.1 The main risks with Treasury Management are security of investment and volatility of return. To combat this, the Authority operates within a clearly defined Treasury Management Policy and annual borrowing and investment strategy, which sets out the control framework

9.0 EQUALITY AND DIVERSITY ISSUES

9.1 There are no issues under this heading.

10.0 LIST OF BACKGROUND PAPERS UNDER SECTION 100D OF THE LOCAL GOVERNMENT ACT 1972

10.1 There are no background papers under the meaning of the Act.