REPORT TO:	Executive Board Sub Committee
DATE:	28th January 2010
REPORTING OFFICER:	Operational Director – Financial Services
SUBJECT:	Treasury Management 2009/10 3rd Quarter: October - December
WARDS:	

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 <u>Economic Background</u>

The third quarter of 2009/10 saw:

- Activity indicators suggest that the economy is finally exiting the recession;
- Household spending grow at its fastest rate since early 2008;
- The deterioration of the labour market slow considerably;
- Little improvement in the UK's trade position;
- Monetary policy loosened again...
- ...but with only limited effect on asset markets and the growth of the money supply;
- Inflation rise as higher energy costs pushed up the annual comparison;
- Financial markets make further gains, but at a much slower pace;
- International economies grow at a faster rate than the UK.

Monetary policy was loosened further in the third quarter. At its meeting in November, the Monetary Policy Committee (MPC) increased the amount of asset purchases under the Bank's Quantitative Easing (QE) programme by £25bn to £200bn. However, QE continued to have a relatively limited effect, and there were only tentative signs of a positive impact outside of financial markets.

Household spending in Q3 looks set to have grown at its fastest rate since early 2008. The annual growth in retail sales was the highest in nearly eighteen months in October. Retail sales should have received at least some support towards the end of the year as consumers brought forward spending before the reinstatement of the standard rate of VAT on the 1st January. High street spending appears to have been stronger too. New private car registrations were 86% higher in October and 141% higher in November than a year ago, partly as a result of the Government's car scrappage scheme.

Q3 also saw the rate of deterioration in the labour market slow considerably. Unemployment claimant count rose by 5,900 in October but *fell* by 6,300 in November 2009.

The improvement in the labour market no doubt supported the housing market, which continued to recover in the third quarter, albeit at a slightly slower rate than in Q2. The Nationwide house price index finished the quarter 1.5% higher than at the end of the previous quarter. The Halifax measure, which had been a little less buoyant in Q2, also posted decent rises. However, the rise in house prices continued to be largely driven by the shortage of homeowners putting their homes up for sale, suggesting that the rises may prove to be temporary.

Consumer Price Inflation (CPI) rose in the third quarter, from 1.1% in September to 1.5% in October and 1.9% in November, while RPI inflation returned to positive territory. Much of the rise in inflation was the result of energy price inflation turning from negative to positive.

The third quarter saw the global recovery continue to take hold. Once again, the recovery appeared to be strongest in the US. In the euro-zone, the output balance of the composite PMI index rose over the quarter to be consistent with quarterly growth in euro-zone GDP of around 0.5%. The recovery looked set to be strongest in France and Germany. But, like in the US, there were concerns that households in all countries remained reticent to spend.

3.2 Economic Forecast

The Council's Treasury Advisors, Sector, provides the following forecast:

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Bank rate	0.50%	0.50%	0.75%	1.00%	1.50%	2.25%	2.75%	3.25%	3.50%	3.75%	4.25%	4.25%	4.50%
5yr PWLB rate	3.05%	3.20%	3.30%	3.40%	3.60%	3.85%	4.15%	4.55%	4.60%	4.80%	4.80%	4.85%	4.85%
10yr PWLB rate	4.00%	4.05%	4.15%	4.30%	4.45%	4.60%	4.80%	4.90%	5.00%	5.10%	5.10%	5.15%	5.15%
25yr PWLB rate	4.55%	4.65%	4.70%	4.80%	4.90%	5.00%	5.05%	5.10%	5.20%	5.30%	5.30%	5.35%	5.35%
50yr PWLB rate	4.60%	4.70%	4.75%	4.90%	5.00%	5.10%	5.15%	5.20%	5.30%	5.40%	5.40%	5.45%	5.45%

- The forecast is based on moderate economic recovery and moderate MPC concerns about inflation looking 2 years ahead
- The first Bank Rate increase expected to be in the quarter ending September 2010; and is expected to reach 4.5% by the end of March 2013
- Long term PWLB rates are expected to steadily increase to reach 5.45% by end of 2012 due to huge gilt issuance, reversal of QE and investor concerns over inflation
- There is considerable uncertainty in all forecasts due to the difficulties of forecasting the timing and amounts of QE reversal, the fiscal effect of a general election, speed of recovery of banks profitability and balance sheet position, changes in the consumer saving ratio, rebalancing of the UK economy in terms of export and import etc

3.3 Short Term Rates

The bank base rate remained at 0.5% throughout the quarter. Investment rates continued to be historically poor.

		October		November		December	
	Start	Mid	End	Mid	End	Mid	End
	%	%	%	%	%	%	%
Call Money (Market)	0.50	0.50	0.50	0.50	0.50	0.50	0.50
1 Month (Market)	0.55	0.50	0.50	0.50	0.50	0.45	0.50
3 Month (Market)	0.65	0.60	0.60	0.60	0.60	0.60	0.60

3.4 Longer Term Rates

		October		November		December	
	Start	Mid	End	Mid	End	Mid	End
	%	%	%	%	%	%	%
1 Year (Market)	1.30	1.30	1.30	1.30	1.30	1.35	1.30
10 Year (PWLB)	3.80	3.69	3.87	4.02	3.79	4.12	4.30
25 Year (PWLB)	4.19	4.21	4.30	4.45	4.27	4.52	4.64

The 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	1	1.25
Short Term Investments	43	68.40

Position at Month End

	October £m	November £m	December £m
Short Term Borrowing	0.00	0.00	0.00
Short Term Investments	35.65	29.35	30.05

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	500	578	0.49	5.56
Quarter 2	940	1,105	0.45	5.00
Quarter 3	1,180	1,417	0.43	4.47
Quarter 4	1,335			

The investment income return for the period to date exceeds the target. This reflects the action taken last year to lock a large proportion of the investment portfolio into longer dated fixed rate investments. However as these deals unwind and current advice and practice is to keep investments of a much shorter duration, the lower replacement rates will see the average rate of return decrease dramatically during the rest of this financial year. Since short term rates are forecast to remain at historic lows for some time the investment income next year will be considerably lower.

The target rate is based on the 7 day libid rate. For comparison purposes the 1 month average rate was 0.51%, 3 month rate 0.59% and 6 months 0.81%.

3.6 Longer Term Borrowing/Investments

The authority did not borrow any new long term money. Due to the economic climate and interest rates available the authority did not enter into any long term investments and has continued with the policy of funding the effect of the 2009/10 year capital programme by running down its investments.

3.7 Policy Guidelines

Interest Rate Exposure – complied with.

Approved Counterparty List – 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

3.8 Treasury Management Code of Practice

CIPFA has recently issued a revised Treasury Management Code of Practice and guidance notes (late December 2009), highlighting Best Practice recommendations for Local Authorities to follow. The document recommends that members should be informed of Treasury Management activities quarterly (which is our current practice). This report therefore continues to ensure that the Council is embracing Best Practice in accordance with CIPFA's recommendations. The Annual Strategy Report to Executive Board in February 2010 will explain and update members on any issues which need addressing as a result of the updated Treasury Management Code of Practice 2009.

3.9 A members seminar on Treasury Management has been arranged for the 17th February 2010 in the Stobart Stadium. This will cover all aspects of treasury management and will be delivered by Sector, the Council's treasury management advisors.

4.0 POLICY IMPLICATIONS

4.1 None.

5.0 OTHER IMPLICATIONS

5.1 None.

6.0 IMPLICATIONS FOR THE COUNCIL'S PRIORITIES

6.1 Children and Young People in Halton

None.

6.2 Employment, Learning and Skills in Halton

None.

6.3 A Healthy Halton

None.

6.4 A Safer Halton

None.

6.5 **Halton's Urban Renewal**

None.

7.0 RISK ANALYSIS

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

8.0 EQUALITY AND DIVERSITY ISSUES

8.1 There are no issues under this heading.

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

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