REPORT TO: Executive Board Sub-Committee

DATE: 27th May 2010

REPORTING OFFICER: Operational Director – Finance

SUBJECT: Treasury Management 2009/10
4th Quarter: January - March

1.0 PURPOSE OF REPORT

1.1 The purpose of this 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 fourth quarter of 2009/10 saw:

- Activity indicators suggest that a double-dip recession has so far been avoided;
- Household spending was hit by the rise in VAT and the bad weather;
- The recovery continued to fail to create new jobs;
- The UK's trade position deteriorated, despite the weak pound;
- The Chancellor revised down his forecast for public sector borrowing in the Budget;
- The Monetary Policy Committee paused QE and kept official interest rates on hold at 0.5%;
- CPI Inflation increased to above 3%, but measures of core inflation fell;

The first official estimate of UK GDP for 2010 suggested that the economy managed to avoid a 'double-dip' recession and expand at a fairly decent rate in the fourth quarter of the financial year.

The recovery continued to fail to create jobs. Employment fell by 54,000 in the three months to January. Pay growth also remained weak.

The UK's trade position continued to deteriorate at the start of the last quarter, despite the weak pound. However, the continued strengthening of the export orders suggested that export volumes may pick up soon.

Public finances continued to deteriorate during the quarter, albeit at a slower pace than had been widely expected.

Temporary factors such as the rise in the rate of VAT in January and the rebound in oil prices pushed up the headline measures of inflation. Consumer Price Inflation (CPI) rose from 2.8% to 3.5% in January before falling to 3.0% in February. Inflation is forecast to fall due to spare capacity still available within the UK economy.

The Monetary Policy Committee (MPC) voted to keep official interest rates on hold at 0.5% and to pause its programme of Quantitative Easing (QE) at its key meeting in February, maintaining its stance in March.

House prices edged up. However, the recent recovery in the housing market petered out during the quarter, with the Bank of England's measure of mortgage approvals falling both in January and February.

3.2 Economic Forecast

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

	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%	0.50%	1.00%	1.50%	2.00%	2.50%	3.00%	3.25%	3.75%	4.25%	4.50%
5yr PWLB rate	3.10%	3.15%	3.20%	3.40%	3.65%	4.00%	4.30%	4.50%	4.65%	4.75%	4.80%	4.85%
10yr PWLB rate	4.35%	4.45%	4.50%	4.60%	4.70%	4.75%	4.90%	4.95%	5.10%	5.10%	5.15%	5.15%
25yr PWLB rate	4.75%	4.80%	4.85%	4.90%	5.00%	5.05%	5.10%	5.20%	5.30%	5.35%	5.35%	5.35%
50yr PWLB rate	4.75%	4.80%	4.85%	4.90%	5.05%	5.10%	5.15%	5.15%	5.30%	5.30%	5.30%	5.30%

- The forecast is based on moderate economic recovery and MPC inflation forecast being below target in two years' time.
- The first Bank Rate increase is expected to be 2011; and to reach 4.5% by March 2013.
- Long term PWLB rates are expected to steadily increase to reach 5.3% by early 2013 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.
- The balance of risks is weighted to the downside.
- There is still some risk of a "double-dip" recession.

3.3 Short Term Investment Rates

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

		January		February		March	
	Start	Mid	End	Mid	End	Mid	End
	%	%	%	%	%	%	%
Call Money (Market)	0.5	0.5	0.5	0.5	0.5	0.5	0.5
1 Month (Market)	0.5	0.6	0.6	0.6	0.6	0.6	0.6
3 Month (Market)	0.6	0.7	0.7	0.7	0.7	0.7	0.7

3.4 Longer Term Investment Rates

		January		February		March	
	Start	Mid	End	Mid	End	Mid	End
	%	%	%	%	%	%	%
1 Year (Market)	1.30	1.40	1.40	1.40	1.40	1.40	1.40
10 Year (PWLB)	4.30	4.27	4.25	4.33	4.27	4.34	4.26
25 Year (PWLB)	4.64	4.56	4.56	4.66	4.71	4.77	4.67

3.5 Temporary Borrowing/Investments

Turnover during period

	No. Of Deals Struck	Turnover £m
Short Term Borrowing	3	3.0
Short Term Investments	40	56.1

Position at Month End

	January £m	February £m	March £m
Short Term Borrowing	0	1.0	2.0
Short Term Investments	26.50	25.60	16.10

3.6 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	1,617	0.42	4.27

As previously reported, the investment income return for the period 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 has seen the average rate of return decrease dramatically during the latter part of the financial year. Since short term rates are forecast to remain at historic lows for some time the investment income in 2010/11 will be considerably lower.

3.7 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.

3.8 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

The Council continues to update its approved counterparty list to reflect the changes in credit worthiness of the organisations it lends to in line with its Treasury Management Practices. Following the sovereign downgrading of Spain, Santander UK PLC have issued a statement confirming that a majority of its UK business is done within the UK domestic market. It does not expect the Spanish downgrade to effect its UK business or deposits it receives from UK customers.

Halton Borough Council does not have any deposits with non UK banks.

The fluctuating nature of the world economy has meant a large number of financial organisations have had their credit worthiness reduced. This gives the council the added difficulty in choosing suitable counterparty's from its approved lend list. A formal review of the Counterparty list will be undertaken before the end of the year.

3.9 Treasury Management Strategy Statement

The Treasury Management Strategy Statement (TMSS) for 2009/10 was approved by full Council on 4th March 2009. The Council's Annual Investment Strategy, which is incorporated into the TMSS outlines the Council's investment priorities as follows:

- Security of Capital
- Liquidity

The Council will aim to achieve a return on investments commensurate with the proper levels of security and liquidity. In the current economic climate, it is considered appropriate to keep investments short, and only invest with highly credit rated financial institutions, using Sectors suggested credit worthiness approach.

3.10 Professional Services

The Council has a long and well established professional relationship with Sector. Sector provides a range of quality treasury services to a number of local authorities throughout the country. The Council's contract with Sector has recently been extended for a further 3 years and looks forward to working with Sector in the challenging times ahead.

In addition, the Council has extended its contract for Banking Services with Natwest for a further 3 years.

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

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