REPORT TO: Executive Board Sub-Committee

DATE: 5th November 2009

REPORTING OFFICER: Operational Director – Financial Services

SUBJECT: Treasury Management 2009/10
2nd Quarter: July –September

WARDS: Borough Wide

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.

1.2 CIPFA issued an interim Treasury Management guidance document in March 2009, highlighting Best Practice recommendations for Local Authorities to follow. The document suggests that members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This report therefore ensures this Council is embracing Best Practice in accordance with CIPFA's recommendations. It is expected that CIPFA will issue an updated Treasury Management Code of Practice in the autumn of 2009.

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:

Highlights of the quarter:

- There are some signs of recovery in the market, with some sectors showing growth
- Concerns remain about the fragile state of any recovery with the impact of rising unemployment, therefore bank rate/investment rates expected to stay lower for longer
- House prices rise at the fastest rate in over five years;
- An extension of the Bank of England's quantitative easing programme...
- ...but have limited success in boosting credit or money supply growth;

- Unemployment continue to rise and pay growth weaken further;
- Inflationary pressures in the economy ease further, but more slowly than had been expected;
- Conditions in financial markets improve further, and equity prices rally strongly;
- The pound fall back, yielding much of the gains made in the first quarter;
- Other major economies exit the recession, including the US.

At its meeting in August, the Monetary Policy Committee (MPC) increased the amount of asset purchases under the Bank's quantitative easing (QE) programme by £50bn to £175bn.

Net lending to businesses increased in August for the first month since March, however, the household sector as a whole reduced unsecured debt in August. Banks are likely to remain reluctant to lend while conditions in the labour market are still deteriorating. The claimant count rose by 25,200 in July and 24,400 in August. While these were smaller rises than in the first quarter, they were enough to take the claimant count above 1.6m, the highest level since Q2 1997.

Inflationary pressures in the economy eased further in the quarter, although at a slower rate than in the previous quarter, and more slowly than many expected. CPI inflation fell from 1.8% in June to 1.6% in August, largely as a result of falls in the annual rate of food and utility price inflation. However, core inflation rose from 1.6% in June to 1.8% in August – a higher rate than in other advanced economies. The rise most likely reflects the lagged impact of the pound's depreciation last year, and so should prove temporary.

The most upbeat news was from the housing market. The Nationwide house price index rose 3.8% in Q2, the largest quarterly rise since Q2 2004. House prices by this measure are now only 13.5% below their peak. And while the Halifax measure remained more downbeat, it too posted increases in the quarter. However, the rise in house prices appeared to be largely driven by the scarcity of homeowners putting their homes up for sale, suggesting that

3.2 Economic Forecast

The following forecast has been provided by Sector;

	Dec-09	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%	0.50%	0.75%	1.25%	1.75%	2.50%	3.00%	3.75%	4.00%	4.25%	4.50%	4.50%	4.50%
5yr PWLB rate	2.80%	2.90%	3.10%	3.20%	3.30%	3.55%	3.85%	4.15%	4.55%	4.60%	4.80%	4.80%	4.85%	4.85%
10yr PWLB rate	3.75%	3.80%	3.90%	4.00%	4.15%	4.30%	4.55%	4.75%	4.95%	5.00%	5.10%	5.15%	5.15%	5.15%
25yr PWLB rate	4.35%	4.45%	4.55%	4.60%	4.70%	4.90%	5.00%	5.00%	5.10%	5.20%	5.30%	5.30%	5.35%	5.35%
50yr PWLB rate	4.50%	4.55%	4.70%	4.75%	4.90%	5.00%	5.15%	5.15%	5.20%	5.25%	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 is expected to be in Q2 of 2010/11
- Bank Rate to reach 4.5% in Q2 of 2012/13
- Long term PWLB rates to steadily increase to reach 5.45% by the end of 2012 due to high gilt issuance, reversal of QE and investor concerns over inflation
- There is a high level of uncertainties in all the above forecasts. This is due to the difficulties of forecasting the timing and amounts of QE reversal, fiscal contraction after the general election expected by May 2010, speed of recovery of banks' profitability and balance sheet positions, changes in the consumer saving ratio and rebalancing of the UK economy towards exports.

3.3 Short Term Rates

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

		July		August		September	
	Start	Mid	End	Mid	End	Mid	End
	%	%	%	%	%	%	%
Call Money (Market)	0.45	0.50	0.50	0.50	0.50	0.50	0.50
1 Month (Market)	0.65	0.60	0.60	0.60	0.55	0.55	0.55
3 Month (Market)	1.25	1.10	1.00	0.90	0.85	0.70	0.65

3.4 Longer Term Rates

		July		August		September	
	Start	Mid	End	Mid	End	Mid	End
	%	%	%	%	%	%	%
1 Year (Market)	1.95	1.80	1.90	1.55	1.35	1.35	1.30
10 Year (PWLB)	3.68	3.90	4.12	3.85	3.71	3.78	3.80
25 Year (PWLB)	4.47	4.51	4.76	4.33	4.21	4.19	4.19

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	3	7.20
Short Term Investments	47	64.70

Position at Month End

	July £m	August £m	September £m
Short Term Borrowing	2.50	0.00	0.00
Short Term Investments	42.75	42.00	42.95

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			
Quarter 4	1,335			

The investment income return for the half year 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 0.43%, 3 month rate 0.67% and 6 months averaging 0.89%.

3.6 <u>Longer Term Borrowing/Investments</u>

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 it's investments.

3.7 <u>Policy Guidelines</u>

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

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.