REPORT TO:	Executive Board Sub-Committee
DATE:	4th November 2010
REPORTING OFFICER:	Operational Director – Finance
TITLE:	Treasury Management 2010/11 2nd Quarter: July - September
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.

1.2 CIPFA issued the revised Code of Practice for Treasury Management in November 2009. The revised code suggests members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This report therefore ensures Halton Borough Council is embracing Best Practice in accordance with CIPFA's revised Code.

2.0 RECOMMENDED: That the report be noted,

3.0 SUPPORTING INFORMATION

3.1 <u>Economic Background</u>

The following has been provided by Sector, the Council's Treasury Management advisors:

The second quarter of 2010/11 saw

- Activity indicators suggest that the recovery had faded sharply from the previous quarter (1st April to 30th June).
- The pace of recovery in retail spending had slowed, but the recovery in spending off the high street gathered pace.
- Further doubt had been cast on the sustainability of the recovery in the labour market.
- The recovery in the housing market had faltered.
- Disappointment that the public finances were not on a clearly improving trend.
- The UK's trade deficit had widened further, despite the continued weakness of the sterling.
- CPI inflation had fallen at a slower pace than in the previous quarter.

Activity indicators have suggested that the recovery has lost considerable pace since real GDP (Gross Domestic Product) expanded by only 1.2% in the second quarter of 2010. The data suggests that GDP growth will slow to around 0.2% by the end of the year (well below the long term average of about 0.5%).

The recovery off the high street may have picked up but the recovery in retail spending through shops seemed to have deteriorated as retail sales volumes fell by 0.5% on the previous month.

Further doubt has been cast on the sustainability of the recovery in the labour market. The ILO measure of employment was around 8,000 lower in the 3 months to July although employment actually rose by 286,000 over the same period.

The recovery in the housing market had also begun to falter. 47,400 mortgages for new house purchases were approved in August on the Bank of England's official measure. The Nationwide house price index fell by 0.5% and 0.8% in July and August respectively, before rising by 0.1% in September.

Augusts' public finance figures severely dented hopes that the fiscal position was on an improving trend. The public borrowing figure of £15.9bn in August was nearly £2bn larger than at the same time a year ago. The figure left a cumulative borrowing total in the first five months of the fiscal year at £58.1bn, around £4bn below last years equivalent figure of £61.9bn.

The UK's trade deficit widened further despite the continued weakness in sterling. The trade in goods deficit rose from £7.5bn to £8.7bn in July which was the largest deficit on record.

CPI (Consumer Price Inflation) fell from 3.2% to 3.1% in July and remained unchanged in August. An easing in clothes deflation and a pick-up in food and drink inflation were responsible for preventing CPI falling further. The Bank of England had suggested that inflation would fall below the 2% target and remain there at the two-year policy horizon. The MPC (Monetary Policy Committee) voted to maintain the outstanding stock of asset purchases under quantitative easing (QE) at £200bn.

3.2 Economic Forecast

The following forecast has been provided by Sector:

	NOW	Dec10	Mar11	Jun11	Sep11	Dec11	Mar12	Jun12	Sep12	Dec12	Mar13	Jun13
Sectors Bank Rate View	**0.50%**	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.50%	3.00%	3.25%
5yr PWLB	**1.88%**	2.20%	2.20%	2.40%	2.60%	2.80%	3.00%	3.30%	3.60%	3.80%	4.10%	4.40%
10yr PWLB	**3.14%**	3.30%	3.30%	3.40%	3.70%	3.90%	4.00%	4.30%	4.40%	4.60%	4.60%	4.90%
25yr PWLB	**4.04%**	4.20%	4.30%	430%	4.40%	4.50%	4.70%	4.70%	4.80%	5.00%	5.00%	5.00%
50yr PWLB	**4.10%**	4.20%	4.30%	4.30%	4.40%	4.50%	4.70%	4.70%	4.80%	5.00%	5.00%	5.00%

The data suggests that Bank rate will remain at 0.50% for at least the next 12 months, rising to 0.75% in September 2011 and to 3.25% by June 2013.

5 year and 25 year PWLB rates will begin to rise in December 2010 increasing steadily to 4.40% and 5.00% respectively by June 2013.

It is difficult to say with confidence exactly how long the UK economic recovery is likely to take. There are huge uncertainties in all economic forecasts due to the major difficulties in forecasting the areas of:

- The speed of the recovery in the US and EU;
- The degree to which the coalition governments austerity programmes dampen economic growth;
- The speed of rebalancing the UK economy towards exporting;
- The potential for more quantitative easing and its timing in the UK and US;
- The speed of the banks return to profitability and balance sheet stability;
- The potential for future sovereign EU debt crisis impacting on financial markets and the global economy.

The overall balance of risks is weighted to the downside and there is some risk of a double dip recession.

3.3 Short Term Rates

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

		July		August		September	
	Start	Mid	End	Mid	End	Mid	End
	%	%	%	%	%	%	%
Call Money (Market)	0.55	0.55	0.55	0.55	0.55	0.55	0.55
1 Month (Market)	0.57	0.57	0.57	0.57	0.57	0.57	0.57
3 Month (Market)	0.73	0.73	0.74	0.73	0.73	0.72	0.73

3.3 Longer Term Rates

		July		August		September	
	Start	Mid	End	Mid	End	Mid	End
	%	%	%	%	%	%	%
1 Year (Market)	1.46	1.46	1.48	1.46	1.46	1.47	1.47
10 Year (PWLB)	3.64	3.71	3.62	3.41	3.13	3.39	3.22
25 Year (PWLB)	4.29	4.35	4.40	4.19	3.91	4.20	3.96

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	1	6.25
Short Term Investments	44	72.52

Position at Month End

	July £m	August £m	September £m
Short Term Borrowing	6.25	0	0
Short Term Investments	35.95	24.35	25.15

During the period, short term investments have been used to meet expenditure in the early and middle parts of the year, rather than choosing to borrow at additional cost. This has resulted in a reduction of short term investments held at the end of each month. There was no short term borrowings outstanding at the end of the quarter.

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			
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.

The target rate is based on the 7-day LIBID rate. For comparison purposes the 1 month average rate was 0.44%, 3 month rate was 0.61% and the 6 month rate was 0.90%.

3.6 Policy Guidelines

Interest Rate Exposure – complied with.

Approved Counterparty List – The council actively reviews the creditworthiness of counterparties within its approved lendlist. A deposit was placed with Natwest, the council's own bank, which exceeded the deposit limit by £1.6 million for 1 day in July.

This decision was taken based on the council's priority towards the security and liquidity of funds it deposits as opposed to the potential yield generated from investing funds on the money market at a higher risk.

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 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Councils Treasury Management Strategy Statement and in compliance with the Councils Treasury Management Practices. The Prudential and Treasury Indicators are shown in appendix 1.

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 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

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.

Appendix 1: Prudential and Treasury Indicators as at 30th September 2010

Prudential Indicator	**2010/11 Indicator**	**Q2 - Actual**
Capital Financing Requirement (CFR)	£99.9m	
Gross Borrowing		£22.0m
Investments		£25.2m
Net Investments		£3.2m
Authorised limit for external debt	£84.7m	£22.0m
Operational boundary for external debt	£79.7m	£22.0m
Upper Limit on interest rate exposure on fixed rate debt	£59.75m	£10.0m
Upper Limit on interest rate exposure on Variable rate debt	£59.75m	£10.0m
Principal Sums invested >364 days		
12 months to 2 years	60%	0%
2 years to 3 years	30%	0%
Maturity Structure of new borrowing		
Under 12 Months	50%	0%
12 months to 2 years	75%	0%
2 years to 5 years	75%	0%
5 years to 10 years	75%	0%
10 years above	75%	0%