REPORT TO:	Executive Board
DATE:	24th May 2012
REPORTING OFFICER:	Operational Director – Finance
TITLE:	Treasury Management 2011/12 4th Quarter: January - March
PORTFOLIO:	Resources
WARDS:	Borough Wide

1.0 PURPOSE OF REPORT

1.1 The purpose of the report is to update the board 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

(Provided by Sector Treasury Services)

- News on the economy generally improved;
- Demand on the high street increased, albeit driven in part by discounting;
- Employment rose, but not at a quick enough rate to stop unemployment from rising;
- The Chancellor presented a fiscally-neutral Budget;
- Inflation continued to drop;
- The Monetary Policy Committee (MPC) announced another tranche of quantitative easing (QE) but were cooler on the prospect of further asset purchases thereafter;
- Sentiment towards the Eurozone improved due to the ECB's generous liquidity provision and Eurozone agreement of a second bailout for Greece;

The pick-up in the business surveys at the start of the year suggest that the economy managed to avoid relapsing into a technical recession in the first quarter of the year (after output contracted by 0.3% in Q4). The weighted output balance of the CIPS/Markit surveys rose to a level consistent with a quarterly expansion of approximately 0.5%. The CIPS surveys, which exclude the retail sector and high street spending, which were also strong at the start of the year.

However, there were tentative signs later in the quarter that the recovery might have started to lose momentum. The business surveys fell in February, as did the official measure of consumer spending. The Bank of England's agents' scores were also painting a less upbeat picture of activity than the CIPS/Markit surveys.

Employment continued to increase. The Labour Force Survey measure of employment rose by 9,000 in the three months to January. The quarterly Workforce Jobs measure of employment rose by some 123,000 in Q4, helping to narrow the gap that had previously opened up with the LFS measure. Some of the more forward-looking employment surveys also improved.

However, employment failed to rise fast enough to keep pace with the growth of those losing their jobs. Accordingly, unemployment rose further. Admittedly, the rises in the claimant count measure of unemployment were modest – about 7,000 in both January and February.

Pay growth remained very weak. Lower bonuses pulled annual growth of overall average earnings down to 1.2% in January. Excluding bonuses, growth was 1.7%. Given the high rates of inflation, real pay continued to fall sharply.

House prices remained volatile. The Halifax measure rose and the Nationwide measure fell in January – and vice versa in February. Mortgage approvals fell in February, even though the approaching end of the stamp duty holiday for first-time buyers should have boosted demand.

Banks' funding costs eased a little at the start of the quarter although they remained elevated. Banks have begun to pass these costs onto borrowers by raising their borrowing rates on certain types of mortgages.

Meanwhile, the trade data continued to hold up surprisingly well given the crisis in the UK's main export market, the Eurozone. In January, the trade deficit shrank to its lowest level since 2003. Exports to peripheral Eurozone countries continued to fall, but held up to the bigger Eurozone economies.

Survey measures of export orders painted a mixed picture; the CBI measure picked up sharply in the quarter, whilst the BCC and the CIPS/Markit measures weakened.

The latest public finance figures suggested that, contrary to previous indications, public sector borrowing in 2011/12 was unlikely to undershoot the forecasts made by the Office for Budget Responsibility (OBR) in November. Indeed, in its new forecasts published alongside the Budget on 21st March, the OBR nudged down its borrowing forecast by just £1bn to £126bn.

Borrowing was lowered by a cumulative £11bn over the total forecast period. However, the Chancellor was still only expected to meet his fiscal mandate (to balance the cyclically-adjusted current budget) with little headroom.

The Chancellor delivered a broadly fiscally-neutral Budget. An extra 1% cut in corporation tax and a rise in the personal tax allowance was paid for by a freeze in tax allowances for the elderly, extra taxes on the very rich (other than a cut in the 50p tax rate to 45p) and lower spending on Afghanistan.

Elsewhere, inflation fell further in the first quarter. CPI inflation fell from 4.2% in December to 3.4% in February. Core inflation fell as January 2011's rise in the rate of VAT fell out of the annual comparison.

At 3.4% CPI remains above the 2% inflation target. The 2.5% rise in petrol prices suggests that inflation may hold steady or even rise in March.

Oil prices stabilised during the quarter at about $125 per barrel. Medium-term indicators of inflation suggested that underlying price pressures are still weak. Admittedly, inflation expectations nudged up during the quarter. However, this was probably a temporary response to the rise in oil prices.

Sentiment towards the Eurozone improved following the ECB's second Long-Term Refinancing Operation in February and the conclusion of a second bailout package for Greece in the second half of the quarter. This followed an agreement by the Greek Government to another major austerity package and agreement by private holders of Greek debt to a substantial haircut in the value of their holdings. This bailout dissipated fears of an imminent Lehman's type meltdown in financial markets. However, the economic news suggested that the Eurozone economy was still heading towards recession and major concerns continued that this 'resolution' has done little more than to buy some time.

In the UK the MPC announced another £50bn of quantitative easing (QE) in February, having completed the previous £75bn of purchases. But the consensus view was that the MPC is unlikely to undertake further purchases once the current ones are finished in May. February's Bank of England Inflation Report suggested that the inflation target would be met on the current policy stance.

Markets also brought forward their timing of the first interest rate rise, as a result of the improved economic news, subsiding concerns of the EU debt crisis, and a consequent partial reversal of safe haven flows into non-EU government bonds. Gilt yields rose during the quarter, with ten year yields reaching around 2.4%, before falling back at the end of the quarter to 2.2%.

The US economy strengthened outperforming most economies. Although all the evidence suggested that annualised GDP growth in the first quarter did not match the 3% of the fourth quarter of 2011, growth of between 1.5% and 2.0% seemed plausible. What's more, it won't be long before the increases in non-farm payroll employment by more than 200,000 in each of the three months to February translate into faster income and consumption growth.

3.2 Economic Forecast

The following forecast has been provided by Sector:

	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.25%	2.50%
5yr PWLB rate	2.30%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.10%	3.30%	3.50%	3.70%
10yr PWLB rate	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.80%	4.00%	4.20%	4.40%	4.60%	4.80%
25yr PWLB rate	4.20%	4.30%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%
50yr PWLB rate	4.30%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%

The Sector central forecast is for the first increase in bank rate to be in September 2013. With low growth predictions for the U.K, and financial markets unconvinced that politicians have resolved the Eurozone sovereign debt crisis, we are likely to continue to experience high levels of volatility.

SUMMARY OUTLOOK

The outlook for the global economy remains clouded with uncertainty. The UK economy has struggled to generate a sustained recovery so this offers little hope for a strong recovery in 2012, and possibly even into 2013. Consumer and business confidence levels are generally low and it is not easy to see potential for a significant increase in the growth rate in the short term.

Eurozone

- Sovereign debt crisis has abated following agreement on a second bailout package of €130bn for Greece in mid February;
- ECB provided c. €1trn of 3yr funding to EU banks at 1%;
- Eurozone banks used this financing at 1% to buy new sovereign debt issues yielding significantly higher rates; this has pushed some Eurozone sovereign yields down below panic levels – notably Spain and Italy;
- One potential problem on the horizon is various national elections. Greece is likely to go to the polls in April / May 2012; Germany in 2013; French presidential election in April / May 2012 where Sarkozy is lagging behind the Socialist front runner;
- Major uncertainties surround future prospects for the bloc.

US

- Economic prospects encouraged by some positive news, but improvement is still limited;
- The likelihood of a weak rate of growth going forward will mean slow progress in reducing the high level of unemployment which is acting as such a dampener on the economy;
- Bernanke has hinted at the possibility of another round of QE aimed at encouraging a strong enough rate of growth to reduce the total level of unemployment significantly;

- US still has to address reducing the huge total of public debt and annual deficits by adopting austerity measures;
- Presidential elections are due in November 2012.

China
- Falling inflation has opened the way for relaxing credit restrictions to boost growth, which has been flagging;
- However, current expectations are that it will maintain a reasonable rate of growth, though less than in previous years.

UK
- Austerity measures, aimed at getting the public sector deficit into order over the next four years, have yet to fully impact on the economy;
- However, it looks likely that the private sector will not make up for the negative impact on employment in the public sector over the next year;
- Lack of significant progress in generating a rebalancing of the UK economy to manufacturing from services and an export led recovery - albeit some upbeat data in April has been received;
- The housing market, a gauge of consumer confidence, remains weak and the outlook is for house prices to be little changed for a prolonged period;
- Economic forecasts for 2012 and beyond have been revised lower on a near quarterly basis;
- Bank of England embarked on a £75bn second round of Quantitative Easing (QE) to stimulate economic activity in October 2011. Another £50bn was added to the programme in February 2012. The MPC is currently split on whether there needs to be another increase in QE in 2012, after some reasonably encouraging economic statistics, indicating that the fall in GDP in Q4 2011 looks like being a one off, rather than the start of a new trend towards recession;
- Inflation has eased from its peak of 5.2% (CPI) in September 2011, with strong expectation that CPI will hit 2% target rate within the MPC's two year time horizon;
- UK AAA rating put on negative outlook by Moody's in February 2012 and by Fitch in March. Concerns over growth outlook and potential shocks from the Eurozone to also depress growth;
- However, "safe haven" status has underpinned demand for gilts and kept yields at historic lows. Unlikely to see material change in near term.

Sector's forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. Key areas of uncertainty include:

- The potential for the unravelling or failure of implementation of the second Greek bailout package causing a worsening of the Eurozone debt crisis. Election likely in Greece in April / May 2012. Elections due in the US, Germany and France in 2012 or 2013;
- Inter-government agreement on how to deal with the Eurozone debt crisis could fragment, particularly as a result of upcoming national election results;

- The impact of the Eurozone crisis on financial markets and the banking sector;
- The impact of the UK Government's austerity plan on confidence and growth;
- Potential for failure of UK inflation to fall back to near the 2% target;
- Monetary policy action failing to stimulate growth in western economies;
- The potential for weak growth or recession in the UK's main trading partners - the EU and US;
- High oil prices depressing world growth and stoking inflation;
- The political situation in the Middle East, particularly over Iran's nuclear ambitions;
- Potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China;
- A hard landing for slowing growth in China.

The overall balance of risks remains weighted to the downside. The view is that the longer run trend is for gilt yields and PWLB rates are set to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

Given the weak outlook for economic growth, the prospects for any interest rate changes before late 2013 as very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

3.3 Short Term Rates

The bank base rate remained at 0.50% throughout the quarter.

		Jan		Feb		Mar	
	Start	Mid	End	Mid	End	Mid	End
	%	%	%	%	%	%	%
Call Money (Market)	0.63	0.63	0.62	0.61	0.60	0.59	0.58
1 Month (Market)	0.77	0.78	0.77	0.76	0.74	0.71	0.70
3 Month (Market)	1.08	1.09	1.08	1.08	1.06	1.04	1.03

3.4 Longer Term Rates

		Jan		Feb		Mar	
	Start	Mid	End	Mid	End	Mid	End
	%	%	%	%	%	%	%
1 Year (Market)	1.87	1.88	1.89	1.89	1.88	1.87	1.86
10 Year (PWLB)	3.11	3.11	3.12	3.26	3.26	3.48	3.30
25 Year (PWLB)	4.03	3.99	4.03	4.24	4.20	4.42	4.33

Market rates are based on LIBOR rates published at the middle and end of each month. PWLB rates are for new loans based on principal repayable at maturity.

3.5 Temporary Borrowing/Investments

Turnover during period

	No. Of Deals Struck	Turnover £m
Short Term Borrowing	7	15.50
Short Term Investments	32	65.85

Position at Month End

	Jan £m	Feb £m	Mar £m
Short Term Borrowing	23.00	26.00	27.00
Short Term Investments	62.25	72.05	76.85

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	19	34	0.46	1.09
Quarter 2	37	218	0.47	1.16
Quarter 3	64	449	0.50	1.27
Quarter 4	90	755	0.48	1.40

The actual rate exceeds the benchmark rate. This is due to the management of cash deposits around the planned delivery of the capital programme and most notably the acquisition of land for the Mersey Gateway project.

The target rate is based on the 7-day LIBID rate. For comparison purposes the 1 month average rate was 0.62%, 3 month rate was 0.94% and the 6 month rate was 1.25%.

3.6 New Borrowing

Sector's 25 year PWLB target rate for new long term borrowing for the quarter remained at 4.20%. Due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement - CFR), new external borrowing of £10.0m was undertaken from PWLB as follows:

Source	Value (£m)	Rate (%)
PWLB	10.00	1.76

3.7 Policy Guidelines

The Treasury Management Strategy Statement (TMSS) for 2011/12, which includes the Annual Investment Strategy, was approved by the Council on 2nd March 2011. It sets out the Council's investment priorities as being:

- Security of Capital;
- Liquidity; and
- Yield

The Council will also aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate and the heightened credit concerns it is considered appropriate to keep investments short term with a maximum duration of 3 months.

This limit will apply to all entities on the suggested Sector Credit List with the following exceptions:

1. UK Government and related entities such as Local Authorities. Their suggested duration limit will remain at 5yrs.

2. UK semi-nationalised institutions (Lloyds / RBS). We continue to view the current significant UK ownership of these entities as providing significant comfort to investors.

During the financial year to date the Council has operated within the treasury limits and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

During the final quarter of 2011/12, the Council temporarily breached its Operational Boundary when acquiring further borrowing for the Mersey Gateway. This was a short term breach that was eliminated in the first quarter of 2012/13. There were no other breaches of approved limits within the Annual Investment Strategy for the quarter ended 30th March 2012.

4.0 DEBT RESCHEDULING

4.1 No debt rescheduling was undertaken during the quarter.

5.0 IMPLICATIONS FOR THE COUNCIL'S PRIORITIES

5.1 There are no direct implications, however, the revenue budget and capital programme support the delivery and achievement of all the Council's priorities.

6.0 RISK ANALYSIS

6.1 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

7.0 EQUALITY AND DIVERSITY ISSUES

7.1 There are no issues under this heading.

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

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