Committee and Date	Item
SMB 31 October 2011 Audit Committee 10 November 2011 Cabinet 16 November 2011	**4** Public

TREASURY MANAGEMENT UPDATE – QUARTER 2 2011/12

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1. Summary

1.1. The report outlines the treasury management activities of the Council in the last quarter. It highlights the economic environment in which treasury management decisions have been made and the interest rate forecasts of the Council's Treasury Advisor, Sector Treasury Services. It also updates Members on the internal treasury team's performance.

1.2. During the second quarter of 2011/12 the internal treasury team achieved a return of 0.98% on the Council's cash balances outperforming the benchmark by 0.59%. This amounts to additional income of £141,600 during the quarter which is included within the Council's projected outturn position in the monthly revenue monitor.

2. Recommendations

2.1. Members are asked to accept the position as set out in the report.

REPORT

3. Risk Assessment and Opportunities Appraisal

3.1. The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998.

3.2. There are no direct environmental, equalities or climate change consequences arising from this report.

3.3. Compliance with the CIPFA Code of Practice on Treasury Management, the Council's Treasury Policy Statement and Treasury Management Practices and the Prudential Code for Capital Finance together with the rigorous internal controls will enable the Council to manage the risk associated with Treasury Management activities and the potential for financial loss.

4. Financial Implications

4.1. There are no direct financial implications arising from this report.

5. Background

5.1. The Council defines its treasury management activities as "the management of the authority's investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks". The report informs Members of the treasury activities of the Council between 1 July 2011 and 30 September 2011.

6. Economic Background

6.1. Sector's view is that the economic recovery in the UK has ground to a halt during the quarter. Indicators suggest that the economy has at best stagnated. Conditions on the high street have deteriorated further and the levels of employment have fallen again. The pace of job losses across the whole economy looks unlikely to ease off in the coming months. In the US and the eurozone, economic recovery has also lost a significant amount of momentum.

6.2. Conditions in the housing market have also continued to deteriorate. Whilst the number of mortgage approvals for new house purchases rose during the quarter this has not prevented renewed falls in house prices.

6.3. Inflationary pressures continued to rise during the quarter. Consumer Price Inflation (CPI) rose from 4.2% in June to 4.4% in July and 4.5% in August. A series of rises in electricity and gas prices also took effect in late August and September which, together with a rise in food inflation, could push inflation close to 5% in September.

6.4. The Monetary Policy Committee (MPC) voted to keep official interest rates on hold at 0.5% during the quarter and to not increase its programme of asset purchases under the Bank's quantitative easing (QE) programme. However, since the end of the quarter the MPC decided to increase its QE programme by a further £75 billion, this clearly underlines how concerned the MPC now is about the prospects for growth of the UK economy. Most MPC members still think that the rise in inflation will only be temporary and that inflation will fall back sharply next year. So despite the worsening near term inflation outlook, the weakness of the activity data has pushed members further away from an interest rate rise.

6.5. Financial market sentiment deteriorated sharply in the second quarter, reflecting declining prospects for economic growth and renewed risk aversion as a result of the eurozone sovereign debt crisis. The FTSE 100 index finished the quarter 14% lower than its level at the end of the first quarter.

7. Economic Forecast

7.1. The Council receives its treasury advice from Sector Treasury Services. Sector has recently undertaken a review of their interest rate forecasts as a result of two major events. The decision by the MPC to expand quantitative easing over the next four months by a further £75 billion had an immediate effect of reducing long term borrowing rates and the marked deterioration of growth prospects in the US, EU and UK, especially as concerns have further increased over Greece and the potential fall out from their debt situation also depressed PWLB rates to even lower levels. Their latest interest rate forecasts to 31 March 2015 are shown below:

Sector's Interest Rate View															
	Now	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Sector's Bank Rate View	**0.50%**	0.50%	0.50%	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	**2.41%**	2.30%	2.30%	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	**3.46%**	3.30%	3.30%	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	**4.31%**	4.20%	4.20%	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	**4.42%**	4.30%	4.30%	4.30%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%

7.2. Sector believes the Bank Rate will remain at its current low level of 0.50% until September 2013 when it is expected to rise to 0.75%. The Bank Rate is then expected to gradually increase to reach 1.25% by 31 March 2014 and 2.5% by 31 March 2015.

7.3. Long term PWLB rates are expected to fall slightly to 4.30% in December 2011 before steadily increasing over time to reach 5.30% by 31 March 2015 due to high gilt issuance in the UK and the high volume of debt issuance in other major western countries.

7.4. There is considerable uncertainty in all forecasts due to the speed of economic recovery in the US and EU, the degree to which government austerity programmes will dampen economic growth, the potential for more quantitative easing and the timing of this in both the UK and US, the potential for a major EU sovereign debt crisis and the speed of recovery of banks profitability and balance sheet position.

8. Treasury Management Strategy

8.1. The Treasury Management Strategy (TMS) for 2011/12 was approved by Full Council on 24 February 2011. The Council's Annual Investment Strategy, which is incorporated in the TMS, outlines the Council's investment priorities as the security and liquidity of its capital.

8.2. The Council aims to achieve the optimum 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 term (up to 1 year), and only invest with highly credit rated financial institutions using the Sector's suggested creditworthiness approach, including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Sector. The Treasury Team continue to take a prudent approach keeping investments short term and with the most highly credit rated organisations. This approach has been endorsed by our external advisors, Sector.

8.3. In the second quarter of 2011/12 the internal treasury team outperformed its benchmark by 0.59%. The investment return was 0.98% compared to the benchmark of 0.39%. This amounts to additional income of £141,600 during the quarter which is included in the Council's projected outturn position in the monthly revenue monitor.

8.4. A full list of investments held as at 30 September 2011, compared to Sector's counterparty list, and changes to Fitch, Moody's and Standard & Poor's credit ratings are shown in Appendix A. None of the approved limits within the Annual Investment Strategy were breached during the second quarter of 2011/12. Officers continue to monitor the credit ratings of institutions on a daily basis. Delegated authority has been put in place to make any amendments to the approved lending list.

8.5. As illustrated in the economic background section above, investment rates available in the market are at an historical low point. The average level of funds available for investment purposes in the second quarter of 2011/12 was £96 million.

8.6. The Council's interest receivable/payable budgets are currently projecting a surplus of £163,000 due to no long term borrowing being undertaken to date.

9. Borrowing

9.1. It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy. A list of the approved limits is shown in Appendix B. The schedule at Appendix C details the Prudential Borrowing approved and utilised to date.

9.2. The Prudential Indicators were not breached during the second quarter of 2011/12 and have not been previously breached. The Internal Treasury team made loans totalling £94 million during the quarter and £99 million was repaid during the quarter.

9.3. Sector's target rate for new long term borrowing (25 years) for the second quarter of 2011/12 started at 5.40% and ended at 5.10%. Due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement - CFR), new external borrowing of £8 million (excluding HRA) is required in 2011/12, however no long term borrowing has been undertaken to date. As outlined below, borrowing rates have fallen during the quarter across all bands. The low points during the quarter were seen in the latter part of September. The high points were seen on the 1 July 2011.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.42%	2.18%	3.31%	4.41%	4.54%
Date	23/09/11	13/09/11	13/09/11	23/09/11	23/09/11

High	1.64%	3.17%	4.50%	5.28%	5.25%
Date	01/07/11	01/07/11	01/07/11	01/07/11	01/07/11
Average	1.50%	2.59%	3.82%	4.84%	4.88%

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)
Cabinet 03 August 2011, Treasury Management Update Quarter 1 2011/12.
Council, 24 February 2011, Treasury Strategy 2011/12.

Cabinet Member:
Keith Barrow, Leader of the Council

Local Member
N/A

Appendices
A. Investment Report as at 30 September 2011
B. Prudential Limits
C. Prudential Borrowing Schedule