Subject:	**TREASURY MANAGEMENT QUARTER THREE REPORT**
Meeting and Date:	**Governance Committee – 14 March 2013**
Report of:	**Mike Davis, Director of Finance, Housing & Community**
Classification:	**Unrestricted**
Purpose of the report:	To provide details of the Council's treasury management for the quarter ended 31st December 2012 and an update of activity to date.
Recommendation:	That the report is received

1. Summary

As at 31st December 2012, the Council's in-house investments (approximately £10.5m or 45% of total investments) and investments with the investment managers, Investec (approximately £12.9m or 55% of total investments) are currently outperforming their benchmark[1]. The total interest received for the quarter (£137k) is above budget for the period.

The Council has remained within its Treasury Management and Prudential Code guidelines during the period.

2. Introduction and Background

CIPFA (the Chartered Institute of Public Finance and Accountancy) issued the revised Code of Practice for Treasury Management in November 2009: it recommends that members should be updated on treasury management activities at least twice a year, but preferably quarterly. This report therefore ensures this council is implementing best practice in accordance with the Code.

In order to comply with the CIPFA code referred to above, but minimise the resource requirements in producing this report, a brief summary is provided below, and Annex 1 contains a full report from the Council's Treasury Management Advisers, Sector.

Council adopted the 2012/13 Treasury Management Strategy on 7th March 2012 as part of the 2012/13 Budget and Medium Term Financial Plan.

3. Annual investment strategy

The investment portfolio as at the end of September is attached at Annex 2. Since the end of quarter three, in-house investments with Bank of Scotland totalling £4m have matured and are currently held in a call account to support the cash flow over the year-end period. In addition, a number of externally managed investments have matured or been sold since the end of the quarter. An update is attached at Annex 4.

In the current economic climate and with 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] The "benchmark" is the interest rate against which performance is assessed. DDC use the London Inter-Bank Bid Rate or LIBID, as its benchmark.

- UK Government and related entities such as Local Authorities. Their suggested duration limit remains at 5 years.

- UK semi-nationalised institutions (Lloyds / RBS). Sector continue to view the current significant UK ownership of these entities as providing significant comfort to investors. Their suggested duration limit is 12 months.

- Money Market Funds, which are “instant access” accounts.

Sector do not believe we should be unduly worried about prior investment decisions, rather that by restricting new investments to the above limits portfolios will be allowed to lower risk naturally as investments mature.

4. **Economic background**

The report attached contains information up to the end of December 2012; since then we have received the following update from Sector:

UK Sovereign Rating

Moody's Investors Service downgraded the sovereign rating of the United Kingdom by one notch to AA1 from AAA. The Outlook on the rating is now Stable. The downgrade itself was not a real surprise to the markets as Moody’s had the UK on negative watch since February 2012. The move did not tell us anything we did not already know. It has been clear for some time that the coalition Government’s fiscal consolidation plans have been blown off course. Indeed, stripping out special factors, underlying public borrowing is set to rise slightly this year and will be some £35bn above the forecast in the original plans published back in 2010.

The main drivers of the downgrade were as follows:

- The continuing weakness in the UK's medium-term growth outlook, with a period of sluggish growth which Moody's now expects will extend into the second half of the decade;
- The challenges that subdued medium-term growth prospects pose to the government's fiscal consolidation programme, which will now extend well into the next parliament;
- And, as a consequence of the UK's high and rising debt burden, a deterioration in the shock absorption capacity of the government's balance sheet, which is unlikely to reverse before 2016.

Moody's stated that the UK's creditworthiness remains extremely high, rated at AA1, because of the country's significant credit strengths. These include (i) a highly competitive, well□diversified economy; (ii) a strong track record of fiscal consolidation and a robust institutional structure; and (iii) a favourable debt structure, with supportive domestic demand for government debt, the longest average maturity structure (15 years) among all highly-rated sovereigns globally and the resulting reduced interest rate risk on UK debt.

The Stable Outlook on the UK's AA1 sovereign rating reflects Moody's expectation that a combination of political will and medium-term fundamental underlying economic strengths will, in time, allow the Government to implement its fiscal consolidation plan and reverse the UK's debt trajectory.

We would also like to stress that Moody's has said it "…does not consider this rating change has any implications for the standalone strength of UK financial institutions, or for the systemic support uplift factored into certain UK financial institutions' unguaranteed debt ratings." Sector, therefore, does not expect any consequent action on UK entities in the near term.

UK GDP

The UK economy contracted by 0.3% in the final quarter of 2012 as originally estimated, but yearly growth was revised up. The figures highlight the danger of a third recession since the 2008 financial crisis, less than a month before finance minister George Osborne lays out his budget plans for the coming year. Admittedly, there were a few positives in this release. For a start, GDP is now estimated to have grown by 0.2% rather than to have flat-lined in 2012, reflecting small upward revisions to growth in the first and third quarters. And of course, the drop in GDP in Q4 largely reflected the fading of the Olympics boost in Q3.

Bank of England (BoE) – MPC minutes

The Bank of England's Monetary Policy Committee was split 6-3 on more bond purchases at its latest meeting, unexpectedly reviving the prospect that the central bank might restart its quantitative easing programme. Bank of England governor Mervyn King, executive director for markets Paul Fisher and external MPC member David Miles all voted for an increase in the central bank's bond purchases to 400 billion pounds from 375 billion pounds. The last time there was a similar 6-3 split on the MPC was in June 2012, and the following month a majority of the MPC backed a 50 billion pound increase in asset purchases. In recent months, only Miles had supported more bond purchases

UK CPI

Britain's inflation rate unexpectedly remained unchanged for the fourth consecutive month in January, holding at its highest level since May. The Office for National Statistics said that annual consumer price inflation held at 2.7 percent. This was the first time inflation remained unchanged for four months in a row since records began in 1996, the ONS said. The biggest upward contribution to the annual rate came from an 8.5 percent rise in the prices of alcohol and tobacco, while the main downward pressures came from slower increases in the prices of miscellaneous goods and services, such as money transfer fees, as well as clothes and shoes. Persistently high inflation has in the past few years restrained consumer spending - traditionally a key driver of economic growth in Britain - and limited the scope for asset purchases by the central bank, aimed at supporting the economy.

UK Consumer Confidence

British consumer morale rose in January when people grew less pessimistic about the year ahead and more willing to undertake major purchases, a survey from GfK NOP showed. GfK NOP's headline consumer confidence index rose to -26 from December's -29, beating analysts' forecasts for it to remain unchanged and moving back towards the 18-month high of -22 hit in November. There have been some more positive signs for consumers from the Bank of England's Funding for Lending Scheme, which appears to have boosted mortgage availability and supported house prices.

UK Retail Sales

British retail sales posted a surprise fall in January as unusually snowy weather hurt food stores in particular. The Office for National Statistics said sales volumes including automotive fuel fell 0.6 percent on the month and on the year - confounding economists' forecasts for higher sales. The ONS said the main reason behind the falls was bad weather during the month, which led to shutdowns of some smaller grocers and drove the biggest monthly fall in food sales since May 2011.

5. **Interest Rates**

Given the circumstances, and the potential for damaging prospects for recovery, Sector sees the prospects for any interest rate changes before early 2014 as very limited.

6. **New Borrowing**

The Council's borrowing portfolio is attached at Annex 3. No new borrowing was undertaken during the quarter.

7. **Debt Rescheduling**

At this time it is not of benefit to the Council to consider rescheduling of its long-term debt, as advised by Sector.

8. **Compliance with Treasury and Prudential Limits**

The Council has operated within the treasury limits and Prudential Indicators and in compliance with the Council's Treasury Management Practices.

9. **Iceland update**

The Icelandic Supreme Court found in favour of UK local authorities and other UK wholesale depositors last year. This judgment means that UK local authorities' claims have been recognised as deposits with priority status over other creditors' claims and that they will be paid first when it comes to getting their money back.

It is estimated that we will receive approximately 100% of the value of the deposit back. However, this will fluctuate due to currency valuations as the sums are being paid in sterling, US dollars, Euros and Icelandic Kroner. To date we have received £499,515, leaving a balance of £500,485, as shown in Annex 2.

10. **Appendices**

Appendix 1 – Sector treasury management report for quarter two
Appendix 2 – Investment portfolio as at 31st December 2012
Appendix 3 – Borrowing portfolio as at 31st December 2012
Appendix 4 – Investment portfolio as at 31st January 2013 (Sector) and 28th February 2013 (In-House)

11. **Background Papers**

Medium Term Financial Plan 2012/13 – 2014/15

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