Subject:	**TREASURY MANAGEMENT QUARTER TWO REPORT**
Meeting and Date:	**Governance – 6 December 2012**
Report of:	**Mike Davis, Director of Finance, Housing & Community**
Purpose of the report:	To provide details of the Council's treasury management for the quarter ended 30th September 2012 and an update of activity to date.
Recommendation:	That the report is received

1. **Summary**

As at 30th September 2012, the Council's in-house investments (approximately £11.6m or 47% of total investments) and investments with the investment managers, Investec (approximately £12.8m or 53% of total investments) are currently outperforming their benchmark[1]. The total interest received for the quarter (£80k) 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 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 two, an in-house investment with Bank of Scotland for £5m matured and has been re-invested with them over varying durations. 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 year

- 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 September 2012; since then we have received the following update from Sector:

UK GDP

The UK economy left recession in the third quarter after posting its strongest quarterly GDP growth in five years, although temporary effects may have masked a weaker underlying picture. The Office for National Statistics (ONS) said Britain's gross domestic product rose by 1.0 percent between July and September after shrinking by 0.4 percent between April and June. On the year, the economy was flat. The return to growth after three consecutive quarters of contraction is welcome news for a coalition government under pressure to do more to revive the economy. The third quarter reading was boosted by ticket sales for the London Olympics and a rebound from the previous three months when an extra public holiday dented output. Bank of England Governor Mervyn King cautioned that the recovery would remain slow, with threats posed by the Eurozone debt crisis and a cooling of the fast-growing economies of India, China and Brazil. Nevertheless, investors scaled back expectations for another cash boost from the BoE as King said policymakers would think "long and hard" before extending the currently approved 375 billion pounds of quantitative easing bond purchases.

UK CPI

UK CPI jumped to a five-month high in October, driven by higher university fees and food prices. Annual CPI surged to 2.7 percent from 2.2 percent in September, the Office for National Statistics said, raising the chance the BoE will have to increase its short-term inflation forecast. Inflation hit its lowest level since November 2009 in September. The central bank had already expected the decline to stall, and currently does not forecast inflation will drop below its 2 percent target until the second half of 2013. Some central bankers have voiced inflation concerns, as well as doubts about whether further purchases of government debt can boost growth at a time when major headwinds include ongoing worries about the Eurozone and a lack of bank credit. The main driver for October's rise in inflation was an increase in maximum university tuition fees to £9,000 a year from just over £3,000 previously, adding 0.3 percentage points to the inflation rate. Also pushing up inflation were higher food prices, in part due to bad weather raising the cost of potatoes, as well as higher transport costs due to higher second-hand car prices.

UK Unemployment

The number of Britons claiming unemployment benefits posted its sharpest increase in over a year in October after a jobs boost from the Olympics faded, data showed, highlighting the fragile health of the British economy. The number of people claiming jobless benefit rose by 10,100 last month, the largest increase since September 2011, the Office for National Statistics said. Analysts had forecast an unchanged reading. The number of people without a job on the wider ILO measure fell by 49,000 in the three months through September to 2.514 million. The jobless rate dipped to 7.8 percent, compared with forecasts for a reading of 7.9 percent. While the ONS had no direct anecdotal evidence that people lost jobs after the end of the Olympics and Paralympics, which took place in August and September, the statisticians said the claimant count rose in London in the last two months.

Bank of England Inflation Report (November 12)

UK inflation is likely to be significantly higher over the next 18 months than expected in August, posing a barrier to further policy stimulus. In its quarterly Inflation Report, the central bank's projections showed it would take until the third quarter of 2014 before inflation fell below its 2 percent target, nine months later than predicted in August, despite sluggish growth.

UK Trade

UK's trade deficit narrowed more than expected in September, and third-quarter construction output fell by a similar amount to earlier estimates, reducing the chance of a downward revision to quarterly GDP. UK's economy bounced out of recession in the third quarter, growing by 1 percent, but weak economic data since then had made some analysts concerned that this growth figure could be revised lower.

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 £438,264, leaving a balance of £561,736, as shown in Annex 2.

10. **Appendices**

Annex 1 – Sector treasury management report for quarter two
Annex 2 – Investment portfolio as at 30th September 2012
Annex 3 – Borrowing portfolio as at 30th September 2012
Annex 4 – Investment portfolio as at 19th November 2012

11. **Background Papers**

Medium Term Financial Plan 2011/12– 2013/14

Medium Term Financial Plan 2012/13 – 2014/15

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