PART A

Report to: Audit Committee
Date of meeting: 13th March 2013
Report of: Head of Strategic Finance
Title: Treasury Management Update Report

1.0 SUMMARY

1.1 This report provides the regular review of the Council's Treasury Management Strategy and investment performance.

2.0 RECOMMENDATIONS

2.1 That the Committee notes the report.

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3.0 Background

3.1 The United Kingdom has lost its much prized triple AAA status with one of the credit rating agencies (Moody's, which has however put the UK on a 'stable' rating which makes it unlikely any further down grade would occur for at least 18 months). The other two main credit rating agencies (Fitch and Standard & Poors) will probably follow suit in the near future. Only Germany and Canada now have a triple AAA credit rating throughout the World.

3.2 The downgrade to AA1 was anticipated to cause a run on sterling with predictions that it would reach parity with the Euro (currently 1.15 Euros to the £); and with a large fall against the dollar (currently 1.50 dollars to the £). Contrary to the Bank of England's perceived 'wisdom' a fall in the £ would not be good news. Mervyn King has consistently talked down sterling over the past three years with little or no effect upon an increase in the UK's export performance. The downside of course is that most raw materials / utility costs are all paid in dollars and will therefore increase the cost to consumers.

3.3 The markets initially reacted negatively when they opened on Monday 25th February with falls against the two major currencies. Then along came the Italian Election which to some extent has saved the UK's bacon.

3.4 The uncertainties within the Euro zone that had abated have re-surfaced as a consequence of the Italian general election result where the majority of seats were won by 'anti-austerity' parties. The two leaders of these parties, Beppe Grillo and Silvio Berlusconi have threatened to pull Italy out of the euro currency block and reinstate the lira. The previous 'technocrat' prime minister imposed on Italy by Brussels & Berlin, Mario Monti, polled a miserable 9% of the vote and is totally discredited.

3.5 Berlusconi (who won the majority of seats in the Upper House, the Senate), has stated…'A deal with Monti is impossible. His austerity policies have put the Country into a dangerous recessionary spiral, with rising debt and unemployment, and the closure of a thousand firms a day.'….

3.6 The threat to pull Italy out of the euro is not necessarily 'tub thumping' as Italy is one of the few countries that could potentially survive very well outside the euro zone. It has low private debt and 9 trillion euros of private wealth. Its total debt level is lower than France, the UK, the US or Japan and its budget is in near primary balance (and was in surplus before 'austerity').

3.7 On the downside however it needs to refinance 420billion euros of debt in 2013 where it is suffering by having to pay 3.30% more in borrowing costs than Germany (and traders anticipate the election result uncertainty will raise this to 4%).

3.8 The great fear is that the European Central bank will find it impossible to prop up the Italian bond market under its blanket ‘Outright Monetary Transactions’ scheme if the Italian Government is unwilling to continue to follow the Brussels/ German diktat of more austerity. The fear of contagion is being priced in by the markets and as a consequence, the UK has escaped (for now) an increase in its own borrowing costs as it continues to enjoy safe haven status.

3.9 The United States has arrived at its ‘monthly’ crisis as it has yet to resolve the political impasse between tax increases and expenditure cuts and is currently reducing expenditure within the public sector as a short term expedient. This is only a sticking plaster however and a proper future strategy needs to be hammered out.

3.10 The UK has its own ‘challenge’ coming up in the near future with much attention focussed upon the Chancellor’s Budget on 20th March. Prior to that, the Bank of England’s Monetary Policy Committee meet on 7th March and may well inject a further £25 billion into its (now) discredited Quantitative Easing project which, apart from having increasingly limited effect upon lending, actually puts pressure on inflation and is steadily causing critical problems for the UK Pensions Funding industry through deteriorating investment returns.

3.11 The United Kingdom would appear to have failed to protect banking institutions in the UK from pay and bonus controls even where staff are located outside the euro zone area. This resulted from a late change of heart by Germany and it is feared will encourage major banks to relocate outside the euro zone area altogether. The greatest victim should this occur would be the United Kingdom.

4.0 The Council’s Current Investment Strategy

4.1 The Council’s strategy gives priority to the security of its assets before seeking a high interest rate return. The current relative calm had encouraged the Portfolio to have a longer maturity profile of between 3 to 6 months.

4.2 The current returns on offer are truly depressing as the information below indicates:

	1month %	3 months %	6 months %	9 months %	12 months %
Barclays	0.30	0.38	0.52	0.67	0.80
Lloyds	0.40	0.70	0.80	0.95	1.10
Santander	0.43	0.48	0.60	0.79	0.88
Leeds BS	-	-	0.50	0.69	0.76
Skipton BS	0.40	0.43	0.65	0.75	0.95

4.3 Information from the Council's Treasury advisers, Sector, indicate this same profile exists even should the Council wish to use highly credit rated foreign banks (always assuming they wish to accept relatively small investment deposits). The Council could of course access Russian banks where I am informed the going rate is 11%, but this is not a course I am recommending !

4.4 Two deposits are due back on 4/5th March. Both from Barclays (one of which paying 1.82% reflects just how much the 'market' has changed) and we will effectively just 'tread water' with £2m going back out to Barclays for 3 months @ 0.38%; and another £2m being placed with Nationwide @ 0.44%.

4.5 The Council's current investment portfolio is attached at **Appendix 1.**

5.0 IMPLICATIONS

5.1 **Financial Issues**

The Head of Strategic Finance comments that the revenue estimates for 2012/ 2013 has assumed £325k of investment interest will be achieved (based upon a 1.3% rate of return). It is anticipated that this will be achieved due to fact that the investment portfolio has been larger than originally anticipated which has offset the fact that the investment return is likely to be closer to 1.15%.

5.2 For 2013/2014, should interest rates continue on their current course then it is unlikely that the £270k investment interest assumed within the Budget will be achieved. This will be reviewed before the next Meeting of the Audit Committee in June.

5.3 **Legal Issues** (Monitoring Officer)

The Head of Legal and Property Services comments that there are statutory limitations governing cash fund investments and all proposals within this report ensure continued compliance.

5.4 **Potential Risks**

Potential Risk	**Likelihood**	**Impact**	**Overall score**
Investment with non approved body	1	3	3
Investment with an approved counterparty that subsequently defaults	1	4	4
Failure to achieve investment interest budget targets	3	2	6
Those risks scoring 9 or above are considered significant and will need specific attention in project management. They will also be added to the service's Risk Register.			

5.5 **Staffing & Equalities**

None Directly

5.6 **Accommodation**

None Directly