

Treasury Management Strategy Statement and Annual Investment Strategy for 2010/11

1. Introduction

1.1 The Revised CIPFA Treasury Management Code of Practice 2009

In the light of the Icelandic situation in 2008, CIPFA has amended the CIPFA Treasury Management in the Public Services Code of Practice (the Code) and Cross-Sectoral Guidance Notes and Guidance Notes for Local Authorities including Police and Fire Authorities and the template for the revised Treasury Management Policy Statement. As both the Code and the Treasury Policy Statement have been revised in response to the new guidance, the Council is required to formally adopt the Code as set out at **Appendix 1** of this document and an update of the Treasury Policy Statement as set out at **Appendix 2** of this document.

The revised Code has emphasised a number of key areas including the following: -

- a) All councils must formally adopt the revised Code and four clauses.
- b) The strategy report will affirm that the effective management and control of risk are prime objectives of the Council's treasury management activities.
- c) The Council's appetite for risk must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out.
- d) Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation.
- e) Credit ratings should only be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on government support for banks and the credit ratings of that government support.
- f) Councils need a sound diversification policy with high credit quality counterparties and should consider setting country, sector and group limits.
- g) Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme or to finance future debt maturities.
- h) The main annual treasury management reports **MUST** be approved by full council.
- i) There needs to be, at a minimum, a mid year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved.
- j) Each council must delegate the role of scrutiny of treasury management strategy and policies to a specific named body.
- k) Treasury management performance and policy setting should be subjected to prior scrutiny.
- l) Members should be provided with access to relevant training.

- m) Those charged with governance are also personally responsible for ensuring they have the necessary skills and training.
- n) Responsibility for these activities must be clearly defined within the organisation.
- o) Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Council (this will form part of the updated Treasury Management Practices).

This strategy statement has been prepared in accordance with the revised Code. Accordingly, the Council's Treasury Management Strategy will be approved annually by full Council and there will also be a mid year report. In addition there will be monitoring reports and regular review by members in both executive and scrutiny functions. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

This Council will adopt the following reporting arrangements in accordance with the requirements of the revised Code: -

Area of Responsibility	Council/ Committee/ Officer	Frequency
Treasury Management Policy Statement (revised)	Full Council	Initial adoption in 2010
Treasury Management Strategy / Annual Investment Strategy / MRP policy	Full Council	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid year report	Finance and Property Advisory Board and Cabinet	Mid year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions	Full Council	As required
Annual Treasury Outturn Report	Cabinet and full Council	Annually by 30 June after the end of the year
Treasury Management Monitoring Reports	Finance and Property Advisory Board / Cabinet	As appropriate
Treasury Management Practices	Finance and Property Advisory Board / Cabinet	As required
Scrutiny of treasury management strategy	Audit Committee	Annually before the start of the year
Scrutiny of treasury management performance	Audit Committee	As appropriate

1.2 Revised CIPFA Prudential Code

CIPFA has also issued a revised Prudential Code which primarily covers borrowing and the Prudential Indicators. Three of these indicators have now been moved from being Prudential Indicators to being Treasury Indicators: -

- authorised limit for external debt
- operational boundary for external debt
- actual external debt.

1.3 Revised Investment Guidance

It should also be noted that the Department for Communities and Local Government is currently undertaking a consultation exercise on draft revised investment guidance which will result in the issue of amended investment guidance for English local authorities to come into effect from 1 April 2010. It is not currently expected that there will be any major changes required over and above the changes already required by the revised Code.

1.4 Treasury Management Strategy for 2010/11

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act) (included as paragraph 7 of this document); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy for 2010/11 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Sector Treasury Services.

The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council
- prudential and treasury Indicators (**Appendix 3**)
- the current treasury position
- the borrowing requirement
- prospects for interest rates (**Appendix 4**)
- the investment strategy
- policy on use of external service providers

1.5 Balanced Budget Requirement

It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from: -

1. increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
2. any increases in running costs from new capital projects are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

2. Treasury Limits for 2010/11 to 2012/13

It is a statutory duty under Section 3 of the Act and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years, details of which can be found at **Appendix 3**.

3. Prudential and Treasury Indicators for 2010/11 – 2012/13

Prudential and Treasury Indicators (the latter as set out at **Appendix 3** are relevant for the purposes of setting an integrated treasury management strategy.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The original 2001 Code was adopted on 30 September 2003 by the full Council and the revised Code will be adopted on 18 February 2010.

4. Current Portfolio Position

The Council is debt free and as such the overall treasury portfolio position at 31/12/09 comprised only investments, which totalled £38.2m and were generating an averaged return of 2.1%.

5. Borrowing Requirement

Other than for cash flow purposes and then within the limits set out at **Appendix 3**

borrowing will not be necessary.

6. Prospects for Interest Rates

The Council has appointed Sector Treasury Services as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. **Appendix 4** draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view.

Sector Bank Rate forecast for financial year ends (March)

- 2010 0.50%
- 2011 1.50%
- 2012 3.50%
- 2013 4.50%

There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected. A detailed view of the current economic background is contained within **Appendix 5** to this report.

7. Annual Investment Strategy

7.1 Investment Policy

The Council will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are: -

- (a) the security of capital and
- (b) the liquidity of its investments.

The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

Investment instruments identified for use in the financial year are listed in **Appendix 6** under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices.

7.2 Creditworthiness policy

This Council uses the creditworthiness service provided by Sector Treasury Services. This service has been progressively enhanced over the last year and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does

not rely solely on the current credit ratings of counterparties but also uses the following as overlays: -

- credit watches and credit outlooks from credit rating agencies
- CDS spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to inform the process for determining the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector's weekly credit list of worldwide potential counterparties. The Council will therefore use only those counterparties within the following durational bands:

- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour not to be used

This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moodys are currently very much more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending list. The Sector creditworthiness service uses ratings from all three agencies, but by using a scoring system does not give undue preponderance to just one agency's ratings.

All credit ratings will be reviewed on a weekly basis and monitored on a daily basis. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- In addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and information, information on government support for banks and the credit ratings of that government support.

7.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA from Fitch Ratings (or equivalent from other agencies if Fitch does not provide) The list of countries that qualify using this credit criteria as at the date of this report are shown in **Appendix 7**. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

In the event of the Sovereign rating of the UK being downgraded from AAA, investments may continue to be made with those institutions named by the UK Government and underpinned by their implicit support.

Avoidance of a concentration of investments in too few counterparties or countries is a key to the effectiveness of limits and in this regard the limits set out below are thought to achieve a prudent balance between risk and practicality in respect of core and cash flow funds:

State/Sector and Counter party type	UK	Europe excl UK	Rest of the world
Core Funds			
Geographical sector	75%	40%	40%
AAA sovereign states within each geographical sector	100%	25%	25%
Group limit as % of geographical sector limit	25%	25%	25%
Individual counter party limit as a % of geographical sector limit – F1+/AA-/B/2	25%	25%	25%
Individual counter party limit as a % of geographical sector limit – the eight named UK institutions and wholly owned subsidiaries whose support rating reflects the implicit support of HMG	20%	N/A	N/A
Cash flow funds excluding AAA MR1+ Money Market Funds			
Geographical sector	100%	40%	40%
AAA sovereign states within each geographical sector	100%	25%	25%
Group limit as % of geographical sector limit	25%	25%	25%
Individual counter party limit as a % of	25%	25%	25%

geographical sector limit – F1+/AA-/B/2			
Individual counter party limit as a % of geographical sector limit – the eight named UK institutions and wholly owned subsidiaries whose support rating reflects the implicit support of HMG	20%	N/A	N/A

7.4 In-house funds:

The Council's in-house managed funds currently comprise a mix of core and cash flow funds.

Core investment

The core investments managed internally will be held until maturity unless credit worthiness concerns prompt a request for early repayment. Upon maturity these funds are to be transferred to the external fund manager in order to further reduce counter party risk, through access to the highest quality names. The details of the core investments are as follows:

Counterparty	Amount	Interest rate	Maturity or call dates
Ulster Bank Markets Ltd	£5.0m	5.74%	26/1/10
Barclays Bank plc	£2.5m	7.05%	19/7/10 and 17/1/11
Nationwide Building Society	£2.5m	6.25%	27/5/11

The anticipated averaged rate of return on those core investments extending into 2010/11 is 6.4% based on the expectation that Barclays Bank will exercise their right to call for repayment on 19/7/10.

Cash flow investments

The average cash flow balance expected to be managed internally during the coming year will be in the region of £4.5m. That balance excludes surpluses available for longer than 3 months, which under the Investment Strategy for 2009/10 are placed with the external fund manager. For 2010/11 this is to remain the default action unless the Treasury Management Team determine in concert that a better rate of return can be achieved without undue added risk from managing those funds internally.

Investments in respect of cash flow will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Bank Rate is forecast to commence rising in quarter 3 of 2010 and then to rise steadily from thereon. Bank Rate forecasts for financial year ends (March) are as follows: -

- **2010** 0.50%
- **2011** 1.50%
- **2012** 3.50%
- **2013** 4.50%

There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

The Council will, accordingly, avoid locking into longer term deals while investment rates are down at historically low levels unless exceptionally attractive rates are available which make longer term deals worthwhile.

An investment return of 1.25% is currently considered achievable on cash flow investments placed during the financial year through the use of business reserve accounts, money market funds and short-dated deposits (overnight to three months) to benefit from the compounding of interest.

7.5 External fund managers

Around £20m of the Council's funds core and cash flow surpluses available for longer than 3 months are currently externally managed on a discretionary basis by Investec Asset Management Ltd, who are obliged to comply with the Annual Investment Strategy. The agreement between the Council and the fund manager additionally stipulate guidelines and duration and other limits in order to contain and control risk.

Investec's view on interest rates and opportunities for gilts/bonds is to:

Remain defensively positioned holding short dated money market instruments in anticipation of the eventual rise in official rates from what are emergency levels. Official rates may not rise till June or possibly even the Sept quarter, but market rates will anticipate the move well before, especially in longer dated assets of 1year and longer. Short dated Gilt yields are likely to rise sharply once QE finishes and it is anticipated this market may well offer the greatest area of interest and value during 10/11, as the huge issuance program will require attractive yields to attract investors in order for them to hold such paper under so much issuance. In summary, the strategy is to remain defensively positioned until yields start to rise and to then look to increase duration by extending maturities in both gilts and money market instruments as yields become more compelling.

For 2010/11 the central case forecast of investment return is 2% and it is suggested that the Council should budget for this figure on core investments.

7.6 Overall return on core investments

When taking into account the internally managed core funds referred to at paragraph 7.4 and the anticipated rate of return predicted by Investec ay paragraph 7.5 the overall investment return on core funds is currently expected to be 2.5%.

7.7 End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

8. Policy on the use of external service providers

The Council uses Sector Treasury Services as its external treasury management advisers.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

9. Scheme of delegation

Please refer to **Appendix 8** for details of the scheme of delegation.

10. Role of the section 151 officer

Please refer to **Appendix 9** for details of the role of the section 151 officer.

APPENDICES

1. CIPFA Treasury Management Code of Practice 2009
 2. Treasury Management Policy Statement
 3. Prudential and Treasury indicators
 4. Interest rate forecasts
 5. Economic background
 6. Specified and non specified investments
 7. Approved countries for investments
 8. Treasury management scheme of delegation
 9. The treasury management role of the section 151 officer
-

Appendix 1

CIPFA Treasury Management Code of Practice 2009

INTRODUCTION

The CIPFA Code of Practice on Treasury Management in Local Authorities was last updated in 2001 and has been revised in 2009 in the light of the default by Icelandic banks in 2008. The revised Code requires that a report be submitted to the council, board or other appropriate body, setting out four amended clauses which should be formally passed in order to approve adoption of the new version of the Code of Practice and Cross-Sectoral Guidance Notes.

The revised Code also includes an amended version of the treasury management policy statement (TMPS) incorporating just three clauses and a revised definition of treasury management activities. The Code does not require this statement to be approved by the council, board or other appropriate body.

The revised Code has also set out various requirements which have been summarised in paragraph 1 of the latest Treasury Management Strategy Statement.

RESOLUTIONS

CIPFA recommends that all public service organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances, the following four clauses.

1. This organisation will create and maintain, as the cornerstones for effective treasury management:

- a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
- suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.

2. The Cabinet will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs for recommendation to Council as appropriate and in accordance with the Council's Financial Procedure Rules and legislation.

3. This organisation delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Cabinet via the Finance and Property Advisory Board, and for the execution and administration of treasury management decisions to the Director of Finance, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

4. This organisation nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Appendix 2**Treasury Management Policy Statement**

1. This organisation 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”.
2. This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.
3. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.”

Appendix 3

Prudential and Treasury Indicators

The prudential indicators cannot be set until the capital programme is finally determined and will as a consequence be reported as part of the Setting the Budget 2010/11 report that is to be submitted to Cabinet on 2 February.

The treasury management indicators are as set out in the table below:

TREASURY MANAGEMENT INDICATORS	2008/09	2009/10	2010/11	2011/12	2012/13
	actual	estimate	estimate	estimate	estimate
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt - borrowing	£Nil	£5,000	£5,000	£5,000	£5,000
other long term liabilities	£Nil	£Nil	£Nil	£Nil	£Nil
TOTAL	£Nil	£Nil	£5,000	£5,000	£5,000
Operational Boundary for external debt - Borrowing on overdraft	£2,600	£2,000	£2,000	£2,000	£2,000
other long term liabilities	£Nil	£Nil	£Nil	£Nil	£Nil
TOTAL	£2,600	£2,000	£2,000	£2,000	£2,000
Actual external debt	£Nil	£Nil	£Nil	£Nil	£Nil
Upper limit for net fixed (>1year) interest rate exposure-	27%	10%	It is anticipated that the net exposure will range between 0 % to 60%.		
Upper limit for net variable (<1 year) rate exposure	73%	90%	It is anticipated that net exposure will range between 40% to 100%		
Upper limit for total principal sums invested for over 364 days	£5,000	£2,500	60% of core funds	60% of core funds	60% of core funds
Maturity structure of fixed rate borrowing during 2010/11			upper limit	lower limit	
under 12 months			100%	0%	
Over 12 months			0%	0%	

Appendix 4

Interest Rate Forecasts

The data below shows a variety of forecasts published by a number of institutions. The first three are individual forecasts including those of UBS and Capital Economics (an independent forecasting consultancy). The final one represents summarised figures drawn from the population of all major City banks and academic institutions.

The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

1. INDIVIDUAL FORECASTS

Sector interest rate forecast – 23.11.09

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Bank rate	0.50%	0.50%	0.75%	1.00%	1.50%	2.25%	2.75%	3.25%	3.50%	3.75%	4.25%	4.25%	4.50%
5yr PWLB rate	3.05%	3.20%	3.30%	3.40%	3.60%	3.85%	4.15%	4.55%	4.60%	4.80%	4.80%	4.85%	4.85%
10yr PWLB rate	4.00%	4.05%	4.15%	4.30%	4.45%	4.60%	4.80%	4.90%	5.00%	5.10%	5.10%	5.15%	5.15%
25yr PWLB rate	4.55%	4.65%	4.70%	4.80%	4.90%	5.00%	5.05%	5.10%	5.20%	5.30%	5.30%	5.35%	5.35%
50yr PWLB rate	4.60%	4.70%	4.75%	4.90%	5.00%	5.10%	5.15%	5.20%	5.30%	5.40%	5.40%	5.45%	5.45%

Capital Economics interest rate forecast – 5.11.09

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
5yr PWLB rate	2.65%	2.15%	2.15%	2.15%	2.15%	2.15%	2.15%	2.15%
10yr PWLB rate	3.15%	2.65%	2.65%	2.65%	2.65%	2.65%	2.65%	2.65%
25yr PWLB rate	3.95%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%
50yr PWLB rate	4.15%	4.05%	4.05%	4.05%	4.05%	4.05%	4.05%	4.05%

UBS interest rate forecast (for quarter ends) – 30.10.09

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Bank Rate	0.50%	0.50%	0.75%	1.00%	1.50%	2.00%	2.50%	3.00%
10yr PWLB rate	3.90%	4.05%	4.40%	4.75%	4.90%	5.15%	5.40%	5.40%
25yr PWLB rate	4.45%	4.65%	5.00%	5.15%	5.40%	5.65%	5.90%	5.90%
50yr PWLB rate	4.55%	4.75%	5.10%	5.25%	5.50%	5.75%	6.00%	6.00%

2. SURVEY OF ECONOMIC FORECASTS

HM Treasury December 2009 – summary of forecasts of 23 City and 12 academic analysts for Q4 2009 and 2010. Forecasts for 2010 – 2013 are based on 21 forecasts in the last quarterly forecast – November 2009.

BANK RATE FORECASTS	quarter ended			annual average Bank Rate			
	actual	Q4 2009	Q4 2010	ave. 2010	ave. 2011	ave. 2012	ave. 2013
Median	0.50%	0.50%	1.30%	0.70%	1.80%	3.00%	3.70%
Highest	0.50%	0.50%	2.30%	1.30%	3.30%	4.30%	4.60%
Lowest	0.50%	0.50%	0.50%	0.50%	0.50%	1.00%	1.40%

Economic Background

4.1. Introduction

- § The credit crunch storm of August 2007 eventually fed through to the near collapse of the world banking system in September 2008. This then pushed most of the major economies of the world into a very sharp recession in 2009 accompanied by a dearth of lending from banks anxious to rebuild their weakened balance sheets. Many governments were forced to recapitalise and rescue their major banks and central banks precipitately cut their central bank rates to 0.10 – 1.00% in order to counter the recession.
- § The long awaited start of growth eventually came in quarter 3 2009 in the US and the EU. However, there was disappointment that the UK failed to emerge from recession in quarter 3.
- § Inflation has plunged in most major economies and is currently not seen as being a problem for at least the next two years due to the large output gaps and high unemployment putting a lid on wage growth. In many countries there have been widespread pay freezes in 2009 and these are likely to be persistent for some time.
- § Deflation could become a threat in some economies if they were to go into a significant double dip recession.
- § Asian countries, especially China, are buoying world demand through their own stimulus measures.
- § There still needs to be a radical world rebalancing of excess savings rates by cash rich Asian and oil based economies and excess consumption rates in Western economies if the world financial system is not to avoid a potential rerun of this major financial crisis in years to come.
- § Most major economies have resorted to a huge expansion of fiscal stimulus packages in order to encourage a fast exit from recession. This, together with expenditure on direct support provided to ailing banks, has led to a drastic expansion in government debt levels which will take many years to eliminate and to restore the previous health of national finances.

4.2 Two growth scenarios

- § The current big issue is 'how quickly will the major world economies recover?' There is a sharp division of opinion on this question as set out below. The knock on effects on forecasts for interest rates can be seen in **Appendix 4** – UBS strong recovery, Capital Economics – weak recovery.

4.2.1 Strong recovery

- § This is a normal cyclical recovery which will be strong in the major world economies. The US still has potential to add further fiscal stimulus in 2010 to ensure that strong recovery continues after the current round of stimulus measures end. Growth in the EU is likely to be strong in 2010 and not require such help.

The UK:

- § GDP growth will almost get back to the long term average of about 2.5% in 2011 but is likely to peak in the first half of the year as inventory rebuilding and stimulus measures fade and fiscal contraction kicks in later in the year.
- § The economy will rebalance with strong growth in exports and import substitution helped by strong recovery in the EU and the rest of the world.
- § Sterling has depreciated by 25% since the peak in 2007 and is likely to stay weak.
- § Consumer spending – only a mediocre recovery is expected due to a steady increase in the savings ratio from +5.6% in 2009 to about 8% in 2011 as consumers pay down debt or build cash balances. Consumer incomes will be held down by wage freezes and increases in taxation.
- § House price recovery is expected to persist helped by a low Bank Rate for a prolonged period; the peak to trough fall in house prices is now expected to be no more than 20%. House prices to rise by about 6% in 2010, and 3% in 2011; mortgage approvals will rise back to the level of 75 - 80,000 per month needed to ensure a continuation of a trend of rising house prices.
- § CPI inflation to peak @ 2.5% in early 2010 after the rise in VAT in January but then to fall to a trough near 1.5% in early 2011 and to stay below 2% for the rest of 2011.
- § The current MPC attitude is one of hang on as long as possible before increasing Bank Rate. The aim of this would be to try to ensure that growth gets going at a decent rate and that Bank Rate gets back to 4 – 5% before the next recession and that all assets purchased through QE have been sold off by then. The first Bank Rate increase is expected in Q3 2009.
- § If there is a change of Government in 2010 with a more aggressive fiscal approach then this could delay the timing of Bank Rate starting to go up.
- § The fiscal deficit is 6.4% of GDP, about £90bn, which is expected to fall at £11bn p.a. over eight years at currently planned rates. This is similar to the peak deficit of 7% in 1990s which was remedied to a surplus of 1.6% in the space of 6 years helped by strong, steady economic growth of 3% p.a. supported by loose monetary policy that compensated for the fiscal squeeze.
- § Gilt yields, especially longer term ones, are currently artificially low due to the Bank of England's Quantitative Easing operations. £200bn of gilts, commercial bonds and paper are being purchased under this scheme which has inflated prices and depressed yields. Once this campaign ends, yields will inevitably rise but will also rise due to the huge level of issuance of new gilts to finance the fiscal deficit. Long gilt yields are therefore forecast to reach 6% during 2011.
- § Gilt yields could rise higher if there was a hung Parliament in 2010 or if the fiscal situation deteriorates further.
- § The major risk to this scenario would be a lack of supply of bank credit. However, it is felt that the Bank of England is on alert to ensure that this does not happen and would continue various measures to assist the expansion of credit.

4.2.2 Weak recovery

- § The current economic cycle is not a normal business cycle but a balance sheet driven cycle. Over borrowed banks, corporates and consumers are focused on

shrinking their levels of borrowing to more viable and affordable levels and this balance sheet adjustment will take several years to be effected. Repayment of debt will therefore act as a major head wind to the required increase in demand in the economy. Consequently there will only be weak economic recovery over the next few years after the initial sharp inventory rebuilding rebound fades. GDP growth is forecast to reach only +1.5% in 2011.

- § Fiscal contraction will further dampen economic recovery driven by a strong political agenda to accelerate cuts in expenditure and increases in taxation after the general election in 2010.
- § The consumer savings ratio will rise so as to eliminate over borrowing and to insure against people losing their jobs during this downturn. This will depress consumer expenditure, the main driver of the UK economy.
- § Growth will also be hampered by a reduced supply of credit from weakened banks compounded by weak demand for credit.
- § The eventual reversal of Quantitative Easing will take cash out of the economy and reduce demand in the economy.
- § Unemployment is likely to rise to near 3m in 2010 and take years to subside due to weak growth. High unemployment will reduce tax income and increase expenditure on benefits and the costs of local authority services.
- § Inflation will not be a threat for several years as the current 6% output gap will take until 2014 to be eliminated.
- § However, deflation is a major danger for some years: the major falls in manufacturing prices over the last 12 -18 months have still to feed through to the economy and then to impact wage deflation.
- § CPI inflation will blip up over 2% in early 2010 but will then be on a strong downward trend to about -1% in 2011.
- § There is no need for the MPC to change Bank Rate from 0.5% in 2010 or 2011 and possibly for 5 years as they will need to counter the fiscal contraction which will dampen demand in the economy.
- § Long PWLB rates will FALL from current levels to near 4% in 2010 due to weak economic recovery and minimal inflation so that the real rate of return (net of inflation) on long gilts is healthy at these low levels

4.2.3 Sector view

- § Sector recognises that at the current time it is difficult to have confidence as to exactly how strong the UK economic recovery will prove to be. Both the above scenarios are founded on major assumptions and research which could or could not turn out to be correct.
- § Sector has adopted a more moderate view between these two scenarios outlined above i.e. a moderate return to growth.
- § We do, however, feel that the risks that long term gilt yields and PWLB rates will rise markedly are high.
- § There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas: -
 - degree of speed and severity of fiscal contraction after the general election

- timing and amounts of the reversal of Quantitative Easing,
- speed of recovery of banks' profitability and balance sheet imbalances
- changes in the consumer savings ratio
- rebalancing of the UK economy towards exporting and substituting imports

§ The overall balance of risks is weighted to the downside i.e. the pace of economic growth disappoints and Bank Rate increases are delayed and / or lower

§ There is an identifiable risk of a double dip recession and deleveraging creating a downward spiral of falling demand, falling jobs and falling prices and wages leading to deflation but this is considered to be a small risk and an extreme view at the current time on the basis of current evidence.

APPENDIX 6

Specified and Non-Specified Investments

Specified Investments:_(All such investments must be sterling denominated, with maturities of up to maximum of 1 year, meeting the minimum ‘high’ rating criteria where applicable)

Investment type	Minimum ‘High’ Credit Criteria	Use
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house
Term deposits – banks and building societies	F1+,AA-,B, 2 Sovereign rating AAA	In-house and Fund Managers
Term deposits with nationalised UK banks and the 8 institutions named by the Govt and subject to an implicit guarantee: <ul style="list-style-type: none"> • Santander • Barclays • HBOS • Lloyds TSB • HSBC • Nationwide Building Society • RBS • Standard Chartered 	F1,A+,B/C,1 Sovereign rating AAA	In-house and Fund Manager
Certificates of deposits issued by banks and building societies	F1+,AA-,B,2 Sovereign rating AAA	In-house and Fund Manager
UK Govt Gilts	--	Fund Manager
Commercial paper	F1+,AA-,B,2 Sovereign rating AAA	Fund Manager
Treasury Bills	--	Fund Manager
Bonds issued by a financial institution guaranteed by HMG	F1+,AA-,B, 2	Fund Manager
Bonds issued by multilateral development banks	Long Term and Sovereign AAA	Fund Manager
Sovereign bonds issues by other than UK Govt	Long Term and Sovereign AAA	Fund Manager
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs):		
1. UK Government Liquidity Funds	--	In-house and Fund Manager
2. Money Market Funds	AAAMR1+	In-house and Fund Manager
3. Enhanced cash funds	AAA	In-house and Fund Manager

Non-Specified Investments A maximum of 60% of core funds will be held in aggregate in non-specified investment

Investment type	Minimum Credit Criteria	Use	Max % of core investments	Max. maturity period
Fixed term deposits with variable rate and variable maturities: - Structured deposits	Short-term F1+, Long-term AA-, Individual B, Support 2	In-house	10%	2 years
Commercial paper issuance by UK banks covered by UK Government guarantee	UK Government explicit guarantee	In-house and Fund Manager	10%	2 years
Commercial paper other	Short-term F1+, Long-term AA-, Individual B, Support 2	In-house	10%	2 years
Other debt issuance by UK banks covered by UK Government guarantee	UK Government explicit guarantee	In-house and Fund Manager	20%	2 years
Term deposits – local authorities	--	In-house	20%	2 years
Term deposits – banks and building societies	Short-term F1+, Long-term AA-, Individual B, Support 2	In-house	20%	2 years
Certificates of deposits issued by banks and building societies	Short-term F1+, Long-term AA-, Individual B, Support 2	In house and Fund Manager	20%	2 years
UK Government Gilts	Sovereign AAA	In-house and Fund Manager	50%	5 years
Bonds issued by multilateral development banks	AAA	Fund Manager	25%	5 years
Bonds issued by a financial institution which is guaranteed by the UK government	--	Fund Manager	15%	5 years
Sovereign bond issues (i.e. other than the UK govt)	AAA	Fund Manager	15%	5 years

Appendix 7**Approved countries for investments**

Sovereign rating of AAA

- Canada
- Denmark
- Finland
- France
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- U.K.
- U.S.A.

Appendix 8**Treasury management scheme of delegation****(i) Full council**

- budget approval
- approval of treasury management policy.
- approval of the annual Treasury Management Strategy Statement and Annual Investment Strategy.
- approval of amendments to the council's adopted clauses, treasury management policy statement and the annual Treasury Management Strategy Statement and Investment Strategy.

(ii) Cabinet

- budget consideration
- approval of Treasury Management Practices
- approval of the division of responsibilities
- approval of the selection of external service providers and agreeing terms of appointment.
- acting on recommendations in connection with monitoring reports.

(iii) Audit Committee scrutiny

- reviewing the annual Treasury Management Strategy Statement and Investment Strategy and making recommendations to Cabinet and Council
- reviewing treasury management policy, performance, practices and procedures and making recommendations to Cabinet and Council.

(iv) Finance and Property Advisory Board

- receiving and reviewing regular monitoring reports and making recommendations there on to Cabinet.

Appendix 9**The treasury management role of the section 151 (responsible) officer:**

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.