ARGYLL AND BUTE COUNCIL	EXECUTIVE
HEAD OF STRATEGIC FINANCE	8 MARCH 2012

TREASURY MANAGEMENT MONITORING REPORT – 31 DECEMBER 2011

1 INTRODUCTION

1.1 This report summarises the monitoring as at 31 December 2011 of the Council's:

- Overall Borrowing Position
- Borrowing Activity
- Investment Activity
- Economic Forecast
- Prudential Indicators.

2 RECOMMENDATIONS

2.1 The treasury management monitoring report is noted.

3 DETAIL

Overall Borrowing Position

3.1 The table below details the estimated capital financing requirement (CFR) and compares this with the estimated level of external debt at the 31 March 2012. The CFR represents the underlying need for the Council to borrow to fund its fixed assets and accumulated capital expenditure.

	Forecast 2011/12 £000's	Budget 2011/12 £000's	Forecast 2012/13 £000's	Forecast 2013/14 £000's
CFR at 1 April	264,298	279,431	265,524	252,904
Net Capital Expenditure	23,230	23,264	10,274	7,363
Less Loans Fund Principal Repayments	(22,004)	(22,004)	(22,894)	(23,574)
Estimated CFR 31 March	**265,524**	**280,691**	**252,904**	**236,693**
Less Funded by NPDO	(81,921)	(81,921)	(80,719)	(79,517)
Estimated Net CFR 31 March	**183,603**	**198,770**	**172,185**	**157,176**
Estimated External Borrowing at 31 March	160,341	165,032	160,341	160,341
Gap	**23,262**	**33,738**	**11,844**	**(3,165)**

3.2 Borrowing is currently estimated to be below the CFR for the period to 2012-13. This reflects the approach taken to minimise surplus cash on deposit in order to avoid overdue exposure to investment / credit worthiness risks. However if it becomes clear that longer term interest rates are due to increase significantly the position will be reviewed to ensure the Council locks in funding at low interest rates.

3.3 The Council's estimated net capital financing requirement at the 31 December 2011 is £183.603m. The table below shows how this has been financed. Whilst borrowing is less than CFR there are substantial internal balances (mainly the General Fund) of which £47m is currently invested.

	at 30/9/2011 £000's	**at 31/12/2011 £000's**
Loans	160,315	160,386
Internal Balances	72,317	70,548
Less Investments & Deposits	(49,029)	(47,331)
Total	183,603	183,603

Borrowing Activity

3.4 The table below summarises the borrowing and repayment transactions in the period 1 October 2011 to 31 December 2011.

	Actual £000's
External Loans Repaid 1 October to 31 December 2011	0
Borrowing undertaken 1 October to 31 December 2011	72
Net Movement in External Borrowing	**72**

3.5 No repayments have been made in the period 1 September 2011 to 31 December 2011.

3.6 Two new temporary deposits were placed with the Council during the period 1 September 2011 to 31 December 2011.

3.7 The table below summarises the movement in level and rate of temporary borrowing at the start and end of the quarter. Owing to the levels of internal balances and surplus costs temporary borrowing has been minimal.

	£000s	% Rate
Temp borrowing at 30 September 2011	440	0.15
Temp borrowing at 31 December 2011	512	0.18

Investment Activity

3.8 The average rate of return achieved on the Council's investments to 31 December 2011 was 0.64% compared to the average LIBID rate for the same period of 0.48% which demonstrates that the Council is achieving a reasonable rate of return on its cash investments. At the 31 December 2011 the Council had £47m of short term investment at an average rate of 1.483%. The table below details the counterparties that the investments were placed with and the credit rating applicable for each of the counterparties.

Counterparty	Investment £	Rating
Bank of Scotland	25.0m	Short Term F1+, Long Term A
Royal Bank of Scotland	14.0m	Short Term F1, Long Term A-
Clydesdale Bank	8.3m	Short Term F1+, Long Term BBB+
Total	**47.3m**	

3.9 The limit on the level of funds which can be held with the Clydesdale Bank has been revised to £5m. On 4 January 2012 the £5m held in a 30 Day notice account was returned and since that date the balance of funds held with the Bank has not exceeded the £5m limit.

3.10 All investments and deposits are in accordance with the Council's approved list of counterparties and within the limits and parameters defined in the Treasury Management Practices. The counterparty list is constructed based on assessments by leading credit reference agencies adjusted for additional market information available in respect of the counterparties.

3.11 The current market conditions have made investment decisions more difficult as the number of counterparties which meet the Council's parameters has reduced making it harder to achieve reasonable returns while limiting the exposure to any one institution.

3.12 In response to the low investment returns available in the market and the reduced likelihood of increases in base rate it has been decided to place fixed deposits with the part nationalised banks for periods up to 12 months to increase returns without significantly increasing the risks associated with the investments.

Economic Forecast

3.13 The economic background for the period to 31 December 2011 is shown in appendix 1.

Prudential Indicators

3.14 The prudential indicators for 2011-2012 are attached in appendix 2.

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Appendix 1

Economic background:

- Indicators suggest that the economy is at higher risk of recession;
- Weak demand on the high street has forced retailers to offer generous discounts;
- The labour market deteriorated, but at a slower pace than in previous months;
- Public borrowing has fallen in line with the fiscal plans, but forecasts for future deficits have been revised up;
- Inflation begins to fall;
- The Monetary Policy Committee (MPC) restart quantitative easing (QE) and indicate its intention to sanction more;
- Gilt yields reach new lows, in spite of a recovery in equity prices and growing fiscal fears;
- Euro-zone policymakers fail to make progress towards a solution to the region's debt crisis.

Activity indicators suggested that the economic recovery ground to a complete halt in the third quarter and output may even have contracted. The weighted output balance of the CIPS/Markit surveys in October fell to a level that has been consistent in the past with a contraction in GDP. The output balance then broadly held at that level in November.

The CIPS surveys exclude the retail sector and the latest news from the high street has been poor, reflecting the pressures on households' finances. According to the official figures, retail sales volumes (ex. petrol) rose by 0.9% m/m in October but then fell by 0.7% in November, despite deep discounts offered by retailers. Timelier survey and anecdotal evidence suggests that, by and large, spending was weaker than usual in December.

Conditions in the labour market have also continued to deteriorate, albeit at a slower pace than in previous months. The Labour Force Survey measure of employment fell by 63,000 in the three months to October, a slower pace of deterioration than seen in the second quarter. The number of employees plummeted by 252,000 – but this was partly offset by a 166,000 rise in self-employment. Rises in the timelier claimant count measure of unemployment also became more modest – it increased by 'just' 2,500 on the previous month in October and 3,000 in November. Despite this moderating trend, employment surveys have continued to point to further job losses ahead.

The housing market has continued to recover, albeit slowly. The number of mortgage approvals for new house purchase rose from 51,200 in September to 52,900 in November. And according to the Nationwide, house prices were 0.6% higher in December than they were in September. Nonetheless, banks began the process of passing on the rise in their wholesale funding costs, reflecting the adverse effects of the euro-zone debt crisis, to consumers during the quarter.

The latest trade data tentatively suggested that net trade was on course to make a positive contribution to GDP growth in the third quarter. The trade in goods and services deficit narrowed from £4.3bn in September to £1.6bn in October (although the monthly deficit figures have been volatile recently). Some survey measures have also pointed to a recent pick-up in demand for exports as the new export orders balance of the CIPS manufacturing survey rose from 49.0 in November to 53.5 in December. At that level, it points to a quarterly rise in the volume of manufactured goods exports of around 2%.

Despite much weaker than expected GDP growth, the latest public finance figures showed that borrowing is coming in comfortably below last year's totals. Spending growth has slowed, while growth in tax receipts is still holding up reasonably well. And if the trend so far this fiscal year is sustained, borrowing will total about £122bn in 2011/12, equal to what the Office for Budget Responsibility (OBR) was forecasting until it revised its forecast to £127bn in its Economic and Fiscal Outlook that accompanied the Chancellor's Autumn Statement. The OBR also revised up its forecasts for borrowing in future years to reflect its much weaker expectations for GDP growth.

Inflation fell in the third quarter with CPI inflation falling from its recent peak of 5.2% in September to 5.0% in October and 4.8% in November. It probably fell further in December as past rises in energy prices a year ago dropped out of the annual comparison. Inflation remained on track to fall further in the coming months. Oil prices, for example, remained largely range-bound between $105pb and $115pb, while petrol prices began to fall. Meanwhile, the continued weakness of indicators of money supply growth and firms' pricing intentions, as well as the still large degree of spare capacity in the economy, suggested that underlying inflationary pressures are still very weak.

Granted, measures of inflation expectations remained quite high – the Bank of England's measure of households' inflation expectations for the year ahead only edged down from 4.2% to 4.1% in Q3. But considerable slack in the labour market should continue to prevent the translation of these expectations into stronger earnings growth. Indeed, the annual rate of average earnings growth including bonuses rose was just 2% in October (a slight rise from 1.9% in September). Real pay growth has therefore remained negative.

The MPC restarted quantitative easing (QE) in October and announced £75bn of additional gilt purchases would be completed by February. The MPC also looked primed to sanction further purchases in Q4. The November Inflation Report forecast projected CPI inflation to be well below the 2% target in two years' time, while speeches by certain members of the Committee (such as Martin Weale and Paul Fisher) suggested that they thought there was a strong case for more purchases.

Largely reflecting this dovish stance, markets expectations for official interest rates continued to fall during Q3, helping government bond yields to drop to new record lows (the 10-year gilt yield fell from 2.43% to 2% at the end of the year). The drop may also have reflected growing demand for safe-havens – while bond markets thought that default risk on UK government bonds had grown during the quarter, they viewed that risk to be lower than in many other major economies, including Germany.

In contrast to the UK, the economic data improved in the US in Q3. The manufacturing ISM strengthened in November and December to a level consistent in the past with annual GDP growth of 2.5% to 3.0%. Non-farm payrolls also increased by 112,000 in October and 100,000 in November.

In the euro-zone, policymakers made little progress to deal with the region's debt crisis. The economic data in the euro-zone also continued to weaken – while the composite PMI rose in November in December, it remained below the theoretical "no-change" level of 50 and on past form was consistent with quarterly falls in GDP of almost 1%. A deep recession in the euro-zone remains a key risk to the outlook for the UK economy

APPENDIX 2 : PRUDENTIAL INDICATORS

PRUDENTIAL INDICATOR	2011/12	2011/12	2012/13	2013/14
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORT	**£ p**	**£ p**		**£ p**
	Original Estimate	**Forecast Outturn**	**Forecast Outturn**	**Forecast Outturn**
Capital Expenditure	**£'000**	**£'000**	**£'000**	**£'000**
Non - HRA	23,264	23,264	10,274	7,363
TOTAL	23,264	23,264	10,274	7,363
Ratio of financing costs to net revenue stream				
Non - HRA	11.68%	11.68%	11.90%	12.14%
Net borrowing requirment				
brought forward 1 April *	279,431	279,431	282,122	271,086
carried forward 31 March *	282,122	282,122	271,086	257,124
in year borrowing requirement	2,691	2,691	(11,036)	(13,962)
In year Capital Financing Requirement				
Non - HRA	2,691	2,691	(11,036)	(13,962)
TOTAL	2,691	2,691	(11,036)	(13,962)
Capital Financing Requirement as at 31 March				
Non - HRA	282,122	282,122	271,086	257,124
TOTAL	282,122	282,122	271,086	257,124
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p
Increase in Council Tax (band D) per annum	32.40	32.40	7.99	(12.02)

PRUDENTIAL INDICATOR	2010/11	2011/12	2012/13
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**
Authorised limit for external debt -			
borrowing	240,000	239,000	231,000
other long term liabilities	91,500	91,500	91,500
TOTAL	331,500	330,500	322,500
Operational boundary for external debt -			
borrowing	235,000	234,000	226,000
other long term liabilities	88,500	88,500	88,500
TOTAL	323,500	322,500	314,500
Upper limit for fixed interest rate exposure			
Principal re fixed rate borrowing	100%	100%	100%
Upper limit for variable rate exposure			
Principal re variable rate borrowing	30%	30%	30%
Upper limit for total principal sums invested for over 364 days (per maturity date)	£10m	£10m	£10m

Maturity structure of new fixed rate borrowing during 2011/12	upper limit	lower limit
under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%