



## **FINANCIAL COMMENTARY NO 81**

### **The Economy**

The Chancellors April 23<sup>rd</sup> Budget came nowhere near what the City expected with regard to the borrowing requirement and the over optimistic growth forecasts. Interest rates have been held at 0.50% and judging by comments made by the Governor of the Bank of England will remain so for the foreseeable future. The programme of Quantitative easing has also been extended to £125 billion. Figures released last month showed that the UK economy shrank by 1.90% in the first three months of 2009, the biggest three month decline in GDP since the third quarter of 1979. Unemployment figures showed that the number of people out of work rose to 2.1 million.

This said however, purchasing managers indexes indicated that the pace of the downturn in the manufacturing sector had slowed by an unexpected amount in April, while the service sector shrank at its slowest pace since last August. In addition, the Nationwide Building Society said in April that UK consumer confidence had seen its biggest rise in 2 years. The number of mortgage products on offer is rising, and lenders are starting to accept smaller deposits from house buyers indicating that the mortgage market may be starting a revival in a small but positive way. CPI fell to 2.3% in May with the Bank of England indicating that this would fall below the 2% target later in the year. This has all had the effect of instilling a little confidence into the market.

### **The Market**

3 Month LIBOR has continued to fall throughout the last 2 month period indicating that Interbank lending is starting to resume. Local Authorities, in general, continue to struggle in producing workable counterparty lists. The result being disappointing returns received from the DMO. Moody's and Fitch downgraded a number of Building Societies on the basis that were the property market to fall by 60% they might suffer as a result of their exposure, in particular, to the commercial property market. Given the recent forecasting record of ratings agencies it is probably worth considering whether it is realistic to assume a 60% drop in property prices is likely. Standard and Poor's downgraded the outlook rating for the UK, which will potentially affect the UK's ability to issue Gilts at favourable rates which in turn may result in higher PWLB.

## **Cash Fund Management**

The preparation of Statement of Accounts, the acceleration of the closure programme and the introduction of International Financial Accounting procedures has increased the pressure on Councils' resources and treasury teams. They have had to cope with lower returns and perhaps a more stringent assessment of counterparty risk as the opinions of ratings agencies, regulators and advisors have been brought into question. We believe that our highly experienced managers, Stuart Selleck and Paul Ewles, are ideally placed to assist Authorities in strategically managing cash deposits in the current challenging investment environment.

## **David Ingram**

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