



FINANCIAL COMMENTARY NO 87

So the election is over and for the first time in 65 years we have a coalition Government. Prior to the 7th May who would have thought that we would see Messer's Cameron and Clegg as new "Best friends forever". It almost seems that we are witnessing some kind of political "Love in", and the harsh words exchanged between them in the Electoral leadership debates, not 4 weeks ago, seem a lifetime away. There are without doubt differences between the policies of both the Conservative party and the Liberal Democrats, but these appear to have been put aside in the spirit of compromise and the attempt to form strong, unified Government. The emergency Budget is set for the 22nd June, the market, the Bank of England, the Country and the international community wait expectantly.

The Economy

The Bank of England has held Base Rate at 0.50% for the last two months, and put the policy of QE on pause. This reflects Mervyn King's view that a loose monetary policy is desirable to prevent the fragile recovery from being quashed. It is likely that the new Government will introduce wide ranging fiscal measures in the emergency budget, to deal with CPI inflation, which reached a higher than expected 3.4% in March, and an even worse 3.7% in April, and is expected to continue to rise again in the future. Unemployment in April and May continued to rise, reaching a 16 year peak of 2.51 million. GDP rose 0.2%, although a rise of 0.4% was expected. March retail sales rose by 0.4% although they were below the anticipated 0.6% rise. The April figure of a rise of 0.3% was slightly better than expected. Against these generally disappointing figures industrial production in May saw a 2% bumper rise against an expected rise of 0.3%. This was thought to have been as a result of the weak pound making UK exports more competitive abroad, and yet the UK trade deficit for March rose to £3.7 billion throwing an element of doubt and confusion into the interpretation of these figures.

The Market

Concerns over the stability of the Euro zone, and the possibility of Greece defaulting on its debt repayments have dominated the market over recent weeks. A rescue package has been agreed and the Greek Government have passed an austerity budget with the intention of making significant reductions in the National Debt. However the question of "Is it enough?" is still present. Markets are not completely convinced which is why the Euro has continued to trade lower against the worlds major currencies, stock markets across the world have recorded large falls in value and LIBOR rates have steadily increased. PWLB has fallen, reflecting the increased demand for Gilts as investors seek safe havens. This is good news for those Local Authority's that are looking to take fresh borrowing, but not so great for those considering early redemption of debt. There has been an increase in Local Authorities seeking LOBO pricing, particularly on a forward start basis as strategic borrowing, partly fuelled by the uncertainty of a new Government, and partly by the prospect of rising interest rates, comes to the fore. Structured products of 2-3 year duration continue to be a vehicle by which significant coupon with appropriate counterparties can be achieved. Once again pro-active Treasury management pays dividend.

The new Government is likely to impose cuts on Local Government as it strives to deal with the Budget deficit. It therefore becomes increasingly more important that Councils create workable counterparty lists in order to enhance yield within acceptable risk parameters. I recently wrote to all Authorities to make them aware of Ark Risk Advisory Ltd. www.arkrisk.co.uk. It may be that the utilization of their services would be of benefit to Councils that need to increase yield but are unsure of what constitutes “Acceptable risk”.

Cash Fund Management

The pending pressure on Councils’ finances will inevitably require a more positive use of cash balances if income returns are essential to the budget process. Consequently, Authorities’ treasury teams will face ever-increasing demands to maximise returns, albeit within strict counterparty guidelines. Our scheme is one of the very few still providing a segregated fund service which can be tailored to suit individual clients’ investment parameters.

The result of the general election still leaves the market undecided about the timing of any Bank rate movements and sovereign rating issues. In these uncertain times, we feel that experience is the overriding factor in making strategic investment decisions to which the two managers have in abundance. Consequently, the poor response to recent written updates extolling the virtues of the cash management scheme has been disappointing.

It is understood that Councils are perhaps reticent to change the status quo until “normality” returns, but by then pro-active opportunities may be lost. We continue to focus on depositing with the strongest counterparties where our constructive strategy is reaping rewards for our existing cash management clients. Any opinions expressed here are given in good faith and no liability whatsoever is accepted for any direct or consequential loss arising from the use of this document.

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