AUDIT COMMITTEE	AGENDA ITEM No. 7 Appendix 1
18 MARCH 2024	PUBLIC REPORT

Report of:	Cecilie Booth, Executive Director of Corporate Services /S151 Officer	
Cabinet Member(s) responsible:	Cllr John Howard, Cabinet Member for Finance	
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TREASURY MANAGEMENT UPDATE
Quarter Ended 31st December 2023 (Q3 2023/24)

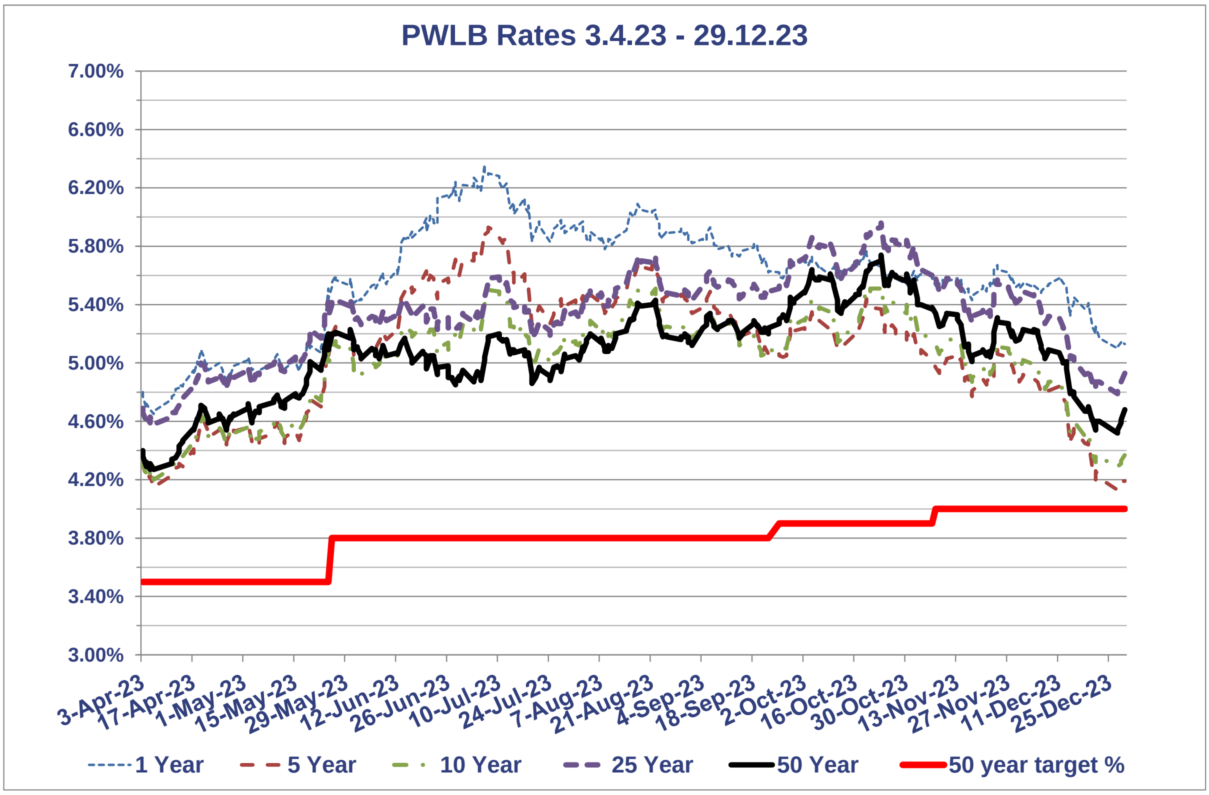
The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management 2021 recommends that members be updated on treasury management activities at least quarterly. This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

The financial year 2023/24 is the first year in which Cabinet will receive quarterly treasury updates. Whilst it is a requirement of the Code that the annual and mid-year reports on treasury activity must be ratified by full Council, the reports for the first and third quarters of the financial year only need to be presented to Cabinet.

1. Economics update

- The third quarter of 2023/24 saw:
  - A 0.3% m/m decline in real GDP in October, potentially partly due to unseasonably wet weather, but also due to the ongoing drag from higher interest rates. Growth for the second quarter, ending 30th September, was revised downwards to -0.1% and growth on an annual basis was also revised downwards, to 0.3%;
  - A sharp fall in wage growth, with the headline 3myy rate declining from 8.0% in September to 7.2% in October, although the ONS “experimental” rate of unemployment has remained low at 4.2%;
  - CPI inflation continuing on its downward trajectory, from 8.7% in April to 4.6% in October, then again to 3.9% in November;
  - Core CPI inflation decreasing from April and May’s 31 years’ high of 7.1% to 5.1% in November, the lowest rate since January 2022;
  - The Bank of England holding rates at 5.25% in November and December;

- A steady fall in 10-year gilt yields as investors revised their interest rate expectations lower.



2. Interest rate forecasts

The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.

Link Group Interest Rate View	07.11.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.25	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.30	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.40	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.50	3.30	3.30	3.30	3.30	3.30
5 yr PWLB	5.00	4.90	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.60	3.50	3.50	3.50
10 yr PWLB	5.10	5.00	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.70	3.60	3.60	3.50
25 yr PWLB	5.50	5.30	5.10	4.90	4.70	4.50	4.30	4.20	4.10	4.10	4.00	4.00	4.00
50 yr PWLB	5.30	5.10	4.90	4.70	4.50	4.30	4.10	4.00	3.90	3.90	3.80	3.80	3.80

- The Link forecast for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short-term cash at any one point in time.

A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

- Our central forecast for interest rates was previously updated on 7th November and reflected a view that the MPC would be keen to underpin its anti-inflation credentials by keeping Bank Rate at 5.25%

until at least H2 2024. We expect rate cuts to start when both the CPI inflation and wage/employment data are unequivocally supportive of such a move, and that there is a strong likelihood of the overall economy enduring tepid growth (at best) or a mild recession (at worst) over the coming months.

- Naturally, timing on this matter will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

- In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine, and Gaza and Israel.

- On the positive side, consumers are still anticipated to be sitting on some excess savings left over from the pandemic, which could cushion some of the impact of the above challenges and may be the reason why the economy is performing a little better at this stage of the economic cycle than may have been expected. Nonetheless, with approximately 400,000 households per quarter facing a mortgage interest reset at higher levels than their current rate, the economy will face on-going headwinds from that source, in addition to lower income households having to spend disproportionately on essentials such as food, energy and rent payments.

PWLB RATES

- As illustrated in the charts in section 1, gilt yields have endured a volatile nine months with yields rising significantly on the back of inflation concerns before retracing much of those increases in November and December. With the market now anticipating rate cuts by H2 2024, the short and medium parts of the curve are now close to where they started 2023/24, but the longer part of the curve is still a little higher. At the time of writing there is c50 basis points difference between the 5 and 50 year parts of the curve.

The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is to the downside.

Downside risks to current forecasts for UK gilt yields and PWLB rates include: -

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, could keep gilt yields high for longer).

- **The Bank of England** has increased Bank Rate too fast and too far over recent months, and subsequently brings about a deeper and longer UK recession than we currently anticipate.

- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- **Geopolitical risks,** for example in Ukraine/Russia, the Middle East, China/Taiwan/US, Iran and North Korea, which could lead to increasing safe-haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates: -

- Despite the recent tightening to 5.25%, the **Bank of England proves too timid** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to remain elevated for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project.

- **The pound weakens** because of a lack of confidence in the UK Government's pre-election fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.

- Longer-term **US treasury yields** rise strongly if inflation remains more stubborn there than the market currently anticipates, consequently pulling gilt yields up higher.

- Projected **gilt issuance, inclusive of natural maturities and Quantitative Tightening (QT),** could be too much for the markets to comfortably digest without higher yields compensating.

3. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2023/24, which includes the Annual Investment Strategy, was approved by the Council on 13 February 2023. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

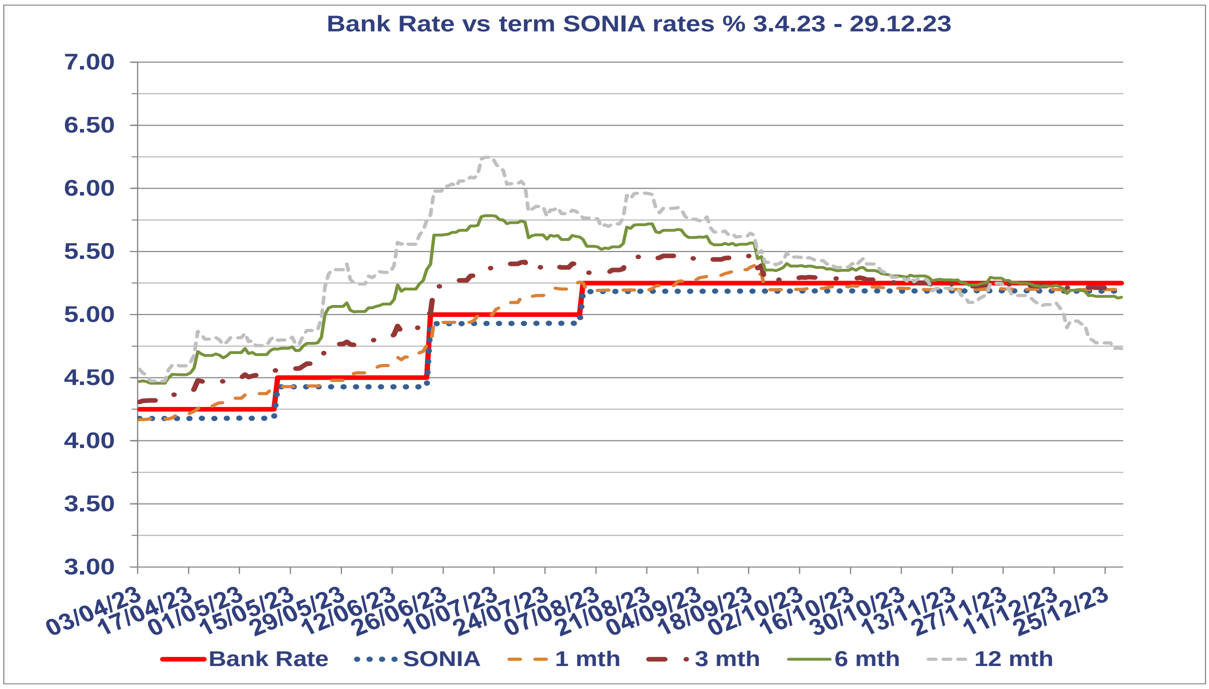
The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity, aligned with the Council's risk appetite. In the current economic climate, over and above keeping investments short-term to cover cash flow needs, there is a benefit to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

As shown by the charts below and the interest rate forecasts in section 2, investment rates have remained elevated during 2023/24 but are now expected to have peaked.

Creditworthiness.
There have been few changes to credit ratings over the quarter under review. However, officers continue to closely monitor these, and other measures of creditworthiness to ensure that only appropriate counterparties are considered for investment purposes.

Investment counterparty criteria
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

CDS prices
For UK banks, there are no underlying negative themes. Prices are not misaligned with other creditworthiness indicators, such as credit ratings. Nevertheless, it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.



FINANCIAL YEAR TO QUARTER ENDED 29/12/2023

	Bank Rate	SONIA	1 mth	3 mth	6 mth	12 mth
High	5.25	5.19	5.39	5.48	5.78	6.25
High Date	03/08/2023	24/11/2023	19/09/2023	30/08/2023	07/07/2023	07/07/2023
Low	4.25	4.18	4.17	4.31	4.46	4.47
Low Date	03/04/2023	04/04/2023	03/04/2023	03/04/2023	06/04/2023	06/04/2023
Average	4.95	4.89	4.96	5.10	5.26	5.36
Spread	1.00	1.01	1.22	1.17	1.33	1.77

The Council's budgeted investment return for 2023/24 is **£955k**, and performance for the year to date is £**81k** above budget.

Approved limits
Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 31st December 2023

4. Borrowing

Due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement - CFR), new external borrowing of **£**28.5m was undertaken in month of December from the PWLB / Temporary borrowing at an average rate of 5.30%.

It is likely that the council will need to borrow further in Quarter 4 to finance its capital programme and cashflow projections. The position remains under constant review and any new borrowing will be undertaken to maximise any downward movement in borrowing rates.

5. Compliance with Treasury and Prudential Limits

The prudential and treasury Indicators are shown in Appendix 1.

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits, During the *quarter ended* 31st December 2023*,* the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2023/24. The Director of Finance reports that no difficulties are envisaged for the current or future years in complying with these indicators.

All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

APPENDIX 1: Prudential and Treasury Indicators for 2023-24 as of 31st December 2023

Capital Expenditure	2023/24 Indicator £m	2023/24 Actual at 30.12.2023 £m	2023/24 Forecast Outturn £m
Capital Bids	76.9	94.0	130.1
Transformation/Invest to Save	5.6	0.0	0.0
Total	**82.5**	**94.0**	**130.1**

The actual and outturn now includes £51.8m of additional approved capital funding in the capital programme. This includes the purchase of Sand Martin House for £50m and funding of phase 3 of the University for £1.3m. The actual and outturn also includes £14m of slippage from 22/23.

Financed By	2023/24 Indicator £m	2023/24 Forecast Outturn £m
Capital receipts to be used to fund capital programme	13.4	13.4
Capital grants & contributions	63.5	65
Revenue contributions	0	0
Transformation/invest to Save	5.6	5.6
Net Financing Requirement	0	46.1
Total	**82.5**	**130.1**

Capital Financing Requirement	2023/24 Indicator £m	2023/24 Forecast Outturn £m
CFR B/fwd	586.8	608.4
Net financing requirement	6.0	46.1
Less MRP & Other financing	-19.0	-19.4
CFR C/fwd	**573.8**	**635.1**

Ratio of Gross Financing Costs to Net Revenue Budget	2023/24 Indicator	2023/24 Forecast Outturn
Total Ratio	16%	16%

Gross debt & capital financing requirement	2023/24 Indicator £m	2023/24 Actual at 31.12.2023 £m	2023/24 Forecast Outturn £m
External Borrowing			
Market Borrowing	420.5	457.5	457.5
Repayment of borrowing	-50.1	-129.5	-146.0
Expected change in borrowing	35.9	148.5	188.5
Other long-term liabilities	46.3	28.5	28.5
Gross Debt on 31 December 2023	**452.6**	**505.0**	**528.5**
CFR	**573.8**	**-**	**635.1**
% Of Gross Debt to CFR	**78.90%**	**-**	**83.21%**

The council has an internal borrowing position of approximately £107m which it is achieving through the use of internal balances and reserves rather than borrowing externally from financial markets. This minimises the cost of borrowing and also help to reduce credit risk.

Operational Boundary	2023/24 Indicator £m	2023/24 Actual at 31.12.2023 £m	2023/24 Forecast Outturn £m
Borrowing	586.8	586.8	635.1
Other long-term liabilities	46.3	46.3	28.5
Total	**633.1**	**633.1**	**663.6**

Authorised Limit	2023/24 Indicator £m	2023/24 Actual at 31.12.2023 £m	2023/24 Forecast Outturn £m
Borrowing*	606.8	606.8	645.1
Other Liabilities	46.3	46.3	28.5
Total Authorised Limit	**653.1**	**653.1**	**673.6**

Maturity Structure of borrowing	Upper Limit	As of 31 December 2023 £m	As of 31 December 2023 %
Under 12 months	40%	78.5	16%
12 months to 2 years	20%	24.0	5%
2 years to 5 years	30%	28.5	6%
5 years to 10 years	80%	39.3	8%
10 years and above	100%	306.1	64%

	2023/24 Indicator £m	2023/24 Actual at 31.12.2023 £m	2023/24 Forecast Outturn £m
Principal sums invested >365 days	10	**0**	**10**

Investment Portfolio '000	31 December 2023		
	Principal (£'m)	Average Rate (%)	Average Life (days)
MMFs	10.5	5.38%	1
Banks		0.00%	0
Local Authorities	0.0	0.00%	0
Total Investments	10.5	5.38%	1

Current investment balances are being kept liquid to help support daily cashflow management and the council's underlying internal borrowing position whilst at the same time maximising the investment rates available.

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