REPORT TO:	**AUDIT COMMITTEE**		
DATE:	18 September 2023		
TITLE:	**QUARTER 1 TREASURY REPORT 2023/24**		
TYPE OF REPORT:	Review		
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OPEN/EXEMPT	Open	WILL BE SUBJECT TO A FUTURE CABINET REPORT:	No

Date of meeting: 18 September 2023

QUARTER ONE TREASURY REPORT 2023/2024

Summary

The Council has formally adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2021) and remains fully compliant with its requirements. One of the primary requirements of the Code is receipt by Council of a quarterly Review Report.

The Quarterly Review Report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- A review of the Treasury Management Strategy;
- The Council's capital expenditure (prudential indicators);
- An economic update for the first three months of 2023/24.

Additional Supporting Information
Appendix 1 – Economic Update
Appendix 2 – Interest Rate forecasts
Appendix 3 – Prudential and Treasury Indications for 2023-24
Appendix 4 – Investment Portfolio
Appendix 5 – Approved countries for investment

Recommendation

Audit Committee is asked to note the report and the treasury activity.

Reason for Recommendation

The Council has formally adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2021) and remains fully compliant with its requirements. One of the primary requirements of the Code is, receipt by Audit Committee of a Quarterly Review Report.

1. The Treasury Management Quarterly Review 2023/24

1.1 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2021).

1.2 The primary requirements of the Code are as follows:

a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

b) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

c) Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during the previous year.

d) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

e) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Audit Committee.

1.3 This quarterly report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2023/24 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- A review of the Council's investment portfolio for 2023/24;
- A review of the Council's borrowing strategy for 2023/24;
- A review of any debt rescheduling undertaken during 2023/24;
- A review of compliance with Treasury and Prudential Limits for 2023/24.

2. Economic Update

2.1 Appendix 1 details the economic outlook from the Council Treasury Management Advisers. Some comments to note include:-

2.1.1 The Bank of England continues to combat inflation though Base Rate hikes. Core inflation continues to be higher than the BoE target rate of 2%, but the rate of inflation is slowing. CPI inflation fell from 10.1% to 8.7% in April, before remaining at 8.7% in May. Core CPI inflation (CPI inflation with volatile elements removed – food & fuel) rose in both April and May, reaching a new 31-year high of 7.1%. A key assumption is that inflation will drop to the 2.0% target only if the Bank triggers a recession by raising rates to at least 5.5% and keeps rates there until at least mid-2024.

2.1.2 As at 26 June 2023 Link are forecasting that the Bank rate won't drop to below 3% until Sept 2025, compared to their forecast as at 27 March 2023 when they forecast that it would be March 2025".

3. Annual Investment Strategy

3.1 The Treasury Management Strategy Statement (TMSS) for 2023/24, which includes the Annual Investment Strategy, was approved by the Council on 7 February 2023. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

a) Security of capital
b) Liquidity
c) Yield

3.2 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.

3.3 As shown by the interest rate forecasts in Appendix 2, investment rates have improved dramatically during the first quarter of 2023/24 and are expected to improve further as the Bank Rate continues to increase over the next few months.

3.4 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.

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

3.6 Investment balances
The average level of funds available for investment purposes during the quarter was £23.6m**.** These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme. The funds in investment as at 30 June 2023 are shown in Appendix 4, whilst appendix 5 shows the Countries approved for investment with at that time based on credit ratings.

3.7 The annual budgeted return on investment for 2023/24 is £1,013,880 (£253,470 to quarter 1). The performance for return on investments is £38,304 below budget at £215,166 against the forecast budget of £253,470), this is a reflection on the value invested.

3.8 Approved limits
Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 30th June 2023.

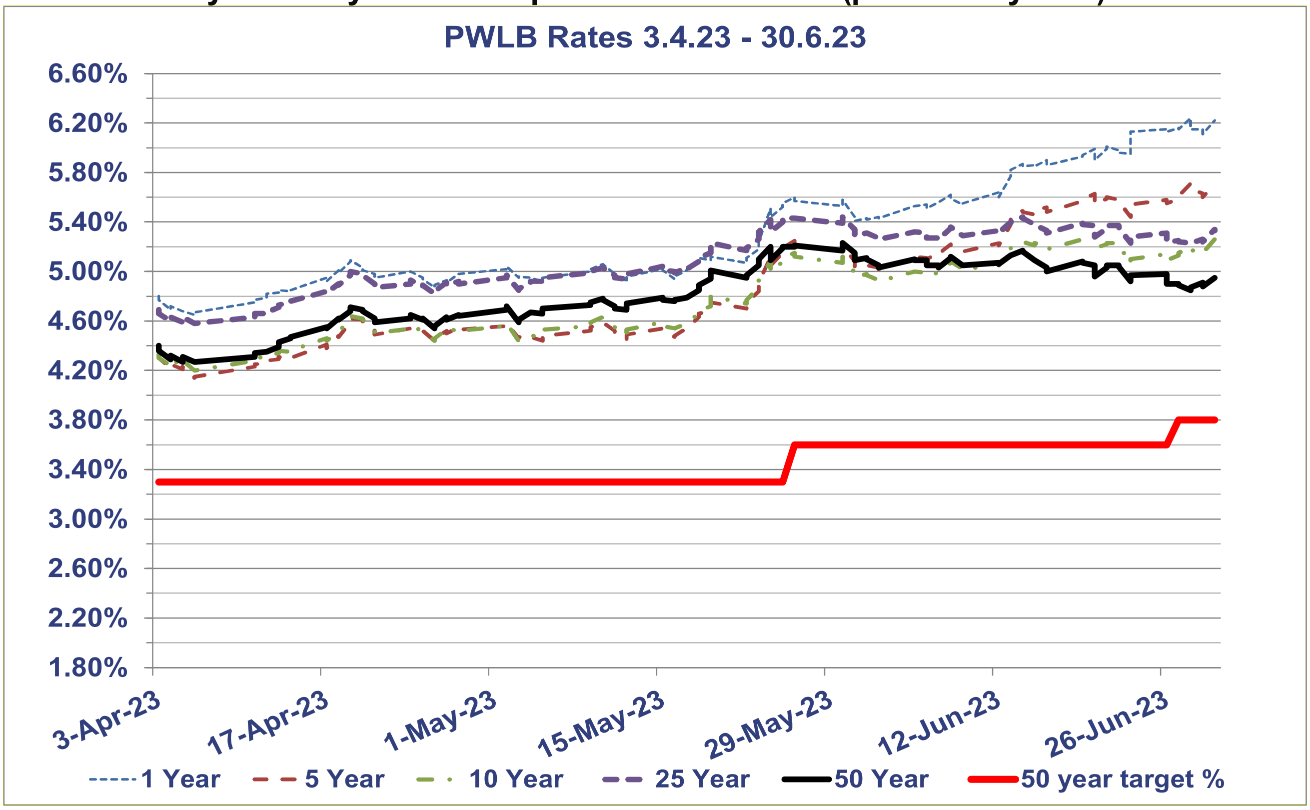
4. Borrowing

4.1 No additional borrowing was undertaken during the quarter ended 30th June 2023.

4.2 The Public Works Loan Board PWLB lending facility is operated by the UK Debt Management Office (DMO) on behalf of HM Treasury. The facility provides loans to local authorities, and other specified bodies, from the National Loans Fund, operating within a policy framework set by HM Treasury.

4.3 The 50-year PWLB Certainty Rate target for new long-term borrowing started 2023/24 at 3.30% before Increasing to a peak of 3.80% in June. As can be seen, with rates elevated across the whole of the curve, it is advised to not borrow long-term unless the Authority wants certainty of rate and judges the cost to be affordable.

PWLB maturity Certainty Rates 1st April to 30th June 2023 (provided by Link)



5. Debt rescheduling

5.1 Debt rescheduling opportunities are not required on the Council's current loan of £10m at 3.81%. Members will be advised if there is value to be had by rescheduling or repaying a part of the debt portfolio.

6. Compliance with Treasury and Prudential Limits

6.1 The Prudential and Treasury Management Indicators are shown in Appendix 3.It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the quarter ended 30th June 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 Assistant Director Resources reports that the Capital programme is reviewed monthly for material variation. Monitoring is currently focussed on reprofiling the budget 2023/2024 and forecast spend for the year and subsequent years likely to smooth to more consistent level across each year. This will be reflected in the "Quarter 2 – Treasury Monitoring Report". As a result, no difficulties are envisaged for the current or future years in complying with the prudential indicators.

Appendix 1 Economic Update

The Following is provided by the Council's Treasury Advisers, The Link Group as at end of quarter 1 2023/2024.

The Economy and Interest Rates UK Economy

The first quarter of 2023/24 saw:

- A 0.2% m/m rise in real GDP in April, partly due to fewer strikes;
- CPI inflation falling from 10.1% to 8.7% in April, before remaining at 8.7% in May. This was the highest reading in the G7;
- Core CPI inflation rise in both April and May, reaching a new 31-year high of 7.1%;
- A tighter labour market in April, as the 3myy growth of average earnings rose from 6.1% to 6.5%;
- Interest rates rise by a further 75bps over the quarter, taking Bank Rate from 4.25% to 5.00%;
- 10-year gilt yields nearing the "mini-Budget" peaks, as inflation surprised to the upside.

The economy has weathered the drag from higher inflation better than was widely expected. The 0.2% m/m rise in real GDP in April, following March's 0.3% m/m contraction will further raise hopes that the economy will escape a recession this year. Some of the strength in April was due to fewer strikes by train workers and teachers in that month. Moreover, some of the falls in activity in other areas in April were probably temporary too. Strikes by junior doctors and civil servants contributed to the fall in health output (0.9% m/m) and the meagre 0.1% m/m increase in public administration.

The fall in the composite Purchasing Managers Index (PMI) from 54.0 in May to a three-month low of 52.8 in June (>50 points to expansion in the economy, <50 points to contraction) was worse than the consensus forecast of 53.6. Both the services and manufacturing PMIs fell. The decline in the services PMI was bigger (from 55.2 to 53.7), but it remains consistent with services activity expanding by an annualised 2%. The fall in the manufacturing PMI was smaller (from 47.1 to 46.2), but it is consistent with the annual rate of manufacturing output falling from -0.8% in April to around -5.0%. At face value, the composite PMI points to the 0.1% q/q rise in GDP in Q1 2023 being followed by a 0.2% q/q gain in Q2 2023.

Meanwhile, the 0.3% m/m rise in retail sales volumes in May was far better than the consensus forecast of a 0.2% m/m decline and followed the robust 0.5% m/m rise in April. Some of the rise was due to the warmer weather. Indeed, the largest move was a 2.7% m/m jump in non-store sales, due to people stocking up on outdoor-related goods. But department stores also managed to squeeze out a 0.6% m/m rise in sales and the household goods sub-sector enjoyed a reasonable performance too. Overall, the figures were far better than analysts had expected. In addition, the GfK measure of consumer confidence rebounded from -27 to a 17-month high of -24 in June.

The recent resilience of the economy has been due to a confluence of factors including the continued rebound in activity after the pandemic, households spending some of their pandemic savings, and the tight labour market and government handouts both supporting household incomes. That said, as government support fades, real household incomes are unlikely to grow rapidly. Furthermore, higher interest rates will mean GDP is likely to contract later this year. Our central assumption is that inflation will drop to the 2.0% target only if the Bank triggers a recession by raising rates from 5.00% now to at least 5.5% and keeps rates there until at least mid-2024. Our colleagues at Capital Economics estimate that around 60% of the drag on real activity from the rise in rates has yet to bite, and the drag on the quarterly rate of real GDP growth over the next year may be about 0.2ppts bigger than over the past year.

The labour market became tighter over the quarter and wage growth reaccelerated. Labour demand was stronger than the consensus had expected. The three-month change in employment rose from +182,000 in March to +250,000 in April. Meanwhile, labour supply continued to recover as the size of the labour force grew by 303,000 in the three months to April. That was supported by a further 140,000 decline in inactivity as people returned to work from retirement and caring responsibilities (while inactivity due to long-term sick continued to rise). But it was not enough to offset the big rise in employment, which meant the unemployment rate fell from 3.9% to 3.8%

The tighter labour market supported wage growth in April, although the 9.7% rise in the National Living Wage on 1st April (compared to the 6.6% increase in April last year) probably had a lot to do with it too. The 3myy rate of average earnings growth reaccelerated from 6.1% to 6.5% (consensus 6.1%) and UK wage growth remains much faster than in the US and the Euro-zone. In addition, regular private sector wage growth increased from 7.1% 3myy to 7.6%, which left it well above the Bank's forecast for it to fall below 7.0%. Overall, the loosening in the labour market appears to have stalled in April and regular private sector wage growth was well above the Bank's forecast.

CPI inflation stayed at 8.7% in May (consensus 8.4%) and, perhaps more worryingly, core CPI inflation rose again, from 6.8% to a new 31-year high of 7.1%. The rise in core inflation built on the leap from 6.2% in March to 6.8% and means it is accelerating in the UK while it is slowing in the US and the Euro-zone (both fell to 5.3%). A further decline in fuel inflation, from -8.9% to -13.1%, and the second fall in food inflation in as many months, from 19.3% to 18.7%, explained why overall CPI inflation didn't rise. And the scheduled fall in the average annual utility price from £2,500 to £2,074 on 1st July means overall CPI inflation will probably ease in the coming months. But the problem is that the recent surge in core inflation and the reacceleration in wage growth shows that domestic inflationary pressures are still strengthening.

This suggests the Bank may have more work to do than the Fed or ECB. Indeed, the Bank of England sounded somewhat hawkish in the June meeting. This came through most in the MPC's decision to step up the pace of hiking from the 25bps at the previous two meetings. The 7-2 vote, with only two members voting to leave rates unchanged at 4.50%, revealed support for stepping up the fight against high inflation.

That said, the Bank has not committed to raising rates again or suggested that 50bps rises are now the norm. What it did say was that "the scale of the recent upside surprises in official estimates of wage growth and services CPI inflation suggested a 0.5 percentage point increase in interest rates was required at this particular meeting". Moreover, the Committee did not strengthen its forward guidance that any further rate hikes would be conditional on the data. However, it looks highly probable, given the on-going strength of inflation and employment data, that the Bank will need to raise rates to at least 5.5% and to keep rates at their peak until the mid-point of 2024. We still think it is only a matter of time before the rise in rates weakens the economy sufficiently to push it into recession. That is why instead of rising to between 6.00%-6.25%, as is currently priced in by markets, we think rates are more likely to peak between 5.50-6.00%. Our forecast is also for rates to be cut in the second half of 2024, and we expect rates to then fall further than markets are pricing in.

Growing evidence that UK price pressures are becoming increasingly domestically generated has driven up market interest rate expectations and at one point pushed the 10-year gilt yield up to 4.49% in late June, very close to its peak seen after the "mini-budget". Yields have since fallen slightly back to 4.38%. But growing expectations that rates in the UK will remain higher for longer than in the US mean they are still more than 70 bps above US yields. While higher interest rates are priced into the markets, the likely dent to the real economy from the high level of interest rates is not. That's why we think there is scope for market rate expectations to fall back in 2024 and why we expect the 10-year PWLB Certainty Rate to drop back from c5.20% to 5.00% by the end of this year and to 4.20% by the end of 2024.

The pound strengthened from $1.24 at the start of April to a one-year high at $1.26 in early May, which was partly due to the risks from the global banking issues being seen as a bigger problem for the US than the UK. The pound then fell back to $1.23 at the end of May, before rising again to $1.28 in the middle of June as the strong core CPI inflation data released in June suggested the Bank of England was going to have to raise rates more than the Fed or ECB in order to tame domestic inflation. However, sterling's strong run may falter because more hikes in the near term to combat high inflation are likely to weaken growth (and, hopefully, at some point inflation too) to such a degree that the policy rate will probably be brought back down, potentially quite quickly, as the economic cycle trends downwards decisively. This suggests that additional rate hikes are unlikely to do much to boost the pound.

In early April, investors turned more optimistic about global GDP growth, pushing up UK equity prices. But this period of optimism appears to have been short-lived. The FTSE 100 has fallen by 4.8% since 21st April, from around 7,914 to 7,553, reversing part of the 7.9% rise since 17th March. Despite the recent resilience of economic activity, expectations for equity earnings have become a bit more downbeat. Nonetheless, further down the track, more rate cuts than markets anticipate should help the FTSE 100 rally.

MPC meetings 11th May and 22nd June 2023

On 11th May, the Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 25 basis points to 4.50%, and on 22nd June moved rates up a further 50 basis points to 5.00%. Both increases reflected a split vote – seven members voting for an increase and two for none.

Nonetheless, with UK inflation significantly higher than in other G7 countries, the MPC will have a difficult task in convincing investors that they will be able to dampen inflation pressures anytime soon. Talk of the Bank's inflation models being "broken" is perhaps another reason why gilt investors are demanding a premium relative to US and Euro-zone bonds, for example.

Of course, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has already hiked short-term rates to a range of 5.00%-5.25%, but a further increase is pencilled in for July, whilst the ECB looks likely to raise its Deposit rate at least once more to a peak of 3.75%, with upside risk.

Appendix 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. Link have provided the following analysis.

Interest rate forecasts

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.

The latest forecast, made on 26th June, sets out a view that both short and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy, against a backdrop of a stubbornly robust economy and a tight labour market.

You will note that our forecasts have steadily increased during the quarter as the data continued to spring upside surprises, and the Bank of England continued to under-estimate how prevalent inflation is, and how tight the labour market is. The Government has also noted that despite immigration increasing markedly, high levels of ill-health amongst the workforce has led to wage demands remaining strong until such time as there is a loosening in demand for business services.

Our current and previous PWLB rate forecasts below are based on the Certainty Rate.

Link Group Interest Rate View	26.06.23												
	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26
BANK RATE	5.00	5.50	5.50	5.50	5.25	4.75	4.25	3.75	3.25	2.75	2.75	2.50	2.50
3 month ave earnings	5.30	5.60	5.50	5.30	5.00	4.50	4.00	3.50	3.00	2.70	2.60	2.50	2.50
6 month ave earnings	5.80	5.90	5.70	5.50	5.10	4.60	4.00	3.50	3.00	2.70	2.60	2.60	2.60
12 month ave earnings	6.30	6.20	6.00	5.70	5.30	4.80	4.10	3.60	3.10	2.80	2.70	2.70	2.70
5 yr PWLB	5.50	5.60	5.30	5.10	4.80	4.50	4.20	3.90	3.60	3.40	3.30	3.30	3.20
10 yr PWLB	5.10	5.20	5.00	4.90	4.70	4.40	4.20	3.90	3.70	3.50	3.50	3.50	3.40
25 yr PWLB	5.30	5.40	5.20	5.10	4.90	4.70	4.50	4.20	4.00	3.90	3.80	3.80	3.70
50 yr PWLB	5.00	5.10	5.00	4.90	4.70	4.50	4.30	4.00	3.80	3.60	3.60	3.50	3.50

Link Group Interest Rate View	24.05.23												
	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26
BANK RATE	4.75	5.00	5.00	4.75	4.50	4.00	3.50	3.25	2.75	2.50	2.50	2.50	2.50
3 month ave earnings	4.80	5.00	5.00	4.80	4.50	4.00	3.50	3.30	2.80	2.50	2.50	2.50	2.50
6 month ave earnings	5.10	5.20	5.10	4.90	4.50	3.90	3.40	3.20	2.90	2.60	2.60	2.60	2.60
12 month ave earnings	5.40	5.40	5.30	5.00	4.50	3.90	3.40	3.20	2.90	2.70	2.70	2.70	2.70
5 yr PWLB	5.00	5.00	5.00	4.80	4.50	4.10	3.70	3.50	3.30	3.20	3.20	3.10	3.10
10 yr PWLB	5.00	5.00	5.00	4.80	4.40	4.10	3.80	3.60	3.50	3.40	3.30	3.30	3.30
25 yr PWLB	5.30	5.30	5.20	5.10	4.80	4.50	4.20	4.00	3.80	3.70	3.60	3.60	3.60
50 yr PWLB	5.10	5.10	5.00	4.90	4.60	4.30	4.00	3.80	3.60	3.50	3.40	3.40	3.40

LIBOR and LIBID rates ceased at the end of 2021. In a continuation of previous views, money market yield forecasts are based on expected average earnings by local authorities for 3 to 12 months.

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.

Appendix 3 : Prudential and Treasury Indicators for 2023-24 as of 30th June 2023

Treasury Indicators	2023/24 Budget £'000	30 June 2023/24 £'000
Authorised limit for external debt	86,000	10,000
Operational boundary for external debt	81,000	10,000
Gross external debt	10,000	10,000
Investments		(16,450)
Net borrowing / (Investment)		**(6,450)**

Maturity structure of fixed rate borrowing - upper and lower limits	2023/24 Budget £'000	2023/24 Estimate £'000
Under 12 months	0	0
12 months to 50 years	0	0
50 years +	10,000	10,000

Upper limit for principal sums invested over 365 days (Per annum)	12,000	4,000

Prudential Indicators	2023/24 Budget £'000	Budget to 30/06/2023	30.06.23 Actual £'000
Capital expenditure (approved by council February 2023)	59,870	15,000	5,038

Capital Expenditure is monitored monthly and reported in the quarterly budget monitoring report. The spend to date indicates a need to review the spending profile for the current. This will take place and be updated for Quarter 2 reporting.

Net Borrowing and CFR	31/03/2023 Actual £m	Original Budget £m
Borrowing	10.000	10.000
Investments	(27.113)	(16.450)
Net Position	**(17.113)**	**(6.450)**
Capital Financing Requirement	50.391	69.259

In order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not, except in the short term, exceed the CFR. The Council has complied with this prudential indicator.

Prudential Indicators	2023/24 Original Budget February 2023 £'000	2023/2024 Revised Estimate £'000	Notes
In year borrowing requirement	43,483	40,297	1
Ratio of financing costs to net revenue stream *	-0.05%	-0.05%	2

Notes

1. The quarter 1 internal borrowing figure is lower than budgeted reflecting the Capital programme budget as reported to Cabinet 1 August 2023. As a result internal borrowing remains with affordable limits as per the Capital Financing Requirement.

2. Ratio of financing costs to net revenue stream is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet net borrowing costs. It remains at a low position, following only a minor change (£20k) to Capital budget in the Quarter 1 budget monitoring report.

Appendix 4 : Investment Portfolio

Investments held as of 30th June 2023:

Treasury Investments	Principal	Start Date	End Date	Rate %
Aberdeen Liquidity – Money Market Fund	£1,650,000	n/a	n/a	4.790
Handelsbanken	£4,000,000	n/a	n/a	4.150
HSBC Sterling – Money Market Fund	£2,800,000	n/a	n/a	4.800
Total Liquid Accounts	**£8,450,000**			
Lancashire County Council	£4,000,000	31/08/2022	30/08/2023	2.100
Landesbank Hessen-Thueringen Girozentrale (Heleba)	£4,000,000	23/06/2023	07/07/2023	4.920
Total Fixed Term Investments	**£8,000,000**			
Total Treasury Investments	**£16,450,000**			

Appendix 5 : Approved countries for investments as of 30th June 2023

Based on lowest available rating

AAA

- Australia
- Denmark
- Germany
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)

AA-

- Belgium
- France (downgraded by Fitch on 9th May 2023)
- Qatar
- **U.K.**