REPORT TO:	**AUDIT COMMITTEE**		
DATE:	27 November 2023		
TITLE:	**TREASURY REPORT - 2023/24 QUARTER 2**		
TYPE OF REPORT:	Review		
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OPEN/EXEMPT	Open	WILL BE SUBJECT TO A FUTURE CABINET REPORT:	No

Date of meeting: 27 November 2023

TREASURY REPORT - 2023/2024 QUARTER 2

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 six 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 half 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 Treasury Management Advisers to the Council. Some comments to note include:-

2.1.1 CPI inflation fell to 6.7% in August from 10.1% in April. The Bank of England Monetary Policy Committee (MPC) uses monetary policy to manage inflation to the target rate of 2%, of which there is evidence that the rate of inflation is slowing.

2.1.2 As at 28 September 2023 Link are forecasting that the Bank rate won't drop to below 3% until December 2025, compared to their forecast as at 27 March 2023 when they forecast that it would be March 2025.

2.1.3 The Bank of England wants the markets to believe in the higher for longer narrative. The MPC statement did not say that rates have peaked and once again said if there was evidence of more persistent inflation pressures "further tightening in policy would be required".

2.1.4 *Advisors predict* **"**the economy will continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year. And with CPI inflation past its peak and expected to decline further, the economy has got through the cost-of- living crisis without recession. But even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. We expect the Bank of England to keep interest rates at the probable peak of 5.25% until the second half of 2024".

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 23 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 half of 2023/24 and are expected to remain at 5% or above until September 2024. This has been reflected in forecast investment returns for 2023/2024.

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 £20.7m**.** 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 September 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 (£506,940 to quarter 2). The performance for return on investments is £58,404 below budget at £448,536; against the forecast budget of £506,940, this is a reflection on the value invested.

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

4. Borrowing

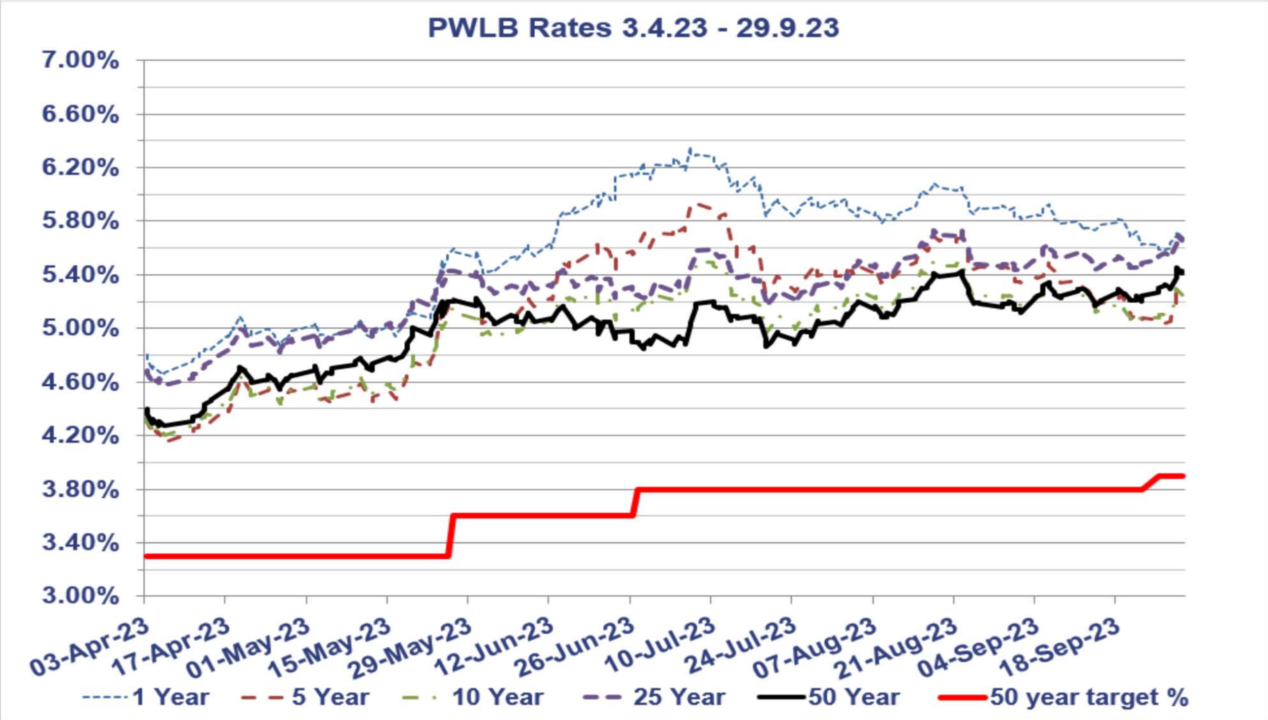
4.1 No additional borrowing was undertaken during the quarter ended 30th September 2023.

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 July saw short-dated rates peak at their most expensive. The 1-year rate spiked to 6.36% and the 5-year rate to 5.93%. Although, in due course, short-dated rate expectations fell, the medium dates shifted higher through August and the 10-year rate pushed higher to 5.51% and the 25-year rate to 5.73%. The 50-year rate was 4.27% on 5th April but rose to 5.45% on 28th September.

4.4 Rates are forecast to fall back over the next two to three years as inflation stabilises. The CPI measure of inflation is expected to fall below 2% in the second half of 2024, and we forecast 50-year rates to stand at 3.90% by the end of September 2025. However, there is considerable gilt issuance to be digested by the market over the next couple of years, as a minimum, so there is a high degree of uncertainty as to whether rates will fall that far.

PWLB maturity Certainty Rates 1st April to 30th September 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 September 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. As a result, no difficulties are envisaged for the current or future years in complying with the prudential indicators.

Appendix 1 Economic Update

- The first half of 2023/24 saw:
  - Interest rates rise by a further 100bps, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.
  - Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.
  - A 0.5% m/m decline in real GDP in July, mainly due to more strikes.
  - CPI inflation falling from 8.7% in April to 6.7% in August, its lowest rate since February 2022, but still the highest in the G7.
  - Core CPI inflation declining to 6.2% in August from 7.1% in April and May, a then 31 years high.
  - A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3myy growth of average earnings rose to 7.8% in August, excluding bonuses).
- The 0.5% m/m fall in GDP in July suggests that underlying growth has lost momentum since earlier in the year. Some of the weakness in July was due to there being almost twice as many working days lost to strikes in July (281,000) than in June (160,000). But with output falling in 10 out of the 17 sectors, there is an air of underlying weakness.
- The fall in the composite Purchasing Managers Index from 48.6 in August to 46.8 in September left it at its lowest level since COVID-19 lockdowns reduced activity in January 2021. At face value, it is consistent with the 0.2% q/q rise in real GDP in the period April to June, being followed by a contraction of up to 1% in the second half of 2023.
- The 0.4% m/m rebound in retail sales volumes in August is not as good as it looks as it partly reflected a pickup in sales after the unusually wet weather in July. Sales volumes in August were 0.2% below their level in May, suggesting much of the resilience in retail activity in the first half of the year has faded.
- As the growing drag from higher interest rates intensifies over the next six months, we think the economy will continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year. And with CPI inflation past its peak and expected to decline further, the economy has got through the cost-of- living crisis without recession. But even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. We expect the Bank of England to keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.
- The tightness of the labour market continued to ease, with employment in the three months to July falling by 207,000. The further decline in the number of job

vacancies from 1.017m in July to 0.989m in August suggests that the labour market has loosened a bit further since July. That is the first time it has fallen below 1m since July 2021. At 3.0% in July, and likely to have fallen to 2.9% in August, the job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth. Meanwhile, the 48,000 decline in the supply of workers in the three months to July offset some of the loosening in the tightness of the labour market. That was due to a 63,000 increase in inactivity in the three months to July as more people left the labour market due to long term sickness or to enter education. The supply of labour is still 0.3% below its pre-pandemic February 2020 level.

- But the cooling in labour market conditions still has not fed through to an easing in wage growth. While the monthly rate of earnings growth eased sharply from an upwardly revised +2.2% in June to -0.9% in July, a lot of that was due to the one-off bonus payments for NHS staff in June not being repeated in July. The headline 3myy rate rose from 8.4% (revised up from 8.2%) to 8.5%, which meant UK wage growth remains much faster than in the US and in the Euro-zone. Moreover, while the Bank of England's closely watched measure of regular private sector wage growth eased a touch in July, from 8.2% 3myy in June to 8.1% 3myy, it is still well above the Bank of England's prediction for it to fall to 6.9% in September.
- CPI inflation declined from 6.8% in July to 6.7% in August, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.2%. That reverses all the rise since March and means the gap between the UK and elsewhere has shrunk (US core inflation is 4.4% and in the Euro-zone it is 5.3%). Core goods inflation fell from 5.9% to 5.2% and the further easing in core goods producer price inflation, from 2.2% in July to a 29-month low of 1.5% in August, suggests it will eventually fall close to zero. But the really positive development was the fall in services inflation from 7.4% to 6.8%. That also reverses most of the rise since March and takes it below the forecast of 7.2% the Bank of England published in early August.
- In its monetary policy meeting on 20 September, the Bank of England left interest rates unchanged at 5.25%. The weak August CPI inflation release, the recent loosening in the labour market and the downbeat activity surveys appear to have convinced the Bank of England that it has already raised rates far enough. The minutes show the decision was "finely balanced". Five MPC members (Bailey, Broadbent, Dhingra, Pill and Ramsden) voted for no change and the other four (Cunliffe, Greene, Haskel and Mann) voted for a 25bps hike.
- Like the US Fed, the Bank of England wants the markets to believe in the higher for longer narrative. The statement did not say that rates have peaked and once again said if there was evidence of more persistent inflation pressures "further tightening in policy would be required". Governor Bailey stated, "we'll be watching closely to see if further increases are needed". The Bank also retained the hawkish guidance that rates will stay "sufficiently restrictive for sufficiently long".
- This narrative makes sense as the Bank of England does not want the markets to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments. A rebound in services inflation, another surge in wage growth and/or a further leap

in oil prices could conceivably force it to raise rates at the next meeting on 2nd November, or even pause in November and raise rates in December.

- The yield on 10-year Gilts fell from a peak of 4.74% on 17th August to 4.44% on 29th September, mainly on the back of investors revising down their interest rate expectations. But even after their recent pullback, the rise in Gilt yields has exceeded the rise in most other Developed Market government yields since the start of the year. Looking forward, once inflation falls back, Gilt yields are set to reduce further. A (mild) recession over the next couple of quarters will support this outlook if it helps to loosen the labour market (higher unemployment/lower wage increases).
- The pound weakened from its cycle high of $1.30 in the middle of July to $1.21 in late September. In the first half of the year, the pound bounced back strongly from the Truss debacle last autumn. That rebound was in large part driven by the substantial shift up in UK interest rate expectations. However, over the past couple of months, interest rate expectations have dropped sharply as inflation started to come down, growth faltered, and the Bank of England called an end to its hiking cycle.
- The FTSE 100 has gained more than 2% since the end of August, from around 7,440 on 31st August to 7,608 on 29th September. The rebound has been primarily driven by higher energy prices which boosted the valuations of energy companies. The FTSE 100's relatively high concentration of energy companies helps to explain why UK equities outperformed both US and Euro-zone equities in September. Nonetheless, as recently as 21st April the FTSE 100 stood at 7,914.

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.

The latest forecast on 25th September sets out a view that short, medium 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.

The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps, calculated as gilts plus 80bps) which has been accessible to most authorities since 1st November 2012.

Link Group Interest Rate View	25.09.23												
	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	3.00	2.75	2.75	2.75	2.75	2.75
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.00	2.80	2.80	2.80	2.80	2.80
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.10	2.90	2.90	2.90	2.90	2.90
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.20	3.00	3.00	3.00	3.00	3.00
5 yr PWLB	5.10	5.00	4.90	4.70	4.40	4.20	4.00	3.90	3.70	3.70	3.60	3.60	3.50
10 yr PWLB	5.00	4.90	4.80	4.60	4.40	4.20	4.00	3.80	3.70	3.60	3.60	3.50	3.50
25 yr PWLB	5.40	5.20	5.10	4.90	4.70	4.40	4.30	4.10	4.00	3.90	3.80	3.80	3.80
50 yr PWLB	5.20	5.00	4.90	4.70	4.50	4.20	4.10	3.90	3.80	3.70	3.60	3.60	3.60

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

Treasury Indicators	2023/24 Budget £'000	30 Sep 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		(18,000)
Net borrowing / (Investment)		**(8,000)**

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	2023/24 Revised Budget £'000	30.09.23 Actual £'000
Capital expenditure (Budget approved by council February 2023)	59,870	35,980	12,753

Capital Expenditure is monitored monthly and reported in the quarterly budget monitoring report.

Net Borrowing and CFR	31/03/2023 Actual £m	September Revised 23/24 Budget £m
Borrowing	10.000	10.000
Investments	(27.113)	(18.000)
Net Position	**(17.113)**	**(8.000)**
Capital Financing Requirement	50.391	63.961

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 September Revised Estimate £'000	Notes
In year internal borrowing requirement	43,483	40,594	1
Ratio of financing costs to net revenue stream *	-0.05%	-0.05%	2

Notes

1. The quarter two internal borrowing figure is lower than originally budgeted. Capital receipts are reduced in the current year as a result of the change in budget, this will see a reduction in the borrowing requirement in later years. 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. There is no movement on this as no additional financing costs are expected.

Appendix 4 : Investment Portfolio

Investments held as of 30th September 2023:

Treasury Investments	Principal	Start Date	End Date	Rate %
Handelsbanken	£4,000,000	n/a	n/a	4.700
Federated (PR)	£4,000,000	n/a	n/a	5.245
LGIM Sterling	£4,000,000	n/a	n/a	5.147
HSBC Sterling – Money Market Fund	£2,000,000	n/a	n/a	5.261
Total Liquid Accounts	**£14,000,000**			
SMBC Bank International Plc	£4,000,000	06/09/2023	16/10/2023	5.330
Total Fixed Term Investments	**£4,000,000**			
Total Treasury Investments	**£18,000,000**			

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.**