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| REPORT TO: | **AUDIT COMMITTEE** | | |
| DATE: | 11 March 2024 | | |
| TITLE: | **TREASURY REPORT - 2023/24 QUARTER 3** | | |
| TYPE OF REPORT: | Review | | |
| PORTFOLIO(S): | Cllr Chris Morley<br>E-mail: cllr.chris.morley@west-norfolk.gov.uk | | |
| REPORT AUTHOR: | Carl Holland<br>E-mail: carl.holland@west-norfolk.gov.uk<br>Direct Dial: 01553 616549 | | |
| OPEN/EXEMPT | Open | WILL BE SUBJECT TO A FUTURE CABINET REPORT: | No |

**Date of meeting: 11 March 2023**

**TREASURY REPORT - 2023/2024 QUARTER 3**


**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 nine 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
Appendix 6 - Glossary

**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 nine months 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** Consumer Price Indices (CPI) inflation continued to fall to 3.9% in November from 10.1% in April but remains variable. 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** The Monetary Policy Committee remains unwilling to endorse investors' expectations that rates will be cut as soon as May 2024. Our advisor's forecast for interest rates was previously updated on the 7th November and they 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

## 3. Annual Investment Strategy

**3.1** The Treasury Management Strategy Statement (TMSS) for 2023/2024, 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 Council's Treasury Management advisors 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 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**
The Council's treasury advisors and its investment brokers monitor advise of changes to counterparty credit ratings. 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 £16.3m**.** 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 31 December 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 £725,550 (£544,160 to quarter 2). The performance for return on investments is £27,104 above budget at £581,264

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

## 4. Borrowing

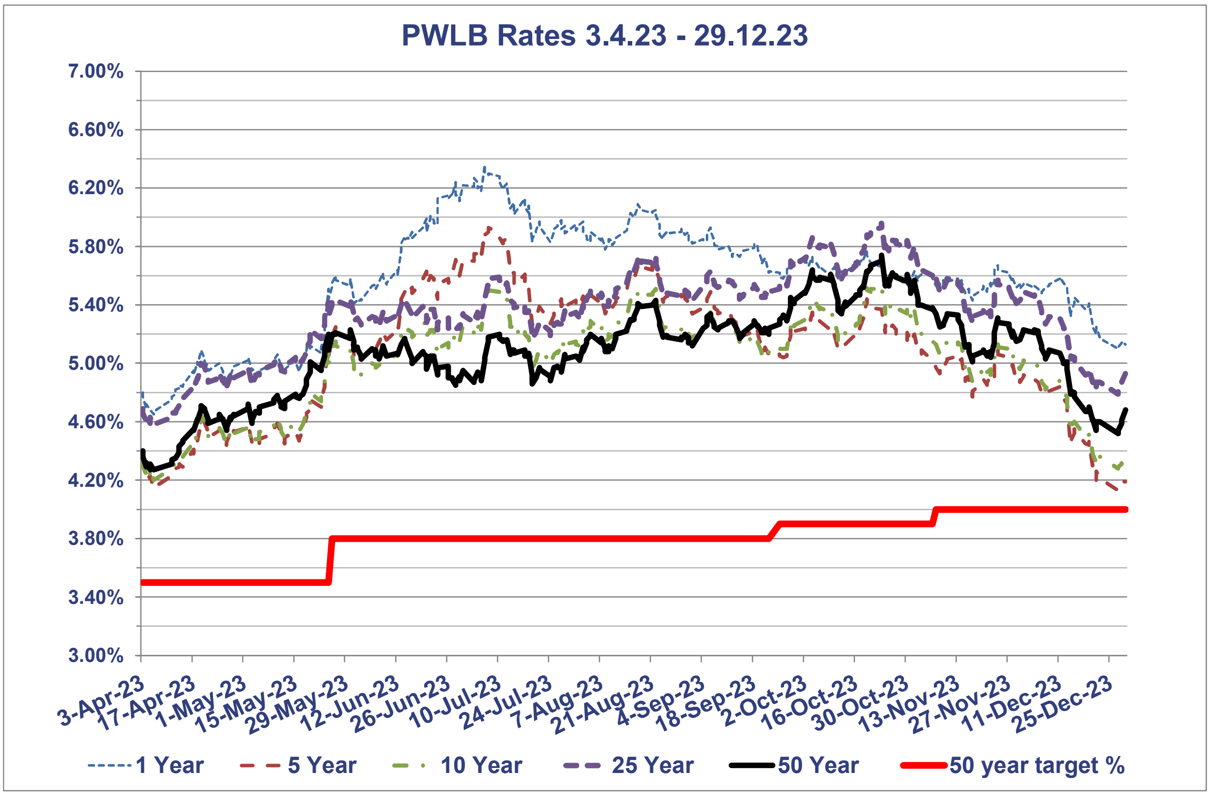
**4.1** No additional borrowing was undertaken during the quarter ended 31st December.

**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.

In their routine commentary the Council's Treasury advisors note the long-term (beyond 10 years) forecast for Bank Rate stands at 2.5%. As all PWLB certainty rates are currently significantly above this level, borrowing strategies will need to be reviewed in that context. Overall, better value can generally be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates will remain elevated for some time to come but may prove the best option whilst the market continues to wait for inflation, and therein gilt yields, to drop back later in 2023 and 2024.

**4.3** 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 31st December 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 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 Assistant Director Resources reports that the Capital programme is reviewed monthly for material variation. The Capital programme, its profile and framework for progressing schemes from feasibility to commitments are being reviewed into 2024.2025 with a view to ensuring more consistent level across each year. This will enable more proactive modelling of the impact on funding when considering new schemes or changes to existing schemes. As a result, no difficulties are envisaged for the current or future years in complying with the prudential indicators.

## Appendix 1 Economic 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.
- The revision of GDP data in Q2 to a 0.1% q/q fall may mean the mildest of mild recessions has begun. Indeed, real GDP in October fell 0.3% m/m which does suggest that the economy may stagnate again in Q3. The weakness in October may partly be due to the unseasonably wet weather. That said, as the weakness was broad based it may also be the case that the ongoing drag from higher interest rates is more than offsetting any boost from the rise in real wages.
- However, the rise in the flash composite activity Purchasing Managers Index, from 50.7 in November to 51.7 in December, did increase the chances of the economy avoiding a contraction in Q3. The improvement was entirely driven by the increase in the services activity balance from 50.9 to 52.7. (Scores above 50 point to expansion in the economy, although only tepid in this instance.) The press release noted that this was primarily driven by a revival in consumer demand in the technological and financial services sectors. This chimes with the further improvement in the GfK measure of consumer confidence in December, from -24 to -22. The services PMI is now consistent with non-retail services output growing by 0.5% q/q in Q3, but this is in stark contrast to the manufacturing sector where the output balance slumped from 49.2 to 45.9 and, at face value, the output balance is consistent with a 1.5% q/q fall in manufacturing output in Q3.
- The 0.3% m/m fall in retail sales volumes in October means that after contracting by 1.0% q/q (which was downwardly revised from -0.8% q/q) in Q2, retail activity remained weak at the start of Q3. That suggests higher interest rates are taking a bigger toll on real consumer spending.
- Higher interest rates have filtered through the financial channels and weakened the housing market but, overall, it remains surprisingly resilient with only marginal falls showing year on year on the Halifax (-1%) and Nationwide (-1.8%) indices. However, the full weakness in real consumer spending and real business investment has yet to come as currently it is estimated that around two thirds to a half of the impact of higher interest rates on household interest payments has yet to be felt.
- Overall, we expect real GDP growth to remain subdued throughout 2024 as the drag from higher interest rates is protracted but a fading of the cost-of-living crisis and interest rate cuts in the second half of 2024 will support a recovery in GDP growth in 2025.

- The labour market remains tight by historical standards, but the sharp fall in wage growth seen in October will reinforce the growing belief in markets that interest rates will be cut mid-2024. Wage growth eased in October much faster than the consensus expected. Total earnings fell by 1.6% m/m, which meant the headline 3myy rate eased from 8.0% in September to 7.2% in October. This news will be welcomed by the Bank of England. Indeed, the timelier three-month annualised rate of average earnings growth fell from +2.4% to -1.2%. Excluding bonuses, it fell from 5.3% to 2.0%. Furthermore, one of the Bank's key barometers of inflation persistence, regular private sector pay growth, dropped from 7.9% 3myy to 7.3%, which leaves it comfortably on track to fall to 7.2% by December, as predicted by the Bank in November.
- The fall in wage growth occurred despite labour demand being stronger in October than expected. The three-month change in employment eased only a touch from +52,000 in September to +50,000 in October. But resilient labour demand was offset by a further 63,000 rise in the supply of workers in the three months to October. That meant labour supply exceeded its pre-pandemic level for the first time, and the unemployment rate remained at 4.2% in October. In the three months to November, the number of job vacancies fell for the 17$^{th}$ month in a row, from around 959,000 in October to around 949,000. That has reduced the vacancy to unemployment ratio as demand for labour eases relative to supply, which may support a further easing in wage growth in the coming months.
- CPI inflation fell from 6.7% in September to 4.6% in October, and then again to 3.9% in November. Both these falls were bigger than expected and there are clear signs of easing in domestic inflationary pressures. The fall in core CPI inflation from 5.7% to 5.1% in November was bigger than expected (consensus forecast 5.6%). That's the lowest rate since January 2022. Some of the decline in core inflation was due to the global influence of core goods inflation, which slowed from 4.3% to 3.3%. But some of it was due to services inflation falling from 6.6% to 6.3%. The Bank views the latter as a key barometer of the persistence of inflation and it came in further below the Bank's forecast of 6.9% in its November Monetary Policy Report. This will give the Bank more confidence that services inflation is now on a firmly downward path.
- The Bank of England sprung no surprises with its December monetary policy committee (MPC) meeting, leaving interest rates at 5.25% for the third time in a row and pushing back against the prospect of near-term interest rate cuts. The Bank continued to sound hawkish, with the MPC maintaining its tightening bias saying that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures". And it stuck to the familiar script, saying that policy will be "sufficiently restrictive for sufficiently long" and that "monetary policy is likely to need to be restrictive for an extended period of time". In other words, the message is that the MPC is not yet willing to endorse investors' expectations that rates will be cut as soon as May 2024.
- Looking ahead, our colleagues at Capital Economics forecast that the recent downward trends in CPI and core inflation will stall over the next few months before starting to decline more decisively again in February. That explains why we think the Bank of England won't feel comfortable cutting interest rates until H2 2024.
- The fall in UK market interest rate expectations in December has driven most of the decline in 10-year gilt yields, which have fallen in line with 10-year US Treasury and euro-zone yields. 10-year gilt yields have fallen from 4.68% in October 2023 to around 3.70% at the time of writing, with further declines likely if the falling inflation story is maintained.
- Investors' growing expectations that the Fed will cut interest rates soon has led to an improvement in risk sentiment, which has boosted the pound and other risky assets. In addition, the rise in the pound, from \$1.21 in November to \$1.27 now, has also been supported by the recent relative decline in UK wholesale gas prices.

- The further fall in 10-year real gilt yields in December has supported the recent rise in the FTSE 100. That said, the index remains 5% below its record high in February. This modest rise in equities appears to have been mostly driven by strong performances in the industrials and rate-sensitive technology sectors. But UK equities have continued to underperform US and euro-zone equities. The FTSE 100 has risen by 2.2% in December, while the S&P 500 has risen by 3.8%. This is partly due to lower energy prices, which have been a relatively bigger drag on the FTSE 100, due to the index's high concentration of energy companies.

**MPC meetings 2nd November and 14th December 2023**

- On 2nd November, the Bank of England's Monetary Policy Committee (MPC) voted to keep Bank Rate on hold at 5.25%, and on 14th December reiterated that view. Both increases reflected a split vote, the latter by 6 votes to 3, with the minority grouping voting for an increase of 0.25% as concerns about "sticky" inflation remained in place.
- Nonetheless, with UK CPI inflation now at 3.9%, and core inflating beginning to moderate (5.1%), markets are voicing a view that rate cuts should begin in Q1 2024/25, some way ahead of the indications from MPC members. Of course, the data will be the ultimate determinant, so upcoming publications of employment, wages and inflation numbers will be of particular importance, and on-going volatility in Bank Rate expectations and the gilt yield curve can be expected.
- In addition, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has kept short-term rates in the range of 5.25%-5.50%, whilst the ECB has moved its Deposit rate to a probable peak of 4%. Markets currently expect both central banks to start cutting rates in 2024

## 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 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 |

**Appendix 3 : Prudential and Treasury Indicators for 2023-24 as of 31st December 2023**

| Treasury Indicators | 2023/24 Budget £'000 | 31 December 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 | | (16,300) |
| Net borrowing / (Investment) | | **(6,300)** |

| 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 | 31 December 2023 Actual £'000 |
|---|---|---|---|
| Capital expenditure (Budget approved by council February 2023), (Revised Budget – December Monitoring Report) | 59,870 | 35,520 | 24,550 |

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

| **Net Borrowing and CFR** | **31/03/2023 Actual £m** | **December Revised 23/24 Budget £m** |
|---|---|---|
| **Borrowing** | 10.000 | 10.000 |
| **Investments** | (27.113) | (16.300) |
| Net Position | **(17.113)** | **(6.300)** |
| **Capital Financing Requirement** | 50.391 | 63.501 |

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 December Revised Estimate £'000** | **Notes** |
|---|---|---|---|
| **In year internal borrowing requirement** | 43,483 | 40,134 | 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 31st December 2023:

| Treasury Investments | Principal | Start Date | End Date | Rate % |
|---|---|---|---|---|
| Handelsbanken | £4,000,000 | n/a | n/a | 4.700 |
| BNP Paribas – Money Market Fund | £2,300,000 | n/a | n/a | 5.314 |
| LGIM Sterling – Money Market Fund | £4,000,000 | n/a | n/a | 5.111 |
| **Total Liquid Accounts** | **£10,300,000** | | | |
| Babergh District Council | £4,000,000 | 15/12/2023 | 07/06/2024 | 5.700 |
| South Ayrshire Council | £2,000,000 | 16/10/2023 | 16/10/2025 | 5.650 |
| **Total Fixed Term Investments** | **£6,000,000** | | | |
| **Total Treasury Investments** | **£16,300,000** | | | |

## 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.**

**APPENDIX 6 – Glossary**

| Term | Definition |
|---|---|
| Authorised Limit for External Borrowing | Represents a control on the maximum level of borrowing. |
| Capital Expenditure | Expenditure capitalised in accordance with regulations i.e. material expenditure either by Government Directive or on capital assets, such as land and buildings, owned by the Council (as opposed to revenue expenditure which is on day-to-day items including employees' pay, premises costs and supplies and services). |
| Capital Financing Requirement (CFR) | A measure of the Council's underlying borrowing need i.e. it represents the total historical outstanding capital expenditure which has not been paid for from either revenue or capital resources. The difference between the CFR and the total of long-term liabilities and existing and new borrowing indicates that the Council has made temporary use of internal cash balances to finance the capital programme. This is known as "internal borrowing". |
| Capital Loan | Funding that KLWN provide to support the transfer of housing to West Norfolk Housing Co. Ltd. |
| Counterparties | Financial Institutions with which funds may be placed |
| Internal Borrowing | the Council can finance the capital programme (on a temporary basis) by using its cash balances. These are essentially earmarked reserves, general fund reserves and net movement on current assets. As the cash in these reserves is not required in the short term for the reserves' specific purposes, it has been utilised to reduce external borrowing. It costs less than external borrowing, the cost being the opportunity cost of interest foregone by not investing the cash. |
| Minimum Revenue Provision (MRP) | Revenue charge to finance the repayment of debt. for capital expenditure that had not yet been met from grants, contributions or capital receipts. |

| | |
|---|---|
| Money Market Fund | Highly liquid and low risk investment fund. |
| Operational Boundary | Limit which external borrowing is not normally expected to exceed. |
| Unsupported borrowing | Funded from within the budgets of services. Used for mobile assets, typically vehicles. |