CRMG Scrutiny Committee	27 February 2024
Cabinet Meeting	12 March 2024

TREASURY MANAGEMENT Q3 REPORT 2023/24

Report of the Deputy Chief Executive (Section 151 Officer)

1 INTRODUCTION AND PURPOSE OF REPORT

1.1 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that Members be updated on treasury management activities regularly (annual, mid-year and quarterly reports). This report therefore ensures this Council is implementing best practice in accordance with the Code.

2. ECONOMICS UPDATE

2.1 The third quarter of 2023/24 saw:

- A 0.3% month on month decline in real GDP in October 2023, potentially partly due to unseasonably wet weather, but also due to the ongoing drag from higher interest rates. Growth for the second quarter, ending 30 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 3-month year on year rate declining from 8.0% in September 2023 to 7.2% in October, although the Office for National Statistics unemployment rate has remained low at 4.2%;
- CPI inflation generally continuing on its downward trajectory, from 8.7% in April 2023 to 4.6% in October and 3.9% in November; however, there was a small rise to 4% in December;
- Core CPI inflation decreasing from April and May's 31 years' high of 7.1% to 5.1% in November 2023 was the lowest rate since January 2022;
- The Bank of England holding Bank Rate at 5.25% in November and December 2023; and
- A steady fall in 10-year gilt yields as investors revised their interest rate expectations lower.

2.2 The revision of GDP data in Q2 to a 0.1% quarter on quarter fall may mean the mildest of mild recessions has begun. Indeed, real GDP in October 2023 fell 0.3% month on month 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.

2.3 However, the rise in the flash composite activity Purchasing Managers Index, which is an estimate of manufacturing, from 50.7 in November 2023 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 2023, from -24 to -22. The services PMI is now consistent with non-retail services output growing by 0.5% quarter on quarter 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% quarter on quarter fall in manufacturing output in Q3.

2.4 The 0.3% month on month fall in retail sales volumes in October 2023 means that after contracting by 1.0% quarter on quarter (which was downwardly revised from -0.8% quarter on quarter) 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.

2.5 Higher interest rates have filtered through the financial channels and weakened the housing market but, overall, it remains surprisingly resilient with the Halifax house price index recently pointing to a 1.7% year on year increase whilst Nationwide's December 2023 data pointed to a -1.8% year on year decrease. 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.

2.6 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.

2.7 The labour market remains tight by historical standards, but the sharp fall in wage growth seen in October 2023 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% month on month, which meant the headline 3 month year on year rate eased from 8.0% in September 2023 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% 3 month year on year to 7.3%, which leaves it comfortably on track to fall to 7.2% by December, as predicted by the Bank in November.

2.8 The fall in wage growth occurred despite labour demand being stronger in October 2023 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 17th 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.

2.9 CPI inflation fell from 6.7% in September 2023 to 4.6% in October, and then again to 3.9% in November (with a small rise to 4% in December 2023). Both falls (in Oct and Nov) were bigger than expected and showed there are clear signs of easing in domestic inflationary pressures. It is expected that the small rise in December 2023 was a ‘temporary blip’ at the close of the year. 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.

2.10 The Bank of England sprung no surprises with its December 2023 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.

2.11 Looking ahead, Capital Economics forecast that the recent (generally) downward trends in CPI and core inflation will stall over the next few months before starting to decline more decisively again in February 2024. That explains why we think the Bank of England won’t feel comfortable cutting interest rates until the second half of 2024.

2.12 The fall in UK market interest rate expectations in December 2023 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% in early January, with further declines likely if the falling inflation story is maintained.

2.13 Investors’ growing expectations that the US Federal Reserve 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 2023 to $1.27 at the time of writing this report, has also been supported by the recent relative decline in UK wholesale gas prices.

2.14 The further fall in 10-year real gilt yields in December 2023 has supported the recent rise in the FTSE 100. That said, the index remains 5% below its record high in February 2023. 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 in the US 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.

2.15 In the chart below, the rise in gilt yields across the curve in the first half of 2023/24, and therein PWLB rates, is clear to see, prior to the end of year rally based on a mix of supportive domestic and international factors.

	PWLB				
	1 Year	**5 Year**	**10 Year**	**25 Year**	**50 Year**
Low	4.65%	4.13%	4.20%	4.58%	4.27%
Date	06.04.23	27.12.23	06.04.23	06.04.23	05.04.23
High	6.36%	5.93%	5.53%	5.96%	5.74%
Date	06.07.23	07.07.23	23.10.23	23.10.23	23.10.23
Average	5.60%	5.09%	5.03%	5.35%	5.08%
Spread	1.71%	1.80%	1.33%	1.38%	1.47%

2.16 **MPC meetings November and December 2023**

2.16.1 On 2 November 2023, the Bank of England's Monetary Policy Committee (MPC) voted to keep Bank Rate on hold at 5.25%, and on 14 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, i.e. inflation does not immediately react to changes in monetary policy, remained in place.

2.16.2 Nonetheless, with UK CPI inflation now at 4% and core inflation beginning to moderate, 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.

2.16.3 In addition, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC (Federal Open Market Committee) has kept short-term rates in the range of 5.25%-5.50%, whilst the European Central Bank has moved its Deposit rate to a probable peak of 4%. Markets currently expect both central banks to start cutting rates in 2024.

3 <u>INTEREST RATE FORECASTS</u>

3.1 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 basis points, i.e. -0.2%) which has been accessible to most authorities since 1 November 2012.

3.2 The latest forecast, made on 8 January 2024, sets out a view that the Monetary Policy Committee (MPC) will be keen to further demonstrate its anti-inflation credentials by keeping Bank Rate at 5.25% until at least the second half of the year 2024. We expect rate cuts to start when both the Consumer Price Indices (CPI) inflation and wage/employment data are supportive of such a move, and when there is a likelihood of the overall economy enduring at least a slowdown or mild recession over the coming months (although most recent Gross Domestic Product (GDP) releases have surprised with their on-going robustness).

3.3 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.

3.4 Current PWLB rate forecasts below are based on the Certainty Rate.

	June 2024	Sept 2024	Dec 2024	March 2025	June 2025	Sept 2025	Dec 2025	March 2026	June 2026	Sept 2026	Dec 2026	March 2027
Bank Rate	5.25%	4.75%	4.25%	3.75%	3.25%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
3m ave earn *	5.30%	4.80%	4.30%	3.80%	3.30%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
6m ave earn *	5.10%	4.60%	4.10%	3.70%	3.30%	3.10%	3.10%	3.10%	3.10%	3.10%	3.10%	3.10%
12m ave earn *	4.90%	4.40%	3.90%	3.60%	3.20%	3.10%	3.10%	3.10%	3.10%	3.10%	3.20%	3.20%
5y PWLB	4.40%	4.30%	4.20%	4.10%	4.00%	3.80%	3.70%	3.60%	3.60%	3.50%	3.50%	3.50%
10y PWLB	4.50%	4.40%	4.30%	4.20%	4.10%	4.00%	3.90%	3.80%	3.70%	3.70%	3.70%	3.70%
25y PWLB	5.10%	4.90%	4.80%	4.60%	4.40%	4.30%	4.20%	4.20%	4.10%	4.10%	4.10%	4.10%
50y PWLB	4.90%	4.70%	4.60	4.40%	4.20%	4.10%	4.00%	4.00%	3.90%	3.90%	3.90%	3.90%

* 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.

3.5 **Forecast PWLB RATES**
The short and medium part of the gilt curve has rallied since the start of November as markets price in a quicker reduction in Bank Rate through 2024 and 2025 than held sway back then. This reflects market confidence in inflation falling back in a similar manner to that already seen in the US and the Euro-zone. At the time of writing there is circa 70 basis points difference between the 5 and 50-year parts of the curve.

3.6 **The balance of risks to the UK economy:**
The overall balance of risks to economic growth in the UK is even.

3.7 **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.

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

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

- Despite the tightening in Bank Rate to 5.25%, the Bank of England allows inflationary pressures to remain elevated for a long 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, which may prove inflationary, resulting in investors pricing in a risk premium for holding UK sovereign debt.

- **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.

4 TREASURY MANAGEMENT ACTIVITY

4.1 The overall treasury position as at 30 December 2023 is shown in the table below:

Treasury Position	**Financial Year 2023/24 Mid-Year Position**				**Financial Year 2023/24 Q3 Position**			
	General Fund		**HRA**		**General Fund**		**HRA**	
	£m	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
	as at 30.09.23		**as at 30.09.23**		**as at 31.12.23**		**as at 31.12.23**	
Fixed Rate Funding:								
PWLB	327.024	3.11%	73.126	4.75%	327.024	3.11%	73.126	4.75%
Market (LOBO)	10.942	4.26%	6,558	4.26%	4.690	4.95%	2.810	4.95%
Market (converted LOBOs)	37.517	3.89%	22.483	3.89%	37.517	3.89%	22.483	3.89%
Market (other long-term loans)	40.000	2.33%	0	0%	40.000	2.33%	0	0%
Market (short-term)	135.000	4.95%	0	0%	149.000	5.25%	0	0%
Salix loans	3.700	0%	0	0%	3.036	0%	0	0%
Sub-total	554.183		102.167		**561.267**		**98.419**	
Variable Rate Funding:								
Market (short-term fixed period)	10.000	5.25%	0	0%	0	0%	0	0%
Market (short-term)	30.020	5.25%	0	0%	30.020	4.25%	0	0%
Sub-total	40.020				**30.020**		**0**	
Total Debt	594.203	3.67%	102.167	4.53%	**591.287**	**3.76%**	**98.419**	**4.56%**
Total Investments	38.775	5.66%	0	0%	**38.385**	**5.67%**	**0**	**0%**
Net Debt	555.428		102.167		**552.902**		**98.419**	

- Net debt has marginally decreased between the mid-year point of 2023/24 and the end of Q3, reducing from £657.595m to £651.321m. The overall cost of borrowing (GF and HRA) is 3.81% average year to date and has moved up in line with increased cost of borrowing.
- The change in LOBO debt also reflects the repayment of a £10m LOBO loan in December 2023, which came about when the LOBO option was called. The lender proposed an increase in interest rate from 3.75% to 4.45% at the option date, 22 December 2023 and as interest rate forecasts indicate rates will start to decrease during 2024 to below this level, the Council made the decision to repay the loan.

5 ANNUAL INVESTMENT STRATEGY (AIS)

5.1 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, 'Security of Capital, Liquidity and Yield (SLY)'.

5.2 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.

5.3 As shown by the charts in 5.8 below and the interest rate forecasts in Section 3, investment rates have remained elevated during 2023/24 but are now expected to have peaked.

5.4 **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.

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

5.6 **CDS prices[1]**
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.

5.7 **Investment balances**
The average level of funds available for investment purposes during the quarter was £52.002m. 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 Council does not hold core cash balances for investment purposes (i.e., funds available for more than one year).

5.8 The Council uses the Sterling Overnight Index Averages (SONIA) to benchmark its investment returns. There is a choice of using the forward looking (term) benchmarks and the backward-looking benchmarks. The forward-looking benchmark reflects where the market has moved to over time, whereas the Council uses the backward-looking benchmark as this reflects where the market was positioned when investments were placed.

Investment Performance (year to date) quarter ended 31 December 2023
Bank Rate vs backward looking SONIA

- [1] A Credit Default Swap (CDS) is a contract between two parties in which one party purchases protection from another party against losses from the default of a borrower for a defined period of time. CDS prices are often quoted in terms of credit spreads, the implied number of basis points that the credit protection seller receives from the credit protection buyer to justify providing the protection. A credit default swap (CDS) is a financial derivative that allows an investor to swap or offset their credit risk with that of another investor. To swap the risk of default, the lender buys a CDS from another investor who agrees to reimburse them if the borrower defaults.
- Most CDS contracts are maintained via an ongoing premium payment similar to the regular premiums due on an insurance policy. A lender who is worried about a borrower defaulting on a loan often uses a CDS to offset or swap that risk.

	Bank Rate	SONIA	7 day	30 day	90 day	180 day	365 day
High	5.25%	5.19%	5.19%	5.20%	5.22%	5.20%	4.70%
High Date	03.08.23	24.11.23	27.11.23	12.12.23	22.12.23	29.12.23	29.12.23
Low	4.25%	4.18%	4.18%	4.02%	3.81%	3.32%	2.27%
Low Date	03.04.23	04.04.23	11.04.23	03.04.23	03.04.23	03.04.23	03.04.23
Average	**4.95%**	**4.89%**	**4.88%**	**4.84%**	**4.71%**	**4.43%**	**3.60%**
Spread	1.00%	1.01%	1.01%	1.18%	1.41%	1.88%	2.43%

5.9 The table below illustrates the investment returns achieved during the third quarter of 2023/24 split by time duration.

Q1 2023/24	**COUNCIL PERFORMANCE**			
		Ave Balance Invested	% Return	Ave Duration (days)
Combined Investments	April 2023	£53.266m	4.35%	61.32
	May 2023	£53.310m	4.41%	44.08
	June 2023	£51.377m	4.52%	27.93
Average Q1		**£52.658m**	**4.42%**	**44.63**
	July 2023	£52.762m	5.21%	70.12
	Aug 2023	£52.181m	5.39%	63.43
	Sept 2023	£47.944m	5.45%	49.96
Average Q2		**£50.995m**	**5.35%**	**61.63**
	Oct 2023	£50.236m	5.59%	44.26
	Nov 2023	£55.494m	5.58%	24.96
	Dec 2023	£50.390m	5.59%	9.75
Average Q3		**£52.002m**	**5.59%**	**26.28**
Average Year to Date		**£51.882m**	**5.12%**	**44.07**

5.10 As illustrated in the table above, the Council's return for Q3 has *outperformed* the benchmark in all periods.

5.11 The budgeted investment return given in the initial Annual Investment Strategy Report for 2023/24 was 4.40%, assuming an average investment duration of up to three months; (this represents the Council's typical investment duration which is predominantly at the short end of the curve and fairly liquid to cater for cashflow needs). This was based on the interest rate forecast in February 2023 which assumed Bank rate would peak at 4.50% by Q2 2023 Bank rate has risen more quickly and steeply than those initial assumptions and the return for 2023/24 was therefore revised upwards in the Md-Year Treasury Management Review Report 2023/24 to 5.30%. This was purely based on prospects for Bank rate and not an expectation that the Council will place significant investments for longer periods than 3 months later in the year. It was however based on forecasts at the time that saw Bank rate reaching 5.50%. Now interest rates appear to have peaked at 5.25% this return may be a little ambitious and is expected to be closer to 5.15%.

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

6 <u>BORROWING STRATEGY</u>

6.1 PWLB maturity Certainty Rates to 31 December 2023

6.1.1 Gilt yields and PWLB rates have endured a volatile nine months from April to December 2023 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 the second half of 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 around 50 basis points difference between the 5 and 50-year parts of the curve.

6.1.2 Gilt yields and PWLB rates were on a rising trend from April through to October but dropped back significantly in November and December. The 50-year PWLB Certainty Rate target for new long-term borrowing started 2023/24 at 3.50% (the lowest forecast rate within a two-year time horizon), increasing to a peak of 4.00% in November. 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. (Please also note that from 15 June, HRA borrowing is 0.40% lower than the Certainty Rate.)

6.2 **PWLB Rates Q3**

The following table summarises movements in PWLB Certainty rates from 1 year out to 50 years up to the end of Q3 2023/24.

PWLB	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.65%	4.13%	4.20%	4.58%	4.27%
Date	06.04.23	27.12.23	06.04.23	06.04.23	05.04.23
High	6.36%	5.93%	5.53%	5.96%	5.74%
Date	06.07.23	07.07.23	23.10.23	23.10.23	23.10.23
Average	5.60%	5.09%	5.03%	5.35%	5.08%
Spread	1.71%	1.80%	1.33%	1.38%	1.47%

6.3 **Revised PWLB Borrowing trigger rates**

The table below provides revised PWLB Certainty trigger borrowing rates.

Term	Current Rate (at 08.01.24 p.m.) £	Target Borrowing Rate (end of Q3 2025
5 year	4.53%	3.70%
10 year	4.67%	3.90%
25 year	5.19%	4.20%
50 year	4.97%	4.00%

Please note, the Council has now set trigger rates <u>18 months forward from now</u> (this assumes that ideally long-term borrowing will not be until the end of 2025) and so trigger rates look at the forecasts for new PWLB long-term borrowing in Q3 2025. This is because inflation is expected to start to fall throughout the remainder of 2024 and therefore long-term rates by 2025 are expected to be lower. This forward period is when we expect rates to have fallen back, and you will note that trigger levels are therefore significantly below where borrowing levels currently are.

6.4 It is unlikely that the Council will take long-term PWLB borrowing in Q4 of 2023/24 but quite probable that short duration PWLB loans (1-2 years) may be taken due to enduring liquidity shortages in the short-term market. At the time of writing the 1- year PWLB Certainty rate was 5.29% (2 February) and so not dissimilar to Bank rate.

6.5 The long-term (beyond 10 years) forecast for Bank Rate stands at 3%. As all PWLB certainty rates are currently significantly above this level, borrowing strategies will need to remain within that context. Overall, better value can generally be obtained at the shorter end of the curve and short-dated fixed local authority to local authority monies will continue to be the best option, although supply issues are prevalent at present. 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.

6.6 As both short and long-term interest rates have now risen significantly, a £10m LOBO loan the Council had was ‘called’ on its interest payment/option date in December 2023, meaning the lender (in this case Dexia) requested a 70 basis point increase to the interest rate. The Council chose to repay the loan as current forecasts would suggest that long-term rates would have fallen below this revised level by the end of 2025.

7 DEBT RESCHEDULING

7.1 Debt rescheduling opportunities have increased significantly in the current quarter where gilt yields, which underpin PWLB rates and market loans, have risen materially. Members will be advised if there is value to be had by rescheduling or repaying a part of the debt portfolio.

8 COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

8.1 The prudential and treasury Indicators are shown in Appendix 1.

8.2 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the quarter ended 30 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 Deputy Chief Executive (Section 151 Officer) reports that no difficulties are envisaged for the current or future years in complying with these indicators.

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

OTHER CONSIDERATIONS

9.1 FINANCIAL AND RISK ASSESSMENT CONSIDERATIONS

9.1.1 The financial implications are covered in the body of the report.

9.1.2 There are no further financial and risk considerations arising from the report. This report is produced as a finance report and discusses in detail risk mitigation processes which are at the heart of Treasury Management Policy. Treasury Management Risk Management is the practice of planning for unexpected expenditures. It is primarily about mitigating and avoiding the impact of the changing financial environment on the Council’s cash flow objectives.

9.1.3 It is confirmed that the Deputy Section 151 Officer has signed off the financial implications detailed within the report.

9.2 LEGAL CONSIDERATIONS

9.2.1 There are no Legal and Governance implications to consider as a result of the report and recommendations.

9.2.2 The Council will ensure that all its treasury management activities comply with its statutory powers and regulatory requirements. In framing its credit and counterparty policy under Treasury Management Practice (TMP1) *Counterparty credit risk management*, it will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may effect with the Council, particularly with regard to duty of care and fees charged.

9.2.3 The Council recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to manage the risk of these impacting adversely on the Council.

9.3 HUMAN RESOURCES IMPACT

9.3.1 There is no impact to the workforce or the workforce of partner organisations as a result of the report and recommendations.

9.3.2 The Council recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills.

9.3.3 The Council will also ensure that Members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

9.3.4 The present arrangements, including a knowledge and skills schedule, are detailed in the relevant Treasury Management Practice (TMP). This *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes* (the TM Code) revision for 2021 introduces strengthened requirements for skills and training.

9.4 EQUALITIES IMPACT

9.4.1 A full Equalities Impact Assessment was undertaken with the initial Treasury Management Strategy Report for 2023/24 that went to Council on 23 February 2023. This is a backward-looking performance report on that Strategy.

9.5 ENVIRONMENTAL IMPACT

9.5.1 The Treasury Management Strategy, Annual Investment Strategy and Minimum Review Policy Report 2024/25 provided detailed clarification of the way the Council is looking to incorporate environmental considerations in the Council's Investment Strategy.

9.5.2 Environmental, social and governance (ESG) issues are increasingly significant for investors and investment managers. This is better developed in equity and bond markets than for short-term cash deposits and there is a diversity of market approaches to ESG classification and analysis.

9.5.3 This means that a consistent and developed approach to ESG for the Council in its treasury management dealings is challenging. The Council is considering its credit and counterparty policies in light of ESG information and developing ESG investment policies and treasury management practices consistent with the Council’s own relevant policies where possible, for example, climate change policies.

10 CONCLUSIONS AND RECOMMENDATIONS

10.1 The Council's treasury management function has functioned well in Q3 2023/24; investment performance has achieved a return of 5.59% and debt costs have been minimised at an overall rate of 3.64% (year to date Q1-Q3).

10.2 During the quarter the Council operated within the treasury limits and Prudential Indicators set out in the Council’s Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

10.3 The Council has had as its first priority the security of invested funds and its policy to place appropriate parameters (in terms of credit quality), to organisations with whom it invests. This has safeguarded the Council's investments during Q3 2023/24.

10.4 Since the December MPC rate decision, the Bank of England’s hawkish bias has not prevented the markets from forming a view that rates will be falling soon. Accordingly, swap rates and gilt yields have reduced significantly over the past month despite a partial rebound upwards since the turn of the year.

10.5 Looking further afield, we suspect the wider economy may only endure the lightest of recessions or, possibly, not at all. The Bank’s November Quarterly Monetary Policy Report saw it revise down its Q3 and Q4 GDP forecasts for 2023 and its annual forecast for 2024 from 0.4% to 0.0% (2023 stayed at 0.5%). But it could be this outlook underestimates the robustness and resilience of the UK economy, particularly considering upward revisions to GDP stemming from the pandemic years.

10.6 As outlined in November, there are, of course, significant risks to Link’s central forecast, with a meaningful and prolonged shift up in oil prices from $75 per barrel to something closer to $120 keeping inflation higher for longer.

10.7 Regarding PWLB rates, movement in the short part of the curve has reflected the revised Bank Rate expectations to a large degree, whilst medium to longer-dated PWLB rates will remain influenced not only by the outlook for inflation, but by the market’s appetite for significant gilt issuance. Indeed, although we have a slightly lower starting point for the envisaged reduction in short and medium dated gilts, we now forecast the 10, 25 and 50-years part of the curve to not fall quite as low as we thought in November.

10.9 A General Election will also take place in the next year, so Government fiscal policy may potentially loosen at the same time as the Bank’s monetary policy is still trying to take momentum out of the economy. That may mean that Bank rate stays elevated for a little longer than forecast in this report.

10.10 From a Treasury standpoint the Council whilst looking to borrow will, most probably, need to continue to focus on optimising its cashflow forecasts, and given the elevated level of rates right across the curve at present, seek to continue to fund either temporarily from local authorities or possibly with short-dated loans from the PWLB. Members will see from the latest forecast that we still expect both short and longer-term rates to be somewhat lower over the duration of the forecast.

10.11 The Cabinet is asked to:

- Note the report and treasury activity and approve any changes to the prudential indicators.

BACKGROUND PAPERS

There are none.

Anyone wishing to inspect the above background papers or requiring further information should contact Lorna Soufian

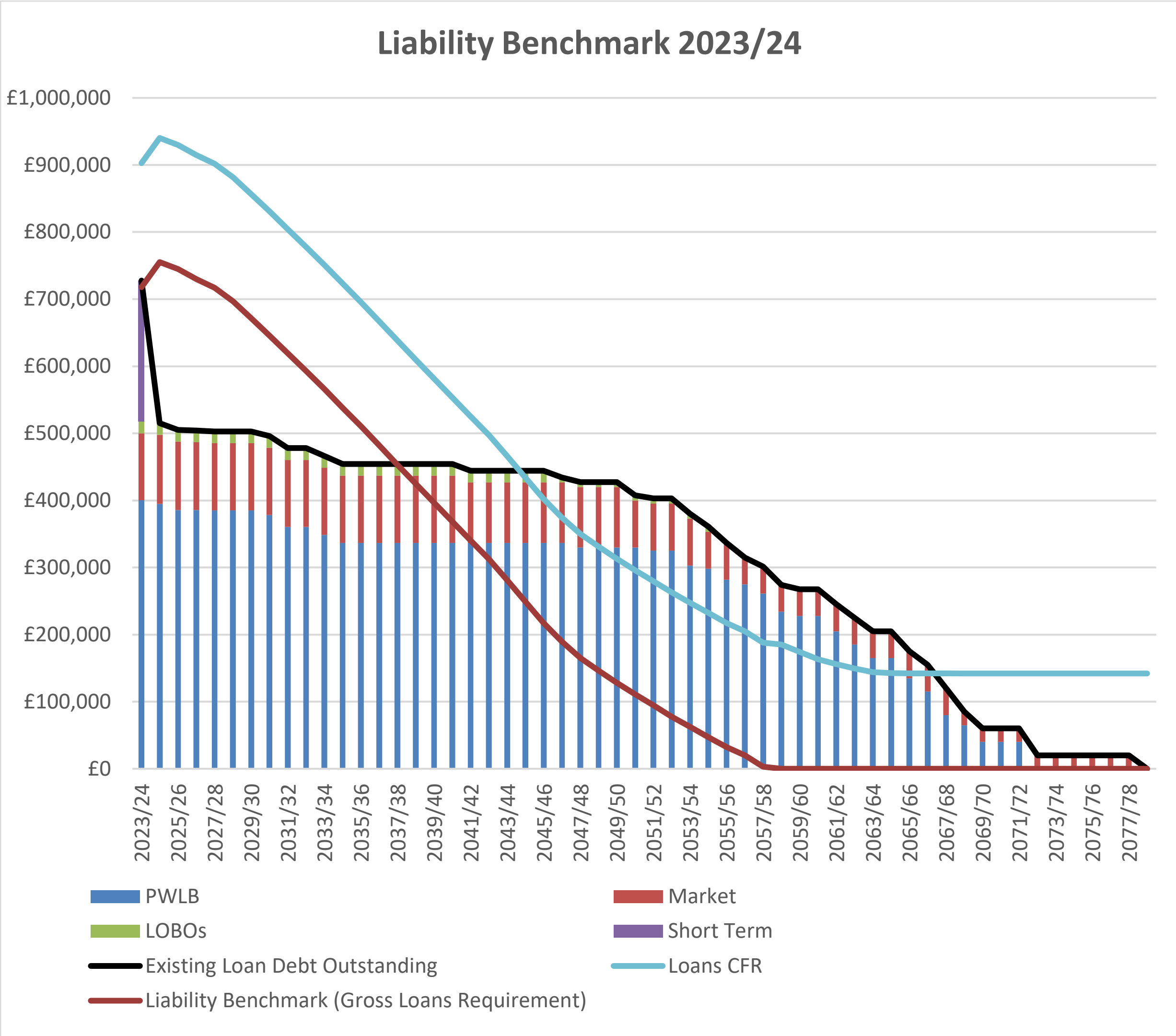
Lorna Soufian on Tel: 0161 474 4026 or by email

APPENDIX 1

Prudential and Treasury Indicators 2023/24 Q3

Capital Indicators

	Budget 2023/24 £M	Q3 2023/24 £M
Capital expenditure	188.479	140.069
Capital Financing Requirement (CFR)	939.398	902.811
Annual change in CFR	72.658	36.587
In-year borrowing requirement (excluding MRP)	96.777	70.146
Ratio of financing costs to net revenue stream (non HRA)	9.60%	8.94%
Ratio of financing costs to net revenue stream (HRA)	10.76%	10.85%
Incremental impact of capital investment decisions:		
Increase in council tax (band change) per annum	£45.54	£41.53
Increase in average housing rent per week	£1.38	£0.14



Treasury Indicators

	2023/24 Budget £M	2023/24 Q3 £M
Authorised limit for external debt	976.000	976.000
Operational boundary for external debt	956.000	956.000
Gross external debt (maximum Q3)	812.530	696.389

Maturity Structure of fixed rate borrowing upper and lower limits

Period	2023/24 Lower	2023/24 Upper	Actual 31.12.23
Under 12 months	0%	30%	18%
12 months to 2 years	0%	20%	5%
2 years to 5 years	0%	20%	0%
5 years to 10 years	0%	20%	5%
10 years to 20 years	0%	20%	4%
20 years to 30 years	5%	30%	9%
30 years to 40 years	20%	50%	25%
40 years to 50 years	20%	50%	26%
50 years and above	0%	40%	3%

Interest Rate Limits

	2023/24 Budget %	2023/24 Q3 Actual %
Upper limit of variable interest rates based on gross debt	40%	5%

Principal Sums

	2023/24 Budget £M	2023/24 Actual Q3 £M
Upper limit for principal sums invested over 365 days	80	0