

A summary of the strategy agreed for 2023/24 and the economic factors affecting this strategy.

1. Background information

1.1 Full Council approved the annual Treasury Management Strategy report in February 2023, which set out the proposed strategy for the 2023/24 financial year. This strategy included the limits and criteria for organisations to be used for the investment of cash surpluses and has to be approved by the Council.

1.2 This Council has always adopted a prudent approach to its investment strategy and in the last few years, there have been regular changes to the list of the approved organisations used for investment of surpluses. This list is regularly reviewed to ensure that the Council is able to invest in the best available rates consistent with low risk; the organisations are regularly monitored to ensure that their financial strength and low risk has been maintained.

1.3 The original strategy for 2023/24 was prepared within the context of the financial challenge being faced by the County Council over the Medium Term Financial Plan:

- Utilising long term cash balances as effectively as possible by investing in longer term instruments and/or using to fund borrowing to reduce borrowing costs;
- Ensuring the investment portfolio is working hard to maximise income in a rising interest rate environment.
- Ensuring effective management of the borrowing portfolio by exploring rescheduling opportunities and identifying and exploiting the most cost effective ways of funding the Council's borrowing requirement.

1.4 At the same time, the Treasury Management Policy Statement was agreed as unchanged for 2023/24.

East Sussex County Council defined its treasury management activities as:

“The management of the organisation's cash flows, its banking, money market and Capital market transactions (other than those of the Pension Fund) the effective management of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

The Council regards the successful identification, monitoring and management of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

This authority acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.”

2. Investment

2.1 When the strategy was agreed in February 2023, it emphasised the continued importance of taking account of the current and predicted future state of the financial sector. The Treasury Management Advisors (Link Asset Services) commented on short term interest

rates, the UK economy, inflation, the outlook for long term interest rates and these factors were taken into account when setting the Strategy.

2.2 The Council continued to explore Investment options that meet Environmental, Social and Governance (ESG) aims. The parameter acts as an added 4th consideration to investment decisions behind Security, Liquidity and Yield. The preservation of capital is the Council's principal and overriding priority.

2.3 The Council, in addition to other tools, uses the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- credit default swap (CDS) spreads to give early warning of likely changes in credit ratings; and
- sovereign ratings to select counterparties from only the most creditworthy countries.

2.4 The strategy continued with the policy of ensuring minimum risk, but was also intended to deliver secure investment income on the Councils cash balances.

2.5 The strategy aimed to ensure that in the economic climate it was essential that a prudent approach was maintained. This would be achieved through investing with selected banks and funds which met the Council's rating criteria. The emphasis would continue on security (protection of the capital sum invested) and liquidity (keeping money readily available for expenditure when needed) rather than yield. The strategy continued with this prudent approach.

3. Borrowing

3.1 The capital expenditure plans of the Council were set out in the Capital Strategy Report sent to Council in February 2023. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes so that sufficient cash is available to meet the capital expenditure plans.

3.2 Capital investment that is not funded from these new and/or existing resources (e.g. capital grants, receipts from asset sales, revenue contributions or earmarked reserves) increases the Council's need to borrow. However, external borrowing does not have to take place immediately to finance its related capital expenditure: the Council can utilise cash being held for other purposes (such as earmarked reserves and working capital balances) to temporarily defer the need for external borrowing. This is known as 'internal borrowing'.

3.3 The Council's primary objective is to strike an appropriate balance between securing cost certainty, securing low interest rates. The Council's cumulative need to borrow is known as the Capital Financing Requirement (CFR). The CFR and the actual level of external borrowing will differ according to decisions made to react to expected changes in interest rates and the prevailing economic environment. Where a decision to defer borrowing (or internally borrow) is made, the Council will be under borrowed. Where a decision to borrow in advance of need to secure cost certainty, the Council will be overborrowed.

3.4 On 25 November 2020 the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to PWLB borrowing for any local authority which intended to purchase assets primarily for yield in its three year capital programme. The

reduction in future borrowing costs will be factored into the funding of the capital programme which contains no such assets for yield purchases.

3.5 While the Council will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

4. The economy in 2023/24 – Commentary from Link Asset Services (Treasury Management Advisors) in April 2024

4.1 Against a backdrop of stubborn inflationary pressures, the Russian invasion of Ukraine, and war in the Middle East, UK interest rates have continued to be volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2023/24.

4.2 Markets have sought an end to central banks' on-going phase of keeping restrictive monetary policy in place on at least one occasion during 2023/24 but to date only the Swiss National Bank has cut rates and that was at the end of March 2024.

4.3 UK, EZ and US 10-year yields have all stayed stubbornly high throughout 2023/24. The table below provides a snapshot of the conundrum facing central banks: inflation is easing, albeit gradually, but labour markets remain very tight by historical comparisons, making it an issue of fine judgment as to when rates can be cut.

	UK	Eurozone	US
Bank Rate	5.25%	4%	5.25%-5.5%
GDP	-0.3%q/q Q4 (-0.2%/y/y)	+0.0%q/q Q4 (0.1%/y/y)	2.0% Q1 Annualised
Inflation	3.4%/y/y (Feb)	2.4%/y/y (Mar)	3.2%/y/y (Feb)
Unemployment Rate	3.9% (Jan)	6.4% (Feb)	3.9% (Feb)

4.4 The Bank of England sprung no surprises in their March meeting, leaving interest rates at 5.25% for the fifth time in a row and, despite no MPC members no longer voting to raise interest rates, it retained its relatively hawkish guidance. The Bank's communications suggest the MPC is gaining confidence that inflation will fall sustainably back to the 2.0% target. However, although the MPC noted that "the restrictive stance of monetary policy is weighing on activity in the real economy, is leading to a looser labour market and is bearing down on inflationary pressures", conversely it noted that key indicators of inflation persistence remain elevated and policy will be "restrictive for sufficiently long" and "restrictive for an extended period".

4.5 The UK economy has started to perform a little better in Q1 2024 but is still recovering from a shallow recession through the second half of 2023. Indeed, Q4 2023 saw negative GDP growth of -0.3% while y/y growth was also negative at -0.2%.

4.6 But it was a strange recession. Unemployment is currently sub 4%, against a backdrop of still over 900k of job vacancies, and annual wage inflation is running at above 5%. With gas and electricity price caps falling in April 2024, the CPI measure of inflation - which peaked at 11.1% in October 2022 – is now due to slide below the 2% target rate in April and to remain below that Bank of England benchmark for the next couple of years, according to Capital Economics. The Bank of England still needs some convincing on that score, but upcoming inflation and employment releases will settle that argument shortly. It is noted that core CPI was still a heady 4.5% in February and, ideally, needs to fall further.

4.7 Shoppers largely shrugged off the unusually wet weather in February, whilst rising real household incomes should support retail activity throughout 2024. Furthermore, the impact of

higher interest rates on household interest payments is getting close to its peak, even though fixed rate mortgage rates on new loans have shifted up a little since falling close to 4.5% in early 2024.

4.8 From a fiscal perspective, the further cuts to national insurance tax (from April) announced in the March Budget will boost real household disposable income by 0.5 - 1.0%. After real household disposable income rose by 1.9% in 2023, Capital Economics forecast it will rise by 1.7% in 2024 and by 2.4% in 2025. These rises in real household disposable income, combined with the earlier fading of the drag from previous rises in interest rates, means GDP growth of 0.5% is envisaged in 2024 and 1.5% in 2025. The Bank of England is less optimistic than that, seeing growth struggling to get near 1% over the next two to three years.

4.9 As for equity markets, the FTSE 100 has risen to nearly 8,000 and is now only 1% below the all-time high it reached in February 2023. The modest rise in UK equities in February was driven by strong performances in the cyclical industrials and consumer discretionary sectors, whilst communications and basic materials have fared poorly. Despite its performance, the FTSE 100 is still lagging behind the S&P 500, which has been at an all-time high for several weeks.