

A summary of the strategy agreed for 2024/25 and the economic factors affecting this strategy.

1. Background information

1.1 Full Council approved the annual Treasury Management Strategy report in February 2024, which set out the proposed strategy for the 2024/25 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 Full 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 2024/25 was prepared within the context of the financial challenge being faced by the County Council over the Medium Term Financial Plan:

- maximising investment income by seeking ways to increase cash balances.
- A review of the Capital Programme profile to assist with reducing borrowing and to delay expenditure.
- utilising cash balances to fund the Council's borrowing need in order to minimise borrowing costs as far as possible.
- ensuring the investment portfolio is working hard to maximise income by seeking appropriate investment opportunities that meet the Council's security requirements during 2024/25.
- 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 2024/25.

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 2024, it emphasised the continued importance of taking account of the current and predicted future state of the financial sector. The Treasury Management Advisors (MUFG) 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 Strategy was set in the context of the Council's deficit revenue budget forecast for 2024/25 and medium-term financial plan for 2025/26 to 2027/28. The Investment Strategy appropriately contributes to mitigating the Council's deficit revenue position. Cash balances and therefore investment balances were expected to reduce to support the authority's borrowing need. However, in this context, the Council's risk appetite for investments is not be modified to increase income. The strategy continued to prioritise security of the Council's funds. New investment options could be explored within the risk appetite and strategy parameters.

2.3 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.

2.4 The Council, in addition to other tools, uses the creditworthiness service provided by MUFG. 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.

3. Borrowing

3.1 The capital expenditure plans of the Council were set out in the Capital Strategy Report sent to Council in February 2024. 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 The Borrowing Strategy and the Capital Programme identified a borrowing need of £94m over the next 3 years (between 2024/25 and 2026/27). This level of borrowing was identified following a review and reprofiling of the Capital Programme. The objective of the review was to minimise borrowing costs within the Treasury Management revenue budget. This review reduced the borrowing requirement by £48m from £142m originally planned for the period between 2024/25 and 2026/27.

3.3 Officers utilised cash from the Council's own reserves to initially fund borrowing. This decreased the Council's cash balances, reduced counterparty risk, and reduced borrowing costs. Modelling of the Council's capital plans and cashflows identified an appropriate level of internal borrowing of around £50m in the longer term. This was increased to £75m to 2024/25 on the basis that it is preferable to maximise internal borrowing as far as possible at a time where interest rates were higher. The strategy was kept under review as there are risks that are required to be managed and balanced during the year. The Capital Programme needs to be funded in the most cost-effective way. Maximising internal borrowing will reduce investment balances and therefore investment income.

3.4 The budget within the Medium Term Financial Plan (MTFP) is calculated using the Treasury Management Tool that reflects the costs of borrowing in support of the targeted basic need programme offset by returns on investment of the Council's balances. It is therefore reflective of a point in time. The treasury management tool, developed as part of the Capital Strategy, is reviewed regularly for reasonableness.

3.5 The liability benchmark demonstrated that if the Council were to internally borrow to utilise its cash-backed reserves and balances whilst maintaining a buffer for cash requirements, external borrowing could be avoided until 2027/28. This indicator will be used to assist with future borrowing decisions, in conjunction with the Treasury management Tool.

4. The economy in 2024/25 MUFG (Treasury Management Advisors) in April 2025

4.1 UK inflation has proved somewhat stubborn throughout 2024/25. Having started the financial year at 2.3% y/y (April), the CPI measure of inflation briefly dipped to 1.7% y/y in September before picking up pace again in the latter months. The latest data shows CPI rising by 2.8% y/y (February), but there is a strong likelihood that figure will increase to at least 3.5% by the Autumn of 2025.

4.2 Against that backdrop, and the continued lack of progress in ending the Russian invasion of Ukraine, as well as the potentially negative implications for global growth as a consequence of the implementation of US tariff policies by US President Trump in April 2025, Bank Rate reductions have been limited. Bank Rate currently stands at 4.5%, despite the Office for Budget Responsibility reducing its 2025 GDP forecast for the UK economy to only 1% (previously 2% in October).

4.3 UK, Moreover, borrowing has becoming increasingly expensive in 2024/25. Gilt yields rose significantly in the wake of the Chancellor's Autumn Statement, and the loosening of fiscal policy, and have remained elevated ever since, as dampened growth expectations and the minimal budget contingency (<£10bn) have stoked market fears that increased levels of borrowing will need to be funded during 2025.

4.4 The table below provides a snapshot of the conundrum facing central banks: inflation pressures remain, labour markets are still relatively tight by historical comparisons, and central banks are also having to react to a fundamental re-ordering of economic and defence policies by the US administration.

	UK	Eurozone	US
Bank Rate	4.50%	2.5%	4.25%-4.5%
GDP	0.1%q/q Q4 (1.1%y/y)	+0.1%q/q Q4 (0.7%y/y)	2.4% Q4 Annualised
Inflation	2.8%y/y (Feb)	2.3%y/y (Feb)	2.8%y/y (Feb)
Unemployment Rate	4.4% (Jan)	6.2% (Jan)	4.1% (Feb)

4.5 The Bank of England sprung no surprises in their March meeting, leaving Bank Rate unchanged at 4.5% by a vote of 8-1, but suggesting further reductions would be gradual. The Bank of England was always going to continue its cut-hold-cut-hold pattern by leaving interest rates at 4.50% but, in the opposite of what happened at the February meeting, the vote was more hawkish than expected. This suggested that as inflation rises later in the year, the Bank

cuts rates even slower, but the initial impact of President Trump's tariff policies in April 2025 on the financial markets underpin our view that the Bank will eventually reduce rates to 3.50%.

4.6 Having said that, the Bank still thinks inflation will rise from 2.8% in February to 3¼% in Q3. And while in February it said "inflation is expected to fall back thereafter to around the 2% target", this time it just said it would "fall back thereafter". That may be a sign that the Bank is getting a bit more worried about the "persistence in domestic wages and prices, including from second-round effects". Accordingly, although we expect a series of rate cuts over the next year or so, that does not contradict the Bank taking "a gradual and careful" approach to cutting rates, but a tepid economy will probably reduce inflation further ahead and prompt the Bank to cut at regular intervals.

4.7 From a fiscal perspective, the increase in businesses' national insurance and national minimum wage costs from April 2025 is likely to prove a headwind, although in the near-term the Government's efforts to provide 300,000 new homes in each year of the current Parliament is likely to ensure building industry employees are well remunerated, as will the clamp-down on immigration and the generally high levels of sickness amongst the British workforce. Currently wages continue to increase at a rate close to 6 y/y. The MPC would prefer a more sustainable level of c3.5%.

4.8 As for equity markets, the FTSE 100 has recently fallen back to 7,700 having hit an all-time intra-day high 8,908 as recently as 3rd March. The £ has also endured a topsy-turvy time, hitting a peak of \$1.34 before dropping to \$1.22 in January and then reaching \$1.27 in early April 2025.