**Appendix C**

## The Treasury Management Activity Mid-Year Report – 2023/24

## 1. Background

1.1 The Treasury Management and Annual Investment Strategy for 2023/24 was approved by Full Council on 7 February 2023.

1.2 The Strategy was prepared within the context the financial challenge being faced by the County Council over the Medium Term Financial Plan and seeks to compliment the Council Plan by:

- 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 by further use of alternative appropriate investment opportunities during 2023/24;
- 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.

1.3 Changes in the Annual Investment Strategy were recommended and outlined in the table below:

| 2022/23 Strategy | 2023/24 Current Strategy | Reason for proposed change |
|---|---|---|
| Non-UK banks – minimum criteria of AA+ banks in AA+ sovereign countries. | Non-UK banks – minimum criteria of AA- banks in AA- sovereign countries. | Whilst a reduction in the credit criteria of non-UK banks, in reality, there are no AA+ Banks that can be used under the existing criteria. The change therefore expands the list of names that the council can lend to (allowing better diversification of the investment portfolio) whilst still maintaining a high level of security. |
| No risk benchmarking criteria. | Introduction of benchmarking the risk of the investment portfolio against historic default rates of counterparties. (See 2.7) | To ensure that the risk of the portfolio is monitored closely and reported to members quarterly. A maximum risk indicator will be set to ensure that security is prioritised within acceptable levels. |
| No performance Benchmarking. | Introduction of benchmarking the return of the portfolio against the Sterling Overnight Interbank Average Rate (SONIA) (see 2.9) | Monitoring the investment portfolio against market interest rates will assess whether the portfolio is maintaining its value. This |

| | | |
|---|---|---|
| | | will be reported to members quarterly. |

1.4 Officers continue to seek out Environmental Social & Governance (ESG) investment opportunities with counterparties that meet the council's investment parameters. The council continues to invest in Standard Chartered's sustainable fixed deposits which aligns the Council's investments with the bank's ESG strategy. The market for green and broader ESG investments is still relatively immature, which reduces the ability to actively invest in products that support the Council's aspirations. However, research and the consideration of the suitability of ESG investment products will continue into 2023/24.

**2. Investment Activity to 30 September 2023**

2.1 The Bank of England increased bank rate on 3 occasions, the movements summarised below.

| | **New Rate** | **Movement** |
|---|---:|---:|
| 11 May 2023 | 4.50% | +0.25% |
| 22 June 2023 | 5.00% | +0.50% |
| 3 August 2023 | 5.25% | +0.25% |

2.2 During the first half year investments have been held in Money Market Funds, high quality Banking names, other Local Authorities and the CCLA Local Authority Property Fund. Counterparty credit quality remains a primary concern for the treasury team, with security, liquidity and yield in that order a priority.

2.3 Measures have been undertaken to ensure that levels of liquidity are available during the last 6 months but also opportunities explored in this rising interest rate environment to secure investment returns. Several fixed term bank deposits have been reinvested up to 12 months securing a fixed rate of return between 4.36% - 6.20% within a low credit risk parameter.

2.4 Local Authority deposits have been placed in the period at rates ranging between 5.30-5.80%, their inclusion forms part of a balanced portfolio.

2.5 Deposits held for liquidity purposes in Money Market Funds are providing a return nearing the prevailing base rate, compared to previous years where they performed well below that benchmark.

2.6 The Council is continuing to invest in deposits with regard to ESG and sustainable lending, through Standard Chartered Bank. These investments are assigned to sustainable assets with the aim of addressing the UN sustainable development goals. The offering fulfils the key principle of security, liquidity and yield and is consistent with the banks current other fixed term deposit rates.

2.6 The average investment balance to September 2023 was £294m and generated investment income of £6.6m. The forecast for 2023/24 is £14m and dependent on cashflow and the future interest rate environment.

2.7 **Investment Risk**

2.8 During the half year monitoring of the security of the Council's investment has taken place, to assess the risk of investments losing their value. These risks were assessed using the financial standing of the groups invested in, the length of each investment, and the historic default rates. The investment strategy sets an allowable risk level of 0.050% (i.e. that there is a 99.95% probability that the Council will get its investments back). The actual indicator ranged between 0.003% and 0.008%, reflecting the high proportion of investments held in highly secure and/or very liquid investments.

| | |
|---|---|
| Investment Risk benchmark | 0.050% |
| Maximum investment risk experienced Q1-Q2 | 0.008% |

2.9 **Investment Benchmarking**

2.10 The average investment return during the period was 4.47% under-performing the benchmark rate by 26 basis points (or 0.26 percentage points) This is typical in a rising interest rate environment as a result of the time lag between changes in base rate and investments maturing and being able to re-invest at more favourable rates.

| **Average Investment Balance Q1-Q2 £m** | **Average Investment return Q1 & Q2** | **Average Benchmark Rate*** | **Difference** |
|---|---|---|---|
| 294.428 | 4.47% | 4.73% | (0.26%) |

**the Benchmark rate used is the Standard Overnight Index Average; a rate administered by the Bank of England based on actual transactions of overnight borrowing by financial institutions.*

## 3. Borrowing Activity to 30 September 2023

3.1 No short term loan borrowing was arranged during the period. Future short-term borrowing in the current year is not forecasted but remains an option to cover temporary cashflow requirements.

3.2 The level of Council long-term debt at 30 September 2023 was £217m, two loans matured with the PWLB during the period on the 30 June (£3m) and the 30 September 2023 (£1.3m) held at 7.75% and 7.38%. The next PWLB maturities are on the 30 June 2024, totalling £5m at rates of 7.63% and 7.75%.

3.3 Opportunities to reduce the cost of carry (interest paid against interest received) are constantly being explored as and when options arise. The forecast for interest paid on long-term debt in 2023/24 is approximately £10.5m and is within the budgeted provision.

3.4 **Borrowing Benchmarking**

3.5 The table below shows the Council's total external borrowing and average rate as at 30 September 2023: .

| | **Balance as at 30 September 2023 £m** | **Average Rate** |
|---|---|---|
| PWLB | 210.142 | 4.53% |
| Market Loans | 6.450 | 4.25% |
| **Total borrowing** | **216.592** | **4.52%** |

3.6 The table below shows the forecast of the Capital Financing Requirement (CFR) compared to the estimate within the 2023/24 strategy approved in February 2023. The CFR is expected to give rise to new borrowing required of £86.534m by the end of the year, compared to the original estimate of £83.932m. The strategy currently forecasts that the level of reserves and balances in the medium term allows internal borrowing of up to £50.000m, and therefore it is currently expected that external borrowing of £36.534m may be required to support the capital programme.

| **Capital Financing Requirement (CFR) (Underlying Borrowing Need)** | **Original Estimate 2023/24 £m** | **Revised forecast as at 30 September 2023 £m** |
|---|---|---|
| Opening CFR | 274.367 | 272.225 |
| Borrowing Need | 34.904 | 38.305 |
| Minimum Revenue Provision | (7.429) | (7.404) |
| **Closing CFR** | **301.842** | **303.126** |
| **External Borrowing as at 30 September 2023** | | **216.592** |
| **Forecast Underborrowing (if no action taken)** | | **86.534** |

3.7 The table below shows that the Council is operating within the Operational Boundary and Authorised Borrowing Limits set within the Treasury Management strategy and has sufficient headroom to cover the borrowing need arising from the year's capital programme.

| **Borrowing Limits** | **Operational Boundary £m** | **Authorised Borrowing Limit £m** |
|---|---|---|
| Limit set for 2023/24 | 376.000 | 396.000 |
| Less: PFI & Leases | 65.000 | 65.000 |
| Limit for Underlying Borrowing | 311.000 | 331.000 |
| Actual External Borrowing at 30 September | 216.592 | 216.592 |
| Headroom* | 94.408 | 114.408 |

**Authorised Borrowing headroom cannot be less than zero*

3.8 The maturity profile of the Authority's borrowing is within the limits set within the strategy.

| Maturity Structure of borrowing | Lower Limit set | Upper Limit set | Actual as at 30 September 2024 |
|---|---|---|---|
| Under 12 Months | 0% | 25% | 2% |
| 12 months to 2 years | 0% | 40% | 2% |
| 2 years to 5 years | 0% | 60% | 7% |
| 5 years to 10 years | 0% | 70% | 16% |
| Over 10 years | 0% | 90% | 72% |

**4 Economic performance to date and outlook (commentary supplied by Link Asset Services). September 2023.**

4.1 The second quarter 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
- Signs of Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.
- A 0.5% month on month decline in real GDP in July, mainly due to more industrial action across certain sectors.
- 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 year high.
- 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).

4.2 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.

4.3 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.

4.4 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.

4.5 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.

4.6 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.

4.7 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.

4.8 In its latest 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.

4.9 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.

4.10 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.

4.11 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.

## 5.0 Interest rate forecast

5.1 Link Asset Services, has provided the following forecast as at 30 September 2023

| | 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 |

5.2 The latest forecast 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.