MEETING:	**GOVERNANCE AND AUDIT COMMITTEE**
DATE:	**23 MAY 2024**
TITLE:	**TREASURY MANAGEMENT QUARTERLY UPDATE**
PURPOSE:	**CIPFA's Code of Practice requires that the prudential indicators are reported on a quarterly basis**
RECOMMENDATION:	**RECEIVE THE REPORT FOR INFORMATION**
AUTHOR:	**DELYTH JONES-THOMAS, INVESTMENT MANAGER**

1. Introduction

The Council has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) This new quarterly report provides an additional update and includes the new requirement in the 2021 Code, mandatory from 1st April 2023, of quarterly reporting of the treasury management prudential indicators.

The Council's Treasury Management Strategy for 2023/24 was approved at Full Council on 2nd March 2023. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's Treasury Management Strategy.

2. External Context

Economic Background: UK inflation rates finally started to decline, mirroring the sharp but earlier drop seen in the Eurozone and US. Despite the fall, the Consumer Price Index (CPI) remained substantially in excess in the Bank of England's (BoE) 2% target, at 3.9% for November 2023. Market expectations for further rises in Bank Rate fell from October through to year end, indicating that the 5.25% level reached in August 2023 was indeed the peak for Bank Rate.

Economic growth in the UK remained weak over the period, edging into recessionary territory. In calendar Q3 2023, the economy contracted by 0.1%, following no change in Q2. Monthly GDP data showed a 0.3% contraction in October, following a 0.2% rise in September. While other indicators have suggested a pickup in activity in the subsequent months, Q4 GDP growth is likely to continue the weak trend.

July data showed the unemployment rate increased to 4.2% (3mth/year) while the employment rate rose to 75.7%. Pay growth edged lower as the previous strong pay rates waned; total pay (including bonuses) growth was 7.2% over the three months to October 2023, while regular pay growth was 7.3%. Adjusting for inflation, pay growth in real terms were positive at 1.3% and 1.4% for total pay and regular pay respectively.

Inflation continued to fall from its peak as annual headline CPI declined to 3.9% (down from 4.6%) in November 2023. The largest downward contribution came from energy and food prices. The core rate also surprised on the downside, falling to 5.1% from 5.7%.

The BoE's Monetary Policy Committee held Bank Rate at 5.25% throughout the period, although a substantial minority continued to vote for a 25 basis point rate rise. The Bank continues to tighten monetary policy through asset sales, as it reduces the size of its balance sheet. Financial market Bank Rate expectations moderated over the period as falling inflation and weakening data showed that higher interest rates were working in the UK, US, and Eurozone.

Following the December MPC meeting, Arlingclose, the authority's treasury adviser, maintained its central view that 5.25% is the peak in Bank Rate. Short term risks are broadly balanced, but over the remaining part of the time horizon the risks are to the downside from economic activity weakening more than expected.

The lagged effect of monetary policy together with the staggered fixed term mortgage maturities over the next 12-24 months means the full impact from Bank Rate rises are still yet to be felt by households. As such, while consumer confidence continued to improve over the period, it is likely this will reverse at some point and spending will struggle. Higher rates will also impact exposed businesses; according to S&P/CIPS survey data, the UK manufacturing and construction sectors contracted during the quarter. The services sector recovered, however, with the PMI rising strongly in December, possibly due to improving consumer confidence.

The US Federal Reserve held its key interest rate at 5.25-5.50% over the period. While policymakers continued to talk up the risks to inflation and therefore interest rates, this stance ebbed over the quarter culminating in a relatively dovish outcome from the December FOMC meeting.

The European Central Bank continues to resist market policy loosening expectations, but the Eurozone CPI rate has fallen sharply as GDP growth as markedly slowed, hitting 2.4% in November (although rising to 2.9% on energy-related base effects).

Financial markets: Financial market sentiment and bond yields remained volatile, but the latter rapidly trended downwards towards the end of 2023 on signs of sharply moderating inflation and economic growth.

Gilt yields fell towards the end of the period. The 10-year UK benchmark gilt yield rose from 4.57% to peak at 4.67% in October before dropping to 3.54% by the end of December 2023. The Sterling Overnight Rate (SONIA) averaged 5.19% over the period.

Credit review: Arlingclose maintained the advised maximum duration limit for all banks on its recommended counterparty list to 35 days over the period.

In October, Moody's revised the outlook on the UK's Aa3 sovereign rating to stable from negative. This led to similar rating actions on entities that include an element of government support in their own credit ratings, including banks and housing associations. Local authorities were, however, downgraded on expectations of lower government funding.

Following the issue of a Section 114 notice, in November Arlingclose advised against undertaking new lending to Nottingham City Council. After reducing its recommended duration on Warrington Borough Council to a maximum of 100 days in September, the local authority was subsequently suspended from the Arlingclose recommended list following a credit rating downgrade by Moody's to Baa1.

Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress, but no changes were made to recommended durations over the period.

Heightened market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.

3. Treasury Management Summary

At 31st December 2023 the Council had net investments of £93.6m arising from its revenue and capital activities.

The Council pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

	31.3.23 Balance £m	**Movement £m**	**31.12.23 Balance £m**
Long- term borrowing	100.9	(2.3)	98.6
Short-term borrowing	1.1	1.4	2.5
PFI	1.2	0	1.2
Total borrowing	**103.2**	**(0.9)**	**102.3**
Short-term investments	(89.9)	(43.4)	(133.3)
Cash and cash equivalents	(62.8)	0.2	(62.6)
Total investments	**(152.7)**	**(43.2)**	**(195.9)**
Net borrowing/ (investment)	**(49.5)**	**(44.1)**	**(93.6)**

No new long-term borrowing has been undertaken in 2023, with existing loans maturing without replacement. This strategy enabled the Council to reduce net borrowing costs (despite foregoing investment income) and reduce overall treasury risk.

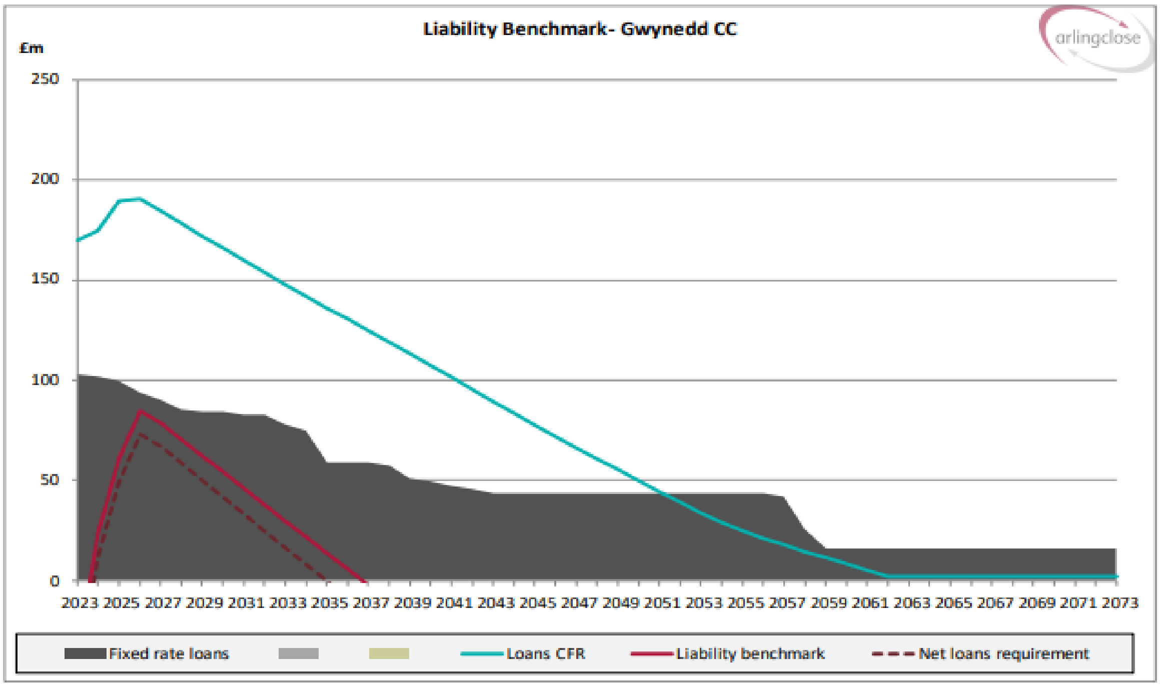
4. Treasury Management Prudential Indicators

As required by the 2021 CIPFA Treasury Management Code, the Council monitors and measures the following treasury management prudential indicators.

I. Liability Benchmarking: This new indicator compares the Council's actual existing borrowing against a liability benchmark that has been calculated to show the lowest risk level of borrowing. The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. It represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level of £11.5m required to manage day-to-day cash flow.

	31.3.23 Actual £m	31.3.24 Estimate £m	31.3.25 Forecast £m	31.3.26 Forecast £m	31.3.27 Forecast £m
CFR	**170.8**	**175.9**	**190.5**	**191.7**	**192.9**
Less: Balance sheet resources	-220.1	-163.4	-140.5	-117.5	-117.5
Net loans requirement	**-49.3**	**12.5**	**50.0**	**74.2**	**75.4**
Plus: Liquidity allowance	11.5	11.5	11.5	11.5	11.5
Liability Benchmark	**-37.8**	**24.0**	**61.5**	**85.7**	**86.9**
Existing Borrowing	**102.1**	**99.6**	**94.0**	**90.0**	**85.4**

Following on from the medium-term forecasts in the table above, the long-term liability benchmark assumes no further debt funded capital expenditure, minimum revenue provision on new capital expenditure based on a 50 year straight line method. This is shown in the following chart together with the maturity profile of the Council's existing borrowing:



The chart shows that there is no need to borrow long- term based on current projections.

II. Maturity Structure of Borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

	31.12.23 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	2.44%	25%	0%	✓
12 months and within 24 months	5.72%	25%	0%	✓
24 months and within 5 years	8.56%	50%	0%	✓
5 years and within 10 years	17.88%	75%	0%	✓
10 years and above	65.41%	100%	0%	✓

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

III. Long-term Treasury Management Investments: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management limits are:

	2023/24	2024/25	2025/26	No precise date
Actual principal invested beyond year end	£22m	£0	£0	£0
Limit on principal invested beyond year end	£40m	£20m	£20m	£20m
Complied	✓	✓	✓	✓

Additional indicators:
The Council measures and manages its exposures to treasury management risks using the following indicators:

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the time-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment and taking the arithmetic average, weighted by the length of each investment. Unrated investments are assigned a score based on their perceived risk.

	31.12.23 Actual	2023/24 Target	Complied
Portfolio average credit score	5.07	A score of 6 or lower	✓

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	31.12.23 Actual	2023/24 Target	Complied
Total cash available within 3 months	£175m	£10m	✓

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates was:

	31.12.23 Actual	2023/24 Limit	Complied
Upper limit on one year revenue impact of a 1% rise in interest rates	£1,603,125	£1,039,420	x
Upper limit on one year revenue impact of a 1% fall in interest rates	£1,603,125	£1,039,420	x

This indicator has not been complied with because the indicator was set when interest rates were low, but interest levels have risen significantly in the year without warning and therefore it is reasonable that the amounts are above the limit.

5. Recommendation

To receive the report for information.