MEETING:	**GOVERNANCE AND AUDIT COMMITTEE**
DATE:	**12 OCTOBER 2023**
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**

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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. Economic Background

From the start of the quarter until May it looked like peak global monetary policy rates were in sight as inflation continued to ease and central banks turned more dovish in tone. Only a few weeks later, stronger and more persistent inflation data, particularly in the UK, changed the picture.

The UK situation was not welcome news for the Bank of England. GDP growth was weak, confirmed at 0.1% in Q1, although more recent monthly GDP data has been somewhat better. The housing market has stalled, consumer demand is weak but seemingly recovering despite higher interest rates, and labour demand remained strong, with repercussions for wage growth which is accelerating.

April data showed the unemployment rate increased to 3.8% while the employment rate rose to 76.0%. Pay growth was 6.5% for total pay (including bonuses) and 7.2% for regular pay, the largest growth rate of the latter outside of the Covid pandemic. Once adjusted for inflation, however, growth in total pay and regular pay remained negative.

Inflation fell from its peak of 11.1% reached in October 2022, but annual headline CPI in May 2023 was higher than the consensus forecast at 8.7% (8.4% expected), largely driven by services inflation, while the annual measure of underlying core inflation rose to 7.1% from 6.8%.

After a sharp rise in interest rate expectations, with clearly serious implications for mortgage markets due to higher inflation and wage data, the Bank of England's Monetary Policy Committee reaccelerated monetary policy tightening over the period with a 0.25% rise in May to a 0.5% rise in June, taking Bank Rate to 5.0%. At both meetings the vote was 7-2 in favour of increasing rates, with the two dissenters preferring to keep rates on hold.

Interest rate expectations priced in further hikes in policy rates. Arlingclose, the authority's treasury adviser, revised its forecast to forecast a further 0.5% of monetary tightening to take Bank Rate to 5.5%. The risks, however, are that rates could be higher; financial markets are forecasting policy interest rates above 6%.

With many mortgages at low fixed rates now systematically being re-set over the next 12-24 months at higher rates at the end of their fixed rate period, there has been a lagged effect of the feed through of monetary policy on households' disposable income. The economic slowdown is expected to develop over time and therefore, despite the GfK measure of consumer confidence rising to -24 in June, it is likely confidence will be negatively affected at some point. The manufacturing sector contracted during the quarter according to survey data, which will eventually feed into services, whose expansion is slowing.

Despite the US Federal Reserve increasing its key interest rate to 5.00-5.25% over the period, activity in the region continued to defy monetary tightening, particularly in labour markets which have so far appeared robust, supporting the Fed's assertations of two more rate hikes after it paused in June. Annual US inflation continued to ease, falling from 4.9% in April to 4.0% in May, the lowest level since March 2021. US GDP growth at 2% annualised in the first calendar quarter of 2023 was also significantly stronger than expected against the initial estimate of 1.3%.

In the euro zone, the picture was somewhat different. The European Central Bank maintained its hawkish tone and increased its key deposit, main refinancing, and marginal lending interest rates to 3.50%, 4.00% and 4.25% respectively. There were signs of weakening activity, particularly in Germany whose manufacturing sector has taken a hit from high energy prices and weaker global demand. However, inflation remained sticky, annual headline CPI fell to 5.5% in June while annual core inflation rose to 5.4% from 5.3%, which means the ECB is unlikely to stop monetary tightening.

3. Treasury Management Summary

At 30th June 2023 the Council had net investments of £55m 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**	**30.6.23 Balance £m**
Long- term borrowing	100.9	(1.4)	99.5
Short-term borrowing	1.1	1.2	2.3
PFI	1.2	(0.0)	1.2
Total borrowing	**103.2**	**(0.2)**	**103.0**
Short-term investments	(89.9)	(8.6)	(98.5)
Cash and cash equivalents	(62.8)	3.8	(59.0)
Total investments	**(152.7)**	**(4.8)**	**(157.5)**
Net borrowing/ (investment)	**(49.5)**	**(5.0)**	**(54.5)**

No new long-term borrowing was undertaken in 2022/23, 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.

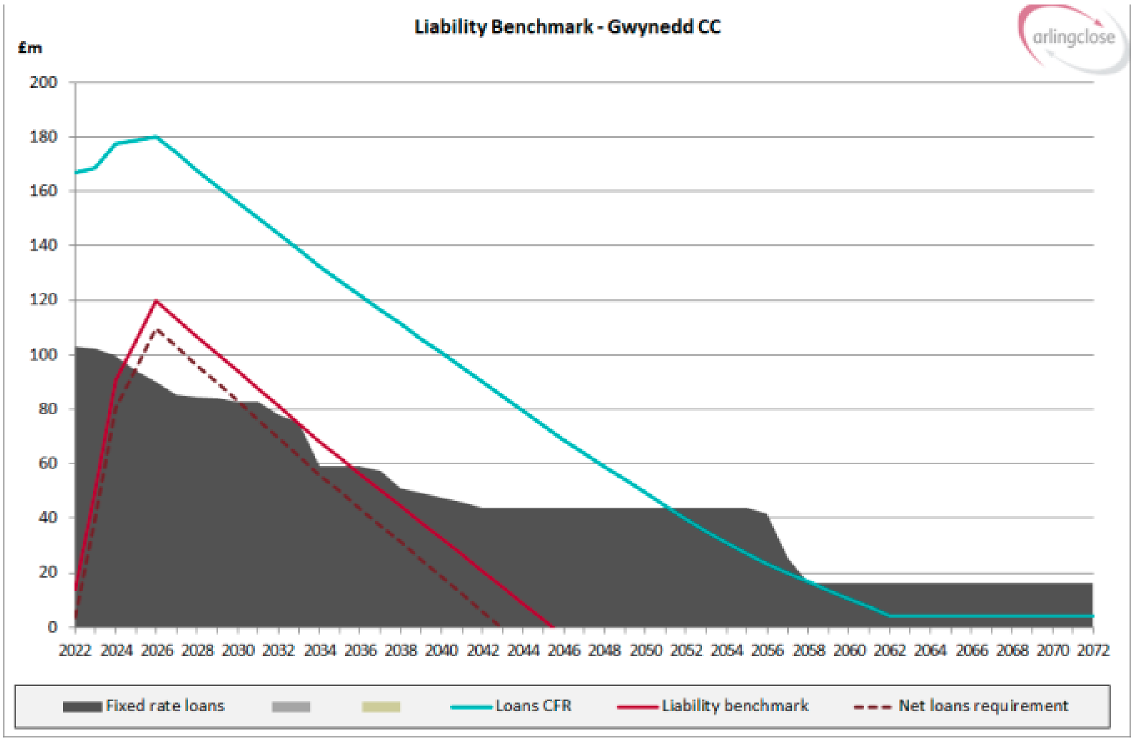
1. **Liability Benchmarking:** This new indicator compares the Council's actual existing borrowing against a liability benchmark that has been calculated to show the lowest risk level of borrowing. The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term 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 £m required to manage day-to-day cash flow.

	31.3.23 Actual	**31.3.24 Estimate**	**31.3.25 Estimate**	**31.3.26 Estimate**
Loans CFR	171.0	177.5	178.9	179.9
Less: Balance Sheet resources	(129.7)	(177.1)	(103.6)	(90.2)
Net loans requirements	41.3	60.4	75.3	89.7

Plus: Liquidity allowance	10.0	10.0	10.0	10.0
Liability benchmark	**51.3**	**70.4**	**85.3**	**99.7**
Existing borrowing	**102.0**	**98.3**	**92.7**	**88.7**

The table shows that the Council expects to remain borrowed above its liability benchmark up until 2025. This is because the Council holds reserves, and cash outflows to date have been below the assumptions made when the loans were borrowed.

Following on from the medium-term forecast above, the long-term liability benchmark assumes no new capital expenditure funded by borrowing, minimum revenue provision on new capital expenditure based on a 50 year straight line method. This is shown in the chart below 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, but maybe in the short term in the near future.

2. **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:

	30.6.23 Actual	**Upper Limit**	**Lower Limit**	**Complied**
Under 12 months	2.4%	25%	0%	✓
12 months and within 24 months	5.5%	25%	0%	✓
24 months and within 5 years	9.5%	50%	0%	✓

5 years and within 10 years	9.1%	75%	0%	✓
10 years and above	73.5%	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.

3. **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	£15m	£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.

	30.6.23 Actual	**2023/24 Target**	**Complied**
Portfolio average credit score	4.71	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.

	30.6.23 Actual	**2023/24 Target**	**Complied**
Total cash available within 3 months	£134m	£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:

	30.6.23 Actual	**2023/24 Limit**	**Complied**

Upper limit on one year revenue impact of a 1% rise in interest rates	£1,314,010	£1,039,420	X
Upper limit on one year revenue impact of a 1% fall in interest rates	£1,314,010	£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.