MEETING:	**PENSIONS COMMITTEE**
DATE:	**22 JANUARY 2024**
TITLE:	**TREASURY MANAGEMENT 2023-24 MID YEAR REVIEW**
PURPOSE:	**CIPFA's Code of Practice recommends that a report on the Council's actual Treasury Management during the current financial year is produced.**
RECOMMENDATION:	**RECEIVE THE REPORT FOR INFORMATION**
AUTHOR:	**DELYTH JONES-THOMAS, INVESTMENT MANAGER**

EXECUTIVE SUMMARY

During the six month period between 1 April and 30 September 2023, the Council's borrowing and investments remained well within the limits originally set. There were no new defaults by banks in which the Council deposited money. Furthermore, it is estimated that the Council's actual investment income will be higher than the expected income in the 2023/24 budget.

---

1. INTRODUCTION

The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that Authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end). This report provides a mid-year update.

This report includes the new requirement in the 2021 Code, mandatory from 1st April 2023, of quarterly reporting of the treasury management prudential indicators. The non-treasury prudential indicators are incorporated in the Council's normal quarterly reports.

It was decided at the Pensions Committee, 27 March 2023 to allow the surplus funds of the Pension Fund to be pooled and co-invested with the Council's overall cash flow for the financial year 2023/24.

2. EXTERNAL CONTEXT

Economic background: UK inflation remained stubbornly high over much the period compared to the US and euro zone, keeping expectations elevated of how much further the Bank of England (BoE) would hike rates compared to the regions. However, inflation data published in the latter part of the period undershot expectations, causing financial markets to reassess the peak in BoE Bank Rate. This was followed very soon after by the BoE deciding to keep Bank Rate on hold at 5.25% in September, against expectation for another 0.25% rise.

Economic growth in the UK remained relatively weak over the period. In calendar Q2 2023, the economy expanded by 0.2%. However, monthly GDP data showed a 0.5% contraction in July, the largest fall to date in 2023 and worse than the 0.2% decline predicted which could be an indication the monetary tightening cycle is starting to cause recessionary or at the very least stagnating economic conditions.

July data showed the unemployment rate increased to 4.3% (3mth/year) while the employment rate rose to 75.5%. Pay growth was 8.5% for total pay (including bonuses) and 7.8% for regular pay, which for the latter was the highest recorded annual growth rate. Adjusting for inflation, pay growth in real terms were positive at 1.2% and 0.6% for total pay and regular pay respectively.

Inflation continued to fall from its peak as annual headline CPI declined to 6.7% in July 2023 from 6.8% in the previous month against expectations for a tick back up to 7.0%. The largest downward contribution came from food prices. The core rate also surprised on the downside, falling to 6.2% from 6.9% compared to predictions for it to only edge down to 6.8%.

The Bank of England's Monetary Policy Committee continued tightening monetary policy over most of the period, taking Bank Rate to 5.25% in August. Against expectations of a further hike in September, the Committee voted 5-4 to maintain Bank Rate at 5.25%. Each of the four dissenters were in favour of another 0.25% increase.

Financial market Bank Rate expectations moderated over the period as falling inflation and weakening data gave some indication that higher interest rates were working. Expectations fell from predicting a peak of over 6% in June to 5.5% just ahead of the September MPC meeting, and to then expecting 5.25% to be the peak by the end of the period.

Following the September MPC meeting, Arlingclose, the Council's treasury adviser, modestly revised its interest forecast to reflect the central view that 5.25% will now be the peak in Bank Rate. In the short term the risks are to the upside if inflation increases again, 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, the GfK measure hit -21 in September, it is likely this will reverse at some point. Higher rates will also impact business and according to S&P/CIPS survey data, the UK manufacturing and services sector contracted during the quarter with all measures scoring under 50, indicating contraction in the sectors.

The US Federal Reserve increased its key interest rate to 5.25-5.50% over the period, pausing in September following a 0.25% rise the month before, and indicating that it may have not quite completed its monetary tightening cycle.

Having fallen throughout 2023, annual US inflation started to pick up again in July 2023, rising from 3% in June, which represented the lowest level since March 2021, to 3.2% in July and then jumping again to 3.7% in August, beating expectations for a rise to 3.6%. Rising oil prices were the main cause of the increase. US GDP growth registered 2.1% annualised in the second calendar quarter of 2023, down from the initial estimate of 2.4% but above the 2% expansion seen in the first quarter.

The European Central Bank increased its key deposit, main refinancing, and marginal lending interest rates to 4.00%, 4.50% and 4.75% respectively in September, and hinted these levels may represent the peak in rates but also emphasising rates would stay high for as long as required to bring inflation down to target.

Although continuing to decline steadily, inflation has been sticky, Eurozone annual headline CPI fell to 5.2% in August while annual core inflation eased to 5.3% having stuck at 5.5% in the previous two months. GDP growth remains weak, with recent data showing the region expanded by only 0.1% in the three months to June 2023, the rate as the previous quarter.

Financial markets: Financial market sentiment and bond yields remained volatile, with the latter generally trending downwards as there were signs inflation, while still high, was moderating and interest rates were at a peak.

Gilt yields fell towards the end of the period. The 5-year UK benchmark gilt yield rose from 3.30% to peak at 4.91% in July before trending downwards to 4.29%, the 10-year gilt yield rose from 3.43% to 4.75% in August before declining to 4.45%, and the 20-year yield from 3.75% to 4.97% in August and then fell back to 4.84%. The Sterling Overnight Rate (SONIA) averaged 4.73% over the period.

Credit review: Having completed a review of its credit advice on unsecured deposits at UK and non-UK banks following concerns of a wider financial crisis after the collapse of Silicon Valley Bank purchase of Credit Suisse by UBS, as well as other well-publicised banking sector issues, in March Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days. This stance continued to be maintained at the end of the period.

During the second quarter of the period, Moody's revised the outlook on Svenska Handelsbanken to negative from stable, citing concerns around the Swedish real estate sector.

Having put the US sovereign rating on Rating Watch Negative earlier in the period, Fitch took further action in August, downgrading the long-term rating to AA+, partly around ongoing debt ceiling concerns but also an expected fiscal deterioration over the next couple of years.

Following the issue of a Section 114 notice, in September Arlingclose advised against undertaking new lending to Birmingham City Council, and later in the month cut its recommended duration on Warrington Borough Council to a maximum of 100 days.

Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress and although no changes were made to recommended durations over the period, Northern Trust Corporation was added to the counterparty list.

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

3. TREASURY INVESTMENT ACTIVITY

CIPFA revised TM Code defines treasury management investments as those which arise from the Council's cash flows or treasury risk management activity that ultimately represents balances which need to be invested until the cash is required for use in the course of business.

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the 6 months, the Council's investment balance ranged between £139.5 and £223.4 million due to timing differences between income and expenditure. The investment position during the period is shown in the following table:

Treasury Investment Position

	31.3.23 Balance £m	6 month Movement £m	30.9.23 Balance £m	30.9.23 Income Returns %
Banks & building societies (unsecured)	29.1	(7.4)	21.7	5.21
Local authorities	20.1	44.9	65.0	5.19
Money Market Funds	60.8	(2.8)	58.0	5.27
Pooled Funds	8.7	2.8	11.5	5.13
Debt Management Office	34.0	(0.9)	33.1	5.27
Total investments	**152.7**	**36.6**	**189.3**	

Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in the table below.

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2023	4.63	A+	62%	33	4.04
30.09.2023	4.57	A+	45%	47	5.23
Similar Las	**4.21**	**AA-**	**29%**	**86**	**4.89**
All LAs	**4.47**	**AA-**	**59%**	**13**	**4.79**

Bank Rate increased by 1%, from 4.25% at the beginning of April to 5.25% by the end of September. Short-dated cash rates rose commensurately, with 3-month rates rising to around 5.25% and 12-month rates to nearly 6%. The rates on DMADF deposits also rose, ranging between 4.8% and 5.4% by the end of June and Money Market Rates between 4.9% and 5.3%.

£13m of the Council's investments has been invested in externally managed strategic pooled property, multi-asset and equity funds where short- term security and liquidity are lesser consideration, and the objectives instead are regular revenue income and long- term price stability. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued stability in meeting the Council's investment objective are regularly reviewed.

The performance of our pooled property, multi-asset and equity funds at 30 September 2023 can be seen below:

STRATEGIC POOLED FUND PORTFOLIO			GWYNEDD					From:	30/09/2022	To:	30/09/2023
FUND NAME	**ASSET CLASS**	**No of Units Held in Period**	**Current Value £**	**Capital Growth £**	**Dividends Earned £**	**Holding Period (yrs)**	**Capital Return**	**Income Return**	**Total Return**	**Volatility**	
AEGON (KAMES) DIVERSIFIED MONTHLY INCOME FUND	MULTI ASSET	1,158,480	1,082,514	34,230	65,039	1.0	3.27%	6.20%	9.47%	7.9%	
CCLA - LAMIT PROPERTY FUND	PROPERTY	1,524,344	4,269,535	-949,819	202,067	1.0	-18.20%	3.87%	-14.33%	8.9%	
NINETY ONE (INVESTEC) DIVERSIFIED INCOME FUND	MULTI ASSET	1,228,153	1,085,123	4,735	43,617	1.0	0.44%	4.04%	4.48%	4.1%	
PAYDEN ABSOLUTE RETURN BOND FUND	ABSOLUTE RETURN	233,541	1,991,803	-8,197	10,509	0.0	-0.41%	0.53%	0.12%	0.1%	
SCHRODER INCOME MAXIMISER FUND	EQUITY - UK	7,675,245	3,046,305	221,954	168,782	0.7	7.86%	5.98%	13.83%	13.8%	
GRAND TOTAL			11,475,279	-697,098	490,014	0.8	-5.73%	4.03%	-1.70%	4.7%	
		Unrealised capital loss since purchase:		-1,524,722		Annualised income return:		5.13%			

It is evident that the combined capital value of £11.475m is less than the initial investment of £13m. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters, and even years; but with the confidence that over a three to five year period total returns will exceed cash interest rates. Investment in these funds will be maintained in the medium term.

4. TREASURY MANAGEMENT PERFORMANCE

i. Investment Limits

	Counterparty Maximum during period	Counterparty 30.9.23 Actual	Counterparty 2023/24 Limit	Complied
The UK Government	£95.3m	£33.1m	Unlimited	✓
Local authorities & other government entities	£5m	£5m	£10m	✓
Secured investments	£0m	£0m	£10m	✓
Banks (unsecured)	£5m	£5m	£5m	✓
Building societies (unsecured)	£5m	£5m	£5m	✓
Registered providers (unsecured)	£0m	£0m	£5m	✓
Money market funds	£10m	£10m	£10m	✓
Strategic pooled funds	£5m	£5m	£10m	✓
Real Estate Investment Trusts	£0m	£0m	£10m	✓
Other investments	£0m	£0m	£5m	✓

ii. 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	✓	✓	✓	✓

iii. 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.

	30.9.23 Actual	2023/24 Target	Complied
Portfolio average credit score	4.57	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.

	30.9.23 Actual	2023/24 Target	Complied
Total cash available within 3 months	£147.8m	£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:

	30.9.23 Actual	2023/24 Limit	Complied
Upper limit on one year revenue impact of a 1% rise in interest rates	£1,485,115	£1,039,420	X
Upper limit on one year revenue impact of a 1% fall in interest rates	£1,485,115	£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.

iv. Treasury Management Performance

The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates.

The Council’s budgeted investment income for the year is £1.9m, however the actual expected investment income for the year 2023/24 is significantly higher, estimated at £3.0m due to the increase in the base rate and forecasted future increases.

5. INVESTMENT TRAINING

During the period, officers have attended investment training with Arlingclose and CIPFA relevant to their roles.

6. RECOMMENDATION

To receive the report for information.