

**Treasury Management Update – Quarterly Report 30 June 2023****Contents**

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## Treasury Management Update – Quarterly Report 30 June 2023

### Treasury Management Update

#### Quarter Ended 30th June 2023

The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management 2021 recommends that members be updated on treasury management activities at least quarterly. This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

#### 1. Economics update

The following information has been received from our Treasury Management advisors.

- The first quarter of 2023/24 saw:
  - CPI inflation falling from 10.1% to 8.7% in April, before remaining at 8.7% in May. This was the highest reading in the G7.
  - Core CPI inflation rise in both April and May, reaching a new 31-year high of 7.1%.
  - Interest rates rise by a further 75bps over the quarter, taking Bank Rate from 4.25% to 5.00%.
- The economy has weathered the drag from higher inflation better than was widely expected and will further raise hopes that the economy will escape a recession this year.
- The recent resilience of the economy has been due to a confluence of factors including the continued rebound in activity after the pandemic, households spending some of their pandemic savings, and the tight labour market and government handouts both supporting household incomes. That said, as government support fades, real household incomes are unlikely to grow rapidly.
- Our Treasury Management advisor's central assumption is that inflation will drop to the 2.0% target only if the Bank of England (the Bank) triggers a recession by raising rates from 5.00% now to at least 5.5% and keeps rates there until at least mid-2024.
- The labour market became tighter over the quarter and wage growth reaccelerated. Labour demand was stronger than the consensus had expected.
- This suggests the Bank may have more work to do than the Federal Reserve (Fed) or European Central Bank (ECB). Indeed, the Bank of England

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sounded somewhat hawkish in the June meeting. This came through most in the Monetary Policy Committee's (MPC) decision to step up the pace of hiking from the 25bps at the previous two meetings. The 7-2 vote, with only two members voting to leave rates unchanged at 4.50%, revealed support for stepping up the fight against high inflation.

### MPC meetings 11th May and 22nd June 2023

- On 11th May, the Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 25 basis points to 4.50%, and on 22nd June moved rates up a further 50 basis points to 5.00%. Both increases reflected a split vote – seven members voting for an increase and two for none.
- Nonetheless, with UK inflation significantly higher than in other G7 countries, the MPC will have a difficult task in convincing investors that they will be able to dampen inflation pressures anytime soon.
- Outside of the first quarter, on 3<sup>rd</sup> August, the MPC increased bank rates further to 5.25%. However, on the 21<sup>st</sup> September the MPC decided to hold rates at 5.25%, the first time rates have been held since December 2021.

## 2. Interest rate forecasts

The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The Public Works Loan Board (PWLB) rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.

The latest forecast, made on 26th June, sets out a view that both short 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, against a backdrop of a stubbornly robust economy and a tight labour market.

You will note that Link Group's forecasts have steadily increased during the quarter as the data continued to spring upside surprises, and the Bank of England continued to under-estimate how prevalent inflation is, and how tight the labour market is. The Government has also noted that despite immigration increasing markedly, high levels of ill-health amongst the workforce has led to wage demands remaining strong until such time as there is a loosening in demand for business services.

The current PWLB rate forecast below is based on the Certainty Rate.

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Link Group Interest Rate View	26.06.23												
	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26
<b>BANK RATE</b>	5.00	5.50	5.50	5.50	5.25	4.75	4.25	3.75	3.25	2.75	2.75	2.50	2.50
3 month ave earnings	5.30	5.60	5.50	5.30	5.00	4.50	4.00	3.50	3.00	2.70	2.60	2.50	2.50
6 month ave earnings	5.80	5.90	5.70	5.50	5.10	4.60	4.00	3.50	3.00	2.70	2.60	2.60	2.60
12 month ave earnings	6.30	6.20	6.00	5.70	5.30	4.80	4.10	3.60	3.10	2.80	2.70	2.70	2.70
5 yr PWLB	5.50	5.60	5.30	5.10	4.80	4.50	4.20	3.90	3.60	3.40	3.30	3.30	3.20
10 yr PWLB	5.10	5.20	5.00	4.90	4.70	4.40	4.20	3.90	3.70	3.50	3.50	3.50	3.40
25 yr PWLB	5.30	5.40	5.20	5.10	4.90	4.70	4.50	4.20	4.00	3.90	3.80	3.80	3.70
50 yr PWLB	5.00	5.10	5.00	4.90	4.70	4.50	4.30	4.00	3.80	3.60	3.60	3.50	3.50

- LIBOR and LIBID rates ceased at the end of 2021. In a continuation of previous views, money market yield forecasts are based on expected average earnings by local authorities for 3 to 12 months.
- The Link forecast for earnings are averages, actual rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short-term cash at any one point in time.

### A Summary Overview of the Future Path of Bank Rate

- Link's central forecast for interest rates was previously updated on 25th May and reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened to a degree, especially as it moved to a more aggressive 0.5% hike in June but, with inflation remaining elevated, it is anticipated that Bank Rate will need to increase to at least 5.5%, if not higher, to sufficiently slow the UK economy and loosen the labour market.
- Moreover, it is still anticipated that the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us – but timing on this will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged. Link's current judgment is that rates will have to increase and stay at their peak until the second quarter of 2024 as a minimum.
- In the upcoming months, the forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine and whether there are any further implications for Russia itself following the recent aborted mutiny by the Wagner group.
- On the positive side, consumers are still estimated to be sitting on excess savings left over from the pandemic, which could cushion some of the impact of the above challenges and may be the reason why the economy is performing somewhat better at this stage of the economic cycle than may

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have been expected. However, most of those excess savings are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy, and rent/mortgage payments.

### PWLB Rates

- Gilt yield curve movements have shifted upwards, especially at the shorter end of the yield curve since our previous forecast but remain relatively volatile. PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.90% to 5.60%.
- We view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the elevated inflation outlook.

### The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is to the downside.

### Downside risks to current forecasts for UK gilt yields and PWLB rates include:

- Labour and supply shortages prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, the rising gilt yields we have seen of late).
- The Bank of England increases Bank Rate too fast and too far over the coming months, and subsequently brings about a deeper and longer UK recession than we currently anticipate.
- UK / EU trade arrangements – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
- Geopolitical risks, for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.
- A broadening of banking sector fragilities, which have been successfully addressed in the near-term by central banks and the market generally, but which may require further intervention if short-term interest rates stay elevated for longer than is anticipated.

### Upside risks to current forecasts for UK gilt yields and PWLB rates:

- Despite the recent tightening by 0.5%, the Bank of England proves too timid in its pace and strength of increases in Bank Rate and, therefore, allows

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inflationary pressures to remain elevated for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project.

- The pound weakens because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.
- Longer-term US treasury yields rise strongly if inflation remains more stubborn than the market currently anticipates, pulling gilt yields up higher consequently.
- Projected gilt issuance, inclusive of natural maturities and Quantitative Tightening (QT), could be too much for the markets to comfortably digest without higher yields compensating.

### 3. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2023/24, which includes the Annual Investment Strategy, was approved by the Council on 30 March 2023. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity, aligned with the Council's risk appetite. In the current economic climate, over and above keeping investments short-term to cover cash flow needs, there is a benefit to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

As shown by the interest rate forecasts in section 2, investment rates have improved dramatically during the first quarter of 2023/24 and are expected to improve further as Bank Rate continues to increase over the next few months.

#### Creditworthiness

There have been few changes to credit ratings over the quarter under review. However, officers continue to closely monitor these, and other measures of creditworthiness to ensure that only appropriate counterparties are considered for investment purposes.

#### Investment counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

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### CDS prices

For UK banks, these have retreated from the spikes caused by the Truss / Kwarteng policy approach in September 2022. Prices are not misaligned with other creditworthiness indicators, such as credit ratings. Nevertheless, it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

### Investment balances

The Council has been able to invest a total of £122.5m during the first quarter of 2023/24, with an average investment value of £4m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of the Council's payments, receipt of grants and progress on the capital programme.

The following table displays a selection of interest rates prevailing as of 1 April 2023 and 30 June 2023.

	01/04/2023	30/06/2023
Bank Base Rate	4.25%	5.00%
1 Month SONIA	4.17%	4.94%
PWLB 10 year Maturity	4.50%	5.45%
PWLB 15 year maturity	4.74%	5.51%
PWLB 25 year maturity	4.86%	5.53%

Appendix A gives details of the investments made during the year, and the following table gives a summary, which shows the Council's average rate of return was below the benchmark. This is in line with the Authority's risk averse policy whereby the security of the capital sum is the number one priority at the expense of more competitive investment returns.

	Total Value of Investments	Average Investment	Investment Returns	Average Rate of Return	Benchmark Return *
<b>Internally Managed</b>	£122.5m	£4.0m	£650k	3.49%	4.46%

\* Benchmark = 1 month SONIA uncompounded 4.46%

The above investment returns include £285,000 of interest received in relation to the ongoing investment of the funds received from the Welsh Government in respect of the Rail Infrastructure Loan. There is a condition of the funding approval that states any interest earned from holding the loan must be added to the works programme. Therefore, this income will be placed into a reserve until such time it is used to fund

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works or can be transferred to the Authority. The remaining £365,000 investment returns relates to interest due from the investment of the Council's own funds.

As illustrated, the Council underperformed the benchmark by 97 bps. The Council's budgeted investment return for 2023/24 is £320,500. Due to the availability of funds to invest and the continued increases in bank rates above previous forecasts, the Council has exceeded this estimate.

### **Approved limits**

Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 30th June 2023.

## **4. Borrowing**

No new long-term borrowing has been undertaken during this financial year. The Authority has repaid £6m of market loans during the quarter ended 30 June 2023, however these have not been replaced with long term borrowing.

Due to the current elevated level of interest rates, the Council is not planning to undertake any long-term borrowing but will instead borrow in the short-term for re-financing of long-term debt or for cash flow purposes, due to the expectation that interest rates will begin to fall during 2024.

This situation will be monitored closely by the Treasury Management section, who will plan the future borrowing requirement of the Council in line with forecast interest rates.

### **PWLB maturity Certainty Rates 1st April to 30th June 2023**

Gilt yields and PWLB rates were on a rising trend between 1st April and 30th June.

The 50-year PWLB Certainty Rate target for new long-term borrowing started 2023/24 at 3.30% before increasing to a peak of 3.80% in June. As can be seen, with rates elevated across the whole of the curve, it is advised to not borrow long-term unless the Authority wants certainty of rate and judges the cost to be affordable.

### **Temporary Loans**

Appendix B lists the short-term loan activity during the year and shows that over the period a total of £48.365 million loans were brought forward from the previous year and £16 million of new short-term loans were raised. A total of £36 million of these loans have been repaid during the year (including the brought forward loans), leaving a balance outstanding as at 30 June 2023 of £28.4 million. The decrease in short-term loans can be attributed to the running down of our own investments in order to reduce the requirement of the need to borrow to fund short term cash flow deficits.



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The following table gives a summary which shows that the average rate of interest paid was well within the benchmark. However, this is due to the Council entering into short-term borrowing when interest rates were low. With the current high level of interest rates, further borrowing will exceed the benchmark rate. This is still seen as the preferred option of borrowing, instead of entering into long-term borrowing now when rates are expected to fall during 2024.

	Total Value of Loans during the period	Average Loan	Interest paid during the period	Average Interest Rate	Benchmark Interest Rate *
Short Term borrowing	£64.4m	£4.0m	£193,900	3.01%	4.50%

\* Benchmark = budgeted interest rate for new borrowings 4.50%

As shown in section 3, the Council has exceeded its investment returns target for the financial year. It is anticipated that any additional investment interest received will offset the increased cost of borrowing anticipated throughout the remainder of the financial year, due to the current and forecast interest rates above the benchmark rate.

### 5. Debt rescheduling

Debt rescheduling opportunities have increased significantly in the current quarter where gilt yields, which underpin PWLB rates and market loans, have risen materially. Members will be advised if there is value to be had by rescheduling or repaying a part of the debt portfolio.

No debt rescheduling has been undertaken during the financial year.

### 6. Compliance with Treasury and Prudential Limits

The prudential and treasury Indicators are shown in Appendix 2.

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the quarter ended 30th June 2023, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2023/24. The Chief Officer Resources reports that no difficulties are envisaged for the current or future years in complying with these indicators.

All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

Please note that the outturn figures for 2022/23 are unaudited at this stage, so may be subject to change.