Appendix 1

Treasury Management Update | Quarter 1 2024/25

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TREASURY MANAGEMENT UPDATE

Quarter Ended 30th June 2024

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. ECONOMIC UPDATE

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

- The first quarter of 2024/25 we saw:

  - GDP growth flatlining in April following positive Q4 2023/24 growth figures of 0.7% q/q.
  - A stalling in the downward trend in wage growth, with the headline 3myy rate staying at 5.9% in April.
  - CPI inflation falling from 2.3% in April to 2.0% in May.
  - Core CPI inflation decreasing from 3.9% in April to 3.5% in May.
  - The Bank of England holding rates at 5.25% in May and June.
  - 10-year gilt yields climbing to 4.35% in April, before closing out at 4.32% in May.

- The news that the economy grew by 0.7% q/q in Q4 2023/24 confirmed that it moved out of its very mild technical recession that prevailed at the back end of 2023. However, data released for April and May so far shows a slight stalling in the recovery, with GDP data for April coming out at 0.0% m/m, as inclement weather weighed on activity. Moreover, the fall in the composite Purchasing Manager Index output balance from 53.0 in May to 51.7 in June confirms tepid growth.
- On a more positive note, the 2.9% m/m increase in retail sales volumes in May more than reversed the 1.8% m/m drop in April as rainfall returned to seasonal norms. The strength was broad-based across the retail sector, including online, (+5.9% m/m) suggesting an underlying strengthening in sales beyond weather effects. With inflation falling back to target, Bank Rate likely to be reduced soon and with consumer confidence improving, retail sales may well continue to strengthen.
- Stronger consumer spending, as low inflation allows households' real incomes to strengthen and the drag from higher interest costs fades, suggests that real consumption will strengthen substantially over the next two years. However, investment will only make a modest contribution to GDP growth. With the industrial sector still 12% smaller than in 2019, excess capacity will continue to cap the need for industrial firms to invest. But improving business sentiment should raise investment by services' firms. Further, a fall in mortgage rates should trigger a recovery in residential investment. Overall, strong consumer spending is likely to be the backbone of GDP growth, along with government consumption. Our colleagues at Capital Economics forecast that following GDP growth of 1.0% in 2024, activity will continue to surprise to the upside with GDP growth of 1.5% for both 2025 and 2026 (consensus forecasts are 1.2% and 1.4% respectively).

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- Nonetheless, the on-going stickiness of wage growth in April will be a lingering concern for the Bank of England. The 3myy rate of average earnings growth stayed at 5.9% in April (consensus 5.7%), whilst the more timely 3m annualised rate rebounded from 5.9% to 9.3%. This stickiness partly reflected April's 9.8% increase in the minimum wage. This leaves the Bank of England's forecast for a fall back in regular private sector pay growth from 5.8% in April to 5.1% in June looking a challenge.
- Despite the stickiness of wage growth in April, sharp falls in employment and a move up in unemployment suggests that wage growth will soon be back on a downward path. The 139,000 fall in employment in the three months to April was accompanied by a rise in the unemployment rate from 4.3% to 4.4%. This was the fourth increase in a row and took it to its highest level since September 2021. The rise would have been larger were it not for the 132,000 increase in inactivity in the three months to April as the UK's disappointing labour market participation performance since the pandemic continued. The vacancies data also paint a picture of a slowly cooling labour market. The number of job vacancies fell from an upwardly revised 908,000 to 904,000, leaving vacancies 31% below the peak in May 2022, but 11% above the pre-pandemic level.
- The fall in CPI inflation in May back to the Bank's 2% target for the first time since July 2021 will have come as welcome news to the Bank. Furthermore, with CPI inflation of 3.3% in the US and 2.6% in the Euro-zone in May, the UK appears to have won the race to get CPI inflation back to 2.0%. A further easing in food inflation from 2.8% in April to 1.6% in May played a part in the fall in overall CPI inflation and with food producer price inflation at just 0.2% in May, food price inflation will probably soon fall to zero.
- The core inflation rate also fell back from 3.9% to 3.5%. Within that, core goods CPI inflation slipped below zero for the first time since October 2016. As expected, clothing/footwear, recreation/culture and restaurants/hotels categories inflation declined, reflecting base effects from big increases last May. While services inflation fell from 5.9% to 5.7%, this decline was smaller than the Bank of England expected (forecast 5.3%). And the timelier three-month annualised rate of services prices has rebounded from 8.5% to 9.2%. This suggests that the persistence in domestic inflation that the Bank is worried about is fading more slowly than it thought. Even so, there is scope for inflation to fall further.
- There was little chance that the Bank would cut rates at its June meeting, given upside surprises on services CPI inflation and wage growth. But several developments implied a rate cut is getting closer (August?). First, two members of the MPC, Ramsden and Dhingra voted again to reduce rates immediately to 5.00%. Second, despite the recent run of stronger inflation and activity, the minutes noted "indicators of inflation persistence had continued to moderate" and that a range of indicators suggest pay growth had continued to ease. And there was new wording that members of the MPC will consider all the information available and how this affects the assessment that the risks from inflation persistence are receding "as part of the August forecast round".

MPC meetings 9th May and 20th June 2024

- On 9th May, the Bank of England's Monetary Policy Committee (MPC) voted 7-2 to keep Bank Rate at 5.25%. This outcome was repeated on 20th June.
- Nonetheless, with UK CPI inflation now back at 2% and set to fall further over the coming months, MPC members Ramsden and Dhingra – who voted again to reduce rates immediately to 5.00% in June – may shortly be joined by some members in the

no-change camp, for whom the June decision was "finely balanced" as the upside news on services price inflation was more likely to be a reflection of one-off effects and volatile components rather than factors that would push up "medium-term inflation".

2. INTEREST RATES FORECAST

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, updated on 28th May, sets out a view that both short and long-dated interest rates will start to fall once it is evident that the Bank of England has been successful in squeezing excess inflation out of the economy, despite a backdrop of a stubbornly robust economy and a tight labour

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

Link Group Interest Rate View	28.05.24											
	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.00	4.50	4.00	3.50	3.25	3.25	3.25	3.25	3.00	3.00	3.00
3 month ave earnings	5.30	5.00	4.50	4.00	3.50	3.30	3.30	3.30	3.30	3.00	3.00	3.00
6 month ave earnings	5.30	4.90	4.40	3.90	3.50	3.30	3.30	3.30	3.30	3.10	3.10	3.20
12 month ave earnings	5.10	4.80	4.30	3.80	3.50	3.40	3.40	3.40	3.40	3.20	3.30	3.40
5 yr PWLB	4.90	4.70	4.50	4.30	4.10	4.00	3.90	3.90	3.90	3.90	3.90	3.80
10 yr PWLB	5.00	4.80	4.60	4.40	4.30	4.10	4.10	4.10	4.00	4.00	4.00	3.90
25 yr PWLB	5.30	5.20	5.00	4.80	4.70	4.50	4.50	4.40	4.40	4.40	4.30	4.30
50 yr PWLB	5.10	5.00	4.80	4.60	4.50	4.30	4.30	4.20	4.20	4.20	4.10	4.10

- 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.

An Overview of the Future Path of Bank Rate

- In the upcoming months, the forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies. The General Election is not expected to have a significant impact on UK monetary policy. There is minimal leeway for further tax cuts or added spending without negatively impacting market sentiment. It may even be the case that the Bank of England will steer clear of an August rate cut – should that be supported by the inflation data – in favour of weighing up fiscal policy implications and market sentiment in the aftermath of the election.

- Increasing uncertainties internationally, such as the U.S presidential election in November, 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 conflicts between Russia and Ukraine, Gaza and Israel, may impact on global inflation levels and thus monetary policy decisions.

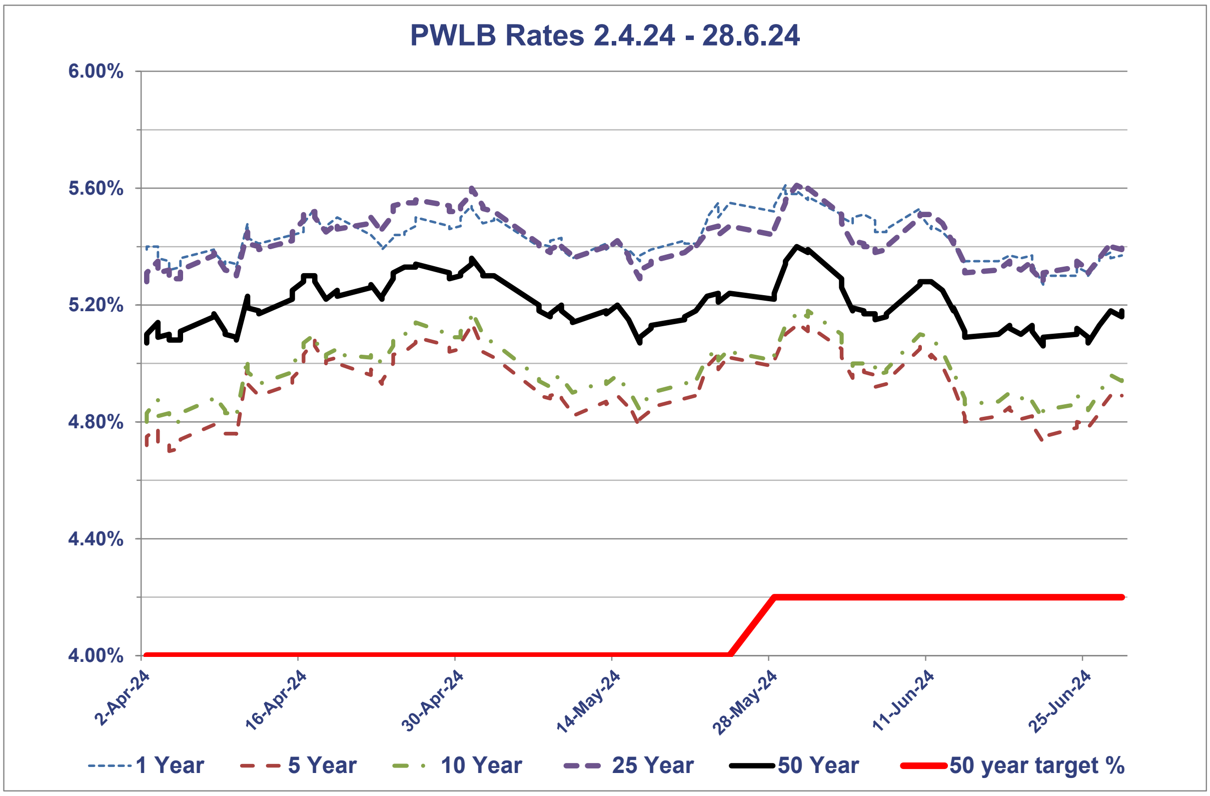
- Link's central forecast for interest rates was previously updated on 28th May 2024 and reflects a view that the MPC would be keen to underpin its anti-inflation credentials by keeping Bank Rate at 5.25% until at least the Summer of 2024. Link's central case is still for a rate cut before the end of September but are not committed to whether it will be in August or September. Thereafter, the path and speed of rate cuts is similar to that which we previously forecast, with Bank Rate eventually falling to a low of 3% by Q3 2026.

- Naturally, timing on this matter will remain one of fine judgement: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

PWLB Rates

- Movement in the short-end of the curve is expected to reflect Link's Bank Rate expectations to a large degree, whilst medium to longer-dated PWLB rates will remain influenced not only by the outlook for inflation, domestically and globally, but also by the market's appetite for significant gilt issuance.

- The 50-year PWLB Certainty Rate target for new long-term borrowing (the low point of our forecast on a two-year timeline) started 2024/25 at 4.00% and increased to 4.20% on 28th May. As can be seen, with rates remaining 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.



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, could keep gilt yields high for longer).

- The Bank of England has increased Bank Rate too fast and too far over recent 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, the Middle East, China/Taiwan/US, Iran and North Korea, which could lead to increasing safe-haven flows.

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

- Despite the tightening of Bank Rate to 5.25%, the Bank of England proves too timid in its pace and strength of increases in Bank Rate and, therefore, allows 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 pre-election 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 there than the market currently anticipates, consequently pulling gilt yields up higher.

- 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.

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3. ANNUAL INVESTMENT STRTAEGY

The Treasury Management Strategy Statement (TMSS) for 2024/25, which includes the Annual Investment Strategy, was approved by the Council on 21st March 2024. 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 charts below and the interest rate forecasts in section 2, investment rates have remained stable during 2024/25 but are now expected to have peaked and fall back through the second half of 2024 as inflation reduces and the MPC starts to loosen monetary policy.

The following table displays a selection of interest rates prevailing as of 1 April 2024 and 28 June 2024.

	01/04/2024	28/06/2024
Bank Base Rate	5.25%	5.25%
1 Month SONIA	5.19%	5.20%
PWLB 10-year Maturity	5.03%	5.16%
PWLB 15-year maturity	5.32%	5.42%
PWLB 25-year maturity	5.51%	5.60%

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.

CDS prices

For UK banks, there are no underlying negative themes. 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 £82m during the first quarter of 2024/25, with an average investment value of £2.4m. 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.

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 *
Internally Managed	£82.00m	£2.42m	£0.42m	6.52%	5.20%

** Benchmark = 1 month SONIA uncompounded 5.20%*

The above investment returns include £10,696 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 works or can be transferred to the Authority. The remaining £409,377 investment returns relates to interest due from the investment of the Council's own funds.

As illustrated, the Council overperformed the benchmark by 1.32%. The Council's budgeted investment return for 2024/25 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 2024.

It should be noted that on 16th May 2024 a planned investment with a money market fund was unable to be completed due to the notification deadline being missed by a matter of minutes. Consequentially, officers were unable to invest with another counterparty, resulting in the closing balance being £977,290 above the £10m limit set in the Annual Investment Policy. The excess funds were re-invested the following morning.

Officers will take the lessons learned and plan cashflows in a timelier manner and ensure the bank balance is kept at a lower minimum level in the future.

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4. BORROWING

Due to the current elevated level of interest rates, the Council is not planning to undertake 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 second half 2024 and 2025.

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.

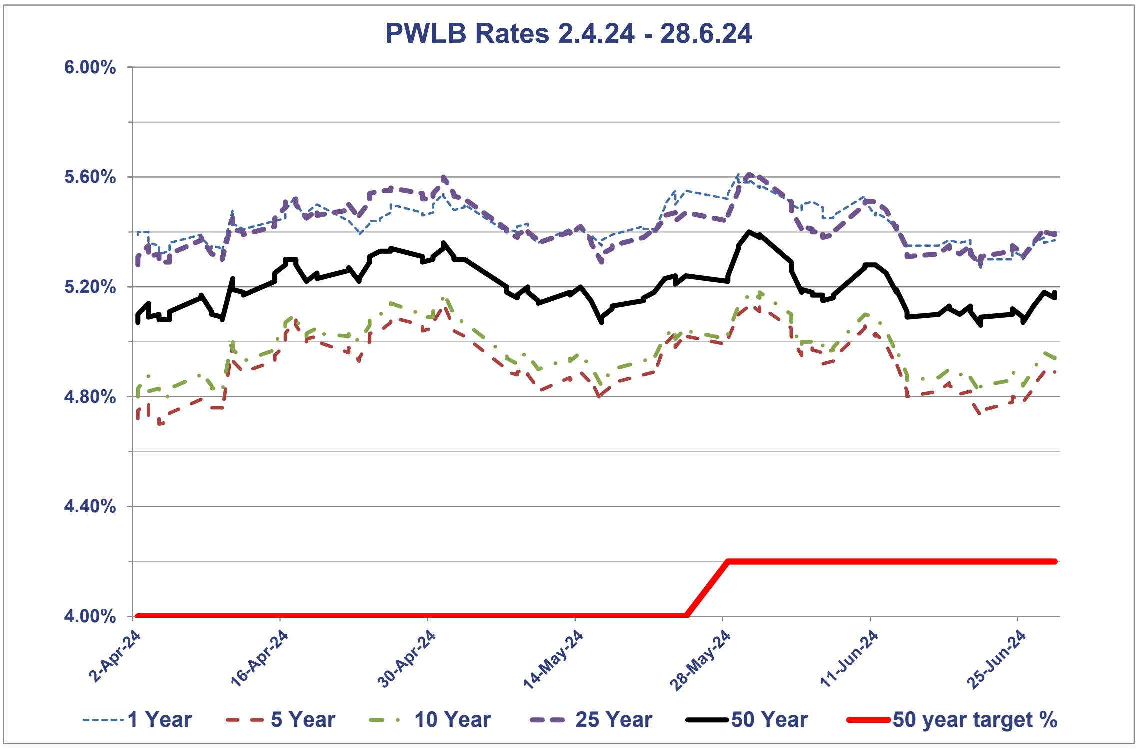
PWLB maturity Certainty Rates 1st April to 30th June 2024

Gilt yields and PWLB rates remained relatively stable between 1st April and 30th June. Having said that, the spread between the low and high points during the quarter was between 0.3% and 0.45% across the curve

The 50-year PWLB Certainty Rate target for new long-term borrowing (the low point of our forecast on a two-year timeline) started 2024/25 at 4.00% and increased to 4.20% on 28th May. As can be seen, with rates remaining 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

Movement in the short-end of the curve is expected to reflect Link's Bank Rate expectations to a large degree, whilst medium to longer-dated PWLB rates will remain influenced not only by the outlook for inflation, domestically and globally, but also by the market's appetite for significant gilt issuance.

PWLB RATES 02.04.2024 – 28.06.2024



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Temporary Loans

Appendix B lists the short-term loan activity during the year and shows that over the period a total of £38.45 million loans were brought forward from the previous year and £7 million of new short-term loans were raised. A total of £8 million of these loans have been repaid during the year (including the brought forward loans), leaving a balance outstanding as of 30th June 2024 of £37.45 million. The slight 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.

The following table gives a summary which shows that the average rate of interest paid was above the benchmark, due to interest rates exceeding the forecast this financial year, the Bank of England increased rates higher than expected to curb the high level of inflation within the UK economy.

With the current high level of interest rates, further borrowing will exceed the benchmark rate until the base rate falls below 4.50%. 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 and 2025.

	Total Value of Loans during the period	Average Loan	Interest paid during the period	Average Interest Rate	Benchmark Interest Rate *
Short Term borrowing	£45.5m	£5.1m	£0.5m	5.44%	4.50%

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

As a comparison, the council's average rate of interest on borrowing has exceeded the Benchmark - 3 month SONIA uncompounded interest rate of 5.17% by 27 basis points.

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 RESCHEDULLING

Debt rescheduling opportunities have remained a possibility in the current quarter for those authorities with significant surplus cash and a flat or falling Capital Financing Requirement in future years. 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 2024, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2024/25. 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 2023/24 are unaudited at this stage, so may be subject to change.