REPORT REFERENCE NO.	**RC/23/4**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**23 NOVEMBER 2022**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2022-23 – QUARTER 3**
LEAD OFFICER	**TREASURER**
RECOMMENDATIONS	***That the performance in relation to the treasury management activities of the Authority for 2022-23 (to December 2022) be noted.***
EXECUTIVE SUMMARY	The Chartered Institute of Public Finance and Accountancy (CIPFA) issued a Code of Practice for Treasury Management. The Code suggests that members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This report therefore ensures this Authority is embracing Best Practice in accordance with CIPFA's Code of Practice.
RESOURCE IMPLICATIONS	As indicated within the report.
EQUALITY IMPACT ASSESSMENT	An initial assessment has not identified any equality issues emanating from this report.
APPENDICES	Appendix A – Investments held as at 31 December 2022.
LIST OF BACKGROUND PAPERS	Treasury Management Strategy (including Prudential and Treasury Indicators) as approved at the meeting of the Fire & Rescue Authority held on the 21 February 2022 – Minute DSFRA/11C refers.

1. INTRODUCTION

1.1. The Treasury Management Strategy for Devon and Somerset Fire & Rescue Authority has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in Public Services Code of Practice (the Code) and the CIPFA Prudential Code. The Code recommends that members be updated on treasury management activities regularly (TMSS, annual and midyear reports). This report, therefore, ensures this Authority is implementing best practice in accordance with the Code and includes:

1.1.1 The creation and maintenance of a Treasury Management Policy Statement, which sets out the policies and objectives of the Authority's treasury management activities;

1.1.2 The creation and maintenance of Treasury Management Practices, which set out the manner in which the Authority will seek to achieve those policies and objectives;

1.1.3 The receipt by the full Authority of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year;

1.1.4 The delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

1.2 Treasury management in this context is defined as:

> "The management of the local authority's borrowing, investments, cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.3 The preparation of this report demonstrates that the Authority is implementing best practice in accordance with the code.

2. ECONOMICS UPDATE

2.1. The third quarter of 2022/23 saw:

- A 0.5% month on month (m/m) rise in Gross Domestic Product (GDP) in October 2022, mostly driven by the reversal of bank holiday effects;
- Signs of economic activity losing momentum as households increased their savings;
- Consumer Price Index (CPI) inflation fall to 10.7% in November 2022 after peaking at 11.1% in October;
- A small loosening in the labour market which pushed the unemployment rate up to 3.7% in October 2022;

- Interest rates rise by 125 base points (bps) over Quarter 4 2022, taking Bank Rate to 3.50%;
- Reduced volatility in UK financial markets but a waning in global risk appetite.

2.2. GDP fell by 0.3% quarter on quarter (q/q) in Quarter 3 of 2022 (ending 30th September), which probably marked the start of the UK recession. About half of that decline was the effects of the extra bank holiday in September for the Queen's funeral. The unwinding of those bank holiday effects meant that GDP rebounded in October 2022 and explained at least 0.3 percentage points (ppts) of the 0.5% m/m rise. Accordingly, if GDP were to avoid falls of more than 0.2% m/m in November and December, 2022 then GDP over Quarter 4 as a whole could avoid a contraction, which would prevent a recession in 2022.

2.3. However, at 49.0 in December 2022, the flash composite activity Purchasing Manager's Index (PMI) stayed below the "boom-bust" level of 50 and pointed to a small 0.1% q/q contraction in GDP in Quarter 4. Consumer confidence was -42 in December and stayed close to its record low of -49 in September. Strike action could be another small drag and may mean that GDP is 0.0% to 0.5% lower than otherwise in December. GDP is projected to contract marginally in Quarter 4 by around 0.1% q/q.

2.4. Meanwhile, the 0.4% m/m fall in retail sales volumes in November 2022 only reversed some of the 0.9% m/m rise in October. That left sales volumes 4.5% below their level at the start of the year. Indeed, the rise in the household saving rate from 6.7% in Quarter 2 to 9.0% in Quarter 3 implied that higher interest rates are encouraging households to save more. And a larger-than-usual £6.2bn rise in cash in household bank accounts in October may imply households have started to increase their precautionary savings.

2.5. There were signs that the labour market was loosening gradually going into the final quarter of 2022. Although employment in the three months to October 2022 rose by 27,000, the fall in the composite PMI employment balance in December took it into contractionary territory and suggests that labour demand will cool. Meanwhile, labour supply improved as inactivity fell by 76,000 in the three months to October 2022. That helped drive a rise in the unemployment rate from 3.6% in September to 3.7% in October. The number of job vacancies in November 2022 fell for the sixth consecutive month and were 18% below their peak in May 2022.

2.6. Crucially, though, wage growth remained resilient. Average earnings growth, excluding bonuses, grew by 0.7% m/m in October 2022, above the 2022 monthly average of 0.5% m/m. That drove the 3myy rate up to 6.2%, well above the rates of 3-3.5% consistent with inflation at its 2% target. Wage growth is likely to slow gradually in the coming months as the labour market loosens further but if extensive strike action is successful in achieving large pay increases, then wage growth could be a bit stronger for longer.

2.7. CPI inflation peaked in October at a 41-year high of 11.1% and fell to 10.7% in November. Goods price inflation, which is driven largely by global factors, has peaked. The sharp rises in energy prices in 2022 mean that energy price inflation will fall sharply in 2023. Meanwhile, the large fall in agricultural prices since May 2022 means that food price inflation should start to decline soon. What's more, upward pressure on goods price inflation from global supply shortages is fading quickly.

2.8. Domestic inflation pressures also eased in Quarter 4. The 0.2% m/m rise in core CPI inflation in November 2022 was the smallest monthly gain since August 2020 and drove a fall in core CPI inflation from 6.5% in October to 6.3% in November. Services CPI inflation was stable at 6.3% in November despite the resilience of wage growth. And the easing of price expectations in the Bank of England's Decision Maker Panel survey in November 2022 suggests that inflation may become less persistent.

2.9. The Chancellor's Autumn Statement on 17th November 2022 succeeded in restoring the government's fiscal credibility in the eyes of the financial markets without deepening the recession. The total fiscal consolidation package of £54.9bn (1.8% of GDP) in 2027/28 made the outlook for fiscal policy much tighter than at the beginning of Quarter 4. The package was heavily backloaded, with net handouts of £3.8bn (0.15% of GDP) in 2023/24 and £0.3bn (0.01% of GDP) in 2024/25, and most of the tightening kicking in after 2024/25. The largest fiscal support was the extension of the Energy Price Guarantee for another 12 months, until April 2024, although at a higher price cap of £3,000 from April 2023 rather than £2,500. At the same time, Chancellor Hunt loosened the fiscal rules by requiring debt as a percentage of GDP to be falling in five years' time, rather than three. The Office of Budget Responsibility (OBR) estimated that the Chancellor will meet this new rule with a slim £9.2bn (0.3% of GDP) to spare.

2.10. With fiscal policy now doing much less to fan domestic inflation pressures, ot is thought Bank Rate will peak at 4.50%, or at least close to that figure. Despite stepping up the pace of policy tightening to a 75-basis point (bps) rate hike in November 2022, taking Bank Rate from 2.25% to 3.00%, the Monetary Policy Committee (MPC) communication was dovish. The (MPC pushed back heavily against market rate expectations, which at the time were for Bank Rate to peak at 5.25%. The Bank's new forecasts predicted a deeper and longer recession than the analyst consensus, of eight quarters and with a peak-to-trough fall in real GDP of 2.9%.

2.11. The Bank sounded dovish again in December 2022 when it slowed the pace of tightening with a 50bps rate rise, from 3.00% to 3.50%. Two members, Dhingra and Tenreyro, voted to leave rates unchanged, judging that the current level of Bank Rate was sufficient to bring inflation back to target. That said, the rest of the MPC appeared to suggest that further rate hikes would be necessary. It is expected that the majority of the MPC will need to see stronger signs that activity is slowing, the labour market is loosening, and wage growth is slowing before stopping rate rises.

2.12. As such, it is expected that the MPC will deliver three further rate hikes in February, March and May 2023, taking Bank Rate to a peak of 4.50% but with the pace of increase reducing to 25bps in March and May.

2.13. Gilt yields have fallen sharply since their highs following the “mini-budget” on 23rd September 2022 as government fiscal credibility has been largely restored with the resignation of Truss-Kwarteng and the fiscal consolidation package announced at the Autumn Statement on 17th November. 2022. Indeed, the 10-year yield fell from a peak of 4.55% to about 3.60% now, while the 30-year yield fell from 5.10% to 3.90%. Admittedly, yields rose by around 50bps in December 2022, partially on the back of a global rise in yields. But if Link is right in thinking Bank Rate will fall back in 2024 and 2025, then gilt yields will probably fall over the next two years, with the 10-year yield slipping from around 3.60% now to 3.30% by the end of 2023 and to 2.80% by the end of 2024.

2.14. Lower volatility in gilt markets in Quarter 4 meant that the Bank of England was able to stop its purchases of long-term gilts for financial stability reasons as planned on 14th October 2022. It was also able to begin active gilt sales in November 2022, albeit with a focus on shorter dated gilts. So far quantitative tightening has had little influence on short-term money markets. But as it is still an experiment, the risk of a widespread tightening in financial conditions remains.

2.15. The restoration of fiscal credibility boosted the pound and the FTSE 100 early in Quarter 4. While much of the benefit passed in the first half of Quarter 4, sterling continued to rally against a softer dollar. Colleagues at Capital Economics do not think that the global recession is fully priced into markets, and so expect a further fall in risk appetite to boost safe haven demand for the dollar and weigh on the pound. They are expecting the pound to fall from $1.19 now to $1.10 in mid-2023, before climbing to $1.15 by the end of 2023 as the prospect of lower interest rates and a recovery in global economic growth buoys equity prices.

2.16. Through December 2022, the rally in the Financial Times Stock Exchange (FTSE) 100 petered out as investors have become increasingly concerned by the prospect of a global recession. However, the relatively dovish tone of the Bank of England, compared to the Federal Reserve and the European Central Bank (ECB) meant that UK equities held up better than other developed market indices. Indeed, at 7,452 at the December month end, the FTSE 100 is only marginally below its peak of 7,568 on 5th December 2022, while the Standard & Poor’s (S&P) 500 is around 4% lower over the same period. Nevertheless, there is a great deal of uncertainty as to which direction markets will move in 2023 and at what pace. Continued volatility is anticipated.

MPC meetings 3rd November and 15th December 2022

2.17. On 3rd November 2022, the Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 75 bps to 3.00%, and on 15th December 2022 moved rates up a further 50 bps to 3.50%. The later increase reflected a split vote – six members voting for a 50 basis points increase, one for 75 basis points and two for none.

2.18. Nonetheless, the UK government appears more settled now, with Rishi Sunak as Prime Minister, and Jeremy Hunt as Chancellor. Having said that, a multitude of strikes across several public services and the continued cost-of-living squeeze is going to make for a difficult backdrop to maintain fiscal rectitude without pushing the economy into anything worse than a mild recession.

2.19. Of course, what happens outside of the UK is also critical to movement in gilt yields. The US Federal Open Market Committee (FOMC) has led with increases of 425 basis points in 2022 and is expected to increase rates further in 2023. Similarly, the ECB has also started to tighten monetary policy, albeit from an ultra-low starting point, as have all the major central banks apart from Japan (although the Bank of Japan has "tightened" its policy by widening the accepted yield levels for 10yr Japanese Government Bond (JGB), from 0.25% to 0.5% on 20th December 2022). Arguably, though, it is US monetary policies that are having the greatest impact on global bond markets.

2.20. What happens in Ukraine will also impact the global economy, but particularly in Europe. The search for alternative providers of energy, other than Russia, will take both time and effort. The weather will also play a large part in how high energy prices stay and for how long.

Interest rate forecasts

2.21. The Authority has appointed Link Group as its treasury advisors and part of their service is to assist the Authority 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.

2.22. The latest forecast, made on 19th December 2022, 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, whilst the government is also providing a limited package of fiscal loosening to try and protect households and businesses from the ravages of ultra-high wholesale gas and electricity prices. PWLB rates reflect a less elevated yield curve than prevailed under the Truss/Kwarteng government, and the 17th of November Autumn Statement made clear the government's priority is the establishment and maintenance of fiscal rectitude.

2.23. In addition, the MPC has tightened short-term interest rates with a view to trying to slow the economy sufficiently to keep the secondary effects of inflation – as measured by wage rises – under control.

Link Group Interest Rate View 19.12.22													
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.20	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.30	4.40	4.40	4.30	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.30
25 yr PWLB	4.60	4.60	4.60	4.50	4.40	4.20	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.30	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.30	3.20	3.20

3. TREASURY MANAGEMENT STRATEGY STATEMENT

Annual Investment Strategy

3.1 The Authority's Annual Investment Strategy, which is incorporated in the Treasury Management Strategy Statement (TMSS) was approved by the Authority on the 21 February 2022. It outlines the Authority's investment priorities as follows:

- Security of Capital
- Liquidity
- Yield

3.2 The Authority will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Authority's risk appetite. In the current economic climate it is considered appropriate to keep investments short-term to cover cash flow needs, but also 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.

3.3 As shown by the interest rate forecasts in section 2, rates have improved dramatically during Quarter 1 and Quarter of 2 2022 and are expected to improve further as Bank Rate continues to increase over the next year or so.

Creditworthiness

3.4 Significant levels of downgrades to Short and Long Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, as economies have reopened, there have been some instances of previous lowering of Outlooks being reversed.

3.5 A full list of investments held as at 31 December 2022 are shown in Appendix A.

3.6 The average level of funds available for investment purposes during the quarter was £38.157m (£40.441m at the end of Quarter 2). These funds were available on a temporary basis and the level of funds was dependent on the level of reserves, timing of precept payments, receipt of grants and progress on the Capital Programme.

Benchmark	Benchmark Return	Authority Performance	Investment interest to Quarter 3
3 Month SONIA	2.74%	4.05%	£0.232m.

3.7 As illustrated above, the Authority out-performed the 3-month Sterling Overnight Index Average (SONIA) benchmark by 1.31bp. SONIA replaced LIBID at the end of December and has traded at a higher average rate than the LIBID benchmarks. Based on current market deposit rates on offer, it is currently anticipated that the actual investment return for the whole of 2022-23 will over recover the Authority's budgeted investment target of £0.100m by £0.715m.

Borrowing Strategy

<u>Prudential Indicators</u>

3.8 It is a statutory duty for the Authority to determine and keep under review the "Affordable Borrowing Limits". The Authority's approved Prudential Indicators (affordability limits) are outlined in the approved TMSS.

3.9 A full list of the approved limits (as amended) are included in the Financial Performance Report 2022-23, considered elsewhere on the agenda, which confirms that no breaches of the Prudential Indicators were made in the period to September 2022 and that there are no concerns that they will be breached during the financial year.

Current external borrowing

3.10 The Authority has not taken any external loans since June 2012 and has been using cash resources to meet any capital expenditure. The amount of outstanding external borrowing as at 31 December 2022 was £24.711m, forecast to reduce to £24.264m by the end of the financial year as a result of standard loan repayments. All of this debt is at fixed rate with the remaining principal having an average rate of 4.25% and average life of 23.3 years.

Loan Rescheduling

3.11 No debt rescheduling was undertaken during the quarter. As per previous updates, the Authority will continue to work closely with our treasury advisors to explore any opportunities to repay existing loans, however the differential between current Public Works Loan Board early repayment rates and new loan rates, mean there is no financial benefit in undertaking premature loan repayment at this time. A number of options were run during Q2 2022 and will be kept under review, especially as bank rates are on an upward trajectory.

New Borrowing

3.12 Gilt yields and PWLB rates were on a rising trend between 1st April and 30th September 2022 but have fallen back from their September peaks in Quarter 3.

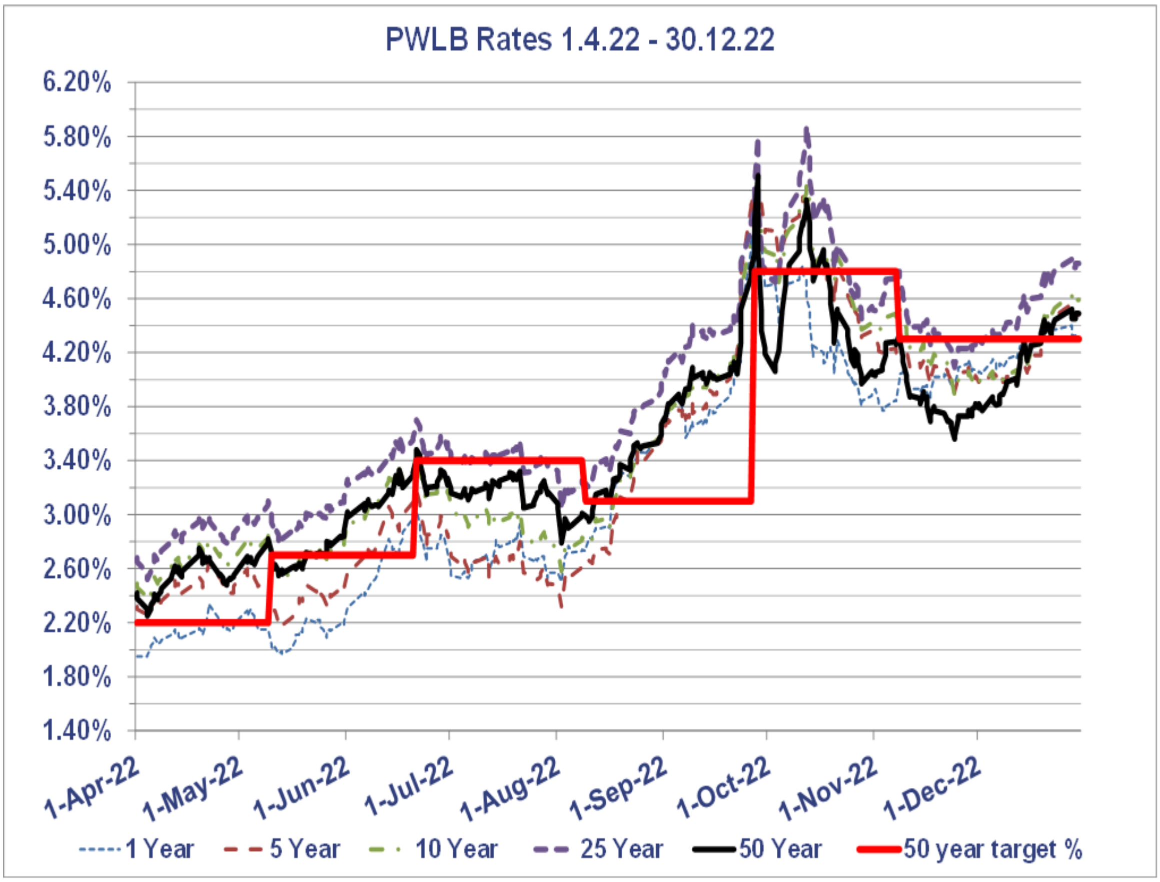
3.13 The 50-year PWLB target certainty rate for new long-term borrowing started 2022/23 at 2.20% before increasing to a peak of 4.80% in September and then latterly reducing to 4.30% in November

3.14 No new borrowing was undertaken during the quarter and none is planned during 2022-23 as a result of the Authority's adopted financial strategy to utilise revenue funds (revenue budget and reserves) to finance capital investment needs for the medium term.

3.15 PWLB rates quarter ended 31 Dec ember 2022:

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.45%	5.88%	5.51%
Date	28/09/2022	28/09/2022	12/10/2022	12/10/2022	28/09/2022
Average	3.26%	3.41%	3.57%	3.85%	3.51%
Spread	3.16%	3.26%	3.09%	3.36%	3.26%

3.16 Borrowing rates for this quarter are shown below.



<u>Borrowing in Advance of Need</u>

3.17 The Authority has not borrowed in advance of need during this quarter.

4. SUMMARY AND RECOMMENDATION

4.1. In compliance with the requirements of the Chartered Institute of Public Finance and Accountancy Code of Practice of Treasury Management, this report provides the Committee with the first quarter report on treasury management activities for 2022-23 to December 2022. As is indicated in this report, none of the Prudential Indicators have been breached, and a prudent approach has been taken in relation to investment decisions taken so far, with priority being given to liquidity and security over yield. Whilst investment returns are recovering as a result of the increase in interest rates, the Authority is still anticipating that investment returns will meet the budgeted target, as rates were forecast to rise when the budget was set.

SHAYNE SCOTT
Treasurer

Investments as at 31 December 2022						
Counterparty	**Maximum to be invested**	**Amount Invested**	**Maturity Date**	**Call or Term**	**Period invested**	**Interest rate(s)**
	£m	£m				
First Abu Dhabi Bank	7.000	-4.000	23/03/2023	T	6 mths	2.01%
Standered Chartered Sustainable	7.000	-2.000	06/01/2023	T	6 mths	2.11%
National Bank of Kuwait (International) PLC	7.000	-5.000	27/01/2023	T	12 mths	2.57%
Lloyds Bank	7.000	-2.000	27/02/2023	T	12 mths	3.00%
Heleba	7.000	-3.000	27/02/2023	T	12 mths	2.93%
Heleba	7.000	-2.000	08/09/2023	T	6 mths	4.01%
First Abu Dhabi Bank	7.000	-3.000	04/10/2023	T	6 mths	4.99%
Bayerische Landesbank	7.000	-1.000	04/04/2023	T	6 mths	4.08%
Goldman Sachs	7.000	-5.000	22/05/2023	T	4 mths	4.01%
Standered Chartered Sustainable	7.000	-2.000	28/04/2023	T	12 mths	3.91%
National Bank of Canada	7.000	-1.000	22/05/2023	T	12 mths	4.07%
Barclays Bank	8.000	-0.150		C	Instant Access	Variable
Aberdeen Standard	8.000	-0.635		C	Instant Access	Variable
Total Amount Invested		**-30.785**				