REPORT REFERENCE NO.	**RC/23/12**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**5 SEPTEMBER 2023**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2023-24 – QUARTER 1**
LEAD OFFICER	**Director of Finance and Corporate Service (Treasurer)**
RECOMMENDATIONS	***That the performance in relation to the treasury management activities of the Authority for 2023-24 (to June 2023) 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 30 June 2023.
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 15 February 2023 – Minute DSFRA/28D 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:

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

1.2. 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.

1.3. 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."

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

2. ECONOMICS UPDATE

2.1. The first quarter of 2023/24 saw:

- A 0.2% month on month (m/m) rise in real Gross Domestic Product (GDP) in April 2023, partly due to fewer strikes;
- Consumer Proce inflation (CPI) inflation falling from 10.1% to 8.7% in April 2023, before remaining at 8.7% in May 2023. This was the highest reading in the G7;
- Core CPI inflation rise in both April and May 2023, reaching a new 31-year high of 7.1%;
- A tighter labour market in April 2023, as the 3m/yy growth of average earnings rose from 6.1% to 6.5%;

- Interest rates rise by a further 75 base points (bps) over the quarter, taking Bank Rate from 4.25% to 5.00%;
- 10-year gilt yields nearing the “mini-Budget” peaks, as inflation surprised to the upside.

2.2. The economy has weathered the drag from higher inflation better than was widely expected. The 0.2% m/m rise in real GDP in April, following March’s 0.3% m/m contraction will further raise hopes that the economy will escape a recession this year. Some of the strength in April was due to fewer strikes by train workers and teachers in that month. Moreover, some of the falls in activity in other areas in April were probably temporary too. Strikes by junior doctors and civil servants contributed to the fall in health output (0.9% m/m) and the meagre 0.1% m/m increase in public administration.

2.3. The fall in the composite Purchasing Managers Index (PMI) from 54.0 in May 2023 to a three-month low of 52.8 in June (>50 points to expansion in the economy, <50 points to contraction) was worse than the consensus forecast of 53.6. Both the services and manufacturing PMIs fell. The decline in the services PMI was bigger (from 55.2 to 53.7), but it remains consistent with services activity expanding by an annualised 2%. The fall in the manufacturing PMI was smaller (from 47.1 to 46.2), but it is consistent with the annual rate of manufacturing output falling from -0.8% in April to around -5.0%. At face value, the composite PMI points to the 0.1% quarter on quarter (q/q) rise in GDP in Quarter 1 of 2023 being followed by a 0.2% q/q gain in Quarter 2 of 2023.

2.4. Meanwhile, the 0.3% m/m rise in retail sales volumes in May was far better than the consensus forecast of a 0.2% m/m decline and followed the robust 0.5% m/m rise in April. Some of the rise was due to the warmer weather. Indeed, the largest move was a 2.7% m/m jump in non-store sales, due to people stocking up on outdoor-related goods. But department stores also managed to squeeze out a 0.6% m/m rise in sales and the household goods sub-sector enjoyed a reasonable performance too. Overall, the figures were far better than analysts had expected. In addition, the Growth from Knowledge (GfK) measure of consumer confidence rebounded from -27 to a 17-month high of -24 in June 2023.

2.5. 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. Furthermore, higher interest rates will mean GDP is likely to contract later this year. Our central assumption is that inflation will drop to the 2.0% target only if 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. Colleagues at Capital Economics estimate that around 60% of the drag on real activity from the rise in rates has yet to bite, and the drag on the quarterly rate of real GDP growth over the next year may be about 0.2ppts bigger than over the past year.

2.6. The labour market became tighter over the quarter and wage growth reaccelerated. Labour demand was stronger than the consensus had expected. The three-month change in employment rose from +182,000 in March to +250,000 in April. Meanwhile, labour supply continued to recover as the size of the labour force grew by 303,000 in the three months to April. That was supported by a further 140,000 decline in inactivity as people returned to work from retirement and caring responsibilities (while inactivity due to long-term sick continued to rise). But it was not enough to offset the big rise in employment, which meant the unemployment rate fell from 3.9% to 3.8%.

2.7. The tighter labour market supported wage growth in April 2023, although the 9.7% rise in the National Living Wage on 1st April 2023 (compared to the 6.6% increase in April last year) probably had a lot to do with it too. The 3myy rate of average earnings growth reaccelerated from 6.1% to 6.5% (consensus 6.1%) and UK wage growth remains much faster than in the US and the Euro-zone. In addition, regular private sector wage growth increased from 7.1% 3myy to 7.6%, which left it well above the Bank's forecast for it to fall below 7.0%. Overall, the loosening in the labour market appears to have stalled in April and regular private sector wage growth was well above the Bank's forecast.

2.8. CPI inflation stayed at 8.7% in May 2023 (consensus 8.4%) and, perhaps more worryingly, core CPI inflation rose again, from 6.8% to a new 31-year high of 7.1%. The rise in core inflation built on the leap from 6.2% in March 2023 to 6.8% and means it is accelerating in the UK while it is slowing in the US and the Euro-zone (both fell to 5.3%). A further decline in fuel inflation, from -8.9% to -13.1%, and the second fall in food inflation in as many months, from 19.3% to 18.7%, explained why overall CPI inflation didn't rise. And the scheduled fall in the average annual utility price from £2,500 to £2,074 on 1st July 2023 means overall CPI inflation will probably ease in the coming months. But the problem is that the recent surge in core inflation and the reacceleration in wage growth shows that domestic inflationary pressures are still strengthening.

2.9. This suggests the Bank may have more work to do than the Federal Bank (Fed) or European Central Bank (ECB). Indeed, the Bank of England sounded somewhat hawkish in the June 2023 meeting. This came through most in the Monetary Policy Committee's (MPC's) 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.

2.10. That said, the Bank has not committed to raising rates again or suggested that 50bps rises are now the norm. What it did say was that "the scale of the recent upside surprises in official estimates of wage growth and services CPI inflation suggested a 0.5 percentage point increase in interest rates was required at this particular meeting". Moreover, the Committee did not strengthen its forward guidance that any further rate hikes would be conditional on the data.

2.11. It looks highly probable, however, given the on-going strength of inflation and employment data, that the Bank will need to raise rates to at least 5.5% and to keep rates at their peak until the mid-point of 2024. We still think it is only a matter of time before the rise in rates weakens the economy sufficiently to push it into recession. That is why instead of rising to between 6.00%-6.25%, as is currently priced in by markets, we think rates are more likely to peak between 5.50-6.00%. Our forecast is also for rates to be cut in the second half of 2024, and we expect rates to then fall further than markets are pricing in.

2.12. Growing evidence that UK price pressures are becoming increasingly domestically generated has driven up market interest rate expectations and at one point pushed the 10-year gilt yield up to 4.49% in late June, very close to its peak seen after the “mini-budget”. Yields have since fallen slightly back to 4.38%. But growing expectations that rates in the UK will remain higher for longer than in the US mean they are still more than 70 bps above US yields. While higher interest rates are priced into the markets, the likely dent to the real economy from the high level of interest rates is not. That’s why we think there is scope for market rate expectations to fall back in 2024 and why Link expect the 10-year Public Loans Works Board (PWLB) Certainty Rate to drop back from c.5.20% to 5.00% by the end of 2023 and to 4.20% by the end of 2024.

2.13. The pound strengthened from $1.24 at the start of April 2023 to a one-year high at $1.26 in early May 2023, which was partly due to the risks from the global banking issues being seen as a bigger problem for the US than the UK. The pound then fell back to $1.23 at the end of May, before rising again to $1.28 in the middle of June 2023 as the strong core CPI inflation data released in June suggested the Bank of England was going to have to raise rates more than the Fed or ECB in order to tame domestic inflation. However, sterling’s strong run may falter because more hikes in the near term to combat high inflation are likely to weaken growth (and, hopefully, at some point inflation too) to such a degree that the policy rate will probably be brought back down, potentially quite quickly, as the economic cycle trends downwards decisively. This suggests that additional rate hikes are unlikely to do much to boost the pound.

2.14. In early April 2023, investors turned more optimistic about global GDP growth, pushing up UK equity prices. But this period of optimism appears to have been short-lived. The FTSE 100 has fallen by 4.8% since 21st April, from around 7,914 to 7,553, reversing part of the 7.9% rise since 17th March. Despite the recent resilience of economic activity, expectations for equity earnings have become a bit more downbeat. Nonetheless, further down the track, more rate cuts than markets anticipate should help the FTSE 100 rally.

MPC Meetings 11th May and 22nd June 2023

2.15. On 11th May 2023, the Bank of England’s Monetary Policy Committee (MPC) increased Bank Rate by 25 basis points to 4.50%, and on 22nd June 2023, 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.

2.16. 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. Talk of the Bank's inflation models being "broken" is perhaps another reason why gilt investors are demanding a premium relative to US and Euro-zone bonds, for example.

2.17. Of course, what happens outside of the UK is also critical to movement in gilt yields. The US Federal Open Market Committee (FOMC) has already hiked short-term rates to a range of 5.00%-5.25%, but a further increase is pencilled in for July 2023, whilst the ECB looks likely to raise its Deposit rate at least once more to a peak of 3.75%, with upside risk of higher to come.

Interest Rate Forecasts

2.18. 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 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.

2.19. 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.

2.20. You will note that our 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.

2.21. The current and previous PWLB rate forecasts below are based on the Certainty Rate.

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
BANK RATE	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

A Summary Overview of The Future Path of Bank Rate

2.22. Our 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, we anticipate 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.

2.23. Moreover, we also still anticipate 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. Our current judgment is that rates will have to increase and stay at their peak until the second quarter of 2024 as a minimum.

2.24. In the upcoming months, our 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.

2.25. 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 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.

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 15 February 2023. 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. (Amend if you use your own creditworthiness approach.)

3.3. As shown by the interest rate forecasts in section 2, rates have improved dramatically during Quarter 1 and Quarter 2 of 2023 and are expected to improve further as Bank Rate continues to increase over the next year or so.

Creditworthiness

3.4. The Authority will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity, aligned with the Authority'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. (Amend if you use your own creditworthiness approach.)

3.5. As shown by the charts below and 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.

3.6. 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.

Benchmark	Benchmark Return	Authority Performance	Investment interest to Quarter 1
3 Month SONIA	4.38%	4.87%	£0.028m.

3.7. As illustrated above, the Authority outperformed the 3-month Sterling Overnight Index Average (SONIA) benchmark by 0.49bp. SONIA replaced LIBID at the end of December 2022 and has traded at a higher average rate than the previous LIBID benchmarks. Based on current market deposit rates on offer, it is currently anticipated that the actual investment return for the whole of 2023-24 will over recover the Authority's budgeted investment target of £0.525m by £0.807m. However, there is much volatility with interest rates at the moment, so this forecast is likely to be revised.

Borrowing Strategy

Prudential Indicators:

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 2023-24, considered elsewhere on the agenda for this meeting, which confirms that no breaches of the Prudential Indicators were made in the period to June 2023 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 30 June 2023 was £24.264m, forecast to reduce to £23.771m 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 23.2 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 Q1 2022 and will be kept under review. Savings could materialise following the increases in the UK Bank Rate.

New Borrowing

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

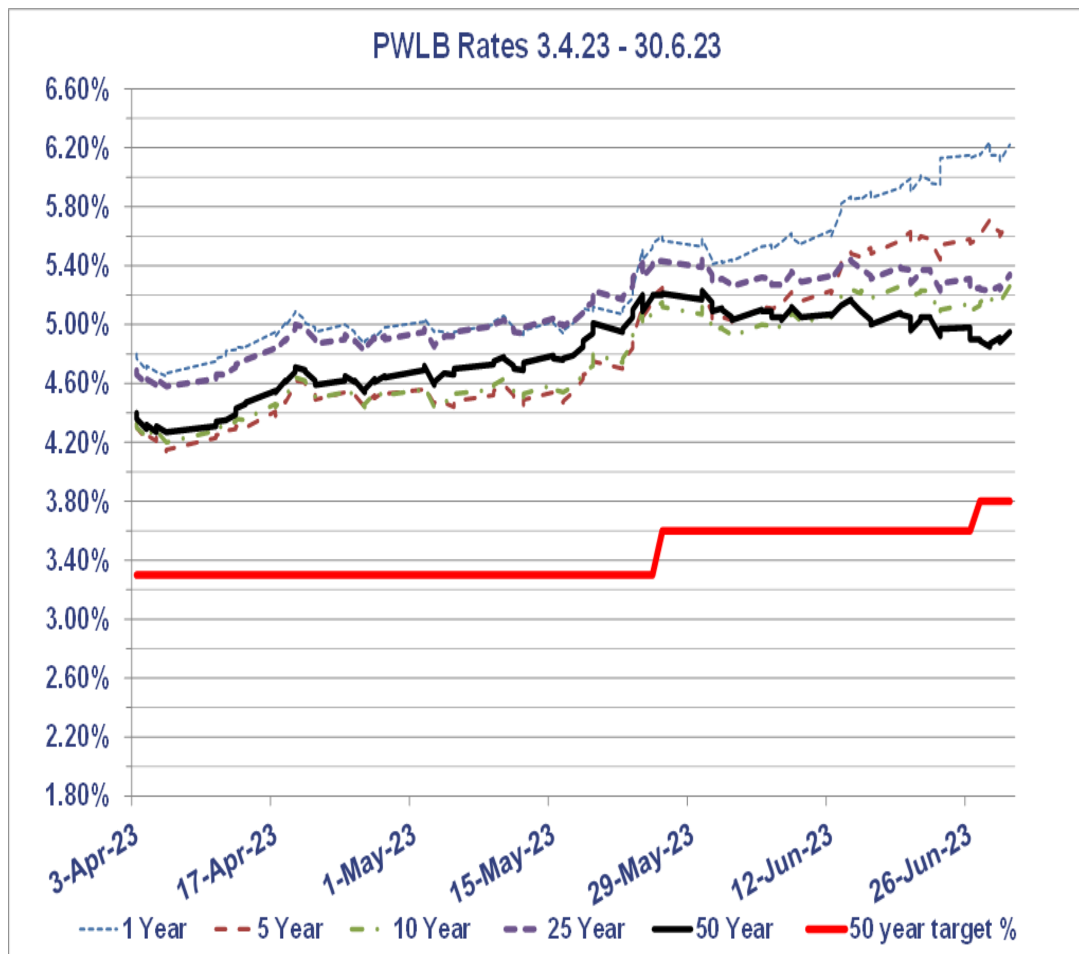
3.13. The 50-year PWLB target certainty rate for new long-term borrowing started 2023/24 at 3.30% before increasing to a peak of 5.23% in June. As can be seen, with rates elevated across the whole of the curve, it is advised to not borrow long-term unless the Authority wants certainty of rate and judges the cost to be affordable.

3.14. No new borrowing was undertaken during the quarter, and none is planned during 2023-24 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.

PWLB rates quarter ended 30 June 2023

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.65%	4.14%	4.20%	4.58%	4.27%
Date	06/04/2023	06/04/2023	06/04/2023	06/04/2023	05/04/2023
High	6.24%	5.71%	5.28%	5.44%	5.23%
Date	28/06/2023	28/06/2023	20/06/2023	30/05/2023	30/05/2023
Average	5.32%	4.87%	4.78%	5.09%	4.82%
Spread	1.59%	1.57%	1.08%	0.86%	0.96%

3.15. Borrowing rates for this quarter are shown below:



Borrowing in Advance of Need

3.16. 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 2023-24 to June 2023. 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 high 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
Director of Finance and Corporate Services (Treasurer)

APPENDIX A TO REPORT RC/23/12

Investments as at 30 June 2023						
Counterparty	Maximum to be invested	Amount Invested	Maturity Date	Call or Term	Period invested	Interest rate(s)
	£m	£m				
National Bank of Canada	7.000	-2.000	19/07/2023	T	6 mths	4.32%
Bayerische Landesbank	7.000	-2.000	31/07/2023	T	5 mths	4.19%
Lloyds	7.000	-1.000	30/08/2023	T	4 mths	4.74%
Helaba	7.000	-2.000	08/09/2023	T	12 mths	4.01%
First Abu Dhabi	7.000	-3.000	04/10/2023	T	12 mths	4.99%
Bayerische Landesbank	7.000	-3.000	31/08/2023	T	3 mths	4.56%
Bayerische Landesbank	7.000	-2.000	29/09/2023	T	4 mths	4.65%
Helaba	7.000	-2.000	29/02/2024	T	9 mths	5.31%
Natwest	7.000	-5.000	30/11/2023	T	5 mths	5.52%
Nationwide	7.000	-4.000	21/12/2023	T	6 mths	5.09%
Barclays Bank	8.000	-0.150		C	Instant Access	Variable
Aberdeen Standard	8.000	-7.190		C	Instant Access	Variable
Black Rock	8.000	-0.974		C	Instant Access	Variable
Total Amount Invested		**-34.314**				