

REPORT REFERENCE NO.	RC/23/17
MEETING	RESOURCES COMMITTEE
DATE OF MEETING	22 NOVEMBER 2023
SUBJECT OF REPORT	TREASURY MANAGEMENT PERFORMANCE 2023-24 – QUARTER 2
LEAD OFFICER	Director of Finance and Corporate Service (Treasurer)
RECOMMENDATIONS	<i>That the performance in relation to the treasury management activities of the Authority for 2023-24 (to September 2023) be noted.</i>
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	A. Investments held as at 30 September 2023. B. A detailed look on how the economy fared during Quarter 2 of 2023/24.
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; and
- 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 half of 2023/24 saw:

- Interest rates rise by a further 100 base points (bps), taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle;
- Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside;
- A 0.5% month on month (m/m) decline in real GDP in July, mainly due to more strikes;
- Consumer Price index (CPI) inflation falling from 8.7% in April 2023 to 6.7% in August 2023, its lowest rate since February 2022, but still the highest in the G7;

- Core CPI inflation declining to 6.2% in August 2023 from 7.1% in April and May 2023, a then 31 years high; and
- A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3myy growth of average earnings rose to 7.8% in August, excluding bonuses).

2.2. Further detail on the economy can be found within Appendix B of this report.

3. INTEREST RATE FORECASTS

3.1. 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 Loans 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.

3.2. The latest forecast on 25th September 2023 sets out a view that short, medium and long-dated interest rates will be elevated for some while, as the Bank of England seeks to squeeze inflation out of the economy.

3.3. The Public Works Loans Board (PWLB) rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps, calculated as gilts plus 80bps) which has been accessible to most authorities since 1st November 2012.

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

Link Group Interest Rate View	25.09.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.00	2.75	2.75	2.75	2.75	2.75
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.00	2.80	2.80	2.80	2.80	2.80
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.10	2.90	2.90	2.90	2.90	2.90
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.20	3.00	3.00	3.00	3.00	3.00
5 yr PWLB	5.10	5.00	4.90	4.70	4.40	4.20	4.00	3.90	3.70	3.70	3.60	3.60	3.50
10 yr PWLB	5.00	4.90	4.80	4.60	4.40	4.20	4.00	3.80	3.70	3.60	3.60	3.50	3.50
25 yr PWLB	5.40	5.20	5.10	4.90	4.70	4.40	4.30	4.10	4.00	3.90	3.80	3.80	3.80
50 yr PWLB	5.20	5.00	4.90	4.70	4.50	4.20	4.10	3.90	3.80	3.70	3.60	3.60	3.60

4. TREASURY MANAGEMENT STRATEGY STATEMENT

Annual Investment Strategy

- 4.1. 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

- 4.2. 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.)

Creditworthiness

- 4.3. Following the Government's fiscal event on 23rd September 2022, rating agencies placed the UK sovereign debt rating on Negative Outlook, reflecting a downside bias to the current ratings in light of expectations of weaker finances and a challenging economic outlook. Nothing further has evolved in the first half of 2023/24.

Benchmark	Benchmark Return	Authority Performance	Investment interest to Quarter 2
3 Month SONIA	5.09%	5.15%	£0.429m.

- 4.4. As illustrated above, the Authority outperformed the 3-month Sterling Overnight Index Average (SONIA) benchmark by 0.06bp. 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 £1.055m. However, there is much volatility with interest rates at the moment, so this forecast is likely to be revised.

Borrowing Strategy

Prudential Indicators:

- 4.5. 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.

- 4.6. A full list of the approved limits (as amended) are included in the Financial Performance Report 2023-24, considered elsewhere on the agenda, which confirms that no breaches of the Prudential Indicators were made in the period to September 2023 and that there are no concerns that they will be breached during the financial year.

Current external borrowing

- 4.7. 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 September 2023 was £24.217m, 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 23.0 years.

Loan Rescheduling

- 4.8. 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.

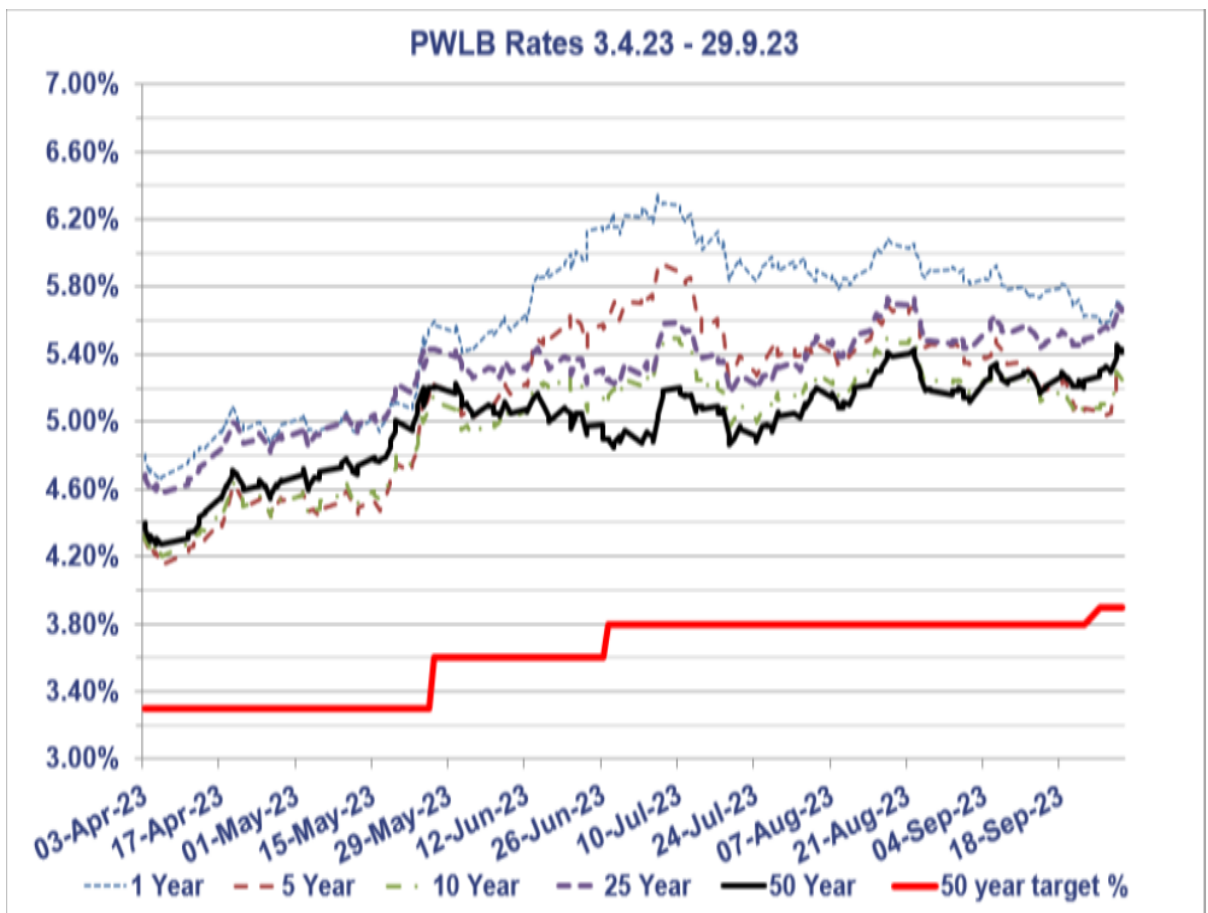
New Borrowing

- 4.9. Gilt yields and PWLB certainty rates were on a generally rising trend throughout the first half of 2023/24. At the beginning of April, the 5-year rate was the cheapest part of the curve and touched 4.14% whilst the 25-year rate was relatively expensive at 4.58%.
- 4.10. July 2023 saw short-dated rates peak at their most expensive. The 1-year rate spiked to 6.36% and the 5-year rate to 5.93%. Although, in due course, short-dated rate expectations fell, the medium dates shifted higher through August and the 10-year rate pushed higher to 5.51% and the 25-year rate to 5.73%. The 50-year rate was 4.27% on 5th April but rose to 5.45% on 28th September.
- 4.11. It is forecast that rates will fall back over the next two to three years as inflation dampens. The CPI measure of inflation is expected to fall below 2% in the second half of 2024, and we forecast 50-year rates to stand at 3.90% by the end of September 2025. However, there is considerable gilt issuance to be digested by the market over the next couple of years, as a minimum, so there is a high degree of uncertainty as to whether rates will fall that far.

PWLB rates quarter ended 29 September 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	6.36%	5.93%	5.51%	5.73%	5.45%
Date	06/07/2023	07/07/2023	22/08/2023	17/08/2023	28/09/2023
Average	5.62%	5.16%	5.01%	5.29%	5.00%
Spread	1.71%	1.79%	1.31%	1.15%	1.18%

4.12. Borrowing rates for this quarter are shown below.



Borrowing in Advance of Need

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

5. SUMMARY AND RECOMMENDATION

- 5.1. 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 30th September 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/23/17

Investments as at 30 September 2023						
Counterparty	Maximum to be invested	Amount Invested	Maturity Date	Call or Term	Period invested	Interest rate(s)
	£m	£m				
First Abu Dhabi	7.000	-3.000	04/10/2023	T	12 mths	4.99%
NatWest	7.000	-5.000	30/11/2023	T	5 mths	5.52%
Nationwide	7.000	-4.000	21/12/2023	T	4 mths	5.09%
National Bank of Canada	7.000	-2.000	29/01/2024	T	6 mths	5.87%
National Bank of Canada	7.000	-2.000	19/01/2024	T	6 mths	5.72%
Heleba	7.000	-2.000	29/02/2024	T	9 mths	5.31%
National Bank of Canada	7.000	-3.000	29/02/2024	T	6 mths	5.77%
Heleba	7.000	-3.000	26/07/2024	T	12 mths	5.97%
Heleba	7.000	-2.000	06/09/2024	T	12 mths	5.87%
Barclays Bank	8.000	-0.150		C	Instant Access	Variable
Aberdeen Standard	8.000	-5.400		C	Instant Access	Variable
Black Rock	8.000	-5.780		C	Instant Access	Variable
Total Amount Invested		-37.330				

A detailed update on the economy for Quarter 2 2023/24

- The 0.5% m/m fall in Gross Domestic Product (GDP) in July 2023 suggests that underlying growth has lost momentum since earlier in the year. Some of the weakness in July was due to there being almost twice as many working days lost to strikes in July (281,000) than in June (160,000). But with output falling in 10 out of the 17 sectors, there is an air of underlying weakness.
- The fall in the composite Purchasing Managers Index from 48.6 in August 2023 to 46.8 in September left it at its lowest level since COVID-19 lockdowns reduced activity in January 2021. At face value, it is consistent with the 0.2% q/q rise in real GDP in the period April to June 2023, being followed by a contraction of up to 1% in the second half of 2023.
- The 0.4% m/m rebound in retail sales volumes in August 2023 is not as good as it looks as it partly reflected a pickup in sales after the unusually wet weather in July 2023. Sales volumes in August 2023 were 0.2% below their level in May, suggesting much of the resilience in retail activity in the first half of the year has faded.
- As the growing drag from higher interest rates intensifies over the next six months, we think the economy will continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year. And with CPI inflation past its peak and expected to decline further, the economy has got through the cost-of-living crisis without recession. But even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. We expect the Bank of England to keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.
- The tightness of the labour market continued to ease, with employment in the three months to July falling by 207,000. The further decline in the number of job vacancies from 1.017m in July 2023 to 0.989m in August 2023 suggests that the labour market has loosened a bit further since July. That is the first time it has fallen below 1m since July 2021. At 3.0% in July, and likely to have fallen to 2.9% in August, the job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth. Meanwhile, the 48,000 decline in the supply of workers in the three months to July offset some of the loosening in the tightness of the labour market. That was due to a 63,000 increase in inactivity in the three months to July 2023 as more people left the labour market due to long term sickness or to enter education. The supply of labour is still 0.3% below its pre-pandemic February 2020 level.

- But the cooling in labour market conditions still has not fed through to an easing in wage growth. While the monthly rate of earnings growth eased sharply from an upwardly revised +2.2% in June 2023 to -0.9% in July 2023, a lot of that was due to the one-off bonus payments for NHS staff in June 2023 not being repeated in July 2023. The headline 3myy rate rose from 8.4% (revised up from 8.2%) to 8.5%, which meant UK wage growth remains much faster than in the US and in the Euro-zone. Moreover, while the Bank of England's closely watched measure of regular private sector wage growth eased a touch in July, from 8.2% 3myy in June 2023 to 8.1% 3myy, it is still well above the Bank of England's prediction for it to fall to 6.9% in September.
- CPI inflation declined from 6.8% in July 2023 to 6.7% in August 2023, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.2%. That reverses all the rise since March 2023 and means the gap between the UK and elsewhere has shrunk (US core inflation is 4.4% and in the Euro-zone it is 5.3%). Core goods inflation fell from 5.9% to 5.2% and the further easing in core goods producer price inflation, from 2.2% in July 2023 to a 29-month low of 1.5% in August, suggests it will eventually fall close to zero. But the really positive development was the fall in services inflation from 7.4% to 6.8%. That also reverses most of the rise since March 2023 and takes it below the forecast of 7.2% the Bank of England published in early August 2023.
- In its latest monetary policy meeting on 20 September 2023, the Bank of England left interest rates unchanged at 5.25%. The weak August CPI inflation release, the recent loosening in the labour market and the downbeat activity surveys appear to have convinced the Bank of England that it has already raised rates far enough. The minutes show the decision was "finely balanced". Five Monetary Policy Committee (MPC) members (Bailey, Broadbent, Dhingra, Pill and Ramsden) voted for no change and the other four (Cunliffe, Greene, Haskel and Mann) voted for a 25bps hike.
- Like the US Federal Bank, the Bank of England wants the markets to believe in the higher for longer narrative. The statement did not say that rates have peaked and once again said if there was evidence of more persistent inflation pressures "further tightening in policy would be required". Governor Bailey stated, "we'll be watching closely to see if further increases are needed". The Bank also retained the hawkish guidance that rates will stay "sufficiently restrictive for sufficiently long".
- This narrative makes sense as the Bank of England does not want the markets to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments. A rebound in services inflation, another surge in wage growth and/or a further leap in oil prices could conceivably force it to raise rates at the next meeting on 2nd November 2023, or even pause in November and raise rates in December 2023.

- The yield on 10-year Gilts fell from a peak of 4.74% on 17th August 2023 to 4.44% on 29th September 2023, mainly on the back of investors revising down their interest rate expectations. But even after their recent pullback, the rise in Gilt yields has exceeded the rise in most other Developed Market government yields since the start of the year. Looking forward, once inflation falls back, Gilt yields are set to reduce further. A (mild) recession over the next couple of quarters will support this outlook if it helps to loosen the labour market (higher unemployment/lower wage increases).
- The pound weakened from its cycle high of \$1.30 in the middle of July 2023 to \$1.21 in late September 2023. In the first half of the year, the pound bounced back strongly from the Truss debacle last autumn. That rebound was in large part driven by the substantial shift up in UK interest rate expectations. However, over the past couple of months, interest rate expectations have dropped sharply as inflation started to come down, growth faltered, and the Bank of England called an end to its hiking cycle.
- The FTSE 100 has gained more than 2% since the end of August, from around 7,440 on 31st August to 7,608 on 29th September 2023. The rebound has been primarily driven by higher energy prices which boosted the valuations of energy companies. The FTSE 100's relatively high concentration of energy companies helps to explain why UK equities outperformed both US and Euro-zone equities in September 2023. Nonetheless, as recently as 21st April the FTSE 100 stood at 7,914.