

REPORT REFERENCE NO.	RC/24/14
MEETING	RESOURCES COMMITTEE
DATE OF MEETING	30 SEPTEMBER 2024
SUBJECT OF REPORT	TREASURY MANAGEMENT PERFORMANCE 2024-25 – QUARTER 1
LEAD OFFICER	Head of Finance (Treasurer)
RECOMMENDATIONS	<i>That the performance in relation to the treasury management activities of the Authority for 2024-25 (to June 2024) 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 June 2024.
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 16 February 2024 – Agenda DSFRAC/25/5 – item 10c 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;and
- 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 first quarter of 2024-25 saw:

- Gross Domestic product (GDP) growth flatlining in April 2024 following a positive quarter 4 of 2023/24 growth figures of 0.7% quarter on quarter (q/q);
- A stalling in the downward trend in wage growth, with the headline 3-month year on year (myy) rate staying at 5.9% in April 2024;
- Consumer Price Index (CPI) inflation falling from 2.3% in April 2024 to 2.0% in May 2024;
- Core CPI inflation decreasing from 3.9% in April to 3.5% in May 2024;

- The Bank of England holding rates at 5.25% in May and June 2024; and
- 10-year gilt yields climbing to 4.35% in April 2024, before closing out at 4.32% in May 2024.

- 2.2. The news that the economy grew by 0.7% q/q in quarter 4 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 2024 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 2024 to 51.7 in June 2024 confirms tepid growth.
- 2.3. On a more positive note, the 2.9% m/m increase in retail sales volumes in May 2024 more than reversed the 1.8% m/m drop in April 2024 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 was likely to be reduced soon and with consumer confidence improving, retail sales may well continue to strengthen.
- 2.4. 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. 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).
- 2.5. Nonetheless, the on-going stickiness of wage growth in April 2024 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 2024 to 5.1% in June 2024 looking a challenge.

- 2.6. Despite the stickiness of wage growth in April 2024, 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 2024 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 2024 as the UK's disappointing labour market participation performance since the pandemic continued. The vacancies data also paints 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.
- 2.7. The fall in CPI inflation in May 2024 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 2024, 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 2024 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.
- 2.8. The core 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.
- 2.9. There was little chance that the Bank would cut rates at its June 2024 meeting, given upside surprises on services CPI inflation and wage growth. But several developments implied a rate cut is getting closer (August 2024 potentially). First, two members of the Monetary Policy Committee (MPC), Ramsden and Dhingra voted again to reduce rates immediately to 5.00%. Secondly, 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. 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".
- 2.10. Throughout the quarter there was a degree of volatility in the gilt market and, by way of example, the 10-year gilt yield rose from 4.05% on 2nd April 2024 to finish at 4.15% on 28th June 2024 but it has exceeded 4.30% on several occasions. Overall, investors judged that interest rates will need to remain high for longer to keep inflation around the 2.0% target.

- 2.11. Meanwhile, the Financial Times Stock Exchange (FTSE) 100 broke through the 8,000 mark in April 2024 for the first time since its brief three-day flutter in February 2023 and reached a record closing high of 8,446 on 15th May 2024. However, by the end of the quarter, despite AI-fuelled rises in the US S&P500, it finished rather tamely and had fallen back to 8,164. Arguably, significant interest rate cuts and an on-going UK economic recovery will be required for a further resurgence to take hold.

3. MPC MEETINGS 9TH MAY AND 20TH JUNE 2024

- 3.1. On 9th May 2024, 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 2024.
- 3.2. Nonetheless, with UK CPI inflation now back at 2% and set to fall further over the coming months, Ramsden and Dhingra – who voted again to reduce rates immediately to 5.00% in June 2024 – 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”.

4. INTEREST RATE FORECASTS

- 4.1. 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.
- 4.2. The latest forecast, updated on 28th May 2024, 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 market.
- 4.3. Moreover, whatever the shape of domestic data, recent gilt market movements have been heavily influenced by the sentiment pertaining to US monetary policy. Again, inflation and labour data has proven sticky and the market's expectation for rate cuts has gradually reduced throughout the course of the year, so that possibly rates may not be cut more than once, or possibly twice, before the end of 2024. In any event, even if the Bank of England starts to cut rates first, it may mean that the medium and longer parts of the curve take longer to fully reflect any such action until the US yield curve shifts lower too. Given the potential inflationary upside risk to US treasuries if Trump wins the presidential election in November (increased tariffs on imports from China for example), therein lies a further risk to yields remaining elevated for longer.

- 4.4. Closer to home, 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 2024 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.
- 4.5. Accordingly, Link’s central case is still for a rate cut before the end of September, but it is not committed to whether it will be in August or September 2024. 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 H2 2026.
- 4.6. However, given the increased uncertainty surrounding Link’s central gilt market forecasts, and the significant issuance that will be on-going from several of the major central banks, it has marginally increased its PWLB forecasts by c20 to 30 basis points across the whole curve since the previous quarter.
- 4.7. In summary, regarding 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 (£200bn+ for each of the next few years). As noted at the Link March Strategic Issues webinars, there is upside risk to that part of our forecast despite the Debt Management Office skewing its issuance to the shorter part of the curve.

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

5. **TREASURY MANAGEMENT STRATEGY STATEMENT**

Annual Investment Strategy

5.1. The Authority's Annual Investment Strategy, which is incorporated in the Treasury Management Strategy Statement (TMSS) was approved by the Authority on the 16 February 2024. It outlines the Authority's investment priorities as follows:

Security of Capital

Liquidity

Yield

5.2. 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.

5.3. As shown by the charts below and the interest rate forecasts in section 3, investment rates remained elevated during the first quarter of 2024-25 but, are expected to fall back through the second half of 2024 as inflation reduces, the MPC will start to loosen monetary policy.

Creditworthiness

5.4. 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	5.20%	5.25%	£0.028m.

5.5. As illustrated above, the Authority outperformed the 3-month Sterling Overnight Index Average (SONIA) benchmark by 0.05bp. 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 2024-25 will match the Authority's budgeted investment target of £1.2m. However, there is much volatility with interest rates at the moment, so this forecast is likely to be revised.

Borrowing Strategy

Prudential Indicators:

- 5.6. 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.
- 5.7. A full list of the approved limits (as amended) are included in the Financial Performance Report 2024-25, considered elsewhere on the agenda, which confirms that no breaches of the Prudential Indicators were made in the period to June 2024 and that there are no concerns that they will be breached during the financial year.

Current external borrowing

- 5.8. 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 2024 was £23.771m, forecast to reduce to £23.313m by the end of the financial year as a result of contractual loan repayments. All of these existing loans are at fixed rate with the remaining principal having an average rate of 4.25% and average life of 22.6 years.

Loan Rescheduling

- 5.9. 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 Quarter 1 2022 and will be kept under review.

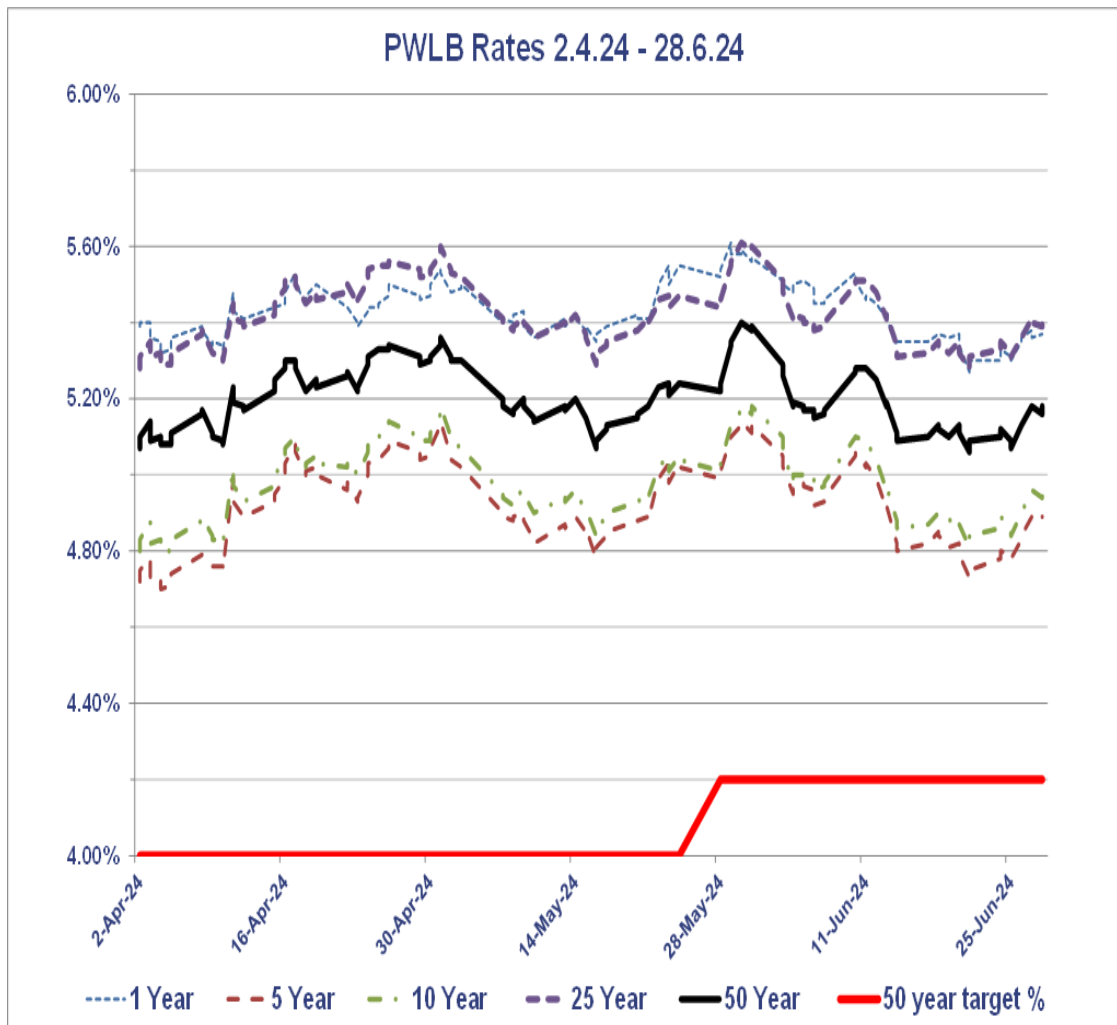
New Borrowing

- 5.10. Gilt yields and PWLB rates remained relatively stable between 1st April and 30th June 2024. Having said that, the spread between the low and high points during the quarter was between 0.3% and 0.45% across the curve.
- 5.11. 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.
- 5.12. No new borrowing was undertaken during the quarter, and none is planned during 2024-25 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 2024

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	5.27%	4.70%	4.80%	5.28%	5.06%
Date	21/06/2024	04/04/2024	02/04/2024	02/04/2024	21/06/2024
High	5.61%	5.14%	5.18%	5.61%	5.40%
Date	29/05/2024	01/05/2024	01/05/2024	30/05/2024	30/05/2024
Average	5.43%	4.92%	4.98%	5.42%	5.20%
Spread	0.34%	0.44%	0.38%	0.33%	0.34%

5.13. Borrowing rates for this quarter are shown overleaf.



Borrowing in Advance of Need

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

6. SUMMARY AND RECOMMENDATION

6.1.. 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 2024-25 to June 2024. 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.

ANDREW FURBEAR
Head of Finance (Treasurer)

APPENDIX A TO REPORT RC/24/14

Investments as at 30 June 2024						
Counterparty	Maximum to be invested	Amount Invested	Maturity Date	Call or Term	Period invested	Interest rate(s)
	£m	£m				
Lloyds	7.000	-2.000	05/07/2024	T	6 mths	5.35%
Heleba	7.000	-3.000	26/07/2024	T	12 mths	5.97%
National Bank of Canada	7.000	-2.000	30/08/2024	T	4 mths	5.21%
Heleba	7.000	-2.000	06/09/2024	T	12 mths	5.87%
Heleba	7.000	-1.000	02/10/2024	T	6 mths	5.26%
Aberdeen City Council	7.000	-5.000	21/11/2024	T	12 mth	5.60%
National Bank of Canada	7.000	-4.000	17/12/2024	T	6 mth	5.22%
Lloyds	7.000	-2.300	28/07/2024	T	1 mth	5.30%
Barclays Bank	8.000	-0.150		C	Instant Access	Variable
Aberdeen Standard	8.000	-4.150		C	Instant Access	Variable
Total Amount Invested		-25.600				