REPORT REFERENCE NO.	**RC/24/17**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**22 NOVEMBER 2024**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2024-25: QUARTER 2**
LEAD OFFICER	**Head of Finance (Treasurer)**
RECOMMENDATIONS	***That the performance in relation to the treasury management activities of the Authority for 2024-25 (to September 2024) 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	A. Investments held as at 30 September 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 (Treasury Management Strategy Statement (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 TMSS - 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.

- 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 second quarter of 2024 (July to September) saw:

- Gross Domestic Product (GDP) growth stagnating in July 2024 following downwardly revised Quarter 2 figures (0.5% quarter on quarter (q/q));
- A further easing in wage growth as the headline 3myy rate (including bonuses) fell from 4.6% in June 2024 to 4.0% in July;
- Consumer Price Index (CPI) inflation hitting its target in June 2024 before edging above it to 2.2% in July and August;
- Core CPI inflation increasing from 3.3% in July to 3.6% in August 2024;
- The Bank of England initiating its easing cycle by lowering interest rates from 5.25% to 5.0% in August 2024 and holding them steady in its September meeting;
- 10-year gilt yields falling to 4.0% in September 2024.

2.2. The economy's stagnation in June and July 2024 points more to a mild slowdown in GDP growth than a sudden drop back into a recession. Moreover, the drop in September's composite activity Purchasing Managers Index (PMI), from 53.8 in August 2024 to 52.9, was still consistent with GDP growth of 0.3%-0.4% for the summer months. This is in line with the Bank of England's view, and it was encouraging that an improvement in manufacturing output growth could be detected, whilst the services PMI balance suggests non-retail services output grew by 0.5% q/q in Quarter 3. Additionally, the services PMI future activity balance showed an uptick in September, although readings after the Chancellor's announcements at the Budget on 30th October 2024 will be more meaningful.

2.3. The 1.0% month on month (m/m) jump in retail sales in August 2024 was stronger than the consensus forecast for a 0.4% m/m increase. The rise was reasonably broad based, with six of the seven main sub sectors recording monthly increases, though the biggest gains came from clothing stores and supermarkets, which the Office for National Statistics (ONS) reported was driven by the warmer-than-usual weather and end of season sales. As a result, some of that strength is probably temporary.

2.4. The government's plans to raise public spending by around £16bn a year (0.6% GDP) have caused concerns that a big rise in taxes will be announced in the Budget, which could weaken GDP growth in the medium-term. However, if taxes are raised in line with spending (i.e., by £16bn) that would mean the overall stance of fiscal policy would be similar to the previous government's plan to reduce the budget deficit. Additionally, rises in public spending tend to boost GDP by more than increases in taxes reduce it. Colleagues at Capital Economics suggest GDP growth will hit 1.2% in 2024 before reaching 1.5% for both 2025 and 2026.

2.5. The further easing in wage growth will be welcomed by the Bank of England as a sign that labour market conditions are continuing to cool. The 3myy growth rate of average earnings fell from 4.6% in June to 4.0% in July 2024. On a three-month annualised basis, average earnings growth eased from 3.0% to 1.8%, its lowest rate since December 2023. Excluding bonuses, the 3myy rate fell from 5.4% to 5.1%.

2.6. Other labour market indicators also point to a further loosening in the labour market. The 59,000 fall in the alternative Pay as Your Earn (PAYE) measure of the number of employees in August marked the fourth fall in the past five months. And the 77,000 decline in the three months to August 2024 was the biggest drop since November 2020. Moreover, the number of workforce jobs fell by 28,000 in Quarter 2. The downward trend in job vacancies continued too. The number of job vacancies fell from 872,000 in the three months to July 2024 to 857,000 in the three months to August 2024. That leaves it 34% below its peak in May 2022, and just 5% above its pre-pandemic level. Nonetheless, the Bank of England is still more concerned about the inflationary influence of the labour market rather than the risk of a major slowdown in labour market activity.

2.7. CPI inflation stayed at 2.2% in August 2024, but services inflation rose from a two-year low of 5.2% in July 2024 to 5.6%, significantly above its long-run average of 3.5%. Food and fuel price inflation exerted some downward pressure on CPI inflation, but these were offset by the upward effects from rising furniture/household equipment inflation, recreation/culture inflation and a surprisingly large rise in airfares inflation from -10.4% in July to +11.9% in August. As a result, core inflation crept back up from 3.3% to 3.6%. CPI inflation is also expected to rise in the coming months, potentially reaching 2.9% in November 2024, before declining to around 2.0% by mid-2025.

2.8. The Bank initiated its loosening cycle in August 2024 with a 25 basis point (bps) rate cut, lowering rates from 5.25% to 5.0%. In its September 2024 meeting, the Bank, resembling the European Central bank (ECB) more than the Federal (Fed), opted to hold rates steady at 5.0%, signalling a preference for a more gradual approach to rate cuts. Notably, one Monetary Policy Committee (MPC) member (Swati Dhingra) voted for a consecutive 25bps cut, while four members swung back to voting to leave rates unchanged. That meant the slim 5-4 vote in favour of a cut in August 2024 shifted to a solid 8-1 vote in favour of no change.

2.9. Looking ahead, CPI inflation will likely rise in the coming months before it falls back to its target of 2.0% in mid-2025. The increasing uncertainties of the Middle East may also exert an upward pressure on inflation, with oil prices rising in the aftermath of Iran's missile attack on Israel on 1 October 2024. China's recent outpouring of new fiscal support measures in the latter stages of September has also added to the upshift in broader commodity prices, which, in turn, may impact on global inflation levels and thus monetary policy decisions. Despite these recent developments, the central forecast is still for rates to fall to 4.5% by the end of 2024 with further cuts likely throughout 2025. This is in line with market expectations, however, although a November 2024 rate cut still looks likely, December may be more problematic for the Bank if CPI inflation spikes towards 3%. In the second half of 2025, though, it is thought that a more marked easing in inflation will prompt the Bank to speed up, resulting in rates eventually reaching 3.0%, rather than the 3.25-3.50% currently priced in by financial markets.

2.10. Our forecast is next due to be updated around mid-November following the 30 October 2024 Budget, 5 November 2024 US Presidential Election, the 7 November 2024 MPC meeting and the release of the Bank of England Quarterly Monetary Policy Report.

2.11. Looking at gilt movements in the first half of 2024/25, and it is noted that the 10-year gilt yield declined from 4.32% in May 2024 to 4.02% in August 2024 as the Bank's August rate cut signalled the start of its loosening cycle. Following the decision to hold the Bank Rate at 5.0% in September 2024, the market response was muted, with the 10-year yield rising by only 5bps after the announcement. This likely reflected the fact that money markets had priced in a 25% chance of a rate cut prior to the meeting. The yield had already increased by about 10bps in the days leading up to the meeting, driven in part by the Fed's "hawkish cut" on 18 September. There is a possibility that gilt yields will rise near-term as UK policymakers remain cautious due to persistent inflation concerns, before declining in the longer term as rates fall to 3.0%.

2.12. The Financial Times Stock Exchange (FTSE) 100 reached a peak of 8,380 in the third quarter of 2024, but its performance is firmly in the shade of the US S&P500, which has breached the 5,700 threshold on several occasions recently. Its progress, however, may pause for the time being whilst investors wait to see who is elected the next US President, and how events in the Middle East (and Ukraine) unfold. The catalyst for any further rally (or not) is likely to be the degree of investors' faith in Artificial Intelligence.

3. MPC MEETINGS: 9 MAY, 20 JUNE, 1 AUGUST, 19 SEPTEMBER 2024

3.1. On 9 May, the Bank of England's Monetary Policy Committee (MPC) voted 7-2 to keep Bank Rate at 5.25%. This outcome was repeated on 20th June 2024.

3.2. However, by the time of the August 2024 meeting, there was a 5-4 vote in place for rates to be cut by 25bps to 5%. However, subsequent speeches from MPC members have supported Governor Bailey's tone with its emphasis on "gradual" reductions over time.

3.3. Markets thought there may be an outside chance of a further Bank Rate reduction in September, following the 50bps cut by the Federal Open Market Committee (FOMC), but this came to nothing.

3.4. Nonetheless, November still looks most likely to be the next month to see a rate cut to 4.75% but, thereafter, inflation and employment data releases, as well as geo-political events, are likely to be the determinant for what happens in the remainder of 2024/25 and into 2025/26.

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. Our latest forecast on 28 May 2024 sets out a view that short, medium and long-dated interest rates will fall back over the next year or two, although there are upside risks in respect of the stickiness of inflation and a continuing tight labour market, as well as the size of gilt issuance.

Link Group Interest Rate View	28.05.24									
	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	4.50	4.00	3.50	3.25	3.25	3.25	3.25	3.00	3.00	3.00
3 month ave earnings	4.50	4.00	3.50	3.30	3.30	3.30	3.30	3.00	3.00	3.00
6 month ave earnings	4.40	3.90	3.50	3.30	3.30	3.30	3.30	3.10	3.10	3.20
12 month ave earnings	4.30	3.80	3.50	3.40	3.40	3.40	3.40	3.20	3.30	3.40
5 yr PWLB	4.50	4.30	4.10	4.00	3.90	3.90	3.90	3.90	3.90	3.80
10 yr PWLB	4.60	4.40	4.30	4.10	4.10	4.10	4.00	4.00	4.00	3.90
25 yr PWLB	5.00	4.80	4.70	4.50	4.50	4.40	4.40	4.40	4.30	4.30
50 yr PWLB	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 4, 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	5.04%	5.03%	£0.028m.

5.5. As illustrated on the previous page, the Authority slightly underperformed the 3-month Sterling Overnight Index Average (SONIA) benchmark by 0.01bp. SONIA replaced the London Interbank Bid Rate (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 anticipated currently that the actual investment return for the whole of 2024-25 will exceed the Authority's budgeted investment target of £1.2m by £0.773m. 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 September 2024 and that there are no concerns that these 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 September 2024 was £23.724m, 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 22.4 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 its treasury advisors to explore any opportunities to repay existing loans, however the differential between current Public Works Loan Board (PWLB) 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 of 2022 and will be kept under review.

New Borrowing

5.10. Gilt yields and PWLB certainty rates were less volatile than at this time last year. Overall, the 10, 25 and 50-year part of the curve endured a little volatility but finished September 2024 very much as it started in April 2024.

5.11. Where there was some movement downwards, this came in the shorter part of the curve as markets positioned themselves for Bank Rate cuts in the second half of 2024 and into 2025, although the continued stickiness of inflation and the prevailing tight labour market is a concern for those looking for more sizeable falls ahead.

5.12. At the beginning of April 2024, the 5-year certainty rate was the cheapest part of the curve at 4.72% whilst the 25-year rate was relatively expensive at 5.28%. May 2024 saw yields at their highest across the whole curve.

5.13. Conversely, 17 September 2024 saw the low point for the whole curve, with the 5-year certainty rate falling to 4.31% before rebounding to 4.55% by the end of the month. Similarly, the 50-year certainty rate fell to 4.88% but finished the month at 5.13%, slightly higher than at the start of April 2024.

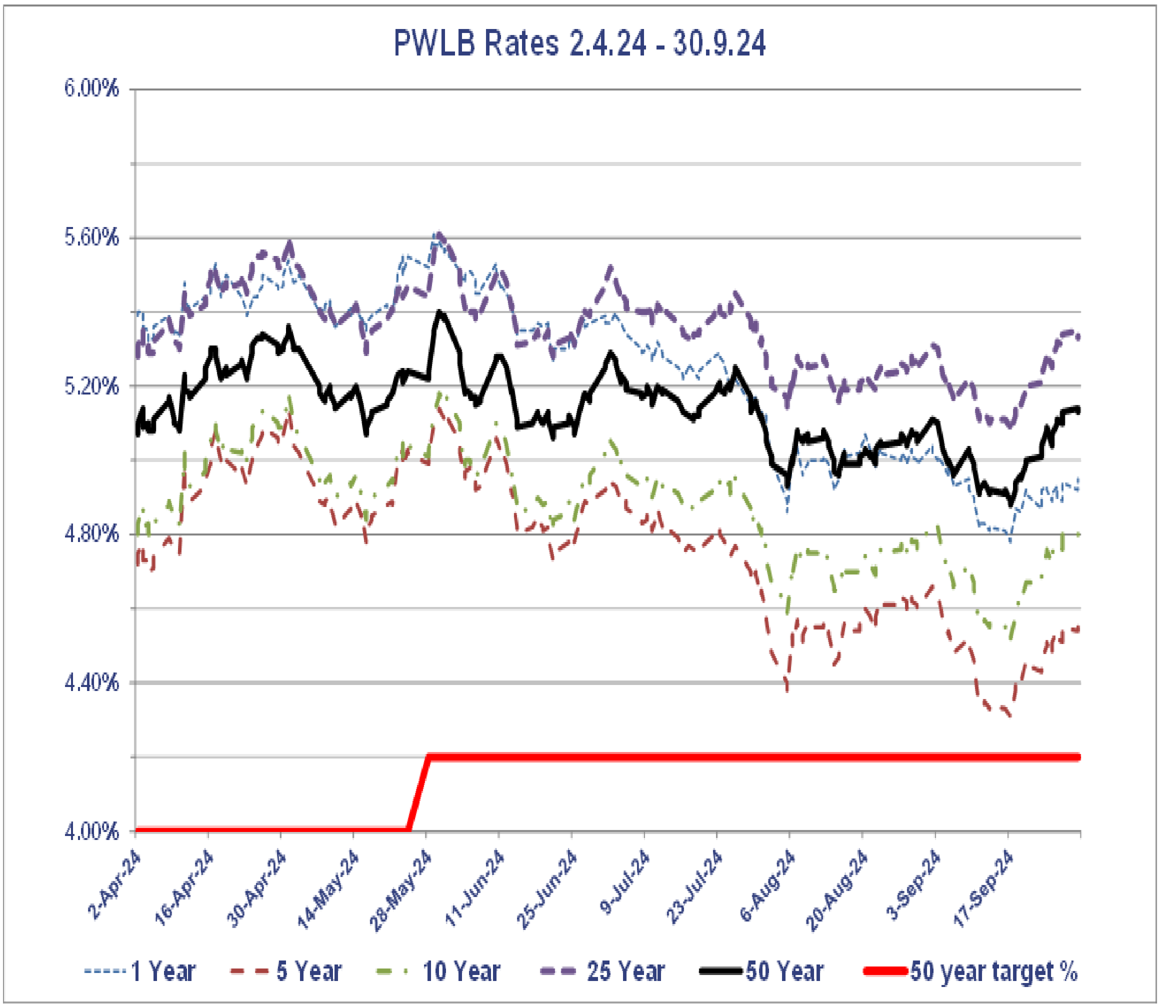
5.14. At this juncture, it is still forecast that rates will fall back over the next two to three years as inflation dampens, although there is upside risk to the Bank Rate forecast at present. The CPI measure of inflation is expected to fall below 2% in the second half of 2025, however, and it is forecast that 50-year rates will stand at 4.20% by the end of September 2026. The major caveats are that there is considerable gilt issuance to be digested by the market over the next couple of years, and geo-political uncertainties – which are generally negative for inflation prospects – abound in Eastern Europe and the Middle East, in particular.

5.15. 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

5.16. Public Works Loan Board (PWLB) rates quarter ended 30 September 2024

	1 Year	5 Year	10 Year	25 Year	50 Year
02/04/2024	5.39%	4.72%	4.80%	5.28%	5.07%
30/09/2024	4.95%	4.55%	4.79%	5.33%	5.13%
Low	4.78%	4.31%	4.52%	5.08%	4.88%
Low date	17/09/2024	17/09/2024	17/09/2024	17/09/2024	17/09/2024
High	5.61%	5.14%	5.18%	5.61%	5.40%
High date	29/05/2024	01/05/2024	01/05/2024	01/05/2024	01/05/2024
Average	5.21%	4.76%	4.88%	5.35%	5.14%
Spread	0.83%	0.83%	0.66%	0.53%	0.52%

5.17. Borrowing rates for this quarter are shown below.



Borrowing in Advance of Need

5.18. 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 September 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/24/17

Investments as at 30 September 2024						
Counterparty	**Maximum to be invested**	**Amount Invested**	**Maturity Date**	**Call or Term**	**Period invested**	**Interest rate(s)**
	£m	£m				
Heleba	7.000	-1.000	02/10/2024	T	6 mths	5.26%
Lloyds	7.000	-4.000	25/10/2024	T	12 mths	5.15%
Lloyds	7.000	-3.000	29/10/2024	T	4 mths	5.13%
Standered Chartered Sustainable	7.000	-7.000	29/10/2024	T	12 mths	5.05%
Aberdeen City Council	7.000	-5.000	21/11/2024	T	6 mths	5.60%
National Bank of Canada	7.000	-4.000	17/12/2024	T	12 mth	5.22%
SMBC	7.000	-2.000	17/01/2025	T	6 mth	5.07%
SMBC	7.000	-5.000	24/01/2025	T	1 mth	5.04%
Natwest		-5.000	24/01/2025	T	6 mth	5.03%
Heleba		-1.000	25/02/2025	T	7 mth	5.05%
National Bank of Canada		-2.000	28/02/2025	T	6 mth	4.74%
National Bank of Canada		-1.000	25/03/2025	T	6 mth	4.70%
Blackpool Council		-7.000	12/05/2025	T	8 mth	4.75%
Heleba		-3.000	25/07/2025	T	12 mth	5.01%
Barclays Bank	8.000	-0.150		C	Instant Access	Variable
Aberdeen Standard	8.000	-4.560		C	Instant Access	Variable
Total Amount Invested		**-54.710**				