REPORT REFERENCE NO.	**RC/25/5**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**5 FEBRUARY 2025**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2024-25: QUARTER 3**
LEAD OFFICER	**Head of Finance (Treasurer)**
RECOMMENDATIONS	***(a) That the performance in relation to the treasury management activities of the Authority for 2024-25 (to December 2024) be noted; and*** ***(b) That it be noted that, due to a recent take-over, the treasury management advisors used by the Authority will change from Link Group and will be trading as MUFG Corporate Markets.***
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 31st December 2024.
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 (Minute DSFRA/23/34c 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 Authority, of an annual TMSS including the Annual Investment Strategy and Minimum Revenue Provision Policy, for the year ahead, along with 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.

1.4. On the 16th May 2024, Link Treasury Services, the Treasury Management Advisors used by the Authority, were acquired by MUFG (Mitsubishi United Financial Group of Japan). The new entity rebranded from Link Group to MUFG Corporate Markets from the 20th January 2025.

2. ECONOMICS UPDATE

2.1. The third quarter of 2024/25 (October to December) saw:

- Gross Domestic Product (GDP) growth contracting by 0.1% m/m in October 2024 following no growth in the second quarter ending September 2024;
- The 3myy rate of average earnings growth increasing from 4.4% in September 2024 to 5.2% in October 2024;
- Consumer Price Index (CPI) inflation increased to 2.6% in November 2024;
- Core CPI inflation increasing from 3.3% in October 2024 to 3.5% in November 2024;
- The Bank of England cut interest rates from 5.0% to 4.75% in November 2024 and held them steady in December 2024; and
- 10-year gilt yields started October 2024 at 3.94% before finishing the Quarter at 4.57% as of December 2024, peaking at 4.64%.

2.2. Quarter 3 saw the composite activity Purchasing Manager Index (PMI) dip below the level of 50 that separates expansion from contraction for the first time since October 2023. Although December 2024's composite PMI came in above this level, at 50.5, this was still consistent with the 0% rise in real Gross Domestic Product (GDP) in Quarter 3 being followed by a flat-lining, or potential contraction, in the final quarter of 2024. However, the economy is unlikely to be quite as weak as that given that the PMIs do not capture rises in government spending, but the data does underline the continued divergence in trends between the manufacturing and services sectors.

2.3. The manufacturing PMI fell for its fourth consecutive month in December 2024, from 48.0 in November 2024 to 47.3. This is consistent with manufacturing output falling by 1.5% q/q in the final quarter of 2024 after flatlining through the summer months. This weakness in the manufacturing sector was offset by a rebound in the services sector. The services PMI rose from 50.8 in November 2024 to 51.4 in December 2024, which is consistent with non-retail services output growth increasing from +0.1% q/q to +0.3% for October – December 2024. This suggests that more of the recent slowdown in GDP is being driven by the weakness in activity overseas rather than just domestic factors. Additionally, the services output prices balance rose for the third consecutive month, from 55.4 in November 2024 to 56.9, showing signs that price pressures are reaccelerating

2.4. After rising by 1.4% q/q in July – September 2024, the retail sector had a difficult final quarter of the year. Indeed, the bigger-than-expected 0.7% m/m fall in retail sales in October 2024 (consensus forecast -0.3% m/m) suggested that households' concerns about expected tax rises announced in the Budget on 30th October 2024 contributed to weaker retail spending at the start of the Quarter. The monthly decline in retail sales volumes in October 2024 was reasonably broad based, with sales in five of the seven main sub sectors slipping. However, the potential for seasonally adjusted sales to rise in November - if October 2024's figures were impacted by the timing of the school half term – combined with a rebound in consumer confidence and rising real incomes, points to some promise to the final quarter of 2024.

2.5. The Government's October 2024 budget outlined plans for a significant £41.5bn (1.2% of GDP) increase in taxes by 2029/30, with £25bn derived from a 1.2% rise in employers' National Insurance contributions. The taxes are more than offset by a £47bn (1.4% of GDP) rise in current (day-to-day) spending by 2029/30 and a £24.6bn (0.7% of GDP) rise in public investment, with the latter being more than funded by a £32.5bn (1.0% of GDP) rise in public borrowing. The result is that the Budget loosens fiscal policy relative to the previous government's plans - although fiscal policy is still being tightened over the next five years – and that GDP growth is somewhat stronger over the coming years than had previously been forecasted. By way of comparison, the Bank of England forecasts four-quarter GDP growth to pick up to almost 1.¾% through 2025 (previously forecast to be 0.9%) before falling back to just over 1% in 2026.

2.6. December 2024's pay data showed a rebound in wage growth that will likely add to the Bank of England's inflationary concerns. The 3myy rate of average earnings growth increased from 4.4% in September (revised up from 4.3%) to 5.2% in October 2024 (consensus forecast 4.6%) and was mainly due to a rebound in private sector pay growth from 4.6% to 5.4%. Excluding bonuses, public sector pay stagnated in October 2024 and the 3myy rate fell from 4.7% to 4.3%.

2.7. The number of job vacancies also fell again from 828,000 in the three months to October, to 818,000 in the three months to November. This marks the first time it has dropped below its pre-pandemic February 2020 level of 819,000 since May 2021. Despite this, the Bank of England remains concerned about the inflationary influence of high wage settlements as well as the risk of a major slowdown in labour market activity.

2.8. CPI inflation has been on the rise this quarter, with the annual growth rate increasing from 1.7% in September to 2.3% in October 2024, before rising further to 2.6% in November 2024. Although services CPI inflation stayed at 5.0% in November 2024, the Bank had expected a dip to 4.9%, while the timelier three-month annualised rate of services CPI rose from 5.0% to 5.1%. That shows that there currently isn't much downward momentum. Moreover, the wider measure of core CPI inflation rose from 3.3% to 3.5% in November 2024.

2.9. Both services and core inflation are currently at rates well above those consistent with the 2.0% target and are moving in the wrong direction. Capital Economics forecast that after dipping to 2.5% in December 2024, CPI inflation would rise further in January 2025, perhaps to 2.8%. Although CPI inflation is expected to be back at close to the 2.0% target by the end of 2025, given that a lot of the rise in inflation in the coming months will be due to base effects that won't persist, the potential for a broader set of tariffs to arise from the US as well as the constant threat of geo-political factors to impact energy and food prices suggest risks remain very much to the upside.

2.10. Throughout the quarter gilt yields have risen. The 10-year gilt yield increased from 3.94% at the start of October 2024 to 4.57% by the year end (and has subsequently risen to 4.64% early in 2025). As recently as mid-September 2024, 10-year gilt yields were at their low for the financial year, but since then, and specifically after the Budget at the end of October 2024, yields have soared. Overall, the reaction to the UK Budget highlights how bond markets are both fragile and highly attentive to news about the fiscal outlook.

2.11. The FTSE 100 started off this quarter at 8,276, before finishing up at 8,121. In particular, UK markets have continued to fall further behind US equities, a trend which has accelerated since Trump's election victory in November 2024, partly due to the UK stock market being less exposed to Artificial Intelligence (AI) hype, and it being weighed down by its relatively large exposure to the energy and materials sectors.

3. MONETARY POLICY COMMITTEE (MPC) MEETINGS: 7TH NOVEMBER & 18TH DECEMBER 2024

3.1. On 7 November 2024, Bank Rate was cut by 0.25% to 4.75%. The vote was 8-1 in favour of the cut, but the language used by the MPC emphasised "gradual" reductions would be the way ahead with an emphasis on the inflation and employment data releases, as well as geo-political events.

3.2. At the 18 December 2024 meeting, another split vote arose. Members voted 6-3 to keep Bank Rate on hold at 4.75%, but dissenters (Dhingra, Ramsden and Taylor) were keen for rates to be cut further as concerns over the slowing down of the UK economy took root, despite near-term inflation fears remaining.

3.3. The MPC again stated that "a gradual approach" to rate cuts "remains appropriate" and that policy will "remain restrictive for sufficiently long".

4. INTEREST RATE FORECASTS

4.1. The Authority has appointed MUFG Corporate Markets (formally 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 on 11th November 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	11.11.24												
	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27
BANK RATE	4.75	4.50	4.25	4.00	4.00	3.75	3.75	3.75	3.50	3.50	3.50	3.50	3.50
3 month ave earnings	4.70	4.50	4.30	4.00	4.00	4.00	3.80	3.80	3.80	3.50	3.50	3.50	3.50
6 month ave earnings	4.70	4.40	4.20	3.90	3.90	3.90	3.80	3.80	3.80	3.50	3.50	3.50	3.50
12 month ave earnings	4.70	4.40	4.20	3.90	3.90	3.90	3.80	3.80	3.80	3.50	3.50	3.50	3.50
5 yr PWLB	5.00	4.90	4.80	4.60	4.50	4.50	4.40	4.30	4.20	4.10	4.00	4.00	3.90
10 yr PWLB	5.30	5.10	5.00	4.80	4.80	4.70	4.50	4.50	4.40	4.30	4.20	4.20	4.10
25 yr PWLB	5.60	5.50	5.40	5.30	5.20	5.10	5.00	4.90	4.80	4.70	4.60	4.50	4.50
50 yr PWLB	5.40	5.30	5.20	5.10	5.00	4.90	4.80	4.70	4.60	4.50	4.40	4.30	4.30

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, Minute DSFRA/23/34c refers. It outlines the Authority's investment priorities as follows:

- Security of Capital;
- Liquidity; and
- 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 MUFG Corporate Markets suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

5.3. As shown by the charts later in this section, and in the interest rate forecasts in Section 4, investment rates remained elevated during the second quarter of 2024-25, but are expected to fall back through the second half of 2025 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. Officers continue to closely monitor these, however, 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 3
3 Month SONIA	4.81%	4.78%	£0.698m.

5.5. As illustrated above, the Authority slightly underperformed the 3-month Sterling Overnight Index Average (SONIA) benchmark by 0.03bp. 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 currently anticipated that the actual investment return for the whole of 2024-25 will exceed the Authority's budgeted investment target of £1.7m by £0.502m. 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 this agenda, which confirms that no breaches of the Prudential Indicators were made in the period to December 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 31st December 2024, was £23,724m, forecast to remain like this to 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 22.2 years.

Loan Rescheduling

5.9. No debt rescheduling was undertaken during the quarter. 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. Medium and longer-dated gilt yields, and therein PWLB rates, have moved significantly higher over the course of the financial year, culminating in long-term rates approaching levels last seen in 1998. The rise in medium to long-term yields has arisen because of several factors. Namely, the inflation outlook has become stickier than the market anticipated earlier in the year, with wages remaining somewhat elevated (currently increases are c5% y/y) and the labour market tight (unemployment a little above 4% and job vacancies more than 800,000).

5.11. Moreover, the Government has not fully convinced the markets that the UK economy is about to undergo a material increase in productivity and growth. The quarter ending 30th September saw UK GDP stagnate and the prospects for 2025 are somewhat opaque at present. With the UK public finances seemingly under pressure too (as of 7th January 2025, it is estimated that the Chancellor's October 2024 Budget contingency is less than £1bn following the recent rise in gilt yields), and historic buyers of longer-dated gilts – pension funds and insurance companies – targeting shorter-dated maturities of late, it is not that great a surprise that yields have risen in the longer dates even as the Debt Management Office has sought to issue debt with shorter durations than might normally have been the case.

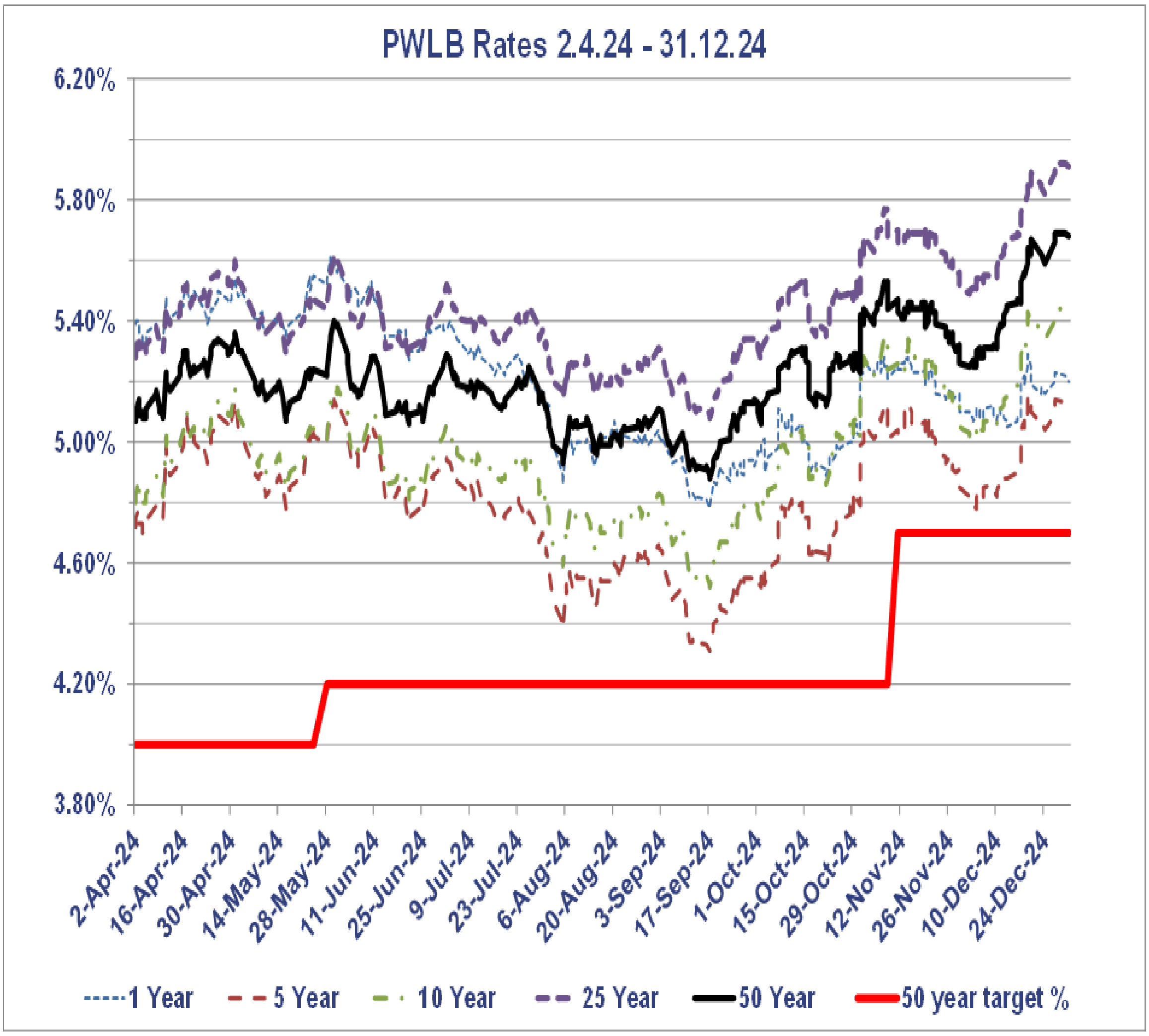
5.12. There is also anecdotal evidence that hedge funds, who are not long-term holders of long-dated debt issuance, as a rule, may be more active in this part of the market than has normally been the case. Their presence, arguably, adds volatility to the equation. Consequently, and pulling all these factors together, it is clear that any signs of public finance weakness could lead to elevated yields from time to time.

5.13. 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.

5.14. Public Works Loan Board (PWLB) rates quarter ended 31st December 2024

	1 Year	5 Year	10 Year	25 Year	50 Year
02/04/2024	5.39%	4.72%	4.80%	5.28%	5.07%
31/12/2024	5.20%	5.12%	5.43%	5.91%	5.68%
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%	5.16%	5.44%	5.92%	5.69%
High date	29/05/2024	19/12/2024	19/12/2024	19/12/2024	27/12/2024
Average	5.22%	4.80%	4.96%	5.43%	5.21%
Spread	0.83%	0.85%	0.92%	0.84%	0.81%

5.15. Borrowing rates for this quarter are shown below.



Borrowing in Advance of Need

5.16. 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 third quarter report on treasury management activities for 2024-25 to December 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/25/5

INVESTMENTS HELD AS AT 31ST DECEMBER 2024.

Investments as at 31st December 2024						
Counterparty	**Maximum to be invested**	**Amount Invested**	**Maturity Date**	**Call or Term**	**Period invested**	**Interest rate(s)**
	£m	£m				
SMBC	7.000	-2.000	17/01/2025	T	6 mths	5.07%
SMBC	7.000	-5.000	24/01/2025	T	6 mths	5.04%
Natwest	7.000	-5.000	24/01/2025	T	6 mths	5.03%
Heleba	7.000	-1.000	25/02/2025	T	7 mths	5.05%
National Bank of Canada	7.000	-2.000	28/02/2025	T	6 mths	4.74%
National Bank of Canada	7.000	-1.000	25/03/2025	T	6 mth	4.70%
Heleba	7.000	-3.000	31/03/2025	T	5 mth	4.56%
Standered Chartered Sustainable	7.000	-7.000	28/04/2025	T	6 mth	4.59%
Blackpool Council	7.000	-7.000	12/05/2025	T	8 mth	4.75%
Aberdeen City Council	7.000	-5.000	22/05/2025	T	6 mth	5.25%
National Bank of Canada	7.000	-4.000	17/06/2025	T	6 mth	4.62%
Heleba	7.000	-3.000	25/07/2025	T	12 mth	5.01%
Barclays Bank	8.000	-0.150		C	Instant Access	Variable
Aberdeen Standard	8.000	-4.660		C	Instant Access	Variable
Total Amount Invested		**-49.810**				