Rochford District Council

COMMITTEE TITLE Overview & Scrutiny

DATE 1st February 2024

REPORT TITLE:	TREASURY MANAGEMENT QUARTER 3 REVIEW 2023/24
REPORT OF:	Tim Willis, Interim Resources Director

REPORT SUMMARY

This report is to provide an update of the Council's Treasury Management activity for the period April 2023 to 31 December 2023 in accordance with the Council's Treasury Management Policy and good practice in treasury management.

RECOMMENDATIONS

It is proposed that the Overview & Scrutiny Committee **RESOLVES** to recommend the contents of this Treasury Management Quarter Three Report to Full Council.

SUPPORT ING INFORMATION

1 REASONS FOR RECOMMENDATIONS

1.1 The council is required by the CIPFA Code of Practice on Treasury Management and the Prudential Code for Capital Finance in Local Authorities to produce a quarterly review of its treasury management activities.

1.2 Overview & Scrutiny Committee is asked to consider the contents of this report and recommend it for approval by Full Council on 20 February 2024.

1.3 The council's income from treasury management activities for the period April to December 2023 was £818,179 against a total budget for the year of £275,000.

2 BACKGROUND INFORMATION

2.1 The Treasury Management Strategy Statement (TMSS) for 2023/24, which includes the Annual Investment Strategy, was approved by the Council on 1 February 2023. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity, aligned with the Council'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.

As shown by the charts below and the interest rate forecasts in section 3.1.7, investment rates have improved dramatically during 2023/24 and are expected to remain the same as Bank Rate continues to remain high over the next few months.

2.2 Creditworthiness

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.

2.3 Investment counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

2.4 Investment balances

The average level of funds available for investment purposes during the quarter was **£23.8m**. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

Benchmark	Benchmark Return %	Council Performance %	Investment Interest Earned £
7 day	4.88	5.15	111,870
1 month	4.84	5.31	531,140
3 month	4.71	5.25	175,169
6 month	4.43	n/a	n/a
12 month	3.60	n/a	n/a

As illustrated, the Council *overperformed* the benchmark by 1.28 **bps**. The Council's budgeted investment return for 2023/24 is **£275,000**, and performance for the year to date is **£818,179** which is above budget for the year. Our predicted performance for the year is £1,041,036, which is £766,036 above budget.

2.5 The breakdown of the investments held at 31 December 2023 are shown in the table below:

Investment held at 31 December 2023	Amount	Term	Interest
Handelsbanken	£6,000,000	3M Fixed	5.25%
Money Market – Deutsche	£5,000,000	Instant	5.32%
Money Market – Prime	£5,000,000	Instant	5.37%
Money Market – HSBC	£5,000,000	Instant	5.32%
Lloyds	£3,000,000	5M Fixed	5.22%

2.6 Approved limits

Officers can confirm that the approved limits within the Annual Investment Strategy were breached during the quarter ended 31st December 2023. This was due to a delay in sending the precepts that resulted in the bank balance exceeding £5m overnight. All decisions on borrowing, investment or financing are delegated to the Section 151 Officer as the Chief Finance Officer and this delegation is documented in the Financial Regulations.

2.7 The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by Members. Member training on Overview of Local Government Finance, which encompassed treasury management, was undertaken during the year on 19 September 2023 in order to support members' scrutiny role.

2.8 The table below shows the forecast outturn for capital expenditure at 31 December 2023 compared to the original budget agreed on 21 February 2023.

Capital Expenditure	2023/24 Original Estimate £'000s	2023/24 End of Year Forecast £'000s
Total	**4,870**	**3,675**
Financed by:		
S106 income	70	389

Disabled Facilities Grant via Better Care Fund	540	540
Capital Finance Reserve	2,523	836
New Homes Bonus	97	93
Air Quality Grant Income	-	36
Investment Reserve	1,640	1,731
Match Funding	0	50
Total Financing	**4,870**	**3,675**

2.9 The Council has not undertaken any external borrowing during the period 1 April to 31 December 2023 and therefore no interest costs were incurred.

2.9.1 Net external borrowing should not, except in the short term, exceed the total of Capital Financing Requirement (CFR) in the preceding year plus the estimates of any additional CFR for 2022/23 and next two financial years.

£000s	2022/23 Actual	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
CFR	777	777	777	777
Movement in CFR	-	-	-*	-*

** No movement is projected in the current estimates.*

2.9.2 The Council's current Treasury Management Advisors are Link Asset Services (LAS). The contract cost for 2023/24 was £8,750 which represents good value for money via the provision of specialist advice and training to the Council officers and members which enables sound investment decisions to be made.

3.0 ECONOMIC UPDATE

3.1 The third quarter of 2023/24 saw:

- A 0.3% m/m decline in real GDP in October, potentially partly due to unseasonably wet weather, but also due to the ongoing drag from higher interest rates. Growth for the second quarter, ending 30th September, was revised downwards to -0.1% and growth on an annual basis was also revised downwards, to 0.3%;
- A sharp fall in wage growth, with the headline 3myy rate declining from 8.0% in September to 7.2% in October, although the ONS "experimental" rate of unemployment has remained low at 4.2%;
- CPI inflation continuing on its downward trajectory, from 8.7% in April to 4.6% in October, then again to 3.9% in November;

- Core CPI inflation decreasing from April and May's 31 years' high of 7.1% to 5.1% in November, the lowest rate since January 2022;
- The Bank of England holding rates at 5.25% in November and December;
- A steady fall in 10-year gilt yields as investors revised their interest rate expectations lower.

3.1.1 The revision of GDP data in Q2 to a 0.1% q/q fall may mean the mildest of mild recessions has begun. Indeed, real GDP in October fell 0.3% m/m which does suggest that the economy may stagnate again in Q3. The weakness in October may partly be due to the unseasonably wet weather. That said, as the weakness was broad based it may also be the case that the ongoing drag from higher interest rates is more than offsetting any boost from the rise in real wages

3.1.2 However, the rise in the flash composite activity Purchasing Managers Index, from 50.7 in November to 51.7 in December, did increase the chances of the economy avoiding a contraction in Q3. The improvement was entirely driven by the increase in the services activity balance from 50.9 to 52.7. (Scores above 50 point to expansion in the economy, although only tepid in this instance.) The press release noted that this was primarily driven by a revival in consumer demand in the technological and financial services sectors. This chimes with the further improvement in the GfK measure of consumer confidence in December, from -24 to -22. The services PMI is now consistent with non-retail services output growing by 0.5% q/q in Q3, but this is in stark contrast to the manufacturing sector where the output balance slumped from 49.2 to 45.9 and, at face value, the output balance is consistent with a 1.5% q/q fall in manufacturing output in Q3.

3.1.3 Higher interest rates have filtered through the financial channels and weakened the housing market but, overall, it remains surprisingly resilient with only marginal falls showing year on year on the Halifax (-1%) and Nationwide (-1.8%) indices. However, the full weakness in real consumer spending and real business investment has yet to come as currently it is estimated that around two thirds to a half of the impact of higher interest rates on household interest payments has yet to be felt.

3.1.4 Overall, real GDP growth is expected to remain subdued throughout 2024 as the drag from higher interest rates is protracted but a fading of the cost-of-living crisis and interest rate cuts in the second half of 2024 will support a recovery in GDP growth in 2025.

3.1.5 The labour market remains tight by historical standards, but the sharp fall in wage growth seen in October will reinforce the growing belief in markets that interest rates will be cut mid-2024. Wage growth eased in October much faster than the consensus expected. Total earnings fell by 1.6% m/m, which meant the headline 3myy rate eased from 8.0% in September to 7.2% in October. This news will be welcomed by the Bank of England. Indeed, the timelier three-month annualised rate of average earnings growth fell from +2.4% to -1.2%. Excluding bonuses, it fell from 5.3% to 2.0%. Furthermore, one of the Bank's key barometers of inflation persistence, regular private sector pay growth, dropped from 7.9% 3myy to 7.3%, which leaves it comfortably on track to fall to 7.2% by December, as predicted by the Bank in November.

3.1.6 CPI inflation fell from 6.7% in September to 4.6% in October, and then again to 3.9% in November. Both these falls were bigger than expected and there are clear signs of easing in domestic inflationary pressures. The fall in core CPI inflation from 5.7% to 5.1% in November was bigger than expected (consensus forecast 5.6%). That's the lowest rate since January 2022. Some of the decline in core inflation was due to the global influence of core goods inflation, which slowed from 4.3% to 3.3%. But some of it was due to services inflation falling from 6.6% to 6.3%. The Bank views the latter as a key barometer of the persistence of inflation and it came in further below the Bank's forecast of 6.9% in its November Monetary Policy Report. This will give the Bank more confidence that services inflation is now on a firmly downward path.

3.1.7 The Bank of England sprung no surprises with its December monetary policy committee (MPC) meeting, leaving interest rates at 5.25% for the third time in a row and pushing back against the prospect of near-term interest rate cuts. The Bank continued to sound hawkish, with the MPC maintaining its tightening bias saying that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures". And it stuck to the familiar script, saying that policy will be "sufficiently restrictive for sufficiently long" and that "monetary policy is likely to need to be restrictive for an extended period of time". In other words, the message is that the MPC is not yet willing to endorse investors' expectations that rates will be cut as soon as May 2024.

3.1.8 Looking ahead, Capital Economics forecast that the recent downward trends in CPI and core inflation will stall over the next few months before starting to decline more decisively again in February. That explains why the Bank of England is reluctant to cut interest rates until H2 2024.

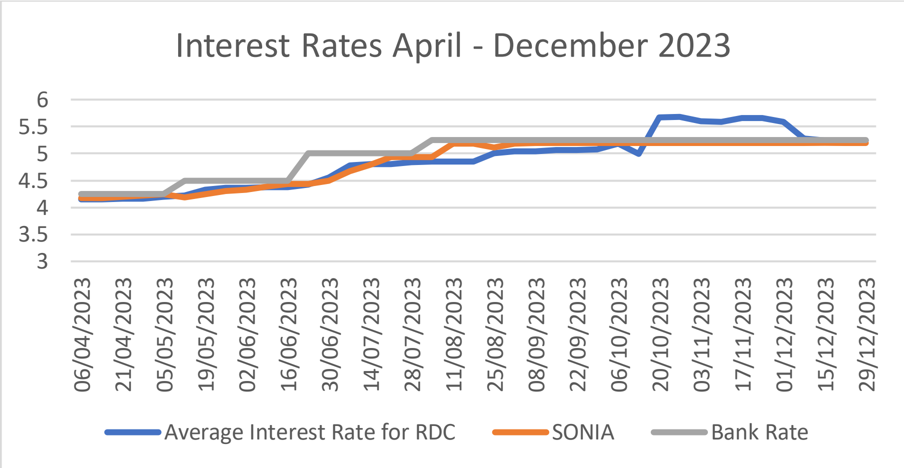
3.1.9 The fall in UK market interest rate expectations in December has driven most of the decline in 10-year gilt yields, which have fallen in line with 10-year US Treasury and euro-zone yields. 10-year gilt yields have fallen from 4.68% in October 2023 to around 3.70% at the time of writing, with further declines likely if the falling inflation story is maintained.

3.1.10 The further fall in 10-year real gilt yields in December has supported the recent rise in the FTSE 100. That said, the index remains 5% below its record high in February. This modest rise in equities appears to have been mostly driven by strong performances in the industrials and rate-sensitive technology sectors. But UK equities have continued to underperform US and euro-zone equities. The FTSE 100 has risen by 2.2% in December, while the S&P 500 has risen by 3.8%. This is partly due to lower energy prices, which have been a relatively bigger drag on the FTSE 100, due to the index's high concentration of energy companies.

3.1.11 Link Asset Service's current PWLB rate forecasts below are based on the Certainty Rate:

Link Group Interest Rate View 08.01.24													
	Mar-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	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	4.80	4.30	3.80	3.30	3.00	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.60	4.10	3.70	3.30	3.10	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.40	3.90	3.60	3.20	3.10	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

3.1.12 The following graph shows a comparison of average rate of interest earned, Bank base rate and the benchmark (7-day London Interbank Rate); this shows the correlation in the average interest rate the Council achieved compared to the Bank of England Base rate. Starting April at 4.25%, Bank Rate moved up in stepped increases of 0.25%, 0.5% and 0.25%, reaching 5.25% by the end of August, with the potential to remain the same within 2023/24.



4.0 FINANCIAL IMPLICATIONS

4.1 Interest rates are set to remain the same for the rest of 2023/24 before starting to decrease in 2024/25.

5.0 LEGAL IMPLICATIONS

5.1 None

6.0 RESOURCE IMPLICATIONS: STAFFING, ICT AND ASSETS

6.1 None

7.0 RELEVANT RISKS

7.1 The Council's agreed Treasury Management Strategy sets out in detail the risks involved in making investments and in particular the risk that a counter party may fail during the duration of an investment. The Authority is responsible for managing the investment of public funds and must adopt a prudent approach.

8.0 ENGAGEMENT/CONSULTATION

8.1 None

9.0 EQUALITY IMPLICATIONS

9.1 None

10.0 ENVIRONMENT AND CLIMATE IMPLICATIONS

10.1 None

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APPENDICES

BACKGROUND PAPERS

None

SUBJECT HISTORY (last 3 years)

Council Meeting	**Date**
An Annual Treasury Strategy in advance of the year – Council	**01/02/2023**
Q1 review – O&S and Council	**05/7/2023 – 7/09/2023**
A Mid-Year Treasury Update Report – O&S and Council	**05/12/2023 – 14/12/2023**