REPORT TO:	Executive Board
DATE:	17 November 2022
REPORTING OFFICER:	Operational Director – Finance
PORTFOLIO:	Leader
TITLE:	Treasury Management 2022-23 Half Year Update
WARDS:	Borough-wide

1.0 PURPOSE OF REPORT

1.1 The purpose of this report is to provide an update regarding activities undertaken on the money market during the first half of the financial year to 30 September 2022, as required by the Treasury Management Policy.

2.0 RECOMMENDED: That the report be noted.

3.0 SUPPORTING INFORMATION

Economic Outlook

3.1 The following analysis of the economic situation has been provided by Link Asset Services, the Council's treasury management advisors.

3.2 During the six months ended 30 September 2022

- GDP rose by 0.2% from -0.1%, which means the UK economy has avoided recession for the time being;
- There were signs of economic activity losing momentum as production fell due to rising energy prices;
- CPI inflation eased to 9.9% in August, but domestic price pressures are showing little sign of abating in the short-term;
- The unemployment rate fell to a 48-year low of 3.6% due to a large shortfall in labour supply;
- The Bank Rate rose by 1.5% over the period to 2.25% with further rises to come;
- Gilt yields surged and sterling fell following the "fiscal event" of the new Prime Minister and Chancellor on 23rd September.

3.3 The UK economy grew by 0.2% during the period, though revisions to historic data left it below pre-pandemic levels.

3.4 There are signs of higher energy prices creating more persistent downward effects in economic activity. Both industrial production (-0.3%) and construction output (-0.8%) fell in July 2022 for a second month in a row. With the drag on real activity from high inflation having grown in recent months, GDP is at risk of contracting through the autumn and winter months.

3.5 Retail sales volumes fell by 1.6% in August, which was the ninth fall in ten months. That left sales volumes in August just 0.5% above their pre-Covid level and 3.3% below their level at the start of the year. There are also signs that households are spending their excess savings in response to high prices. Indeed, cash in households' bank accounts rose by £3.2bn in August, which was below the £3.9bn rise in July and much smaller than the 2019 average monthly rate of £4.6bn.

3.6 The labour market remained exceptionally tight. Data for July and August provided further evidence that the weaker economy is leading to a cooling in labour demand. The number of vacancies has started to level off from recent record highs but there have been few signs of a slowing in the upward momentum on wage growth

3.7 CPI inflation eased from 10.1% in July to 9.9% in August, though inflation has not peaked yet. The easing in August was mainly due to a decline in fuel prices reducing fuel inflation from 43.7% to 32.1%. With the oil price now just below $90 per barrel, we would expect to see fuel prices fall further in the coming months.

3.8 However, utility price inflation is expected to add 0.7% to CPI inflation in October when the Ofgem unit price cap increases to, typically, £2,500 per household (prior to any benefit payments). But, as the Government has frozen utility prices at that level for two years, energy price inflation will fall sharply after October and have a big downward influence on CPI inflation.

3.9 During the year, there has been a change of both Prime Minister and two changes of Chancellor. The new team (Liz Truss and Kwasi Kwarteng) made a step change in Government policy. The Government's huge fiscal loosening from its proposed significant tax cuts will add to existing domestic inflationary pressures and will potentially leave a legacy of higher interest rates and public debt. These included the reversal of April's national insurance tax on 6th November, the cut in the basic rate of income tax from 20p to 19p in April 2023, the cancellation of next April's corporation tax rise, the cut to stamp duty and the removal of the 45p tax rate, although the majority of these already been reversed with the appointment of Jeremy Hunt as Chancellor.

3.10 Fears that the Government has no “fiscal anchor” on the back of these announcements meant that the pound has weakened again, adding further upward pressure to interest rates. Whilst the pound fell to a record low of $1.035 on the Monday following the Government’s “fiscal event”, it has since recovered to around $1.12. That is due to hopes that the Bank of England will deliver a very big rise in interest rates at the policy meeting on 3rd November and the Government will lay out a credible medium-term plan in the near term. This was originally expected as part of the fiscal statement on 23rd November but has subsequently been moved forward to an expected release date in October. Nevertheless, with concerns over a global recession growing, there are downside risks to the pound.

3.11 The Monetary Policy Committee (MPC) has now increased interest rates seven times in as many meetings in 2022 and has raised rates to their highest level since the Global Financial Crisis. Even so, coming after the US Federal Bank and European Central Bank raised rates by 0.75% in their most recent meetings, the Bank of England’s latest 0.5% rise looks relatively cautious. However, the UK’s status as a large importer of commodities, which have jumped in price, means that households in the UK are now facing a much larger squeeze on their real incomes.

3.12 Since the fiscal event on 23rd September, we now expect the MPC to increase interest rates further and faster, from 2.25% currently to a peak of 5.00% in February 2023. The combination of the Government’s fiscal loosening, the tight labour market and inflation expectations means we expect the MPC to raise interest rates by 1.0% at the policy meetings in November (to 3.25%) and 0.75% in December (to 4%) followed by further 0.5% in February and March (to 5.00%). Market expectations for what the MPC will do are volatile. If the Bank Rate climbs to these levels the housing market looks very vulnerable, which is one reason why the peak in our forecast is lower than the peak of 5.50% - 5.75% priced into the financial markets at present.

3.13 Throughout 2022/23, gilt yields have been on an upward trend. They were initially caught up in the global surge in bond yields triggered by the surprisingly strong rise in CPI inflation in the US in May. The rises in two-year gilt yields (to a peak of 2.37% on 21st June) and 10-year yields (to a peak of 2.62%) took them to their highest level since 2008 and 2014 respectively. However, the upward trend was exceptionally sharp at the end of September as investors demanded a higher risk premium and expected faster and higher interest rate rises to offset the Government’s extraordinary fiscal stimulus plans. The 30-year gilt yield rose from 3.60% to 5.10% following the “fiscal event”, which threatened financial stability by forcing pension funds to sell assets into a falling market to meet cash collateral requirements. In response, the Bank did two things. First, it postponed its plans to start selling some of its quantitative easing (QE) gilt holdings until 31st October. Second, it committed to buy up to £65bn of long-term gilts to "restore orderly market conditions" until 14th October. In other words, the Bank is restarting QE, although for financial stability reasons rather than monetary policy reasons.

3.14 Since the Bank's announcement on 28th September, the 30-year gilt yield has fallen back from 5.10% to 3.83%. The 2-year gilt yield dropped from 4.70% to 4.30% and the 10-year yield fell back from 4.55% to 4.09%.

3.15 There is a possibility that the Bank continues with QE at the long-end beyond 14th October or it decides to delay quantitative tightening beyond 31st October, even as it raises interest rates. So far at least, investors seem to have taken the Bank at its word that this is not a change in the direction of monetary policy nor a step towards monetary financing of the government's deficit. But instead, that it is a temporary intervention with financial stability in mind.

Interest Rate Forecast

3.16 The following forecast has been provided by Link Asset Services.

Link Group Interest Rate View	27.09.22											
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
BANK RATE	4.00	5.00	5.00	5.00	4.50	4.00	3.75	3.25	3.00	2.75	2.75	2.50
3 month ave earnings	4.50	5.00	5.00	5.00	4.50	4.00	3.80	3.30	3.00	2.80	2.80	2.50
6 month ave earnings	4.70	5.20	5.10	5.00	4.60	4.10	3.90	3.40	3.10	3.00	2.90	2.60
12 month ave earnings	5.30	5.30	5.20	5.00	4.70	4.20	4.00	3.50	3.20	3.10	3.00	2.70
5 yr PWLB	5.00	4.90	4.70	4.50	4.20	3.90	3.70	3.50	3.40	3.30	3.20	3.20
10 yr PWLB	4.90	4.70	4.60	4.30	4.10	3.80	3.60	3.50	3.40	3.30	3.20	3.20
25 yr PWLB	5.10	4.90	4.80	4.50	4.30	4.10	3.90	3.70	3.60	3.60	3.50	3.40
50 yr PWLB	4.80	4.60	4.50	4.20	4.00	3.80	3.60	3.40	3.30	3.30	3.20	3.10

Short Term Borrowing Rates

3.17 The bank base rate has increased steadily from 0.75% on 31st March to 2.25% on 22nd September 2022.

	Mar	Apr	May	Jun	Jul	Aug	Sep
	%	%	%	%	%	%	%
Base Rate	0.75	0.75	1.00	1.25	1.25	1.75	2.25
Call Money (Market)	0.55	0.65	1.15	1.15	1.20	1.55	2.15
1 Month (Market)	0.75	0.95	0.90	1.15	1.60	1.90	2.45
3 Month (Market)	1.10	1.15	0.90	1.55	1.95	2.30	3.80

Longer Term Borrowing Rates

	Mar	Apr	May	Jun	Jul	Aug	Sep
	%	%	%	%	%	%	%
1 Year (Market)	1.55	1.80	1.95	2.70	2.75	3.60	4.95
10 Year (PWLB)	2.44	2.66	2.81	3.20	2.82	3.63	4.94
25 Year (PWLB)	2.62	2.83	3.09	3.48	3.36	3.91	4.80

3.18 Market rates are based on LIBOR rates and PWLB rates are for new loans based on principal repayable at maturity. The rates are shown for the end of each month.

Borrowing and Investments

Turnover during the period

	No of deals	Turnover £m
Short Term Borrowing	-	-
Short Term Investments	6	41

Position at month-end

	Mar £m	Apr £m	May £m	Jun £m	Jul £m	Aug £m	Sep £m
Total Borrowing	172	172	172	172	172	172	172
Total Investments	(121)	(121)	(121)	(121)	(131)	(121)	(121)
Call Account Balance	(11)	(14)	(21)	(18)	(20)	(11)	(6)

Investment benchmarking

Benchmark	Benchmark Return %	Performance Apr - Sep %	Investment Interest Earned £000
7 day	1.29	0.02	29
1 month	0.98	0.00	-
3 months	1.22	0.00	-
6 months	1.54	0.35	157
12 months	1.98	0.37	138
Over 12 months	-	0.90	46
Property Fund	-	3.40	170
Total			**540**

3.19 The above table shows the Council has underachieved on all benchmarks over the first six months of the year. This was due to the fast and unexpected increase in rates during this period, whilst the majority of the Council's investments are fixed for either six or twelve month's duration. A substantial increase in rates achieved will be seen in the second half of the year, due to the lower rate investments maturing and being replaced at significantly higher rates. There are no benchmarks available for the Council's investment in the CCLA property fund, or for investments held over 12 months.

Budget Monitoring

	Net Interest at 30 September 2022		
	Budget to Date £000	**Actual To Date £000**	**Variance (o/spend) £000**
Investments	(289)	(540)	251
Borrowings	550	550	0
Net Total	260	10	251

3.20 Due to the increase in interest rates during the period, the Council has generated an additional £251,000 net income over budget, in the first half of the year from its treasury management activities. This is expected to increase further in the second half of the year, due to the continued increases in interest rates.

New Long Term Borrowing

3.21 No new long term borrowing has been taken in this period.

Policy Guidelines

3.22 The Treasury Management Strategy Statement (TMSS) for 2022/23, which includes the Annual Investment Strategy, was approved by Council on 17 February 2022. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield

3.23 The Council will therefore aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate and the heightened credit concerns it is considered appropriate to keep the majority of investments short term and to ensure all investments are in in line with Sector's credit rating methodology.

Treasury Management Indicators

3.24 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators were set out in the Treasury Management Strategy Statement and are reviewed in Appendix 1.

Debt Rescheduling

3.25 No debt rescheduling was undertaken during the quarter.

4.0 POLICY IMPLICATIONS

4.1 None.

5.0 FINANCIAL IMPLICATIONS

5.1 The financial implications are as set out in the report.

6.0 IMPLICATIONS FOR THE COUNCIL’S PRIORITIES

6.1 There are no direct implications, however, the revenue budget and capital programme support the delivery and achievement of all the Council’s priorities.

7.0 RISK ANALYSIS

7.1 The main risks with Treasury Management are security of investment and volatility of return. To mitigate these, the Council operates within a clearly defined Treasury Management Policy and annual borrowing and investment strategy, which sets out the control framework

8.0 EQUALITY AND DIVERSITY ISSUES

8.1 None.

9.0 LIST OF BACKGROUND PAPERS UNDER SECTION 100D OF THE LOCAL GOVERNMENT ACT 1972

9.1 There are no background papers under the meaning of the Act.

Appendix 1

Treasury and Prudential Indicators – 2022/23 – Quarter 2

	2021/22	2022/23	
Prudential Indicators	**Full Year Actual £000**	**Original Estimate £000**	**Quarter 2 Estimate £000**
Capital Expenditure	26,761	30,496	39,720
Net Financing Need for the Year *(Borrowing Requirement)*	7,311	18,397	13,364
Increase / (Decrease) in CFR *(Capital Financing Requirement)*	(2,412)	(193)	(5,218)
Ratio of Financing Costs to Net Revenue Stream *(Proportion of cost of borrowing to Council's net revenue)*	6.2%	6.8%	5.5%
External Debt *(Borrowing plus PFI and lease liabilities)*	537,678	525,358	525,358
Operational Boundary *(Limit of which external debit is not epected to exceed)*	559,675	552,679	552,679
Authorised Limit *(Limit beyound which external debit is prohibited)*	630,824	627,133	627,133

Maximum Principal invested > 365 days	**Investment Limit £000**	**2021/22 Actual £000**	**2022/23 Estimate £000**
Principal Sums Invested over 365 days	40,000	15,700	10,000