Treasury Management Update

Quarterly report

30th June 2024

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Treasury Management Update
Quarter Ended 30th June 2024

The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management 2021 recommends that members be updated on treasury management activities at least quarterly. This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

1. Economics update – Provided by LINK (Councils Treasury Advisors)

- The first quarter of 2024/25 saw:
  - GDP growth flatlining in April following positive Q4 2023/24 growth figures of 0.7% from the previous qtr
  - A stalling in the downward trend in wage growth, with the headline 3m rate of the previous year staying at 5.9% in April.
  - CPI inflation falling from 2.3% in April to 2.0% in May.
  - Core CPI inflation decreasing from 3.9% in April to 3.5% in May.
  - The Bank of England holding rates during Q1 but subsequently reduced this to 5% in August.
  - 10-year gilt yields climbing to 4.35% in April, before closing out at 4.32% in May.
- The news that the economy grew by 0.7% in Q4 2023/24 from the previous qtr 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 so far shows a slight stalling in the recovery, with GDP data for April coming out at 0.0% over the previous month, as inclement weather weighed on activity.
- On a more positive note, the 2.9% month on month increase in retail sales volumes in May more than reversed the 1.8% drop in April as rainfall returned to seasonal norms. The strength was broad-based across the retail sector, including online, 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.
- 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.
- Nonetheless, the on-going stickiness of wage growth in April will be a lingering concern for the Bank of England. The 3m year on year rate of average earnings growth stayed at 5.9% in April.

- Despite the stickiness of wage growth in April, 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 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 fall in CPI inflation in May 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, 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 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.
- There was little chance that the Bank would cut rates at its June meeting, given upside surprises on services CPI inflation and wage growth. But several developments implied a rate cut was getting closer and duly took place in August.

2. Interest rate forecasts

The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The 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. For Housing Revenue Account authorities, the lower Housing Revenue Account (HRA) PWLB rate has also been available since 15 June 2023 (standard rate minus 60 bps) but is available for HRA borrowing only.

The latest forecast, updated on 28th May, 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.

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.

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.

Accordingly, Link's central case is that following the rate cut in August, the path and speed of rate cuts will be similar to that which we previously forecast, with Bank Rate eventually falling to a low of 3% by 2026.

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.

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

- Money market yield forecasts are based on expected average earnings by local authorities for 3 to 12 months.
- The Link forecast for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short-term cash at any one point in time.

3. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2024/25, which includes the Annual Investment Strategy, was approved by the Council on 8th February 2024. 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 seeking 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.

As shown by the charts below and the interest rate forecasts in section 2, investment rates have remained elevated during the first quarter of 2024/25 but have are fallen back in the second half of 2024 as inflation reduces and the MPC starts to loosen monetary policy.

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.

Investment counterparty criteria

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

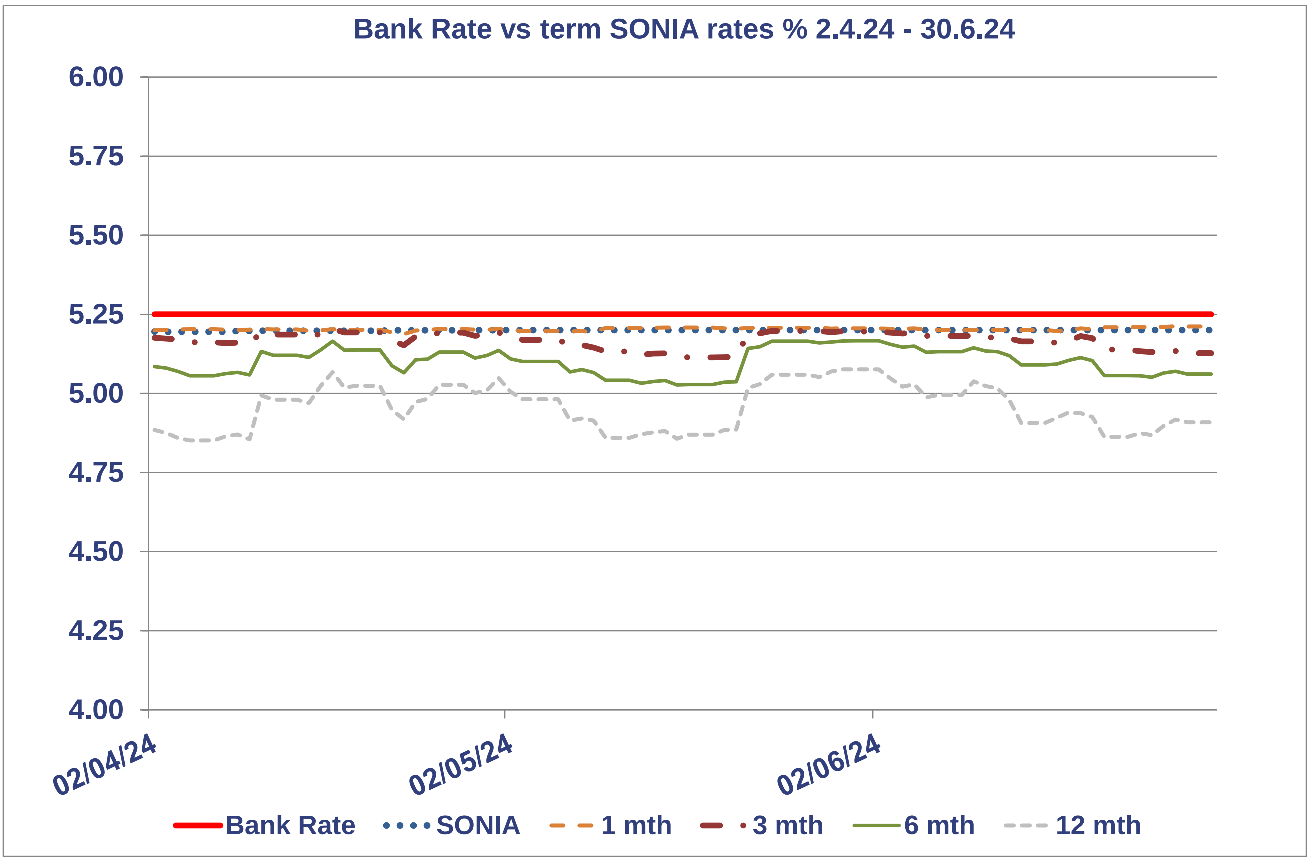
CDS prices

For UK banks, these have remained low, and prices are not misaligned with other creditworthiness indicators, such as credit ratings. **Nevertheless, it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.**

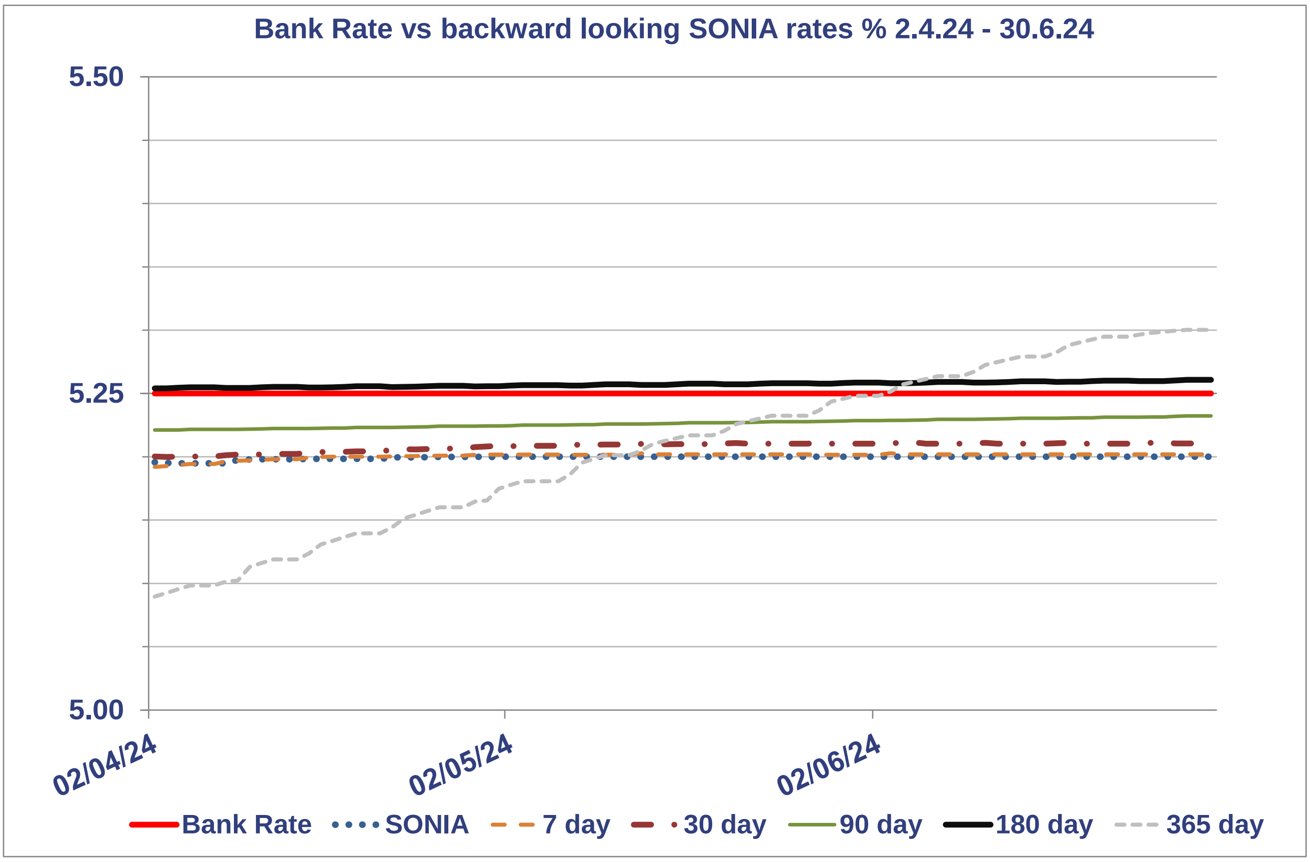
Investment balances

The average level of funds available for investment purposes during the quarter was **£23.2m**. 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. The Council holds **£2m** core cash balances for investment purposes (i.e., funds available for more than one year).

Investment performance year to date as of end-June 2024



FINANCIAL YEAR TO QUARTER ENDED 30/06/2024						
	Bank Rate	**SONIA**	**1 mth**	**3 mth**	**6 mth**	**12 mth**
High	5.25	5.20	5.21	5.20	5.17	5.08
High Date	02/04/2024	03/05/2024	27/06/2024	17/04/2024	31/05/2024	30/05/2024
Low	5.25	5.19	5.19	5.11	5.03	4.85
Low Date	02/04/2024	04/04/2024	23/04/2024	17/05/2024	16/05/2024	05/04/2024
Average	5.25	5.20	5.20	5.17	5.10	4.96
Spread	0.00	0.01	0.02	0.09	0.14	0.23



FINANCIAL YEAR TO QUARTER ENDED 30/06/2024							
	Bank Rate	**SONIA**	**7 day**	**30 day**	**90 day**	**180 day**	**365 day**
High	5.25	5.20	5.20	5.21	5.23	5.26	5.30
High Date	02/04/2024	03/05/2024	13/05/2024	26/06/2024	28/06/2024	28/06/2024	28/06/2024
Low	5.25	5.19	5.19	5.20	5.22	5.25	5.09
Low Date	02/04/2024	04/04/2024	02/04/2024	03/04/2024	02/04/2024	02/04/2024	02/04/2024
Average	5.25	5.20	5.20	5.21	5.23	5.26	5.21
Spread	0.00	0.01	0.01	0.01	0.01	0.01	0.21

The weighted average rate of return earned on investments for the first quarter of 2024/25 was 5.50%. The comparable performance indicator is the average 7-day SONIA rate, which was 5.20%.

The Council's budgeted investment return for 2024/25 is **£932k** (across both General Fund and HRA), and performance for the year based on Q1 data is currently forecasting a surplus of **£164k** above budget.

Fund investments

- Money Market Funds (MMFs) – with bank rates remaining steady, the return on MMFs has followed the trend and remaining at around 5.2% at the end of quarter one.
- Property Funds – As regards the Councils £2m investment in the CCLA property fund the latest valuation has improved with the value at March 2024 increasing from £1.775m to £1.794m as at 30th June but this does still represent a notional loss currently. However, there has been a positive move in the interest return with the Q1 return being 4.87% compared to 4.71% at the end of March.

Approved limits
Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 30th June 2024.

A full list of investments held as of 30th June 2024 is in Appendix 2.

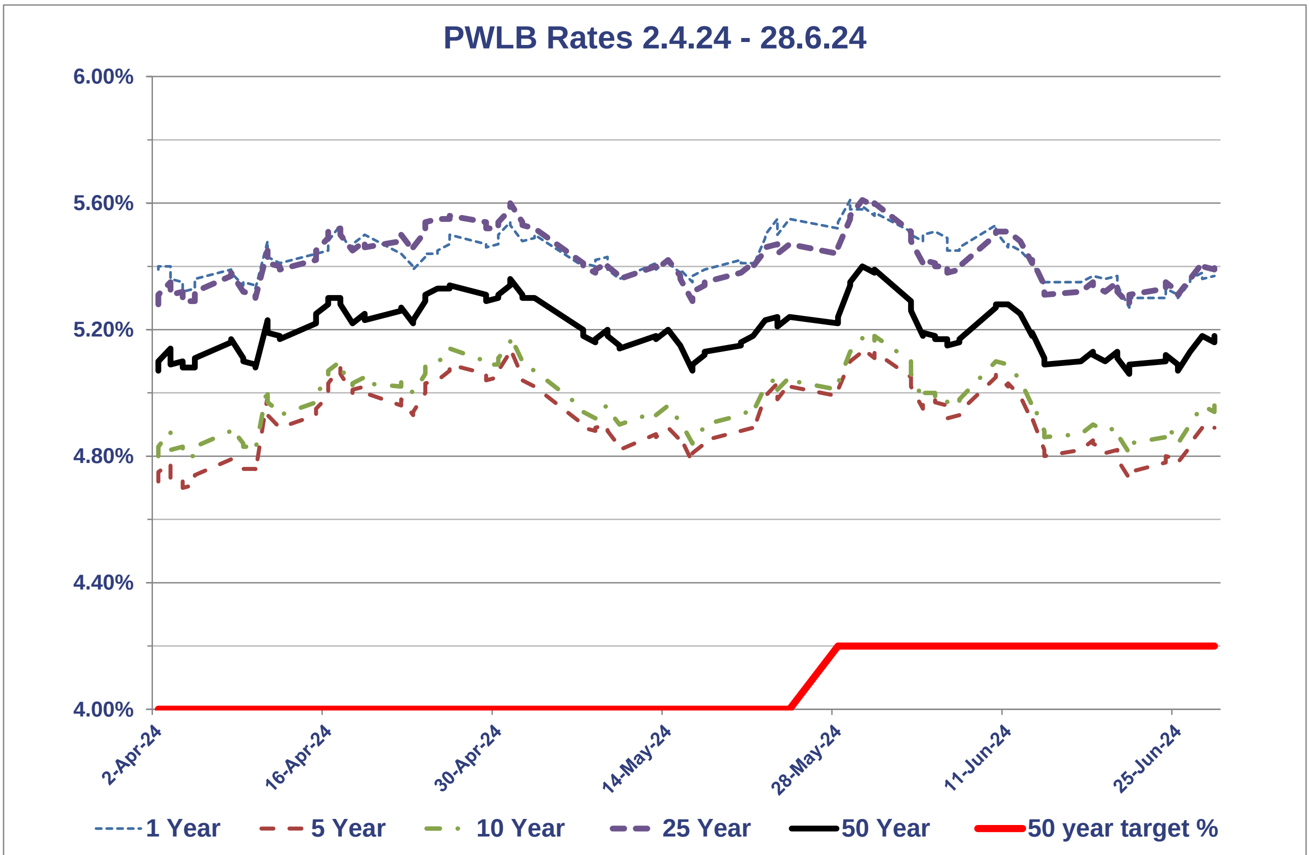
4. Borrowing

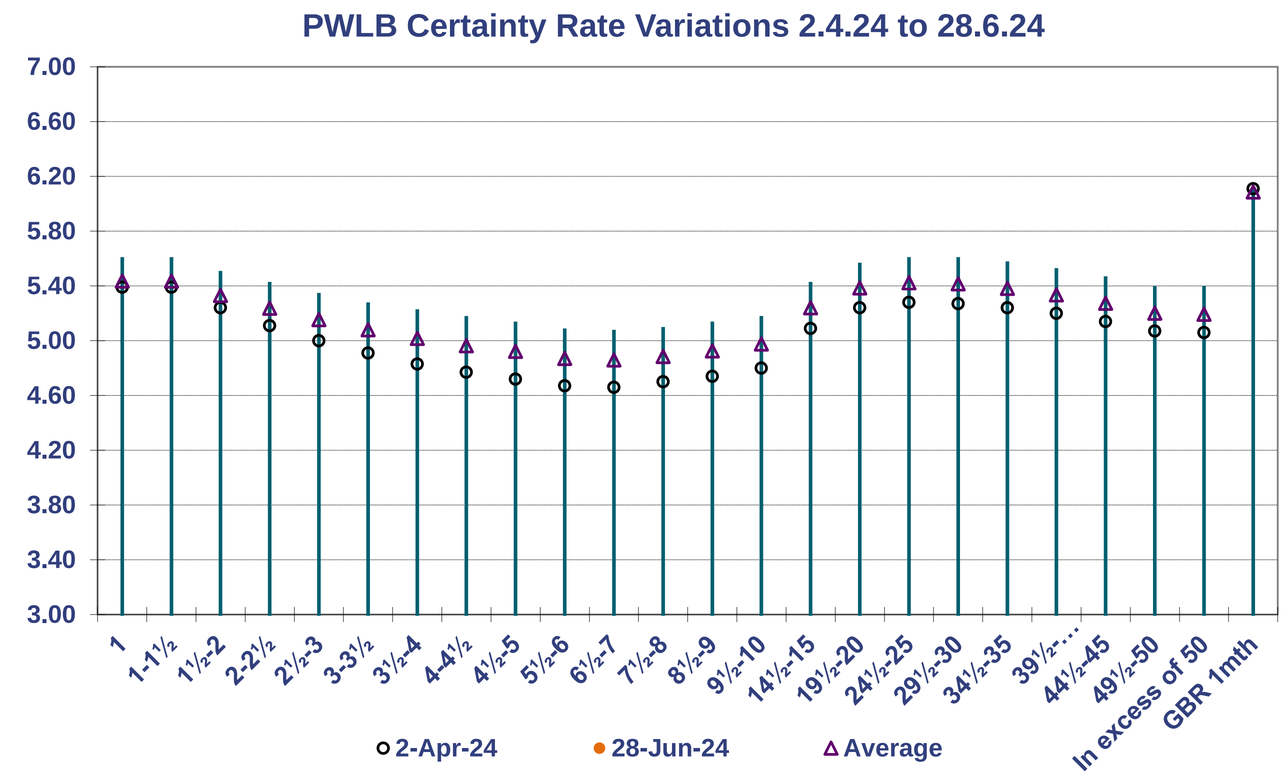
No borrowing was undertaken during the quarter ended 30th June 2024.

PWLB maturity Certainty Rates 1st April to 30th June 2024
Gilt yields and PWLB rates remained relatively stable between 1st April and 30th June. Having said that, the spread between the low and high points during the quarter was between 0.3% and 0.45% across the curve.

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.

PWLB RATES 02.04.24 - 28.06.24 (note: the 1st April & 29th and 30th June were bank holidays/weekends)





HIGH/LOW/AVERAGE PWLB RATES FOR 02.04.24 – 28.06.24

	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. Debt rescheduling

Debt rescheduling opportunities have remained a possibility in the current quarter for those authorities with significant surplus cash and a flat or falling Capital Financing Requirement in future years. Members will be advised if there is value to be had by rescheduling or repaying a part of the debt portfolio.

6. Compliance with Treasury and Prudential Limits

The prudential and treasury Indicators are shown in Appendix 1.

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the quarter ended 30th June 2024, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2024/25. The Director for Corporate Services reports that no difficulties are envisaged for the current or future years in complying with these indicators.

All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

APPENDIX 1: Prudential and Treasury Indicators for 2024-25 as of 30th June 2024

Treasury Indicators	2024/25 Budget £'000	31.06.24 Actual £'000
Authorised limit for external debt	46,000	46,000
Operational boundary for external debt	34,000	34,000
Gross external debt	31,413	31,413
Investments	22,000	24,125
Net borrowing	9,413	7,288

Maturity structure of fixed rate borrowing - upper and lower limits	Lower	Upper	
Under 12 months	0%	50%	0.31%
12 months to 2 years	0%	50%	12.73%
2 years to 5 years	0%	50%	0.96%
5 years to 10 years	0%	50%	0.96%
10 years to 20 years *1	0%	50%	15.92%
20 years to 30 years *1	0%	50%	32.92%
30 years to 40 years *1	0%	50%	36.21%
40 years to 50 years *1	0%	50%	0%

Upper limit for principal sums invested over 365 days *(split by financial years beyond current year end): -* ***2** **Year 1** **Year 2** **Year 3 etc** **Total**	Upper Limit £10m annually	Actual invested £2m (property fund)

Prudential Indicators	2024/25 Budget £'000		2024/25 Forecast £'000	
	HRA	GF	HRA	GF
Capital expenditure *	3,805	3,356	5,531	17,165
Capital Financing Requirement (CFR) *	31,484	32	31,484	32
Annual change in CFR *	0	-11	0	-11
In year borrowing requirement	0	0	0	0
Ratio of financing costs to net revenue stream *	27.04	-10.5	25.68	-11.07

APPENDIX 2: Investment Portfolio

Investments held as of 30th June 2024 compared to our counterparty list:

Melton Borough Council

Current Investment List

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest LT / Fund Rating	Historic Risk of Default	Expected Credit Loss (£)
MMF Insight	970,000	5.24%		MMF	AAAm		
MMF Invesco	3,000,000	5.21%		MMF	AAAm		
Standard Chartered Bank (ESG)	1,000,000	6.21%	01/08/2023	31/07/2024	A+	0.004%	39
SMBC Bank International Plc	3,000,000	5.30%	26/06/2024	27/08/2024	A-	0.007%	220
Standard Chartered Bank (ESG)	1,000,000	6.15%	04/09/2023	03/09/2024	A+	0.008%	82
Standard Chartered Bank (ESG)	1,000,000	5.84%	03/10/2023	02/10/2024	A+	0.012%	119
First Abu Dhabi Bank PJSC	1,000,000	5.78%	01/11/2023	31/10/2024	AA-	0.007%	75
National Bank of Kuwait (International) PLC	2,000,000	5.32%	17/01/2024	16/01/2025	A	0.025%	506
National Bank of Kuwait (International) PLC	1,000,000	5.32%	01/02/2024	31/01/2025	A	0.027%	272
National Bank of Kuwait (International) PLC	1,000,000	5.43%	12/03/2024	12/03/2025	A	0.032%	322
Qatar National Bank	1,000,000	5.50%	02/04/2024	02/04/2025	A+	0.035%	349
First Abu Dhabi Bank PJSC	1,000,000	5.31%	02/05/2024	02/05/2025	AA-	0.019%	186
Qatar National Bank	1,000,000	5.62%	02/05/2024	02/05/2025	A+	0.039%	387
Qatar National Bank	3,000,000	5.72%	30/05/2024	30/05/2025	A+	0.042%	1267
Qatar National Bank	1,000,000	5.51%	26/06/2024	26/06/2025	A+	0.046%	456
Borrower - Funds	**Principal (£)**	**Interest Rate**	**Start Date**	**Maturity Date**			
CCLA Property Fund	2,000,000	1.00%					
Total Investments	**£23,970,000**	**5.13%**					
Total Investments - excluding Funds	**£21,970,000**	**5.51%**				**0.024%**	**£4,279**
Total Investments - Funds Only	**£2,000,000**	**1.00%**					

Note: An historic risk of default is only provided if a counterparty has a counterparty credit rating and is not provided for an MMF or USDBF, for which the rating agencies provide a fund rating. The portfolio's historic risk of default therefore measures the historic risk of default attached only to those investments for which a counterparty has a counterparty credit rating and also does not include investments which are not rated.
The Historic Risk of Default column is based on the lowest long term rating. If clients are using this % for their Expected Credit Loss calculation under IFRS 9, please be aware that the Code does not recognise a loss allowance where the counterparty is central government or a local authority since relevant statutory provisions prevent default. For these instruments, the Expected Credit Loss will be nil. Please note that we are currently using Historic Default Rates from 1990-2023 for Fitch, 1983-2023 for Moody's and 1981 to 2023 for S&P.