TREASURY MANAGEMENT STRATEGY QUARTER 2 UPDATE 2023/24

REPORT OF THE TREASURER

CLEVELAND FIRE AUTHORITY

For Approval

1. PURPOSE OF REPORT

1.1 The purpose of the repot is to provide the second quarter update of the 2023/24 Treasury Management activity.

2. BACKGROUND

2.1 The Treasury Management Strategy covers:

- The strategy for the Authority's borrowing requirement arising from historic capital expenditure and the element of the approved Asset Management Plan funded from Prudential Borrowing; and
- The annual investment strategy relating to the Authority's cash flow.

2.2 The Local Government Act 2003 requires the Authority to 'have regard to' the CIPFA (Chartered Institute of Public Finance and Accountancy) Prudential Code and to set prudential indicators for the next three years to ensure that the Authority's capital investment plans are affordable, prudent and sustainable.

2.3 The Act requires the Authority to set out a Treasury Management Strategy for borrowing and to prepare an Annual Investment Strategy, which sets out the policies for managing investments and for giving priority to the security and liquidity of those investments. The Secretary of State has issued Guidance on Local Government Investments which came into force on 1st April, 2004, and has subsequently been updated, most recently in 2021.

2.4 The Authority is required to nominate a body to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies, before making recommendations to the full Authority. This responsibility has been allocated to the Audit and Governance Committee.

2.5 This report covers the following areas:

- Economic background and outlook for interest rates
- Treasury Management Strategy 2023/24 second quarter review

2.6 ECONOMIC BACKGROUND AND OUTLOOK FOR INTEREST RATES

2.7 **UK –** Since February 2023 the UK economy has faced an extended and on-going period of economic uncertainty with significant inflationary pressures. In response the Bank of England's Monetary Policy Committee (MPC) have increased interest rates, with the most recent 0.25% increase in August taking the rate to 5.25%.

The Bank of England's MPC again held the Bank Rate unchanged at 5.25% at its November meeting, by a majority of 6-3.

In November Governor Andrew Bailey said: "Higher interest rates are working and inflation is falling. But we need to see inflation continuing to fall all the way to our 2% target. We've held rates unchanged this month, but we'll be watching closely to see if further rate increases are needed. It's much too early to be thinking about rate cuts."

To provide context to the recent increases:

- the interest rate in January 2022 was 0.25% - which highlights the scale of the increase to 5.25%; and

- the interest rate over the period March 2009 to December 2021 never exceeded 0.75% and for the majority of this period was 0.5%.

2.8 The September 2023 Consumer Price Index data remained unchanged in September 2023 at 6.7%, the same level as August 2023.

2.9 The Office for Budget Responsibility's revised growth forecasts up to 2027 are set out in the following table:

Year	March 2022 Growth Forecast	March 2023 Growth Forecast
2023	1.8%	(0.2%)
2024	2.1%	1.8%
2025	1.8%	2.5%
2026	1.7%	2.1%
2027		1.9%

2.10 **European Union (EU) –** The European Central Bank (ECB) left interest rates unchanged at its October meeting following ten consecutive rate hikes previously. In October inflation fell to 2.9% (from 4.3% in October), falling below 3% for the first time since mid-2021.

2.11 **USA –** The Federal Reserve left its target interest range unchanged at its November meeting at 5.25% to 5.5%, at a current 22-year high as it seeks to stabilise price rises. It signals that the Central Bank may delay lowering interest rates, as inflation currently stands at 3.7%, which is still above the Federal Reserve target of 2%.

2.12 **Other Economies –** In China, although the economy appears to have avoided a further slowdown, it is still facing some major challenges. CPI turned negative in July at -0.3%, while Produce Price Index (PPI) deflation continued for the 10^{th} month in a row. A rebound in the coming months seems unlikely as household confidence also remained weak. Policy rates were cut for the second time in three months, but the declines are considered by economists to be too small to have much impact. In Japan, headline inflation decreased to 2.8% in September from 3.2% in the prior month.

2.13 **Interest Rate Forecasts**

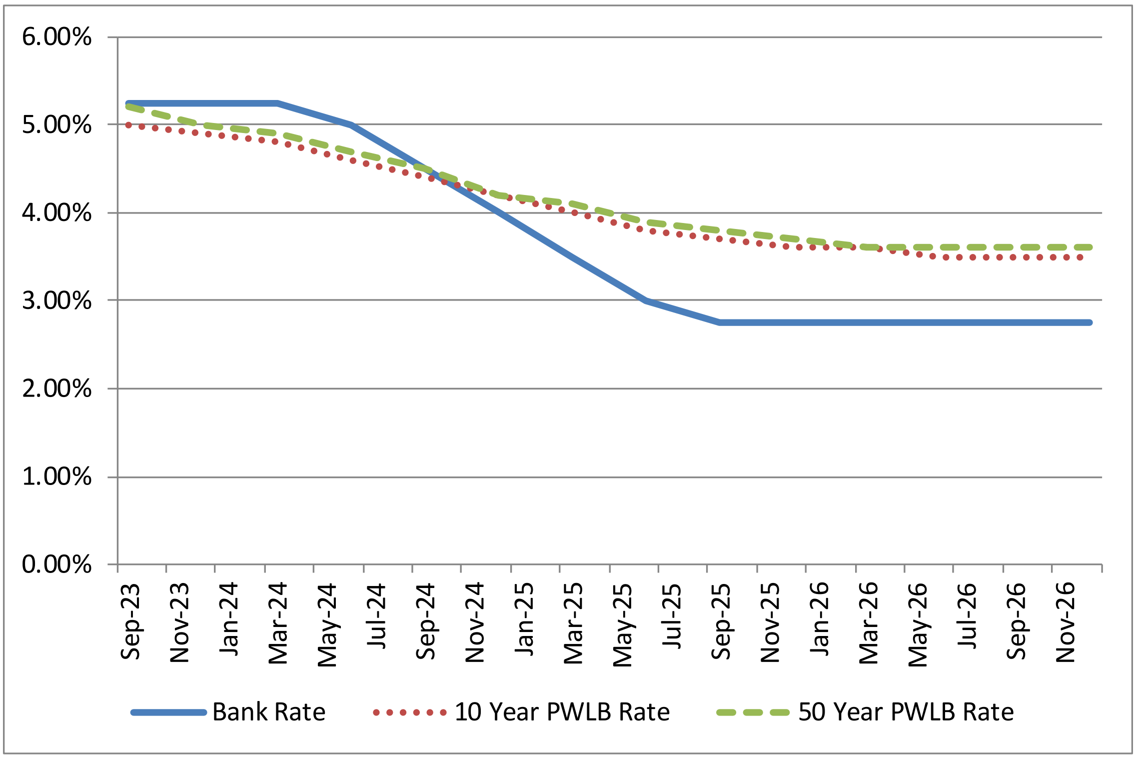
2.14 Link Asset Services (the Authority's Treasury Management advisors) continue to update their interest rate forecasts to reflect statements made by the Governor of the Bank of England and changes in the economy.

2.15 Expectations are that the Bank Rates will remain on hold at 5.25% for the best part of the year. Data is suggesting that inflation is dipping, albeit slowly, and that the economy is heading for a very low growth, with a potential risk of a shallow recession. This would suggest that further interest rate increase above 5.25% may not be required.

2.16 Link anticipate the Bank of England will be keen to reduce interest rates when the worst of the inflationary pressures are behind us – but the timing will be one of fine judgement; cut too soon, and inflationary pressure may well build up further; cut too late and any downturn or recession may be prolonged.

2.17 Economic and interest rate forecasting remains difficult with so many influences impacting on the economy. UK gilt yields (i.e., Government borrowing) and PWLB rates forecasts made by Link Asset Services may be liable to further amendment depending on how the political and economic developments transpire over the next year. What seems clear is we will not see a return to the recent ultra-low base rate of 0.25% and a base rate just below 3% is forecast mid to late 2025.

2.18 Interest Rate Forecast up to December 2026



3. TREASURY MANAGEMENT STRATEGY 2023/24 2nd QUARTER REVIEW

3.1 The 2023/24 Treasury Management Strategy was approved on the 24th March, 2023. The Authority's borrowing and investment position as at 30th September 2023 is summarised as follows:

	£m	**Average Rate**
LOBO Loan #	2.0	3.95%
PWLB Loans	6.8	2.92%
Gross Long Term Debt	**8.8**	**3.15%**
Investments	19.0	4.50%
Net Investment	**10.2**	

A LOBO (Lender Option, Borrower Option) loan was taken out in March 2007 at which time interest rates for comparative PWLB loans were 4.3%.

3.2 As part of the Treasury Management Strategy for 2023/24 the Authority set a number of prudential indicators. Compliance against these indicators is monitored on a regular basis and there are no breaches to report.

3.3 The CFR and Capital Expenditure Financed by Borrowing will vary from the original estimate approved by the Fire Authority in March 2023 owing to planned capital expenditure being re-phased between financial years.

3.4 **Investment Strategy** - The Authority had previously limited investments to 1 year or less. However, earlier in the year this strategy was revised and the Authority approved the time limit for investment be extended to up to 2 years. This limit would be applied using the existing counterparty criteria with a total limit for investments of up to 2 years of £5m. There were no changes to the counterparty investment limits as set out in the table below.

Category	Fitch	Moody's	Standard & Poor's	Proposed Counterparty Limit	Proposed Time Limit
A	F1+/AA-	P-1/Aa3	A-1+/AA-	£7m	2 years
B	F1/A-	P-1/A3	A-1/A-	£5m	2 years
C	Debt Management Office/Treasury Bills/Gilts			£14m	1 year
D	Nationalised Banks			£5m	2 years
E	Other Local Authorities Individual Limits per Authority: - £3m County, Metropolitan or Unitary Councils - £1.5 District Councils, Police or Fire Authorities			£15m	2 years
F	Three Money Market Funds (AAA) with maximum investment of £1.5m per fund			£4.5m	Liquid (instant access)

3.5 As at 30th September, the temporary investment funds amounted to £19.0m, which reflected strategic investments, the positive cashflow impact of when capital expenditure is incurred and the receipt of the Pension Grant. All investments complied with the Annual Investment Strategy and are shown below.

Borrower	Duration	Value of Loan (£m)	Rate (%)	Start Date	Maturity Date
Call Accounts*					
Svenska Handelsbanken	On Call	4.701	2.100		Call
NatWest Bank	On Call	0.002	1.150		Call
		4.703	**2.100**		
Fixed term Deposits					
CFB Risk Management	1 year	0.090	2.740		
Lloyds	1 year	5.000	5.370	07/10/22	06/10/23
Goldman Sachs	1 year	5.000	5.270	21/10/22	20/10/23
Debt Management Office	<1 month	2.114	5.035	19/09/23	13/10/23
Debt Management Office	1 month	2.092	5.265	20/09/23	31/10/23
		14.296	**5.294**		
Total Deposits		**18.999**	**4.503**		

*On Call interest rate can vary on a day-to-day basis. The figure quoted here is as at 06/10/23.

3.6 Since the recommended strategy to invest for up to 2 years was approved by the Authority, we have seen the Bank of England hold the base rate at 5.25%. In response the financial market is not currently providing 2-year investment periods as they believe the next interest rates change will be a reduction.

3.7 In order to secure the investment income reported as part of the Medium Term Financial Strategy the Authority's strategic investments have been placed on the basis of phased maturity dates to address the change in the financial market. This revised approach has enabled the Authority to secure very favourable current interest rates on the £10m of strategy investments which matured in October - £5m invested for 12 months, £3m invested for 9 months and £2m invested for 6 months. This approach will then enable 12 month interest rates to be secured when these investments mature, which will provide the certainty for the Medium Term Financial Strategy.

3.8 **Borrowing Strategy** - In relation to the Authority's borrowing requirement for approved capital expenditure in 2023/24 it is not recommended that any new borrowing is undertaken during the current year as interest rates are expected to fall in future years. Therefore, by deferring borrowing decisions the Authority will not lock into these high interest rates.

3.9 It is recognised that there is a potential risk that current interest rates may prevail longer than currently anticipated. However, it is expected these rates will fall once the Bank of England is satisfied inflation is under control, although interest rates are unlikely to fall to the previously historical low level of recent years.

3.10 In the short-term any borrowing requirement for the approved 2023/24 capital programme will be funded from a combination of netting down investments and borrowing (in a similar way to an individual having an offset mortgage), or temporary borrowing for a short period if this is necessary. This approach will minimise the net overall costs of the Authority's investments and borrowing requirement.

4. CONCLUSIONS

4.1 For over a decade UK and international interest rates were at a historically and unprecedented low level and this included the Bank of England base rating being 0.5% for a sustained period. It was always anticipated that this position would not be sustained, although the change to slightly higher rates was expected to be gradual and the new 'normal' interest rates would still remain low by historic standards.

4.2 During this period the Authority's Treasury Management Strategy secured long term borrowing at low interest rates. This has secured the financing of a significant element of the Asset Management Plan and has protected the authority against increases in longer term interest rates.

4.3 The significant economic turmoil of the last year, which is driven by the invasion of Ukraine by Russia, has resulted in an unprecedented spike in inflation. This has resulted in central banks across the world increasing interest rates. Within the UK the Bank of England has had to increases interest rates by more than they had indicated earlier in the year in response to inflation remaining high. With interest rates increasing from 0.25% in January 2022 to the current level of 5.25%.

4.4 The current economic environment makes Treasury Management significantly more challenging than it has been for over a decade. Against this background the recommended strategy is designed to manage these risks and minimise costs to the Authority.

4.5 The report sets out how the Authority will comply with the regulatory framework to ensure the Council achieves the lowest borrowing costs and security for any temporary cash investments. Within this framework and the more uncertain / volatile financial environment officers will continue to actively manage borrowing and investments to support the overall financial position of the Authority.

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