Appendix 3

Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review Report 2022/23

2022 / 23

Date: October 2022
Owner: Strategic Finance

North Tyneside Council

Table of Contents

Foreword

1.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management stipulates that the Chief Finance Officer should set out in advance the Treasury Management Strategy for the forthcoming financial year, and subsequently report the treasury management activities during that year.

1.2 The primary requirements of the Code are as follows:

(a) forecast the likely activity for the forthcoming year (in the Annual Treasury Management Strategy Report);
(b) a mid-year review report; and,
(c) review actual activity for the preceding year, including a summary of performance.

1.3 This section of the document contains the required mid-year review report for 2022/23. This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

• An economic update for the first six months of 2022/23;
• A review of the Treasury Management Strategy Statement and Annual Investment Strategy for 2022/23;
• A review of the Authority's investment portfolio for 2022/23;
• A review of the Authority's borrowing strategy for 2022/23; and,
• A review of compliance with Treasury and Prudential Limits for 2022/23 (detailed in Reference to appendix 2).

Economic Performance and Outlook Summary

2.1 Economic performance continues to be driven by rising energy prices, cost of living crisis and the conflict in Ukraine with signs of economic activity losing momentum. The Bank rate continues to rise by 100bps over the last quarter taking the rate up to 2.25% with further rises forecast. Although the UK economy grew by 0.2% in July, revisions to historic data left it below pre-pandemic levels.

2.2 Inflation still remains the key topic over the MTFP, inflation recently rose to 10.1%, over 7% against September 2022.

2.3 There are signs of higher energy prices creating more persistent downward effects in economic activity. The search for alternative providers of energy, other than Russia, will take both time and effort. In August, the Bank of England's MPC increased Bank Rate to 1.75%, and on 22nd September moved rates up even further to 2.25%

Interest Rate Forecast

3.1 Link Asset services currently forecast Bank of England base rate to increase from the current 2.25% during Q3 of 2022.

Table 1: Link Asset Services BoE base rate forecast

Month	Dec-22	Dec-23	Dec-24
BBR Rate	4.00%	4.50%	3.00%

3.2 The latest forecast on 27th September 2022 sets out a view that both short and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy, whilst the government is providing a package of fiscal loosening to try and protect households and businesses from the effects of ultra-high wholesale gas and electricity prices.

As indicated in table 1, one increase in Bank Rate from 2.25% to 4.00% has now been included in 2023, a second increase to 4.50% in 2023 and before reducing to 3.00% in 2024.

3.3 The MPC has tightened short-term interest rates with a view to trying to slow the economy sufficiently to keep the secondary effects of inflation – as measured by wage rises – under control, however has been made more difficult of recent, following the more recent political uncertainty.

3.4 Chancellor Kwarteng was dismissed on the 14th October 2022, followed by Liz Truss resigning on the 25th October 2022. Rishi Sunak has been appointed Prime Minister, and Jeremy Hunt as Chancellor. Markets appeared to have stabilised marginally following the change.

Bond Yields and Increase in the cost of borrowing from the PWLB

4.1 Throughout 2022/23, gilt yields have been on an upward trend. The trend was exceptionally sharply 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. Policies proposed by Liz Truss and Kwasi Kwarteng made a step change in government policy. The government's huge fiscal loosening from its proposed significant tax cuts added to existing domestic inflationary pressures and will potentially leave a legacy of higher interest rates and public debt.

4.2 The 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 Fed and ECB raised rates in their most recent meetings, the Bank of England's hike looks relatively dovish. 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.

4.3 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%..

4.4 For local authorities, this means that investment interest, both short and long dated, will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy.

4.5 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. In July, the 3my/y rate of average earnings growth rose from 5.2% in June to 5.5%.

4.6 Whilst the government's utility price freeze, which could cost up to £150bn (5.7% of GDP) over 2 years, will reduce peak inflation from 14.5% in January next year to 10.4% in November this year, the long list of tax measures announced at the "fiscal event" adds up to a loosening in fiscal policy relative to the previous government's plans of £44.8bn (1.8% of GDP) by 2026/27.

4.7 The Authority has previously borrowed only from the PWLB as its main source of long-term funding; the changing market means the Authority should consider alternative sources of borrowing as necessary. At the current time, this area is still currently developing. The market has seen financial institutions entering the long-term borrowing market and make borrowing products available; however, this remains suitable for larger capital drawdowns in and around £50m+. Therefore, whilst this has limited appeal to North Tyneside Council, we continue to watch this space for future developments.

Balance of Risk to the UK

5.1 The overall balance of risks to economic growth in the UK is now to the downside, due to increases in inflation, labour and supply shortages, UK / EU trade arrangements and Geopolitical risks, for example in Ukraine/Russia.

5.2 There is a balance of upside risks, The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates an even more rapid series of increases in Bank Rate faster than we currently expect.

Annual Investment Strategy

6.1 The Treasury Management Strategy Statement (TMSS) for 2022/23, which includes the Annual Investment Strategy, was approved by the Council on 17 February 2022. There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

6.2 The 17 February 2022 Council approved TMSS sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield.

6.3 The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. 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 highly credit rated financial institutions.

6.4 The approved limits within the Annual Investment Strategy were exceeded for 1 day on the 26 April 2022. This was due to an under investment on this day, leading to a balance larger than forecast overnight.

6.5 During the six months of the financial year, Treasury Management activities continue to manage the surplus cash balance whilst minimising the Authority's requirements to borrow.

Table 2: Investment performance at 30 September 2022

Investments	30/09/2022 £m	Average rate of Return %	Interest Earned period to 30/09/2022
Debt Management Office	20.750	1.09%	£148,173
Other Local Authority	20.000	1.19%	£19,326
Bank Deposits	6.800	1.53%	£13,807
Cash at Bank	6.253	0.01%	£0

6.7 As shown by the interest rate forecasts in section, rates have improved dramatically during the first half of 2022/23 and are expected to improve further as Bank Rate continues to increase.

Borrowing

7.1 The Authority's total capital financing requirement (CFR) including PFI for 2022/23 is £609.108m. The CFR denotes the Authority's underlying need to borrow for capital purposes. If the CFR is positive the Authority may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The summary table provided below provides the borrowing position as at 30 September 2022. Total external debt including PFI's is £504.569m.

7.2 In August 2022, the Authority drew down £10.000m of PWLB long term loans. This was to part fund a PWLB maturity, de-risk our borrowing position as well as take advantage of low interest rates at the time.

Table 3: Total External Debt 30 September 2022

Principal £m	
	External Borrowing
382.443	Public Works Loan Board (PWLB)
20.000	Lender Option Borrower Option (LOBO)
0.000	Other Local Authorities
402.443	**Total**
	Other External Debt
102.216	PFI & Finance Lease (as at 01 Apr 22)
504.659	**Total External Debt**
	Split of External Borrowing
244.672	Housing Revenue Account
157.771	General Fund
402.443	**Total**

7.3 Following introduction of self-financing for the Housing Revenue Account, from 1 April 2012, loans were split between General Fund and Housing. However, decisions on borrowing for both General Fund and Housing will continue to be made within the overall Treasury Management Strategy and will be reported jointly.

7.4 The difference between the CFR and external borrowing is known as internal borrowing. The level of internal borrowing is determined within the Treasury Management Strategy, by a number of factors including market conditions for investments and the level of the Authority's reserves and balances.

7.5 The Authority's borrowing strategy continues to focus on minimising the borrowing cost of carry and is doing so by use of internal borrowing. This may pose a risk in the future when the Authority is required to materialise this by a way of external borrowing.

Debt Rescheduling

8.1 Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

Compliance with Treasury and Prudential Limits

9.1 It is a statutory duty for the Authority to determine and keep under review the affordable borrowing limits. During the half year ended 30 September 2022, the Authority has operated within the treasury and prudential indicators set out in the Authority's Treasury Management Strategy Statement for 2022/23. All treasury management operations have also been conducted in full compliance with the Authority's Treasury Management Practices.