Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review Report 2023/24

North
Tyneside
Council

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Owner: Strategic Finance

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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 2023/24. 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 2023/24;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy for 2023/24;
- A review of the Authority's investment portfolio for 2023/24;
- A review of the Authority's borrowing strategy for 2023/24; and,
- A review of compliance with Treasury and Prudential Limits for 2023/24 (detailed in Reference to appendix 2).

Economic Performance and Outlook Summary

2.1 Economic performance continues to be driven by volatile 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 a further 50bps over the last quarter. At its latest meeting on the 2nd November 2023, the MPC voted to leave the rate unchanged at 5.25%. CPI inflation declined from 6.8% in July to 6.7% in both August and September, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.2%

2.2 Inflation still remains the key topic over the MTFP, UK consumer prices, as measured by the Consumer Prices Index (CPI), were 6.7% higher in September 2023 than a year before, unchanged from August, which was the lowest rate since February 2022. This was a little higher than expected, with economists forecasting a small decline to 6.6%.

2.3 There are signs that energy prices continue to impact economic activity. Between June and July 2023, gas prices fell at record rates of 25.2%. This was largely because of the lowering of the Office of Gas and Electricity Markets (Ofgem) price cap in that month.

2.4 UK food and non-alcoholic drink prices were 12.1% higher in September 2023 compared to the previous year, based on the CPI measure of inflation. This continued the decline from the recent peak of 19.1% in March 2023, which was the highest rate of increase in food prices since 1977. Over the two years from September 2021 to September 2023 food prices rose by 28.4%. It previously took over 13 years, from April 2008 to September 2021, for average food prices to rise by the same amount.

Interest Rate Forecast

3.1 Link Asset services currently forecast Bank of England base rate to remain at 5.25% for the remainder of the financial year.

Table 1: Link Asset Services BoE base rate forecast

Month	Dec-23	Dec-24	Dec-25
BBR Rate	5.25%	4.50%	2.75%

3.2 The latest forecast on 25th September 2023 sets out a view that both short and long-dated interest rates will remain at a constant elevated level for a little while, as the Bank of England seeks prove their higher for longer narrative whilst still trying to reach their 2% inflation target.

As indicated in table 1, a stabilised Bank Rate at 5.25% shows throughout 2023 until Q1 of 2024, before a gradual reduction to 4.50% in Q3 2024 and then further reducing to 2.75% in 2025.

3.3 The MPC will continue to monitor closely indications of persistent inflationary pressures and resilience in the economy as a whole, including the tightness of labour market conditions and the behaviour of wage growth and services price inflation. Monetary policy will need to be sufficiently restrictive for sufficiently long to return inflation to the 2% target sustainably in the medium term, in line with the Committee's remit. Further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures.

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

4.1 Throughout 2022/23, Short, medium and long-dated gilts remained elevated as inflation impacted on markets. Gilt yields and PWLB certainty rates were on a generally rising trend throughout the first half of 2023/24. At the beginning of April, the 5-year rate was the cheapest part of the curve and touched 4.14% whilst the 25-year rate was relatively expensive at 4.58%.

4.2 Our Treasury advisors, Link, forecast rates to fall back over the next two to three years as inflation dampens. The CPI measure of inflation is expected to fall below 2% in the second half of 2024, and they forecast 50-year rates to stand at 3.90% by the end of September 2025. However, there is considerable gilt issuance to be digested by the market over the next couple of years, as a minimum, so there is a high degree of uncertainty as to whether rates will fall that far.

4.3 July saw short-dated rates peak at their most expensive. The 1-year rate spiked to 6.36% and the 5-year rate to 5.93%. Although, in due course, short-dated rate expectations fell, the medium dates shifted higher through August and the 10-year rate pushed higher to 5.51% and the 25-year rate to 5.73%. The 50-year rate was 4.27% on 5th April but rose to 5.45% on 28th September.

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

4.5 The tightness of the labour market continued to ease, with employment in the three months to July falling by 207,000. The further decline in the number of job vacancies from 1.017m in July to 0.989m in August suggests that the labour market has loosened a bit further since July. That is the first time it has fallen below 1m since July 2021. At 3.0% in July, and likely to have fallen to 2.9% in August, the job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth.

4.6 Like the US Fed, the Bank of England wants the markets to believe in the "higher for longer" narrative. The statement did not say that rates have peaked and once again said if there was evidence of more persistent inflation pressures "further tightening in policy would be required". Governor Bailey stated, "we'll be watching closely to see if further increases are needed". The Bank also retained guidance that rates will stay "sufficiently restrictive for sufficiently long".

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.

5.2 There is a balance of upside risks; if the Bank of England is too slow in its pace and strength of increases in Bank Rate, which allows inflationary pressures to build up too strongly and for a longer period within the UK economy, this could necessitate 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 2023/24, which includes the Annual Investment Strategy, was approved by the Council on 16 February 2023. 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 16 February 2023 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 26th of May 2023 and for 1 day on the 23rd of August 2023. This was due to an under investment on this day following unexpected cash inflows after treasury activities has been undertaken. This led to balances in excess of approved exposures.

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 as at 30 September 2023

Investments	30/09/2023 £m	Average rate of Return %	Interest Earned period to 30/09/2023
Debt Management Office	20.250	4.66%	£121,393
Other Local Authority	10.000	3.97%	£93,493
Bank Deposits	5.000	5.09%	£163,784
Cash at Bank	1.264	0.00%	£0

Borrowing

7.1 The Authority's total capital financing requirement (CFR) including PFI for 2023/24 is £605.931m. 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 2023. Total external debt including PFI is £510.332.

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 2023

Principal £m	
	External Borrowing
382.443	Public Works Loan Board (PWLB)
20.000	Lender Option Borrower Option (LOBO)
5.000	Other Local Authorities
407.443	**Total**
	Other External Debt
102.889	PFI & Finance Lease (as at 01 Apr 23)
510.332	**Total External Debt**
	Split of External Borrowing
240.701	Housing Revenue Account
166.742	General Fund
407.443	**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 2023, the Authority has operated within the treasury and prudential indicators set out in the Authority's Treasury Management Strategy Statement for 2023/24. All treasury management operations have also been conducted in full compliance with the Authority's Treasury Management Practices.