

## **AUDIT COMMITTEE – 19<sup>th</sup> September 2023**

### **Report of the Head of Finance**

**Lead Member: Councillor Ashcroft**

#### **Part A**

#### **TREASURY MANAGEMENT QUARTER 1 UPDATE REPORT**

##### **Purpose of Report**

This report reviews the Treasury Management Strategy and the Annual Investment Strategy, plus the various Prudential Borrowing and Treasury Indicators for the first three months of the year from April – June 2023.

##### **Recommendations**

That it be recommended that Audit Committee note this report as set out in part B.

##### **Reasons**

To ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the CIPFA code of practice for Treasury Management 2021. It recommends that members be updated on treasury management activities at least quarterly, the report ensures this Council is implementing best practice in accordance with the code.

##### **Policy Justification and Previous Decisions**

The Capital Strategy including the Treasury Management Strategy, Annual Investment Strategy and Minimum Revenue Provision Policy, Prudential & Treasury Indicators must be approved by Council each year and on a quarterly basis. This review is set out in the attached report as Part B. The Strategy for the year was approved by Council on 27<sup>th</sup> February 2023.

##### **Implementation Timetable including Future Decisions and Scrutiny**

This report will be presented to Audit Committee on 19<sup>th</sup> September 2023.

## Report Implications

The following implications have been identified for this report.

### *Financial Implications*

There are no direct financial implications arising from this report.

### *Risk Management*

There are no direct risks arising from the recommendation in this report. Risks associated with the Treasury Policy, etc and in general are set out within Part B.

Key Decision: No

Background Papers: None

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## 1. Economics update – (Appendix 3)

- Summary of the first quarter of 2023/24 saw:
  - A 0.2% month on month rise in real GDP in April, partly due to fewer strikes;
  - CPI inflation falling from 10.1% to 8.7% in April, before remaining at 8.7% in May. This was the highest reading in the G7;
  - Core CPI inflation rise in both April and May, reaching a new 31-year high of 7.1%;
  - A tighter labour market in April, as the 3myy growth of average earnings rose from 6.1% to 6.5%;
  - Interest rates rise by a further 75bps over the quarter, taking Bank Rate from 4.25% to 5.00%;
  - 10-year gilt yields nearing the “mini-Budget” peaks, as inflation surprised to the upside.
- The tighter labour market supported wage growth in April, although the 9.7% rise in the National Living Wage on 1st April (compared to the 6.6% increase in April last year) probably had a lot to do with it too. The 3myy rate of average earnings growth reaccelerated from 6.1% to 6.5% (consensus 6.1%) and UK wage growth remains much faster than in the US and the Euro-zone. In addition, regular private sector wage growth increased from 7.1% 3myy to 7.6%, which left it well above the Bank’s forecast for it to fall below 7.0%. Overall, the loosening in the labour market appears to have stalled in April and regular private sector wage growth was well above the Bank’s forecast.
- CPI inflation stayed at 8.7% in May (consensus 8.4%) and, perhaps more worryingly, core CPI inflation rose again, from 6.8% to a new 31-year high of 7.1%. The rise in core inflation built on the leap from 6.2% in March to 6.8% and means it is accelerating in the UK while it is slowing in the US and the Euro-zone (both fell to 5.3%). A further decline in fuel inflation, from -8.9% to -13.1%, and the second fall in food inflation in as many months, from 19.3% to 18.7%, explained why overall CPI inflation didn’t rise. And the scheduled fall in the average annual utility price from £2,500 to £2,074 on 1st July means overall CPI inflation will probably ease in the coming months. But the problem is that the recent surge in core inflation and the reacceleration in wage growth shows that domestic inflationary pressures are still strengthening.

### Monetary Policy Committee meetings 11<sup>th</sup> May and 22<sup>nd</sup> June 2023

- On 11<sup>th</sup> May, the Bank of England’s Monetary Policy Committee (MPC) increased Bank Rate by 25 basis points to 4.50%, and on 22<sup>nd</sup> June moved rates up a further 50 basis points to 5.00%. Both increases reflected a split vote – seven members voting for an increase and two for none.
- Nonetheless, with UK inflation significantly higher than in other G7 countries, the MPC will have a difficult task in convincing investors that they will be able to dampen inflation pressures anytime soon. Talk of the Bank’s inflation models being “broken” is perhaps another reason why gilt investors are demanding a premium relative to US and Euro-zone bonds, for example.
- Of course, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has already hiked short-term rates to a range of 5.00%-5.25%, but a further increase is pencilled in for July, whilst the ECB looks likely to raise its Deposit rate at least once more to a peak of 3.75%, with upside risk of higher to come.

- **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 1<sup>st</sup> November 2012.

The latest forecast, made on 26<sup>th</sup> June, 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, against a backdrop of a stubbornly robust economy and a tight labour market.

You will note that our forecasts have steadily increased during the quarter as the data continued to spring upside surprises, and the Bank of England continued to under-estimate how prevalent inflation is, and how tight the labour market is. The Government has also noted that despite immigration increasing markedly, high levels of ill-health amongst the workforce has led to wage demands remaining strong until such time as there is a loosening in demand for business services.

The current PWLB rate forecast below are based on the Certainty Rate.

| Link Group Interest Rate View 26.06.23 |        |        |        |        |        |        |        |        |        |        |        |        |        |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
|  | Jun-23 | Sep-23 | Dec-23 | Mar-24 | Jun-24 | Sep-24 | Dec-24 | Mar-25 | Jun-25 | Sep-25 | Dec-25 | Mar-26 | Jun-26 |
| <b>BANK RATE</b>                       | 5.00   | 5.50   | 5.50   | 5.50   | 5.25   | 4.75   | 4.25   | 3.75   | 3.25   | 2.75   | 2.75   | 2.50   | 2.50   |
| 3 month ave earnings                   | 5.30   | 5.60   | 5.50   | 5.30   | 5.00   | 4.50   | 4.00   | 3.50   | 3.00   | 2.70   | 2.60   | 2.50   | 2.50   |
| 6 month ave earnings                   | 5.80   | 5.90   | 5.70   | 5.50   | 5.10   | 4.60   | 4.00   | 3.50   | 3.00   | 2.70   | 2.60   | 2.60   | 2.60   |
| 12 month ave earnings                  | 6.30   | 6.20   | 6.00   | 5.70   | 5.30   | 4.80   | 4.10   | 3.60   | 3.10   | 2.80   | 2.70   | 2.70   | 2.70   |
| 5 yr PWLB                              | 5.50   | 5.60   | 5.30   | 5.10   | 4.80   | 4.50   | 4.20   | 3.90   | 3.60   | 3.40   | 3.30   | 3.30   | 3.20   |
| 10 yr PWLB                             | 5.10   | 5.20   | 5.00   | 4.90   | 4.70   | 4.40   | 4.20   | 3.90   | 3.70   | 3.50   | 3.50   | 3.50   | 3.40   |
| 25 yr PWLB                             | 5.30   | 5.40   | 5.20   | 5.10   | 4.90   | 4.70   | 4.50   | 4.20   | 4.00   | 3.90   | 3.80   | 3.80   | 3.70   |
| 50 yr PWLB                             | 5.00   | 5.10   | 5.00   | 4.90   | 4.70   | 4.50   | 4.30   | 4.00   | 3.80   | 3.60   | 3.60   | 3.50   | 3.50   |

- LIBOR and LIBID rates ceased at the end of 2021. In a continuation of previous views, 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.

## A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

- Our central forecast for interest rates was previously updated on 25<sup>th</sup> May and reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened to a degree, especially as it moved to a more aggressive 0.5% hike in June but, with inflation remaining elevated, we anticipate that Bank Rate will need to increase to at least 5.5%, if not higher, to sufficiently slow the UK economy and loosen the labour market.
- Moreover, we also still anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us – but timing on this will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged. Our current judgment is that rates will have to increase and stay at their peak until the second quarter of 2024 as a minimum.
- In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine and whether there are any further implications for Russia itself following the recent aborted mutiny by the Wagner group.
- On the positive side, consumers are still estimated to be sitting on excess savings left over from the pandemic, which could cushion some of the impact of the above challenges and may be the reason why the economy is performing somewhat better at this stage of the economic cycle than may have been expected. However, most of those excess savings are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

## PWLB RATES

- Gilt yield curve movements have shifted upwards, especially at the shorter end of the yield curve since our previous forecast but remain relatively volatile. PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.90% to 5.60%.
- We view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the elevated inflation outlook.

### The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is to the downside.

### Downside risks to current forecasts for UK gilt yields and PWLB rates include: -

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, the rising gilt yields we have seen of late).
- **The Bank of England** increases Bank Rate too fast and too far over the coming months, and subsequently brings about a deeper and longer UK recession than we currently anticipate.

- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
- **Geopolitical risks**, for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.
- **A broadening of banking sector fragilities**, which have been successfully addressed in the near-term by central banks and the market generally, but which may require further intervention if short-term interest rates stay elevated for longer than is anticipated

#### **Upside risks to current forecasts for UK gilt yields and PWLB rates: -**

- Despite the recent tightening by 0.5%, the **Bank of England proves too timid** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to remain elevated for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project.
- **The pound weakens** because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.
- Longer-term **US treasury yields** rise strongly if inflation remains more stubborn than the market currently anticipates, pulling gilt yields up higher consequently.

Projected **gilt issuance, inclusive of natural maturities and QT**, could be too much for the markets to comfortably digest without higher yields compensating.

### **3. Annual Investment Strategy**

The Treasury Management Strategy Statement, (TMSS), for 2023/24, which includes the Annual Investment Strategy was approved by this Council on 27<sup>th</sup> February 2023, in accordance with the CIPFA Treasury Management code of Practice, it sets out the councils' 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 seek 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 table below, the interest rate and investment rates show the first quarter rates of 2023/24, and these are expected to improve further as Bank Rate continues to increase over the next few months to the end of the financial year and then to reduce slightly.

| FINANCIAL YEAR TO QUARTER ENDED 30/06/2023 |            |            |            |            |            |            |            |
|--|------------|------------|------------|------------|------------|------------|------------|
|  | Bank Rate  | SONIA      | 7 day      | 30 day     | 90 day     | 180 day    | 365 day    |
| High                                       | 5.00       | 4.93       | 4.93       | 4.57       | 4.38       | 4.10       | 3.14       |
| High Date                                  | 22/06/2023 | 30/06/2023 | 30/06/2023 | 30/06/2023 | 30/06/2023 | 30/06/2023 | 30/06/2023 |
| Low  | 4.25       | 4.18       | 4.18       | 4.02       | 3.81       | 3.32       | 2.27       |
| Low Date                                   | 03/04/2023 | 04/04/2023 | 11/04/2023 | 03/04/2023 | 03/04/2023 | 03/04/2023 | 03/04/2023 |
| Average                                    | 4.44       | 4.37       | 4.34       | 4.27       | 4.11       | 3.74       | 2.70       |
| Spread                                     | 0.75       | 0.75       | 0.75       | 0.55       | 0.57       | 0.78       | 0.87       |

### 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 retreated from the spikes caused by the Truss / Kwarteng policy approach in September. 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 level of funds available for internal investment purposes as at 30<sup>th</sup> June 2023 was **£60m. (Appendix 1)** These funds are available on a temporary basis, and the level of funds available are mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

## 4. Compliance with Treasury and Prudential Limits

The Operational Boundary borrowing limits and the Authorised limits are part of the prudential guidelines and these limits remain as they were previously reported in the Treasury Management Strategy 2023.

The Operational Boundary is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be similar to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under borrowing by other cash resources.

| <i>Operational boundary</i> | <i>2023/24<br/>Budget<br/>£'000</i> | <i>2022/23<br/>Actual<br/>£'000</i> |
|-----------------------------|-------------------------------------|-------------------------------------|
| Debt                        | 108,090                             | 89,190                              |
| Non-financial investments   | 15,000                              | 0                                   |
| <b>Total</b>                | <b>123,090</b>                      | <b>89,190</b>                       |

A further prudential indicator controls the overall level of borrowing. This is **the Authorised Limit** which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected

maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

| <b>Authorised limit</b>   | <b>2023/24<br/>Budget<br/>£'000</b> | <b>2022/23<br/>Actual<br/>£'000</b> |
|---------------------------|-------------------------------------|-------------------------------------|
| Debt                      | 120,000                             | 89,190                              |
| Non-financial investments | 15,000                              | 0                                   |
| <b>Total</b>              | <b>135,000</b>                      | <b>89,190</b>                       |

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the *quarter ended* 30<sup>th</sup> June 2023, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2023/24. The Director of Finance, Governance and Contracts 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.

### **Prudential Indicator for Capital Expenditure**

The Capital Expenditure below is shown as reported to Finance & Performance Committee on 12th September 2023 for Period 4 April-July which provides a more up to date position of spend against budget for General Fund and HRA.

The General Fund full year capital budget is £25,663k, Period 4 profiled budget is £8,554k compared to spend of £3,287k, 38% with an underspend of £5,267k.

The HRA Full year capital budget is £15,369k, Period 4 profiled budget is £5,123k compared to spend of £2,948k, 58% with an underspend of £2,175k.

| <b>Capital Summary</b>       | <b>Full<br/>Year<br/><br/>Budget</b> | <b>Period 4<br/><br/>Budget</b> | <b>Period 4<br/><br/>Actual<br/>Spend</b> | <b>Period 4<br/><br/>Variance<br/>under/(Over)</b> | <b>Period 4<br/><br/>% Spend<br/>against<br/>Budget</b> |
|------------------------------|--------------------------------------|---------------------------------|---|--|---|
| <b>General Fund</b>          | 25,663                               | 8,554                           | 3,287                                     | 5,267  | 38  |
| <b>HRA</b>                   | 15,369                               | 5,123                           | 2,948                                     | 2,175  | 58  |
|                              | <b>41,032</b>                        | <b>13,677</b>                   | <b>6,235</b>                              | <b>7,442</b>                                       | <b>46</b>   |
| <b>General Fund Split</b>    |                                      |                                 |   |  |   |
| GF Live Schemes              | 8,631                                | 2,877                           | 2,795                                     | 82   | 97  |
| GF Provisional Schemes       | 15,087                               | 5,029                           | 0   | 5,029  | 0   |
| GF 3rd Party/S106<br>Schemes | 1,945                                | 648                             | 492                                       | 156  | 76  |
| <b>Total</b>                 | <b>25,663</b>                        | <b>8,554</b>                    | <b>3,287</b>                              | <b>5,267</b>                                       | <b>38</b>   |



## Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

|                       | <b>30<sup>th</sup> June<br/>2023<br/>£'000</b> |
|-----------------------|--|
| <b>Debt</b>           |  |
| General Fund          | 2,000  |
| HRA                   | 79,190   |
| <b>Gross Debt</b>     | <b>81,190</b>                                  |
| Less investments/Cash | (60,335)                                       |
| <b>Total Net Debt</b> | <b>20,855</b>                                  |
| <b>CFR</b>            | <b>106,622</b>                                 |

## 5. Borrowing

The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council 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; however, Table below shows the Council has actual borrowings in 2022/23 of £81,190m, this is £2m of an external loan which matures in 2024 and £79,190 HRA Debt.

The table shows that the Council has complied with the prudential indicator in the current year and does not envisage difficulties in the future.

|                                | <b>2023/24<br/>Budget<br/>£'000</b> | <b>2022/23<br/>Actual<br/>£'000</b> |
|--------------------------------|-------------------------------------|-------------------------------------|
| External Debt at 1 April       | 81,190                              | 81,190                              |
| Expected change in Debt        | 15,000                              | 0                                   |
| <b>Actual debt at 31 March</b> | <b>96,190</b>                       | <b>81,190</b>                       |
| Capital Financing Requirement  | 120,429                             | 106,030                             |
| <b>Under borrowing</b>         | <b>24,239</b>                       | <b>24,840</b>                       |

## **6. Debt Rescheduling.**

Debt rescheduling opportunities have increased significantly in the current quarter where gilt yields, which underpin PWLB rates and market loans, have risen materially. Members will be advised if there is value to be had by rescheduling or repaying a part of the debt portfolio. No debt rescheduling is planned in the current financial year. No new external borrowing has also been undertaken.

## **Appendices**

Appendix 1: Portfolio of investments as at 30th June 2023

Appendix 2: Approved countries for investments as at 30<sup>th</sup> June 2023

Appendix 3: Economic Update as at 30<sup>th</sup> June 2023

Appendix 4: Glossary of Terms

## Investment Portfolio - Appendix 1

| Investments held as at 30 June 2023           | Maturity Date | £000          | Interest Rate |
|---|---------------|---------------|---------------|
| Bayerische Landesbank                         | 05/07/2023    | 5,000         | 4.14%         |
| Lloyds Bank Corporate Markets                 | 24/07/2023    | 3,000         | 4.36%         |
| Close Brothers                                | 28/07/2023    | 2,000         | 4.10%         |
| Oversea-Chinese Banking Corporation Ltd       | 08/09/2023    | 5,000         | 4.35%         |
| Lloyds Bank Corporate Markets                 | 02/10/2023    | 5,000         | 4.88%         |
| Lloyds Bank Corporate Markets                 | 14/11/2023    | 3,000         | 4.99%         |
| SMBC Bank International                       | 14/11/2023    | 3,000         | 4.84%         |
| Close Brothers                                | 28/11/2023    | 3,000         | 5.00%         |
| Landesbank Hessen-Thuringen Girozentrale      | 30/11/2023    | 5,000         | 4.47%         |
| Standard Chartered Bank – Sustainable Deposit | 12/10/2023    | 3,000         | 4.72%         |
| Landesbank Hessen-Thuringen Girozentrale      | 10/05/2024    | 3,000         | 5.01%         |
| Federated Hermes Money Market Fund            | 1 Day Notice  | 12,000        | 4.73%         |
| Aberdeen Money Market Fund                    | 1 Day Notice  | 3,335         | 4.79%         |
| <b>Total Managed Internally</b>               |               | <b>55,335</b> |               |
| Lothbury Property Fund                        | n/a           | 2,500         | n/a           |
| Hermes Property Fund                          | n/a           | 2,500         | n/a           |
| <b>Total Managed Externally</b>               |               | <b>5,000</b>  |               |
| <b>TOTAL TREASURY INVESTMENTS</b>             |               | <b>60,335</b> |               |

### Internal Investment performance year to date as at 30<sup>th</sup> June 2023 (Excludes Property Funds)

| Benchmark | Sonia Ave 90 day backward looking | Council Performance | Internal Investment Interest Earned (Excl Property Funds) |
|-----------|-----------------------------------|---------------------|---|
| 3 month   | 4.11%                             | 4.76%               | £630k   |

SONIA: the Sterling Overnight Index Average. Generally, a replacement set of indices (for LIBID) for those benchmarking their investments. The benchmarking option used is a 90 day backward-looking average SONIA un compounded rate that reflects the investment yield curve at the time an investment decision was taken. This shows that the Council have outperformed this benchmark for quarter 1.

### Property Funds

Property Funds performance table below for the first quarter has produced a net return of 0.83% for Lothbury & 1% for Hermes this compares to the Property fund benchmark 365 day backward looking compounded rate for property funds of 0.347%, currently both fund returns are higher in quarter 1. The projected annual return based on quarter 1 would provide a net return of 3.70% which is lower than the money market returns on investments.

To note both Property funds market valuations are currently below the original fund values and current market analysis suggests this will recover, we are therefore closely monitoring these two property funds.

**Property Funds  
2023/24 Quarter 1**

| Property Fund    | Date Acquired | Original Cost<br>£000 | Entry Fee<br>£000 | Total Original Cost<br>£000 | Current Valuation Q1<br>£000 | Current Valuation Gain/(Loss)<br>£000 | Total Interest Received Year to Date<br>£000 | Interest Received Q1<br>£000 | Gross Return on Property Fund Q1<br>% | Expenses Deducted Q1<br>£000 | Net Return on Property Fund Q1<br>% |
|------------------|---------------|-----------------------|-------------------|-----------------------------|------------------------------|---------------------------------------|--|------------------------------|---------------------------------------|------------------------------|-------------------------------------|
| Lothbury         | 01/03/2018    | 2,417                 | 84                | 2,501                       | 2,034                        | (383)                                 | 23   | 23                           | 1.11                                  | 6                            | 0.83                                |
| Federated Hermes | 26/07/2018    | 2,500                 | 119               | 2,619                       | 2,286                        | (214)                                 | 24   | 24                           | 1.05                                  | 1                            | 1.0                                 |
| <b>Total</b>     |               | <b>4,917</b>          | <b>203</b>        | <b>5,120</b>                | <b>4,320</b>                 | <b>(597)</b>                          | <b>47</b>                                    | <b>47</b>                    |                                       | <b>7</b>                     |                                     |

**IFRS 9 fair value of investments**

Following the consultation undertaken by the Department of Levelling Up, Housing and Communities [DLUHC] on IFRS 9, the Government has extended the mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds to 31st March 2025. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.

## Approved countries for investments as of 30<sup>th</sup> June 2023 – Appendix 2

### *Based on lowest available rating*

#### AAA

- Australia
- Denmark
- Germany
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

#### AA+

- Canada
- Finland
- U.S.A.

#### AA

- Abu Dhabi (UAE)

#### AA-

- Belgium
- France (downgraded by Fitch on 9<sup>th</sup> May 2023)
- Qatar
- **U.K.**

## **Economics Update - Appendix 3 ( [link Asset Services](#) )**

- The economy has weathered the drag from higher inflation better than was widely expected. The 0.2% m/m rise in real GDP in April, following March's 0.3% m/m contraction will further raise hopes that the economy will escape a recession this year. Some of the strength in April was due to fewer strikes by train workers and teachers in that month. Moreover, some of the falls in activity in other areas in April were probably temporary too. Strikes by junior doctors and civil servants contributed to the fall in health output (0.9% m/m) and the meagre 0.1% m/m increase in public administration.
- The fall in the composite Purchasing Managers Index (PMI) from 54.0 in May to a three-month low of 52.8 in June (>50 points to expansion in the economy, <50 points to contraction) was worse than the consensus forecast of 53.6. Both the services and manufacturing PMIs fell. The decline in the services PMI was bigger (from 55.2 to 53.7), but it remains consistent with services activity expanding by an annualised 2%. The fall in the manufacturing PMI was smaller (from 47.1 to 46.2), but it is consistent with the annual rate of manufacturing output falling from -0.8% in April to around -5.0%. At face value, the composite PMI points to the 0.1% q/q rise in GDP in Q1 2023 being followed by a 0.2% q/q gain in Q2 2023.
- Meanwhile, the 0.3% m/m rise in retail sales volumes in May was far better than the consensus forecast of a 0.2% m/m decline and followed the robust 0.5% m/m rise in

April. Some of the rise was due to the warmer weather. Indeed, the largest move was a 2.7% m/m jump in non-store sales, due to people stocking up on outdoor-related goods. But department stores also managed to squeeze out a 0.6% m/m rise in sales and the household goods sub-sector enjoyed a reasonable performance too. Overall, the figures were far better than analysts had expected. In addition, the GfK measure of consumer confidence rebounded from -27 to a 17-month high of -24 in June.

- The recent resilience of the economy has been due to a confluence of factors including the continued rebound in activity after the pandemic, households spending some of their pandemic savings, and the tight labour market and government handouts both supporting household incomes. That said, as government support fades, real household incomes are unlikely to grow rapidly. Furthermore, higher interest rates will mean GDP is likely to contract later this year. Our central assumption is that inflation will drop to the 2.0% target only if the Bank triggers a recession by raising rates from 5.00% now to at least 5.5% and keeps rates there until at least mid-2024. Our colleagues at Capital Economics estimate that around 60% of the drag on real activity from the rise in rates has yet to bite, and the drag on the quarterly rate of real GDP growth over the next year may be about 0.2ppts bigger than over the past year.
- The labour market became tighter over the quarter and wage growth reaccelerated. Labour demand was stronger than the consensus had expected. The three-month change in employment rose from +182,000 in March to +250,000 in April. Meanwhile, labour supply continued to recover as the size of the labour force grew by 303,000 in the three months to April. That was supported by a further 140,000 decline in inactivity as people returned to work from retirement and caring responsibilities (while inactivity due to long-term sick continued to rise). But it was not enough to offset the big rise in employment, which meant the unemployment rate fell from 3.9% to 3.8%
- The tighter labour market supported wage growth in April, although the 9.7% rise in the National Living Wage on 1st April (compared to the 6.6% increase in April last year) probably had a lot to do with it too. The 3myy rate of average earnings growth reaccelerated from 6.1% to 6.5% (consensus 6.1%) and UK wage growth remains much faster than in the US and the Euro-zone. In addition, regular private sector wage growth increased from 7.1% 3myy to 7.6%, which left it well above the Bank's forecast for it to fall below 7.0%. Overall, the loosening in the labour market appears to have stalled in April and regular private sector wage growth was well above the Bank's forecast.
- CPI inflation stayed at 8.7% in May (consensus 8.4%) and, perhaps more worryingly, core CPI inflation rose again, from 6.8% to a new 31-year high of 7.1%. The rise in core inflation built on the leap from 6.2% in March to 6.8% and means it is accelerating in the UK while it is slowing in the US and the Euro-zone (both fell to 5.3%). A further decline in fuel inflation, from -8.9% to -13.1%, and the second fall in food inflation in as many months, from 19.3% to 18.7%, explained why overall CPI inflation didn't rise. And the scheduled fall in the average annual utility price from £2,500 to £2,074 on 1st July means overall CPI inflation will probably ease in the coming months. But the problem is that the recent surge in core inflation and the reacceleration in wage growth shows that domestic inflationary pressures are still strengthening.
- This suggests the Bank may have more work to do than the Fed or ECB. Indeed, the Bank of England sounded somewhat hawkish in the June meeting. This came through most in the MPC's decision to step up the pace of hiking from the 25bps at the previous two meetings. The 7-2 vote, with only two members voting to leave

rates unchanged at 4.50%, revealed support for stepping up the fight against high inflation.

- That said, the Bank has not committed to raising rates again or suggested that 50bps rises are now the norm. What it did say was that “the scale of the recent upside surprises in official estimates of wage growth and services CPI inflation suggested a 0.5 percentage point increase in interest rates was required at this particular meeting”. Moreover, the Committee did not strengthen its forward guidance that any further rate hikes would be conditional on the data. However, it looks highly probable, given the on-going strength of inflation and employment data, that the Bank will need to raise rates to at least 5.5% and to keep rates at their peak until the mid-point of 2024. We still think it is only a matter of time before the rise in rates weakens the economy sufficiently to push it into recession. That is why instead of rising to between 6.00%-6.25%, as is currently priced in by markets, we think rates are more likely to peak between 5.50-6.00%. Our forecast is also for rates to be cut in the second half of 2024, and we expect rates to then fall further than markets are pricing in.
- Growing evidence that UK price pressures are becoming increasingly domestically generated has driven up market interest rate expectations and at one point pushed the 10-year gilt yield up to 4.49% in late June, very close to its peak seen after the “mini-budget”. Yields have since fallen slightly back to 4.38%. But growing expectations that rates in the UK will remain higher for longer than in the US mean they are still more than 70 bps above US yields. While higher interest rates are priced into the markets, the likely dent to the real economy from the high level of interest rates is not. That’s why we think there is scope for market rate expectations to fall back in 2024 and why we expect the 10-year PWLB Certainty Rate to drop back from c5.20% to 5.00% by the end of this year and to 4.20% by the end of 2024.
- The pound strengthened from \$1.24 at the start of April to a one-year high at \$1.26 in early May, which was partly due to the risks from the global banking issues being seen as a bigger problem for the US than the UK. The pound then fell back to \$1.23 at the end of May, before rising again to \$1.28 in the middle of June as the strong core CPI inflation data released in June suggested the Bank of England was going to have to raise rates more than the Fed or ECB in order to tame domestic inflation. However, sterling’s strong run may falter because more hikes in the near term to combat high inflation are likely to weaken growth (and, hopefully, at some point inflation too) to such a degree that the policy rate will probably be brought back down, potentially quite quickly, as the economic cycle trends downwards decisively. This suggests that additional rate hikes are unlikely to do much to boost the pound.
- In early April, investors turned more optimistic about global GDP growth, pushing up UK equity prices. But this period of optimism appears to have been short-lived. The FTSE 100 has fallen by 4.8% since 21<sup>st</sup> April, from around 7,914 to 7,553, reversing part of the 7.9% rise since 17<sup>th</sup> March. Despite the recent resilience of economic activity, expectations for equity earnings have become a bit more downbeat. Nonetheless, further down the track, more rate cuts than markets anticipate should help the FTSE 100 rally.

### **Monetary Policy Committee meetings 11<sup>th</sup> May and 22<sup>nd</sup> June 2023**

- On 11<sup>th</sup> May, the Bank of England’s Monetary Policy Committee (MPC) increased Bank Rate by 25 basis points to 4.50%, and on 22<sup>nd</sup> June moved rates up a further 50 basis points to 5.00%. Both increases reflected a split vote – seven members voting for an increase and two for none.

- Nonetheless, with UK inflation significantly higher than in other G7 countries, the MPC will have a difficult task in convincing investors that they will be able to dampen inflation pressures anytime soon. Talk of the Bank's inflation models being "broken" is perhaps another reason why gilt investors are demanding a premium relative to US and Euro-zone bonds, for example.
- Of course, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has already hiked short-term rates to a range of 5.00%-5.25%, but a further increase is pencilled in for July, whilst the ECB looks likely to raise its Deposit rate at least once more to a peak of 3.75%, with upside risk of higher to come.

## **Glossary of Terms - Appendix 4**

### **Capital Financing Requirement**

CFR is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of expenditure above, which has not immediately been paid for, will increase the CFR. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.

### **Operational Boundary**

The operational boundary is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

### **Authorised Limit for External Debt**

A further key prudential indicator represents a control on the maximum level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

### **Gross External Debt**

This is the total amount borrowed by the Council at a point in time.

### **Net Borrowing**

Net borrowing is gross external debt less investments.

### **Loans**

In this mid-year (and previously) interest receivable has exceeded interest payable for the General Fund producing a negative number for net interest payable and a somewhat odd-looking negative ratio; this can be construed as indicating that the Council has no issues servicing General Fund loans at this time.



