West Suffolk Council

Treasury Management Strategy Statement 2024 to 2025

1 Introduction

1.1 Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

1.2 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.3 Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.

2 Local Context

2.1 On 31st December 2023, the Council held £9.5 million of external borrowing, £47.6 million of internal borrowing and £55.75 million of treasury investments. This is set out in further detail at Appendix B.

2.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The table below details the forecast for the councils Capital Financing Requirement over the next 3 years.

Table 1: Capital Financing Requirement

	31 March 23 Actual £million	31 March 24 Estimate £million	31 March 25 Forecast £million	31 March 26 Forecast £million	31 March 27 Forecast £million
Capital Financing Requirement	56.31	59.37	95.02	117.90	117.63

2.3 The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, whilst also looking to secure long term certainty of interest rates by fixing some borrowing externally when it is advantageous to do so. The Council will continue to monitor this strategy in order to decide whether external borrowing to pre-fund future years requirements would better meet its borrowing objectives.

2.4 The Council has an increasing CFR due to the capital programme. Consequently, investment levels will continue to fall in future years, as capital receipts and revenue reserves are used to finance capital expenditure and the revenue budget.

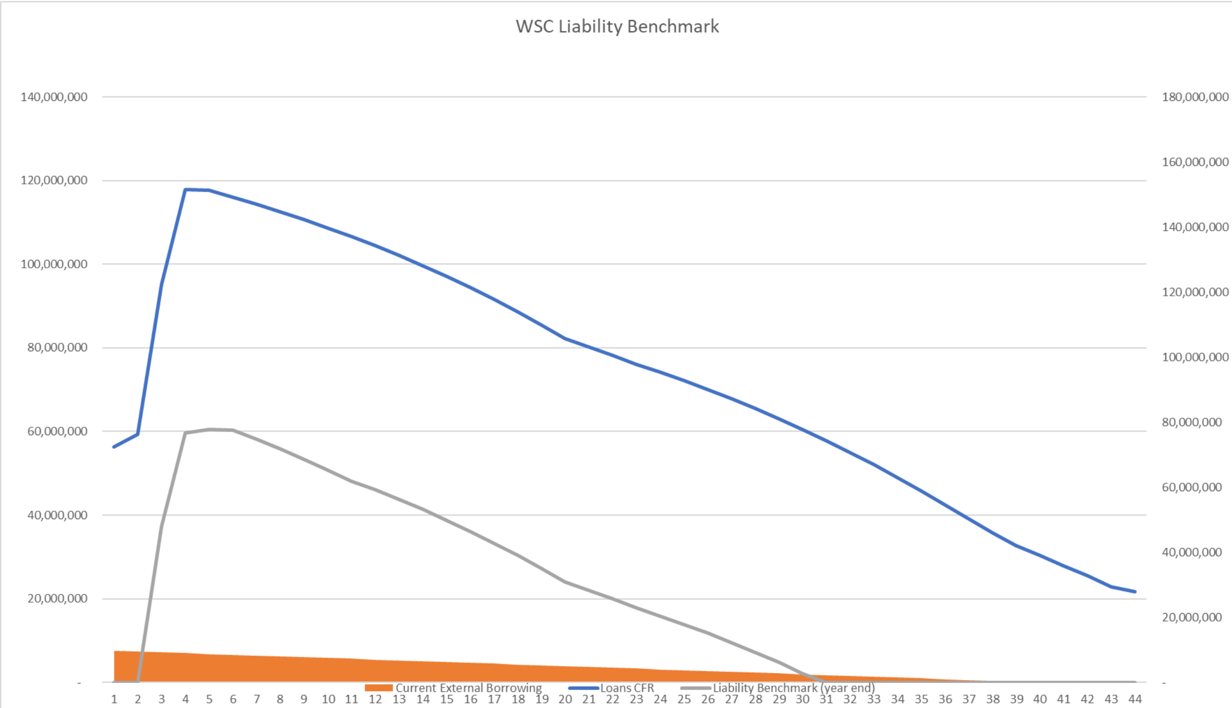
2.5 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. The Council expects to comply with this recommendation during 2024 to 2025.

3 Liability Benchmark

3.1 To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes cash and investment balances are kept to a minimum level of £10 million at each year-end to maintain sufficient liquidity but minimise credit risk.

3.2 The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

3.3 The long-term liability benchmark assumes capital expenditure funded by borrowing of £0.5 million a year, minimum revenue provision on new capital expenditure based on a 40 year asset life and reserves maintaining their current levels. This is shown in the chart below together with the maturity profile of the Council's existing borrowing.



3.4 The Liability Benchmark graph above shows that the Council is likely to be a long-term borrower in the future. Although the Council's CFR is forecast to increase to £118 million by the 2025 to 2026 financial year (as shown by the higher line in the graph), the Liability Benchmark (the maximum amount the Council would likely need to borrow – shown by the lower line in the graph) peaks at £60 million. The difference between the two lines in the graph is the amount of internal resources the Council has which can be used for internal borrowing, negating the need for extra external borrowing which would place an additional cost on the Council. The block at the bottom of the graph represents the current external borrowing the Council has.

4 Borrowing Strategy

4.1 The Council currently holds £9.5 million of loans, a £0.25 million decrease on the previous year, as part of its strategy for funding previous years' capital programmes. If the Council's full capital programme is delivered then it expects to externally borrow in 2024 to 2025. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing detailed in the Council's Prudential Indicators.

4.2 **Objectives:** The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

4.3 **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. It is likely to be more cost effective in the short-term to use internal borrowing, however opportunities to fix longer term external borrowing will be explored in order to achieve long-term security at advantageous interest rates.

4.4 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly to confirm that this is still the most advantageous strategy. Arlingclose will assist the Council with this and it may be determined that the Council borrows additional sums at long-term fixed rates in 2024 to 2025 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

4.5 The Council's default position is to raise the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council intends to seek activity which will not obstruct its access to PWLB loans.

4.6 Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

4.7 In addition, the Council may borrow short-term loans to cover unplanned cash flow shortages.

4.8 **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- UK Infrastructure Bank Ltd
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except the Suffolk County Council Local Government Pension Scheme)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

4.9 **Other sources of debt finance:** In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback
- similar asset based finance

4.10 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

4.11 **Short-term and variable rate loans:** These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

4.12 **Debt rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

5 Treasury Investment Strategy

5.1 The Council holds significant level of invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council’s treasury investment balance has ranged between £43 million and £58 million. If the Council’s capital programme is delivered in full, these investment balances are expected to reduce in the forthcoming year.

5.2 **Objectives:** The CIPFA Code requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal to or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. The Council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

5.3 **Strategy:** As demonstrated by the liability benchmark above, the Council expects to be a long-term borrower and new treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments.

5.4 The CIPFA Code does not permit local authorities to both borrow and invest long-term for cash flow management. But the Council may make long-term investments for treasury risk management purposes, including to manage interest rate risk by investing sums borrowed in advance for the capital programme for up to three years; to manage inflation risk by investing usable reserves in instruments whose value rises with inflation; and to manage price risk by adding diversification to the strategic pooled fund portfolio.

5.5 **ESG policy:** Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore this strategy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Council will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code, as advised by the Council's treasury management advisors.

5.6 **Approved counterparties:** The Council may invest its surplus funds with any of the counterparty types in table 2 below, subject to the limits shown.

Table 2: Treasury investment counterparties and limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	3 years	Unlimited	n/a
Local authorities & other government entities	3 years	£10m	Unlimited
Secured investments *	3 years	£10m	Unlimited
Banks (unsecured) *	13 months	£6m	Unlimited
Building societies (unsecured) *	13 months	£6m	£30m
Registered providers (unsecured) *	3 years	£5m	£10m
Money market funds *	n/a	£10m	Unlimited
Strategic pooled funds	n/a	£5m	£10m
Real estate investment trusts	n/a	£5m	£10m
Other investments *	3 years	£5m	£15m

This table must be read in conjunction with the notes below

* **Minimum credit rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

5.7 For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £5m per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.

5.8 **Government:** Loans to, and bonds and bills issued or guaranteed by, national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 3 years.

5.9 **Secured investments:** Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

5.10 **Banks and building societies (unsecured):** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

5.11 **Registered providers (unsecured):** Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

5.12 **Money market funds:** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

5.13 **Strategic pooled funds:** Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

5.14 **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

5.15 **Other investments:** This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Council's investment at risk.

5.16 **Operational bank accounts:** The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £1 million per bank. However, amounts in excess of £1 million may be held for up to five consecutive days to cover planned cashflow requirements. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

5.17 **Risk assessment and credit ratings:** Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

5.18 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "negative watch") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

5.19 **Other information on the security of investments:** The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

5.20 **Reputational aspects:** The Council is aware that investment with certain counterparties, while considered secure from a purely financial perspective, may leave it open to criticism, valid or otherwise, that may affect its public reputation, and this risk will therefore be taken into account when making investment decisions.

5.21 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008, 2020 and 2022, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

5.22 **Investment limits:** The Council's revenue reserves available to cover investment losses are forecast to be £41.1 million on 31 March 2024 and £40.8 million on 31 March 2025. In order that no more than 40% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £12 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

5.23 Credit risk exposures arising from non-treasury investments, financial derivatives and balances greater than £1.5 million in operational bank accounts count against the relevant investment limits.

5.24 **Liquidity management:** The Council uses a purpose-built cash flow forecasting spreadsheet to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

5.25 The Council will spread its liquid cash over available providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

6 Treasury Management Prudential Indicators

6.1 The Council measures and manages its exposures to treasury management risks using the following indicators.

6.2 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	Target
Portfolio average credit score	6.0

6.3 **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments on instant access, without additional borrowing.

Liquidity risk indicator	Target
Total cash available on instant access	£5m

6.4 **Maturity structure of borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	90%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and above	90%	0%

6.5 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

6.6 **Long-term treasury management investments:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management investments will be:

Price risk indicator	2024 to 2025	2025 to 2026	2026 to 2027
Limit on principal invested beyond year end	£40m	£25m	£25m

6.7 Long-term investments with no fixed maturity date include strategic pooled funds and real estate investment trusts but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

7 Related Matters

7.1 The CIPFA Code requires the Council to include the following in its treasury management strategy.

7.2 **Financial derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

7.3 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

7.4 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

7.5 In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

7.6 **External Funds:** The Council does not hold external funds on behalf of other organisations.

7.7 **Markets in Financial Instruments Directive:** The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Director of Resources and Property / Chief Financial Officer believes this to be the most appropriate status.

8 Financial Implications

8.1 The budget for investment income in 2024 to 2025 is £1,080,000, based on an average investment portfolio of £27 million at an interest rate of 4.00 per cent. The budget for debt interest paid in 2024 to 2025 is £1,581,300. Please note, these figures are provisional budget figures and may be subject to change during the budget setting approval process.

8.2 If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

8.3 Where investment income exceeds budget, e.g. from higher risk investments including pooled funds, or debt interest paid falls below budget, e.g. from cheap short-term borrowing, then the revenue savings may be transferred to the Council’s capital projects financing reserve to cover the risk of capital losses or higher interest rates payable in future years.

9 Other Options Considered

9.1 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Director of Resources and Property/Chief Finance Officer, having consulted the Cabinet Member for Resources, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-

		term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Appendix A – Existing Investment & Debt Portfolio Position

Investments held as at 31 December 2023				
Counterparty	**Principal Amount (£)**	**Interest Rate**	**Date Loaned**	**Date Returned**
Santander 365 Day notice	8,000,000	4.91%	01/04/23	11/06/24
Santander 95 Day notice	500,000	4.73%	01/04/23	95 day Notice
Lloyds Treasury Account	2,250,000	4.55%	01/04/23	On call availability
Barclays 32 Day notice	2,000,000	5.20%	20/11/23	32 day notice
CCLA Money Market Fund	4,000,000	Variable	01/04/23	On call availability
HM Debt Man. Office	3,000,000	5.450%	24/08/23	23/02/24
HM Debt Man. Office	3,000,000	5.240%	02/10/23	19/01/24
HM Debt Man. Office	3,000,000	5.240%	02/10/23	15/01/24
HM Debt Man. Office	4,000,000	5.260%	02/10/23	15/02/24
HM Debt Man. Office	2,000,000	5.220%	13/10/23	22/01/24
HM Debt Man. Office	6,000,000	5.200%	01/11/23	19/02/24
HM Debt Man. Office	3,000,000	5.205%	01/11/23	15/03/24
HM Debt Man. Office	3,000,000	5.200%	10/11/23	15/04/24
HM Debt Man. Office	5,000,000	5.200%	01/12/23	25/04/24
HM Debt Man. Office	5,000,000	5.185%	01/12/23	19/03/24
HM Debt Man. Office	2,000,000	5.190%	20/12/23	15/05/24
There were no other fixed term investments				
Total	**55,750,000**			

External Borrowing as at 31 December 2023				
Counterparty	**Outstanding Balance (£)**	**Interest Rate**	**Start Date**	**Maturity Date**
PWLB	9,500,000	1.840%	03/12/21	01/12/61

Appendix B - External Context

Economic Background

The impact on the UK from higher interest rates and inflation, a weakening economic outlook, an uncertain political climate due to an upcoming general election, together with war in Ukraine and the Middle East, will be major influences on the Council's treasury management strategy for 2024 to 2025.

The Bank of England (BoE) increased Bank Rate to 5.25 per cent in August 2023, before maintaining this level in September, November and then again in December. Members of the BoE's Monetary Policy Committee voted 6-3 in favour of keeping Bank Rate at 5.25 per cent in December. The three dissenters wanted to increase rates by another 0.25 per cent.

Office for National Statistics (ONS) figures showed Consumer Price Index (CPI) inflation was 3.9 per cent in November 2023, down from 4.6 per cent in October and lower than the 4.3 per cent expected. Core CPI inflation also fell to 5.1 per cent from 5.7 per cent, and lower than the 5.6 per cent expected

Office for National Statistics figures showed the UK economy shrank by 0.1 per cent between July and October 2023 (Quarter 3). Indicators are pointing to a weak quarter 4, with a drop in monthly Gross Domestic Product (GDP) in October of -0.3 per cent. This increases the likelihood of a technical recession (two consecutive quarters of negative growth), albeit a mild one.

The labour market in late 2023 showed signs of loosening. The unemployment rate remained stable at 4.2 per cent in the three months to October 2023. Pay growth indicators, while still elevated, showed a decline.

Having increased its key interest rate to a target range of 5.25 to 5.50 per cent in August 2023, the US Federal Reserve paused in September and November, maintaining the Fed Funds rate target at this level. It is likely this level represents the peak in US rates, but central bank policymakers emphasised that any additional tightening would be dependent on the cumulative impact of rate rises to date, together with inflation and developments in the economy and financial markets.

US GDP grew at an annualised rate of 4.9 per cent between July and September 2023, ahead of expectations for a 4.3 per cent expansion and the 2.1 per cent reading for quarter 2. But as the impact from higher rates is felt in the coming months, a weakening of economic activity is likely. Annual CPI inflation remained at 3.7 per cent in September after increasing from 3 per cent and 3.2 per cent consecutively in June and July.

Eurozone inflation has declined steadily since the start of 2023, falling to an annual rate of 2.9 per cent in October 2023. Economic growth has been weak, and GDP was shown to have contracted by 0.1 per cent in the three months to September 2023. In line with other central banks, the European Central Bank has been increasing rates, taking its deposit facility, fixed rate tender, and marginal lending rates to 3.75 per cent, 4.25 per cent and 4.50 per cent respectively.

Credit Outlook

Credit Default Swap (CDS) prices were volatile during 2023, spiking in March on the back of banking sector contagion concerns following the major events of Silicon Valley Bank becoming insolvent and the takeover of Credit Suisse by UBS. After then falling back in quarter 2 of calendar 2023, in the second half of the year, higher interest rates and inflation, the ongoing war in Ukraine, and now the Middle East, have led to CDS prices increasing steadily.

On an annual basis, CDS price volatility has so far been lower in 2023 compared to 2022, but this year has seen more of a divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities once again.

Moody's revised its outlook on the UK sovereign to stable from negative to reflect its view of restored political predictability following the volatility after the 2022 mini-budget. Moody's also affirmed the Aa3 rating in recognition of the UK's economic resilience and strong institutional framework.

Following its rating action on the UK sovereign, Moody's revised the outlook on five UK banks to stable from negative and then followed this by the same action on five rated local authorities. However, within the same update the long-term ratings of those five local authorities were downgraded.

There remain competing tensions in the banking sector, on one side from higher interest rates boosting net income and profitability against another of a weakening economic outlook and likely recessions that increase the possibility of a deterioration in the quality of banks' assets.

However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

Interest Rate Forecast (December 2023)

Although UK inflation and wage growth remain elevated, the Council's treasury management adviser Arlingclose forecasts that Bank Rate has peaked at 5.25 per cent. The Bank of England's Monetary Policy Committee will cut rates in the medium term to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. Arlingclose sees rate cuts from quarter 3 2024 to a low of around 3 per cent by early to mid 2026.

Arlingclose expects long-term gilt yields to be flat from current levels (following a drop in yields at the end of 2023). However, yields will remain relatively higher than in the past, due to quantitative tightening and significant bond supply. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

A more detailed economic and interest rate forecast provided by Arlingclose is in Appendix C.

Appendix C – Arlingclose Economic & Interest Rate Forecast – December 2023

- UK inflation and wage growth remain elevated but have eased over the past two months fuelling rate cuts expectations. Near-term rate cuts remain unlikely, although downside risks will increase as the UK economy likely slides into recession.
- The Monetary Policy Committee (MPC) message remains unchanged as the Committee seeks to maintain tighter financial conditions. Monetary policy will remain tight as inflation is expected to moderate to target slowly, although some wage and inflation measures are below the Bank's last forecasts.
- Despite some deterioration in activity data, the UK economy remains resilient in the face of tighter monetary policy. Recent data has been soft but mixed; the more timely Purchasing Managers' Index (PMI) figures suggest that the services sector is recovering from a weak Quarter 3. Tighter policy will however bear down on domestic and external activity as interest rates bite.
- Employment demand is easing. Anecdotal evidence suggests slowing recruitment and pay growth, and we expect unemployment to rise further. As unemployment rises and interest rates remain high, consumer sentiment will deteriorate. Household and business spending will therefore be weak.
- Inflation will fall over the next 12 months. The path to the target will not be smooth, with higher energy prices and base effects interrupting the downtrend at times. The MPC's attention will remain on underlying inflation measures and wage data. We believe policy rates will remain at the peak for another 10 months, or until the MPC is comfortable the risk of further 'second-round' effects has diminished.
- Maintaining monetary policy in restrictive territory for so long, when the economy is already struggling, will require significant loosening in the future to boost activity.
- Global bond yields will remain volatile. Markets are currently running with expectations of near-term US rate cuts, fuelled somewhat unexpectedly by US policymakers themselves. Term premia and bond yields have experienced a marked decline. It would not be a surprise to see a reversal if data points do not support the narrative, but the current 10-year yield appears broadly reflective of a lower medium- term level for Bank Rate.
- There is a heightened risk of fiscal policy and / or geo-political events causing substantial volatility in yields.

Forecast

- The MPC held Bank Rate at 5.25 per cent in December. We believe this is the peak for Bank Rate.
- The MPC will cut rates in the medium term to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. We see rate cuts from Quarter 3 2024 to a low of around 3 per cent by early to mid 2026.

- The immediate risks around Bank Rate have become more balanced, due to the weakening UK economy and dampening effects on inflation. This shifts to the downside in the short term as the economy weakens.
- Long-term gilt yields are now substantially lower. Arlingclose expects yields to be flat from here over the short-term reflecting medium term Bank Rate forecasts. Periodic volatility is likely.

	Current	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00
Central Case	5.25	5.25	5.25	5.25	5.00	4.75	4.25	4.00	3.75	3.50	3.25	3.00	3.00
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
3-month money market rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00
Central Case	5.40	5.40	5.40	5.30	5.15	4.80	4.30	4.10	3.80	3.50	3.25	3.05	3.05
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
5yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.77	3.75	3.75	3.75	3.70	3.60	3.50	3.50	3.40	3.30	3.30	3.30	3.35
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
10yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.72	3.75	3.80	3.80	3.80	3.80	3.80	3.80	3.75	3.65	3.60	3.65	3.70
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
20yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	4.16	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.25
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
50yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.76	3.80	3.85	3.90	3.90	3.90	3.90	3.90	3.90	3.90	3.95	3.95	3.95
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00 per cent
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80 per cent
PWLB HRA Rate (Maturity Loans) = Gilt yield + 0.40 per cent
UK Infrastructure Bank Rate (Maturity Loans) = Gilt yield + 0.40 per cent