Board	Policy and Organisation Board
Date of meeting:	4th OCTOBER 2023
Title:	Treasury Management Annual Review 2022/23, Progress Report 2023/24, & Prudential Indicators
Author:	Borough Treasurer
Status:	For noting

Purpose

The annual treasury report is a requirement of the Council's reporting procedures and covers the treasury activity for 2022/23 together with an in year review 2023/24. The report also includes the Prudential Indicators for 2022/23 in accordance with the requirements of the Prudential Code.

Recommendations

The Board notes

- The Treasury Management outturn report 2022/23 as identified in 2.2
- The Treasury Management position for 2023/24 at the end of August 2023 as identified in 2.3
- The Prudential Indicators outturn report 2022/23 as identified in 2.4
- The Prudential Indicators update 2023/24 as identified in 2.5

1 Background

1.1 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 (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.2 The Council's treasury management strategy for 2022/23 was approved at a meeting of Council on 17th March 2022. 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 risk are therefore central to the Council's treasury management strategy.

1.3 The objectives of the Prudential Code are to ensure, within a clear framework, that the capital expenditure plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice and in full understanding of the risks involved and how these risks will be managed to levels that are acceptable to the Council.

1.4 This report also meets the requirement of the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) by reporting the 2022/23 outturn indicators against those approved by Full Council on the 2nd February 2022 as part of the Medium Term Financial Strategy & Budget report 2022/23 and an update on the Prudential Indicators approved by Full Council on the 10th February 2023 as part of the Medium Term Financial Strategy & Budget (Revenue & Capital) report 2023/24.

1.5 Actual figures have been taken from or prepared on a basis consistent with the Council's draft statement of accounts.

2.0 Report

2.1 External Context

2.1.1 A general background description to the Public Sector Treasury Management Environment in 2022/23 and for Quarter 1 2023/24 as provided by Arlingclose Ltd, the Council's Treasury Management advisers is set out in Appendix A.

The narrative covers the following broad areas

- Economic Commentary
- Financial Markets
- Credit review

2.2 TREASURY MANAGEMENT OUTTURN REPORT 2022/23

2.2.1 On 31st March 2023, the Council had net borrowing (borrowings less investments) of £53.9m arising from its revenue and capital income and expenditure, an increase of £9.7m on the previous year. This increase unwinds the cash flow impact of the receipts in previous years of various forms of government financial support in response to Covid 19 and the energy crisis.

The Council pursued its strategy of keeping borrowing and investments below underlying levels as measured by the Capital Financing Requirement, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

Details behind the borrowing and investing activity are set out below.

2.2.2 **Borrowing Activity**

At 31st March 2023, the Council held £57.7m in loans a decrease of £0.1m on the previous year, as part of its strategy for funding previous and current years' capital

programmes. The year end position is summarised below with 2021/22 figures for comparison.

(Following Housing Finance reform, two separate pools are being operated for Council debt and these are also shown below).

2022/23	**General Fund**			**HRA**			**Total**		
	31-Mar £'000	**Rate %**	**Avge Life (Yrs)**	**31-Mar £'000**	**Rate %**	**Avge Life (Yrs)**	**31-Mar £'000**	**Rate %**	**Avge Life (Yrs)**
Fixed rate borrowing:									
PWLB	**5,838**	3.13%	22.94	**43,812**	3.30%	26.11	**49,650**	3.28%	25.74
Variable rate borrowing:									
Local Authority	**8,000**	0.93%	0.15	-	-	-	**8,000**	0.93%	0.15
Gross borrowing	**13,838**			**43,812**			**57,650**		

2021/22	**General Fund**			**HRA**			**Total**		
	31-Mar £'000	**Rate %**	**Avge Life (Yrs)**	**31-Mar £'000**	**Rate %**	**Avge Life (Yrs)**	**31-Mar £'000**	**Rate %**	**Avge Life (Yrs)**
Fixed rate borrowing:									
PWLB	**5,938**	3.10%	23.83	**46,812**	3.25%	25.44	**52,750**	3.12%	25.26
Variable rate borrowing:									
Local Authority	**5,000**	0.56%	0.67	-	-	-	**5,000**	0.56%	0.67
Gross borrowing	**10,938**			**46,812**			**57,750**		

(Fixed rate borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other borrowing are classed as variable rate)

As outlined in the treasury strategy the Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio and, where practicable, to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The cost of both long and short-term borrowing rose dramatically over the year, with rates at the end of March around 2% - 4% higher than those at the beginning of April. Rate rises have been driven primarily by inflation and the need for central banks to control this by raising interest rates. Particularly dramatic rises were seen in September after Liz Truss' 'mini-budget' included unfunded tax cuts and additional borrowing to fund consumer energy price subsidies: over a twenty-four-hour period some PWLB rates increased to 6%. Rates have now fallen from September peaks but remain volatile and well above recent historical norms. The PWLB 10 year maturity certainty rate stood at 4.33% at 31st March 2023, 20 years at 4.70% and 30 years at 4.66%.

In keeping with the objectives no new long term borrowing was undertaken, while existing long term loans of £3.10m were allowed to mature and replaced with short term borrowing.

The Council pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

Short Term borrowing ranged between £3m and £11m averaging £5.1m during 2022/23 compared to an average of £5.9m during 2021/22.

Interest Payable on all borrowings was £1,749,560 compared to a revised budget of £1,768,260 (£1,784,030 in 2021/22).

2.2.2.1 Borrowing Update

CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes.

2.2.3 **Treasury Investment Activity**

CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2021. These define treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held.

The Council's investment balances during 2022/23 are summarised in the table below and vary due to timing differences between income and expenditure.

All Investments were classified as variable rate investments i.e. interest rate was not fixed for a period greater than 1 year.

Investment Position at	Money Market Funds £000's	Rate %	Banks & Building Societies (unsecured) £000's	Rate %	Central Government (DMADF)	Rate %	Local Authorities £000's	Rate %	Total Investments £000's	Average Rate %
31/03/2022	11,550	0.50%	-	-	-	-	2,000	0.75%	13,550	0.54%
Qtr 1 (end)	9,000	0.66%	-	-	2,650	1.03%	2,000	0.75%	13,650	0.75%
Qtr 2 (end)	6,960	1.32%	-	-	3,200	2.07%	-	-	10,160	1.56%
Qtr 3 (end)	6,500	3.29%	25	0.80%	1,000	2.54%	-	-	7,525	3.18%
31/03/2023	3,730	4.10%	25	1.00%	-	-	-	-	3,755	4.08%

All investments undertaken during 2022/23 were in line with the Council's investment strategy.

Both the CIPFA Code and government guidance require the Council to invest its 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.

In furtherance of these objectives the Council maintained a spread of short term investments across Money Market Funds, Central Government's Debt Management Account Deposit Facility (DMADF) and Local Authority Deposits.

Bank Rate which is a key driver of short term interest rates has increased from 0.75% at the beginning of the year to 4.25% at the end of March 2023.

The average return on investments during the year was 1.48% compared with 0.08% the previous year and the Interest receivable on Treasury Management Investments was £275,800 compared to a revised budget of £162,200 (£14,400 in 2021/22).

2.2.4 Treasury Management Indicators

Maturity Structure of Borrowing (duration remaining of loans): This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

The Maturity Structure of Borrowing	31-Mar-22 Actual %	2022/23 Lower %	2022/23 Upper %	Complied
Under 12 months	19%	0%	30%	✔
12 months and within 24 months	5%	0%	25%	✔
24 months and within 5 years	20%	0%	25%	✔
5 years and within 10 years	2%	0%	20%	✔
10 years and above *	54%	30%	50%	x

* No borrowing over 10 years was undertaken during 2022/23, the limits on maturity structure for 2022/23 were calculated assuming a higher level of borrowing at 31/3/2023.

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one year revenue impact of a 1% rise or in rates was measured at 31st March 2023

The impact of a change in interest rate is calculated on the assumption that maturing loans and investments will be replaced at current rates.

Interest rate exposures	2022/23 Revised £000's	2022/23 Actual £000's	Complied
Limits on one-year revenue impact of a 1% rise in interest rates	5	(134)	✔

2.3 THE TREASURY POSITION IN 2023/24 (at the end of August 2023)

2.3.1 A general background description to the Public Sector Treasury Management Environment for Quarter 1 2023/24 as provided by Arlingclose Ltd, the Council's Treasury Management advisers is set out in Appendix A.

2.3.2 At 31st August the Council had net borrowing of £48.6m a decrease of £5.3m from the 31st March 2023, this is only a temporary position reflecting the Council's in year cash flow at this point in time, this is reflected mainly in a reduction in short term borrowing.

Details behind the borrowing and investing activity are set out below.

2.3.2 Borrowing Activity

There has been a substantial rise in the cost of both short- and long-term borrowing over the last 18 months. In the first 5 months of 2023/24, Bank Rate rose from 4.25% at the beginning of April to 5.25% at the end of August and was also significantly higher than its level of 1.25% at the end of August 2022.

Gilt yields faced upward pressure since early April following signs that UK growth has been more resilient and inflation stickier than expected. Consequently, PWLB borrowing rates continued to rise over the quarter. On 31st August, the PWLB certainty rates for maturity loans were 5.18% for 10 year loans, 5.44% for 20-year loans and 5.14% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41%

At the end of August, the Council held £51.6m of loans, a reduction of £6m since the beginning of the financial year. Nearly all of the reduction is in short term borrowing representing the positive cash flow of the Council during the period.

The outstanding loans are summarised in the table below.

31st August 2023	Genera £000's	Rate %	Avge Life (Yrs)	HRA £000's	Rate %	Avge Life (Yrs)	Total £000's	Rate %	Avge Life (Yrs)
Fixed rate borrowing:									
PWLB	**5,788**	3.15%	22.58	**43,812**	3.30%	25.70	**49,600**	3.28%	25.33
Variable rate borrowing:									
Local Authorities	**2,000**	5.00%	0.30	-	-	-	**2,000**	5.00%	0.30
Gross borrowing	**7,788**			**43,812**			**51,600**		

The Council's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing is being maintained.

Liability Benchmark: This new indicator compares the Council's actual existing borrowing against a liability benchmark that has been calculated to show the lowest risk level of borrowing. 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. It 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 of £4m required to manage day-to-day cash flow.

Liability Benchmark	31/03/2024 Estimate £m	31/03/2025 Estimate £m	31/03/2026 Estimate £m
Capital Financing Requirement	83,925.0	83,565.0	82,900.0
Less: Balance Sheet Resources	(18,206.0)	(13,951.0)	(14,701.0)
Net Loans Requirement	65,719.0	69,614.0	68,199.0
Plus Liquidity Allowance	4,000.0	4,000.0	4,000.0
Liability Benchmark	69,719.0	73,614.0	72,199.0
Existing Borrowing	70,750.0	73,750.0	73,750.0

2.3.3 Investments Activity

The Council continues to maintain a spread of short term investments across a number of asset classes to spread risk and maintain liquidity.

The following table summarises the investments of short term surplus funds during 2023/24 up to end August 2023.

All investments are in line with the Council's investment strategy.

(Balances within the Council's operational bank accounts are excluded from the figures below)

Investment Position at	Money Market Funds £000's	Rate %	Banks & Building Societies (unsecured) £000's	Rate %	Central Government (DMADF)	Rate %	Local Authorities £000's	Rate %	Total Investments £000's	Average Rate %
01/04/2023	3,730	4.10%	25	1.00%	-	-	-	-	3,755	4.08%
Qtr 1 (end)	8,050	4.43%	100	1.15%	1,000	4.38%	-	-	9,150	4.39%
31/08/2023	3,000	5.20%	50	1.35%	-	-	-	-	3,050	5.14%

As demonstrated by the liability benchmark in 2.3.3 above, the Council expects to be a long-term borrower and new treasury investments are therefore primarily made to manage day-to-day cash flows using short-term low risk instruments.

The Council has budgeted £158,100 income from its short term investments and Income received up to 31th August was £141,000.

2.3.4 **HRA PWLB Rate Update**

For HRA Authorities a new HRA PWLB rate of gilt yield plus 0.4% (0.4% below the currently available certainty rate) was announced on 15th March 2023. This discounted rate is to support local authorities borrowing for Housing Revenue Accounts and the delivery of social housing and has been available from June 2023, initially for a period of one year.

2.4 THE PRUDENTIAL INDICATORS OUTTURN REPORT 2022/23

2.4.1 The Local Government Act 2003 requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

This report compares the approved indicators with the outturn position for 2022/23.

2.4.2 **THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING 2022/23**

The table below shows the actual capital expenditure which was financed and unfinanced during the year.

Capital Expenditure	**2022/23 Revised £'000**	**2022/23 Actual £'000**	**Difference £'000**
General Fund (GF)			
Capital expenditure	**6,875**	**3,802**	**(3,073)**
Financed in year	(4,732)	(3,300)	1,432
Unfinanced capital expenditure	**2,143**	**502**	**(1,641)**
Housing Revenue Account (HRA)			
Capital expenditure	**3,932**	**3,559**	**(373)**
Financed in year	(3,932)	(3,559)	**373**
Unfinanced capital expenditure	**0**	**0**	**0**

2.4.3 **Capital Financing Requirement:** The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

	2022/23 Revised £'000	**2022/23 Actual £'000**	**Difference £'000**
General Fund	22,024	20,322	**(1,702)**
HRA	61,447	61,447	**0**
Total CFR	**83,471**	**81,769**	**(1,702)**

The CFR was £1.702m less than estimated; this was mainly due to slippage with the 2022/23 capital programme which resulted in a lower level of unfinanced capital expenditure.

2.4.4 **Gross Debt and the Capital Financing Requirement:** In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This is a key indicator of prudence.

Debt and CFR	2022/23 Revised £'000	2022/23 Actual £'000	Difference £'000
Total Debt	66,750	57,650	**(9,100)**
Capital Financing requirement	83,471	81,769	**(1,702)**
Under / (Over) Borrowing	**16,721**	**24,119**	**(7,398)**
Split between			
General Fund	(4,968)	(6,484)	**(1,516)**
HRA	(11,753)	(17,635)	**(5,882)**

The debt remained below the CFR during 2022/23.

2.4.5 **THE AUTHORISED LIMIT AND OPERATIONAL BOUNDARY FOR EXTERNAL DEBT**

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Operational Boundary for External Debt: The operational boundary is based on the Council's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring.

Authorised Limit, Operational Boundary and Total Debt	2022/23 Limits £000's	Maximum Debt 2022/23 £000's	Complied
Operational boundary	80,750	63,600	✔
Authorised Limit	85,174	63,600	✔

2.4.6 **Actual financing costs as a proportion of net revenue stream** - this prudential indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Ratio of Financing Costs to Net Revenue Stream	2022/23 Revised £'000	2022/23 Actual £'000	Difference %
General Fund	1.2%	1.5%	0.4%
HRA	33.7%	32.7%	-1.0%

2.5 PRUDENTIAL INDICATORS – UPDATE 2023/24

The 2023/24 Medium Term Financial Strategy report approved by Council on 10th February 2023 appendix E refers approved a number of prudential indicators for the period 2023/24 – 2025/26

A review of these indicators has taken place to confirm / gain assurance that the Council is operating within these limits.

3 Risk Assessment

3.1 The Council has complied with the relevant statutory and regulatory requirements, which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

3.2 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Arlingclose Ltd, the Council's advisers, has proactively managed the debt and investments over the year.

4 Conclusion

4.1 This report summaries the treasury activities and prudential indicators for 2022/23 and reviews the treasury activities up to 31st August 2023. It is a key governance report for the Treasury Management function.

Financial Services comments:	As contained in the report.
Legal Services comments:	This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Treasury Management Code of Practice.
Equality and Diversity:	N/A
Climate Change Implications	N/A
Crime and Disorder:	N/A
Service Improvement Plan implications:	This report is required in order that to fulfil statutory requirements associated with the achievement of both service improvement plan and corporate plan targets.
Corporate Plan	
Risk Assessment	As contained in the report
Background papers:	Budget and Final Accounts working papers
Appendices/Enclosures:	A. General Background Description To The Public Sector Treasury Management Environment In 2022/23 and Quarter 1 2023/24
Report Author / Lead Officer:	Keith Price

Appendix A

General Background Description To The Public Sector Treasury Management Environment In 2022/23 and Quarter 1 2023/24

2022/23

The following narrative was provided by Arlingclose Ltd

Economic background:

The war in Ukraine continued to keep global inflation above central bank targets and the UK economic outlook remained relatively weak with the chance of a mild recession. The economic backdrop during the January to March period continued to be characterised by high energy and commodity prices, high inflation, and the associated impact on household budgets and spending.

Central Bank rhetoric and actions remained consistent with combatting inflation. The Bank of England, US Federal Reserve, and European Central Bank all increased interest rates over the period, even in the face of potential economic slowdowns in those regions.

Starting the financial year at 5.5%, the annual CPI measure of UK inflation rose strongly to hit 10.1% in July and then 11.1% in October. Inflation remained high in subsequent months but appeared to be past the peak, before unexpectedly rising again in February. Annual headline CPI registered 10.4% in February, up from 10.1% in January, with the largest upward contributions coming from food and housing. RPI followed a similar pattern during the year, hitting 14.2% in October. In February RPI measured 13.8%, up from 13.4% in the previous month.

Following the decision by the UK government under Rishi Sunak and Jeremy Hunt to reverse some of the support to household energy bills announced under Liz Truss, further support in the form of a cap on what energy suppliers could charge household was announced in the March Budget to run from April until end June 2023. Before the announcement, typical household bills had been due to rise to £3,000 a year from April.

The labour market remained tight albeit with some ongoing evidence of potential loosening at the end of the period. The unemployment rate 3mth/year eased from 3.8% April-June to 3.6% in the following quarter, before picking up again to 3.7% between October-December. The most recent information for the period December-February showed an unemployment rate of 3.7%.

The inactivity rate was 21.3% in the December-February quarter, slightly down from the 21.4% in the first quarter of the financial year. Nominal earnings were robust throughout the year, with earnings growth in December-February at as 5.7% for both total pay (including bonuses) and 6.5% for regular pay. Once adjusted for inflation, however, both measures

were negative for that period and have been so throughout most of the year.

Despite household budgets remaining under pressure, consumer confidence rose to -36 in March, following readings of -38 and -45 in the previous two months, and much improved compared to the record-low of -49 in September. Quarterly GDP was soft through the year, registering a 0.1% gain in the April-June period, before contracting by (an upwardly revised) -0.1% in the subsequent quarter. For the October-December period was revised upwards to 0.1% (from 0.0%), illustrating a resilient but weak economic picture. The annual growth rate in Q4 was 0.6%.

The Bank of England increased the official Bank Rate to 4.25% during the financial year. From 0.75% in March 2022, the Monetary Policy Committee (MPC) pushed through rises at every subsequent meeting over the period, with recent hikes of 50bps in December and February and then 25bps in March, taking Bank Rate to 4.25%. March's rise was voted by a majority of 7-2, with two MPC members preferring to maintain Bank Rate at 4.0%. The Committee noted that inflationary pressures remain elevated with growth stronger than was expected in the February Monetary Policy Report. The February vote was also 7-2 in favour of a hike, and again with two members preferring to keep Bank Rate on hold.

After reaching 9.1% in June, annual US inflation slowed for eight consecutive months to 6% in February. The Federal Reserve continued raising interest rates over the period with consecutive increases at each Federal Open Market Committee meetings, taking policy rates to a range of 4.75%- 5.00% at the March meeting.

From the record-high of 10.6% in October, Eurozone CPI inflation fell steadily to 6.9% in March 2023. Energy prices fell, but upward pressure came from food, alcohol, and tobacco. The European Central Bank continued increasing interest rates over the period, pushing rates up by 0.50% in March, taking the deposit facility rate to 3.0% and the main refinancing rate to 3.5%.

Financial markets:

Uncertainty continued to be a key driver of financial market sentiment and bond yields remained relatively volatile due to concerns over elevated inflation and higher interest rates, as well as the likelihood of the UK entering a recession and for how long the Bank of England would continue to tighten monetary policy. Towards the end of the period, fears around the health of the banking system following the collapse of Silicon Valley Bank in the US and purchase of Credit Suisse by UBS caused further volatility.

Over the period the 5-year UK benchmark gilt yield rose from 1.41% to peak at 4.70% in September before ending the financial year at 3.36%. Over the same timeframe the 10-year gilt yield rose from 1.61% to peak at 4.51% before falling back to 3.49%, while the 20-year yield rose from 1.82% to 4.96% and then declined to 3.82%. The Sterling Overnight Rate (SONIA) averaged 2.24% over the period.

Credit review:

Early in the period, Moody's affirmed the long-term rating of Guildford BC but revised the outlook to negative. The agency also downgraded Warrington BC and Transport for London.

In July Fitch revised the outlook on Standard Chartered and Bank of Nova Scotia from negative to stable and in the same month Moody's revised the outlook on Bayerische Landesbank to positive. In September S&P revised the outlook on the Greater London Authority to stable from negative and Fitch revised the outlook on HSBC to stable from negative.

The following month Fitch revised the outlook on the UK sovereign to negative from stable. Moody's made the same revision to the UK sovereign, following swiftly after with a similar move for a number of local authorities and UK banks including Barclays Bank, National Westminster Bank (and related entities) and Santander.

During the last few months of the reporting period there were only a handful of credit changes by the rating agencies, then in March the collapse of Silicon Valley Bank (SVB) in the US quickly spilled over into worries of a wider banking crisis as Credit Suisse encountered further problems and was bought by UBS.

Credit Default Prices had been rising since the start of the period on the back of the invasion of Ukraine, and in the UK rose further in September/October at the time of the then-government's mini budget. After this, CDS prices had been falling, but the fallout from SVB caused a spike on the back of the heightened uncertainty. However, they had moderated somewhat by the end of the period as fears of contagion subsided, but many are still above their pre-March levels reflecting that some uncertainty remains.

On the back of this, Arlingclose reduced its recommended maximum duration limit for unsecured deposits for all UK and Non-UK banks/institutions on its counterparty list to 35 days as a precautionary measure. No changes were made to the names on the list.

As market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.

Local authorities remain under financial pressure, but Arlingclose continues to take a positive view of the sector, considering its credit strength to be high. Section 114 notices have been issued by only a handful of authorities with specific issues. While Arlingclose's advice for local authorities on its counterparty list remains unchanged, a degree caution is merited with certain authorities.

Quarter 1 2023/24

The following narrative was provided by Arlingclose Ltd

Economic background: From the start of the quarter until May it looked like peak global monetary policy rates were in sight as inflation continued to ease and central banks turned more dovish in tone. Only a few weeks later, stronger and more persistent inflation data, particularly in the UK, changed the picture.

The UK situation was not welcome news for the Bank of England. GDP growth was weak, confirmed at 0.1% in Q1, although more recent monthly GDP data has been somewhat better. The housing market has stalled, consumer demand is weak but seemingly recovering despite higher interest rates, and labour demand remained strong, with repercussions for wage growth which is accelerating.

April data showed the unemployment rate increased to 3.8% (3mth/year) while the employment rate rose to 76.0%. Pay growth was 6.5% for total pay (including bonuses) and 7.2% for regular pay, the largest growth rate of the latter outside of the Covid pandemic. Once adjusted for inflation, however, growth in total pay and regular pay remained negative.

Inflation fell from its peak of 11.1% reached in October 2022, but annual headline CPI in May 2023 was higher than the consensus forecast at 8.7% (8.4% expected), largely driven by services inflation, while the annual measure of underlying core inflation rose to 7.1% from 6.8%.

After a sharp rise in interest rate expectations, with clearly serious implications for mortgage markets due to higher inflation and wage data, the Bank of England's Monetary Policy Committee reaccelerated monetary policy tightening over the period with a 0.25% rise in May to a 0.5% rise in June, taking Bank Rate to 5.0%. At both meetings the vote was 7-2 in favour of increasing rates, with the two dissenters preferring to keep rates on hold.

Interest rate expectations priced in further hikes in policy rates. Arlingclose, the authority's treasury adviser, revised its forecast to forecast a further 0.5% of monetary tightening to take Bank Rate to 5.5%. The risks, however, are that rates could be higher; financial markets are forecasting policy interest rates above 6%.

With many mortgages at low fixed rates now systematically being re-set over the next 12-24 months at higher rates at the end of their fixed rate period, there has been a lagged effect of the feed through of monetary policy on households' disposable income. The economic slowdown is expected to develop over time and therefore, despite the GfK measure of consumer confidence rising to -24 in June, it is likely confidence will be negatively affected at some point. The manufacturing sector contracted during the quarter according to survey data, which will eventually feed into services, whose expansion is slowing.

Despite the US Federal Reserve increasing its key interest rate to 5.00-5.25% over the period, activity in the region continued to defy monetary tightening, particularly in labour markets which have so far appeared robust, supporting the Fed's assertations of two more rate hikes after it paused in June. Annual US inflation continued to ease, falling from 4.9% in April to 4.0% in May, the lowest level since March 2021. US GDP growth at 2% annualised in the first calendar quarter of 2023 was also significantly stronger than expected against the initial estimate of 1.3%.

In the euro zone, the picture was somewhat different. The European Central Bank maintained its hawkish tone and increased its key deposit, main refinancing, and marginal lending interest rates to 3.50%, 4.00% and 4.25% respectively. There were signs of weakening activity, particularly in Germany whose manufacturing sector has taken a hit from high energy prices and weaker global demand. However, inflation remained sticky, annual headline CPI fell to 5.5% in June while annual core inflation rose to 5.4% from 5.3%, which means the ECB is unlikely to stop monetary tightening.

Financial markets: Financial market sentiment and bond yields remained volatile, the latter continuing their general upward trend as uncertainty and concern over higher inflation and higher interest rates continued to dominate.

Gilt yields rose over the period. The 5-year UK benchmark gilt yield rose from 3.30% to 4.67%, the 10-year gilt yield from 3.43% to 4.39%, and the 20-year yield from 3.75% to 4.51%. The Sterling Overnight Rate (SONIA) averaged 4.37% over the quarter.

Credit review: Having completed a review of its credit advice on unsecured deposits at UK and non-UK banks following concerns of a wider financial crisis after the collapse of Silicon Valley Bank purchase of Credit Suisse by UBS, as well as other well-publicised banking sector issues, in March Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days.

Over the period S&P upgraded NatWest Group and related entities to A+ (except NatWest Markets which was upgraded to A), revised the UK sovereign outlook to stable from negative, and upgraded both Barclays Bank PLC and Barclays Bank UK PLC to A+.

Fitch put the US sovereign rating on Rating Watch Negative following increased political partisanship which at the time was hindering the latest resolution to raise the debt ceiling. It also upgraded the outlook on United Overseas Bank to stable, the outlook on Clydesdale to positive, and the outlook on Bank of Montreal to stable.

Moody's withdrew Guildford BC's rating (who chose not to continue being rated) and affirmed the Aaa rating of the European Investment Bank.

Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress but made no changes to the counterparty list or recommended durations over the quarter. Nevertheless, heightened market volatility is expected to remain a feature,

at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.