Board	**POLICY AND ORGANISATION BOARD**
Date of meeting:	**30th SEPTEMBER 2024**
Title:	**TREASURY MANAGEMENT ANNUAL REVIEW 2023/24, PROGRESS REPORT 2024/25, & 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 2023/24 together with an in year review 2024/25. The report also includes the Prudential Indicators for 2023/24 in accordance with the requirements of the Prudential Code.

Recommendations

The Board notes

- The Treasury Management outturn report 2023/24 as identified in 2.2
- The Treasury Management position for 2024/25 at the end of August 2024 as identified in 2.3
- The Prudential Indicators outturn report 2023/24 as identified in 2.4
- The Prudential Indicators update 2024/25 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 2023/24 was approved at a meeting of Council on 15th March 2023. 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 2023/24 outturn indicators against those approved by Full Council on the 10th February 2023 as part of the Medium Term Financial Strategy & Budget report 2023/24 and an update on the Prudential Indicators approved by Full Council on the 7th February 2024 as part of the Medium Term Financial Strategy & Budget (Revenue & Capital) report 2024/25.

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 2023/24 and for Quarter 1 2024/25 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 2023/24

2.2.1 On 31st March 2024, the Council had net borrowing (borrowings less investments) of £56.4m arising from its revenue and capital income and expenditure, an increase of £2.5m on the previous year.

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**

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.

At 31st March 2024, the Council held £59.6m in loans an increase of £1.9m 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 2022/23 figures for comparison.

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

2023/24	**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	**5,738**	3.15%	22.00	**46,812**	3.50%	23.50	**52,550**	3.12%	25.26
Variable rate borrowing:									
Local Authority	**7,000**	4.75%	0.22	**-**	**-**	**-**	**7,000**	4.75%	0.67
Gross borrowing	**12,738**			**46,812**			**59,550**		

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**		

(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.

Interest rates have seen substantial rises over the last two years, although these rises have now begun to plateau during 2023/24. Gilt yields fell in late 2023, reaching lows in December 2023 before rebounding to an extent in the first three months of 2024. Gilt yields have remained volatile, seeing upward pressure from perceived sticker inflation at times and downward pressure from falling inflation and a struggling economy at other times.

On 31st December, the PWLB certainty rates for maturity loans were 4.74% for 10-year loans, 5.18% for 20-year loans and 5.01% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41% respectively.

The cost of short term borrowing from other local authorities has generally risen with Base Rate over the year. Interest rates peaked at around 7% towards the later part of March 2024 as many authorities required cash at the same time. These rates have now fallen back to more normal market levels.

A new PWLB HRA rate which is 0.4% below the certainty rate was made available from 15th June 2023. This rate will now be available to June 2025. The discounted rate is to support local authorities borrowing for the Housing Revenue Account and for refinancing existing HRA loans, the Council re-financed £6m of HRA loans benefitting from this discounted rate during this time frame.

The following long term borrowing was undertaken during 2023/24. The previous long term borrowing undertaken by the Council was back in 2015/16. The Council benefited from the HRA certainty rate for both these loans i.e. a 0.6% discount below prevailing PWLB rates.

	Amount (£000's)	**Rate %**	**Period (Years)**
PWLB Annuity (Loan 1 HRA)	3,000	4.08%	10
PWLB Maturity (Loan 2 HRA)	3,000	5.04%	1.08
Total Borrowing	6,000		

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 £2m and £10m averaging £4.5m during 2023/24 compared to an average of £5.1m during 2022/23.

Interest Payable on all borrowings was £1,848,440 compared to a revised budget of £1,904,560 (£1,749,560 in 2022/23).

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.

During the year the Council's investments ranged between £3m and £14m due to the timing differences between income and expenditure. The Council's investment balances at the end of each quarter during 2023/24 are summarised in the table below.

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 %
31/03/2023	3,730	4.10%	25	1.00%	-	-	-	-	3,755	4.08%
Qtr 1 (end)	3,000	5.27%	100	1.35%	-	-	-	-	3,100	5.14%
Qtr 2 (end)	3,070	4.92%	180	1.35%		-	-	-	3,250	4.72%
Qtr 3 (end)	7,350	5.35%	100	1.35%	300	5.20%	-	-	7,750	5.29%
31/03/2024	3,000	5.27%	100	1.35%	-	-	-	-	3,100	5.14%

All investments undertaken during 2023/24 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.

Bank Rate which is a key driver of short term interest rates has increased from 4.25% at the beginning of the year to 5.25% at the end of March 2024.

The average return on investments during the year was 4.91% compared with 1.48% the previous year and the Interest receivable on Treasury Management Investments was £355,160 compared to a revised budget of £394,400 (£275,800 in 2022/23).

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-24 Actual %	2023/24 Lower %	2023/24 Upper %	Complied
Under 12 months	17%	0%	25%	✔
12 months and within 24 months	14%	0%	25%	✔
24 months and within 5 years	12%	0%	25%	✔
5 years and within 10 years	3%	0%	20%	✔
10 years and above *	54%	30%	50%	x

* No borrowing over 10 years was undertaken during 2023/24, the limits on maturity structure for 2023/24 were calculated assuming a higher level of borrowing at 31/3/2024.

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 2024

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	2023/24 Revised £000's	2023/24 Actual £000's	Complied
Limits on one-year revenue impact of a 1% rise in interest rates	(23)	(42)	✔

2.3 THE TREASURY POSITION IN 2024/25 (at the end of August 2024)

2.3.1 A general background description to the Public Sector Treasury Management Environment for Quarter 1 2024/25 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 £46.0m a decrease of £10.4m from the 31st March 2024, this is only a temporary position reflecting the Council's in year cash flow at this point in time, this is mainly reflected in a reduction in short term borrowing £7m and increase in short term investments £3.2m.

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

2.3.2 **Borrowing Activity**

At the present time short term interest rates are higher than long term interest rates. In the first 5 months of 2024/25, Bank Rate reduced from 5.25% at the beginning of April to 5.00% at the end of August.

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.

The PWLB certainty rate for 10-year maturity loans was 4.80% at the beginning of the period and 4.78% percent at the end. The lowest available 10-year maturity rate during the period was 4.63% and the highest was 5.18%. Rates for 20-year maturity loans ranged from 5.08% to 5.57% during the quarter, and 50-year maturity loans from 5.02% to 5.40%.

Whilst the cost of short-term borrowing from other local authorities spiked to around 7% in late March 2024, primarily due a dearth of LA-LA lending/borrowing activity during the month, as expected shorter-term rates reverted to a more normal range and are now closely aligned to the Bank of England base rate. On 31st August, the PWLB certainty rates for maturity loans were 4.78% for 10 year loans, 5.21% for 20-year loans and 5.07% for 50-year loans. Their equivalents on 31st March 2024 were 4.74%, 5.18% and 5.01%

At the end of August, the Council held £52.4m of loans, a reduction of £7.2m 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 2024	**Genera**			**HRA**			**Total**		
	£000's	**Rate %**	**Avge Life (Yrs)**	**£000's**	**Rate %**	**Avge Life (Yrs)**	**£000's**	**Rate %**	**Avge Life (Yrs)**
Fixed rate borrowing:									
PWLB	**5,688**	3.18%	22.11	**46,662**	3.50%	24.18	**52,350**	3.46%	23.96
Variable rate borrowing:									
Local Authorities	-	-	-	-	-	-	-	-	-
Gross borrowing	**5,688**			**46,662**			**52,350**		

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	31/03/2024 Actual £m	31/03/2025 Estimate £m
Capital Financing Requirement	81,502.0	81,155.0	85,497.0
Less: Balance Sheet Resources	(18,206.0)	(23,957.0)	(16,398.0)
Net Loans Requirement	63,296.0	57,198.0	69,099.0
Plus Liquidity Allowance	4,000.0	4,000.0	4,000.0
Liability Benchmark	67,296.0	61,198.0	73,099.0
Existing Borrowing	59,650.0	59,550.0	73,650.0

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 2024/25 up to end August 2024.

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 %
01/04/2024	3,730	4.10%	25	1.00%	-	-	-	-	3,755	4.08%
Qtr 1 (end)	7,930	5.23%	70	3.25%	-	-	-	-	8,000	5.21%
31/08/2024	6,180	5.04%	170	3.25%	-	-	-	-	6,350	4.99%

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 £389,300 income from its short term investments and Income received up to 31th August was £172,850.

2.3.4 HRA PWLB Rate

The PWLB HRA rate which is 0.4% below the certainty rate is available up to June 2025. This discounted rate is to support local authorities borrowing for the Housing Revenue Account and for refinancing existing HRA loans, providing a window of opportunity for HRA-related borrowing £1.6m and to replace the Council's £6m loans relating to the HRA maturing during this time frame.

2.4 THE PRUDENTIAL INDICATORS OUTTURN REPORT 2023/24

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 2023/24.

2.4.2 THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING 2023/24

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

Capital Expenditure	**2023/24 Revised £'000**	**2023/24 Actual £'000**	**Difference £'000**
General Fund (GF)			
Capital expenditure	**3,351**	**2,325**	**(1,026)**
Financed in year	(2,947)	(2,268)	679
Unfinanced capital expenditure	**404**	**57**	**(347)**
Housing Revenue Account (HRA)			
Capital expenditure	**4,300**	**4,157**	**(143)**
Financed in year	(4,300)	(4,157)	**143**
Unfinanced capital expenditure	**0**	**0**	**0**

2.4.3 **Capital Financing Requirement:** the Council's cumulative outstanding amount of debt finance is measured by the capital finance requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to repay debt.

	2023/24 Revised £'000	**2023/24 Actual £'000**	**Difference £'000**
General Fund	20,055	19,708	**(347)**
HRA	61,447	61,447	**0**
Total CFR	**81,502**	**81,155**	**(347)**

The CFR was £0.347m less than estimated; this was mainly due to slippage with the 2023/24 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	2023/24 Revised £'000	2023/24 Actual £'000	Difference £'000
Total Debt	59,650	59,550	**(100)**
Capital Financing requirement	81,502	81,155	**(347)**
Under / (Over) Borrowing	**21,852**	**21,605**	**247**
Split between			
General Fund	(10,099)	(3,970)	**6,129**
HRA	(11,753)	(17,635)	**(5,882)**

The debt remained below the CFR during 2023/24.

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	2023/24 Limits £000's	Maximum Debt 2023/24 £000's	Complied
Operational boundary	69,650	62,550	✔
Authorised Limit	73,851	62,550	✔

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	**2023/24 Revised £'000**	**2023/24 Actual £'000**	**Difference %**
General Fund	9.5%	7.8%	-1.7%
HRA	29.6%	30.0%	0.4%

2.5 PRUDENTIAL INDICATORS – UPDATE 2024/25

The 2024/25 Medium Term Financial Strategy report approved by Council on 7th February 2024 appendix E refers approved a number of prudential indicators for the period 2024/25 to 2026/27

The capital programme for 2024/25 to 2026/27 was reviewed by Full Council on 29th May 2024 the Policy and Organisation Board and that the Borough Treasurer be given delegated authority to amend the Prudential Indicators to reflect the revised Capital Programme.

A review of these indicators has taken place and over the forecast period there are no material changes to report.

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 2023/24 and reviews the treasury activities up to 31st August 2024. 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 2023/24 and Quarter 1 2024/25
Report Author / Lead Officer:	Keith Price

Appendix A

General Background Description To The Public Sector Treasury Management Environment In 2023/24 and Quarter 1 2024/25

2023/24

The following narrative was provided by Arlingclose Ltd

Economic background: UK inflation continued to decline from the 8.7% rate seen at the start of 2023/24. By the last quarter of the financial year headline consumer price inflation (CPI) had fallen to 3.4% in February, but was still above the Bank of England's 2% target at the end of the period. The core measure of CPI, i.e. excluding food and energy, also slowed in February to 4.5% from 5.1% in January, a rate that had stubbornly persisted for three consecutive months.

The UK economy entered a technical recession in the second half of 2023, as growth rates of -0.1% and -0.3% respectively were recorded for Q3 and Q4. Over the 2023 calendar year GDP growth only expanded by 0.1% compared to 2022. Of the recent monthly data, the Office for National Statistics reported a rebound in activity with economy expanding 0.2% in January 2024. While the economy may somewhat recover in Q1 2024, the data suggests that prior increases in interest rates and higher price levels are depressing growth, which will continue to bear down on inflation throughout 2024.

Labour market data provided a mixed message for policymakers. Employment and vacancies declined, and unemployment rose to 4.3% (3mth/year) in July 2023. The same month saw the highest annual growth rate of 8.5% for total pay (i.e. including bonuses) and 7.8% for regular pay growth (i.e. excluding bonuses). Thereafter, unemployment began to decline, falling to 3.9% (3mth/year) in January and pay growth also edged lower to 5.6% for total pay and 6.1% for regular pay, but remained above the Bank of England's forecast.

Having begun the financial year at 4.25%, the Bank of England's Monetary Policy Committee (MPC) increased Bank Rate to 5.25% in August 2023 with a 3-way split in the Committee's voting as the UK economy appeared resilient in the face of the dual headwinds of higher inflation and interest rates. Bank Rate was maintained at 5.25% through to March 2024. The vote at the March was 8-1 in favour of maintaining rates at this level, with the single dissenter preferring to cut rates immediately by 0.25%. Although financial markets shifted their interest rate expectations downwards with expectations of a cut in June, the MPC's focus remained on assessing how long interest rates would need to be restrictive in order to control inflation over the medium term.

In the Bank's quarterly Monetary Policy Report (MPR) released in August 2023 the near-term projection for services price inflation was revised upwards, goods price inflation widespread across products, indicating stronger domestic inflationary pressure with second-round effects in domestic prices and wages likely taking longer to unwind than they did to emerge. In the February 2024 MPR the Bank's expectations for the UK economy were positive for the first half of 2024, with a recovery from the mild recession in calendar H2 2023 being gradual. Headline CPI was forecast to dip below the 2% target quicker than previously thought due to declining energy prices, these effects would hold inflation slightly above target for much of the forecast horizon.

Following this MPC meeting, Arlingclose, the authority's treasury adviser, maintained its central view that 5.25% remains the peak in Bank Rate and that interest rates will most likely start to be cut later in H2 2024. The risks in the short-term are deemed to be to the downside as a rate cut may come sooner than expected, but then more broadly balanced over the medium term.

The US Federal Reserve also pushed up rates over the period, reaching a peak range of between 5.25-5.50% in August 2023, where it has stayed since. US policymakers have maintained the relatively dovish stance from the December FOMC meeting and at the meeting in March, economic projections pointed to interest rates being cut by a total of 0.75% in 2024.

Following a similarly sharp upward trajectory, the European Central Bank hiked rates to historically high levels over period, pushing its main refinancing rate to 4.5% in September 2023, where it has remained. Economic growth in the region remains weak, with a potential recession on the cards, but inflation remains sticky and above the ECB's target, putting pressure on policymakers on how to balance these factors.

Financial markets: Sentiment in financial markets remained uncertain and bond yields continued to be volatile over the year. During the first half of the year, yields rose as interest rates continued to be pushed up in response to rising inflation. From October they started declining again before falling sharply in December as falling inflation and dovish central bank attitudes caused financial markets to expect cuts in interest rates in 2024. When it emerged in January that inflation was stickier than expected and the BoE and the Federal Reserve were data dependent and not inclined to cut rates soon, yields rose once again, ending the period some 50+ bps higher than when it started.

Over the financial year, the 10-year UK benchmark gilt yield rose from 3.44% to peak at 4.75% in August, before then dropping to 3.44% in late December 2023 and rising again to 3.92% (28th March 2024). The Sterling Overnight Rate (SONIA) averaged 4.96% over the period to 31st March.

Credit review: In response to an improving outlook for credit markets, in January 2024 Arlingclose moved away from its previous temporary stance of a 35-day maximum duration and increased its advised recommended maximum unsecured duration limit on all banks on its counterparty list to 100 days.

Earlier in the period, S&P revised the UK sovereign outlook to stable and upgraded Barclays Bank to A+. Moody's also revised the UK outlook to stable, Handelsbanken's outlook to negative, downgraded five local authorities, and affirmed HSBC's outlook at stable while upgrading its Baseline Credit Assessment. Fitch revised UOB's and BMO's outlooks to stable.

In the final quarter of the financial year, Fitch revised the outlook on the UK sovereign rating to stable from negative based on their assessment that the risks to the UK's public finances had decreased since its previous review in October 2022, the time of the mini- budget.

Moody's, meanwhile, upgraded the long-term ratings of German lenders Helaba, Bayern LB and LBBW on better solvency and capital positions, despite challenges from a slowing German economy and exposure to the commercial real estate sector. Moody's also upgraded or placed on review for an upgrade, Australian banks including ANZ, CBA NAB and Westpac on the back of the introduction of a new bank resolution regime.

Credit default swap prices began the financial year at elevated levels following the fallout from Silicon Valley Bank and collapse/takeover of other lenders. From then the general trend was one of falling prices and UK lenders' CDS ended the period at similar levels to those seen in early 2023. Earlier in the year some Canadian lenders saw their CDS prices rise due to concerns over a slowing domestic economy and housing market, while some German lenders were impacted by similar economic concerns and exposure to commercial real estate towards the end of the period, with LBBW remaining the most elevated.

Heightened market volatility is expected to remain a feature, at least in the near term and, credit default swap levels will be monitored for signs of ongoing credit stress. As ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remain under constant review.

Quarter 1 2024/25 (updated to August 2024)

Economic background: UK headline consumer price inflation (CPI) continued to decline over the quarter, falling from an annual rate of 3.2% in March to 2.0% in May, in line with the Bank of England's target. The core measure of inflation, however, only declined from 4.2% to 3.5% over the same period, which, together with stubbornly services price inflation at 5.7% in May, helped contribute to the BoE maintaining Bank Rate at 5.25% during the period, a level unchanged since August 2023.
Data released during the period showed that showed the UK economy had emerged from the technical recession at the end of 2023 to expand by 0.7% (upwardly revised from the initial estimate of 0.6%) in the first quarter of the calendar year. Monthly GDP data showed zero growth in April following an expansion of 0.4% in the previous month.
Labour market data continued to provide mixed messages for policymakers, exacerbated by issues the Office for National Statistics is having compiling the labour force survey. In the three months between February and April 2024, unemployment was up, employment fell, while the decline in vacancies slowed and wage growth remained elevated. Unemployment rose to 4.4% (3mth/year) while average regular earnings (excluding bonuses) was 6.0% and total earnings (including bonuses) was 5.9%. Adjusting for inflation, real regular pay rose by 2.3% and total pay by 2.2%. Given how keenly the 'second-round' impact of inflation on wages is watched by the BoE, policymakers will likely want to see more downward movement before cutting interest rates.

Having started the financial year at 5.25%, the Bank of England's Monetary Policy Committee (MPC) maintained Bank Rate at this level throughout the quarter. In line with expectations, at its June meeting, the Committee voted by a majority of 7-2 in favour of maintaining the status quo. The two dissenters preferred an immediate 0.25% reduction in Bank Rate to 5.0%. This continued dovish tilt by the Committee increased financial market expectations that the first cut in Bank Rate will likely be in August.

In a 'finely balanced' decision, the Bank of England cut Bank Rate in August by25bps to 5.00%. In a 5-4 vote, a majority of MPC members thought inflationary pressures had eased enough to justify a rate cut, while others continued to maintain caution over underlying inflationary persistence and voted for no change.

Earlier in May, in addition to an identical MPC rate decision and voting pattern, the Bank published the latest version of its Monetary Policy Report (MPR). Within the Report, the Committee noted that it expected four-quarter GDP growth to increase over the forecast period, reflecting the declining negative effects of past Bank Rate increases and the predicted downward path of interest rates which should provide support to economic activity. The trajectory of inflation was broadly similar to that in the previous MPR, albeit slightly lower towards the end of the forecast horizon due to the Committee's revised assessment of falling external inflationary pressures from past import price increases. This meant the Committee expected headline inflation to hit the 2% target two quarters sooner than in the February MPR. As was highlighted earlier, inflation data published in June showed that CPI inflation fell to the 2% target in May.

Arlingclose, the authority's treasury adviser, maintained its central view that 5.25% is the peak in Bank Rate and that interest rates will most likely be cut by a further 0.25% to 4.75% in Q3 2024. The risks over the medium term are deemed to be to the upside as while inflation has fallen to target, it is expected to pick up again later in the year and as services price inflation and wage growth are still on the firmer side.

The US Federal Reserve also maintained interest rates over the period, holding the Fed Funds Rate at 5.25%-5.50% for the seventh consecutive month in June, as was expected. US policymakers have maintained a relatively dovish stance throughout the period but have steadily reduced their predictions around the pace and timing of rate cuts in the face of higher inflation and firmer economic growth. At the meeting, economic projections pointed to one rate cut in calendar 2024 and four in 2025.
The European Central Bank cut rates in June, reducing its main refinancing rate from 4.50% to 4.25%. Inflation in the region fell to 2.5% in May, having increased in the previous month, but since February has been fairly sticky at between 2.4% and 2.6%. Economic growth in the region has picked up but remains weak, and with inflation above the ECB's target this continues put pressure on policymakers on how to balance these factors when setting monetary policy.

Financial markets: Sentiment in financial markets showed signs of improvement over the quarter, but bond yields remained volatile. Early in the period yields climbed steadily, but mixed signals from economic data and investors' constant reassessment of when rate cuts might come caused a couple of fairly pronounced but short lived dips in yields. Towards the end of the quarter yields rose once again and were generally higher than at the start of the period.

Over the quarter, the 10-year UK benchmark gilt yield started at 3.94% and ended at 4.18% having reached 4.41% in May. While the 20-year gilt started at 4.40%, hit 4.82% in May, before ending the period at 4.61%. The Sterling Overnight Rate (SONIA) averaged 5.20% over the quarter to 30th June.

Credit review: Arlingclose maintained its advised recommended maximum unsecured duration limit on all banks on its counterparty list at 100 days.

During the quarter, Fitch revised its outlook on Transport for London (TfL) to stable from negative while S&P upgraded its long-term rating for TfL to AA- from A+, in line with its rating of the UK sovereign.

Fitch also upgraded the long-term ratings for the main four Australian banks – Australia & New Zealand Banking Group, Commonwealth Bank of Australia, National Australia Bank and Westpac.

Having placed Warrington Borough Council on review for a downgrade in March, Moody’s subsequently withdrew its ratings for the council in June.

Credit default swap prices started and ended the quarter at broadly similar levels in the UK as they did for the European, Singaporean and Australian lenders on Arlingclose’s counterparty list, while Canadian banks generally trended modestly downwards.

Financial market volatility is expected to remain a feature, at least in the near term and, credit default swap levels will be monitored for signs of ongoing credit stress. As ever, the institutions and durations on the Authority’s counterparty list recommended by Arlingclose remain under constant review.