Appendix 1

Treasury Management Half Yearly Report – 2022/23

1. Background

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate security and liquidity initially before considering optimising investment return (yield).

Accordingly Treasury Management is defined as:

“The management of the local authority’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

The second main function of a treasury management service is the funding of an authority’s capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasions any debt previously drawn may be restructured to meet Council risk or cost objectives.

2. Introduction

In February 2010 the Council adopted 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 treasury management semi-annual and annual reports.

The Council’s treasury management strategy for 2022/23 was approved at a meeting on 23 February 2022. The Council has 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 remains central to the Council’s treasury management strategy.

The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council’s Capital Strategy, complying with CIPFA’s requirement, was approved by full Council on 23 February 2022.

This Half Yearly Report to members is intended to provide an update of the treasury management strategy and performance for the period April to September of this financial year.

3. Economic Update – as provided by the Council’s Treasury Management Advisors, Arlingclose

The ongoing conflict in Ukraine has continued to put pressure on global inflation and the economic outlook for UK and world growth remains weak. The UK political situation towards the end of the period following the ‘fiscal event’ increased uncertainty further.

The economic backdrop during the April to September period continued to be characterised by high oil, gas and commodity prices, ongoing high inflation and its impact on consumers' cost of living, no imminent end in sight to the Russia-Ukraine hostilities and its associated impact on the supply chain, and China's zero-Covid policy.

Central Bank rhetoric and action remained robust. The Bank of England, Federal Reserve and the European Central Bank all pushed up interest rates over the period and committed to fighting inflation, even when the consequences were in all likelihood recessions in those regions.

UK inflation remained extremely high. Annual headline Consumer Price Index Inflation (CPI) hit 10.1% in July, the highest rate for 40 years, before falling modestly to 9.9% in August. Retail Price Index Inflation (RPI) registered 12.3% in both July and August. The energy regulator, Ofgem, increased the energy price cap by 54% in April, while a further increase in the cap from October, which would have seen households with average energy consumption pay over £3,500 per annum, was dampened by the UK government stepping in to provide around £150 billion of support to limit bills to £2,500 annually until 2024.

The labour market remained tight through the period but there was some evidence of easing demand and falling supply. The unemployment rate for April fell to 3.8% and declined further to 3.6% in July. Although now back below pre-pandemic levels, the recent decline was driven by an increase in inactivity rather than demand for labour. Pay growth in July was 5.5% for total pay (including bonuses) and 5.2% for regular pay. Once adjusted for inflation, however, growth in total pay was -2.6% and –2.8% for regular pay.

With disposable income squeezed and higher energy bills still to come, consumer confidence fell to a record low of –44 in August, down –41 in the previous month. Quarterly Gross Domestic Product (GDP) fell -0.1% in the April-June quarter driven by a decline in services output, but slightly better than the 0.3% fall expected by the Bank of England.
The Bank of England increased the official Bank Rate to 2.25% over the period. From 0.75% in March, the Monetary Policy Committee (MPC) pushed through rises of 0.25% in each of the following two MPC meetings, before hiking by 0.50% in August and again in September. August's rise was voted by a majority of 8-1, with one MPC member preferring a more modest rise of 0.25%. The September vote was 5-4, with five votes for an 0.5% increase, three for an 0.75% increase and one for an 0.25% increase. The Committee noted that domestic inflationary pressures are expected to remain strong and so given ongoing strong rhetoric around tackling inflation further Bank Rate rises should be expected.

On 23rd September the UK government, following a change of leadership, announced a raft of measures in a 'mini budget', loosening fiscal policy with a view to boosting the UK's trend growth rate to 2.5%. With little detail on how government borrowing would be returned to a sustainable path, financial markets reacted negatively. Gilt yields rose dramatically by between 0.7% - 1% for all maturities with the rise most pronounced for shorter dated gilts. The swift rise in gilt yields left pension funds vulnerable, as it led to margin calls on their interest rate swaps and risked triggering large scale redemptions of assets across their portfolios to meet these demands. It became necessary for the Bank of England to intervene to preserve market stability through the purchase of long-dated gilts, albeit as a temporary measure, which has had the desired effect with 50-year gilt yields falling over 100bps in a single day.

Bank of England policymakers noted that any resulting inflationary impact of increased demand would be met with monetary tightening, raising the prospect of much higher Bank Rate and consequential negative impacts on the housing market.

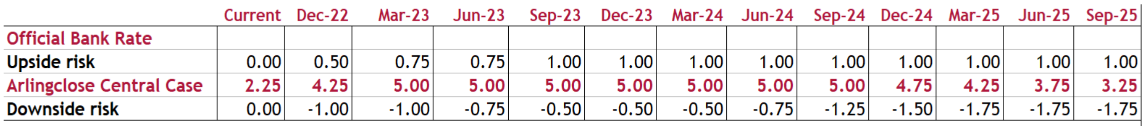
After hitting 9.1% in June, annual United States inflation eased in July and August to 8.5% and 8.3% respectively. The Federal Reserve continued its fight against inflation over the period with a 0.5% hike in May followed by three increases of 0.75% in June, July and September, taking policy rates to a range of 3% - 3.25%.

Eurozone CPI inflation reached 9.1% y/y in August, with energy prices the main contributor but also strong upward pressure from food prices. Inflation has increased steadily since April from 7.4%. In July the European Central Bank increased interest rates for the first time since 2011, pushing its deposit rate from –0.5% to 0% and its main refinancing rate from 0.0% to 0.5%. This was followed in September by further hikes of 0.75% to both policy rates, taking the deposit rate to 0.75% and refinancing rate to 1.25%.

4. Regulatory Updates – as provided by the Council's Treasury Management Advisors, Arlingclose

CIPFA published its revised Treasury Management Code of Practice [the TM Code] and Prudential Code for Capital Finance in December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments. The principles within the two Codes took immediate effect.

5. Arlingclose's Economic Outlook for the remainder of 2022/23 (based on 26th September 2022 interest rate forecast)



	Current	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	2.25	4.25	5.00	5.00	5.00	5.00	5.00	5.00	5.00	4.75	4.25	3.75	3.25
Downside risk	0.00	-1.00	-1.00	-0.75	-0.50	-0.50	-0.50	-0.75	-1.25	-1.50	-1.75	-1.75	-1.75

Arlingclose expects Bank Rate to rise further during 2022/23 to reach 5% by the end of the year.

The MPC is particularly concerned about the demand implications of fiscal loosening, the tight labour market, sterling weakness and the willingness of firms to raise prices and wages.

The MPC may therefore raise Bank Rate more quickly and to a higher level to dampen aggregate demand and reduce the risk of sustained higher inflation. Arlingclose now expects Bank Rate to peak at 5.0%, with 200bps of increases this calendar year.

This action by the MPC will slow the economy, necessitating cuts in Bank Rate later in 2024.

Gilt yields will face further upward pressure in the short term due to lower confidence in UK fiscal policy, higher inflation expectations and asset sales by the BoE. Given the recent sharp rises in gilt yields, the risks are now broadly balanced to either side. Over the longer term, gilt yields are forecast to fall slightly over the forecast period.

6. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy for 2022/23 was approved by Full Council on 23 February 2022. The Council's annual Investment Strategy, which is incorporated in the Treasury Management Strategy, outlines the Council's investment priorities as follows:

- Security of Capital
- Liquidity

The Council will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term, and only invest with highly credit rated financial institutions using the Arlingclose suggested creditworthiness matrices. Currently investments are only being made with UK financial institutions.

Investments during the first six months of the 2022/23 financial year have been in line with the strategy, and there have been no deviations from the strategy.

It is considered that the strategy approved on 23 February 2022 is still fit for purpose in the current economic climate.

7. Investment Portfolio 2022/23

In accordance with the CIPFA Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As detailed in section 3, The Bank of England has increased the official Bank Rate from 0.75% to 2.25% during the period. This has fed through into increasing investment returns.

The Council held investments of £30.3m as at 30 September 2022; £26.5m was placed in the Debt Management Account Deposit Facility (DMADF) with the DMO, £2m was held in the Public Sector Deposit Fund, and £1.8m was held in the Council's Lloyds Current Account for liquidity. In comparison £15.5m was held as at 31 March 2022; £14.0m in the DMADF and £1.5m in the Lloyds Current Account. Investments held have been with institutes with a credit rating of A+ or above. This is greater than the average portfolio credit rating target of A or above set in the Council's Treasury Management Strategy 2022/23.

Funds available for investment purposes during 2022/23 to date have varied throughout the year, with up to £30.3m being available for investment, mainly due to the central government funding received to support small and medium businesses during the coronavirus pandemic and advances of the Town Deal and Future High Streets funding streams. There are fluctuations due to cash inflows and outflows during each month. Large cash inflows include council tax and business rate direct debits and the Housing Benefit subsidy from the Department for Work and Pensions. Large cash outflows include payment of the precepts to Staffordshire County Council, the Fire Authority and the Police, payment of salaries and payment of business rates to Central Government and the Staffordshire Business Rate pool.

The investment portfolio yield for the first six months of the year is 1.13%, at 30 September 2022 this yield was 1.88%. The Council's budgeted investment return for 2022/23 is nil. As at the end of the first 2 quarters of 2022/23 £117,181.96 of interest has been earned.

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 treasury investments before seeking the optimum 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.

Throughout 2022/23 to date, there has been zero interest on the Lloyds Current Account, and up to 1.945% from the DMADF. The return on Money Market Funds net of fees produced returns of up to 1.9551%.

8. Borrowing Position 2022/23

The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. During the first six months of 2022/23 no borrowing has taken place, however it is envisaged that borrowing will be required to cover short-term cash flow deficits together with the capital programme.

With short-term interest rates remaining lower than long-term rates, the Council consider it to be more cost effective in the near term to use internal resources or borrow on a short-term basis. This is also in line with advice provided by Arlingclose Ltd.

However, a need to borrow in order to fund the Council's capital programme was included within the Revenue and Capital Budgets and Strategies 2022/23 reports presented to Council on 23 February 2022. The impact of borrowing is included in the Medium Term Financial Strategy pressures for 2022/23 and future years.

Borrowing Update

Local authorities can borrow from the Public Works Loan Board (PWLB) provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing.

Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

Competitive market alternatives may be available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders.
The Authority is not planning to purchase any investment assets primarily for yield within the next three years and so is able fully access the PWLB.

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.

9. Prudential Indicators 2022/23

Treasury management activity during the first half year has been carried out within the parameters set by the prudential indicators contained in the approved 2022/23 Treasury

Management Strategy. Consequently, there is no intention to revise any of the indicators for the remainder of the year.

10. Compliance

The Head of Finance (S151 Officer) reports that all treasury management activities undertaken during the year to date have complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

Compliance with debt limits:

	Q1 & Q2 2022/23 Maximum	30.09.22 Actual	2022/23 Operational Boundary	2022/23 Authorised Limit	Complied?
Borrowing	£0m	£0m	£75m	£85m	Yes

Compliance with investment limits:

	Q1 & Q2 2022/23 Maximum	30.09.22 Actual	2022/23 Limit	Complied?
The UK Government	£26.5m	£26.5m	Unlimited	Yes
Local authorities & other government entities	£0m	£0m	£7m	Yes
Secured investments	£0m	£0m	£7m	Yes
Banks (unsecured)	£7m	£1.8m	£7m	Yes
Building societies (unsecured)	£0m	£0m	£7m	Yes
Registered providers (unsecured)	£0m	£0m	£10m	Yes
Money market funds	£2m	£2m	£7m	Yes
Other Investments	£0m	£0m	£7m	Yes

Annex A

Treasury Management – Glossary of Terms

- **CIPFA** – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations.

- **CPI** – a measure that examines the weighted average of prices of a basket of consumer goods and services. The Consumer Price Index is calculated by taking price changes for each item in the predetermined basket of goods/services and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

- **DMADF** –is provided by the DMO as part of its cash management operations and in the context of a wider series of measures designed to support local authorities' cash management.

- **DMO** – The Debt Management Office is an Executive Agency of Her Majesty's Treasury responsible for debt and cash management for the UK Government, lending to local authorities and managing certain public sector funds.

- **GDP** – Gross Domestic Product is the market value of all officially recognised final goods and services produced within a country in a given period of time.

- **Liquidity** – relates to the amount of readily available or short term investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.

- **MPC** – the Monetary Policy Committee (MPC) is a committee of the Bank of England, which meets for three and a half days, eight times a year, to decide the official interest rate in the United Kingdom (the Bank Rate).

- **PWLB** – is a statutory body operating within the United Kingdom Debt Management Office. PWLB's function is to lend money from the National Loans Fund to local authorities, and to collect the repayments.