ANNEX 1

TREASURY MANAGEMENT MID YEAR REPORT
2022/23

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1. Mid-Year Performance

Investments

The underlying economic environment continues to remain challenging due to the volatility in the market caused by increased interest rates and inflation. The approach of maintaining short-term investments with high quality counterparties has continued, which allows the Council to be responsive when allocating funding to approved projects.

To manage the associated risks, investments are limited to a small group of banks and some building societies where they meet the Council's Treasury Management Strategy. With rising interest rates, the return on investments should see an increase on prior years.

Borrowing

Borrowing options are monitored in anticipation of the forecast funding requirements of the Capital Programme. The main objective when borrowing is to strike an appropriate risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required.

Strategy Compliance

One matter is highlighted with regard to the approved Treasury Management Strategy Statement for 2022/23:

- Table 14 (Counterparty lists) specifies that non-UK banks must be domiciled in a country which has a minimum sovereign long-term rating of 'AA-';
- This is not consistent with paragraph 4.3 and Appendix 5.5 in the Strategy which stipulates that the Council will only invest in countries which have sovereign ratings of AAA or higher;
- No investments have been made outside of the UK; therefore, this has not resulted in a breach of the Treasury Management Strategy Statement;
- The inconsistency will be addressed in the 2023/24 Strategy.

2. Capital Position (Prudential Indicators)

Prudential Indicator for Capital Expenditure

The table below sets out the latest estimates for capital expenditure and any changes since the Capital Programme original budget was approved earlier this year

Table 1: CAPITAL EXPENDITURE BY SERVICE	2022/23				
	Original Forecast	Prior-Year Approvals Brought Forward	In-Year Movements	Forecast Slippage	Revised Forecast
	£000	£000	£000	£000	£000
People Services	**11,455**	20,765	-	(30,103)	**2,117**
Place Services	**16,742**	10,069	375	7	**27,192**
Organisation Services	**2,086**	6,148	-	-	**8,235**
Forecast Capital Expenditure	**30,283**	**36,982**	**375**	**(30,097)**	**37,544**

The primary reason for the forecast slippage is that there are not yet any firm delivery plans for the Housing Delivery programme.

Capital Programme - Financing

Forecast expenditure will be funded through use of Capital Grants and Capital Receipts.

Table 2: CAPITAL EXPENDITURE AND FINANCING	2022/23					
	Capital Programme Budget				Capital Programme Expenditure	
	Original Budget at 01-Apr-22	Prior-Year Approvals Brought Forward (net)	In-Year Movements	Revised Budget at 30-Sep-22	At 30-Sep-22	Forecast at 31-Mar-23
	£000	£000	£000	£000	£000	£000
Capital Expenditure	**30,283**	6,885	375	**37,544**	12,819	37,544
Financed by:						
Capital Grants & Contributions				**2,649**		
Capital Receipts				**34,895**		
Total Financing				**37,544**		
Forecast Borrowing Requirement				-		

Prudential Indicator: Capital Financing Requirement (CFR)

The table below sets out the cumulative CFR, which is the underlying external need to incur borrowing for a capital purpose.

Table 3: COMPARISON OF BORROWING PARAMETERS TO ACTUAL EXTERNAL BORROWING	**2022/23 Original estimate**	**2022/23 Revised Estimate**	**2023/24 Estimate**	**2024/25 Estimate**
	£000	**£000**	**£000**	**£000**
Opening CFR	**62,874**	**77,556**	**76,061**	**78,471**
Addition to CFR	6,028	(906)	3,003	3,004
Less MRP	(666)	(589)	(593)	(677)
Closing CFR	**68,236**	**76,061**	**78,471**	**80,799**
External Borrowing	-	-	-	-
Authorised Limit	**79,000**	**79,000**	**81,000**	**83,500**
Operational Boundary	**69,000**	**69,000**	**71,000**	**73,500**

Prudential Indicator – Borrowing Limits

As set out in the table above, the CFR is currently forecast to continue to remain within the Authorised Limit during 2022/23; the Limits for 2023/24 onwards will be reviewed when preparing the Treasury Management Strategy for 2023/24.

3. Investment Portfolio

The table below sets out the net treasury investment position at 30 September 2022 and the projected position at 31 March 2023.

Table 4: INVESTMENT PORTFOLIO – TREASURY INVESTMENTS	Actual		Actual		Forecast	
	31-Mar-22		30-Sep-22		31-Mar-23	
	£000	%	£000	%	£000	%
Banks	8,182	31%	11,573	43%	8,448	41%
Building Societies	-	-	-	-	-	-
Aberdeen Liquidity Fund	4,500	17%	-	-	-	-
BlackRock ICS	4,000	15%	5,000	19%	2,000	10%
LGIM Sterling Liquidity 4	10,000	37%	10,000	38%	10,000	49%
TOTAL TREASURY INVESTMENTS	**26,682**	**100%**	**26,573**	**100%**	**20,448**	**100%**

The table below sets out total investments, including non-treasury investments such as investment in property assets and council-owned companies.

Table 5: INVESTMENT PORTFOLIO – NON-TREASURY INVESTMENTS	**Actual**		**Actual**		**Forecast**	
	31-Mar-22		**30-Sep-22**		**31-Mar-23**	
	£000	%	£000	%	£000	%
Third Party Loans:						
Subsidiaries - Greensand Property Holdings Ltd	15,223	25%	15,631	25%	16,036	26%
Companies - Horley Business Park Development LLP	975	2%	1024	2%	1076	2%
Associate - Pathway for Care Ltd	1,100	2%	1,100	2%	1,100	2%
Investment Property[1]	43,372	71%	43,372	71%	43,372	70%
TOTAL NON-TREASURY INVESTMENTS	**60,670**	**100%**	**61,127**	**100%**	**61,584**	**100%**

NOTE1: Investment property is valued by a professional surveyor each year

Values are gross of any impairment for credit loss and include calculated interest receivable to date.

The treasury investment portfolio yield for the first 6 months of the year was 1.22% which equals the selected benchmark, being the 6-month SONIA rate.

Strategy Compliance

There has been one minor breach of counter-party limits during the first six months:

- Lloyds and Bank of Scotland investments

Quarter	Days in period	Days above limit	Average above limit £
One	60	1	168,194
Two	64	-	-

The breach arose due to a timing miscalculation when transferring funds between accounts. Action has been taken to review investment procedures to prevent recurrence.

4. Borrowing Strategy

No external borrowing is anticipated for the foreseeable future based on forecast Capital expenditure and receipts.

5. Link Treasury Services Commentary

The Council's Treasury advisors, Link Treasury Services, provided the following commentary.

Economic update

- *The second quarter of 2022/23 saw:*
  - *GDP revised upwards in Q1 2022/23 to +0.2% q/q from -0.1%, which means the UK economy has avoided recession for the time being;*
  - *Signs of economic activity losing momentum as production fell due to rising energy prices;*
  - *CPI inflation ease to 9.9% y/y in August, having been 9.0% in April, but domestic price pressures showing little sign of abating in the near-term;*
  - *The unemployment rate fall to a 48-year low of 3.6% due to a large shortfall in labour supply;*
  - *Bank Rate rise by 100bps over the quarter, taking Bank Rate to 2.25% with further rises to come;*
  - *Gilt yields surge and sterling fall following the "fiscal event" of the new Prime Minister and Chancellor on 23rd September.*
- *The UK economy grew by 0.2% q/q in Q1 2022/23, though revisions to historic data left it below pre-pandemic levels.*
- *There are signs of higher energy prices creating more persistent downward effects in economic activity. Both industrial production (-0.3% m/m) and construction output (-0.8% m/m) fell in July 2022 for a second month in a row. Although some of this was probably due to the heat wave at the time, manufacturing output fell in some of the most energy intensive sectors (e.g., chemicals), pointing to signs of higher energy prices weighing on production. With the drag on real activity from high inflation having grown in recent months, GDP is at risk of contracting through the autumn and winter months.*
- *The fall in the composite PMI from 49.6 in August to a 20-month low preliminary reading of 48.4 in September points to a fall in GDP of around 0.2% q/q in Q3 and consumer confidence is at a record low. Retail sales volumes fell by 1.6% m/m in August, which was the ninth fall in 10 months. That left sales volumes in August just 0.5% above their pre-Covid level and 3.3%*

below their level at the start of the year. There are also signs that households are spending their excess savings in response to high prices. Indeed, cash in households' bank accounts rose by £3.2bn in August, which was below the £3.9bn rise in July and much smaller than the 2019 average monthly rate of £4.6bn.

- *The labour market remained exceptionally tight. Data for July and August provided further evidence that the weaker economy is leading to a cooling in labour demand. Labour Force Survey (LFS) employment rose by 40,000 in the three months to July (the smallest rise since February). But a renewed rise in inactivity of 154,000 over the same period meant that the unemployment rate fell from 3.8% in June to a new 48-year low of 3.6%. The single-month data showed that inactivity rose by 354,000 in July itself and there are now 904,000 more inactive people aged 16+ compared to before the pandemic in February 2020. The number of vacancies has started to level off from recent record highs but there have been few signs of a slowing in the upward momentum on wage growth. Indeed, in July, the 3my/y rate of average earnings growth rose from 5.2% in June to 5.5%.*
- *CPI inflation eased from 10.1% in July to 9.9% in August, though inflation has not peaked yet. The easing in August was mainly due to a decline in fuel prices reducing fuel inflation from 43.7% to 32.1%. And with the oil price now just below $90pb, we would expect to see fuel prices fall further in the coming months.*
- *However, utility price inflation is expected to add 0.7% to CPI inflation in October when the Ofgem unit price cap increases to, typically, £2,500 per household (prior to any benefit payments). But, as the government has frozen utility prices at that level for two years, energy price inflation will fall sharply after October and have a big downward influence on CPI inflation.*
- *Nonetheless, the rise in services CPI inflation from 5.7% y/y in July to a 30-year high of 5.9% y/y in August suggests that domestic price pressures are showing little sign of abating. A lot of that is being driven by the tight labour market and strong wage growth. CPI inflation is expected to peak close to 10.4% in November and, with the supply of workers set to remain unusually low, the tight labour market will keep underlying inflationary pressures strong until early next year.*
- *During H1 2022, there has been a change of both Prime Minister and Chancellor. The new team (Liz Truss and Kwasi Kwarteng) have made a step change in government policy. The government's huge fiscal loosening from its proposed significant tax cuts will add to existing domestic inflationary pressures and will potentially leave a legacy of higher interest rates and public debt. Whilst the government's utility price freeze, which could cost up to £150bn (5.7% of GDP) over 2 years, will reduce peak inflation from 14.5% in January next year to 10.4% in November this year, the long list of tax measures announced at the "fiscal event" adds up to a loosening in fiscal policy relative to the previous government's plans of £44.8bn (1.8% of GDP) by 2026/27. These included the reversal of April's national insurance tax on 6th November, the cut in the basic rate of income tax from 20p to 19p in April 2023, the cancellation of next April's corporation tax rise, the cut to stamp duty and the removal of the 45p tax rate, although the 45p tax rate cut announcement has already been reversed.*
- *Fears that the government has no fiscal anchor on the back of these announcements has meant that the pound has weakened again, adding further upward pressure to interest rates. Whilst the pound fell to a record low of $1.035 on the Monday following the government's "fiscal event", it has since recovered to around $1.12. That is due to hopes that the Bank of England will deliver a very big rise in interest rates at the policy meeting on 3rd November and the government will lay out a credible medium-term plan in the near term. This was originally expected as part of the fiscal statement on 23rd November but has subsequently been moved forward to an expected release date in October. Nevertheless, with concerns over a global recession growing, there are downside risks to the pound.*
- *The MPC has now increased interest rates seven times in as many meetings in 2022 and has raised rates to their highest level since the Global Financial Crisis. Even so, coming after the Fed and ECB raised rates by 75 basis points (bps) in their most recent meetings, the Bank of England's latest 50 basis points hike looks relatively dovish. However, the UK's status as a large importer of commodities, which have jumped in price, means that households in the UK are now facing a much larger squeeze on their real incomes.*

- *Since the fiscal event on 23rd September, we now expect the Monetary Policy Committee (MPC) to increase interest rates further and faster, from 2.25% currently to a peak of 5.00% in February 2023. The combination of the government's fiscal loosening, the tight labour market and sticky inflation expectations means we expect the MPC to raise interest rates by 100bps at the policy meetings in November (to 3.25%) and 75 basis points in December (to 4%) followed by further 50 basis point hikes in February and March (to 5.00%). Market expectations for what the MPC will do are volatile. If Bank Rate climbs to these levels the housing market looks very vulnerable, which is one reason why the peak in our forecast is lower than the peak of 5.50% - 5.75% priced into the financial markets at present.*
- *Throughout 2022/23, gilt yields have been on an upward trend. They were initially caught up in the global surge in bond yields triggered by the surprisingly strong rise in CPI inflation in the US in May. The rises in two-year gilt yields (to a peak of 2.37% on 21st June) and 10-year yields (to a peak of 2.62%) took them to their highest level since 2008 and 2014 respectively. However, the upward trend was exceptionally sharply at the end of September as investors demanded a higher risk premium and expected faster and higher interest rate rises to offset the government's extraordinary fiscal stimulus plans. The 30-year gilt yield rose from 3.60% to 5.10% following the "fiscal event", which threatened financial stability by forcing pension funds to sell assets into a falling market to meet cash collateral requirements. In response, the Bank did two things. First, it postponed its plans to start selling some of its quantitative easing (QE) gilt holdings until 31st October. Second, it committed to buy up to £65bn of long-term gilts to "restore orderly market conditions" until 14th October. In other words, the Bank is restarting QE, although for financial stability reasons rather than monetary policy reasons.*
- *Since the Bank's announcement on 28th September, the 30-year gilt yield has fallen back from 5.10% to 3.83%. The 2-year gilt yield dropped from 4.70% to 4.30% and the 10-year yield fell back from 4.55% to 4.09%.*
- *There is a possibility that the Bank continues with QE at the long-end beyond 14th October or it decides to delay quantitative tightening beyond 31st October, even as it raises interest rates. So far at least, investors seem to have taken the Bank at its word that this is not a change in the direction of monetary policy nor a step towards monetary financing of the government's deficit. But instead, that it is a temporary intervention with financial stability in mind.*
- *After a shaky start to the year, the S&P 500 and FTSE 100 climbed in the first half of Q2 2022/23 before falling to their lowest levels since November 2020 and July 2021 respectively. The S&P 500 is 7.2% below its level at the start of the quarter, whilst the FTSE 100 is 5.2% below it as the fall in the pound has boosted the value of overseas earnings in the index. The decline has, in part, been driven by the rise in global real yields and the resulting downward pressure on equity valuations as well as concerns over economic growth leading to a deterioration in investor risk appetite.*

Interest rate forecasts

- *The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.*
- *The latest forecast on 27th September sets out a view that both short and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy, whilst the government is providing a package of fiscal loosening to try and protect households and businesses from the ravages of ultra-high wholesale gas and electricity prices.*
- *The increase in PWLB rates reflects a broad sell-off in sovereign bonds internationally but more so the disaffection investors have with the position of the UK public finances after September's "fiscal event". To that end, the MPC has tightened short-term interest rates with a view to trying to slow the economy sufficiently to keep the secondary effects of inflation – as measured by wage rises – under control, but its job is that much harder now.*

- *Our PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps, calculated as gilts plus 80bps) which has been accessible to most authorities since 1st November 2012.*

Link Group Interest Rate View	27.09.22											
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
BANK RATE	4.00	5.00	5.00	5.00	4.50	4.00	3.75	3.25	3.00	2.75	2.75	2.50
3 month ave earnings	4.50	5.00	5.00	5.00	4.50	4.00	3.80	3.30	3.00	2.80	2.80	2.50
6 month ave earnings	4.70	5.20	5.10	5.00	4.60	4.10	3.90	3.40	3.10	3.00	2.90	2.60
12 month ave earnings	5.30	5.30	5.20	5.00	4.70	4.20	4.00	3.50	3.20	3.10	3.00	2.70
5 yr PWLB	5.00	4.90	4.70	4.50	4.20	3.90	3.70	3.50	3.40	3.30	3.20	3.20
10 yr PWLB	4.90	4.70	4.60	4.30	4.10	3.80	3.60	3.50	3.40	3.30	3.20	3.20
25 yr PWLB	5.10	4.90	4.80	4.50	4.30	4.10	3.90	3.70	3.60	3.60	3.50	3.40
50 yr PWLB	4.80	4.60	4.50	4.20	4.00	3.80	3.60	3.40	3.30	3.30	3.20	3.10

November 2022

6. Approved Countries for Investments

This list is based on those countries which have sovereign ratings of AAA or higher (lowest rating from Fitch, Moody's and S&P have banks operating in sterling markets which have credit ratings of 'green or above' in the Link Treasury Services credit worthiness service. Based on lowest available rating.

AAA

1. Australia
2. Denmark
3. Germany
4. Luxembourg
5. Netherlands
6. Norway
7. Singapore
8. Sweden
9. Switzerland

Source: Link Treasury Services
30 September 2022