GMCA GREATER MANCHESTER COMBINED AUTHORITY

GMCA Audit Committee

Date: 24 January 2024

Subject: Treasury Management Update Quarter 3

Report of: Steve Wilson, GMCA Treasurer

Purpose of Report

To update Members on treasury management activities during the third quarter of 2023/24.

Recommendation

Members are requested to:

1. Note the report on treasury activities during the third quarter of 2023/24.

Contact Officers

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Equalities Impact, Carbon and Sustainability Assessment: N/A

Risk Management

There are considerable risks to the security of the GMCA's resources if appropriate Treasury Management strategies and policies are not adopted and followed. The GMCA has established good practice in relation to Treasury Management.

Legal Considerations

This report fulfils the statutory requirements to have the necessary prudential indicators to be included in a Treasury Management Strategy.

Financial Consequences – Revenue

Financial revenue consequences are contained within the body of the report.

Financial Consequences – Capital

Financial capital consequences are contained within the body of the report.

Number of attachments to the report:

None

Comments/recommendations from Overview & Scrutiny Committee

N/A.

Background Papers

Treasury Management Strategy Statement 2023/24, GMCA 24 March 2023

Tracking/ Process

Does this report relate to a major strategic decision, as set out in the GMCA Constitution?

No

Exemption from call in

Are there any aspects in this report which means it should be considered to be exempt from call in by the relevant Scrutiny Committee on the grounds of urgency? N/A

GM Transport Committee - N/A

Overview and Scrutiny Committee - N/A

1. Economics update

1.1 The third quarter of 2023/24 saw:

a) A 0.3% m/m decline in real Gross Domestic Product (GDP) in October 2023, potentially partly due to unseasonably wet weather, but also due to the ongoing drag from higher interest rates. Growth for the second quarter, ending 30 September 2023, was revised downwards to -0.1% and growth on an annual basis was also revised downwards, to 0.3%;

b) A sharp fall in wage growth, with the headline 3myy rate declining from 8.0% in September 2023 to 7.2% in October 2023, although the Office for National Statistics (ONS) “experimental” rate of unemployment has remained low at 4.2%;

c) Consumer Price Indexation (CPI) inflation continuing on its downward trajectory, from 8.7% in April 2023 to 4.6% in October 2023, then again to 3.9% in November 2023;

d) Core CPI inflation decreasing from April 2023 and May 2023’s 31 years’ high of 7.1% to 5.1% in November 2023, the lowest rate since January 2022;

e) The Bank of England holding rates at 5.25% in November 2023 and December 2023;

f) A steady fall in 10-year gilt yields as investors revised their interest rate expectations lower.

1.2 The revision of GDP data in Q2 to a 0.1% q/q fall may mean the mildest of mild recessions has begun. Indeed, real GDP in October 2023 fell 0.3% m/m which does suggest that the economy may stagnate again in Q3. The weakness in October 2023 may partly be due to the unseasonably wet weather. That said, as the weakness was broad based it may also be the case that the ongoing drag from higher interest rates is more than offsetting any boost from the rise in real wages.

1.3 However, the rise in the flash composite activity Purchasing Managers Index (PMI), from 50.7 in November 2023 to 51.7 in December 2023, did increase the chances of the economy avoiding a contraction in Q3. The improvement was entirely driven by the increase in the services activity balance from 50.9 to 52.7. (Scores above 50 point to expansion in the economy, although only tepid in this instance.) The press release noted that this was primarily driven by a revival in consumer demand in the technological and financial services sectors. This chimes with the further improvement in the Growth from Knowledge (GfK) measure of consumer confidence in December 2023, from -24 to -22. The services PMI is now consistent with non-retail services output growing by 0.5% q/q in Q3, but this is in stark contrast to the manufacturing sector where the output balance slumped from 49.2 to 45.9 and, at face value, the output balance is consistent with a 1.5% q/q fall in manufacturing output in Q3.

1.4 The 0.3% m/m fall in retail sales volumes in October 2023 means that after contracting by 1.0% q/q (which was downwardly revised from -0.8% q/q) in Q2, retail activity remained weak at the start of Q3. That suggests higher interest rates are taking a bigger toll on real consumer spending.

1.5 Higher interest rates have filtered through the financial channels and weakened the housing market but, overall, it remains surprisingly resilient with only marginal falls showing year on year on the Halifax (-1%) and Nationwide (-1.8%) indices. However, the full weakness in real consumer spending and real business investment has yet to come as currently it is estimated that around two thirds to a half of the impact of higher interest rates on household interest payments has yet to be felt.

1.6 Overall, we expect real GDP growth to remain subdued throughout 2024 as the drag from higher interest rates is protracted but a fading of the cost-of-living crisis and interest rate cuts in the second half of 2024 will support a recovery in GDP growth in 2025.

1.7 The labour market remains tight by historical standards, but the sharp fall in wage growth seen in October 2023 will reinforce the growing belief in markets that interest rates will be cut mid-2024. Wage growth eased in October 2023 much faster than the consensus expected. Total earnings fell by 1.6% m/m, which meant the headline 3myy rate eased from 8.0% in September 2023 to 7.2% in October 2023. This news will be welcomed by the Bank of England. Indeed, the timelier three-month annualised rate of average earnings growth fell from +2.4% to -1.2%. Excluding bonuses, it fell from 5.3% to 2.0%. Furthermore, one of the Bank’s key barometers of inflation persistence, regular private sector pay growth, dropped from 7.9% 3myy to 7.3%, which leaves it comfortably on track to fall to 7.2% by December 2023, as predicted by the Bank in November 2023.

1.8 The fall in wage growth occurred despite labour demand being stronger in October 2023 than expected. The three-month change in employment eased only a touch from +52,000 in September 2023 to +50,000 in October 2023. But resilient labour demand was offset by a further 63,000 rise in the supply of workers in the three months to October 2023. That meant labour supply exceeded its pre-pandemic level for the first time, and the unemployment rate remained at 4.2% in October 2023. In the three months to November 2023, the number of job vacancies fell for the 17th month in a row, from around 959,000 in October 2023 to around 949,000. That has reduced the vacancy to unemployment ratio as demand for labour eases relative to supply, which may support a further easing in wage growth in the coming months.

1.9 CPI inflation fell from 6.7% in September 2023 to 4.6% in October 2023, and then again to 3.9% in November 2023. Both these falls were bigger than expected and there are clear signs of easing in domestic inflationary pressures. The fall in core CPI inflation from 5.7% to 5.1% in November 2023 was bigger than expected (consensus forecast 5.6%). That's the lowest rate since January 2022. Some of the decline in core inflation was due to the global influence of core goods inflation, which slowed from 4.3% to 3.3%. But some of it was due to services inflation falling from 6.6% to 6.3%. The Bank views the latter as a key barometer of the persistence of inflation and it came in further below the Bank's forecast of 6.9% in its November 2023 Monetary Policy Report. This will give the Bank more confidence that services inflation is now on a firmly downward path.

1.10 The Bank of England sprung no surprises with its December 2023 Monetary Policy Committee (MPC) meeting, leaving interest rates at 5.25% for the third time in a row and pushing back against the prospect of near-term interest rate cuts. The Bank continued to sound hawkish, with the MPC maintaining its tightening bias saying that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures". And it stuck to the familiar script, saying that policy will be "sufficiently restrictive for sufficiently long" and that "monetary policy is likely to need to be restrictive for an extended period of time". In other words, the message is that the MPC is not yet willing to endorse investors' expectations that rates will be cut as soon as May 2024.

1.11 Looking ahead, our colleagues at Capital Economics forecast that the recent downward trends in CPI and core inflation will stall over the next few months before starting to decline more decisively again in February 2024. That explains why we think the Bank of England won't feel comfortable cutting interest rates until H2 2024.

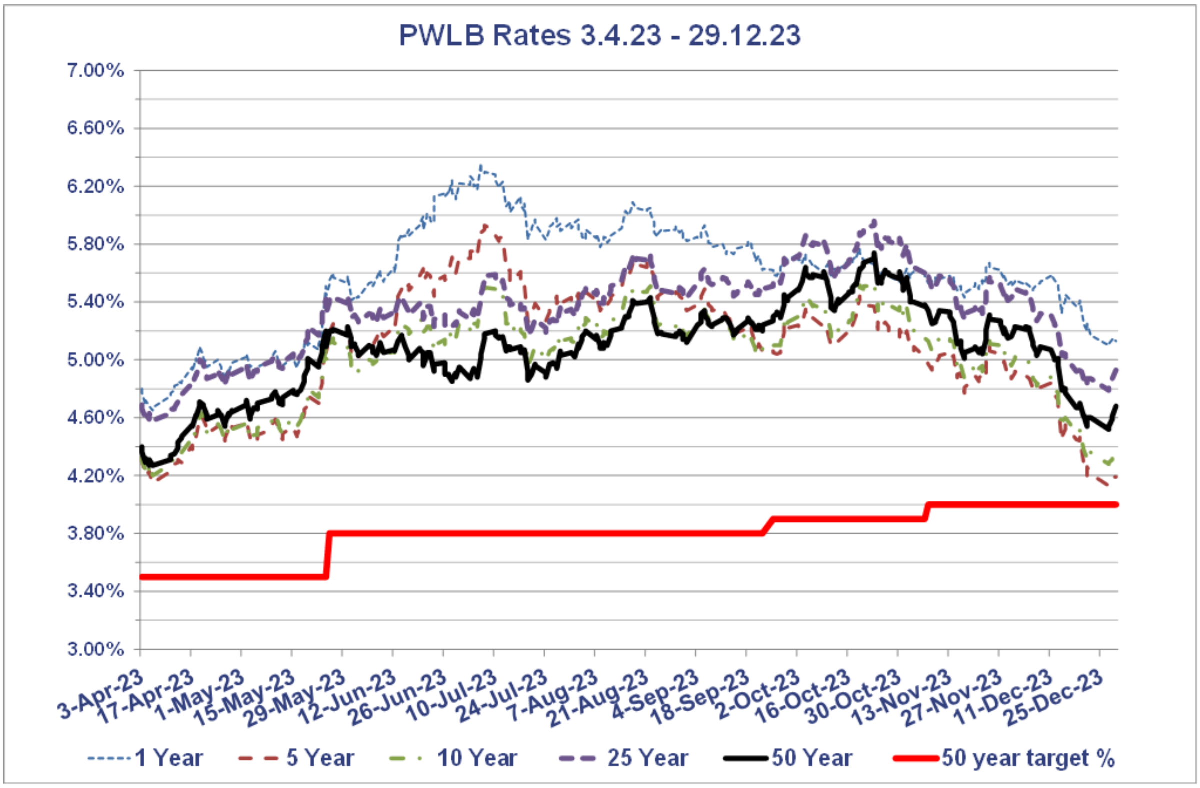
1.12 The fall in United Kingdom (UK) market interest rate expectations in December 2023 has driven most of the decline in 10-year gilt yields, which have fallen in line with 10-year United States (US) Treasury and euro-zone yields. 10-year gilt yields have fallen from 4.68% in October 2023 to around 3.70% at the time of writing, with further declines likely if the falling inflation story is maintained.

1.13 Investors' growing expectations that the Fed will cut interest rates soon has led to an improvement in risk sentiment, which has boosted the pound and other risky assets. In addition, the rise in the pound, from $1.21 in November to $1.27 now, has also been supported by the recent relative decline in UK wholesale gas prices.

1.14 The further fall in 10-year real gilt yields in December 2023 has supported the recent rise in the Financial Times Stock Exchange (FTSE) 100. That said, the index remains 5% below its record high in February 2023. This modest rise in equities appears to have been mostly driven by strong performances in the industrials and rate-sensitive technology sectors. But UK equities have continued to underperform US and euro-zone equities. The FTSE 100 has risen by 2.2% in December 2023, while the Standard & Poor (S&P) 500 has risen by 3.8%. This is partly due to lower energy prices, which have been a relatively bigger drag on the FTSE 100, due to the index's high concentration of energy companies.

1.15 In the chart below, the rise in gilt yields across the curve in the first half of 2023/24, and therein Public Works Loan Board (PWLB) rates, is clear to see, prior to the end of year rally based on a mix of supportive domestic and international factors.

PWLB RATES 3 April 2023 – 29 December 2023



1.16 MPC meetings 2 November 2023 and 14 December 2023

1.16.1 On November 2023, the Bank of England's MPC voted to keep Bank Rate on hold at 5.25%, and on 14 December 2023 reiterated that view. Both increases reflected a split vote, the latter by 6 votes to 3, with the minority grouping voting for an increase of 0.25% as concerns about "sticky" inflation remained in place.

1.16.2 Nonetheless, with UK CPI inflation now at 3.9%, and core inflating beginning to moderate (5.1%), markets are voicing a view that rate cuts should begin in Q1 2024/25, some way ahead of the indications from MPC members. Of course, the data will be the ultimate determinant, so upcoming publications of employment, wages and inflation numbers will be of particular importance, and on-going volatility in Bank Rate expectations and the gilt yield curve can be expected.

1.16.3 In addition, what happens outside of the UK is also critical to movement in gilt yields. The US Federal Open Markey Committee (FOMC) has kept short-term rates in the range of 5.25%-5.50%, whilst the European Central Bank (ECB) has moved its Deposit rate to a probable peak of 4%. Markets currently expect both central banks to start cutting rates in 2024.

2. Interest rate forecasts

2.1 The Authority has appointed Link Group as its treasury advisors and part of their service is to assist the Authority 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 1 November 2012.

Link Group Interest Rate View 7 November 2023

	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.25	3.00	3.00	3.00	3.00	3.00
3 month ave earning	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.30	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.40	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.50	3.30	3.30	3.30	3.30	3.30
5 yr PWLB	5.00	4.90	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.60	3.50	3.50	3.50
10 yr PWLB	5.10	5.00	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.70	3.60	3.60	3.50
25 yr PWLB	5.50	5.30	5.10	4.90	4.70	4.50	4.30	4.20	4.10	4.10	4.00	4.00	4.00
50 yr PWLB	5.30	5.10	4.90	4.70	4.50	4.30	4.10	4.00	3.90	3.90	3.80	3.80	3.80

2.2 London Interbank Offered Rate (LIBOR) and London Interbank Bid Rate (LIBID) rates ceased at the end of 2021. In a continuation of previous views, money market yield forecasts are based on expected average earnings by local authorities for 3 to 12 months.

2.3 The Link forecast for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short-term cash at any one point in time.

2.4 A Summary Overview of the Future Path of Bank Rate

2.4.1 Link's central forecast for interest rates was previously updated on 7 November 2023 and reflected a view that the MPC would be keen to underpin its anti-inflation credentials by keeping Bank Rate at 5.25% until at least H2 2024. We expect rate cuts to start when both the CPI inflation and wage/employment data are unequivocally supportive of such a move, and that there is a strong likelihood of the overall economy enduring tepid growth (at best) or a mild recession (at worst) over the coming months.

2.4.2 Naturally, timing on this matter will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

2.4.3 In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine, and Gaza and Israel.

2.4.4 On the positive side, consumers are still anticipated to be sitting on some excess savings left over from the pandemic, which could cushion some of the impact of the above challenges and may be the reason why the economy is performing a little better at this stage of the economic cycle than may have been expected. Nonetheless, with approximately 400,000 households per quarter facing a mortgage interest reset at higher levels than their current rate, the economy will face on-going headwinds from that source, in addition to lower income households having to spend disproportionately on essentials such as food, energy and rent payments.

2.5 PWLB Rates

2.5.1 As illustrated in the charts in section 1, gilt yields have endured a volatile nine months with yields rising significantly on the back of inflation concerns before retracing much of those increases in November 2023 and December 2023. With the market now anticipating rate cuts by H2 2024, the short and medium parts of the curve are now close to where they started 2023/24, but the longer part of the curve is still a little higher. At the time of writing there is c50 basis points difference between the 5 and 50 year parts of the curve.

2.6 The balance of risks to the UK economy:

2.6.1 The overall balance of risks to economic growth in the UK is to the downside.

2.6.2 Downside risks to current forecasts for UK gilt yields and PWLB rates include: -

a) Labour and supply shortages prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, could keep gilt yields high for longer).

b) The Bank of England has increased Bank Rate too fast and too far over recent months, and subsequently brings about a deeper and longer UK recession than we currently anticipate.

c) UK / EU trade arrangements – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

d) Geopolitical risks, for example in Ukraine/Russia, the Middle East, China/Taiwan/US, Iran and North Korea, which could lead to increasing safe-haven flows.

2.6.3 Upside risks to current forecasts for UK gilt yields and PWLB rates: -

a) Despite the recent tightening to 5.25%, the Bank of England proves too timid in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to remain elevated for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project.

b) The pound weakens because of a lack of confidence in the UK Government's pre-election fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.

c) Longer-term US treasury yields rise strongly if inflation remains more stubborn there than the market currently anticipates, consequently pulling gilt yields up higher.

d) Projected gilt issuance, inclusive of natural maturities and Quantitative Tightening (QT), could be too much for the markets to comfortably digest without higher yields compensating.

3. Annual Investment Strategy

3.1 The Treasury Management Strategy Statement (TMSS) for 2023/24, which includes the Annual Investment Strategy, was approved by the Authority on 24

March 2023. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Authority's investment priorities as being:

a) Security of capital
b) Liquidity
c) Yield

3.2 The Authority will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity, aligned with the Authority's risk appetite. In the current economic climate, over and above keeping investments short-term to cover cash flow needs, there is a benefit to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

3.3 As shown by the charts below and the interest rate forecasts in section 2, investment rates have remained elevated during 2023/24 but are now expected to have peaked.

3.4 Creditworthiness

3.4.1 There have been few changes to credit ratings over the quarter under review. However, officers continue to closely monitor these, and other measures of creditworthiness to ensure that only appropriate counterparties are considered for investment purposes.

3.5 Investment counterparty criteria

3.5.1 The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management.

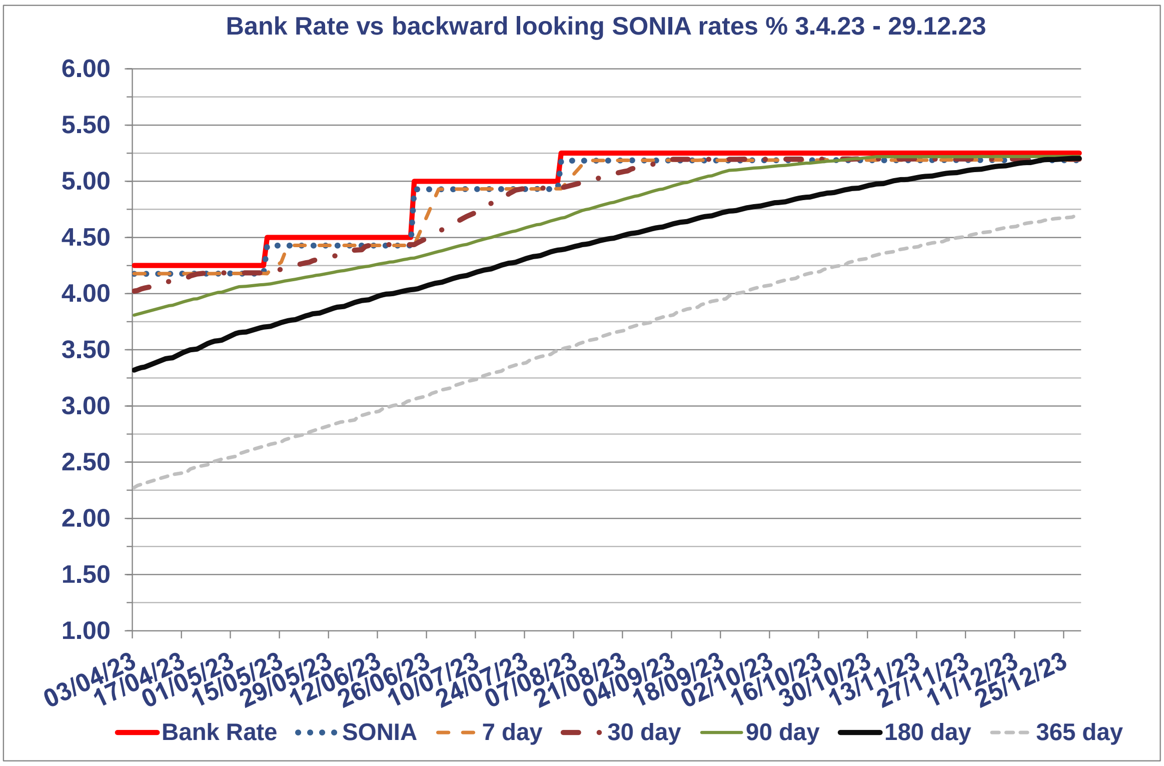
3.6 CDS prices

3.6.1 For UK banks, there are no underlying negative themes. Prices are not misaligned with other creditworthiness indicators, such as credit ratings. Nevertheless, it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

3.7 Investment balances

3.7.1 The average level of funds available for investment purposes during the quarter was £388.6m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

Investment performance 3 April 2023 to 29 December 2023



	Bank Rate	SONIA	7 day	30 day	90 day	180 day	365 day
High	5.25	5.19	5.19	5.20	5.22	5.20	4.70
High Date	3 August 2023	24 November 2023	27 November 2023	12 December 2023	22 December 2023	29 December 2023	29 December 2023
Low	4.25	4.18	4.18	4.02	3.81	3.32	2.27
Low Date	3 April 2023	4 April 2023	11 April 2023	3 April 2023	3 April 2023	3 April 2023	3 April 2023
Average	4.95	4.89	4.88	4.84	4.71	4.43	3.60
Spread	1.00	1.01	1.01	1.18	1.41	1.88	2.43

3.7.2 As illustrated, the Authority outperformed the benchmark by 0.17 bps. The Authority’s budgeted investment return for 2023/24 is £2.257m, and performance for the year to date is £11.577m above budget.

3.8 Approved limits

3.8.1 Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 31 December 2023.

3.8.2 A full list of investments held as of 31 December 2023 is in Appendix 2.

4. Borrowing

4.1 No borrowing was undertaken during the quarter ended 31 December 2023.

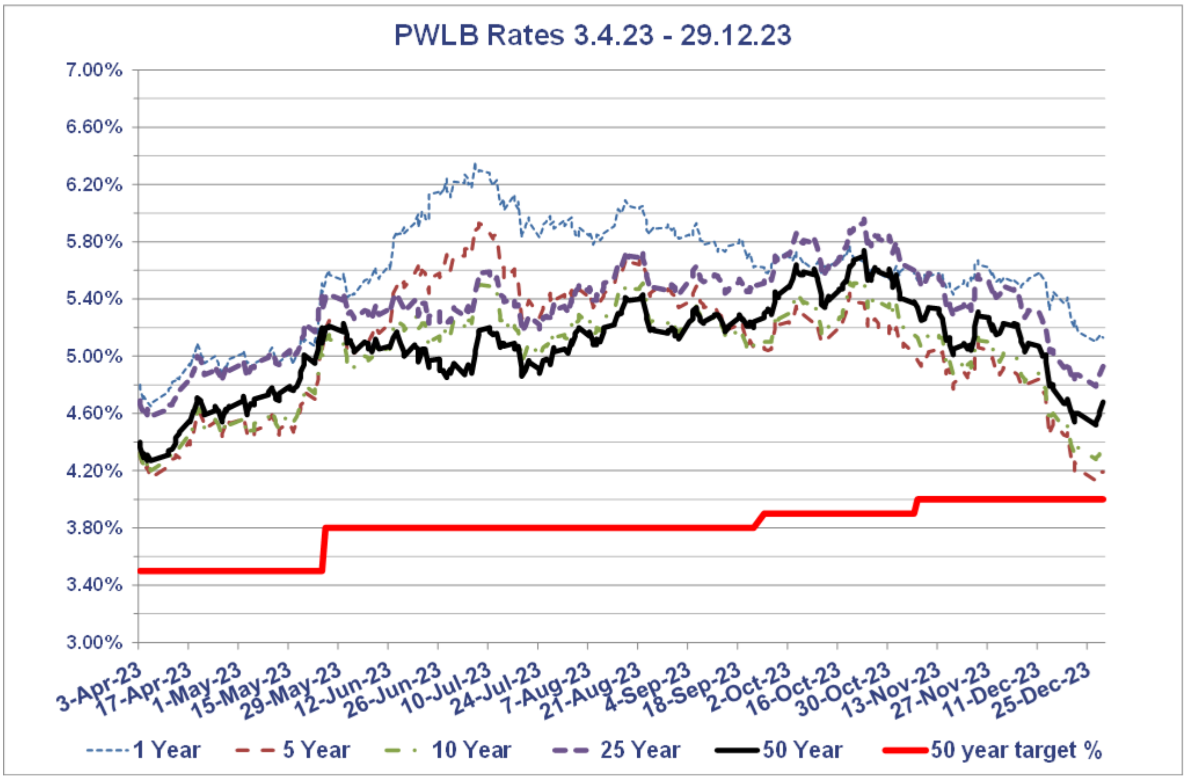
4.2 It is anticipated that further borrowing will / will not be undertaken during this financial year.

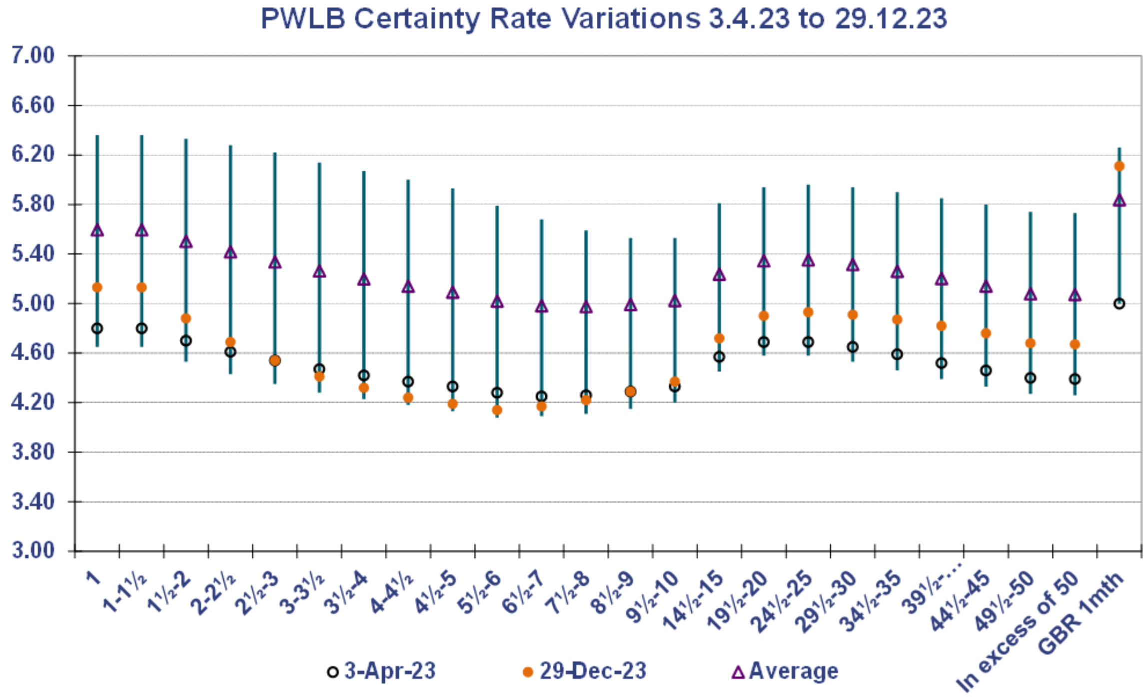
4.3 PWLB maturity Certainty Rates 3 April 2023 to 29 December 2023

4.3.1 Gilt yields and PWLB rates were on a rising trend from April 2023 through to October 2023 but dropped back significantly in November 2023 and December 2023.

4.3.2 The 50-year PWLB Certainty Rate target for new long-term borrowing started 2023/24 at 3.50% (the lowest forecast rate within a two-year time horizon), increasing to a peak of 4.00% in November 2023. With rates elevated across the whole of the curve, it is advised to not borrow long-term unless the Authority wants certainty of rate and judges the cost to be affordable.

PWLB RATES 3 April 2023 – 29 December 2023





High/ Low/ Average PWLB Rates for 3 April 2023 – 29 December23

	1 Year	5 year	10 year	25 year	50 year
Low	4.65%	4.13%	4.20%	4.58%	4.27%
Date	6 April 2023	27 December 2023	6 April 2023	6 April 2023	5 April 2023

High	6.36%	5.93%	5.53%	5.96%	5.74%
Date	6 July 2023	7 July 2023	23 October 2023	23 October 2023	23 October 2023
Average	5.60%	5.09%	5.03%	5.35%	5.08%
Spread	1.71%	1.80%	1.33%	1.38%	1.47%

5. Debt rescheduling

5.1 Debt rescheduling opportunities have increased significantly in the current quarter where gilt yields, which underpin PWLB rates and market loans, have risen materially. Members will be advised if there is value to be had by rescheduling or repaying a part of the debt portfolio.

6. Compliance with Treasury and Prudential Limits

6.1 The prudential and treasury Indicators are shown in Appendix 1.

6.2 It is a statutory duty for the Authority to determine and keep under review the affordable borrowing limits. During the quarter ended 31 December 2023, the Authority has operated within the treasury and prudential indicators set out in the Authority's Treasury Management Strategy Statement for 2023/24. The Treasurer reports that no difficulties are envisaged for the current or future years in complying with these indicators.

6.3 All treasury management operations have also been conducted in full compliance with the Authority's Treasury Management Practices.

APPENDIX 1: Prudential and Treasury Indicators for 2023/24 as of 31 December 2023

Treasury Indicators	2023/24 Budget £m	2023/24 Forecast £m
Authorised limit for external debt	2,771.458	2,712.952
Operational boundary for external debt	2,652.122	2,596.169
Gross external debt	1,490.674	1,394.031
Investments	50.000	100.671
Net borrowing	1,440.674	1,293.360

Prudential Indicators	2023/24 Budget £m	2023/24 Forecast £m
Capital expenditure	629.334	647.731
Capital Financing Requirement (CFR)	2,486.166	2,432.978
Annual change in CFR	78.325	87.003
In year borrowing requirement	124.587	-
Ratio of financing costs to net revenue stream	16.7%	16.4%

APPENDIX 2: Investment Portfolio

Investments held as of 31 December 2023:

Temporary Deposits	Principal Outstanding
Barclays Bank Call A/C	£16,270,000.00
Aviva MMF	£14,280,000.00
BlackRock Heritage MMF	£23,900,000.00
Federated MMF	£25,000,000.00
Lloyds (CD)	£10,000,000.00
Lloyds	£6,500,000.00
Natwest	£10,000,000.00
Santander (CD)	£10,000,000.00
SMBC	£10,000,000.00
Standard Chartered (Sustainable)	£15,000,000.00
Aberdeen City Council	£15,000,000.00
Bolton Metropolitan Borough Council	£5,000,000.00
Bracknell Forest Borough Council	£5,000,000.00
Bury MBC	£4,000,000.00
Central Bedfordshire Council	£10,000,000.00
Cornwall County Council	£25,000,000.00
Devon County Council	£10,000,000.00
Dover District Council	£5,000,000.00
Eastleigh Borough Council	£20,000,000.00
Flintshire County Council	£5,000,000.00
Kingston upon Hull City Council	£10,000,000.00
Lancashire County Council	£15,000,000.00
Leeds City Council	£25,000,000.00
Liverpool City Council	£15,000,000.00
London Borough of Barking & Dagenham	£15,000,000.00
London Borough of Hounslow	£10,000,000.00
PCC Hertfordshire	£7,000,000.00
Plymouth City Council	£10,000,000.00
Stockport Metropolitan Borough Council	£10,000,000.00
Surrey County Council	£25,000,000.00
Telford & Wrekin Council	£5,000,000.00
Wirral Borough Council	£5,000,000.00
TfGM	£53,629,000.00
TOTAL	**£450,579,000.00**

APPENDIX 3: Approved countries for investments as of 31 December 2023

Based on lowest available rating

AAA

Australia

Denmark

Germany

Netherlands

Norway

Singapore

Sweden

Switzerland

AA+

Canada

Finland

U.S.A.

AA

Abu Dhabi (UAE)

AA-

Belgium

France (downgraded by Fitch on 9 May 2023)

Qatar

U.K.