ARGYLL AND BUTE COUNCIL	**POLICY AND RESOURCES COMMITTEE**
FINANCIAL SERVICES	**20 February 2020**

TREASURY MANAGEMENT MONITORING REPORT – DECEMBER 2019

1. EXECUTIVE SUMMARY

1.1 This report sets out the Council's treasury management position for the period 1 November 2019 to 31 December 2019 and includes information on:

- Overall Borrowing Position
- Borrowing Activity
- Investment Activity
- Economic Background
- Interest Rate Forecast
- Prudential Indicators.

1.2 Borrowing is above the Capital Financing Requirement for the period to 31 December 2019. For the first two quarters there were historically low PWLB rates until the decision was made by the Public Works Loans Board (PWLB) in October 2019 to increase the margin of PWLB loans by 1%. This has had the impact of decreasing new public sector borrowing in the third quarter of the year.

1.3 The net movement in external borrowing in the period was a decrease of £0.009m.

1.4 The levels of investments were £95.3m at 31 December 2019. The rate of return achieved was 0.981% which compares favourably with the target of 7 day LIBID which was 0.570%.

TREASURY MANAGEMENT MONITORING REPORT – DECEMBER 2019

2. INTRODUCTION

2.1 This report sets out the Council's treasury management position for the period 1 April 2019 to 31 December 2019 and includes information on:

- Overall Borrowing Position
- Borrowing Activity
- Investment Activity
- Economic Background
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3. DETAIL

Overall Borrowing Position

3.1 The table below details the estimated capital financing requirement (CFR) and compares this with the estimated level of external debt at 31 March 2019. The CFR represents the underlying need for the Council to borrow to fund its fixed assets and accumulated capital expenditure.

	Forecast 2019/20 £000's	**Forecast 2020/21 £000's**	**Forecast 2021/22 £000's**
CFR at 1 April	309,994	297,407	304,430
Net Capital Expenditure	(480)	19,728	11,856
Less Loans Fund Principal Repayments	(7,558)	(8,132)	(8,951)
Less: NPDO Repayment	(4,549)	(4,573)	(4,815)
Estimated CFR 31 March	**297,407**	**304,430**	**302,520**
Less Funded by NPDO	(124,115)	(119,542)	(114,727)
Estimated Net CFR 31 March	**173,292**	**184,888**	**187,793**
Estimated External Borrowing at 31 March	175,958	169,666	165,894
Gap	**(2,666)**	**15,222**	**21,899**

3.2 Borrowing is above the Capital Financing Requirement for the period to 31 December 2020. For the first two quarters there were historically low PWLB rates until the decision was made by the Public Works Loans Board (PWLB) in October 2019 to increase the margin of PWLB loans by 1%. This has had the impact of decreasing new public sector borrowing in the third quarter of the year.

The Councils Treasury Management Strategy states that any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates.

3.3 The Council's estimated net capital financing requirement at the 31 December 2019 is £173.2m. The table below shows how this has been financed. There are substantial internal balances (mainly the General Fund) of which £95.3m is currently invested.

	Position at 31/10/19 £000's	**Position at 31/12/19 £000's**
Loans	178,423	178,413
Internal Balances	107,506	90,200
Less Investments & Deposits	(103,129)	(95,321)
Total	**182,800**	**173,292**

3.4 During the period from 1 November 2019 to 31 December 2019, £0.009m of loans were repaid and no new borrowing was taken, the analysis of the movement in borrowing is shown in the table below:

	Actual
	£000's
External Loans Repaid 1st November 2019 to 31st December 2019	(9)
Borrowing undertaken 1st November 2019 to 31st December 2019	0
Net Movement in External Borrowing	**(9)**

3.5 The external borrowing of the Council decreased by £0.009m during the period from 1 November 2019 to 31 December 2019.

3.6 The table below summarises the movement in the level and rate of temporary borrowing at the start and end of the period.

	£000s	**% Rate**
Temp borrowing at 1st November 2019	582	0.60%
Temp borrowing at 31st December 2019	574	0.60%

Investment Activity

3.7 The average rate of return achieved on the Council's investments to 31 December 2019 was 0.981% compared to the average LIBID rate for the same period of 0.570% which demonstrates that the Council is achieving a reasonable rate of return on its cash investments. At 31 December 2019 the Council had £95.3m of short term investments at an average rate of 0.981%.The table below details the counterparties that the investments were placed with, the maturity date, the interest rate and the credit rating applicable for each of the counterparties.

Counterparty	Maturity	Amount £000s	Interest Rate	Rating S&P
Clydesdale Bank Instant	Instant Access	6,821	0.65%	Short Term A-2, Long Term BBB+
Santander	180 Day Notice	7,500	1.05%	Short Term A-1, Long Term A
Goldman Sachs	185 Day Notice	2,500	1.04%	Short Term A-1, Long Term A+
Goldman Sachs	185 Day Notice	5,000	1.01%	Short Term A-1, Long Term A+
BOS	32 Day Notice	2,500	0.95%	Short Term A-1, Long Term A+
BOS	95 Day Notice	5,000	1.10%	Short Term A-1, Long Term A+
First Abu Dhabi Bank	21/04/2020	5,000	1.10%	Short Term A-1+, Long Term AA-
First Abu Dhabi Bank	25/03/2020	2,500	1.08%	Short Term A-1+, Long Term AA-
ANZ	11/05/2020	5,000	1.14%	Short Term A-1+, Long Term AA-
ANZ	17/06/2020	2,500	1.14%	Short Term A-1+, Long Term AA-
Bank of Scotland	10/06/2020	5,000	1.25%	Short Term A-1, Long Term A+
Natwest	02/07/2020	5,000	0.97%	Short Term A-2, Long Term A
Goldman Sachs	03/02/2020	2,500	0.86%	Short Term A-1, Long Term A+
Santander	05/02/2020	2,500	1.00%	Short Term A-1, Long Term A
Qatar National Bank	16/01/2020	2,500	1.00%	Short Term A-1, Long Term A
Qatar National Bank	23/01/2020	5,000	1.00%	Short Term A-1, Long Term A
Counterparty	**Maturity**	**Amount £000s**	**Interest Rate**	**Rating S&P**

Thurrock Borough Council	15/05/2019	5,000	1.05%	AA
Lancashire County Council	20/05/2020	2,000	1.05%	AA
Lancashire County Council	23/10/2020	5,000	1.00%	AA
Cherwell district Council	14/07/2020	5,000	0.95%	AA
MMF - BNP Paribas	Call	7,500	0.70%	AAA
MMF - Insight	Call	0	0.00%	AAA
MMF – Aberdeen Standard	Call	4,000	0.74%	AAA
MMF - Invesco AIM	Call	0	0.00%	AAA
MMF - CCLA	Call	0	0.00%	AAA
MMF - Aviva	Call	0	0.72%	AAA
Total		**95,321**	**0.981%**	

3.8 All investments and deposits are in accordance with the Council's approved list of counterparties and within the limits and parameters defined in the Treasury Management Practices. The counterparty list is constructed based on assessments by leading credit reference agencies adjusted for additional market information available in respect of counterparties.

3.9 The current market conditions have made investment decisions more difficult as the number of counterparties which meet the Council's parameters has reduced making it harder to achieve reasonable returns while limiting the exposure to any one institution.

In recognition of this, the Council at its meeting on 26 September agreed to amend the 2019-20 Treasury Management Strategy as follows:

a) Increase the investment limit for term deposits with UK Banks from £10m to £15m.

b) Increase the maximum duration that a deposit can be made with other local authorities or public bodies from 1 year to 2 years.

Economic and Interest Rate Forecasts

3.11 The latest economic background is shown in appendix 1 with the interest rate forecast in appendix 2.

Prudential Indicators

3.12 The prudential indicators for 2019-20 are attached in appendix 3.

4. CONCLUSION

4.1 In the period from 1 November 2019 to 31 December 2019, the Council's borrowing decreased by £0.009m, it is currently above the Capital Financing Requirement. There are substantial internal balances, of which £95.3m is currently invested. The investment returns were 0.981% which is above the target of 0.570%.

5. IMPLICATIONS

5.1	Policy –	None.
5.2	Financial -	None
5.3	Legal -	None.
5.4	HR -	None.
5.5	Fairer Scotland Duty -	None.
5.6	Risk -	None.
5.7	Customer Service -	None.

Kirsty Flanagan
Section 95 Officer
13 February 2020

Policy Lead for Financial Services and Major Projects - Councillor Gary Mulvaney

Appendix 1 – Economic Background
Appendix 2 – Interest Rate Forecast
Appendix 3 – Prudential Indicators

Appendix 1

Economic Background (at 03-01-20)

This section has been provided by Link Asset Services and therefore includes their views and opinions of future trends and events.

UK. Economic growth in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 back up to +0.4% and quarter 4 expected to come in around zero. Political and Brexit uncertainty have dampened growth in 2019.
Despite political uncertainty ending with a decisive overall majority for the Conservative government in the December general election which clears the way for the UK to leave the EU on 31 January 2020, we still have much uncertainty as to whether there will be a reasonable trade deal achieved by the end of 2020.

After the Monetary Policy Committee raised **Bank Rate** from 0.5% to 0.75% in August 2018, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the MPC until these remaining uncertainties over the likely type of Brexit become clear. If there was a no deal exit, it is likely that Bank Rate would be cut in order to support growth. However, if growth was to flag significantly in any event, the MPC could also cut Bank Rate in 2020. The Government has announced some major spending increases and is expected to make further commitments in the spring budget; these will provide some support to growth and will take some pressure off the MPC to act to stimulate growth by either cutting Bank Rate or implementing other monetary policy measures.

The MPC did have some concerns over the trend in wage inflation, which was on a rising trend, and peaked at a new post financial crisis high of 3.9% in June. Since then, however, it has been falling steadily back to 3.5% in October, (3 month average figure, excluding bonuses). Growth in employment picked up again to 24,000 in the three months to October, after a fall in the previous month's figures. However, this is still well below the 2018 average, although the unemployment rate remained at 3.8 percent, its lowest rate since 1975.

As for **CPI inflation** itself, this fell to 1.5% in October and November and is likely to remain between 1.5% and 2% over the next two years. If there was a no deal Brexit though, it could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.

The strong wage inflation figure and the fall in CPI inflation is good news for **consumers** as their spending power is improving in this scenario as the difference between the two figures is now around 2.0%, i.e. a real term increase. Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a (temporary) boost in consumption in 2018 which generated an upturn in the rate of growth to 2.9% for 2018, just below his target of 3%. Growth in quarter 1 of 2019 was a strong 3.1% but growth fell back to 2.0% in quarter 2 and 2.1% in quarter 3. The strong growth in employment numbers during 2018 has subsided into a weaker trend of growth during 2019, indicating that the economy is cooling, while inflationary pressures have also been weakening. After the Fed increased rates by 0.25% in December 2018 to between 2.25% and 2.50%, it has taken decisive action to reverse monetary policy by cutting rates by 0.25% in each of July, September and October in order to counter the downturn in the outlook for US and world growth. The Fed is now likely to pause to see how the economy responds during 2020.

EUROZONE. The annual rate of growth has been steadily falling, from 1.8% in 2018 to only 1.1% y/y in quarter 3 in 2019. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in EZ growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels "at least through the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a third round of TLTROs; this provides banks with cheap borrowing every three months from September 2019 until March 2021 which means that, although they will have only a two-year maturity, the Bank is making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting on 12 September, it cut its deposit rate further into negative territory, from -0.4% to -0.5% and announced a resumption of quantitative easing purchases of debt to start in November at €20bn per month, a relatively small amount. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and unsurprisingly, the ECB stated that governments will need to help stimulate growth by fiscal policy.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. The trade war with the US does not currently appear to be having a particularly significant impact on growth. Major progress still needs to be made to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. It also needs to address the level of non-performing loans in the banking and credit systems.

JAPAN. has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

WORLD GROWTH. The trade war between the US and China on tariffs is a major concern to financial markets and is depressing worldwide growth, as any downturn in China will spill over into impacting countries supplying raw materials to China. Concerns are focused on the synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during the first ten months of 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US), and there are concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been weak which gives a forward indication of a downturn in growth; this confirms investor sentiment that the outlook for growth during 2020 is expected to be weak.

Appendix 2

Interest Rate Forecast (at 03-01-20)

The Council's treasury advisor, Link Asset Services, has provided the following forecast:

Link Asset Services Interest Rate View	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

After the August 2018 increase in Bank Rate to 0.75%, the first above 0.5% since the financial crash, the MPC has put any further action on hold, probably until such time as the fog of Brexit might clear. While the general election in December 2019 has provided political certainty leading to implementation of the UK leaving the EU on 31.1.20, there is still much uncertainty on what sort of trade deal may be agreed by the end of 2020 and its likely impact on the UK economy. ***The above forecast, and other comments in this report, are based on a central assumption that there will be some form of muddle through agreement on a reasonable form of Brexit trade deal.*** Bank Rate forecasts will have to change if this assumption does not materialise e.g. a no deal Brexit could prompt the MPC to do an immediate cut of Bank Rate. All other forecasts for investment and borrowing rates would also have to change.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably even, but dependent on a successful outcome of negotiations on a trade deal.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.
- In the event that a Brexit deal is agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

BOND YIELDS / PWLB RATES. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020, and a general background of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued; these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have therefore seen over the last year, many bond yields up to 10 years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at record high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

During the first 10 months of 2019 we therefore saw a sharp fall in longer term PWLB rates to completely unprecedented historic low levels - until the Treasury unexpectedly added 1% to all PWLB rates from 9th October 2019. Since then, those fears have partially subsided and gilt yields and PWLB rates have been rising. The potential danger that may be lurking in investor minds is that Japan has become mired in a 20 year malaise of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that many major western economies could be heading into a similar scenario.

Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt fuelled boom which now makes it harder for economies to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop, (see appendix 4 Eurozone downside risk). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.

Appendix 3

Prudential Indicators

PRUDENTIAL INDICATOR	2019/20	2019/20	2020/21	2021-22
(1). EXTRACT FROM BUDGET				
Capital Expenditure	**Forecast Outturn £'000**	**Original Estimate £'000**	**Forecast Outturn £'000**	**Forecast Outturn £'000**
Non - HRA	-480	9,897	19,728	11,856
TOTAL	-480	9,897	19,728	11,856
Ratio of financing costs to net revenue stream				
Non - HRA	5.83%	5.83%	5.84%	5.89%
Net borrowing Requirement				
brought forward 1 April	309,994	304,389	301,781	309,082
carried forward 31 March	297,407	301,781	309,082	306,056
in year borrowing requirement	(12,587)	(2,608)	7,301	(3,026)
In year Capital Financing Requirement				
Non - HRA	(12,587)	(2,608)	7,301	(3,026)
TOTAL	(12,587)	(2,608)	7,301	(3,026)
Capital Financing Requirement as at 31 March				
Non - HRA	297,407	301,781	309,082	306,056
TOTAL	297,407	301,781	309,082	306,056

PRUDENTIAL INDICATOR	**2019/20**	**2020/21**	**2021-22**
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'M**	**£'M**	**£'M**
Authorised limit for external debt -			
borrowing	205	215	219
other long term liabilities	127	122	117
TOTAL	332	337	336
Operational boundary for external debt -			
borrowing	200	210	214
other long term liabilities	124	119	114
TOTAL	324	329	328
Upper limit for fixed interest rate exposure			
Principal re fixed rate borrowing	190%	190%	190%
Upper limit for variable rate exposure			
Principal re variable rate borrowing	60%	60%	60%
Upper limit for total principal sums invested for over 364 days	£20m	£20m	£20m
(per maturity date)			

Maturity structure of new fixed rate borrowing during 2019/20	upper limit	lower limit
under 12 months	30%	0%
between 12 and 24 months	30%	0%
between 24 months and 5 years	30%	0%
between 5 and 10 years	40%	0%
10 years and above	80%	0%