ARGYLL AND BUTE COUNCIL	POLICY AND RESOURCES COMMITTEE
FINANCIAL SERVICES	12 OCTOBER 2023

TREASURY MANAGEMENT MONITORING REPORT – 31 AUGUST 2023

1. EXECUTIVE SUMMARY

1.1. This report sets out the Council's treasury management position for the period 1 July 2023 to 31 August 2023 and includes information on:

- Overall borrowing position
- Borrowing activity
- Investment activity
- Economic background
- Interest rate forecast
- Prudential Indicators

1.2. Estimated borrowing is below the Capital Financing Requirement for the period to 31 August 2023, at this stage in the financial year capital expenditure is below target. Capital expenditure continued to be lower than anticipated over the last twelve months however there is an expectation this will increase back up again over 2023-24 which will continue to be monitored closely.

1.3. The net movement in external borrowing in the period 1 July 2023 to 31 August 2023 was a decrease of £7m.

1.4. The levels of investments were £96.750m at 31 August 2023. The rate of return achieved was 4.991% compared to the target SONIA rate which was 5.168%.

1.5 The Council has significant cash balances which are invested in accordance with its Annual Treasury Management Strategy on the basis of security first, liquidity second and then return.

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2. INTRODUCTION

2.1. This report sets out the Council's treasury management position for the period 1 July 2023 to 31 August 2023 and includes information on:

- Overall borrowing position
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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 2023. The CFR represents the underlying need for the Council to borrow to fund its fixed assets and accumulated capital expenditure.

	Forecast 2023/24 £000	Forecast 2024/25 £000	Forecast 2025/26 £000
CFR at 1 April	291,782	302,317	319,602
Net Capital Expenditure	22,265	29,477	51,388
Less Loans Fund Principal Repayments	(5,950)	(6,254)	(6,573)
Less: NPDO Repayment	(5,780)	(5,938)	(6,235)
Estimated CFR 31 March	**302,317**	**319,602**	**358,182**
Less Funded by NPDO	(111,564)	(111,784)	(106,846)
Estimated Net CFR 31 March	**190,753**	**207,818**	**251,336**
Estimated External Borrowing at 31 March	176,532	221,513	261,510
Gap	**14,221**	**(13,695)**	**(10,174)**

3.2. Borrowing is below the Capital Financing Requirement for the period to 31 August 2023. Whilst borrowing rates are still comparatively low the Council has significant cash balances which reduces the need to borrow in the short term.

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

3.4. The Council's estimated net capital financing requirement at 31 August 2023 is £190.753m. The table below shows how this has been financed. £125.440m is funded by loans and there are substantial internal balances of £162.063m of which £96.750m are currently invested, as detailed in section 3.7, leaving a net internal balance of £65.313m.

	Position at 30/06/23	Position at 31/08/23
	£000	**£000**
Loans	132,464	125,440
Net Internal Balances	39,965	65,313
Total CFR	**172,429**	**190,753**

3.5. During the period from 1 July 2023 to 31 August 2023, £7m of loans were repaid and no new borrowing was taken. The analysis of the movement in borrowing is shown in the table below:

	Actual
	£m
External Loans Repaid 1st July 2023 to 31st August 2023	(7)
Borrowing undertaken 1st July 2023 to 31st August 2023	0
Net Movement in External Borrowing	**(7)**

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

	£000	% Rate
Temp borrowing at 30th June 2023	308	3.40%
Temp borrowing at 31st August 2023	283	4.40%

Investment Activity

3.7 The average rate of return achieved in the Council's investments to 31 August 2023 was 4.991% compared to the SONIA (Sterling Overnight Index Average) rate for the same period of 5.168%. The Council's rate of return is marginally less than SONIA due to the rapid rise in interest rates which increased SONIA faster than the Council was able to redeem its existing lower rated investments. At 31 August 2023 the Council had £96,750m of short term investments at an average rate of 4.991%. 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 counterparty.

Counterparty	Maturity	Amount £000	Interest Rate	Rating S&P
Clydesdale Bank	Instant	350	5.15%	Short Term A-2, Long
Australia and New Zealand Banking Group	06/10/2023	5,000	4.99%	Short Term A-1+,
Toronto Dominion Bank	13/10/2023	5,000	5.25%	Short Term A-1+,
Cambridgeshire County Council	22/07/2024	5,000	1.00%	AA
Thurrock Borough Council	19/09/2023	5,000	3.50%	AA
London Borough of Croydon	10/10/2024	5,000	4.10%	AA
National Bank of Kuwait	09/04/2024	7,500	5.13%	Short Term A-1, Long
First Abu Dhabi Bank	09/05/2024	5,000	5.27%	Short Term A-1+,
National Bank of Kuwait	10/11/2023	2,500	5.00%	Short Term A-1, Long
Goldman Sachs	10/11/2023	2,500	4.91%	Short Term A-1, Long
London Borough of Croydon	10/06/2024	5,000	5.30%	AA
Australia and New Zealand Banking Group	13/09/2023	5,000	5.04%	Short Term A-1+,
DBS Bank	13/09/2023	5,000	4.98%	Short Term A-1+,
Close Brothers	31/01/2024	2,500	5.87%	Short Term A-1, Long
First Abu Dhabi Bank	01/02/2024	5,000	5.93%	Short Term A-1+,
First Abu Dhabi Bank	09/08/2024	5,000	6.16%	Short Term A-1+,
Goldman Sachs	16/02/2024	5,000	5.93%	Short Term A-1, Long
Australia and New Zealand Banking Group	16/02/2021	5,000	5.92%	Short Term A-1+,
Money Market Fund - BNP Paribas	Call	14,800	5.26%	AAA
MMF - Invesco AIM	Call	1,600	5.27%	AAA
Total		**96,750**		

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 Council has significant cash balances which are invested in accordance with its Annual Treasury Management Strategy. These cash balances are in excess of what is required for normal operating purposes but the economic environment for investments has improved over the last few months with an increase in interest rates, making investing these monies easier than in previous years.

Economic and Interest Rate Forecasts

3.10 The latest economic background is shown in Appendix 1 with the interest rate forecast in Appendix 2.

Prudential Indicators

3.11 The prudential indicators for 2023-24 are attached in Appendix 3.

4. CONCLUSION

4.1 In the period from 1 July 2023 to 31 August 2023, the Council's borrowing decreased by £7m, and is currently below the Capital Financing Requirement. There are substantial internal balances, of which £96,750m is currently invested. The investment returns were 4.991%

5. IMPLICATIONS

5.1	Policy –	None.
5.2	Financial –	Complies with Annual Treasury Strategy.
5.3	Legal –	None.
5.4	HR –	None.
5.5	Fairer Duty Scotland –	None.
5.5.1	Equalities – protected characteristics –	None.
5.5.2	Socio-economic Duty –	None.
5.5.3	Islands –	None.
5.6	Climate Change –	None.
5.7	Risk –	None.
5.8	Customer Service –	None.

Kirsty Flanagan
Section 95 Officer
3 October 2023

Policy Lead for Finance and Commercial Services - Councillor Gary Mulvaney

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

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Appendix 1 – Economics Update

- The first half of 2023/24 saw:
  - Interest rates rise by a further 100bps, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.
  - Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.
  - A 0.5% m/m decline in real GDP in July, mainly due to more strikes.
  - CPI inflation falling from 8.7% in April to 6.7% in August, its lowest rate since February 2022, but still the highest in the G7.
  - Core CPI inflation declining to 6.2% in August from 7.1% in April and May, a then 31 years high.
  - A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3myy growth of average earnings rose to 7.8% in August, excluding bonuses).
- The 0.5% m/m fall in GDP in July suggests that underlying growth has lost momentum since earlier in the year. Some of the weakness in July was due to there being almost twice as many working days lost to strikes in July (281,000) than in June (160,000). But with output falling in 10 out of the 17 sectors, there is an air of underlying weakness.
- The fall in the composite Purchasing Managers Index from 48.6 in August to 46.8 in September left it at its lowest level since COVID-19 lockdowns reduced activity in January 2021. At face value, it is consistent with the 0.2% q/q rise in real GDP in the period April to June, being followed by a contraction of up to 1% in the second half of 2023.
- The 0.4% m/m rebound in retail sales volumes in August is not as good as it looks as it partly reflected a pickup in sales after the unusually wet weather in July. Sales volumes in August were 0.2% below their level in May, suggesting much of the resilience in retail activity in the first half of the year has faded.
- As the growing drag from higher interest rates intensifies over the next six months, we think the economy will continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year. And with CPI inflation past its peak and expected to decline further, the economy has got through the cost-of- living crisis without recession. But even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. We expect the Bank of England to keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.
- The tightness of the labour market continued to ease, with employment in the three months to July falling by 207,000. The further decline in the number of job vacancies from 1.017m in July to 0.989m in August suggests that the labour market has loosened a bit further since July. That is the first time it has fallen below 1m since July 2021. At 3.0% in July, and likely to have fallen to 2.9% in August, the job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth. Meanwhile, the 48,000 decline in the supply of workers in the three months to July offset some of the loosening in the tightness of the labour market. That was due to a 63,000 increase in inactivity in the three months to July as more people left the labour market due to long term sickness or to enter education. The supply of labour is still 0.3% below its pre-pandemic February 2020 level.
- But the cooling in labour market conditions still has not fed through to an easing in wage growth. While the monthly rate of earnings growth eased sharply from an upwardly revised +2.2% in June to -0.9% in July, a lot of that was due to the one-off bonus payments for NHS

staff in June not being repeated in July. The headline 3myy rate rose from 8.4% (revised up from 8.2%) to 8.5%, which meant UK wage growth remains much faster than in the US and in the Euro-zone. Moreover, while the Bank of England's closely watched measure of regular private sector wage growth eased a touch in July, from 8.2% 3myy in June to 8.1% 3myy, it is still well above the Bank of England's prediction for it to fall to 6.9% in September.

- CPI inflation declined from 6.8% in July to 6.7% in August, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.2%. That reverses all the rise since March and means the gap between the UK and elsewhere has shrunk (US core inflation is 4.4% and in the Euro-zone it is 5.3%). Core goods inflation fell from 5.9% to 5.2% and the further easing in core goods producer price inflation, from 2.2% in July to a 29-month low of 1.5% in August, suggests it will eventually fall close to zero. But the really positive development was the fall in services inflation from 7.4% to 6.8%. That also reverses most of the rise since March and takes it below the forecast of 7.2% the Bank of England published in early August.
- In its latest monetary policy meeting on 20 September, the Bank of England left interest rates unchanged at 5.25%. The weak August CPI inflation release, the recent loosening in the labour market and the downbeat activity surveys appear to have convinced the Bank of England that it has already raised rates far enough. The minutes show the decision was "finely balanced". Five MPC members (Bailey, Broadbent, Dhingra, Pill and Ramsden) voted for no change and the other four (Cunliffe, Greene, Haskel and Mann) voted for a 25bps hike.
- Like the US Fed, the Bank of England wants the markets to believe in the higher for longer narrative. The statement did not say that rates have peaked and once again said if there was evidence of more persistent inflation pressures "further tightening in policy would be required". Governor Bailey stated, "we'll be watching closely to see if further increases are needed". The Bank also retained the hawkish guidance that rates will stay "sufficiently restrictive for sufficiently long".
- This narrative makes sense as the Bank of England does not want the markets to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments. A rebound in services inflation, another surge in wage growth and/or a further leap in oil prices could conceivably force it to raise rates at the next meeting on 2nd November, or even pause in November and raise rates in December.
- The yield on 10-year Gilts fell from a peak of 4.74% on 17th August to 4.44% on 29th September, mainly on the back of investors revising down their interest rate expectations. But even after their recent pullback, the rise in Gilt yields has exceeded the rise in most other Developed Market government yields since the start of the year. Looking forward, once inflation falls back, Gilt yields are set to reduce further. A (mild) recession over the next couple of quarters will support this outlook if it helps to loosen the labour market (higher unemployment/lower wage increases).
- The pound weakened from its cycle high of $1.30 in the middle of July to $1.21 in late September. In the first half of the year, the pound bounced back strongly from the Truss debacle last autumn. That rebound was in large part driven by the substantial shift up in UK interest rate expectations. However, over the past couple of months, interest rate expectations have dropped sharply as inflation started to come down, growth faltered, and the Bank of England called an end to its hiking cycle.
- The FTSE 100 has gained more than 2% since the end of August, from around 7,440 on 31st August to 7,608 on 29th September. The rebound has been primarily driven by higher energy prices which boosted the valuations of energy companies. The FTSE 100's relatively high concentration of energy companies helps to explain why UK equities outperformed both US and Euro-zone equities in September. Nonetheless, as recently as 21st April the FTSE 100 stood at 7,914.

Appendix 2 – Interest Rate Forecast

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 25th September sets out a view that short, medium 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.

Our current and previous PWLB rate forecasts below are based on the Certainty Rate.

Link Group Interest Rate View	25.09.23												
	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	3.00	2.75	2.75	2.75	2.75	2.75
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.00	2.80	2.80	2.80	2.80	2.80
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.10	2.90	2.90	2.90	2.90	2.90
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.20	3.00	3.00	3.00	3.00	3.00
5 yr PWLB	5.10	5.00	4.90	4.70	4.40	4.20	4.00	3.90	3.70	3.70	3.60	3.60	3.50
10 yr PWLB	5.00	4.90	4.80	4.60	4.40	4.20	4.00	3.80	3.70	3.60	3.60	3.50	3.50
25 yr PWLB	5.40	5.20	5.10	4.90	4.70	4.40	4.30	4.10	4.00	3.90	3.80	3.80	3.80
50 yr PWLB	5.20	5.00	4.90	4.70	4.50	4.20	4.10	3.90	3.80	3.70	3.60	3.60	3.60

Link Group Interest Rate View 26.06.23													
	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26
BANK RATE	5.00	5.50	5.50	5.50	5.25	4.75	4.25	3.75	3.25	2.75	2.75	2.50	2.50
3 month ave earnings	5.30	5.60	5.50	5.30	5.00	4.50	4.00	3.50	3.00	2.70	2.60	2.50	2.50
6 month ave earnings	5.80	5.90	5.70	5.50	5.10	4.60	4.00	3.50	3.00	2.70	2.60	2.60	2.60
12 month ave earnings	6.30	6.20	6.00	5.70	5.30	4.80	4.10	3.60	3.10	2.80	2.70	2.70	2.70
5 yr PWLB	5.50	5.60	5.30	5.10	4.80	4.50	4.20	3.90	3.60	3.40	3.30	3.30	3.20
10 yr PWLB	5.10	5.20	5.00	4.90	4.70	4.40	4.20	3.90	3.70	3.50	3.50	3.50	3.40
25 yr PWLB	5.30	5.40	5.20	5.10	4.90	4.70	4.50	4.20	4.00	3.90	3.80	3.80	3.70
50 yr PWLB	5.00	5.10	5.00	4.90	4.70	4.50	4.30	4.00	3.80	3.60	3.60	3.50	3.50

- LIBOR and 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.
- 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.

A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

- Our central forecast for interest rates was previously updated on 26 June and reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. Since then, rates have indeed increased to 5.25% but with data suggesting inflation is dipping, albeit slowly, and that the economy is heading for a shallow recession, further monetary policy tightening above 5.25% is not required, at least for now.
- Accordingly, although we anticipate rates staying on hold for the best part of a year, we also still anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us – but timing on this 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.
- 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.

- On the positive side, consumers are still estimated 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 somewhat better at this stage of the economic cycle than may have been expected. However, most of those excess savings are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

PWLB RATES

- Gilt yield curve movements have narrowed, with the short part of the curve seeing yields fall through recent weeks whilst the longer-end continues to reflect inflation concerns. At the time of writing there is <30 basis points difference between the 5 and 50 year parts of the curve.

The balance of risks to the UK economy: -

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

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

- **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).
- **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.
- **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.
- **Geopolitical risks,** for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.
- **A re-emergence of banking sector fragilities,** which have been successfully addressed in the near-term by central banks and the market generally, but which may require further intervention if short-term interest rates stay elevated for longer than is anticipated.

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

- 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.
- **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.
- Longer-term **US treasury yields** rise strongly if inflation remains more stubborn there than the market currently anticipates, consequently pulling gilt yields up higher.
- Projected **gilt issuance, inclusive of natural maturities and QT,** could be too much for the markets to comfortably digest without higher yields compensating.

Appendix 3 – Prudential Indicators

(1). EXTRACT FROM BUDGET				
	Forecast Outturn	Original Estimate	Forecast Outturn	Forecast Outturn
Capital Expenditure	£'000	£'000	£'000	£'000
Non - HRA	23,281	43,110	28,461	51,388
TOTAL	23,281	43,110	28,461	51,388
Ratio of financing costs to net revenue stream				
Non - HRA	4.25%	4.37%	4.40%	4.43%
Net borrowing requirement				
brought forward 1 April *	291,782	304,498	372,359	319,602
carried forward 31 March *	303,333	372,359	319,602	358,182
in year borrowing requirement	11,551	67,861	(52,757)	38,580
In year Capital Financing Requirement				
Non - HRA	11,551	67,861	(52,757)	38,580
TOTAL	11,551	67,861	(52,757)	38,580
Capital Financing Requirement as at 31 March				
Non - HRA	303,333	372,359	319,602	358,182
TOTAL	303,333	372,359	319,602	358,182

PRUDENTIAL INDICATOR	2023-24	2024-25	2025-26
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'M**	**£'M**	**£'M**
Authorised limit for external debt -			
borrowing	268	283	305
other long term liabilities	112	113	108
TOTAL	380	396	413
Operational boundary for external debt -			
borrowing	263	278	300
other long term liabilities	109	110	105
TOTAL	372	388	405
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 2023/24	upper limit	lower limit
under 12 months	30%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	40%	0%
10 years and above	100%	0%