ARGYLL AND BUTE COUNCIL **AUDIT AND SCRUTINY COMMITTEE**

FINANCIAL SERVICES **13 MARCH 2025**

TREASURY MANAGEMENT UPDATE – QUARTER ENDED 31 DECEMBER 2024

1.0 EXECUTIVE SUMMARY

1.1 The Local Government in Scotland Act 2003 requires the council to have regard to the CIPFA Code of Practice on Treasury Management (revised 2021), 'the Code'. The Code recommends that members be updated on treasury management activities at least quarterly. This report demonstrates best practice in accordance with the Code.

1.2 The report provides an update on the council's treasury management activity during the quarter 1 October to 31 December 2024 and the overall position as at 31 December 2024. This covers information on:

- Economic background
- Interest rate forecasts
- Borrowing
- Investments
- Compliance with Treasury and Prudential Limits

1.3 The report concludes that:

- All borrowing and investment activity during the quarter 1 October to 31 December 2024 has been undertaken in accordance with the approved 2024/25 Treasury Management Strategy and Annual Investment Strategy, and the authority has operated within the revised treasury and prudential limits approved by Council on 20 December 2024; and

- Short term borrowing and investment activity has been undertaken to manage day to day cashflow requirements. No new long term borrowing has been undertaken during the period. Whilst there is an underlying requirement to borrow for capital purposes, the level of internal reserve fund balances has continued to allow this to be deferred. This borrowing strategy will require to be regularly reviewed to achieve optimum value and minimise risk exposure in the longer term.

1.4 The Audit and Scrutiny Committee is requested to note the contents of the report and the treasury activity during the period 1 October to 31 December 2024.

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2.0 INTRODUCTION

2.1 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management 2021, 'the Code' recommends that members be updated on treasury management activities at least quarterly. This report demonstrates best practice in accordance with the Code.

2.2 The report provides an update on the council's treasury management activity during the quarter 1 October to 31 December 2024 and the overall position as at 31 December 2024. This covers information on:

- Economic background
- Interest rate forecasts
- Borrowing
- Investments
- Compliance with Treasury and Prudential Limits

3.0 RECOMMENDATIONS

3.1 The Audit and Scrutiny Committee is requested to note the contents of the report and the treasury activity during the period 1 October to 31 December 2024.

4.0 DETAIL

4.1 Economic Background

4.1.1 During the quarter, there was a slight contraction in GDP growth, an increase in wage growth and an increase in CPI inflation to 2.6% in November. There has been an overall increase in gilt yields over the period, which underpin long term borrowing rates. During November, Bank Rate was cut from 5% to 4.75%, held during December, with the Monetary Policy Committee stating that a gradual approach to rate cuts remains appropriate, amidst continuing inflation concerns. A more detailed update on the economic position, provided by the council's treasury advisors, is given within Appendix 1.

4.2 Interest Rate Forecasts

4.2.1 The interest rate forecasts, provided by the council's treasury advisors, have been significantly revised following the October Budget, the outcome of the US Presidential election and the 25bps Bank Rate cut in November. These latest forecasts set out a view that both short and long term interest rates will start to fall, as inflation concerns ease. However, the Bank Rate forecast is now 50bps higher than was previously the case, whilst PWLB forecasts have also materially increased, to not only reflect increased concerns around the future path of inflation, but also the increased level of Government borrowing over the term of the current Parliament. Current forecast interest rates are set out in the table below, while details of the assumptions underpinning this view are outlined within Appendix 2.

Link Group Interest Rate View	11.11.24												
	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27
BANK RATE	4.75	4.50	4.25	4.00	4.00	3.75	3.75	3.75	3.50	3.50	3.50	3.50	3.50
3 month ave eamings	4.70	4.50	4.30	4.00	4.00	4.00	3.80	3.80	3.80	3.50	3.50	3.50	3.50
6 month ave eamings	4.70	4.40	4.20	3.90	3.90	3.90	3.80	3.80	3.80	3.50	3.50	3.50	3.50
12 month ave earnings	4.70	4.40	4.20	3.90	3.90	3.90	3.80	3.80	3.80	3.50	3.50	3.50	3.50
5 yr PWLB	5.00	4.90	4.80	4.60	4.50	4.50	4.40	4.30	4.20	4.10	4.00	4.00	3.90
10 yr PWLB	5.30	5.10	5.00	4.80	4.80	4.70	4.50	4.50	4.40	4.30	4.20	4.20	4.10
25 yr PWLB	5.60	5.50	5.40	5.30	5.20	5.10	5.00	4.90	4.80	4.70	4.60	4.50	4.50
50 yr PWLB	5.40	5.30	5.20	5.10	5.00	4.90	4.80	4.70	4.60	4.50	4.40	4.30	4.30

Note: The PWLB rate forecasts are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012. Rate forecasts for 3, 6, 12 month investments are averages - rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short-term cash at any point in time.

4.2.2 A comparison of current updated forecasts to the previous forecast position on Bank Rate and PWLB interest rates, included within the Mid-year Review report, is outlined in the table below.

Rate Forecast	**March 2026**		**March 2027**	
	Previous	**Current**	***Previous***	**Current**
Short term borrowing:				
Bank Rate	*3.25%*	3.75%	*3.00%*	3.50%
Long term PWLB borrowing:				
5 Year	*3.9%*	4.5%	*3.8%*	4.1%
10 Year	*4.1%*	4.7%	*3.9%*	4.3%
25 Year	*4.4%*	5.1%	*4.3%*	4.7%
50 Year	*4.2%*	4.9%	*4.1%*	4.5%

4.3 Borrowing

4.3.1 PWLB loan principal of £0.840m has been repaid during the quarter ended 31 December 2024. This repayment of principal relates to a 10 year PWLB loan (original principal £21m), which was taken on a fixed Equal Instalments of Principal (EIP) basis. All other PWLB loans will be repayable on maturity.

4.3.2 No Maturity PWLB loans have matured during the quarter. Similarly, no other debt repayments or rescheduling has been undertaken.

4.3.3 The authority has one outstanding market or LOBO loan for £5.255m, with an interest rate of 4.75%, maturing 2048, with call dates every 6 months. This loan was not recalled at the 22 December 2024 call date. There is potential for this loan to be recalled before the end of the financial year, at the next call date of 22 June 2025.

4.3.4 No new long term borrowing has been undertaken during the period. Whilst there is an underlying need to borrow in respect of the Capital Financing Requirement, the level of internal reserve fund balances has continued to provide an opportunity to defer new external borrowing. Borrowing activity has been limited to short term borrowing, to manage day to day cashflow requirements.

4.3.5 As at 31 December 2024, the council's debt totalled £112.767m, as summarised in the table below.

Debt	**Amount £000**	**Annual Average Interest Rate**	**Share of Total Debt**
Public Works Loans Board	107,197	4.42%	95.06%
Market Loans (LOBO)	5,255	4.75%	4.66%
Temporary Loans*	315	4.40%	0.28%
Total Debt	**112,767**	**4.44%**	**100.00%**

**Note: This represents short term borrowing from various institutions.*

4.3.6 Given interest rate forecasts, it is anticipated that any new borrowing required before the end of the financial year will be taken on a short term basis, with current high long term interest rates forecast to fall over future years. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring. The capital plan and our use of reserve balances continues to be kept under regular review, and as such, our borrowing strategy will also be regularly reviewed, to achieve optimum value and minimise risk exposure in the long term.

4.4 Investments

Investment Strategy

4.4.1 In accordance with the CIPFA Treasury Management Code of Practice, the council's approved Annual Investment Strategy sets out the council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

4.4.2 The authority continues to aim to achieve the optimum return (yield) on its investments, commensurate with proper levels of security and liquidity and within the authority's risk appetite. The risk appetite of the council is low, prioritising security and liquidity. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in longer periods with high credit quality financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

4.4.3 As shown within the interest rate forecasts given at paragraph 4.2.1, investment rates have remained relatively elevated during the third quarter of 2024/25 but are expected to fall back in due course.

Creditworthiness

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

Investment counterparty criteria

4.4.5 The current investment counterparty criteria selection, approved within the Strategy, continues to meet the requirements of the treasury management function.

Investment Activity

4.4.6 The council's Section 95 Officer confirms that the principles of the investment strategy have been adhered to. During the period ended 31 December 2024, all investments have been made in line with the approved limits for specific investment instruments, and in accordance with the creditworthiness approach.

4.4.7 The limit of investments has reflected the level of available council reserve balances, together with provision for managing the council's day to day cash flow requirements. Details of the council's investments held as at 31 December 2024, totalling £30.016m, are summarised in the table below.

Counterparty	Maturity	Amount £000	Interest Rate	Rating S&P
Clydesdale Bank	Instant Access	5,016	4.65%	Short Term A-1, Long Term A
ANZ	Fixed Deposit 02/01/2025	5,000	5.07%	Short Term A-1+, Long Term AA-
Money Market Fund (MMF) - Aberdeen Standard	Call Account	8,000	4.78%	AAA
MMF - Legal and General	Call Account	3,600	4.78%	AAA
MMF - Aviva	Call	8,400	4.78%	AAA
Total		**30,016**	**4.81%**	

4.4.8 The weighted average rate of return on the above is 4.805%, with an average investment duration of 16 days. This compares to an average benchmark SONIA rate of 4.802% over the quarter, while Bank Rate was lowered during the period from 5.00% to 4.75% in November.

4.5 Compliance with Prudential and Treasury Limits

4.5.1 It is a statutory duty for the council to determine and keep under review the affordable capital expenditure limits. The revised Prudential and Treasury Indicators for 2024-25, as approved by full Council on 20 December 2024, are attached as Appendix 2. During the quarter ended 31 December 2024, the council has operated within the treasury and prudential indicators. The council's Section 95 Officer confirms that no difficulties are envisaged for the current or future years in complying with these indicators.

5.0 CONCLUSION

5.1 All borrowing and investment activity during the period 1 April to 30 September 2024 has been undertaken in accordance with the approved 2024/25 Treasury Management Strategy and Annual Investment Strategy, and the authority has operated within the revised treasury and prudential limits approved by Council on 20 December 2024.

5.2 Short term borrowing and investment activity has been undertaken to manage day to day cashflow requirements. No new long term borrowing has been undertaken during the period. Whilst there is an underlying requirement to borrow for capital purposes, the level of internal reserve fund balances has continued to allow this to be deferred. This borrowing strategy will require to be regularly reviewed to achieve optimum value and minimise risk exposure in the longer term.

6.0 IMPLICATIONS

6.1	Policy		None
6.2	Financial		Complies with Treasury Management Strategy
6.3	Legal		None
6.4	HR		None
6.5	Fairer Duty Scotland		
	6.5.1	Equalities – protected characteristics	None
	6.5.2	Socio-economic Duty	None
	6.5.3	Islands	None
6.6	Climate Change		None
6.7	Risk		None
6.8	Customer Service		None
6.9	The Rights of the Child (UNCRC)		None

Kirsty Flanagan
Executive Director/Section 95 Officer
17 January 2025

Councillor Ross Moreland, Policy Lead for Finance and Commercial Services

Appendix 1 - Economics Update
Appendix 2 – Treasury and Prudential Indicators

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Appendix 1

Economics Update

- The third quarter of 2024/25 (October to December) saw:
  - GDP growth contracting by 0.1% m/m in October following no growth in the quarter ending September;
  - The 3myy rate of average earnings growth increase from 4.4% in September to 5.2% in October;
  - CPI inflation increase to 2.6% in November;
  - Core CPI inflation increase from 3.3% in October to 3.5% in November;
  - The Bank of England cut interest rates from 5.0% to 4.75% in November and hold them steady in December.
  - 10-year gilt yields starting October at 3.94% before finishing up at 4.57% at the end of December (peaking at 4.64%).
- The 0.1% m/m fall in GDP in October was the second such decline in a row and meant that GDP would need to rise by 0.1% m/m or more in November and December, for the economy to grow in Q4 as a whole rather than contract. With on-going concern over the impact of the October budget and drags from higher interest rates and weak activity in the euro zone, our colleagues at Capital Economics have revised down their forecast for GDP growth in 2025 to 1.3% (it was initially 1.8% in the immediate wake of the Budget.)
- This quarter saw the composite activity Purchasing Manager Index (PMI) dip below the level of 50 that separates expansion from contraction for the first time since October 2023. Although December's composite PMI came in above this level, at 50.5, this was still consistent with the 0% rise in real GDP in Q3 being followed by a flat-lining, or potential contraction, in the final quarter of 2024. However, the economy is unlikely to be quite as weak as that given that the PMIs do not capture rises in government spending, but the data does underline the continued divergence in trends between the manufacturing and services sectors. The manufacturing PMI fell for its fourth consecutive month in December, from 48.0 in November to 47.3. That's consistent with manufacturing output falling by 1.5% q/q in the final quarter of 2024 after flatlining through the summer months. This weakness in the manufacturing sector was offset by a rebound in the services sector. The services PMI rose from 50.8 in November to 51.4 in December, which is consistent with non-retail services output growth increasing from +0.1% q/q to +0.3% for October - December. This suggests that more of the recent slowdown in GDP is being driven by the weakness in activity overseas rather than just domestic factors. Additionally, the services output prices balance rose for the third consecutive month, from 55.4 in November to 56.9, showing signs that price pressures are reaccelerating.
- After rising by 1.4% q/q in July - September, the retail sector had a difficult final quarter of the year. Indeed, the bigger-than-expected 0.7% m/m fall in retail sales in October (consensus forecast -0.3% m/m) suggested that households' concerns about expected tax rises announced in the Budget on 30th October contributed to weaker retail spending at the start of the quarter. The monthly decline in retail sales volumes in October was reasonably broad based, with sales in five of the seven main sub sectors slipping. However, the potential for seasonally adjusted sales to rise in November - if October's figures were impacted by the timing of the school half term – combined with a rebound in consumer confidence and rising real incomes, points to some promise to the final quarter of 2024
- The Government's October budget outlined plans for a significant £41.5bn (1.2% of GDP) increase in taxes by 2029/30, with £25bn derived from a 1.2% rise in employers' national insurance contributions. The taxes are more than offset by a £47bn (1.4% of GDP) rise in current (day-to-day) spending by 2029/30 and a £24.6bn (0.7% of GDP) rise in public investment, with the latter being more than funded by a £32.5bn (1.0% of GDP) rise in public borrowing. The result is that the Budget loosens fiscal policy relative to the previous government's plans - although fiscal policy is still being tightened over the next five years – and that GDP growth is somewhat stronger over the coming years than had previously been forecasted. By way of comparison, the Bank of England forecasts four-quarter GDP growth to pick up to almost 1¾% through 2025 (previously forecast to be 0.9%) before falling back to just over 1% in 2026.
- December's pay data showed a rebound in wage growth that will likely add to the Bank of England's inflationary concerns. The 3myy rate of average earnings growth increased from 4.4% in September (revised up from 4.3%) to 5.2% in October (consensus forecast 4.6%) and was mainly due to a rebound in private sector pay growth from 4.6% to 5.4%. Excluding bonuses, public sector pay stagnated in October and the 3myy rate fell from 4.7% to 4.3%.
- The number of job vacancies also fell again from 828,000 in the three months to October to 818,000 in the three months to November. This marks the first time it has dropped below its pre-pandemic February 2020 level of 819,000 since May 2021. Despite this, the Bank of England remains concerned about the inflationary influence of high wage settlements as well as the risk of a major slowdown in labour market activity.

- CPI inflation has been on the rise this quarter, with the annual growth rate increasing from 1.7% in September to 2.3% in October, before rising further to 2.6% in November. Although services CPI inflation stayed at 5.0% in November, the Bank had expected a dip to 4.9%, while the timelier three-month annualised rate of services CPI rose from 5.0% to 5.1%. That shows that there currently isn't much downward momentum. Moreover, the wider measure of core CPI inflation rose from 3.3% to 3.5% in November. Both services and core inflation are currently at rates well above those consistent with the 2.0% target and are moving in the wrong direction. Capital Economics forecast that after dipping to 2.5% in December, CPI inflation will rise further in January, perhaps to 2.8%. Although CPI inflation is expected to be back at close to the 2.0% target by the end of 2025, given that a lot of the rise in inflation in the coming months will be due to base effects that won't persist, the potential for a broader set of tariffs to arise from the US as well as the constant threat of geo-political factors to impact energy and food prices suggest risks remain very much to the upside.

- Throughout the quarter gilt yields have risen. The 10-year gilt yield increased from 3.94% at the start of October to 4.57% by the year end (and has subsequently risen to 4.64% early in 2025). As recently as mid-September 10-year gilt yields were at their low for the financial year, but since then, and specifically after the Budget at the end of October, yields have soared. Overall, the reaction to the UK Budget highlights how bond markets are both fragile and highly attentive to news about the fiscal outlook.

- The FTSE 100 started off this quarter at 8,276, before finishing up at 8,121. In particular, UK markets have continued to fall further behind US equities, a trend which has accelerated since Trump's election victory in November, partly due to the UK stock market being less exposed to AI hype, and it being weighed down by its relatively large exposure to the energy and materials sectors.

MPC meetings: 7th November & 18th December 2024

- On 7 November, Bank Rate was cut by 0.25% to 4.75%. The vote was 8-1 in favour of the cut, but the language used by the MPC emphasised "gradual" reductions would be the way ahead with an emphasis on the inflation and employment data releases, as well as geo-political events.

- At the 18 December meeting, another split vote arose. Members voted 6-3 to keep Bank Rate on hold at 4.75%, but dissenters (Dhingra, Ramsden and Taylor) were keen for rates to be cut further as concerns over the slowing down of the UK economy took root, despite near-term inflation fears remaining.

- The MPC again stated that "a gradual approach" to rate cuts "remains appropriate" and that policy will "remain restrictive for sufficiently long".

Appendix 2

2024/25 Prudential and Treasury Indicators

Prudential Indicators		Revised Estimate £m
Capital Expenditure		**82**
Capital Financing Requirement as at 31 March		**366**
brought forward 1 April		332
In year Capital Financing Requirement		34
In year borrowing requirement		**34**
Ratio of financing costs to net revenue stream		**4.54%**
Treasury Indicators		**Revised Estimate £m**
Authorised limit for external debt		375
Operational boundary for external debt		367
Gross External Debt		236
Maturity Structure of Fixed Rate Borrowing	**Upper Limit**	**Lower Limit**
Under 12 months	30%	0%
12 months to within 2 years	30%	0%
2 years to within 5 years	30%	0%
5 years to within 10 years	40%	0%
10 years and above	100%	0%
Upper limit for total principal sums invested for over 364 days		**£20m**