Appendix C

The Treasury Management Activity Mid-Year Report – 2024/25

1. Background

1.1 The Treasury Management and Annual Investment Strategy for 2024/25 was approved by Full Council on 6 February 2024.

1.2 The Strategy was prepared within the context the financial challenge being faced by the County Council over the Medium Term Financial Plan and seeks to compliment the Council Plan by:

- utilising long term cash balances as effectively as possible by investing in longer term instruments and/or using to fund borrowing to reduce borrowing costs;
- ensuring the investment portfolio is working hard to maximise income by further use of alternative appropriate investment opportunities during 2024/25;
- ensuring effective management of the borrowing portfolio by exploring rescheduling opportunities and identifying and exploiting the most cost effective ways of funding the Council's borrowing requirement.

1.3 There were no changes in the Annual Investment Strategy recommended for 2024/25.

1.4 Officers continue to seek out Environmental Social & Governance (ESG) investment opportunities with counterparties that meet the council's investment parameters. The council continues to invest in Standard Chartered's sustainable fixed deposits which aligns the Council's investments with the bank's ESG strategy. The market for green and broader ESG investments is still relatively immature, which reduces the ability to actively invest in products that support the Council's aspirations. However, research and the consideration of the suitability of ESG investment products will continue into 2024/25.

2. Investment Activity to 30 September 2024

2.1 The Bank of England cut bank rate once, the movement summarised below.

	New Rate	Movement
1 August 2024	5.00%	-0.25%

2.2 During the first half year investments have been held in Money Market Funds, high quality Banking names, other Local Authorities and the CCLA Local Authority Property Fund. Counterparty credit quality remains a primary concern for the treasury team, with security, liquidity and yield in that order a priority.

2.3 Measures have been undertaken to ensure that levels of liquidity are available during the last 6 months but also opportunities explored to lock in returns in a falling interest rate environment to secure investment returns.

2.4 Deposits held for liquidity purposes in Money Market Funds have provided a return nearing the prevailing base rate, compared to previous years where they performed well below that benchmark.

2.5 Several fixed term bank deposits have been reinvested up to a period of 12 months securing a fixed rate of return between 4.50% - 5.36% within a low credit risk parameter. Local Authority deposits have been placed in the period at rates ranging between 4.70-5.40%, for durations between 3 to 12 months. Their inclusion forms part of a balanced portfolio.

2.6 The average investment balance to September 2024 was £211m and generated investment income of £5.7m. The forecast for 2024/25 is £9.5m and dependent on cashflow and the future interest rate environment.

Investment Risk

2.7 During the half year monitoring of the security of the Council's investment has taken place, to assess the risk of investments losing their value. These risks were assessed using the financial standing of the groups invested in, the length of each investment, and the historic default rates. The investment strategy sets an allowable risk level of 0.050% (i.e. that there is a 99.95% probability that the Council will get its investments back). The actual indicator ranged between 0.007% and 0.009%, reflecting the high proportion of investments held in highly secure and/or very liquid investments.

Investment Risk benchmark	0.050%
Maximum investment risk experienced Q1-Q2	0.009%

Investment Benchmarking

2.8 The average investment return during the period was 5.42% over-performing the benchmark rate by 30 basis points (or 0.30 percentage points). The over performance can be attributed to the falling interest rate environment and a number of investments yet to mature in the portfolio previously placed at higher rates.

Average Investment Balance Q1-Q2 £m	**Average Investment return Q1 & Q2**	**Average Benchmark Rate***	**Difference**
210.894	5.42%	5.12%	0.30%

**the Benchmark rate used is the Standard Overnight Index Average; a rate administered by the Bank of England based on actual transactions of overnight borrowing by financial institutions.*

3. Borrowing Activity to 30 September 2024

3.1 No short term loan borrowing was arranged during the period. Future short-term borrowing in the current year is not forecasted but remains an option to cover temporary cashflow requirements.

3.1 The level of Council long-term debt at 30 September 2024 was £211.6m, two loans matured with the PWLB during the period on the 30 June (£2m & £3m) held at 7.75% and 7.625%. The next PWLB maturities are on the 30 June 2025, totalling £5m at rates of 7.125% and 7.625%.

3.2 Opportunities to reduce the cost of carry (interest paid against interest received) are constantly being explored as and when options arise. The forecast for interest paid on long-term debt in 2024/25 is approximately £9.4m and is within the budgeted provision.

Borrowing Benchmarking

3.4 The table below shows the Council's total external borrowing and average rate as at 30 September 2024:

	Balance as at 30 September 2024 £m	Average Rate
PWLB	205.142	4.45%
Market Loans	6.450	4.25%
Total borrowing	**211.592**	**4.44%**

3.5 The table below shows the forecast of the Capital Financing Requirement (CFR) compared to the estimate within the 2024/25 strategy approved in February 2024. The CFR is expected to give rise to new borrowing required of £61.738m by the end of the year, compared to the original estimate of £93.092m. The strategy currently forecasts that the level of reserves and balances in the medium term allows internal borrowing of up to £75.000m, and therefore it is currently expected that no external borrowing will be required to support the capital programme in year.

Capital Financing Requirement (CFR) (Underlying Borrowing Need)	Original Estimate 2024/25 £m	Revised forecast as at 30 September 2024 £m
Opening CFR	280.571	275.676
Borrowing Need	32.143	5.473
Minimum Revenue Provision	(7.406)	(7.819)
Closing CFR	**304.684**	**273.330**
External Borrowing as at 30 September 2024		**211.592**
Forecast Underborrowing (if no action taken)		**61.738**

3.6 The table below shows that the Council is operating within the Operational Boundary and Authorised Borrowing Limits set within the Treasury Management strategy and has sufficient headroom to cover the borrowing need arising from the year's capital programme.

Borrowing Limits	Operational Boundary £m	Authorised Borrowing Limit £m
Limit set for 2024/25	376.000	396.000
Less: PFI & Leases	65.000	65.000
Limit for Underlying Borrowing	311.000	331.000
Actual External Borrowing at 30 September	211.592	211.592
Headroom*	99.408	119.408

**Authorised Borrowing headroom cannot be less than zero*

3.7 The maturity profile of the Authority's borrowing is within the limits set within the strategy.

Maturity Structure of borrowing	Lower Limit set	Upper Limit set	Actual as at 30 September 2024
Under 12 Months	0%	25%	2%
12 months to 2 years	0%	40%	2%

2 years to 5 years	0%	60%	7%
5 years to 10 years	0%	70%	16%
Over 10 years	0%	90%	73%

4 Economic performance to date and outlook (commentary supplied by Link Asset Services) - September 2024.

4.1 The third quarter of 2024 (July to September) saw:

- GDP growth stagnating in July following downwardly revised Q2 figures (0.5% q/q)
- A further easing in wage growth as the headline 3myy rate (including bonuses) fell from 4.6% in June to 4.0% in July;
- CPI inflation hitting its target in June before edging above it to 2.2% in July and August;
- Core CPI inflation increasing from 3.3% in July to 3.6% in August;
- The Bank of England initiating its easing cycle by lowering interest rates from 5.25% to 5.0% in August and holding them steady in its September meeting;
- 10-year gilt yields falling to 4.0% in September.

4.2 The economy's stagnation in June and July points more to a mild slowdown in GDP growth than a sudden drop back into a recession. Moreover, the drop in September's composite activity Purchasing Managers Index, from 53.8 in August to 52.9, was still consistent with GDP growth of 0.3%-0.4% for the summer months. This is in line with the Bank of England's view, and it was encouraging that an improvement in manufacturing output growth could be detected, whilst the services PMI balance suggests non-retail services output grew by 0.5% q/q in Q3. Additionally, the services PMI future activity balance showed an uptick in September, although readings after the Chancellor's announcements at the Budget on 30th October will be more meaningful.

4.3 The 1.0% m/m jump in retail sales in August was stronger than the consensus forecast for a 0.4% m/m increase. The rise was reasonably broad based, with six of the seven main sub sectors recording monthly increases, though the biggest gains came from clothing stores and supermarkets, which the ONS reported was driven by the warmer-than-usual weather and end of season sales. As a result, some of that strength is probably temporary.

4.4 The government's plans to raise public spending by around £16bn a year (0.6% GDP) have caused concerns that a big rise in taxes will be announced in the Budget, which could weaken GDP growth in the medium-term. However, if taxes are raised in line with spending (i.e., by £16bn) that would mean the overall stance of fiscal policy would be similar to the previous government's plan to reduce the budget deficit. Additionally, rises in public spending tend to boost GDP by more than increases in taxes reduce it. Our colleagues at Capital Economics suggest GDP growth will hit 1.2% in 2024 before reaching 1.5% for both 2025 and 2026.

4.5 The further easing in wage growth will be welcomed by the Bank of England as a sign that labour market conditions are continuing to cool. The 3myy growth rate of average earnings fell from 4.6% in June to 4.0% in July. On a three-month annualised basis, average earnings growth eased from 3.0% to 1.8%, its lowest rate since December 2023. Excluding bonuses, the 3myy rate fell from 5.4% to 5.1%.

4.6 Other labour market indicators also point to a further loosening in the labour market. The 59,000 fall in the alternative PAYE measure of the number of employees in August marked the fourth fall in the past five months. And the 77,000 decline in the three months to August was the biggest drop since November 2020.

4.7 Moreover, the number of workforce jobs fell by 28,000 in Q2. The downward trend in job vacancies continued too. The number of job vacancies fell from 872,000 in the three months to July to 857,000 in the three months to August. That leaves it 34% below its peak in May 2022, and just 5% above its pre-pandemic level. Nonetheless, the Bank of England is still more concerned about the inflationary influence of the labour market rather than the risk of a major slowdown in labour market activity.

4.8 CPI inflation stayed at 2.2% in August, but services inflation rose from a two-year low of 5.2% in July to 5.6%, significantly above its long-run average of 3.5%. Food and fuel price inflation exerted some downward pressure on CPI inflation, but these were offset by the upward effects from rising furniture/household equipment inflation, recreation/culture inflation and a surprisingly large rise in airfares inflation from -10.4% in July to +11.9% in August. As a result, core inflation crept back up from 3.3% to 3.6%. CPI inflation is also expected to rise in the coming months, potentially reaching 2.9% in November, before declining to around 2.0% by mid-2025.

4.9 The Bank initiated its loosening cycle in August with a 25bps rate cut, lowering rates from 5.25% to 5.0%. In its September meeting, the Bank, resembling the ECB more than the Fed, opted to hold rates steady at 5.0%, signalling a preference for a more gradual approach to rate cuts. Notably, one Monetary Policy Committee (MPC) member (Swati Dhingra) voted for a consecutive 25bps cut, while four members swung back to voting to leave rates unchanged. That meant the slim 5-4 vote in favour of a cut in August shifted to a solid 8-1 vote in favour of no change.

4.10 Looking ahead, CPI inflation will likely rise in the coming months before it falls back to its target of 2.0% in mid-2025. The increasing uncertainties of the Middle East may also exert an upward pressure on inflation, with oil prices rising in the aftermath of Iran’s missile attack on Israel on 1 October. China’s recent outpouring of new fiscal support measures in the latter stages of September has also added to the upshift in broader commodity prices, which, in turn, may impact on global inflation levels and thus monetary policy decisions. Despite these recent developments, our central forecast is still for rates to fall to 4.5% by the end of 2024 with further cuts likely throughout 2025. This is in line with market expectations, however, although a November rate cut still looks likely, December may be more problematic for the Bank if CPI inflation spikes towards 3%. In the second half of 2025, though, we think a more marked easing in inflation will prompt the Bank to speed up, resulting in rates eventually reaching 3.0%, rather than the 3.25-3.50% currently priced in by financial markets.

4.11 Looking at gilt movements in the first half of 2024/25, and you will note the 10-year gilt yield declined from 4.32% in May to 4.02% in August as the Bank’s August rate cut signalled the start of its loosening cycle. Following the decision to hold the Bank Rate at 5.0% in September, the market response was muted, with the 10-year yield rising by only 5bps after the announcement. This likely reflected the fact that money markets had priced in a 25% chance of a rate cut prior to the meeting. The yield had already increased by about 10bps in the days leading up to the meeting, driven in part by the Fed's "hawkish cut" on 18 September. There is a possibility that gilt yields will rise near-term as UK policymakers remain cautious due to persistent inflation concerns, before declining in the longer term as rates fall to 3.0%.

4.12 The FTSE 100 reached a peak of 8,380 in the third quarter of 2024, but its performance is firmly in the shade of the US S&P500, which has breached the 5,700 threshold on several occasions recently. Its progress, however, may pause for the time being whilst investors wait to see who is elected the next US President, and how events in the Middle East (and Ukraine) unfold. The catalyst for any further rally (or not) is likely to be the degree of investors' faith in AI.

5.0 Interest rate forecast

5.1 Link Asset Services, has provided the following forecast as at 30 September 2024.

Link Group Interest Rate View	28.05.24									
	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	4.50	4.00	3.50	3.25	3.25	3.25	3.25	3.00	3.00	3.00
3 month ave earnings	4.50	4.00	3.50	3.30	3.30	3.30	3.30	3.00	3.00	3.00
6 month ave earnings	4.40	3.90	3.50	3.30	3.30	3.30	3.30	3.10	3.10	3.20
12 month ave earnings	4.30	3.80	3.50	3.40	3.40	3.40	3.40	3.20	3.30	3.40
5 yr PWLB	4.50	4.30	4.10	4.00	3.90	3.90	3.90	3.90	3.90	3.80
10 yr PWLB	4.60	4.40	4.30	4.10	4.10	4.10	4.00	4.00	4.00	3.90
25 yr PWLB	5.00	4.80	4.70	4.50	4.50	4.40	4.40	4.40	4.30	4.30
50 yr PWLB	4.80	4.60	4.50	4.30	4.30	4.20	4.20	4.20	4.10	4.10

5.2 The latest forecast 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.