South Cambridgeshire District Council

Report to:	Audit & Corporate Governance 26 July 2023
Lead Cabinet Member:	Councillor John Williams Lead Cabinet Member for Resources
Lead Officer:	Peter Maddock, Head of Finance

TREASURY MANAGEMENT PERFORMANCE REPORT: QUARTER ENDING 30 JUNE 2023

Executive Summary

1. This report outlines the performance against the Council's approved Treasury Management Strategy for first three months of 2023/2024, including performance against the approved Prudential Indicators for Treasury Management.

Key Decision

2. This is not a key decision as there are no resource implications directly arising from the report at this stage.

Recommendation

3. **That Committee is invited to review the Treasury Management activity and performance for the quarterly period to 30 June 2023.**

Reason for Recommendation

4. The Committee has within its terms of reference a responsibility to review Treasury Management activity, and this report includes details of investment performance and treasury management activity for the quarter period 1 April 2023 to 30 June 2023.

Details

<u>Treasury Management Strategy</u>

5. Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code), which requires the Council to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and to approve an annual report after the end of each financial year.

6. The Council's Treasury Management Strategy and prudential indicators for 2023/2024 were approved by Full Council at its meeting on 21 February 2023.

7. Changes in the regulatory environment have placed a much greater onus on Members to undertake the review and scrutiny of treasury management policy and activities. This report is important in that respect as it provides details of the actual position for treasury activities and highlights compliance with the Council's policies previously approved by the Council.

8. Any borrowing/investment exposes an organisation to financial risks, including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk is, therefore, central to the Council's treasury management strategy This report covers the treasury management activity for the period 1 April 2023 to 30 June 2023 and the associated monitoring and risk management.

9. The Council has monies available for Treasury Management investment as a result of the following:

- Positive cash flow.
- Receipts (mainly from Government) received in advance of payments being made.
- Capital receipts not yet utilised to fund capital expenditure.
- Provisions made in the accounts for liabilities (e.g. provision for outstanding insurance claims or legal cases which have not yet materialised).
- General and earmarked reserves retained by the Council.

10. Some of the source of funds identified above are short-term and investment of these needs to be highly 'liquid', particularly if it relates to a positive cash flow position which can change in the future. Future monies available for investment will depend on the budget position of the Council and whether the Council will need to substantially run-down capital receipts and reserves. Against a backdrop of unprecedented reductions in Government funding, the Medium-Term Financial Strategy and financial forecasts previously considered by the Council identify that on-going revenue savings will be required to balance the budget in future years; there is a likelihood, therefore, that such actions may be required in the medium term which could reduce the monies available for investment.

11. In line with established practice, it is intended that a mid-year review of the Treasury Management Policy Statement and Treasury Management Strategy will be undertaken with regard to their compliance to the CIPFA Prudential Code and the CIPFA Treasury Management Code, and to ensure their appropriateness in light of the Council's current investment and borrowing portfolios, and the ongoing delivery of the Council service objectives. This will be reported to the Committee at its meeting on 28 November 2023. A full review of the Treasury Management Policy and Treasury Management Strategy Statement will also be presented to Cabinet and Council as part of the 2024/2025 budget determination process.

12. The economic landscape has continued with a degree of uncertainty and volatility during the quarter period to 30 June 2023, with the ongoing financial challenges associated with high inflation levels, increasing interest rates and the consequences of war in Europe, the fear of recession and necessary financial tightening by the Bank of England to control the economy. It is expected that this trend will continue for the immediate future as the economy remains shaky. It will, therefore, remain a priority to include the consequences of these volatile trends in the Council's cash flow planning.

13. In response to the prevailing economic conditions the Bank of England increased the Base Rate several times during 2022/2023, and continues to do so in 2023/24 culminating in the increase to its current level of 5% effective from 22 June 2023. The outlook is for further increases with rates peaking in Summer 2024. Our advisers expect rates to peak at 5.5%, however Markets are pricing in rates as high as 6.25%. Consumer Price Index (CPI) inflation, as a measure of price rises, has also been more stable that in the preceding quarterly periods, with CPI at 8.7% in the period to May 2023 (based upon the Office for National Statistics (ONS) information).

14. Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the former Ministry for Housing, Communities & Local Government (MHCLG) published its revised investment Guidance which came into effect from April 2018. The framework established by the Prudential Code should support local strategic planning, local asset management planning and proper option appraisal. The objectives of the Prudential Code are to ensure, within this clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable.

15. The updated Prudential Code included a new requirement for local authorities to provide a Capital Strategy, which is to be an overarching document approved by Full Council. The Council's Capital Strategy was considered and approved by Full Council on 21 February 2023 and will be reviewed as part of the 2024/2025 budget process.

Investment Activity

16. As at 30 June 2023, the Council held £135.3 million of invested funds (nominal basis), representing income received in advance of expenditure plus balances and reserves held. The Council's investment balances during 2023/2024, for the period to 30 June 2023, have averaged £136.3 million.

17. The Statutory Guidance on Local Government Investments in England, issued by the Secretary of State under section 15(1)(a) of the Local Government Act 2003, gives priority to security and liquidity and the Council's aim is to achieve a yield consistent with these key principles.

18. The table below shows the opening balances of investments held at the beginning of the financial year and the movements on each fund up to 30 June 2023:

Investment Counterparty	01 April 2023	New	Matured	30 June 2023
Short Term:	**£000**	**£000**	**£000**	**£000**
Banks – Call/Liquidity Accounts	2,595	21,610	24,205	Nil
AAA Rated Money Market Fund	2,365	64,170	65,175	1,360
Clearing Banks	7,000		7,000	Nil
Other Banks	5,000	9,000	2,000	12,000
UK Local Authorities	19,000	29,000	29,000	19,000
Building Societies	Nil			Nil
Housing Associations	Nil			Nil
Total Short-Term Investments	**35,960**			**32,360**

Investment Counterparty	01 April 2023	New	Matured	30 June 2023
Long Term:	**£000**	**£000**	**£000**	**£000**
South Cambs Ltd	100,000			100,000
Cambridge Leisure and Ice	2,400			2,400
Cambourne Town Council	500			500
Total Long-Term Investments	**102,900**			**102,900**
Total Investments	**138,860**			**135,260**

19. The downward movement in value of £3.6 million is due to the early payment in full of the A14 contribution that saved the Council £2.35m over a period of 25 years although reduced the current balance available for investments.

20. The most significant movements in the portfolio are an decrease of £7 million placed on Clearing Banks (£nil) and an increase of £7 million on Other Banks (£12m). A more detailed analysis of the investment portfolio as at 30 June 2023 is shown at **Appendix A.**

21. Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving low investment income.

22. In order to achieve these objectives, the Council's portfolio is diversified. The majority of the portfolio is invested in fixed term deposits with Financial Institutions which return 4.45% and Ermine Street Housing which returns 4.25%. Liquidity assets typically returned 4.35% over the quarter. This has to 30 June 2023 generated the Council a blended return of 4.3%.

23. This has been achieved whilst maintaining a low level of credit risk. Counterparty credit quality is assessed and monitored with reference to credit ratings (the Council's minimum long-term counterparty rating is [A-] across all major agencies); credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. This is shown below.

	Weighted Average Risk Number	**Investment Portfolio**	**Bail-In Exposure**		**Average Balance**	**Rate of Return**
		£000	£000	%		
30 June 2023	TBC	135,260	12,000	8.9	136,343	4.30%
31 March 2023	2.70	138,860	12,000	8.6	147,898	4.21%

24. The table also shows how the Council's exposure to Bail in Risk has increased in year as the portfolio has more funds proportionally with Banks. This will increase as balances with Banks and Building Societies increase during subsequent quarters.

Borrowing Strategy

25. As at 30 June 2023, the Council held £205.123 million of long term debt (principal borrowed, excluding lease liabilities), no change on the position at 31 March 2023. The Council held £40 million of short-term debt at 30 June 2023.

26. Affordability and the “cost of carry” remained important influences on the Council’s borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing. As short-term interest rates have remained low and are likely to remain at these levels over the forthcoming two years, the Authority has determined it is more cost effective in the short-term to use internal resources instead of external borrowing.

27. The benefits of internal borrowing are monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Link Asset Services (Treasury Management Advisers) assist the Council with this ‘cost of carry’ and breakeven analysis.

Borrowing Activity

28. As at 31 March 2023 the Council had short-term local authority borrowing of £40 million in addition to £205.123 million of PWLB loans for HRA self-financing.

29. The table below sets out the movement in the Council’s borrowing over the year to date. The Capital Financing Requirement (CFR) is unchanged in the three-month period to 30 June 2023.

	01/04/2023	**Maturing Debt**	**Interest Paid**	**Lease Payments**	**CFR Movement**	**30/06/2023**
	£000	**£000**	**%**	**£000**		**£000**
CFR	329,356				Nil	329,356
Short Term Borrowing (a)	40,000		2.86%			40,000
Long Term Borrowing (b)	205,123		3.51%			205,123
Total Borrowing (a+b)	245,123					245,123
Other Long-Term Liabilities (c)	0					0
Total External Debt (a+b+c)	245,123					245,123

PWLB Certainty Rate and Project Rate Update

30. Councils are required to notify the Department for Levelling Up, Housing and Communities (DLUHC), formerly MHCLG, of any potential future borrowing in order to obtain the ‘Certainty Rate’ (0.20% below the PWLB standard rate) the Council has submitted an application to borrow at this rate until 31 March 2024. There is no penalty if the facility is not used.

Debt Rescheduling

31. The premium charge for early repayment of PWLB debt has become very expensive for the loans in the Council's portfolio and, therefore, unattractive for debt rescheduling activity. As a consequence, no rescheduling activity has been undertaken.

2023/2024 Budget Monitoring

32. The Finance Team monitor and report on the Capital Financing budget on a regular basis. The latest position as at 30 June 2023 is shown in the table below:

	Current Budget	Forecast Outturn	Forecast Variance
	£000	£000	£000
Interest Payments	2,002	1,500	(502)
Minimum Revenue Provision	1,329	1,329	Nil
Total Expenditure	3,331	2,829	(502)
Investment Income	(5,703)	(5,703)	Nil
Commercial Property Rental Income (Net)	(1,300)	(1,300)	Nil
Total Income	(7,003)	(7,003)	Nil
Net Budget	(3,672)	(4,174)	(502)

33. Interest Payments are forecast to be lower than originally budgeted as the amount of short term borrowing will be minimised. This is mainly due to expected slippage within the capital programme. The expectation is long-term borrowing during the year will not be required, due to higher investment balances and use of short-term borrowing in the near term.

34. Minimum Revenue Provision forecast outturn is in line with estimate.

35. Investment Income is forecast to come in line with estimate. Rates with Banks and Money Market funds have increased from record lows since the succession of Bank of England Base rate increases. Ermine Street Housing continues to make a significant contribution, with an expected outturn of £4.25 million as Ermine Street Housing has completed its acquisition programme. The income from the Commercial Property portfolio in the financial year is expected in line with estimate. Vacant areas in one property are being marketed so new lettings would see outturn ahead of estimate.

External Economic Impact on Portfolio

36. The external economic context and market rate data is referenced in the Treasury Advisers report reproduced at **Appendix B**.

37. The Bank of England Base Rate of 4.25%, that has applied effective from 22 March 2023, increased during the quarter period to 5% by 30 June 2023. The increase, compared to 2022/2023 levels, has increased the return on the Council's Money Market Fund holdings and on maturing deposits when reinvested.

Compliance with Performance Indicators

38. The Council has been compliant with the 2023/2024 Prudential Indicators approved by Full Council on 21 February 2023.

39. The Council measures and manages its exposures to treasury management risks using the following indicators:

40. Performance against prudential indicators in 2023/2024 is as follows:

(1) Interest Rate Exposure: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable interest rate exposures are set out in the table below:

Maturity structure of borrowing	Under 12 months	More than 12 months	Under 12 months - Actual	More than 12 months - Actual
Upper limit for fixed interest rate exposure	100%	100%	0%	100%
Upper limit for variable rate exposure	100%	0%	0%	0%

(2) Maturity Structure of Borrowing: The structure of the Council's borrowing is set out below.

Fixed Rate Borrowing		
Lender	Repayable within	Amount £,000
Local Authorities	<12 Months	30,000
Local Authorities	>12 Months <2 years	10,000
PWLB	10 – 15 years	25,000
PWLB	15 – 20 years	50,000
PWLB	20 – 25 years	50,000
PWLB	25 – 30 years	50,000
PWLB	30 – 35 years	30,123

(3) Principal Sums Invested for Periods Longer than 364 Days: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The Council takes in consideration the advice of its Treasury Advisers when determining the duration of investments with financial institutions (excluding Ermine Street Housing and Cambridge Leisure and Ice Centre). The suggested durations for counterparties are:

Counterparty	Suggested maximum duration	Actual duration	Total investments £000
Close Brothers	6 months	730 days	5,000

(4) Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by maintaining a minimum £7 million working cash balance (total investment balance less loans to Ermine Street Housing and Cambridge Leisure & Ice). This liquidity is available to meet unexpected payments without additional borrowing.

Counterparty Type	Amount £000	% of Portfolio at 30 June 2023
Long term (>1yr)		
Ermine St Housing	100,000	74%
CLIC + Cambourne Town Council	2,900	2%
Other Banks	5,000	4%
Total Long term	107,900	
Short term (<365 days)		
Banks (Clearing)	0	
Other Banks	7,000	5%
Building Societies	0	
Housing Assoc.	0	
Local Authorities	19,000	14%
Money Market Funds	1,360	1%
Short Term (Working Cash Balance)	27,360	

Outlook for Quarter 2: 2023/2024

41. The Council will continue to use fixed term deposits and money market funds to manage cashflow. The Council investment balances will increase in Qtr 2 and deposits will be timed to mature in Qtr 4 to cover the period of lower receipts. The expected outturn on short term borrowing is £35 million (2022/23 £40 million).

42. Whilst there is now a degree of stability, the view remains that is that the UK economy still faces a challenging outlook as the Government continues to respond to the ongoing financial pressures associated high inflation levels.

Implications

43. In the writing of this report, taking into account the financial, legal, staffing, risk management, equality and diversity, climate change, community safety and any other key issues, the following implications have been considered:

Legal

44. It is a statutory duty, under Section 3 of the Local Government Act 2003 and supporting regulations, for the Council to approve a range of prudential indicators as part of its approval of the General Fund Revenue Budget and Capital Programme.

45. The Chartered Institute of Public Finance and Accountancy’s Treasury Management Code (CIPFA’s TM Code) requires that authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end).

Policy

46. There are no specific policy implications associated with the recommendations contained in this report. The Chartered Institute of Public Finance & Accountancy (CIPFA) Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (the CIPFA Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities 2017 (as amended) have been used in the preparation of this report.

Finance

47. There are no new resource implications associated with the recommendations contained in this report.

Risk/Opportunities

48. There are clearly inherent risks in placing investments both in terms of the security of the capital invested and the level of return from the investment. The approved Treasury Management Strategy 2023/2024 identified the Councils investment priorities as (i) the security of the capital and (ii) the liquidity of its investments.

49. Compliance with the Treasury Management Strategy and associated Treasury Management Practices seeks to mitigate the risks inherent with the treasury management function. The consideration of Security, Liquidity and Yield, in that order, is critical when assessing potential treasury investments. The Strategy specifically states that the Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving low investment income.

50. The Council engages an external Treasury Management Adviser to provide appropriate and timely advice on the Council's treasury portfolio (and, in particular, to provide advice on counter-party creditworthiness and investment limits). This appointment is regarded as critical given the investment risks.

Climate Change

51. There are no direct environmental implications arising from the report.

Consultation Responses

52. Consultations have been undertaken with the Lead Cabinet Member for Resources and the Council's treasury management adviser.

Alignment with Council Priority Areas

53. Timely and robust consideration of the Council's treasury management activities is vital to ensure that financial performance is in line with expectations.

Background Papers

Where the Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012 require documents to be open to inspection by members of the public, they must be available for inspection:

(a) at all reasonable hours at the offices of South Cambridgeshire District Council;

(b) on the Council's website; and

(c) in the case of documents to be available for inspection pursuant to regulation 15, on payment of a reasonable fee required by the Council by the person seeking to inspect the documents at the offices of South Cambridgeshire District Council.

The following documents are relevant to this report:

- Medium Term Financial Strategy – Report to Cabinet: 12 December 2022
- Medium Term Financial Strategy – Report to Council: 21 February 2023
- General Fund Budget – Report to Cabinet: 6 February 2023
- General Fund Budget – Report to Council: 21 February 2023
- Treasury Management Strategy – Report to Cabinet: 6 February 2023
- Treasury Management Strategy – Report to Council: 21 February 2023

Appendices

A Schedule of Investments as at 30 June 2023

B Treasury Management Adviser – External Economic Context and Market Rate Data

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Appendix A

	Amount £000	Interest £000	Total £000	Term Days	Rate %	Maturity Date
Counterparty						
Uttlesford DC	1,000	0.5	1,000	4	5.00	3 July 2023
Goldman Sachs International Bank	1,000	24	1,024	181	4.85	9 Nov 2023
Standard Chartered Sustainable Fund	1,000	25	2,025	189	4.80	9 Nov 2023
Lloyds Bank Commercial Markets	3,000	80	3,080	191	5.07	9 Nov 2023
Lloyds Bank Commercial Markets	2,000	49	2,049	185	4.88	5 Oct 2023
Ashford BC	3,000	70	3,070	185	4.60	5 Oct 2023
Eastleigh BC	2,000	46	2,046	184	4.60	28 Sep 2023
Eastleigh BC	3,000	72	3,072	191	4.60	5 Oct 2023
Lancashire County Council	2,000	40	2,040	107	4.50	27 Jul 2023
Moray Council	5,000	112	5,112	176	4.65	7 Sep 2023
Folkestone and Hythe DC	2,000	71	2,071	290	4.45	14 Dec 2023
Close Brothers Ltd	5,000	320	5,320	731	3.20	12 Jul 2024
Total	31,000	909.5	31,910			

Appendix B

Treasury Management Adviser – Economics Update

1. Economics update

- The first quarter of 2023/24 saw:
  - A 0.2% m/m rise in real GDP in April, partly due to fewer strikes;
  - CPI inflation falling from 10.1% to 8.7% in April, before remaining at 8.7% in May. This was the highest reading in the G7;
  - Core CPI inflation rise in both April and May, reaching a new 31-year high of 7.1%;
  - A tighter labour market in April, as the 3myy growth of average earnings rose from 6.1% to 6.5%;
  - Interest rates rise by a further 75bps over the quarter, taking Bank Rate from 4.25% to 5.00%;
  - 10-year gilt yields nearing the "mini-Budget" peaks, as inflation surprised to the upside.
- The economy has weathered the drag from higher inflation better than was widely expected. The 0.2% m/m rise in real GDP in April, following March's 0.3% m/m contraction will further raise hopes that the economy will escape a recession this year. Some of the strength in April was due to fewer strikes by train workers and teachers in that month. Moreover, some of the falls in activity in other areas in April were probably temporary too. Strikes by junior doctors and civil servants contributed to the fall in health output (0.9% m/m) and the meagre 0.1% m/m increase in public administration.
- The fall in the composite Purchasing Managers Index (PMI) from 54.0 in May to a three-month low of 52.8 in June (>50 points to expansion in the economy, <50 points to contraction) was worse than the consensus forecast of 53.6. Both the services and manufacturing PMIs fell. The decline in the services PMI was bigger (from 55.2 to 53.7), but it remains consistent with services activity expanding by an annualised 2%. The fall in the manufacturing PMI was smaller (from 47.1 to 46.2), but it is consistent with the annual rate of manufacturing output falling from -0.8% in April to around -5.0%. At face value, the composite PMI points to the 0.1% q/q rise in GDP in Q1 2023 being followed by a 0.2% q/q gain in Q2 2023.
- Meanwhile, the 0.3% m/m rise in retail sales volumes in May was far better than the consensus forecast of a 0.2% m/m decline and followed the robust 0.5% m/m rise in April. Some of the rise was due to the warmer weather. Indeed, the largest move was a 2.7% m/m jump in non-store sales, due to people stocking up on outdoor-related goods. But department stores also managed to squeeze out a 0.6% m/m rise in sales and the household goods sub-sector enjoyed a reasonable performance too. Overall, the figures were far better than analysts had expected. In addition, the GfK measure of consumer confidence rebounded from -27 to a 17-month high of -24 in June.
- The recent resilience of the economy has been due to a confluence of factors including the continued rebound in activity after the pandemic, households spending some of their pandemic savings, and the tight labour market and government handouts both supporting household incomes. That said, as government support fades, real household incomes are unlikely to grow rapidly. Furthermore, higher interest rates will mean GDP is likely to contract later this year. Our central assumption is that inflation will drop to the 2.0% target only if the Bank triggers a recession by raising rates from 5.00% now to at least 5.5% and keeps rates there until at least mid-2024. Our colleagues at Capital Economics estimate that around 60% of the drag on real activity from the rise in rates has yet to bite, and the drag on the quarterly rate of real GDP growth over the next year may be about 0.2ppts bigger than over the past year.
- The labour market became tighter over the quarter and wage growth reaccelerated. Labour demand was stronger than the consensus had expected. The three-month change in employment

rose from +182,000 in March to +250,000 in April. Meanwhile, labour supply continued to recover as the size of the labour force grew by 303,000 in the three months to April. That was supported by a further 140,000 decline in inactivity as people returned to work from retirement and caring responsibilities (while inactivity due to long-term sick continued to rise). But it was not enough to offset the big rise in employment, which meant the unemployment rate fell from 3.9% to 3.8%

- The tighter labour market supported wage growth in April, although the 9.7% rise in the National Living Wage on 1st April (compared to the 6.6% increase in April last year) probably had a lot to do with it too. The 3myy rate of average earnings growth reaccelerated from 6.1% to 6.5% (consensus 6.1%) and UK wage growth remains much faster than in the US and the Euro-zone. In addition, regular private sector wage growth increased from 7.1% 3myy to 7.6%, which left it well above the Bank's forecast for it to fall below 7.0%. Overall, the loosening in the labour market appears to have stalled in April and regular private sector wage growth was well above the Bank's forecast.
- CPI inflation stayed at 8.7% in May (consensus 8.4%) and, perhaps more worryingly, core CPI inflation rose again, from 6.8% to a new 31-year high of 7.1%. The rise in core inflation built on the leap from 6.2% in March to 6.8% and means it is accelerating in the UK while it is slowing in the US and the Euro-zone (both fell to 5.3%). A further decline in fuel inflation, from -8.9% to -13.1%, and the second fall in food inflation in as many months, from 19.3% to 18.7%, explained why overall CPI inflation didn't rise. And the scheduled fall in the average annual utility price from £2,500 to £2,074 on 1st July means overall CPI inflation will probably ease in the coming months. But the problem is that the recent surge in core inflation and the reacceleration in wage growth shows that domestic inflationary pressures are still strengthening.
- This suggests the Bank may have more work to do than the Fed or ECB. Indeed, the Bank of England sounded somewhat hawkish in the June meeting. This came through most in the MPC's decision to step up the pace of hiking from the 25bps at the previous two meetings. The 7-2 vote, with only two members voting to leave rates unchanged at 4.50%, revealed support for stepping up the fight against high inflation.
- That said, the Bank has not committed to raising rates again or suggested that 50bps rises are now the norm. What it did say was that "the scale of the recent upside surprises in official estimates of wage growth and services CPI inflation suggested a 0.5 percentage point increase in interest rates was required at this particular meeting". Moreover, the Committee did not strengthen its forward guidance that any further rate hikes would be conditional on the data. However, it looks highly probable, given the on-going strength of inflation and employment data, that the Bank will need to raise rates to at least 5.5% and to keep rates at their peak until the mid-point of 2024. We still think it is only a matter of time before the rise in rates weakens the economy sufficiently to push it into recession. That is why instead of rising to between 6.00%-6.25%, as is currently priced in by markets, we think rates are more likely to peak between 5.50-6.00%. Our forecast is also for rates to be cut in the second half of 2024, and we expect rates to then fall further than markets are pricing in.
- Growing evidence that UK price pressures are becoming increasingly domestically generated has driven up market interest rate expectations and at one point pushed the 10-year gilt yield up to 4.49% in late June, very close to its peak seen after the "mini-budget". Yields have since fallen slightly back to 4.38%. But growing expectations that rates in the UK will remain higher for longer than in the US mean they are still more than 70 bps above US yields. While higher interest rates are priced into the markets, the likely dent to the real economy from the high level of interest rates is not. That's why we think there is scope for market rate expectations to fall back in 2024 and why we expect the 10-year PWLB Certainty Rate to drop back from c5.20% to 5.00% by the end of this year and to 4.20% by the end of 2024.
- The pound strengthened from $1.24 at the start of April to a one-year high at $1.26 in early May, which was partly due to the risks from the global banking issues being seen as a bigger problem for the US than the UK. The pound then fell back to $1.23 at the end of May, before rising again to $1.28 in the middle of June as the strong core CPI inflation data released in June suggested the Bank of England was going to have to raise rates more than the Fed or ECB in order to tame domestic inflation. However, sterling's strong run may falter because more hikes in the near term to combat high inflation are likely to weaken growth (and, hopefully, at some point inflation too) to such a degree that the policy rate will probably be brought back down, potentially quite quickly, as

the economic cycle trends downwards decisively. This suggests that additional rate hikes are unlikely to do much to boost the pound.

- In early April, investors turned more optimistic about global GDP growth, pushing up UK equity prices. But this period of optimism appears to have been short-lived. The FTSE 100 has fallen by 4.8% since 21st April, from around 7,914 to 7,553, reversing part of the 7.9% rise since 17th March. Despite the recent resilience of economic activity, expectations for equity earnings have become a bit more downbeat. Nonetheless, further down the track, more rate cuts than markets anticipate should help the FTSE 100 rally.

MPC meetings 11th May and 22nd June 2023

- On 11th May, the Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 25 basis points to 4.50%, and on 22nd June moved rates up a further 50 basis points to 5.00%. Both increases reflected a split vote – seven members voting for an increase and two for none.
- Nonetheless, with UK inflation significantly higher than in other G7 countries, the MPC will have a difficult task in convincing investors that they will be able to dampen inflation pressures anytime soon. Talk of the Bank's inflation models being "broken" is perhaps another reason why gilt investors are demanding a premium relative to US and Euro-zone bonds, for example.
- Of course, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has already hiked short-term rates to a range of 5.00%-5.25%, but a further increase is pencilled in for July, whilst the ECB looks likely to raise its Deposit rate at least once more to a peak of 3.75%, with upside risk of higher to come.

2. Interest rate forecasts

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, made on 26th June, sets out a view that both short 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, against a backdrop of a stubbornly robust economy and a tight labour market.

You will note that our forecasts have steadily increased during the quarter as the data continued to spring upside surprises, and the Bank of England continued to under-estimate how prevalent inflation is, and how tight the labour market is. The Government has also noted that despite immigration increasing markedly, high levels of ill-health amongst the workforce has led to wage demands remaining strong until such time as there is a loosening in demand for business services.

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

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

Link Group Interest Rate View	24.05.23												
	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	4.75	5.00	5.00	4.75	4.50	4.00	3.50	3.25	2.75	2.50	2.50	2.50	2.50
3 month ave earnings	4.80	5.00	5.00	4.80	4.50	4.00	3.50	3.30	2.80	2.50	2.50	2.50	2.50
6 month ave earnings	5.10	5.20	5.10	4.90	4.50	3.90	3.40	3.20	2.90	2.60	2.60	2.60	2.60
12 month ave earnings	5.40	5.40	5.30	5.00	4.50	3.90	3.40	3.20	2.90	2.70	2.70	2.70	2.70
5 yr PWLB	5.00	5.00	5.00	4.80	4.50	4.10	3.70	3.50	3.30	3.20	3.20	3.10	3.10
10 yr PWLB	5.00	5.00	5.00	4.80	4.40	4.10	3.80	3.60	3.50	3.40	3.30	3.30	3.30
25 yr PWLB	5.30	5.30	5.20	5.10	4.80	4.50	4.20	4.00	3.80	3.70	3.60	3.60	3.60
50 yr PWLB	5.10	5.10	5.00	4.90	4.60	4.30	4.00	3.80	3.60	3.50	3.40	3.40	3.40

Link Group Interest Rate View	27.03.23											
	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26
BANK RATE	4.50	4.50	4.25	4.00	3.50	3.25	3.00	2.75	2.75	2.50	2.50	2.50
3 month ave earnings	4.50	4.50	4.30	4.00	3.50	3.30	3.00	2.80	2.80	2.50	2.50	2.50
6 month ave earnings	4.50	4.40	4.20	3.90	3.40	3.20	2.90	2.80	2.80	2.60	2.60	2.60
12 month ave earnings	4.50	4.40	4.20	3.80	3.30	3.10	2.70	2.70	2.70	2.70	2.70	2.70
5 yr PWLB	4.10	4.10	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20	3.20	3.10
10 yr PWLB	4.20	4.20	4.00	3.90	3.80	3.70	3.50	3.50	3.40	3.30	3.30	3.20
25 yr PWLB	4.60	4.50	4.40	4.20	4.10	4.00	3.80	3.70	3.60	3.50	3.50	3.40
50 yr PWLB	4.30	4.20	4.10	3.90	3.80	3.70	3.50	3.50	3.30	3.20	3.20	3.10

- 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 25th May and reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened to a degree, especially as it moved to a more aggressive 0.5% hike in June but, with inflation remaining elevated, we anticipate that Bank Rate will need to increase to at least 5.5%, if not higher, to sufficiently slow the UK economy and loosen the labour market.
- Moreover, 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. Our current judgment is that rates will have to increase and stay at their peak until the second quarter of 2024 as a minimum.
- 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 whether there are any further implications for Russia itself following the recent aborted mutiny by the Wagner group.
- On the positive side, consumers are still estimated to be sitting on 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 shifted upwards, especially at the shorter end of the yield curve since our previous forecast but remain relatively volatile. PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.90% to 5.60%.
- We view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the elevated inflation outlook.

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, the rising gilt yields we have seen of late).

- **The Bank of England** increases Bank Rate too fast and too far over the coming 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 broadening 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 by 0.5%, 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 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 than the market currently anticipates, pulling gilt yields up higher consequently.

- Projected **gilt issuance, inclusive of natural maturities and QT,** could be too much for the markets to comfortably digest without higher yields compensating.