South Cambridgeshire District Council

REPORT TO:	Audit & Governance	1 December 2022
LEAD CABINET MEMBER:	Councillor John Williams, Lead Cabinet Member for Finance	
LEAD OFFICER:	Peter Maddock, Head of Finance	

MID YEAR 2022/2023 TREASURY MANAGEMENT REPORT

Executive Summary

1. This report outlines the mid-year treasury management report to 30 September 2022, 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 period to 30 September 2022.

Reason for Recommendation

4. The Committee has within its terms of reference a responsibility to review Treasury Management activity and this report highlights performance for the period 1 April 2022 to 30 September 2022.

Details

Treasury Management Strategy

5. The Council's Treasury Management Strategy and prudential indicators for 2022/2023 were approved by Full Council on 22 February 2022.

6. As part of the Council's Mid-Year Review, the Treasury Management Policy Statement and Treasury Management Strategy for 2022/2023 have been reviewed with regard to their compliance to the CIPFA Prudential Code and the CIPFA Treasury Management Code. They have also been reviewed to ensure their appropriateness in light of the Council's current investment and borrowing portfolios, and the ongoing delivery of the Council service objectives and, following review, they have been found to be appropriate and there are no changes required.

7. In line with established practice, it is intended that a full review of the Treasury Management Policy and Treasury Management Strategy Statement will be presented to Cabinet and Council as part of the 2023/2024 budget determination process.

8. The economic landscape has continued with a degree of uncertainty and volatility during 2022, with the ongoing financial challenges associated with the recovery from the full effects of the Coronavirus pandemic (COVID-19) and high inflation levels. Inflation is currently at record levels and prices are still continuing to rise at nearly their fastest rate in 40 years. Inflation, as a measure of price rises, increased to 11.1% for the 12 months to the end of October up from 10.1% in the 12 months to September 2022, (based upon the Office for National Statistics (ONS) information). The chancellor, in his budget on 17th November, confirmed that the country is now in recession so we can expect a difficult few years for the UK economy.

9. In response to the prevailing economic conditions the Bank of England Base Rate has been increasing during the financial year 2022/2023. The increase to 0.75% from 17 March 2022 was followed by further increases, in response to market conditions, to 1.00% from 5 May 2022, to 1.25% from 16 June 2022, and to 1.75% from 4 August 2022. The Bank of England's Monetary Policy Committee delayed its decision on whether to raise the base rate further, due the period of national mourning following the sad death of Her Majesty Queen Elizabeth II, but further increased the rate to 2.25% when the Committee reconvened on 22 September 2022. The latest increase to 3.00% was on 3 November. The base rate influences the interest rates that lenders charge for mortgages, loans and other types of credit.

10. Whilst there is marginal benefit in terms of investment returns, local authorities have experienced unforeseen cost pressures as a result of increased energy prices, spiralling inflation, and national living wage pressures. These factors will need to be fully taken into account as part of the 2022/2023 budget setting process.

11. 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 2022 to 30 September 2022 and the associated monitoring and risk management.

12. Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the 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.

13. 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 22 February 2022 and is being reviewed as part of the 2023/2024 budget process.

Investment Activity

14. As at 30 September 2022, the Council held £157.4 million of invested funds (nominal basis), representing income received in advance of expenditure plus balances and reserves held. The Council's investment balances during 2022/2023 have averaged £153.2 million over the year to date.

15. 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.

16. The portfolio has been managed throughout 2022 on the basis that there would not be an external borrowing requirement for capital expenditure. In the period to 30 September 2022 there have been further loans of £1.3 million made to Ermine Street Housing. This has been covered by current cashflows. Projected cashflows indicate that no additional external borrowing will be required in the second half of the year. Short term borrowing began in November 2020. This has allowed the Council to increase its allocation to higher yielding Ermine Street Housing loans. The remainder of the portfolio has been held in short term liquid money market funds and fixed deposits with other Local Authorities, Banks, Building Societies and a Housing Association.

17. 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 September 2022:

Investment Counterparty	01 April 2022	New	Matured	30 Sept 2022
Short Term:	**£000**	**£000**	**£000**	**£000**
Banks – Call/Liquidity Accounts	1,885	23,072	(24,827)	130
AAA Rated Money Market Fund	2,155	136,075	(132,805)	5,425
Clearing Banks	Nil	35,000	(5,000)	20,000
Other Banks	8,000	32,000	(15,000)	25,000
UK Local Authorities	2,500	8,500	(6,000)	5,000
Building Societies	2,000	20,000	(20,000)	2,000
Housing Associations	3,500	0	(2,500)	1,000
Total Short-Term Investments	**20,040**			**58,555**

Investment Counterparty	01 April 2022	New	Matured	30 Sept 2022
Long Term:	**£000**	**£000**	**£000**	**£000**
South Cambs Ltd	94,620	1,290	0	95,910
Cambridge Leisure and Ice	2,400	0	0	2,400
Cambourne Town Council	500	0	0	500

Total Long-Term Investments	**97,520**			**98,810**

Total Investments	**117,560**			**157,365**

18. The upward movement in value of £39.8 million is due to an increase in available funds for investment purposes.

19. The most significant movements in the portfolio are an increase of £37 million placed with Clearing Banks (£20m) and Other Banks (£17m), £3.3m on Money Market Funds, £2.5m with a Local Authority suggested by the Council's broker, and a further £1.3 million loaned to Ermine Street Housing. A more detailed analysis of the investment portfolio as at 30 September 2022 is shown at **Appendix A.**

20. 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.

21. In order to achieve these objectives, the Council's portfolio is diversified. The majority of the portfolio is invested in fixed deposits where Financial Institutions return 2.01% and Ermine Street Housing returns 3.70%. Liquidity assets typically return 1.9%. This has to 30 September 2022 generated the Council a blended return of 3.06%.

22. 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 September 2022	4.30	157,365	47,130	30	153,250	3.06%
31 March 2022	4.35	117,560	11,885	10	120,141	3.20%

23. The table also shows how the Council's exposure to Bail in Risk has increased in year as the portfolio has more funds placed with Banks and Building Societies. This will reduce as balances run down during Quarter 4.

Borrowing Strategy

24. As at 30 September 2022, the Council held £205.123 million of long term debt (principal borrowed, excluding lease liabilities), no change on 31 March 2022. The Council held £50 million of short-term debt at 30 September 2022

25. 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.

26. 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

27. As at 31 March 2022 the Council had short-term local authority borrowing of £50 million in addition to £205.123 million of PWLB loans for HRA self-financing. 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 six-month period to 30 September 2022.

	01/04/2022	Maturing Debt	Interest Paid	Lease Payments	CFR Movement	30/09/2022
	£000	£000	%	£000		£000
CFR	358,666				0	358,666
Short Term Borrowing (a)	50,000	0	0.21	0		50,000
Long Term Borrowing (b)	205,123	0	3.51	0		205,123
Total Borrowing (a+b)	**255,123**	**0**	**0**	**0**		**255,123**
Other Long-Term Liabilities (c)	0	0	0	0		0
Total External Debt (a+b+c)	**255,123**	**0**	**2.86**	**0**		**255,123**

PWLB Certainty Rate and Project Rate Update

28. Authorities are required to notify the Department for Levelling Up, Housing and Communities (DLUHC) 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 2023. There is no penalty if the facility is not used.

Debt Rescheduling

29. 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.

2021/2022 Budget Monitoring

30. The Finance Team monitor and report on the Capital Financing budget on a regular basis. The latest position as at 30 September 2022 is shown in the table below:

	Current Budget	Forecast Outturn	Forecast Variance
	£000	£000	£000
Interest Payments	358	591	233
Minimum Revenue Provision	1,090	1,090	0
Total Expenditure	**1,448**	**1,681**	**233**
Investment Income	(3,648)	(4,971)	(1,062)
Commercial Property Rental Income	(2,388)	(1,589)	799
Total Income	**(6,036)**	**(6,560)**	**(524)**
Net Budget	**(4,588)**	**(4,879)**	**(291)**

31. Interest Payments are forecast to be higher than originally budgeted as Bank of England Base Rates increase in the fight against inflation. 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.

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

33. Investment Income is forecast to come in ahead of budget. 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 a slightly higher forecast outturn of £3.576 million versus original forecast of £3.476 million as Ermine Street Housing completes its acquisition programme. The income from the Commercial Property portfolio in the financial year will be lower than budgeted, in part due to vacant areas which are being marketed. The other factor is the change to the investment strategy away from acquisitions for yield to regeneration projects, due to the change in the PWLB borrowing rules meaning that we have invested less than planned. Overall, income is expected to be ahead of budget as a result of interest rates changes and lower short term borrowing balances.

External Economic Impact on Portfolio

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

35. In response to the prevailing economic conditions the Bank of England Base Rate has been increasing during the financial year 2022/2023. The increase to 0.75% from 17 March 2022 was followed by further increases to 1.00% (from 5 May 2022), 1.25% (from 16 June 2022), 1.75% (from 4 August 2022) and 2.25% (from 22 September 2022). At the latest meeting (3 November 2022) the rate was increased to 3%. This has increased the return on the Council's Money Market Fund holdings and on maturing deposits when reinvested.

Compliance with Performance Indicators

36. The Council has been compliant with the 2022/2023 Prudential Indicators approved by Full Council on 22 February 2022.

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

38. Performance against prudential indicators in 2022/2023 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	45,000
Local Authorities	>12 Months <2 years	5,000

PWLB	10 – 15 years	15,000
PWLB	15 – 20 years	50,000
PWLB	20 – 25 years	50,000
PWLB	25 – 30 years	50,000
PWLB	30 – 35 years	40,123

(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
Places for People[1]	N/A	730 days	1,000

[1] Not assessed by the Council's appointed Treasury Advisers

(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 September
Long term (>1yr)		
Ermine St Housing	95,910	61
CLIC + Cambourne Town Council	2,900	2
Other Banks	5,000	3
Total Long term	**103,810**	**66**
Short term (<365 days)		
Banks (Clearing)	20,130	13
Other Banks	20,000	13
Building Societies	2,000	1
Housing Assoc.	1,000	1
Local Authorities	5,000	3
Money Market Funds	5,425	3
Short Term (Working Cash Balance)	**53,555**	**34**

<u>Outlook for Quarter 4 2022/2023</u>

39. The Council will continue to make further loans to Ermine Street Housing. The Council will receive minimal receipts from Council Tax and National Non-Domestic Rates during February and March 2023. The expected outturn on short term borrowing is £40 million.

40. The view is that the UK economy still faces a challenging outlook as the Government continues to respond to the ongoing financial pressures associated with high inflation levels.

Implications

41. 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

42. 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.

43. 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

44. 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

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

Risks

46. There are no specific risk implications associated with the recommendations contained in this report.

Environmental

47. There are no specific environmental implications associated with the recommendations contained in this report.

Equality and Diversity

48. In preparing this report, due consideration has been given to the Council's statutory Equality Duty to eliminate unlawful discrimination, advance equality of opportunity and foster good relations, as set out in Section 149(1) of the Equality Act 2010.

49. A relevance test for equality has determined that the activity has no relevance to South Cambridgeshire District Council's statutory equality duty to eliminate unlawful discrimination, advance equality of opportunity and foster good relation. An equality impact assessment is not needed.

Effect on Council Priority Areas

50. 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:

- at all reasonable hours at the offices of South Cambridgeshire District Council;
- on the Council's website; and
- 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: 6 September 2021
- Medium Term Financial Strategy – Report to Council: 23 September 2021
- General Fund Budget – Report to Cabinet: 2 February 2022
- General Fund Budget – Report to Council: 22 February 2022
- Treasury Management Strategy – Report to Cabinet: 2 February 2022
- Treasury Management Strategy – Report to Council: 22 February 2022

Appendices

A Schedule of Investments as at 30 September 2022

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

Report Authors: Peter Maddock – Head of Finance
e-mail: peter.maddock@scambs.gov.uk

Daniel Hasler – Accountancy Assistant
e-mail: daniel.hasler@scambs.gov.uk

Appendix A – Schedule of Investments as at 30 September 2022

	Amount	Interest	Total	Term	Rate	Maturity Date
	£000	£000	£000	Days	%	
Counterparty						
Barclays FIBCA (Call ac)	130		130	Overnight	1.4	01/10/2022
Federated (MMF)	5,425		5,425	T+1	2.08	01/10/2022
Santander	10,000	59.616	10,060	170	1.28	06/10/2022
SMBC Bank International	2,000	12.389	2,012	170	1.33	06/10/2022
Goldman Sachs Int. Bank	5,000	33.068	5,033	170	1.42	06/10/2022
Standard Chartered	2,000	15.342	2,015	175	1.60	10/11/2022
Standard Chartered	5,000	38.356	5,038	175	1.60	10/11/2022
Nationwide	2,000	9.727	2,010	97	1.83	10/11/2022
Places for People	1,000	12.832	1,012	551	0.85	28/11/2022
Lloyds	5,000	46.861	5,047	189	1.81	14/12/2022
Wirral Borough Council	5,000	29.675	5,030	87	2.49	22/12/2022
Lloyds	3,000	38.117	3,038	187	2.48	31/01/2023
Standard Chartered	2,000	29.438	2,048	175	3.07	23/02/2023
Standard Chartered	1,000	14.719	1,015	175	3.07	23/02/2023
SMBC Bank International	3,000	41.281	3,041	175	2.87	23/02/2023
Lloyds	2,000	29.822	2,030	175	3.11	23/02/2023
Close Brothers	5,000	320.438	5,320	551	3.20	12/07/2024
Ermine Street Housing	90,858				3.85	Various
Ermine Street Housing	5,052				1.00	Various
Cambridge Leisure & Ice	2,400			25 Years	4.31	31/03/2043
Cambourne Town Council[1]	500					TBC
Total	157,365					

[1] Interest will be charged when the loan is repaid and will be at an equivalent rate to that required to recoup the Council's debt management costs in relation to this loan.

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

Economics update

- The second quarter of 2022/23 saw:

  - GDP revised upwards in Q1 2022/23 to +0.2% q/q from -0.1%, which means the UK economy has avoided recession for the time being;

  - Signs of economic activity losing momentum as production fell due to rising energy prices;

  - CPI inflation ease to 9.9% y/y in August, having been 9.0% in April, but domestic price pressures showing little sign of abating in the near-term;

  - The unemployment rate fall to a 48-year low of 3.6% due to a large shortfall in labour supply;

  - Bank Rate rise by 100bps over the quarter, taking Bank Rate to 2.25% with further rises to come;

  - Gilt yields surge and sterling fall following the "fiscal event" of the new Prime Minister and Chancellor on 23rd September.

- The UK economy grew by 0.2% q/q in Q1 2022/23, though revisions to historic data left it below pre-pandemic levels.

- There are signs of higher energy prices creating more persistent downward effects in economic activity. Both industrial production (-0.3% m/m) and construction output (-0.8% m/m) fell in July 2022 for a second month in a row. Although some of this was probably due to the heat wave at the time, manufacturing output fell in some of the most energy intensive sectors (e.g., chemicals), pointing to signs of higher energy prices weighing on production. With the drag on real activity from high inflation having grown in recent months, GDP is at risk of contracting through the autumn and winter months.

- The fall in the composite PMI from 49.6 in August to a 20-month low preliminary reading of 48.4 in September points to a fall in GDP of around 0.2% q/q in Q3 and consumer confidence is at a record low. Retail sales volumes fell by 1.6% m/m in August, which was the ninth fall in 10 months. That left sales volumes in August just 0.5% above their pre-Covid level and 3.3% below their level at the start of the year. There are also signs that households are spending their excess savings in response to high prices. Indeed, cash in households' bank accounts rose by £3.2bn in August, which was below the £3.9bn rise in July and much smaller than the 2019 average monthly rate of £4.6bn.

- The labour market remained exceptionally tight. Data for July and August provided further evidence that the weaker economy is leading to a cooling in labour demand. Labour Force Survey (LFS) employment rose by 40,000 in the three months to July (the smallest rise since February). But a renewed rise in inactivity of 154,000 over the same period meant that the unemployment rate fell from 3.8% in June to a new 48-year low of 3.6%. The single-month data showed that inactivity rose by 354,000 in July itself and there are now 904,000 more inactive people aged 16+ compared to before the pandemic in February 2020. The number of vacancies has started to level off from recent record highs but there have been few signs of a slowing in the upward momentum on wage growth. Indeed, in July, the 3my/y rate of average earnings growth rose from 5.2% in June to 5.5%.

- CPI inflation eased from 10.1% in July to 9.9% in August, though inflation has not peaked yet. The easing in August was mainly due to a decline in fuel prices reducing fuel inflation from 43.7% to 32.1%. And with the oil price now just below $90pb, we would expect to see fuel prices fall further in the coming months.

- However, utility price inflation is expected to add 0.7% to CPI inflation in October when the Ofgem unit price cap increases to, typically, £2,500 per household (prior to any benefit payments). But, as

the government has frozen utility prices at that level for two years, energy price inflation will fall sharply after October and have a big downward influence on CPI inflation.

- Nonetheless, the rise in services CPI inflation from 5.7% y/y in July to a 30-year high of 5.9% y/y in August suggests that domestic price pressures are showing little sign of abating. A lot of that is being driven by the tight labour market and strong wage growth. CPI inflation is expected to peak close to 10.4% in November and, with the supply of workers set to remain unusually low, the tight labour market will keep underlying inflationary pressures strong until early next year.
- During H1 2022, there has been a change of both Prime Minister and Chancellor. The new team (Liz Truss and Kwasi Kwarteng) have made a step change in government policy. The government's huge fiscal loosening from its proposed significant tax cuts will add to existing domestic inflationary pressures and will potentially leave a legacy of higher interest rates and public debt. Whilst the government's utility price freeze, which could cost up to £150bn (5.7% of GDP) over 2 years, will reduce peak inflation from 14.5% in January next year to 10.4% in November this year, the long list of tax measures announced at the "fiscal event" adds up to a loosening in fiscal policy relative to the previous government's plans of £44.8bn (1.8% of GDP) by 2026/27. These included the reversal of April's national insurance tax on 6th November, the cut in the basic rate of income tax from 20p to 19p in April 2023, the cancellation of next April's corporation tax rise, the cut to stamp duty and the removal of the 45p tax rate, although the 45p tax rate cut announcement has already been reversed.
- Fears that the government has no fiscal anchor on the back of these announcements has meant that the pound has weakened again, adding further upward pressure to interest rates. Whilst the pound fell to a record low of $1.035 on the Monday following the government's "fiscal event", it has since recovered to around $1.12. That is due to hopes that the Bank of England will deliver a very big rise in interest rates at the policy meeting on 3rd November and the government will lay out a credible medium-term plan in the near term. This was originally expected as part of the fiscal statement on 23rd November but has subsequently been moved forward to an expected release date in October. Nevertheless, with concerns over a global recession growing, there are downside risks to the pound.
- The MPC has now increased interest rates seven times in as many meetings in 2022 and has raised rates to their highest level since the Global Financial Crisis. Even so, coming after the Fed and ECB raised rates by 75 basis points (bps) in their most recent meetings, the Bank of England's latest 50 basis points hike looks relatively dovish. However, the UK's status as a large importer of commodities, which have jumped in price, means that households in the UK are now facing a much larger squeeze on their real incomes.
- Since the fiscal event on 23rd September, we now expect the Monetary Policy Committee (MPC) to increase interest rates further and faster, from 2.25% currently to a peak of 5.00% in February 2023. The combination of the government's fiscal loosening, the tight labour market and sticky inflation expectations means we expect the MPC to raise interest rates by 100bps at the policy meetings in November (to 3.25%) and 75 basis points in December (to 4%) followed by further 50 basis point hikes in February and March (to 5.00%). Market expectations for what the MPC will do are volatile. If Bank Rate climbs to these levels the housing market looks very vulnerable, which is one reason why the peak in our forecast is lower than the peak of 5.50% - 5.75% priced into the financial markets at present.
- Throughout 2022/23, gilt yields have been on an upward trend. They were initially caught up in the global surge in bond yields triggered by the surprisingly strong rise in CPI inflation in the US in May. The rises in two-year gilt yields (to a peak of 2.37% on 21st June) and 10-year yields (to a peak of 2.62%) took them to their highest level since 2008 and 2014 respectively. However, the upward trend was exceptionally sharply at the end of September as investors demanded a higher risk premium and expected faster and higher interest rate rises to offset the government's extraordinary fiscal stimulus plans. The 30-year gilt yield rose from 3.60% to 5.10% following the "fiscal event", which threatened financial stability by forcing pension funds to sell assets into a falling market to meet cash collateral requirements. In response, the Bank did two things. First, it postponed its plans to start selling some of its quantitative easing (QE) gilt holdings until 31st October. Second, it committed to buy up to £65bn of long-term gilts to "restore orderly market conditions" until 14th October. In other words, the Bank is restarting QE, although for financial stability reasons rather than monetary policy reasons.

- Since the Bank's announcement on 28th September, the 30-year gilt yield has fallen back from 5.10% to 3.83%. The 2-year gilt yield dropped from 4.70% to 4.30% and the 10-year yield fell back from 4.55% to 4.09%.
- There is a possibility that the Bank continues with QE at the long-end beyond 14th October or it decides to delay quantitative tightening beyond 31st October, even as it raises interest rates. So far at least, investors seem to have taken the Bank at its word that this is not a change in the direction of monetary policy nor a step towards monetary financing of the government's deficit. But instead, that it is a temporary intervention with financial stability in mind.
- After a shaky start to the year, the S&P 500 and FTSE 100 climbed in the first half of Q2 2022/23 before falling to their lowest levels since November 2020 and July 2021 respectively. The S&P 500 is 7.2% below its level at the start of the quarter, whilst the FTSE 100 is 5.2% below it as the fall in the pound has boosted the value of overseas earnings in the index. The decline has, in part, been driven by the rise in global real yields and the resulting downward pressure on equity valuations as well as concerns over economic growth leading to a deterioration in investor risk appetite.

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 on 27th September 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, whilst the government is providing a package of fiscal loosening to try and protect households and businesses from the ravages of ultra-high wholesale gas and electricity prices.

The increase in PWLB rates reflects a broad sell-off in sovereign bonds internationally but more so the disaffection investors have with the position of the UK public finances after September's "fiscal event". To that end, the MPC has tightened short-term interest rates with a view to trying to slow the economy sufficiently to keep the secondary effects of inflation – as measured by wage rises – under control, but its job is that much harder now.

Our PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps, calculated as gilts plus 80bps) which has been accessible to most authorities since 1st November 2012.

Link Group Interest Rate View	27.09.22											
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
BANK RATE	4.00	5.00	5.00	5.00	4.50	4.00	3.75	3.25	3.00	2.75	2.75	2.50
3 month ave earnings	4.50	5.00	5.00	5.00	4.50	4.00	3.80	3.30	3.00	2.80	2.80	2.50
6 month ave earnings	4.70	5.20	5.10	5.00	4.60	4.10	3.90	3.40	3.10	3.00	2.90	2.60
12 month ave earnings	5.30	5.30	5.20	5.00	4.70	4.20	4.00	3.50	3.20	3.10	3.00	2.70
5 yr PWLB	5.00	4.90	4.70	4.50	4.20	3.90	3.70	3.50	3.40	3.30	3.20	3.20
10 yr PWLB	4.90	4.70	4.60	4.30	4.10	3.80	3.60	3.50	3.40	3.30	3.20	3.20
25 yr PWLB	5.10	4.90	4.80	4.50	4.30	4.10	3.90	3.70	3.60	3.60	3.50	3.40
50 yr PWLB	4.80	4.60	4.50	4.20	4.00	3.80	3.60	3.40	3.30	3.30	3.20	3.10