South
Cambridgeshire
District Council

Report to:	Audit & Corporate Governance 19 March 2024
Lead Cabinet Member:	Councillor John Williams Lead Cabinet Member for Resources
Lead Officer:	Peter Maddock, Head of Finance

TREASURY MANAGEMENT PERFORMANCE REPORT: QUARTER ENDING 31 DECEMBER 2023

Executive Summary

1. This report outlines the performance against the Council's approved Treasury Management Strategy for first nine 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 31 December 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 31 December 2023.

Details

Treasury Management Strategy

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 2021 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 2023/24 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 31 December 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, a full review of the Treasury Management Policy and Treasury Management Strategy Statement has been presented to Cabinet and Council as part of the 2024/2025 budget determination process. It is further 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 this Committee at its scheduled meeting in November 2024.

12. The economic landscape has continued with uncertainty during the quarter period to 31 December 2023, with the ongoing financial challenges associated with the cost-of-living crisis in the UK and across the world, particular food, and energy prices. This is partly in response to the conflict in Ukraine and global recovery from the coronavirus (COVID-19) pandemic and high inflation levels acting as a dampener on growth and impacting on Council services. Consumer Price Index (CPI) inflation, as a measure of price rises, increased by 4.0% in the 12 months to December 2023, up from 3.9% in November and the first time the rate has increased since February 2023 (based upon the Office for National Statistics (ONS) information).

13. The prospects for economic growth appear limited and a cautious approach is being maintained given the level of uncertainty. It is expected that this trend will continue for the immediate future and it will, therefore, remain a priority to include the consequences of these prevailing trends in the Council's cash flow planning.

14. In response to the prevailing economic conditions the Bank of England Base Rate has been increasing during the financial year 2023/2024. The increase by 0.25%, to 4.25% from 23 March 2023 was followed by further increases, in response to market conditions, to 4.5% from 11 May 2023, to 5% from 22 June 2023, and to 5.25% from 03 August 2023. The base rate influences the interest rates that lenders charge for mortgages, loans and other types of credit.

Investment Activity

15. As at 31 December 2023, the Council held £130.2 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 31 December 2023, have averaged £134.9 million.

16. 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.

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 31 December 2023:

Investment Counterparty	01 April 2023	New	Matured	31 Dec 2023
Short Term:	**£000**	**£000**	**£000**	**£000**
Banks – Call/Liquidity Accounts	2,595	67,055	-67,955	1,695
AAA Rated Money Market Fund	2,365	225,780	-227,520	625
Clearing Banks	7,000		-7,000	Nil
Other Banks	5,000	20,000	-11,000	14,000
UK Local Authorities	19,000	62,000	-70,000	11,000
Building Societies	Nil			Nil
Housing Associations	Nil			Nil
Total Short-Term Investments	**35,960**			**27,320**

Investment Counterparty	01 April 2023	New	Matured	31 Dec 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**			**130,220**

18. The downward movement in value of £8.6 million is due to expenditure on New Build Schemes and the early payment in full of the A14 contribution that saved the Council £2.35 million over a period of 25 years.

19. The most significant movements in the portfolio are an increase of £9 million placed on Other Banks (£14m), and a decrease of £8 million on Local Authorities (£11m). A more detailed analysis of the investment portfolio as at 31December 2023 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 with Financial Institutions which return 5.06% and Ermine Street Housing which returns 4.25%. Liquidity assets typically returned 5.36% over the quarter. This has to 31 December 2023 generated the Council a blended return of 4.42%.

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	%		
31 December 2023	3.30	127,320	15,695	12.3	134,881	4.42%
31 March 2023	2.70	138,860	12,000	8.6	147,898	4.21%

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. This will reduce as balances run down during subsequent quarter periods.

Borrowing Strategy

24. As at 30 December 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 £29 million of short-term debt at 31 December 2023.

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 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.

28. The table below sets out the movement in the Council's borrowing over the year to date. The Capital Financing Requirement (CFR) is reduced in the nine-month period to 31 December 2023 to reflect the Minimum Revenue Provision (MRP).

	01/04/2023	**Maturing Debt**	**Interest Paid**	**Lease Payments**	**CFR Movement**	**31/12/2023**
	£000	**£000**	**%**	**£000**		**£000**
CFR	329,356				(936)	328,420
Short Term Borrowing (a)	40,000	(11,000)	2.15			29,000
Long Term Borrowing (b)	205,123		3.51			205,123
Total Borrowing (a+b)	245,123					234,123
Other Long-Term Liabilities (c)	0					0
Total External Debt (a+b+c)	245,123					234,123

PWLB Certainty Rate and Project Rate Update

29. 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

30. 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

31. The Finance Team monitor and report on the Capital Financing budget on a regular basis. The latest position as at 31 December 2023 is shown in the table below:

	Current Budget	**Forecast Outturn**	**Forecast Variance**

	£000	£000	£000
Interest Payments	1,225	1,183	(42)
Minimum Revenue Provision	936	936	0
Total Expenditure	2,161	2,119	(42)
Investment Income	(5,879)	(5,919)	(40)
Commercial Property Rental Income (Net)	(1,528)	(1,528)	Nil
Total Income	(7,408)	(7,447)	(40)
Net Budget	(5,247)	(5,328)	(82)

32. 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. There will be long-term borrowing obtained for the HRA during Quarter 4 to fund the Affordable Homes New Build Programme. It is expected to borrow £12 million during March 2024.

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

34. Investment Income is forecast to come in above 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 a forecast outturn of £4.25 million as Ermine Street Housing completes its acquisition programme. The income from the Commercial Property portfolio in the financial year is in line with the estimate. Overall, income is expected to be ahead of budget as a result of interest rates and lower short-term borrowing balances.

External Economic Impact on Portfolio

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

36. The Bank of England Base Rate of 4.25%, that applied effective from 23 March 2023, has increased several times during the year in response to market conditions (to 4.5% from 11 May 2023, then to 5% from 22 June 2023) before reaching its current level of 5.25% from 3 August 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

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

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

39. 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	19,000
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	2 yrs	5,000

[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 as at 31 December 2023
Long term (>1yr)		
Ermine St Housing	100,000	77
CLIC + Cambourne Town Council	2,900	2

Other Banks	5,000	3.5
Total Long term	107,900	
Short term (<365 days)		
Banks (Clearing)	1,695	3
Other Banks	9,000	3
Building Societies	Nil	0
Housing Assoc.	Nil	0
Local Authorities	11,000	9
Money Market Funds	625	0.5
Short Term (Working Cash Balance)	22,320	

Outlook for Quarter 3: 2023/2024

40. The Council will continue to use fixed term deposits and money market funds to manage cashflow. The Council investment balances increased in Quarter 3 and deposits have been timed to mature in Quarter 4 to cover the period of low receipts. The expected outturn on short term borrowing is £45 million.

41. 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

42. 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

43. 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.

44. 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

45. 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 (2021 edition) have been used in the preparation of this report.

Finance

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

Risk/Opportunities

47. 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.

48. 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.

49. 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

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

Consultation Responses

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

Alignment with Council Priority Areas

52. 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: 7 November 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
- Treasury Management Strategy – Report to Cabinet: 6 February 2024
- Treasury Management Strategy – Report to Council: 27 February 2024

Appendices

A Schedule of Investments as at 31 December 2023

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

	Amount £000	Interest £000	Total £000	Term Days	Rate %	Maturity Date
Counterparty						
LB of Barking & Dagenham	2,000	27	2,027	91	5.40	15 Jan 2024
SMBC International	1,000	20	1,020	129	5.67	22 Jan 2024
SMBC International	3,000	64	3,064	138	5.66	22 Jan 2024
SMBC International	1,000	16	1,016	104	5.46	22 Jan 2024
Liverpool City Council	2,000	22	2,022	73	5.40	22 Jan 2024
Goldman Sachs International Bank	2,000	60	2,060	189	5.80	19 Feb 2024
Lloyds Bank Commercial Markets	2,000	42	2,042	137	5.56	19 Feb 2024
Cheshire East	5,000	90	5,090	120	5.49	22 Feb 2024
Blackpool Council	2,000	29	2,029	97	5.45	22 Feb 2024
Close Brothers	5,000	320	5,320	731	3.20	12 Jul 2024
Total	25,000	690	25,690			

Appendix B

Treasury Management Adviser – Economics Update

1. Economics update

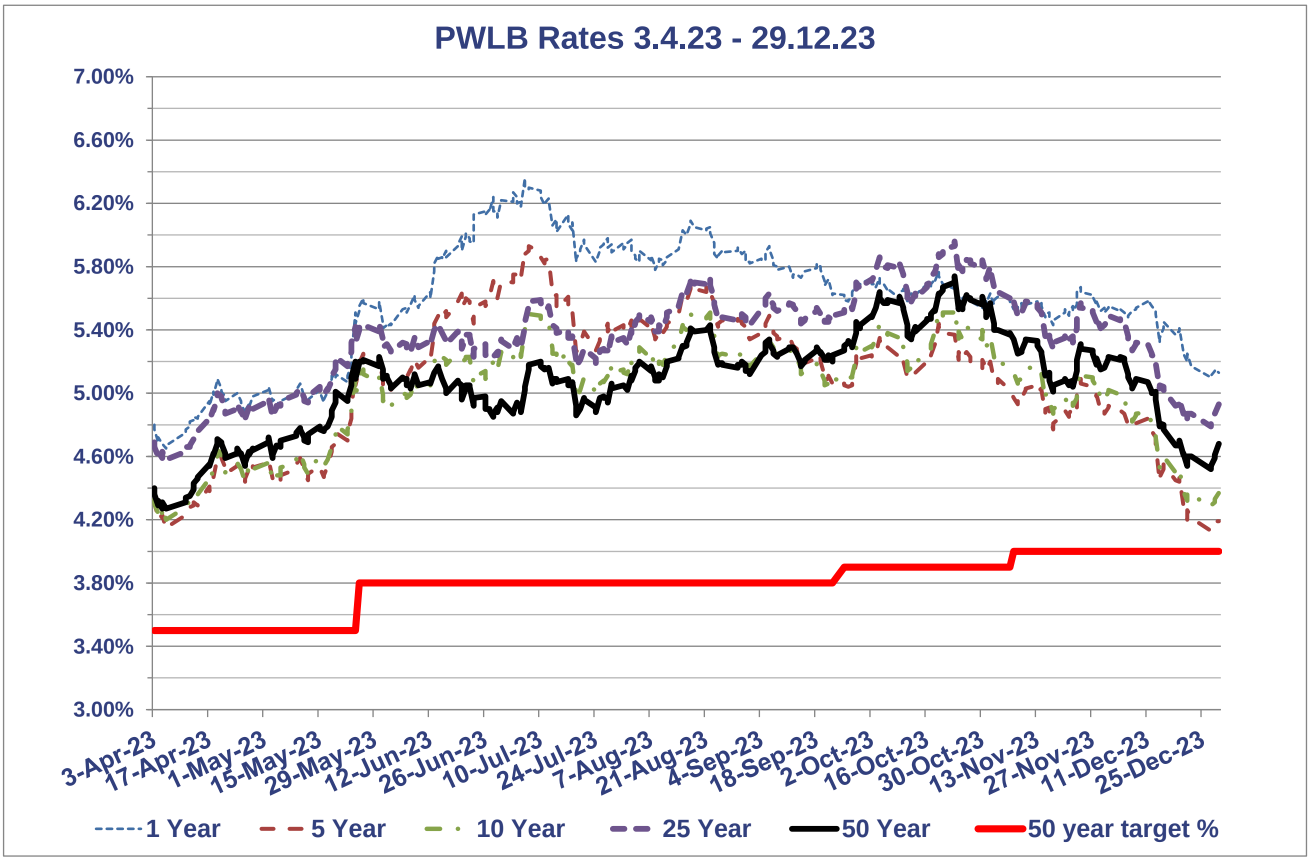
- The third quarter of 2023/24 saw:
  - A 0.3% m/m decline in real GDP in October, potentially partly due to unseasonably wet weather, but also due to the ongoing drag from higher interest rates. Growth for the second quarter, ending 30th September, was revised downwards to -0.1% and growth on an annual basis was also revised downwards, to 0.3%;
  - A sharp fall in wage growth, with the headline 3myy rate declining from 8.0% in September to 7.2% in October, although the ONS “experimental” rate of unemployment has remained low at 4.2%;
  - CPI inflation continuing on its downward trajectory, from 8.7% in April to 4.6% in October, then again to 3.9% in November;
  - Core CPI inflation decreasing from April and May’s 31 years’ high of 7.1% to 5.1% in November, the lowest rate since January 2022;
  - The Bank of England holding rates at 5.25% in November and December;
  - A steady fall in 10-year gilt yields as investors revised their interest rate expectations lower.
- The revision of GDP data in Q2 to a 0.1% q/q fall may mean the mildest of mild recessions has begun. Indeed, real GDP in October fell 0.3% m/m which does suggest that the economy may stagnate again in Q3. The weakness in October may partly be due to the unseasonably wet weather. That said, as the weakness was broad based it may also be the case that the ongoing drag from higher interest rates is more than offsetting any boost from the rise in real wages.
- However, the rise in the flash composite activity Purchasing Managers Index, from 50.7 in November to 51.7 in December, did increase the chances of the economy avoiding a contraction in Q3. The improvement was entirely driven by the increase in the services activity balance from 50.9 to 52.7. (Scores above 50 point to expansion in the economy, although only tepid in this instance.) The press release noted that this was primarily driven by a revival in consumer demand in the technological and financial services sectors. This chimes with the further improvement in the GfK measure of consumer confidence in December, from -24 to -22. The services PMI is now consistent with non-retail services output growing by 0.5% q/q in Q3, but this is in stark contrast to the manufacturing sector where the output balance slumped from 49.2 to 45.9 and, at face value, the output balance is consistent with a 1.5% q/q fall in manufacturing output in Q3.
- The 0.3% m/m fall in retail sales volumes in October means that after contracting by 1.0% q/q (which was downwardly revised from -0.8% q/q) in Q2, retail activity remained weak at the start of Q3. That suggests higher interest rates are taking a bigger toll on real consumer spending.
- Higher interest rates have filtered through the financial channels and weakened the housing market but, overall, it remains surprisingly resilient with only marginal falls showing year on year on the Halifax (-1%) and Nationwide (-1.8%) indices. However, the full weakness in real consumer spending and real business investment has yet to come as currently it is estimated that around two thirds to a half of the impact of higher interest rates on household interest payments has yet to be felt.
- Overall, we expect real GDP growth to remain subdued throughout 2024 as the drag from higher interest rates is protracted but a fading of the cost-of-living crisis and interest rate cuts in the second half of 2024 will support a recovery in GDP growth in 2025.
- The labour market remains tight by historical standards, but the sharp fall in wage growth seen in October will reinforce the growing belief in markets that interest rates will be cut mid-2024. Wage growth eased in October much faster than the consensus expected. Total earnings fell by 1.6%

m/m, which meant the headline 3myy rate eased from 8.0% in September to 7.2% in October. This news will be welcomed by the Bank of England. Indeed, the timelier three-month annualised rate of average earnings growth fell from +2.4% to -1.2%. Excluding bonuses, it fell from 5.3% to 2.0%. Furthermore, one of the Bank's key barometers of inflation persistence, regular private sector pay growth, dropped from 7.9% 3myy to 7.3%, which leaves it comfortably on track to fall to 7.2% by December, as predicted by the Bank in November.

- The fall in wage growth occurred despite labour demand being stronger in October than expected. The three-month change in employment eased only a touch from +52,000 in September to +50,000 in October. But resilient labour demand was offset by a further 63,000 rise in the supply of workers in the three months to October. That meant labour supply exceeded its pre-pandemic level for the first time, and the unemployment rate remained at 4.2% in October. In the three months to November, the number of job vacancies fell for the 17th month in a row, from around 959,000 in October to around 949,000. That has reduced the vacancy to unemployment ratio as demand for labour eases relative to supply, which may support a further easing in wage growth in the coming months.
- CPI inflation fell from 6.7% in September to 4.6% in October, and then again to 3.9% in November. Both these falls were bigger than expected and there are clear signs of easing in domestic inflationary pressures. The fall in core CPI inflation from 5.7% to 5.1% in November was bigger than expected (consensus forecast 5.6%). That's the lowest rate since January 2022. Some of the decline in core inflation was due to the global influence of core goods inflation, which slowed from 4.3% to 3.3%. But some of it was due to services inflation falling from 6.6% to 6.3%. The Bank views the latter as a key barometer of the persistence of inflation and it came in further below the Bank's forecast of 6.9% in its November Monetary Policy Report. This will give the Bank more confidence that services inflation is now on a firmly downward path.
- The Bank of England sprung no surprises with its December monetary policy committee (MPC) meeting, leaving interest rates at 5.25% for the third time in a row and pushing back against the prospect of near-term interest rate cuts. The Bank continued to sound hawkish, with the MPC maintaining its tightening bias saying that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures". And it stuck to the familiar script, saying that policy will be "sufficiently restrictive for sufficiently long" and that "monetary policy is likely to need to be restrictive for an extended period of time". In other words, the message is that the MPC is not yet willing to endorse investors' expectations that rates will be cut as soon as May 2024.
- Looking ahead, our colleagues at Capital Economics forecast that the recent downward trends in CPI and core inflation will stall over the next few months before starting to decline more decisively again in February. That explains why we think the Bank of England won't feel comfortable cutting interest rates until H2 2024.
- The fall in UK market interest rate expectations in December has driven most of the decline in 10-year gilt yields, which have fallen in line with 10-year US Treasury and euro-zone yields. 10-year gilt yields have fallen from 4.68% in October 2023 to around 3.70% at the time of writing, with further declines likely if the falling inflation story is maintained.
- Investors' growing expectations that the Fed will cut interest rates soon has led to an improvement in risk sentiment, which has boosted the pound and other risky assets. In addition, the rise in the pound, from $1.21 in November to $1.27 now, has also been supported by the recent relative decline in UK wholesale gas prices.
- The further fall in 10-year real gilt yields in December has supported the recent rise in the FTSE 100. That said, the index remains 5% below its record high in February. This modest rise in equities appears to have been mostly driven by strong performances in the industrials and rate-sensitive technology sectors. But UK equities have continued to underperform US and euro-zone equities. The FTSE 100 has risen by 2.2% in December, while the S&P 500 has risen by 3.8%. This is partly due to lower energy prices, which have been a relatively bigger drag on the FTSE 100, due to the index's high concentration of energy companies.

In the chart below, the rise in gilt yields across the curve in the first half of 2023/24, and therein PWLB rates, is clear to see, prior to the end of year rally based on a mix of supportive domestic and international factors.

PWLB RATES 3.4.23 - 29.12.23



MPC meetings 2nd November and 14th December 2023

- On 2nd November, the Bank of England's Monetary Policy Committee (MPC) voted to keep Bank Rate on hold at 5.25%, and on 14th December reiterated that view. Both increases reflected a split vote, the latter by 6 votes to 3, with the minority grouping voting for an increase of 0.25% as concerns about "sticky" inflation remained in place.
- Nonetheless, with UK CPI inflation now at 3.9%, and core inflating beginning to moderate (5.1%), markets are voicing a view that rate cuts should begin in Q1 2024/25, some way ahead of the indications from MPC members. Of course, the data will be the ultimate determinant, so upcoming publications of employment, wages and inflation numbers will be of particular importance, and on-going volatility in Bank Rate expectations and the gilt yield curve can be expected.
- In addition, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has kept short-term rates in the range of 5.25%-5.50%, whilst the ECB has moved its Deposit rate to a probable peak of 4%. Markets currently expect both central banks to start cutting rates in 2024.

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.

Link Group Interest Rate View	07.11.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.25	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.30	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.40	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.50	3.30	3.30	3.30	3.30	3.30
5 yr PWLB	5.00	4.90	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.60	3.50	3.50	3.50
10 yr PWLB	5.10	5.00	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.70	3.60	3.60	3.50
25 yr PWLB	5.50	5.30	5.10	4.90	4.70	4.50	4.30	4.20	4.10	4.10	4.00	4.00	4.00
50 yr PWLB	5.30	5.10	4.90	4.70	4.50	4.30	4.10	4.00	3.90	3.90	3.80	3.80	3.80

Link Group Interest Rate View	25.09.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.00	2.75	2.75	2.75	2.75	2.75
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.00	2.80	2.80	2.80	2.80	2.80
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.10	2.90	2.90	2.90	2.90	2.90
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.20	3.00	3.00	3.00	3.00	3.00
5 yr PWLB	5.10	5.00	4.90	4.70	4.40	4.20	4.00	3.90	3.70	3.70	3.60	3.60	3.50
10 yr PWLB	5.00	4.90	4.80	4.60	4.40	4.20	4.00	3.80	3.70	3.60	3.60	3.50	3.50
25 yr PWLB	5.40	5.20	5.10	4.90	4.70	4.40	4.30	4.10	4.00	3.90	3.80	3.80	3.80
50 yr PWLB	5.20	5.00	4.90	4.70	4.50	4.20	4.10	3.90	3.80	3.70	3.60	3.60	3.60

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

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 7th November and reflected a view that the MPC would be keen to underpin its anti-inflation credentials by keeping Bank Rate at 5.25% until at least H2 2024. We expect rate cuts to start when both the CPI inflation and wage/employment data are unequivocally supportive of such a move, and that there is a strong likelihood of the overall economy enduring tepid growth (at best) or a mild recession (at worst) over the coming months.

- Naturally, timing on this matter will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

- In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine, and Gaza and Israel.

- On the positive side, consumers are still anticipated to be sitting on some excess savings left over from the pandemic, which could cushion some of the impact of the above challenges and may be the reason why the economy is performing a little better at this stage of the economic cycle than may have been expected. Nonetheless, with approximately 400,000 households per quarter facing a mortgage interest reset at higher levels than their current rate, the economy will face on-going headwinds from that source, in addition to lower income households having to spend disproportionately on essentials such as food, energy and rent payments.

PWLB RATES

- As illustrated in the charts in section 1, gilt yields have endured a volatile nine months with yields rising significantly on the back of inflation concerns before retracing much of those increases in November and December. With the market now anticipating rate cuts by H2 2024, the short and medium parts of the curve are now close to where they started 2023/24, but the longer part of the curve is still a little higher. At the time of writing there is c50 basis points difference between the 5 and 50 year parts of the curve.

The balance of risks to the UK economy: -

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

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

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, could keep gilt yields high for longer).

- **The Bank of England** has increased Bank Rate too fast and too far over recent months, and subsequently brings about a deeper and longer UK recession than we currently anticipate.

- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- **Geopolitical risks,** for example in Ukraine/Russia, the Middle East, China/Taiwan/US, Iran and North Korea, which could lead to increasing safe-haven flows.

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

- Despite the recent tightening to 5.25%, the **Bank of England proves too timid** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to remain elevated for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project.

- **The pound weakens** because of a lack of confidence in the UK Government's pre-election fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.

- Longer-term **US treasury yields** rise strongly if inflation remains more stubborn there than the market currently anticipates, consequently pulling gilt yields up higher.

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