

Report To: Audit and Standards Committee

Date: 16 January 2023

Report Title: Treasury Management

Report of: Director of Finance and Performance

Ward(s): All

Purpose of report: To present details of recent Treasury Management activity.

Officer Recommendations: To note and recommend that Cabinet accepts that Treasury Management Activity for the period 1 November to 31 December 2022 has been in accordance with the approved Treasury Strategies.

Reasons for recommendations: Requirement of CIPFA Treasury Management in the Public Sector Code of Practice (the Code) and this has to be reported to Full Council.

Contact Officer(s): Name: Ola Owolabi
Post title: Deputy Chief Finance Officer
E-mail: ola.owolabi@lewes-eastbourne.gov.uk
Telephone number: 01273 485083

1. Introduction

- 1.1 The Council's approved Treasury Strategy Statement requires the Audit and Standards Committee to review details of Treasury Strategy transactions against the criteria set out in the Strategy and make observations to Cabinet as appropriate.
- 1.2 The Treasury Strategy Statement also requires the Audit and Standards Committee to review a formal summary report detailing the recent Treasury Management activity before it is considered by Council, in accordance with best practice and guidance issued by the Chartered Institute of Public Finance and Accountancy.
- 1.3 This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit & Standards Committee before they were reported to the full Council.
- 1.4 Treasury Management is an integral part of the Council's overall finances and the performance of this area is very important. Whilst individual years obviously matter, performance is best viewed on a medium / long term basis. The action taken in respect of the debt portfolio in recent years has been extremely beneficial and has resulted in savings. Short term gains might, on occasions, be sacrificed for longer term certainty and stability.

- 1.5 The criteria for lending to Banks are derived from the list of approved counter parties provided by the Council’s Treasury Management advisors, Link Asset Services. The list is amended to reduce the risk to the Council by removing the lowest rated counterparties and reducing the maximum loan duration.

2. Treasury Management Activity

- 2.1 The timetable for reporting Treasury Management activity in 2022/23 is shown in the table below. This takes into account the timescale for the publication of each Committee agenda and is on the basis that it is preferable to report on activity for complete months. Any extraordinary activity taking place between the close of the reporting period and the date of the Audit and Standards Committee meeting will be reported verbally at that meeting.

Meeting date	Reporting period for transactions
4 June 2022	2021/22 Annual Report (up to 31 March 2022)
12 September 2022	1 April to 30 June 2022
14 November 2022	1 July to 30 September 2022
16 January 2023	1 October to 31 December 2022
13 March 2023	1 January to 28 February 2023

2.2 Fixed Term Deposits pending maturity

The following table shows the fixed term deposits held between 1 November to 31 December 2022 and identifies the long-term credit rating of counterparties at the date of investment. It is important to note that credit ratings are only one of the criteria that are taken into account when determining whether a potential counterparty is suitable. All the deposits met the necessary criteria the minimum rating required for deposits made in terms of long-term A- (Fitch).

Counterparty	Date From	Date To	Days	Principal £'000	Int Rate %	Long-term Rating
DMO	06/09/2022	06/02/2023	153	1,000	2.50%	*
DMO	27/09/2022	27/01/2023	122	2,000	2.96%	*
DMO	22/11/2022	07/02/2023	77	5,000	2.96%	*
Standard Charter sustainable	30/11/2022	03/01/2023	34	5,000	3.02%	A+
Bayerische Landesbank	16/12/2022	16/01/2023	31	5,000	3.22%	A-
DMO	22/12/2022	03/01/2023	12	6,500	3.16%	*

*UK Government body and therefore not subject to credit rating

2.3 Fixed Term Deposits which have matured in the reporting period

The table below shows the fixed term deposits which have matured between 1 November to 31 December 2022, in maturity date order. It is important to note that the table includes sums reinvested.

Counterparty	Date From	Date To	Days	Principal £'000	Int. Rate %	Long-term rating
DMO	15/07/2022	17/10/2022	94	2,000	1.56%	*
Cornwall Council	10/08/2022	10/10/2022	61	5,000	1.72%	*
DMO	30/08/2022	31/10/2022	62	4,000	1.95%	*
Standard Charter sustainable	30/08/2022	30/11/2022	92	5,000	2.31%	A+
Bayerische Landesbank	16/09/2022	16/12/2022	91	5,000	2.69%	A-
DMO	03/10/2022	19/10/2022	16	7,500	1.95%	*
DMO	10/10/2022	18/10/2022	8	3,000	1.95%	*
DMO	19/10/2022	09/11/2022	21	5,000	2.03%	*
DMO	01/11/2022	22/11/2022	21	8,500	2.46%	*
DMO	09/11/2022	23/11/2022	14	5,000	2.70%	*
DMO	01/12/2022	22/12/2022	21	6,500	2.95%	*
DMO	15/12/2022	19/12/2022	4	2,500	3.20%	*

*UK Government body and therefore not subject to credit rating

At no stage did the total amount held by any counterparty exceed the approved limit set out in the Investment Strategy. The average rate of interest earned on deposits held in the period 1 November to 31 December 2022 was 1.88%, which was below the average bank base rate for the period of 1.85%.

2.4 Use of Deposit accounts

In addition to the fixed term deposits, the Council has made use of the following interest bearing accounts in the period covered by this report, with the average amount held being £2.6m generating interest of approximately £0.19k.

	Balance at 31 December 2022 £'000	Average balance £'000	Current interest rate %
Santander Business Reserve Account	£5,000	£4,824	1.83
Lloyds Bank Corporate Account	£1,419	£1,067	0.01
Lloyds Bank Call Account	£2,910	£1,995	0.40

2.5 Use of Money Market Funds

Details of the amounts held in the two Money Market Fund (MMF) accounts used by the Council are shown below. The approved Investment Strategy allows a maximum investment of £10m in each fund, and at no time was this limit exceeded.

	Balance at 31 December 2022 £'000	Average balance £'000	Average return %
Goldman Sachs Sterling Liquid Res. Fund	£0,000	0,000	0.00
Deutsche Managed Sterling Fund	£0,001	0,001	0.00

2.6 Treasury Bills (T-Bills)

There were no Treasury Bills held as at 31 December 2022, and there was no activity in the period.

2.7 Secured Investments

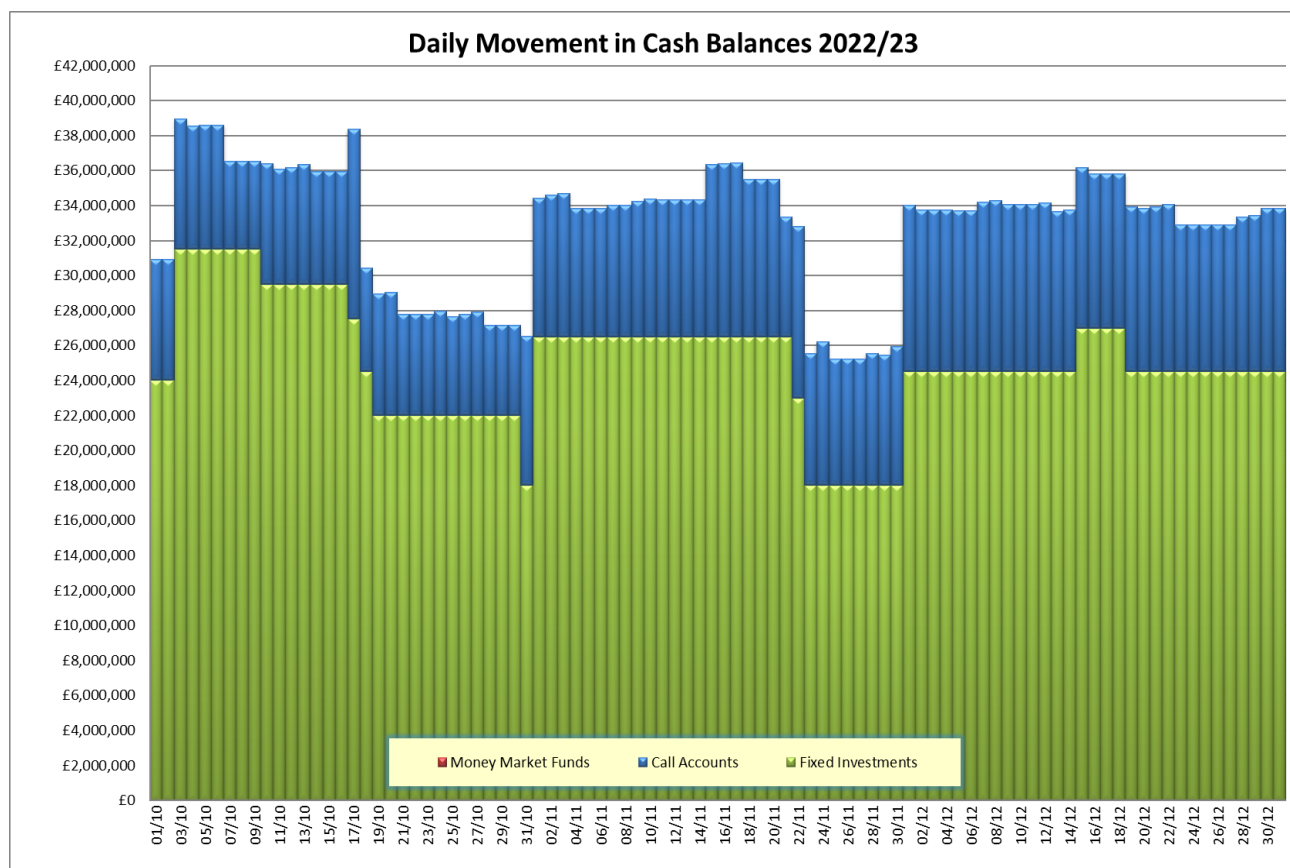
There were no Secured Investments as at 31 December 2022.

2.8 Tradeable Investments

There were no Tradeable Investments as at 31 December 2022, and there was no activity in the period.

3. Overall investment position

3.1 The chart below summarises the Council's investment position over the period 1 November to 31 December 2022. It shows the total sums invested each day as Fixed Term deposits, amounts held in Deposit/call accounts.



3.2 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest 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 unsuitably low investment income.

3.3 In the light of the pandemic crisis and the likelihood of unexpected calls on cash flow the Council continues to hold significant balances in bank call accounts, which have same day availability. This liquid cash was diversified over several fixed term deposit/call accounts to manage both credit and liquidity risks.

4. Annual Investment Strategy

4.1 CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2022. These define treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business

4.2 The Treasury Management Strategy Statement (TMSS) for 2022/23 which includes the Annual Investment strategy, was approved by the Full Council on Monday, 21 February 2022. It sets out the Council's investment priorities as being:

- Security of Capital;
- Liquidity;
- Yield.

Approved limits within the Annual Investment Strategy were not breached during the period ending 31 December 2022, except for the balance held with Lloyds Bank, which exceeded the £5m limit for 1 days during the period.

4.3 Investment rates available in the market have continued at historically low levels. The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate it is considered appropriate to keep investments short-term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach.

4.4 As shown by the interest rate forecasts in section 5.2, it is now difficult to earn the level of interest rates commonly seen in previous decades as all short-term money market investment rates have only risen weakly since Bank Rate was cut to 0.10%. Given this environment and the fact that Bank Rate may only rise marginally before the second half of 2023, investment returns are expected to remain low.

4.5 As for money market funds (MMFs) and the Inter-local authority lending, borrowing rates have declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur.

5. Borrowing

5.1 The current account with Lloyds Bank generally remained within credit limits throughout most of the period and the Council's long term borrowing in the reporting period is £51.7m.

Interest Rate Forecast

- 5.2 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.
- 5.3 The latest forecast, made on 19th December, 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 also providing a limited package of fiscal loosening to try and protect households and businesses from the ravages of ultra-high wholesale gas and electricity prices. PWLB rates reflect a less elevated yield curve than prevailed under the Truss/Kwarteng government, and the 17th of November Autumn Statement made clear the government's priority is the establishment and maintenance of fiscal rectitude. In addition, 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.
- 5.4 The current and previous PWLB rate forecasts below are based on the Certainty Rate.

Link Group Interest Rate View 19.12.22													
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.20	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.30	4.40	4.40	4.30	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.30
25 yr PWLB	4.60	4.60	4.60	4.50	4.40	4.20	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.30	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.30	3.20	3.20

Link Group Interest Rate View 08.11.22													
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.30	4.30	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.50	4.50	4.40	4.30	4.20	4.00	3.90	3.70	3.60	3.50	3.40	3.30	3.20
25 yr PWLB	4.70	4.70	4.60	4.50	4.40	4.30	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.40	3.30	3.20	3.20

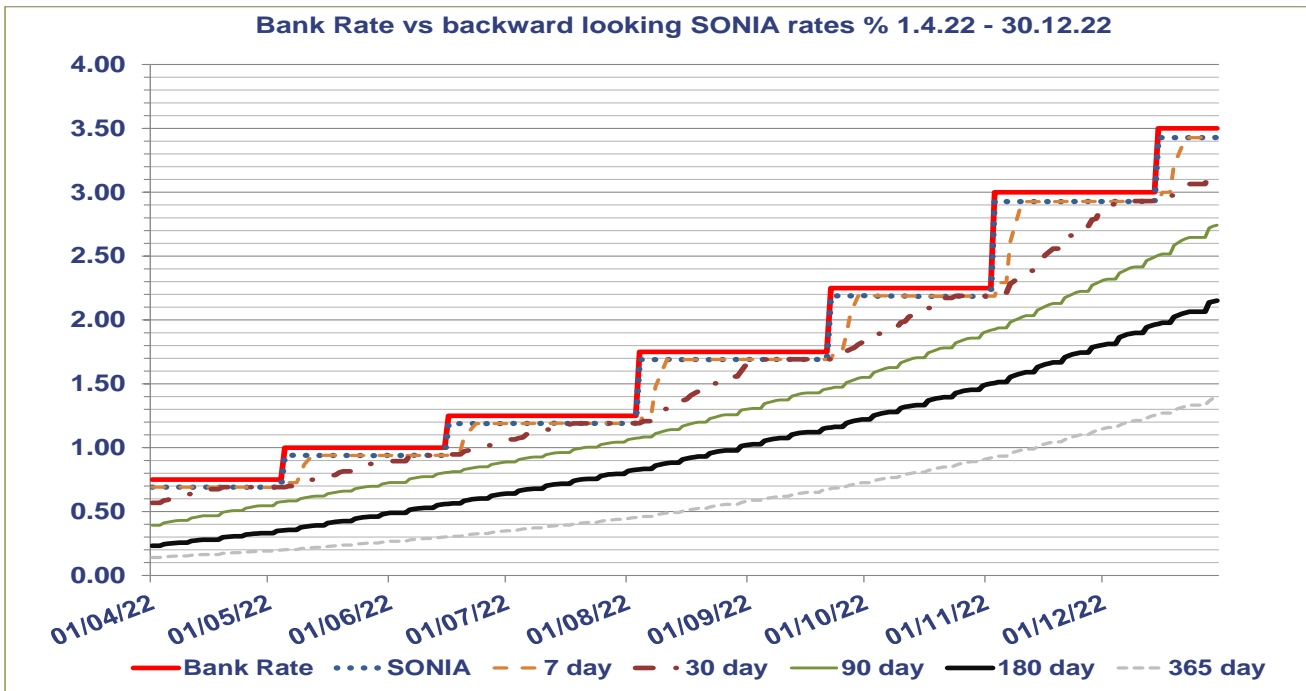
- LIBOR and LIBID rates ceased at the end of 2021. In a continuation of previous views, money market yield forecasts are based on expected average earnings by local authorities for 3 to 12 months.
- The Link forecast for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short-term cash at any one point in time.

5.5 SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

- The central forecast for interest rates was most recently updated on 19th December 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 but the Government's policy of emphasising fiscal rectitude will probably mean Bank Rate will not need to increase to further than 4.5%.
- Further down the road, we anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us – but that timing will be 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.
- The CPI measure of inflation looks to have peaked at 11.1% in Q4 2022 (currently 10.7%). Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market.
- Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started and will focus on the short, medium and longer end of the curve in equal measure now that the short-lived effects of the Truss/Kwarteng unfunded dash for growth policy are firmly in the rear-view mirror.
- 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 the on-going conflict between Russia and Ukraine. (More recently, the heightened tensions between China/Taiwan/US also have the potential to have a wider and negative economic impact.)
- On the positive side, consumers are still estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above challenges. However, most of those 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.

5.6 PWLB RATES

- The yield curve movements have become less volatile of late and PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.10% to 4.80%.
- 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.



FINANCIAL YEAR TO QUARTER ENDED 31/12/2022

	Bank Rate	SONIA	7 day	30 day	90 day	180 day	365 day
High	3.50	3.43	3.43	3.18	2.74	2.15	1.40
High Date	15/12/2022	28/12/2022	30/12/2022	30/12/2022	30/12/2022	30/12/2022	30/12/2022
Low	0.75	0.69	0.69	0.57	0.39	0.23	0.14
Low Date	01/04/2022	28/04/2022	29/04/2022	01/04/2022	01/04/2022	01/04/2022	01/04/2022
Average	1.79	1.73	1.68	1.57	1.31	0.99	0.59
Spread	2.75	2.74	2.74	2.61	2.35	1.92	1.26

Debt Rescheduling

- 5.7 Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010. As short-term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt.
- 5.8 However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred). The reasons for any rescheduling to take place will include:
- The generation of cash savings and / or discounted cash flow savings.
 - Helping to fulfil the treasury strategy.
 - Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt. No debt rescheduling has therefore been undertaken to date in the current financial year.

6 Compliance with Treasury and Prudential Limits

6.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved TMSS. As at 31 December 2022, the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

Revisions to CIPFA Codes

6.2 CIPFA published revised Prudential and Treasury Management Codes, which takes immediate effect, although detailed reporting requirements may be deferred until the 2023/24 financial year. The main changes from previous codes include:

- Additional reporting requirements for the Capital Strategy.
- For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the Authority's overall financial capacity.
- Forward looking prudential code indicators must be monitored and reported to members at least quarterly.
- A new indicator for net income from commercial and service investments to net revenue stream.
- Inclusion of the liability benchmark as a treasury management prudential indicator.
- Excluding investment income from the definition of financing costs.
- Credit and counterparty policies should set out the Authority's policy and practices relating to Environmental, Social and Governance (ESG) investment considerations.
- Additional focus on the knowledge and skills of officers and elected members involved in decision making.

7. Non-treasury investments

7.1 Lewes Housing Investment Company

Lewes Housing Investment Company (LHIC) is a wholly owned subsidiary of the Council. Incorporated in July 2017, LHIC was established to acquire, improve, and let residential property at market rents. A capital allocation of £2.5m was approved as potential commercial loan funding to facilitate property purchases. At 30 December 2022, a total of £2,065 working capital has been drawn down. The balance has been rolled forward into 2022/23. There have been no transactions during the period 1 April 2022 to 31 December 2022.

7.2 Aspiration Homes LLP

Aspiration Homes LLP (AH) is a limited liability Partnership owned equally by Lewes District Council and Eastbourne Borough Council. Incorporated in June 2017, AH was established for the purpose of developing housing to be let at affordable rent. A capital allocation of £17.5m was approved as potential commercial loan funding to AH to facilitate property purchases. At 31 December 2022, a total of £3,043,855 has been drawn down for the purchase of Gray's School, Newhaven, and Caburn Field, Ringmer. The balance has been rolled forward into 2022/23. There have been no transactions during the period 1 April 2022 to 31 December 2022.

A working Capital facility loan of £100,000 has been agreed, at an interest rate of 2% above Base Rate. As at 31 December 2022, £20,000 of the working Capital facility loan had been drawn down. There have been no transactions during the period 1 April 2022 to 31 December 2022.

8. Environmental, Social and Governance Investment - update

- 8.1 The Cabinet at its meeting on 3 February 2022 approved the 2022/23 Treasury Management and Investment Strategy, which include Non-Specified investments in Green Energy Bonds and/or other ESG products that met the Council’s internal and external due diligence criteria.
- 8.2 While a wide range of ESG investment are currently limited, there are expectation to see more banks and funds providing specific products over the coming years. As this area continues to develop and become more prominent, the Council in conjunction with the treasury management advisor (Link Asset Services) will continue to monitor ESG investment opportunities within the parameters of the Council’s counterparty criteria and in compliance with the DLUHC Investment Guidance (i.e., prioritising security, liquidity before yield).
- 8.3 The Council holds a £5m deposit balance within the Standard Chartered Bank Sustainable Time Deposit, which function just like a normal Time Deposit. The difference is in the sustainable impact where the deposits are referenced against qualifying sustainable loans and projects of Standard Chartered that meet their Green and Sustainable Product Framework.
- 8.4 These loan and project assets include green financing, sustainable infrastructure projects, microfinance, and access to finance for SME business banking. It addresses the long-term environmental challenges such as climate change, health, and financial inclusion plus being dedicated towards financing sustainable loans and projects aligned to the United Nation’s Sustainable Development Goals.
- 8.5 **Sustainable Development Goals**



9. Economic Background

- 9.1 As expected, the Bank of England's Monetary Policy Committee continue to increase the Bank Rate and a detailed economic commentary on developments during period ended 31 December 2022 is attached as **Appendix A**.

10. Financial Appraisal

- 10.1 All relevant implications are referred to in the above paragraphs.

11. Risk Management Implications

- 11.1 The risk management implication associated with this activity is explained in the approved Treasury Management Strategy. No additional implications have arisen during the period covered by this report.

12. Equality Analysis

- 12.1 This is a routine report for which detailed Equality Analysis is not required to be undertaken.

13. Legal Implications

- 13.1 There are no legal implications from this report.

14. Environmental sustainability implications

- 14.1 This report notes the treasury management performance of the Council. There are no anticipated environmental implications from this report that would affect the Council's sustainability policy. The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the treasury activities and highlights compliance with the Council's policies previously approved by members.

15. Appendices

- 15.1 Appendix A - Detailed economic commentary
- 15.2 Appendix B - Glossary/Local Authority Treasury Management Terms

16. Background Papers

- 16.1 Treasury Strategy Statements 2022/23

Link Treasury Services Limited - Detailed economic commentary on developments during quarter ended 31 December 2022

The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (annual, mid-year or quarterly reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

Economics update

- The third quarter of 2022/23 saw:
 - A 0.5% m/m rise in GDP in October, mostly driven by the reversal of bank holiday effects;
 - Signs of economic activity losing momentum as households increased their savings;
 - CPI inflation fall to 10.7% in November after peaking at 11.1% in October;
 - A small loosening in the labour market which pushed the unemployment rate up to 3.7% in October;
 - Interest rates rise by 125bps over Q4 2022, taking Bank Rate to 3.50%;
 - Reduced volatility in UK financial markets but a waning in global risk appetite.
- GDP fell by 0.3% q/q in Q3 2022 (ending 30th September), which probably marked the start of the UK recession. About half of that decline was the effects of the extra bank holiday in September for the Queen's funeral. The unwinding of those bank holiday effects meant that GDP rebounded in October and explained at least 0.3 percentage points (ppts) of the 0.5% m/m rise. Accordingly, if GDP were to avoid falls of more than 0.2% m/m in November and December, then GDP over Q4 as a whole could avoid a contraction, which would prevent a recession in 2022.
- However, at 49.0 in December, the flash composite activity PMI stayed below the "boom-bust" level of 50 and pointed to a small 0.1% q/q contraction in GDP in Q4. Consumer confidence was -42 in December and stayed close to its record low of -49 in September. Strike action could be another small drag and may mean that GDP is 0.0% to 0.5% lower than otherwise in December. GDP is projected to contract marginally in Q4 by around 0.1% q/q.
- Meanwhile, the 0.4% m/m fall in retail sales volumes in November only reversed some of the 0.9% m/m rise in October. That left sales volumes 4.5% below their level at the start of the year. Indeed, the rise in the household saving rate from 6.7% in Q2 to 9.0% in Q3 implied that higher interest rates are encouraging households to save more. And a larger-than-usual £6.2bn rise in cash in household bank accounts in October may imply households have started to increase their precautionary savings.
- There were signs that the labour market was loosening gradually going into the final quarter of 2022. Although employment in the three months to October rose by 27,000, the fall in the composite PMI employment balance in December took it into contractionary territory and suggests that labour demand will cool. Meanwhile, labour supply improved as inactivity fell by 76,000 in the three months to October. That helped drive a rise in the unemployment rate from 3.6% in September to 3.7% in October. The number of job vacancies in November fell for the sixth consecutive month and were 18% below their peak in May.

- Crucially, though, wage growth remained resilient. Average earnings growth, excluding bonuses, grew by 0.7% m/m in October, above the 2022 monthly average of 0.5% m/m. That drove the 3myy rate up to 6.2%, well above the rates of 3-3.5% consistent with inflation at its 2% target. Wage growth is likely to slow gradually in the coming months as the labour market loosens further but if extensive strike action is successful in achieving large pay increases, then wage growth could be a bit stronger for longer.
- CPI inflation peaked in October at a 41-year high of 11.1% and fell to 10.7% in November. Goods price inflation, which is driven largely by global factors, has peaked. The sharp rises in energy prices in 2022 mean that energy price inflation will fall sharply in 2023. Meanwhile, the large fall in agricultural prices since May means that food price inflation should start to decline soon. What's more, upward pressure on goods price inflation from global supply shortages is fading quickly.
- Domestic inflation pressures also eased in Q4. The 0.2% m/m rise in core CPI inflation in November was the smallest monthly gain since August 2020 and drove a fall in core CPI inflation from 6.5% in October to 6.3% in November. Services CPI inflation was stable at 6.3% in November despite the resilience of wage growth. And the easing of price expectations in the Bank of England's Decision Maker Panel survey in November suggests that inflation may become less persistent.
- The Chancellor's Autumn Statement on 17th November succeeded in restoring the government's fiscal credibility in the eyes of the financial markets without deepening the recession. The total fiscal consolidation package of £54.9bn (1.8% of GDP) in 2027/28 made the outlook for fiscal policy much tighter than at the beginning of Q4. The package was heavily backloaded, with net handouts of £3.8bn (0.15% of GDP) in 2023/24 and £0.3bn (0.01% of GDP) in 2024/25, and most of the tightening kicking in after 2024/25. The largest fiscal support was the extension of the Energy Price Guarantee for another 12 months, until April 2024, although at a higher price cap of £3,000 from April 2023 rather than £2,500. At the same time, Chancellor Hunt loosened the fiscal rules by requiring debt as a percentage of GDP to be falling in five years' time, rather than three. The Office of Budget Responsibility (OBR) estimated that the Chancellor will meet this new rule with a slim £9.2bn (0.3% of GDP) to spare.
- With fiscal policy now doing much less to fan domestic inflation pressures, we think Bank Rate will peak at 4.50%, or at least close to that figure. Despite stepping up the pace of policy tightening to a 75-basis point (bps) rate hike in November, taking Bank Rate from 2.25% to 3.00%, the MPC's communication was dovish. The MPC pushed back heavily against market rate expectations, which at the time were for Bank Rate to peak at 5.25%. The Bank's new forecasts predicted a deeper and longer recession than the analyst consensus, of eight quarters and with a peak-to-trough fall in real GDP of 2.9%.
- The Bank sounded dovish again in December when it slowed the pace of tightening with a 50bps rate rise, from 3.00% to 3.50%. Two members, Dhingra and Tenreiro, voted to leave rates unchanged, judging that the current level of Bank Rate was sufficient to bring inflation back to target. That said, the rest of the MPC appeared to suggest that further rate hikes would be necessary. We expect that the majority of the MPC will need to see stronger signs that activity is slowing, the labour market is loosening, and wage growth is slowing before stopping rate rises. As such, we expect that the MPC will deliver three further rate hikes in February, March and May, taking Bank Rate to a peak of 4.50% but with the pace of increase reducing to 25bps in March and May.

- Gilt yields have fallen sharply since their highs following the “mini-budget” on 23rd September as government fiscal credibility has been largely restored with the resignation of Truss-Kwarteng and the fiscal consolidation package announced at the Autumn Statement on 17th November. Indeed, the 10-year yield fell from a peak of 4.55% to about 3.60% now, while the 30-year yield fell from 5.10% to 3.90%. Admittedly, yields rose by around 50bps in December, partially on the back of a global rise in yields. But if we are right in thinking Bank Rate will fall back in 2024 and 2025 then gilt yields will probably fall over the next two years, with the 10-year yield slipping from around 3.60% now to 3.30% by the end of 2023 and to 2.80% by the end of 2024.
- Lower volatility in gilt markets in Q4 meant that the Bank of England was able to stop its purchases of long-term gilts for financial stability reasons as planned on 14th October. It was also able to begin active gilt sales in November, albeit with a focus on shorter dated gilts. So far quantitative tightening has had little influence on short-term money markets. But as it is still an experiment, the risk of a widespread tightening in financial conditions remains.
- The restoration of fiscal credibility boosted the pound and the FTSE 100 early in Q4. While much of the benefit passed in the first half of Q4, sterling continued to rally against a softer dollar. Our colleagues at Capital Economics do not think that the global recession is fully priced into markets, and so expect a further fall in risk appetite to boost safe haven demand for the dollar and weigh on the pound. They are expecting the pound to fall from \$1.19 now to \$1.10 in mid-2023, before climbing to \$1.15 by the end of 2023 as the prospect of lower interest rates and a recovery in global economic growth buoys equity prices.
- Through December, the rally in the FTSE 100 petered out as investors have become increasingly concerned by the prospect of a global recession. However, the relatively dovish tone of the Bank of England, compared to the Federal Reserve and the ECB meant that UK equities held up better than other developed market indices. Indeed, at 7,452 at the December month end, the FTSE 100 is only marginally below its peak of 7,568 on 5th December, while the S&P 500 is around 4% lower over the same period. Nevertheless, there is a great deal of uncertainty as to which direction markets will move in 2023 and at what pace. Continued volatility is anticipated.

MPC meetings 3rd November and 15th December 2022

- On 3rd November, the Bank of England’s Monetary Policy Committee (MPC) increased Bank Rate by 75 basis points to 3.00%, and on 15th December moved rates up a further 50 basis points to 3.50%. The later increase reflected a split vote – six members voting for a 50 basis points increase, one for 75 basis points and two for none.
- Nonetheless, the UK government appears more settled now, with Rishi Sunak as Prime Minister, and Jeremy Hunt as Chancellor. Having said that, a multitude of strikes across several public services and the continued cost-of-living squeeze is going to make for a difficult backdrop to maintain fiscal rectitude without pushing the economy into anything worse than a mild recession.
- Of course, what happens outside of the UK is also critical to movement in gilt yields. What happens in Ukraine will also impact the global economy, but particularly in Europe. The search for alternative providers of energy, other than Russia, will take both time and effort. The weather will also play a large part in how high energy prices stay and for how long.

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, rising gilt yields).
- **The Bank of England** acts too quickly, or too far, over the next year to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker 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.

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

- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project or even necessitates a further series of increases in Bank Rate.
- **The Government** acts too quickly to cut taxes and/or increases expenditure in light of the cost-of-living squeeze.
- **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 and pull gilt yields up higher than currently forecast.
- Projected **gilt issuance, inclusive of natural maturities and QT**, could be too much for the markets to comfortably digest without higher yields consequently.

GLOSSARY

Local Authority Treasury Management Terms

Terms	Descriptions
Bond	A certificate of long-term debt issued by a company, government, or other institution, which is tradable on financial markets
Borrowing	Usually refers to the stock of outstanding loans owed, and bonds issued.
CFR	<p>Capital Financing Requirement. A council's underlying need to hold debt for capital purposes, representing the cumulative capital expenditure that has been incurred but not yet financed.</p> <p>The CFR increases with capital expenditure and decreases with capital finance and MRP.</p>
Capital gain or loss	An increase or decrease in the capital value of an investment, for example through movements in its market price.
CIPFA	The Chartered Institute of Public Finance and Accountancy (CIPFA) is a UK-based international accountancy membership and standard-setting body. The only such body globally dedicated to public financial management.
Collective investment scheme	Scheme in which multiple investors collectively hold units or shares. The investment assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'pooled funds').
Cost of carry	When a loan is borrowed in advance of need, the difference between the interest payable on the loan and the income earned from investing the cash in the interim.
Counterparty	The other party to a loan, investment or other contract.
Counterparty limit	The maximum amount an investor is willing to lend to a counterparty, in order to manage credit risk.
Covered bond	Bond issued by a financial institution that is secured on that institution's assets, usually residential mortgages, and is therefore lower risk than unsecured bonds.
CPI	Consumer Price Index - the measure of inflation targeted by the Monetary Policy Committee.

Terms	Descriptions
Deposit	A regulated placing of cash with a financial institution. Deposits are not tradable on financial markets.
Diversified income fund	A collective investment scheme that invests in a range of bonds, equity and property in order to minimise price risk, and also focuses on investments that pay income.
Dividend	Income paid to investors in shares and collective investment schemes. Dividends are not contractual, and the amount is therefore not known in advance.
DMADF	Debt Management Account Deposit Facility – a facility offered by the DMO enabling councils to deposit cash at very low credit risk. Not available in Northern Ireland.
DLUHC	Department for Levelling Up, Housing and Communities (<i>formerly known as Ministry of Housing, Communities & Local Government - MHCLG</i>).
DMO	Debt Management Office – an executive agency of HM Treasury that deals with central government's debt and investments.
Equity	An investment which usually confers ownership and voting rights
Floating rate note (FRN)	Bond where the interest rate changes at set intervals linked to a market variable, most commonly 3-month LIBOR or SONIA
FTSE	Financial Times stock exchange – a series of indices on the London Stock Exchange. The FTSE 100 is the index of the largest 100 companies on the exchange, the FTSE 250 is the next largest 250 and the FTSE 350 combines the two
GDP	Gross domestic product – the value of the national aggregate production of goods and services in the economy. Increasing GDP is known as economic growth.
Income Return	Return on investment from dividends, interest and rent but excluding capital gains and losses.
GILT	Bond issued by the UK Government, taking its name from the gilt-edged paper they were originally printed on.
LIBID	London interbank bid rate - the benchmark interest rate at which banks bid to borrow cash from other banks, traditionally 0.125% lower than LIBOR.

Terms	Descriptions
LIBOR	London interbank offer rate - the benchmark interest rate at which banks offer to lend cash to other banks. Published every London working day at 11am for various currencies and terms. Due to be phased out by 2022.
LOBO	Lender's Option Borrower's option
MMF	Money Market Funds. A collective investment scheme which invests in a range of short-term assets providing high credit quality and high liquidity. Usually refers to Constant Net Asset Value (CNAV) and Low Volatility Net Asset Value (LVNAV) funds with a Weighted Average Maturity (WAM) under 60 days which offer instant access, but the European Union definition extends to include cash plus funds
MPC	The Monetary Policy Committee (MPC) decides what monetary policy action the Bank of England will take to keep inflation low and stable.
OBR	The Office for Budget Responsibility was created to provide independent and authoritative analysis of the UK's public finances. It is one of a growing number of official independent fiscal watchdogs around the world.
PMI	Purchasing Managers' Index (PMI) - A composite PMI is the weighted average of manufacturing and service sector PMIs for a given geography or economy, produced by IHS Markit. Weights are derived from official data relating to each sector's contribution to GDP (value added).
Pooled Fund	Scheme in which multiple investors hold units or shares. The investment assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'pooled funds').
PWLB	Public Works Loan Board – a statutory body operating within the Debt Management Office (DMO) that lends money from the National Loans Fund to councils and other prescribed bodies and collects the repayments. Not available in Northern Ireland.
Quantitative easing (QE)	Process by which central banks directly increase the quantity of money in the economy to promote GDP growth and prevent deflation. Normally achieved by the central bank buying government bonds in exchange for newly created money.
SME	SME finance is the funding of small and medium-sized enterprises and represents a major function of the general business finance market – in which capital for different types of firms are supplied, acquired, and costed or priced.

Terms	Descriptions
SONIA	Sterling overnight interest average – a benchmark interest rate for overnight deposits.
Short-dated	Usually means less than one year
TMSS	Approved Council's Treasury Management Strategy Statement
Total return	The overall return on an investment, including interest, dividends, rent, fees and capital gains and losses.