Report To:	**Audit and Governance Committee**
Date:	**5 October 2023**
Report Title:	**Treasury Management Quarterly Report – Q1**
Report of:	**Director of Finance and Performance (Chief Finance Officer – S151 Officer)**
Ward(s):	**All**
Purpose of report:	**To present details of recent Treasury Management activities**
Decision Type:	**Budget and Policy Framework**
Officer Recommendations:	**The Committee is recommended to note the report of the Director of Finance and Performance and the assurances contained within and agree that Treasury Management Activities for the period April to June 2023 have 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).**
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1. Introduction

1.1 The Council's approved Treasury Strategy Statement requires the Audit and Governance 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 Governance 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 (CIPFA).

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 & Governance 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. Economic Background

2.1 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 30 June 2023 is attached as **Appendix A**.

3. Interest Rate Forecast

3.1 The Council 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.

3.2 The latest forecast (made on 26th June), sets out a view that both short and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy, against a backdrop of a stubbornly robust economy and a tight labour market.

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

3.4 Link's forecast of bank rate and PWLB borrowing rates are set out below.

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

Note

1) 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.

2) 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.

4. Annual Investment Strategy

4.1 CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes in December 2021. 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 2023/24 which includes the Annual Investment strategy (AIS), was approved by the Full Council on 22 February 2023. It sets out the Council's investment priorities as being:

- Security (of Capital);
- Liquidity;
- Yield.

4.3 The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity, aligned with the Council's risk appetite. In the current economic climate, over and above keeping investments short-term to cover cash flow needs, there is a benefit to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

4.4 As per the interest rate forecasts in section 3 above, investment rates have improved dramatically during the first quarter of 2023/24 and are expected to improve further as Bank Rate continues to increase over the next few months.

4.5 There have been few changes to credit ratings over the quarter under review. However, officers continue to closely monitor these, and other measures of creditworthiness to ensure that only appropriate counterparties are considered for investment purposes.

4.6 Approved limits within the Annual Investment Strategy were not breached during the period ending 30 June 2023, except for the balance held with Lloyds Bank (the Council's own bank). The £5m maximum limit was exceeded for 4 days during the period (11 April, 22 May, 16 June and 26 June). Breaches normally occur where (i) other investments have been recalled back to Lloyds a day early in readiness for larger than usual outgoings the following day or (ii) other investments are received back too late in the day to reinvest so remain with Lloyds overnight.

5. Treasury Management Activity

5.1 The timetable for reporting Treasury Management activity in 2023/24 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 Governance Committee meeting will be reported verbally at that meeting.

Meeting date	Reporting period for transactions
5 October 2023	1 April to 30 June 2023 (Q1)
22 November 2023	1 July to 30 September 2023 (Q2)
28 February 2024	1 October to 31 December 2023 (Q3)
June 2024	2023/24 Annual Report (up to 31 March 2024)

5.2 Fixed Term Deposits pending maturity

The following table shows that no fixed term deposits were held at 30 June 2023 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
None	-	-	-	-	-	-

5.3 Fixed Term Deposits which have matured in the reporting period

The table below shows the fixed term deposits which have matured between 1 April to 30 June 2023 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	03/04/2023	12/04/2023	9	2,000,000	4.05%	*
DMO	05/04/2023	12/04/2023	7	1,300,000	4.05%	*
DMO	17/04/2023	02/05/2023	15	3,000,000	4.07%	*
DMO	02/05/2023	27/06/2023	56	3,000,000	4.32%	*
DMO	15/05/2023	26/06/2023	42	4,000,000	4.41%	*
DMO	01/06/2023	26/06/2023	25	5,000,000	4.42%	*
DMO	06/06/2023	29/06/2023	23	2,200,000	4.45%	*
DMO	07/06/2023	16/06/2023	9	11,000,000	4.38%	*
DMO	15/06/2023	23/06/2023	8	2,500,000	4.40%	*
DMO	27/06/2023	29/06/2023	2	4,300,000	4.88%	*

* UK Government body and therefore not subject to credit rating

The weighted average rate of interest earned on deposits held in the period 1 April to 30 June 2023 was 4.34%, which was below the average bank base rate for the period of 4.44%.

5.4 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 £2.47m generating interest of £31k.

	Balance at 30/06/23 £'000	Average balance £'000	Current interest rate %
Santander Business Reserve Account	£5,000	£3,945	2.91%
Lloyds Bank Current Account	£3,156	£1,955	1.70%
Lloyds Bank Call Account	£10	£1,514	0.70%

5.5 Money Market Funds

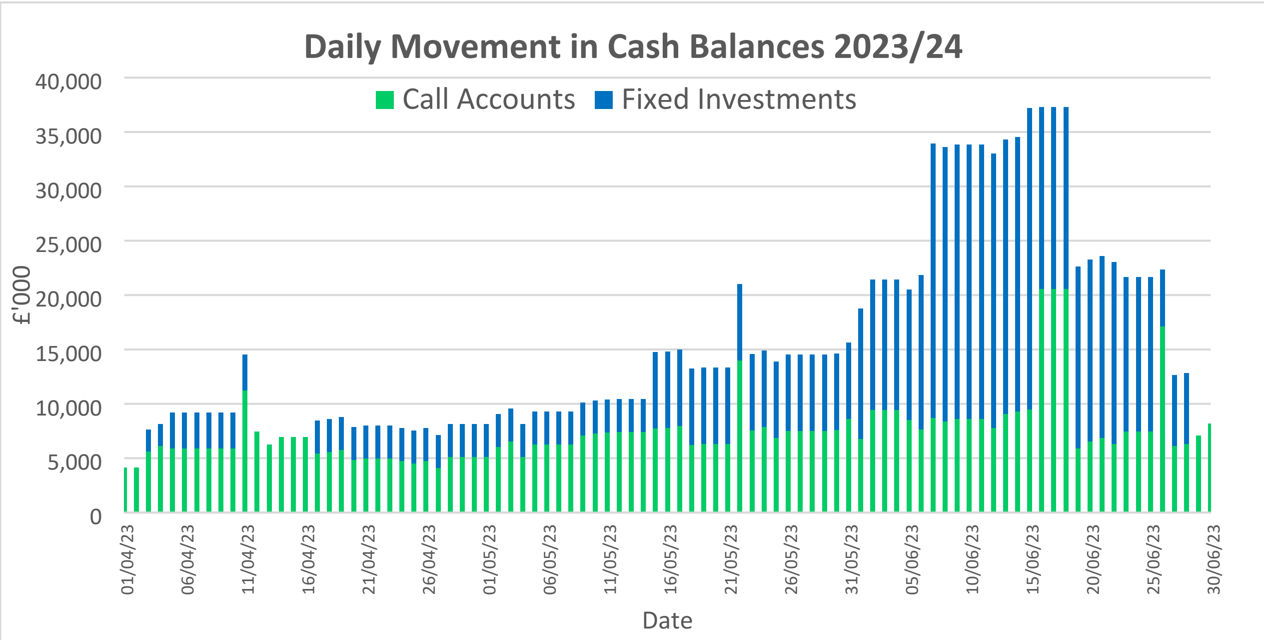
There were no funds Money Market Funds held at 30 June 2023, and there was no activity in the period.

5.6 Bond Funds, Multi-Asset Income Funds and Property Funds

There were no Short Dated Bond Funds, Multi-Asset Income Funds or Property Funds held at 30 June 2023, and there was no activity in the period.

6. Overall investment position

6.1 The chart below summarises the Council's investment position over the period 1 April to 30 June 2023. It shows the total sums invested each day split between Fixed Term investments and amounts held in Call accounts.



6.2 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.

6.3 During the Covid-19 pandemic with unexpected calls on cash flow, significant balances were held in call accounts which are highly liquid. Since then, more funds are being held as fixed term investments and less in call accounts.

7. Borrowing

7.1 The Council's long term borrowing at 30 June was £113.78m with the Public Works Loan Board.

7.2 The table below details short term/temporary borrowing in the quarter from other local authorities. As at 30 June 2023, £67m of loans were held. During the quarter, £35m of loans matured and were repaid on time.

Lender	Principal £000	Date From	Date To	Days	Rate %
Loans held					
Tendring DC	5,000	1 Nov 22	1 Aug 23	273	3.90%
Barrow Borough Council	3,000	20 Jan 23	20 Nov 23	304	3.85%
North Northamptonshire Council	5,000	27 Jan 23	27 Jul 23	181	4.00%
Warwickshire County Council	5,000	8 Feb 23	7 Feb 24	364	4.00%
Salford City Council	5,000	8 Feb 23	7 Feb 24	364	4.00%
Tameside MBC	5,000	13 Feb 23	15 Jan 24	336	4.20%
Gwent Police	4,000	11 Apr 23	29 Dec 23	262	4.40%
West of England Combined Authority	10,000	28 Apr 23	26 Apr 24	364	4.85%
West Yorkshire Combined Authority	5,000	9 May 23	9 Feb 24	276	4.25%
Bolton MBC	10,000	22 May 23	20 May 24	364	4.35%
Wokingham BC	10,000	7 Jun 23	28 Mar 24	295	4.50%
Loans repaid					
West Yorkshire Combined Authority	5,000	23 May 22	9 May 23	351	1.20%
Northern Ireland Housing Executive	10,000	20 Jun 22	19 Jun 23	364	1.20%
West Yorkshire Combined Authority	10,000	25 Jul 22	27 Jun 23	337	1.80%
Northern Ireland Housing Executive	10,000	29 Nov 22	28 Apr 23	150	4.00%

8. PWLB Rates

8.1 Gilt yield curve movements have shifted upwards, especially at the shorter end of the yield curve since the previous forecast but remain relatively volatile. PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.90% to 5.60%. The view is that markets have built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the elevated inflation outlook.

8.2 Link’s core debt management advice remains unaltered, to continue to reappraise any capital expenditure plans/profiles, and internally/temporarily borrow for any financing and re-financing. Only seek longer-dated debt if there is absolute certainty on the long-term rates and can conclude it is affordable, sustainable and prudent if funded at prevailing levels.

9. Debt Rescheduling

9.1 Debt rescheduling opportunities have increased significantly in the current quarter where gilt yields, which underpin PWLB rates and market loans, have risen materially. The Council will be advised if there is value to be had by rescheduling or repaying a part of the debt portfolio. This is dependent on levels of investment balances. No debt rescheduling has currently been undertaken in the financial year.

10. Compliance with Treasury and Prudential Limits

10.1 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 Treasury Management Strategy Statement (TMSS) and Treasury Management Practices (TMPs).

10.2 The table below shows the Treasury and Prudential Indicators as at 30 June 2023, comparing the Budget to the Forecast position for the year.

Treasury and Prudential Indicators	**2023/24 Budget**	**2023/24 Forecast**
Debt and Investments		
Authorised limit for external debt	£241m	£241m
Operational boundary for external debt	£219m	£219m
Gross external debt (short and long term)	£165m	£178m
Investments	£18m	£18m
Net Borrowing	£147m	£160m
Maturity structure of fixed rate borrowing – upper and lower limits		
Under 12 months	75%	75%
12 months and within 2 years	75%	75%
2 years and within 5 years	75%	75%
5 years and within 10 years	75%	75%
10 years and above	75%	75%
Note: the lower limits are all 0%		
Limit for investments over a year	£2.0m	£2.0m
Capital Expenditure		
General Fund	£27.0m	£27.0m
Housing Revenue Account	£14.7m	£14.7m

Treasury and Prudential Indicators	2023/24 Budget	2023/24 Forecast
Commercial & Service Activities	£5.0m	£5.0m
Capital Financing Requirement	£199.0m	£199.0m
Financing costs		
Proportion of GF Financing Costs to Net Revenue Stream	25.4%	29.6%
Proportion of HRA Financing Costs to Rental Income	12.1%	10.7%
Proportion of net income from commercial and service investments to Net Revenue Stream	16.1%	16.1%

10.3 As at 30 June 2023, all the indicators are on target or remain within acceptable parameters.

10.4 Gross external debt has increased by £13m to £178m but remains within the operational boundary. Options are being considered on ways to reduce the current level of borrowing including a review of the capital programme. The proportion of GF Financing Costs to Net Revenue Stream has increased due to base rate increases on temporary borrowing.

10.5 The capital programme original budget figures have been updated for budget carried over from the previous financial year. The quarter one forecast is currently the same as the budget. An updated forecast will be provided at quarter two.

11. Revisions to CIPFA Codes

11.1 CIPFA published revised Prudential and Treasury Management Codes in December 2021. The main changes from the previous codes were:

- 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.

11.2 The code changes came in with immediate effect, although detailed reporting requirements could be deferred until 2023/24. Most of the requirements were implemented in the previous financial year. Full reporting will be achieved and reported by Quarter 2.

12. Non-treasury investments

12.1 The non-treasury investment activity includes the Council provision of a financial guarantee through its subsidiary company.

12.2 Investment Company Eastbourne Limited (ICE) is a private limited company and is incorporated and domiciled in the United Kingdom. The principal activity of the company is to guarantee an external financial liability with Canada Life and the future rental income of Infrastructure Investments Leicester Limited (IIL) by virtue of contractual arrangement.

12.3 ICE is included within the consolidated financial statements of the Eastbourne Borough Council and accurately accounted for as 'joint venture' to reflect the joint control over IIL. The company holds a single investment in its joint venture and exercises joint control over IIL by virtue of the Development and Management Agreement (DAMA). In return for providing the above Guarantee (including rental guarantee) in 2018, ICE receives a £0.3m annual guarantee fee (indexed pa).

12.4 The ICE Board of Directors met on 23rd May 2023 and reviewed key financial monitoring (including the guarantee fees payment schedule) in line with the agreed governance arrangements/agreement (DAMA).

13. Environmental, Social and Governance (ESG) Investment

13.1 The Cabinet at its meeting on 8 February 2023 approved the 2023/24 Treasury Management and Investment Strategy, which included Non-Specified investments such as ESG products that meet the Council's internal and external due diligence criteria.

13.2 While a wide range of ESG investments are currently limited, there are expectations 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).

13.3 There were no green deposits held at 30 June 2023, and there was no activity in the period.

14. Financial Appraisal

14.1 All relevant implications are referred to in the above paragraphs.

15. Risk Management Implications

15.1 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.

16. Equality Analysis

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

17. Legal Implications

17.1 There are no legal implications from this report.

18. Environmental sustainability implications

18.1 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.

19. Appendices

Appendix A - Detailed Link’s Economic Commentary

Appendix B – Glossary of Treasury Management Terms

20. Background Papers

Treasury Management and Prudential Indicators 2023/24, Capital Strategy & Investment Strategy (Cabinet 8/2/23).

Appendix A: Treasury Management Q1- 2023/24

Link Treasury Services Limited - Detailed economic commentary on treasury management activities and developments.

Economics Update

- The first quarter of 2023/24 saw:
  - A 0.2% m/m rise in real GDP in April, partly due to fewer strikes;
  - CPI inflation falling from 10.1% to 8.7% in April, before remaining at 8.7% in May. This was the highest reading in the G7;
  - Core CPI inflation rise in both April and May, reaching a new 31-year high of 7.1%;
  - A tighter labour market in April, as the 3myy growth of average earnings rose from 6.1% to 6.5%;
  - Interest rates rise by a further 75bps over the quarter, taking Bank Rate from 4.25% to 5.00%;
  - 10-year gilt yields nearing the "mini-Budget" peaks, as inflation surprised to the upside.
- The economy has weathered the drag from higher inflation better than was widely expected. The 0.2% m/m rise in real GDP in April, following March's 0.3% m/m contraction will further raise hopes that the economy will escape a recession this year. Some of the strength in April was due to fewer strikes by train workers and teachers in that month. Moreover, some of the falls in activity in other areas in April were probably temporary too. Strikes by junior doctors and civil servants contributed to the fall in health output (0.9% m/m) and the meagre 0.1% m/m increase in public administration.
- The fall in the composite Purchasing Managers Index (PMI) from 54.0 in May to a three-month low of 52.8 in June (>50 points to expansion in the economy, <50 points to contraction) was worse than the consensus forecast of 53.6. Both the services and manufacturing PMIs fell. The decline in the services PMI was bigger (from 55.2 to 53.7), but it remains consistent with services activity expanding by an annualised 2%. The fall in the manufacturing PMI was smaller (from 47.1 to 46.2), but it is consistent with the annual rate of manufacturing output falling from -0.8% in April to around -5.0%. At face value, the composite PMI points to the 0.1% q/q rise in GDP in Q1 2023 being followed by a 0.2% q/q gain in Q2 2023.
- Meanwhile, the 0.3% m/m rise in retail sales volumes in May was far better than the consensus forecast of a 0.2% m/m decline and followed the robust 0.5% m/m rise in April. Some of the rise was due to the warmer weather. Indeed, the largest move was a 2.7% m/m jump in non-store sales, due to people stocking up on outdoor-related goods. But department stores also managed to squeeze out a 0.6% m/m rise in sales and the household goods sub-sector enjoyed a reasonable performance too. Overall, the figures were far better than analysts had expected. In addition, the GfK measure of consumer confidence rebounded from -27 to a 17-month high of -24 in June.

- The recent resilience of the economy has been due to a confluence of factors including the continued rebound in activity after the pandemic, households spending some of their pandemic savings, and the tight labour market and government handouts both supporting household incomes. That said, as government support fades, real household incomes are unlikely to grow rapidly. Furthermore, higher interest rates will mean GDP is likely to contract later this year. Our central assumption is that inflation will drop to the 2.0% target only if the Bank triggers a recession by raising rates from 5.00% now to at least 5.5% and keeps rates there until at least mid-2024. Our colleagues at Capital Economics estimate that around 60% of the drag on real activity from the rise in rates has yet to bite, and the drag on the quarterly rate of real GDP growth over the next year may be about 0.2ppts bigger than over the past year.
- The labour market became tighter over the quarter and wage growth reaccelerated. Labour demand was stronger than the consensus had expected. The three-month change in employment rose from +182,000 in March to +250,000 in April. Meanwhile, labour supply continued to recover as the size of the labour force grew by 303,000 in the three months to April. That was supported by a further 140,000 decline in inactivity as people returned to work from retirement and caring responsibilities (while inactivity due to long-term sick continued to rise). But it was not enough to offset the big rise in employment, which meant the unemployment rate fell from 3.9% to 3.8%
- The tighter labour market supported wage growth in April, although the 9.7% rise in the National Living Wage on 1st April (compared to the 6.6% increase in April last year) probably had a lot to do with it too. The 3myy rate of average earnings growth reaccelerated from 6.1% to 6.5% (consensus 6.1%) and UK wage growth remains much faster than in the US and the Euro-zone. In addition, regular private sector wage growth increased from 7.1% 3myy to 7.6%, which left it well above the Bank's forecast for it to fall below 7.0%. Overall, the loosening in the labour market appears to have stalled in April and regular private sector wage growth was well above the Bank's forecast.
- CPI inflation stayed at 8.7% in May (consensus 8.4%) and, perhaps more worryingly, core CPI inflation rose again, from 6.8% to a new 31-year high of 7.1%. The rise in core inflation built on the leap from 6.2% in March to 6.8% and means it is accelerating in the UK while it is slowing in the US and the Euro-zone (both fell to 5.3%). A further decline in fuel inflation, from -8.9% to -13.1%, and the second fall in food inflation in as many months, from 19.3% to 18.7%, explained why overall CPI inflation didn't rise. And the scheduled fall in the average annual utility price from £2,500 to £2,074 on 1st July means overall CPI inflation will probably ease in the coming months. But the problem is that the recent surge in core inflation and the reacceleration in wage growth shows that domestic inflationary pressures are still strengthening.
- This suggests the Bank may have more work to do than the Fed or ECB. Indeed, the Bank of England sounded somewhat hawkish in the June meeting. This came through most in the MPC's decision to step up the pace of hiking from the 25bps at the previous two meetings. The 7-2 vote, with only two members voting to leave rates unchanged at 4.50%, revealed support for stepping up the fight against high inflation.
- That said, the Bank has not committed to raising rates again or suggested that 50bps rises are now the norm. What it did say was that "the scale of the recent upside surprises in official estimates of wage growth and services CPI inflation suggested a 0.5 percentage point increase in interest rates was required at this particular meeting".

Moreover, the Committee did not strengthen its forward guidance that any further rate hikes would be conditional on the data. However, it looks highly probable, given the on-going strength of inflation and employment data, that the Bank will need to raise rates to at least 5.5% and to keep rates at their peak until the mid-point of 2024. We still think it is only a matter of time before the rise in rates weakens the economy sufficiently to push it into recession. That is why instead of rising to between 6.00%-6.25%, as is currently priced in by markets, we think rates are more likely to peak between 5.50-6.00%. Our forecast is also for rates to be cut in the second half of 2024, and we expect rates to then fall further than markets are pricing in.

- Growing evidence that UK price pressures are becoming increasingly domestically generated has driven up market interest rate expectations and at one point pushed the 10-year gilt yield up to 4.49% in late June, very close to its peak seen after the “mini-budget”. Yields have since fallen slightly back to 4.38%. But growing expectations that rates in the UK will remain higher for longer than in the US mean they are still more than 70 bps above US yields. While higher interest rates are priced into the markets, the likely dent to the real economy from the high level of interest rates is not. That’s why we think there is scope for market rate expectations to fall back in 2024 and why we expect the 10-year PWLB Certainty Rate to drop back from c5.20% to 5.00% by the end of this year and to 4.20% by the end of 2024.
- The pound strengthened from $1.24 at the start of April to a one-year high at $1.26 in early May, which was partly due to the risks from the global banking issues being seen as a bigger problem for the US than the UK. The pound then fell back to $1.23 at the end of May, before rising again to $1.28 in the middle of June as the strong core CPI inflation data released in June suggested the Bank of England was going to have to raise rates more than the Fed or ECB in order to tame domestic inflation. However, sterling’s strong run may falter because more hikes in the near term to combat high inflation are likely to weaken growth (and, hopefully, at some point inflation too) to such a degree that the policy rate will probably be brought back down, potentially quite quickly, as the economic cycle trends downwards decisively. This suggests that additional rate hikes are unlikely to do much to boost the pound.
- In early April, investors turned more optimistic about global GDP growth, pushing up UK equity prices. But this period of optimism appears to have been short-lived. The FTSE 100 has fallen by 4.8% since 21st April, from around 7,914 to 7,553, reversing part of the 7.9% rise since 17th March. Despite the recent resilience of economic activity, expectations for equity earnings have become a bit more downbeat. Nonetheless, further down the track, more rate cuts than markets anticipate should help the FTSE 100 rally.

MPC meetings 11th May and 22nd June 2023

- On 11th May, the Bank of England’s Monetary Policy Committee (MPC) increased Bank Rate by 25 basis points to 4.50%, and on 22nd June moved rates up a further 50 basis points to 5.00%. Both increases reflected a split vote – seven members voting for an increase and two for none.

- Nonetheless, with UK inflation significantly higher than in other G7 countries, the MPC will have a difficult task in convincing investors that they will be able to dampen inflation pressures anytime soon. Talk of the Bank’s inflation models being “broken” is perhaps another reason why gilt investors are demanding a premium relative to US and Euro-zone bonds, for example.
- Of course, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has already hiked short-term rates to a range of 5.00%-5.25%, but a further increase is pencilled in for July, whilst the ECB looks likely to raise its Deposit rate at least once more to a peak of 3.75%, with upside risk of higher to come.

Appendix B

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	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. The CFR increases with capital expenditure and decreases with capital finance and MRP.
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 (*formerly known as Ministry of Housing, Communities & Local Government - MHCLG*).
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.