Committee and Date

Cabinet
15th February 2023

Item

Public

Treasury Management Update Quarter 3 2022/23

Responsible Officer:		James Walton	
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Cabinet Member (Portfolio Holder):		Gwilym Butler, Finance & Corporate Support	

1. Synopsis

The Council currently holds £114.8m in investments and £292m of borrowing. Current investment performance has achieved a return of 2.24%, outperforming the benchmark.

2. Executive Summary

2.1. The report outlines the treasury management activities of the Council in the third quarter of 2022/23. It outlines the economic background against which decisions have been made. It also provides an update on the performance of the treasury management function.

2.2. During Quarter 3 the internal treasury team achieved a return of 2.24% on the Council's cash balances, outperforming the benchmark by 0.12%. This amounts to additional income of £44,220 during the quarter, which is also included within the Council's revenue monitor for quarter 3.

3. Recommendations

3.1. Members are asked to discuss and note the position as set out in the report, in particular the continued compliance with the prudential indicators and the treasury management strategy.

4. Risk Assessment and Opportunities Appraisal

4.1. The assessment and management of risk are key considerations for any Treasury Management approach. Compliance with the CIPFA Code of Practice on Treasury Management, the Council's Treasury Policy Statement and Treasury Management Practices and the Prudential Code for Capital Finance together with the rigorous internal controls and adherence to the Corporate Opportunity Risk Management Strategy methodology enables the Council to manage the risk associated with Treasury Management activities and the potential for financial loss.

4.2. The Council's Audit Committee is the committee responsible for ensuring effective consideration of the Council's Treasury Management Strategy and policies.

4.3. The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998.

4.4. There are no direct environmental, equalities or climate change consequences arising from this report

5. Financial Implications

5.1. The Council makes assumptions about the levels of borrowing and investment income over the financial year. Reduced borrowing as a result of capital receipt generation or delays in delivery of the capital programme will both have a positive impact of the council's cash position. Similarly, higher than benchmarked returns on available cash will also help the Council's financial position. For monitoring purposes, assumptions are made early in year about borrowing and returns based on the strategies agreed by Council in the preceding February. Performance outside of these assumptions results in increased or reduced income for the Council.

5.2. The Quarter 3 performance is above benchmark and has delivered additional income of £44,220.

5.3. As at 31 December 2022 the Council held £114.8million in investments as detailed in Appendix A and borrowing of £292million at fixed interest rates. The level of investments has fallen by £45m in the last 12 months, as reserves (notably COVID grant funding) has been applied to ongoing operations. The level of external borrowing remains the same as 12 months ago - i.e. no further external borrowing has been undertaken in the last 12 months.

6. Climate Change Appraisal

6.1. The Council's Financial Strategy includes proposals to deliver a reduced carbon footprint for the Council therefore the Treasury Team is working with the Council in order to achieve this. There are no direct climate change impacts arising from this report. Shropshire Council's investment portfolio has no level 1, 2 or 3 emissions. It comprises of straightforward cash deposits with financial institutions and other Local Authorities.

7. Background

7.1. The Council defines its treasury management activities as "the management of the authority's borrowing, investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks". The report informs Members of the treasury activities of the Council between 1 October 2022 and 31 December 2022.

7.2. For wider context and consideration of the global financial outlook, an economic and borrowing update for the third quarter is considered in Appendix D.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)

Local Member:	All

Appendices

A. Shropshire Council Monthly Investment Analysis as at 31 December 2022 (provided by Link Group)

B. Prudential Indicators for Quarter 3 2022/23

C. Prudential Borrowing Schedule

D. Economic Background and Borrowing Update

Appendix A. Shropshire Council Investment Analysis Review at 31 December 2022 (from Link Group)

Shropshire Council

Shropshire Council

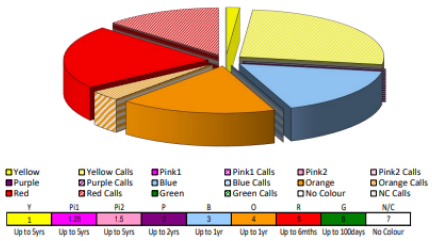
Current Investment List

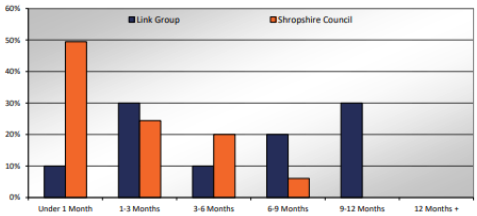
Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest LT / Fund Rating	Historic Risk of Default
Handelsbanken Plc	4,100,000	3.00%		Call	AA-	0.000%
MMF Aberdeen Standard Investments	15,000,000	3.19%		MMF	AAAm	
MMF Insight	15,000,000	3.11%		MMF	AAAm	
HSBC UK Bank Plc (RFB)	5,000,000	0.51%	04/01/2022	03/01/2023	A+	0.000%
Goldman Sachs International Bank	5,000,000	2.80%	18/08/2022	17/01/2023	A+	0.002%
DMO	1,700,000	3.03%	01/12/2022	20/01/2023	AA-	0.001%
HSBC UK Bank Plc (RFB)	3,000,000	0.66%	26/01/2022	25/01/2023	A+	0.003%
National Westminster Bank Plc (RFB)	5,000,000	0.94%	04/02/2022	25/01/2023	A	0.003%
Barclays Bank Plc (NRFB)	3,000,000	3.11%	31/10/2022	31/01/2023	A	0.004%
National Westminster Bank Plc (RFB)	2,000,000	1.00%	18/02/2022	01/02/2023	A	0.004%
Barclays Bank Plc (NRFB)	3,000,000	3.19%	04/11/2022	06/02/2023	A	0.005%
HSBC UK Bank Plc (RFB)	4,000,000	1.01%	08/02/2022	07/02/2023	A+	0.005%
Barclays Bank Plc (NRFB)	4,000,000	3.40%	25/11/2022	24/02/2023	A	0.007%
HSBC UK Bank Plc (RFB)	5,000,000	3.01%	08/12/2022	08/03/2023	A+	0.008%
Barclays Bank Plc (NRFB)	5,000,000	3.60%	16/12/2022	16/03/2023	A	0.009%
Coventry Building Society	2,000,000	2.99%	23/09/2022	23/03/2023	A-	0.010%
Coventry Building Society	3,000,000	3.78%	30/09/2022	30/03/2023	A-	0.011%
Santander UK PLC	15,000,000	3.24%		Call95	A	0.012%
HSBC UK Bank Plc (RFB)	1,500,000	1.61%	24/05/2022	23/05/2023	A+	0.018%
National Westminster Bank Plc (RFB)	5,000,000	2.00%	31/05/2022	31/05/2023	A	0.019%
HSBC UK Bank Plc (RFB)	1,500,000	2.18%	14/06/2022	14/06/2023	A+	0.021%
National Westminster Bank Plc (RFB)	5,000,000	3.05%	23/08/2022	18/08/2023	A	0.029%
National Westminster Bank Plc (RFB)	2,000,000	3.80%	20/09/2022	15/09/2023	A	0.033%
Total Investments	**£114,800,000**	**2.71%**				0.010%

Note: An historic risk of default is only provided if a counterparty has a counterparty credit rating and is not provided for an MMF or USDBF, for which the rating agencies provide a fund rating. The portfolio's historic risk of default therefore measures the historic risk of default attached only to those investments for which a counterparty has a counterparty credit rating and also does not include investments which are not rated.

Shropshire Council

Portfolio Composition by Link Group's Suggested Lending Criteria





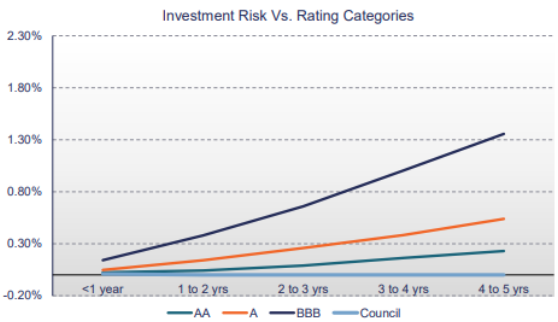
Portfolios weighted average risk number = 3.35

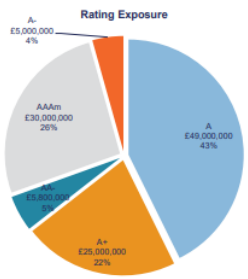
WARoR = Weighted Average Rate of Return
WAM = Weighted Average Time to Maturity

	% of Portfolio	Amount	% of Colour in Calls	Amount of Colour in Calls	% of Call in Portfolio	WARoR	WAM	WAM at Execution	Excluding Calls/MMFs/USDBFs WAM	Excluding Calls/MMFs/USDBFs WAM at Execution
Yellow	27.61%	£31,700,000	94.64%	£30,000,000	26.13%	3.14%	1	3	20	50
Pink1	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Pink2	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Purple	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Blue	16.55%	£19,000,000	0.00%	£0	0.00%	2.08%	137	359	137	359
Orange	20.99%	£24,100,000	17.01%	£4,100,000	3.57%	1.73%	43	245	52	296
Red	34.84%	£40,000,000	37.50%	£15,000,000	13.07%	3.26%	69	112	53	121
Green	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
No Colour	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
	100.00%	**£114,800,000**	**42.77%**	**£49,100,000**	**42.77%**	**2.71%**	**56**	**150**	**76**	**241**

Shropshire Council

Investment Risk and Rating Exposure





Historic Risk of Default

Rating/Years	<1 year	1 to 2 yrs	2 to 3 yrs	3 to 4 yrs	4 to 5 yrs
AA	0.02%	0.04%	0.09%	0.16%	0.23%
A	0.05%	0.14%	0.26%	0.38%	0.54%
BBB	0.14%	0.38%	0.66%	1.01%	1.36%
Council	0.01%	0.00%	0.00%	0.00%	0.00%

Historic Risk of Default
This is a proxy for the average % risk for each investment based on over 30 years of data provided by Fitch, Moody's and S&P. It simply provides a calculation of the possibility of average default against the historical default rates, adjusted for the time period within each year according to the maturity of the investment.

Chart Relative Risk
This is the authority's risk weightings compared to the average % risk of default for "AA", "A" and "BBB" rated investments.

Rating Exposures
This pie chart provides a clear view of your investment exposures to particular ratings.

Note: An historic risk of default is only provided if a counterparty has a counterparty credit rating and is not provided for an MMF or USDBF, for which the rating agencies provide a fund rating. The portfolio's historic risk of default therefore measures the historic risk of default attached only to those investments for which a counterparty has a counterparty credit rating and also does not include investments which are not rated.

Appendix B. Prudential Indicators for Quarter 3 2022/23

Prudential Indicator	2022/23 Indicator £m	Quarter 1 – Actual £m	Quarter 2 – Actual £m	Quarter 3 – Actual £m	Quarter 4 – Actual £m
Non HRA Capital Financing Requirement (CFR)	431*	366	392	396	
HRA CFR	95	95	95	95	
Gross borrowing	348	292	292	292	
Investments	150	129	143	115	
Net borrowing	198	163	149	177	
Authorised limit for external debt	528	292	292	292	
Operational boundary for external debt	460	292	292	292	
Limit of fixed interest rates (borrowing)	528	292	292	292	
Limit of variable interest rates (borrowing)	264	0	0	0	
Internal Team Principal sums invested > 364 days	70	0	0	0	
Maturity structure of borrowing limits	**%**	**%**	**%**	**%**	**%**
Under 12 months	15	2	2	2	
12 months to 2 years	15	0	0	0	
2 years to 5 years	45	1	1	1	
5 years to 10 years	75	16	16	17	
10 years to 20 years	100	31	31	30	
20 years to 30 years	100	22	22	26	
30 years to 40 years	100	17	17	13	
40 years to 50 years	100	2	2	2	
50 years and above	100	9	9	9	

Appendix C. Prudential Borrowing Schedule

Capital Financing Summary

Prudential Borrowing Approvals	Date Approved	Amount Approved £	Applied (Spent) 2006/07 £	Applied (Spent) 2007/08 £	Applied Outturn 08/09 2008/09 £	Applied Outturn 09/10 2009/10 £	Applied Outturn 10/11 2010/11 £	Applied Outturn 11/12 2011/12 £	Applied Outturn 12/13 2012/13 £	Applied Outturn 13/14 2013/14 £	Applied Outturn 14/15 2014/15 £	Applied Outturn 15/16 2015/16 £	Applied Outturn 16/17 2016/17 £	Applied Outturn 17/18 2017/18 £	Applied Outturn 18/19 2018/19 £	Applied Outturn 19/20 2019/20 £	Applied Outturn 20/21 2020/21 £	Applied Outturn 21/22 2021/22 £	Budgeted 2022/23 £	Budgeted 2023/24 £	Budgeted 2024/25 £	Budgeted 2025/26 £	Budgeted 2026/27 £	First year MRP Charged	Asset Life	Final year MRP Charged
Monkmoor Campus	24/02/2006	3,580,000																								
Capital Receipts Shortfall -Cashflow	24/02/2006	5,000,000																								
Applied:																										
Monkmoor Campus			3,000,000		0																			2007/08	25	2031/32
William Brooks					0		3,580,000																	2011/12	25	2035/36
Tern Valley					2,000,000																			2010/11	35	2044/45
		8,580,000	**3,000,000**	**0**	**2,000,000**	**0**	**3,580,000**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0.00**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**			
Highways	24/02/2006	2,000,000	2,000,000																					2007/08	20	2026/27
Accommodation Changes	24/02/2006	650,000	410,200	39,800																				2007/08	6	2012/13
Accommodation Changes - Saving	31/03/2007	(200,000)																								
		450,000	**410,200**	**39,800**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0.00**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**			
The Ptarmigan Building	05/11/2009	3,744,000				3,744,000																		2010/11	25	2034/35
The Mount McKinley Building	05/11/2009	2,782,000				2,782,000																		2011/12	25	2035/36
The Mount McKinley Building	05/11/2009	0					-																	2011/12	5	2015/16
Capital Strategy Schemes - Potential Capital Receipts shortfall	25/02/2010	187,600					-	-	-	0	-	-	-	-	0.00	-									25	
- Desktop Virtualisation						187,600	-																	2010/11	5	2014/15
Carbon Efficiency Schemes/Self Financing	25/02/2010	1,512,442					115,656	1,312,810	83,976	-	-	-	-	-	0.00	-								2011/12	5	2017/18
Transformation schemes		92,635						92,635	-	-														2012/13	3	2014/15
Renewables - Biomass - Self Financing	14/09/2011	92,996						82,408	98,258	(87,670)	-													2014/15	25	2038/39
Solar PV Council Buildings - Self Financing	11/05/2011	56,342						1,283,959	124,584	(1,352,202)	-													2013/14	25	2038/39
Depot Redevelopment - Self Financing	23/02/2012	0							-	-	-													2014/15	10	2023/24
Oswestry Leisure Centre Equipment - Self Financing	04/04/2012	124,521						124,521																2012/13	5	2016/17
Leisure Services - Self Financing	01/08/2012	711,197							711,197															2013/14	5	2016/17
Mardol House Acqusition	26/02/2015	4,160,000									4,160,000	-												2015/16	25	2039/40
Mardol House Adaptation and Refit	26/02/2015	3,340,000									167,640.84	3,172,358.86	-	-	0.00	-								2016/17	25	2041/42
Oswestry Leisure Centre Equipment - Self Financing	01/08/2012	290,274												274,239		16,035								2018/19	5	2022/23
Car Parking Strategy Implementation	17/01/2018	590,021													588,497.06	1,524								2020/21	5	2024/25
JPUT - Investment in Units re Shrewsbury Shopping Centres	13/12/2017	55,299,533												52,204,603	-208,569.18	2,791,967	320,079.38	191,453						2018/19	45	2042/43
JPUT - SSC No 1 Ltd	13/12/2017	527,319												527,319												
CDL Shareholding	28/02/2019	1															1							2021/22		
Children's Residental Care	28/02/2019	2,000,001														1,381,539	230,765	38,486.70	349,210					2020/21	25	2044/45
Pride Hill Shopping Centre Reconfiguration	19/12/2019	1,276,320															434,027	842,293						AUC	25	
Greenacres Supported Living Development	24/09/2020	3,125,000																34,317	90,683	2,000,000	1,000,000			2023/24	25	2046/47
Bishops Castle Business Park	19/09/2019	3,111,899															2,900	1,545,647	1,563,352					2023/24	25	2044/45
Whitchurch Medical Practice (Pauls Moss Development)	26/07/2018	3,778,228																		2,978,228				2023/24	25	2047/48
Oswestry Castleview - Site Acquisition	19/12/2019	3,256,241																	800,000					2020/21	25	2044/45
DVSA Site Acquisiiton		0														3,256,241								2022/23	25	2045/46
NCP Car Park, Wyle Cop, Shrewsbury		0																		0				AUC	25	
Former Morrisons Site, Oswestry	19/09/2019	3,390,145																						2021/22	25	2045/46
Meole Brace Pitch & Putt		5,400,000															3,390,145			4,264,298	503,415			AUC	25	
Maesbury Solar Farm		2,041,173																11,927	620,360					AUC	25	
Commercial Investment Fund	Fin Strat 19/20	5,479,704																		2,041,173				2021/22	25	2044/45
The Tannery Development Block A - Land Acqusition		660,253																			5,479,704			2022/23	25	2045/46
The Tannery Development Block A		6,353,605																62,500	597,753					AUC		
The Tannery Development - Block B & C		7,467,802																		1,353,605	5,000,000			2019/20	25	2045/46
Oswestry Property Acquisition	12/05/2022	3,326,850													3,677,843.83	3,456,019	311,325	16,614	6,000					2023/24	25	2047/48
Shrewsbury Property Acquisition		3,846,000																	3,326,850					2023/24	25	2047/48
Recycling Bin Roll Out Programme		2,932,471																	3,846,000					2022/23	10	2032//33
Highways Investment Programme	ital Strategy Feb	31,565,001																4,395	2,928,076					2022/23	25	2046/47
Whitchurch Swimming & Leisure Facility	22/09/2022	13,100,282																3,983,412	18,011,589	3,545,000	3,695,000	2,330,000		2026/27	45	2046/47
Previous NSDC Borrowing		955,595			821,138	134,457													621,824	4,420,657	5,357,237	2,067,303	633,261	2009/10	5/25	2065/66
		187,607,448	**5,410,200**	**39,800**	**2,821,138**	**6,848,057**	**3,695,656**	**2,896,333**	**1,018,015**	**(1,439,872)**	**4,327,641**	**3,172,359**	**0**	**53,006,161**	**4,057,772**	**10,903,325**	**4,689,242.81**	**6,731,043.78**	**32,761,697**	**20,602,961**	**21,035,356**	**4,397,303**	**633,261**		(1)	

APPENDIX D – ECONOMIC UPDATE (FROM LINK GROUP)

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 Tenreyro, 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. The US FOMC has led with increases of 425 basis points in 2022 and is expected to increase rates further in 2023. Similarly, the ECB has also started to tighten monetary policy, albeit from an ultra-low starting point, as have all the major central banks apart from Japan (although the BoJ has "tightened" its policy by widening the accepted yield levels for 10yr JGBs, from 0.25% to 0.5% on 20th December). Arguably, though, it is US monetary policies that are having the greatest impact on global bond markets.

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.

Interest rate forecasts

The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.

The latest forecast, made on 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.

- 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 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.