Division(s): N/A

COUNCIL – 28 MARCH 2023

TREASURY MANAGEMENT QUARTER 3 PERFORMANCE REPORT 2022/23

Report by Director of Finance

RECOMMENDATION

1. **Council is RECOMMENDED to note the Council's treasury management activity in the third quarter of 2022/23.**

Executive Summary

2. This report covers the treasury management activity for the third quarter of 2022/23 in compliance with the CIPFA Code of Practice on Treasury Management 2021. It provides an update on the anticipated position and prudential indicators set out in the Treasury Management Strategy Statement & Annual Investment Strategy for 2022/23 agreed as part of the council's budget and Medium Term Financial Strategy in February 2022.

3. During the third quarter of the year, £5m of external debt was repaid, taking the council's external debt balance to at £308.38m 31 December 2022.

4. The average daily balance of temporary surplus cash invested in-house in the nine months to 31 December was £447.24m, compared to the £342.00m budget and reflects reprofiling in anticipated capital expenditure and higher balances of capital grants compared to the original forecast. Over that period the average in-house return was 1.25%. That was above the budgeted rate of 0.35% set in the strategy in February 2022, prior to the significant worldwide economic pressures as a result of the war in Ukraine. This has produced gross interest receivable of £4.07m for the nine months to 31 December 2022 compared to the budget of £1.16m.

5. During the first half of the year the Council maintained its holding in external funds. Gross distributions from the council's investments in pooled funds totalled £2.91m in the first three quarters of the year, exceeding the budgeted figure of £2.52m. Forecast returns for the year are £3.81m, in line with the budget of £3.81m.

Introduction

6. The Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice on Treasury Management 2021 recommends that members are informed of Treasury Management activities at least four times per year. This report, and the quarterly updates, ensures the council's reporting is consistent with best practice in accordance with CIPFA's recommendations.

7. The following annexes are attached

   Annex 1 Debt Financing 2022/23

Annex 2 Public Works Loans Board (PWLB) Debt Maturing
Annex 3 Prudential Indicator Monitoring
Annex 4 Specified & Non-Specified Investments 2022/23
Annex 5 External Backdrop Provided by Link Treasury Services

Treasury Management Strategy 2022/23

8. The Treasury Management Strategy & Annual Investment Strategy for 2022/23 outlines the council's strategic objectives in terms of its debt and investment management for the financial year 2022/23.

9. The strategy sets out that the forecast average cash balance for 2022/23 is £442m. The average base rate forecast was 0.35%

10. The council intends to maintain its investment in strategic pooled funds with a purchase value of £101m (23%), with the remaining £341m (77%) being managed internally with a mixture of short, medium and long-term deposits.

11. The strategy for borrowing provided an option to fund new or replacement borrowing. The limit for internal borrowing was combined with the long term lending limit, and will not exceed £300m.

Treasury Management Activity

Debt Financing

12. The Treasury Management Strategy for 2022/23 assumed the level of external borrowing would increase by £46m during the financial year. As a result of slippage in the capital programme noted in the Capital Monitoring Report to Cabinet in July and October 2022 and the forecast for cash balances over the medium term being higher than anticipated this external borrowing does not need to be arranged in 2022/23.

13. The Council's cumulative total external debt reduced from £313.38m from 1 April 2022 to £308.23m at 31 December 2022. No new debt financing has been arranged during the year. The total forecast external debt as at 31 March 2023 is £306.38m. The forecast debt financing position for 31 March 2023 is shown in Annex 1.

14. At 31 December 2022, the authority had 50 PWLB[1] loans totalling £258.38m, nine LOBO[2] loans totalling £45m and one long-term fixed Money Market loan totalling £5m[3]. The combined weighted average interest rate for external debt as at 31 December was 4.44%.

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[1] PWLB (Public Works Loans Board) is a Government agency operating within the United Kingdom Debt Management Office and is responsible for lending money to Local Authorities.
[2] LOBO (Lender's Option/Borrower's Option) Loans are long-term loans which include a re-pricing option for the bank at predetermined intervals.
[3] In June 2016, the Council's LOBO with Barclays PLC was converted to a fixed rate loan at its current interest rate of 3.95% to mature on the 29th May 2065 with Barclays waiving their right to change the interest rate on the loan in the future.

Maturing Debt

15. During the third quarter of the year, £5m of PWLB debt matured. The Council is forecast to repay a further £2m of PWLB debt by 31 March 2023. The details are set out in Annex 2.

Debt Restructuring

16. The premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Authority's portfolio and therefore unattractive for debt restructuring activity. No PWLB debt restructuring activity was undertaken during the first half of the year. However, given the forecast for bond rates, debt restructuring opportunities are being actively sought with our advisors, Link Treasury Services.

LOBOs

17. At the beginning of the financial year the Council held £45m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. £15m of these LOBOs had options during 2022/23. To the 31 December 2022 none had been exercised by the lender.

18. Increased gilt yields in the first six months of the year raised the likelihood of lenders exercising their option to increase the rates on LOBOs, however in the third quarter of the year these risks subsided as UK Government Gilt yields lowered. If gilt yield were to temporarily increase in the short term, and given the level of cash balances and forecasts for gilt yields to lower over the medium term, the Treasury Management Strategy Team (TMST) have agreed that the council will repay any called LOBOs with internal borrowing over the medium term to avoid additional costs of servicing these instruments. The council is also exploring early repayment opportunities of LOBOs with Link Treasury Services.

Investment Strategy

19. The Council holds deposits and invested funds representing income received in advance of expenditure plus balances and reserves. The guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles. The Council continued to adopt a cautious approach to lending to financial institutions and continuously monitored credit quality information relating to counterparties.

20. During the first half of the financial year term fixed deposits have been placed with other Local Authorities as per the approved lending list, whilst Money Market Funds have been utilised for short-term liquidity. Inter Local Authority lending remains an attractive market to deposit funds with from a security perspective, whilst the Government's Debt Management Deposit Facility (DMADF) has also provided a competitive and secure counterparty. With rapidly increasing interest rates, the Council has taken a position of laddering investments, taking advantage of increased market rates and ensuring a continuous cycle of maturities to be invested at higher rates.

21. The Treasury Management Strategy Statement and Annual Investment Strategy for 2022/23 included the use of external fund managers and pooled funds to diversify the investment

portfolio through the use of different investment instruments, investment in different markets, and exposure to a range of counterparties. It is expected that these funds should outperform the Council's in-house investment performance over a rolling three-year period. The strategy permitted up to 50% of the total portfolio to be invested with external fund managers and pooled funds (excluding Money Market Funds). The performance of the pooled funds will continue to be monitored by the TMST throughout the year against respective benchmarks and the in-house portfolio.

22. At the start of the year the UK Bank Rate was 0.75%, which was above the forecast of 0.25% in February 2022, prior to the significant worldwide economic pressures as a result of the war in Ukraine. Official rates rose to 1.25% by June 2022, again to 2.25% by September 2022 and to 3.50% by December 2022. With ongoing inflationary pressures impacting on the UK economy, the current forecast is for interest rates to increase to a high of 4.50% by March 2023. This is down from the forecast of 5.00% in the Mid Term Review. In the medium term, rates are forecast to reduce to 2.50% by 2025.

23. The long term lending limit for 2022/23 is £205m. During the first six months of the year the average available cash headroom within that limit was £10m.

The Council's Lending List

24. The Council's in-house cash balances were deposited with institutions that meet the Council's approved credit rating criteria. The approved Lending List is updated to reflect changes in counterparty credit quality with changes reported to Cabinet on a bi-monthly basis. There were no changes to the lending list in the first three quarter of 2022/23.

25. In the three quarter to 31 December 2022 there were no instances of breaches in policy in relation to the council's Lending List. Any breaches in policy will be reported to Cabinet as part of the monthly Business Management & Monitoring report.

Investment Performance

26. Security of capital has remained the Authority's main investment objective. This has been maintained by following the Authority's counterparty policy as set out in its Treasury Management Strategy Statement and Annual Investment Strategy for 2022/23 and by maintaining a limited exposure to "bail in" banks and favouring deposits with other Local Authorities and the DMADF. As at 31 December 2022, the Council had £370.0m deposited with 43 other Local Authorities with an average deposit total of £8.60m per authority. The maximum deposit with any single local authority was £21m. This was below the limit of £30m. The Council also had £20m deposited with the DMADF as at 31 December 2022.

27. The average daily balance of temporary surplus cash invested in-house in the three quarters to December was £447.26m, compared to the budget of £342.00m. The Council achieved an average in-house return for that period of 1.25%, above the budgeted rate of 0.35% set in the strategy. This has produced gross interest receivable of £4.07m for the nine months to 31 December compared to budget of £1.16m.

28. Whilst the average return for the first 9 months of the year is 1.25%, the monthly return has increased from a low 0.59% in April 2022 to 2.49% in December 2022.

29. Temporary surplus cash includes; developer contributions; council reserves and balances; trust fund balances; and various other funds to which the Council pays interest at each financial year end, based on a margin below the Sterling Overnight Interest Average.

External Fund Managers and Pooled Funds

30. During the first quarter of 2022/23 the Council maintained its holding in external funds. The value of the funds was 94.94m as at 31 December 2022 compared to £95.90m at 30 September 2022, and £101.08m at 30 June 2022. The original purchase cost of the portfolio in March 2019 was £101.0m. Weighted by original purchase value, pooled fund investments produced an annualised income return of 4.16% for the period. These investments are held with a long-term view and performance is assessed accordingly.

31. Gross distributions from pooled funds have totalled £2.91m in the first half of the year, exceeding the budgeted figure of £2.52m.

Prudential Indicators for Treasury Management

32. The Authority confirms compliance with its Prudential Indicators for 2022/23, which were set as part of the Authority's Treasury Management Strategy Statement. The position as at 31 December 2022 for the Prudential Indicators is shown in Annex 3.

Training

33. The Treasury Management Team continue to keep up to date with the latest developments and attend external workshops and conferences to maintain their knowledge and awareness of current issues where relevant

Financial Implications

34. Interest payable and receivable in relation to Treasury Management activities are included within the overall Strategic Measures budget. In house interest receivable for 2022/23 is currently forecast to be £6.70m, which is £5.16m above the £1.54m budget. An estimated £3.44m of this will be applied to Developer Contributions. As at 31 December 2022, £4.07m of the £6.70m interest receivable has been realised.

35. Dividends payable from external funds in 2022/23 are forecast as £4.00m, which is £0.20m above budget.

36. Interest payable is currently forecast to be £13.81m, which is £0.58m below the budgeted figure of £14.39m, due to £46m of new external borrowing not required during the year.

37. The Business Management & Monitoring Report to Cabinet in March 2023 notes that the net impact of the additional interest, after taking account of increases to interest payable on developer contributions is forecast to be £1.7m in 2022/23.

Comments checked by:

Lorna Baxter, Section 151 Officer, lorna.baxter@oxfordshire.gov.uk

Legal Implications

38. There are no direct legal implications arising from this report save for the need for ongoing collaborative working between the S.151 Officer and the Monitoring Office. CIPFA guidance promotes the need for consultative working and collaboration between these respective roles to promote good organisational governance.

Comments checked by:

Paul Grant, Head of Legal and Deputy Monitoring Officer, paul.grant@oxfordshire.gov.uk

Sustainability Implications

39. This report is not expected to have any negative impact with regards to the Council's zero carbon emissions commitment by 2030.

LORNA BAXTER, Director of Finance

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February 2023

Annex 1

OXFORDSHIRE COUNTY COUNCIL DEBT FINANCING 2022/23

Debt Profile		£m
1. PWLB	85%	263.38
2. Other Long Term Loans	15%	50.00
3. Sub-total External Debt		313.38
4. Internal Balances		0.00
5. Actual Debt at 31 March 2022	**100%**	**313.38**
6. Prudential Borrowing		42.62
7. Borrowing in Advance		0.00
8. Minimum Revenue Provision		-10.17
9. Forecast Debt at 31 March 2023		**345.84**
Maturing Debt		
10. PWLB loans maturing during the year		-7.00
11. PWLB loans repaid prematurely in the course of debt restructuring		0.00
12. Total Maturing Debt		**-7.00**
New External Borrowing		
13. PWLB Normal		0.00
14. PWLB loans raised in the course of debt restructuring		0.00
15. Money Market LOBO loans		0.00
16. Total New External Borrowing		**0.00**
Debt Profile Year End		
17. PWLB	74%	256.38
18. Money Market loans (incl £45m LOBOs)	14%	50.00
19. Forecast Sub-total External Debt		306.38
20. Forecast Internal Balances	12%	39.46
21. Forecast Debt at 31 March 2023	**100%**	**345.84**

Line

1 – 5 This is a breakdown of the Council's debt at the beginning of the financial year (1 April 2020). The PWLB is a government agency operating within the Debt Management Office. LOBO (Lender's Option/ Borrower's Option) loans are long-term loans, with a maturity of up to 60 years, which includes a re-pricing option for the bank at predetermined time intervals. Internal balances include provisions, reserves, revenue balances, capital receipts unapplied, and excess of creditors over debtors.

6 'Prudential Borrowing' reflects Prudential Borrowing taken by the authority whereby the associated borrowing costs are met by savings in the revenue budget.

7 'Borrowing in Advance' is the amount the Council borrowed in advance to fund future capital finance costs.

8 The amount of debt to be repaid from revenue. The sum to be repaid annually is laid down in the Local Government and Housing Act 1989, which stipulates that the repayments must equate to at least 4% of the debt outstanding at 1 April each year.

9 The Council's forecast total debt by the end of the financial year, after taking into account new borrowing, debt repayment and movement in funding by internal balances.

10 The Council's normal maturing PWLB debt.

11 PWLB debt repaid early during the year.

12 Total debt repayable during the year.

13 The normal PWLB borrowing undertaken by the Council during 2022/23.

14 New PWLB loans to replace debt repaid early.

15 The Money Market borrowing undertaken by the Council during 2022/23

16 The total external borrowing undertaken.

18-22 The Council's forecast debt profile at the end of the year.

Annex 2

Long-Term Debt Maturing 2022/23

Public Works Loan Board: Loans maturing during 2022/23

Date	Amount £m	Rate %
31/10/2022	4.000	5.050%
31/12/2022	1.000	6.250%
26/03/2023	0.316	6.625%
26/03/2023	1.684	6.625%
Total	**7.000**	

Annex 3

Prudential Indicators Monitoring at 31 December 2022

The Local Government Act 2003 requires the Authority to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. To demonstrate that the Authority has fulfilled the requirements of the Prudential Code the following indicators must be set and monitored each year.

Authorised and Operational Limit for External Debt

Actual debt levels are monitored against the Operational Boundary and Authorised Limit for External Debt below. The Operational Boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. The council confirms that the Operational Boundary has not been breached during 2022/23.

The Authorised Limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements. The Authority confirms that the Authorised limit was not breached in the first half of 2022/23.

Authorised limit for External Debt	£495,000,000
Operational Limit for External Debt	£610,000,000
Capital Financing Requirement for year	£437,546,949

	Actual 31/12/2022	**Forecast 31/03/2023**
Borrowing	£308,382,618	£306,382,618
Other Long-Term Liabilities	£ 17,000,000	£ 17,000,000
Total	**£325,382,619**	**£323,382,618**

Interest Rate Exposures

These indicators are set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest exposures. Fixed rate investments are borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Fixed Interest Rate Exposure	
Fixed Interest Net Borrowing limit	£350,000,000
Actual at 31 December 2022	-£-131,117,382
Variable Interest Rate Exposure	
Variable Interest Net Borrowing limit	£0
Actual at 31 December 2022	-£7,251,990.40

Principal Sums Invested over 365 days

Total sums invested for more than 364 days limit	£215,000,000
Actual sums invested for more than 364 days	£ 94,500,000

Maturity Structure of Borrowing

This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing and the actual structure at 31 December 2022, are shown below. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

	Limit %	Actual %
Under 12 months	0 - 20	10.38
12 – 24 months	0 - 25	5.51
24 months – 5 years	0 - 35	15.24
5 years to 10 years	5 - 40	24.77
10 years +	40 - 95	43.40

Annex 4

Specified and Non Specified Investments 2022/23

Specified Investments

Investment Instrument	Minimum Credit Criteria	Use
Debt Management Agency Deposit Facility	N/A	In-house and Fund Managers
Term Deposits – UK Government	N/A	In-house
Term Deposits – other Local Authorities	N/A	In-house
Term Deposits – Banks and Building Societies	Short-term F1, Long-term BBB+, Minimum Sovereign Rating AA+	In-house and Fund Managers
Certificates of Deposit issued by Banks and Building Societies	A1 or P1	In-house on a buy and hold basis and Fund Managers
Money Market Funds	AAA	In-house and Fund Managers
Other Money Market Funds and Collective Investment Schemes[4]	Minimum equivalent credit rating of A+. These funds do not have short-term or support ratings.	In-house and Fund Managers
UK Government Gilts	N/A	In-house on a buy and hold basis and Fund Managers
Treasury Bills	N/A	In-house and Fund Managers
Reverse Repurchase Agreements - maturity under 1 year from arrangement and counterparty is of high credit quality (not collateral)	Long Term Counterparty Rating A-	In-house and Fund Managers
Covered Bonds – maturity under 1 year from arrangement	Minimum issue rating of A-	In-house and Fund Managers

[4] I.e., credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

Non-Specified Investments

Investment Instrument	Minimum Credit Criteria	Use	Max % of total Investments	Max Maturity Period
Term Deposits – other Local Authorities (maturities in excess of 1 year)	N/A	In-house	50%	3 years
Term Deposits – Banks and Building Societies (maturities in excess of 1 year)	Short-term F1+, Long-term AA-	In-house and Fund Managers	50% in-house; 100% External Funds	3 years
Structured Products (e.g. Callable deposits, range accruals, snowballs, escalators etc.)	Short-term F1+, Long-term AA-	In-house and Fund Managers	50% in-house; 100% External Funds	3 years
UK Government Gilts with maturities in excess of 1 year	N/A	In-house and Fund Managers	50% in-house; 100% External Funds	5 years in-house, 10 years fund managers
Bonds issued by Multilateral Development Banks	AAA	In-house and Fund Managers	50% in-house; 100% External Fund	25 years
Bonds issued by a financial institution which is guaranteed by the UK Government	AA	In-house and Fund Managers	50% in-house; 100% External Fund	5 years in-house
Collective Investment Schemes[5] but which are not credit rated	N/A	In-house and Fund Managers	50% In-house; 100% External Funds	Pooled Funds do not have a defined maturity date

[5] Pooled funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

Sovereign Bond Issues	AAA	In-house on a buy and hold basis. Fund Managers	50% in-house; 100% External Funds	5 year in-house, 30 years fund managers
Reverse Repurchase Agreements - maturity in excess of 1 year, or/and counterparty not of high credit quality.	Minimum long term rating of A-	In-house and Fund Managers	50% in-house; 100% External Funds	3 years
Covered Bonds	AAA	In-house and Fund Managers	50% in-house; 100% External Funds	20 years
Registered Providers	As agreed by TMST in consultation with the Leader and the Cabinet Member for Finance	In-house	50% In-house	5 years

The maximum limits for in-house investments apply at the time of arrangement.

Annex 5

External Backdrop Provided by Link Treasury Services

- 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% quarter on quarter (q/q).

- Meanwhile, the 0.4% month on month (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 50bps increase, one for 75bps 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.

Our 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

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

- 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.