Appendix A

Treasury Management 6 Month Performance Review

1.0 Introduction

The Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Council to approve treasury management semi-annual and annual reports.

The Council's treasury management strategy for 2022/23 was approved at a meeting on 23rd February 2022. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remain central to the Council's treasury management strategy.

CIPFA published its revised Treasury Management Code of Practice and Prudential Code for Capital Finance in December 2021. The key changes in the two codes include permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments. The principles within the two Codes took immediate effect although local authorities could defer introducing the revised reporting requirements within the revised Codes until the 2023/24 financial year if they wish, which this council has elected to do, as the preparations for the 2022/23 strategy was already underway.

Treasury risk management at the Authority is conducted within the framework of the TM Code. This Code now also includes extensive additional requirements for service and commercial investments, far beyond those in the previous (2017) version.

2.0 External Context

2.1 Economic background

The ongoing conflict in Ukraine has continued to put pressure on global inflation and the economic outlook for UK and world growth remains weak. The UK political situation towards the end of the period following the 'fiscal event' increased uncertainty further.

The economic backdrop during the April to September period continued to be characterised by high oil, gas and commodity prices, ongoing high inflation and its impact on consumers' cost of living, no imminent end in sight to the Russia-Ukraine hostilities and its associated impact on the supply chain, and China's zero-Covid policy.

Central Bank rhetoric and action remained robust. The Bank of England, Federal Reserve and the European Central Bank all pushed up interest rates over the period and committed to fighting inflation, even when the consequences were in all likelihood recessions in those regions.

UK inflation remained extremely high. Annual headline CPI hit 10.1% in July, the highest rate for 40 years, before falling modestly to 9.9% in August. RPI registered 12.3% in both July and August. The energy regulator, Ofgem, increased the energy price cap by 54% in April, while a further increase in the cap from October, which would have seen households with average energy consumption pay over £3,500 per annum, was dampened by the UK government stepping in to provide around £150 billion of support to limit bills to £2,500 annually until 2024.

The labour market remained tight through the period but there was some evidence of easing demand and falling supply. The unemployment rate 3m/year for April fell to 3.8% and declined further to 3.6% in July. Although now back below pre-pandemic levels, the recent decline was driven by an increase in inactivity rather than demand for labour. Pay growth in July was 5.5% for total pay (including bonuses) and 5.2% for regular pay. Once adjusted for inflation, however, growth in total pay was -2.6% and –2.8% for regular pay.

With disposable income squeezed and higher energy bills still to come, consumer confidence fell to a record low of –44 in August, down –41 in the previous month. Quarterly GDP fell -0.1% in the April-June quarter driven by a decline in services output, but slightly better than the 0.3% fall expected by the Bank of England.

The Bank of England increased the official Bank Rate to 2.25% over the period. From 0.75% in March, the Monetary Policy Committee (MPC) pushed through rises of 0.25% in each of the following two MPC meetings, before hiking by 0.50% in August and again in September. August's rise was voted by a majority of 8-1, with one MPC member preferring a more modest rise of 0.25%. the September vote was 5-4, with five votes for an 0.5% increase, three for an 0.75% increase and one for an 0.25% increase. The Committee noted that domestic inflationary pressures are expected to remain strong and so given ongoing strong rhetoric around tackling inflation further Bank Rate rises should be expected.

On 23rd September the UK government, following a change of leadership, announced a raft of measures in a 'mini budget', loosening fiscal policy with a view to boosting the UK's trend growth rate to 2.5%. With little detail on how government borrowing would be returned to a sustainable path, financial markets reacted negatively. Gilt yields rose dramatically by between 0.7% - 1% for all maturities with the rise most pronounced for shorter dated gilts. The swift rise in gilt yields left pension funds vulnerable, as it led to margin calls on their interest rate swaps and risked triggering large scale redemptions of assets across their portfolios to meet these demands. It became necessary for the Bank of England to intervene to

preserve market stability through the purchase of long-dated gilts, albeit as a temporary measure, which has had the desired effect with 50-year gilt yields falling over 100bps in a single day.

Bank of England policymakers noted that any resulting inflationary impact of increased demand would be met with monetary tightening, raising the prospect of much higher Bank Rate and consequential negative impacts on the housing market.

After hitting 9.1% in June, annual US inflation eased in July and August to 8.5% and 8.3% respectively. The Federal Reserve continued its fight against inflation over the period with a 0.5% hike in May followed by three increases of 0.75% in June, July and September, taking policy rates to a range of 3% - 3.25%.

Eurozone CPI inflation reached 9.1% y/y in August, with energy prices the main contributor but also strong upward pressure from food prices. Inflation has increased steadily since April from 7.4%. In July the European Central Bank increased interest rates for the first time since 2011, pushing its deposit rate from –0.5% to 0% and its main refinancing rate from 0.0% to 0.5%. This was followed in September by further hikes of 0.75% to both policy rates, taking the deposit rate to 0.75% and refinancing rate to 1.25%.

2.2 Financial markets

Uncertainty remained in control of financial market sentiment and bond yields remained volatile, continuing their general upward trend as concern over higher inflation and higher interest rates continued to dominate. Towards the end of September, volatility in financial markets was significantly exacerbated by the UK government's fiscal plans, leading to an acceleration in the rate of the rise in gilt yields and decline in the value of sterling.

Due to pressure on pension funds, the Bank of England announced a direct intervention in the gilt market to increase liquidity and reduce yields.

Over the period the 5-year UK benchmark gilt yield rose from 1.41% to 4.40%, the 10-year gilt yield rose from 1.61% to 4.15%, the 20-year yield from 1.82% to 4.13% and the 50-year yield from 1.56% to 3.25%. The Sterling Overnight Rate (SONIA) averaged 1.22% over the period.

2.3 Credit review

In July Fitch revised the outlook on Standard Chartered from negative to stable as it expected profitability to improve thanks to the higher interest rate environment. Fitch also revised the outlook for Bank of Nova Scotia from negative to stable due to its robust business profile.

Also in July, Moody's revised the outlook on Bayerische Landesbank to positive and then in September S&P revised the GLA outlook to stable from negative as it expects the authority to remain resilient despite pressures from a weaker macroeconomic outlook coupled with higher inflation and interest rates.

Having completed its full review of its credit advice on unsecured deposits at UK and non-UK banks, in May Arlingclose extended the maximum duration limit for five UK banks, four Canadian banks and four German banks to six months. The maximum duration for unsecured deposits with other UK and non-UK banks on Arlingclose's recommended list is 100 days. These recommendations were unchanged at the end of the period.

Arlingclose continued to monitor and assess credit default swap levels for signs of credit stress but made no changes to the counterparty list or recommended durations. Nevertheless, increased market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.

3.0 Local Context

On 31st March 2022, the Council had theoretical net investments of £85.3m (this level may not be reached due to daily cashflows) arising from its revenue income and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.22 Actual £m
Capital Financing Requirement	71.4
Less: Other debt liabilities*	(0.5)
Total CFR	**69.9**
External borrowing	(38.9)
Internal borrowing	**31.0**
Less: Usable reserves	(78.7)
Less: Working capital	(35.8)
Net (Investing) or New Borrowing	**(83.5)**

*Finance lease for Phoenix Court

The Council pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, to reduce risk and keep interest costs low. The treasury management position as at 30th September 2022 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.22 Balance £m	Movement £m	30.9.22 Balance £m	30.9.22 Rate %
Long-term borrowing	38.92	(0.14)	38.78	2.83[a]
Short-term borrowing	0.00	0.00	0.00	0.00
Total borrowing	**38.92**	**(0.14)**	**38.78**	
Long-term investments	4.00	0.00	4.00	3.70[b]
Short-term investments	21.00	17.00	38.00	1.67[a]
Cash equivalents	28.05	(6.33)	21.72	1.59[a]
Total investments	**53.05**	**10.67**	**63.72**	**1.70**
Net borrowing/(Investing)	**(14.13)**	**(10.81)**	**(24.94)**	

[a] Weighted average

[b]Based on face value of investment and based on Q1 income projected for full year.

The movement in the cash and cash equivalent has been as result of increased reserves and working capital. These funds were invested in bank deposits, the DMO and Money Market Funds to ensure easy access to maintain liquidity.

3.1 Borrowing

CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority.

PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority intends to avoid this activity in order to retain its access to PWLB loans.

3.2 Borrowing Strategy and activity during the period

As outlined in the treasury strategy, the Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required.

Over the April-September period short term PWLB rates rose dramatically, particular in late September after the Chancellor's 'mini-budget', included unfunded tax cuts and additional borrowing to fund consumer energy price subsidies. Exceptional volatility threatened financial stability, requiring Bank of England intervention in the gilt market. Over a twenty-four-hour period some PWLB rates increased to 6%, before the intervention had the desired effect, bringing rates back down by over 1% for certain maturities.

Interest rates rose by over 2% during the period in both the long and short term. As an indication the 5-year maturity certainty rate rose from 2.30% on 1st April to 5.09% on 30th September; over the same period the 30-year maturity certainty rate rose from 2.63% to 4.68%

At 30th September 2022, the Council held £38.92m of loans, a decrease of £0.14m from 31st March 2022. Outstanding loans on 30th September are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.22 Balance £m	Net Movement £m	30.9.22 Balance £m	30.9.22 Weighted Average Rate %	30.9.22 Weighted Average Maturity (years)
Public Works Loan Board	38.88	(0.14)	38.74	2.83%	22
Salix Loan	0.035	0.00	0.035	0.00%	4
Local authorities (short-term)	0.00	0.00	0.00	0.00%	0
Total borrowing	**38.92**	**(0.14)**	**38.78**	**2.83%**	**22**

The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

With short-term interest rates remaining much lower than long-term rates, the Council considered it to be more cost effective in the near term to use internal resources or short-term loans instead. The Council had not used short-term loans facility so far in this financial year.

Although it was anticipated that the Council's CFR would increase due to the capital programme, delays in the capital programme due to the pandemic no new loans have been taken out.

Long-dated Loans borrowed	PWLB Reference	Amount £	Rate %	Period (Years)
PWLB 1	495152	5,000,000	3.90	36
PWLB 2	495153	5,000,000	3.91	35
PWLB 3	502463	165,474	2.24	1
PWLB 4	504487	648,585	3.28	24
PWLB 5	504598	861,233	3.10	24
PWLB 6	504810	428,708	2.18	25
PWLB 7	504922	349,167	3.10	25
PWLB 8	504993	282,599	2.92	25
PWLB 9	505255	557,484	2.31	25
PWLB 10	505372	427,523	2.91	25
PWLB 11	505649	767,264	2.67	25
PWLB 12	506436	5,000,000	2.78	15
PWLB 13	508696	7,291,685	2.49	16
PWLB 15	509389	11,963,000	2.18	17
Salix Loan		35,000	0.00	4
Total borrowing			**2.83**	**(weighted) 22**

Note that loans PWLB 4-11 were paid in full on the 5th of October 2022.

The Council's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing was maintained.

3.3 Treasury Investment Activity

CIPFA revised TM Code defines treasury management investments as those which arise from the Authority's cash flows or treasury risk management activity that ultimately represents balances which need to be invested until the cash is required for use in the course of business.

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the period from 1st April 2022 to 30th September 2022 the balances invested (excluding loans and property fund) ranged between £39.9m and £64.08m.

The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

The weighted average rate for the investment portfolio up to 30.09.2022 was 1.70%.

	31.3.22 Balance £m	Net Movement £m	30.9.22 Balance £m	30.9.22 Income Return %	30.9.22 Weighted Average Maturity Days
Banks & building societies (unsecured)	5.07	0.65	5.72	0.3	1
Government (incl. local authorities)	21.00	17.00	38.00	1.67	76
Money Market Funds	23.00	(7.00)	16.00	1.51	1
Loans to other organisation	6.98	(4.81)	2.17	3.97	>365
Other Pooled Funds .					
- Property fund (CCLA)	4.00	0.00	4.00	3.69	>365
Total investments	**56.05**	**9.84**	**65.89**	**1.70**	

Loans to other organisations has decreased significantly (by £4.8m) because Places for People paid off, in the full, the loan that was advanced in 2015 and intended to mature in 2047. The related PWLB loans (8) were paid off in full on the 5th October 2022 so are still included in the figures for this half year report.

3.4 Risk Management

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 treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

The increases in Bank Rate over the period under review, and with the prospect of more increases to come, short-dated cash rates, which had ranged between 0.7% - 1.5% at the end of March, rose by around 1.5% for overnight/7-day maturities and by nearly 3.5% for 9-12 month maturities.

By end September, the rates on DMADF deposits ranged between 1.85% and 3.5%. The return on the Council's sterling low volatility net asset value (LVNAV) Money

Market Funds ranged between 0.51% - 0.59% in early April and between 1.96% and 2.12% at the end of September

Given the risk of short-term unsecured bank investments and the low returns, the Council has maintained a diversified portfolio of asset classes as shown in table 4 above. An amount of £4m has been maintained in the long term property fund over the period.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure %	Weighted Average Maturity[1] (days)	Internal Investment Return [2] %
31.03.2022	4.10	AA-	57	15	0.39
30.06.2022	3.79	AA-	42	45	0.92
30.09.2022	3.68	AA-	36	12	1.64
Similar LAs	4.34	AA-	57	42	1.70
All LAs	4.07	AA-	55	18	1.72

[1]The weighted average maturity includes the CCLA Property Fund, average maturity of investments is 1 day.
[2] This is short-term investment only and excludes the property fund, investment return as at 30/09/22 including property fund is 1.79%

£4m of the Council's investments are held in externally managed strategic pooled property funds – CCLA Property Fund where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. This fund generated a total return in quarter 1 of £36,879 (3.69%), for period of 1st April to 30th June 2022 which is used to support services in year.

Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives are regularly reviewed. The council was notified in October that the notice period for withdrawals from the fund was being increased from 90 days to 6 months. The council has never made a withdrawal and views the fund as a long-term investment, so in the short to medium term this is not expected to cause any issues, quarterly dividends are expected to be paid as normal. The fund altered the notice period in response to uncertainty in the property market, redemptions from the fund are currently relatively low.

Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates. In light of their performance over the medium-term and the Council's latest cash flow forecasts, investment in these funds has been maintained.

3.5 Non-Treasury Investments

The definition of investments in CIPFA's 2021 Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) also includes within the definition of investments all such assets held partially or wholly for financial return.

The Authority also held investments in:

- directly owned property £69.5m

Table 6: Property held for investment purposes in £'000

Property	31.3.2021	31.3.2022 Actual*	
	Value in accounts	**Gains or (losses)**	**Value in accounts**
Existing Portfolio	33,892	(289)	33,603
2 Stonehill	2,150		2,150
80 Wilbury Way	1,775		1,775
Shawlands Retail Park	5,543	(20)	5,523
1400 & 1500 Parkway, Fareham	4,200	(50)	4,150
Units 21a, 21b,23a,b,c Little End Road, St Neots	3,400	(110)	3,290
Rowley Centre, St Neots	4,008	(705)	3,303
Tri-link, Wakefield	14,250	(50)	14,200
Alms Close	1,502	20	1,522
TOTAL	**70,720**		**69,516**

These investments generated £2.8m of investment income for the Authority from April to September 2022 after taking account of direct costs.

The Authority is dependent on profit generating investment activity to achieve a balanced revenue budget. The table below shows the extent to which the expenditure planned to meet the service delivery objectives and/or place making role of the Authority is dependent on achieving the expected net profit from investments over the lifecycle of the Medium Term Financial Strategy. The current forecast is showing an increase in expected net investment income of £693,000 due to tenants not breaking leases, and better rental agreement terms reached than was expected.

Table 7: Proportionality of Investments in £'000

	2020/21 Actual £000s	2021/22 Actual £000s	2022/23 Budget £000s	2023/24 Budget £000s	2024/25 Budget £000s
Gross service expenditure	121,354(1)	87,068(1)	64,296	63,936	64,741
Investment income	4,892	4,869	4,716	4,650	4,962
Service Investments	293	275	325	325	325
Proportion	4.27%	5.91%	7.84%	7.78%	8.17%

(1) Gross expenditure higher than normal due to covid business grant expenditure.

4.0 Compliance

The Chief Finance Officer (s151 officer) reports that all treasury management activities undertaken during the first half year complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 9 below.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 8 below.

Table 8: Debt Limits

	30.9.22 Actual £m	2022/23 Operational Boundary £m	2022/23 Authorised Limit £m	Complied?
General	10.00	70.00	80.00	Yes
Loans	4.49	15.00	20.00	Yes
CIS	24.26	30.00	35.00	Yes
Total debt	**38.74**	**115.00**	**135.00**	

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure. Total debt was below the operational boundary all through the half year.

Table 9: Investment Limits

	30.9.22 Actual £m	2022/23 Limit £m	Complied?
Deposit Accounts			
NatWest [1]	5.77	£22m	Yes
Debt Management Office (DMO)	34.00	Unlimited	Yes
Barclays	0.001	4.00	Yes
Thurrock Council[2]	4.00	4.00	Yes
Money Market Funds			
Aberdeen Liquidity Fund	3.00	4.00	Yes
BlackRock Institutional sterling liquidity Fund	2.50	4.00	Yes
CCLA Public Sector Deposit Fund	3.00	4.00	Yes
Federated Short Term Prime Fund	2.00	4.00	Yes
HSBC Global Liquidity [3] Funds ESG	0.00	4.00	
Insight Liquidity Funds	1.50	4.00	Yes
Invesco	3.00	4.00	Yes
Legal & General Sterling Liquidity Fund	1.00	4.00	Yes
Property Fund			
CCLA Property Fund	4.00	5.00	Yes
Total	**63.77**		

[1]Natwest is the council's transactional bank, the balance held is sufficient for operational needs. The balance held on 30th September included funds received from Places for People loan repayment, this was received too late to invest elsewhere.

[2]The principal invested with Thurrock was returned on the agreed maturity date (24/10/2022), as well as the agreed interest.

[3]HSBC MMF was opened in September. This fund takes into account ESG factors when investing.

5.0 Treasury Management Indicators

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

Security
The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Table 10: Average Credit Rating

	30.9.22 Actual	2022/23 Target	Complied?
Portfolio average credit rating	AA-	A-	Yes

Liquidity
The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

Table 11: Total Cash Available

	30.9.22 Actual £m	2022/23 Target £m	Complied?
Total cash available within 3 months	63.77	2	Yes

Interest Rate Exposures (Discretionary local measure)
This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Table 12: Interest Rate Risk

Interest rate risk indicator	30.9.22 Actual	30.9.22 Theoretical[1]	2022/23 Limit	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£0	£389,000	£600,000	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0	£389,000	£600,000	Yes

[1]In reality all borrowing is at a fixed interest rate (with PWLB) and so changes in rates will only be realised when and if the loans need to be refinanced. The loans that may need refinancing (ie those linked to asset purchases) have a weighted average years to maturity of 20 years. CIPFA no longer recommends setting limits for interest rate exposure, this is a locally adopted indicator.

The impact of a change in interest rates is calculated on the weighted average rate of interest (2.83%) being increased or reduced by 1%.

Maturity Structure of Borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

Table 13: Maturity Structure

	30.9.22 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	0.4%	80%	0%	Yes
12 months and within 24 months	0.0%	80%	0%	Yes
24 months and within 5 years	0.0%	80%	0%	Yes
5 years and within 10 years	0.0%	100%	0%	Yes
10 years and above	99.6%	100%	0%	Yes

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.

Principal Sums Invested for Periods Longer than a Year

Table 14: Sums Invested for Beyond One Year

	2022/23	2023/24	2024/25
Actual principal invested beyond year end (CCLA Property Fund)	£4.00m	£4.00m	£4.00m
Limit on principal invested beyond year end	£10.00m	£10.00m	£10.00m
Complied?	Yes	Yes	Yes

6.0 Outlook for 2022/23 (Provided by Arlingclose)

Interest Rates

	Current	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	**2.25**	**4.25**	**5.00**	**5.00**	**5.00**	**5.00**	**5.00**	**5.00**	**5.00**	**4.75**	**4.25**	**3.75**	**3.25**
Downside risk	0.00	-1.00	-1.00	-0.75	-0.50	-0.50	-0.50	-0.75	-1.25	-1.50	-1.75	-1.75	-1.75

Arlingclose expects Bank Rate to rise further during 2022/23 to reach 5% by the end of the financial year.

The MPC is particularly concerned about the demand implications of fiscal loosening, the tight labour market, sterling weakness and the willingness of firms to raise prices and wages.

The MPC may therefore raise Bank Rate more quickly and to a higher level to dampen aggregate demand and reduce the risk of sustained higher inflation. Arlingclose now expects Bank Rate to peak at 5.0%, with 200bps of increases this calendar year.

This action by the MPC will slow the economy, necessitating cuts in Bank Rate later in 2024.

Gilt yields will face further upward pressure in the short term due to lower confidence in UK fiscal policy, higher inflation expectations and asset sales by the BoE. Given the recent sharp rises in gilt yields, the risks are now broadly balanced to either side. Over the longer term, gilt yields are forecast to fall slightly over the forecast period.

Background

Monetary policymakers are behind the curve having only raising rates by 50bps in September. This was before the "Mini-Budget", poorly received by the markets, triggered a rout in gilts with a huge spike in yields and a further fall in sterling. In a shift from recent trends, the focus now is perceived to be on supporting sterling whilst also focusing on subduing high inflation.

There is now an increased possibility of a special Bank of England MPC meeting to raise rates to support the currency. Followed by a more forceful stance over concerns on the looser fiscal outlook. The MPC is therefore likely to raise Bank Rate higher than would otherwise have been necessary given already declining demand. A prolonged economic downturn could ensue.

Uncertainty on the path of interest rates has increased dramatically due to the possible risk from unknowns which could include for instance another Conservative leadership contest, a general election, or further tax changes including implementing windfall taxes.

The government's open ended approach to energy price caps, combined with

international energy markets priced in dollars, presents a fiscal mismatch that has contributed to significant decline in sterling and sharp rises in gilt yields which will feed through to consumers' loans and mortgages and business funding costs.

UK government policy has mitigated some of the expected rise in energy inflation for households and businesses flattening the peak for CPI, whilst extending the duration of elevated CPI. Continued currency weakness could add inflationary pressure.

The UK economy already appears to be in recession, with business activity and household spending falling. The short- to medium-term outlook for the UK economy is relatively bleak.

Global bond yields have jumped as investors focus on higher and longer lasting US policy rates. The rise in UK government bond yields has been sharper, due to both an apparent decline in investor confidence and a rise in interest rate expectations, following the UK government's shift to borrow to loosen fiscal policy. Gilt yields will remain higher unless the government's plans are perceived to be fiscally responsible.

The housing market impact of increases in the Base Rate could act as a "circuit breaker" which stops rates rising much beyond 5.0%, but this remains an uncertainty.