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Resources
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Report of: Executive Member for Finance, Planning and Performance

Meeting of: Executive

Date: 8th February 2024

Ward(s): All

Subject: Treasury Management Mid-Year Review

1. Synopsis

1.1. This report reviews the activities of the Council's treasury management function over the half year period ended 30 September 2023. The month of September has been a challenging environment with volatile interest rate and gilt markets.

1.2. Over the reporting period, all treasury management (TM) activities have been carried out in accordance with the approved limits and the prudential indicators (PI) set out in the Council's Treasury Management Strategy.

1.3. Treasury Management comprises:

1.3.1. Managing the Council's borrowing to ensure funding of the Council's future capital programme is at optimal cost;

1.3.2. investing surplus cash balances arising from the day-to-day operations of the Council to obtain an optimal return while ensuring security of capital and liquidity.

2. Recommendation

2.1. To note the Treasury Mid-Year Review

3. Background

3.1 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

3.2 The Council's treasury management strategy for 2023/24 was approved at the Council meeting of 2nd March 2023. 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 remains central to the Council's treasury management strategy.

4. Detailed Report

4.1 On 31st March 2023, the Council had net borrowing of £231.906m arising from its revenue 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:

<u>Table 1: Balance Sheet</u>

	31.3.23 Actual £m
General Fund CFR	190.703
HRA CFR	463.593
Total CFR	**734.849**
Less: *Other debt liabilities	(80.552)
Loans CFR	**654.297**
External borrowing	(285.606)
Internal (over) borrowing	**368.691**
Less: Balance Sheet Resources	(422.4)
Treasury Investments	**53.7**
Net [borrowing / investments]	**231.906**

* finance leases, PFI liabilities and transferred debt that form part of the Council's total debt

4.2 On 30th September 2023, the Council had net borrowing of £193.3m arising from its revenue and capital income and expenditure. The treasury management position as at 30th September 2023, the change over the six months is shown in Table 2.

Table 2: Treasury Management Summary

	31.3.23 Balance £m	Movement £m	30.9.23 Balance £m	30.9.23 Rate %
Long-term borrowing	265.606	(18.062)	247.544	3.95
Short-term borrowing	20.000	0.000	20.000	5.30
Total borrowing	**285.606**	**(18.062)**	**267.544**	**4.05**
Long-term investments	10.000	0.000	10.000	0.55
Short-term investment	43.700	20.500	64.200	5.18
Total investments	**53.700**	**20.500**	**74.200**	**4.55**
Net [borrowing / investments]	**231.906**	**2.438**	**193.344**	

Economic Update

4.3 The Bank of England's Monetary Policy Committee (MPC) sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment. At its meeting ending on 20 September 2023, the MPC voted by a majority of 5–4 to maintain Bank Rate at 5.25%. The Committee also voted unanimously to reduce the stock of UK government bond purchases held for monetary policy purposes, and financed by the issuance of central bank reserves, by £100 billion over the next twelve months, to a total of £658 billion.

4.4 Twelve-month CPI inflation fell from 7.9% in June to 6.7% in August, 0.4 percentage points below expectations at the time of the Committee's previous meeting and triggering the exchange of open letters between the Governor and the Chancellor of the Exchequer that is being published alongside this monetary policy announcement. Core goods CPI inflation has fallen from 6.4% in June to 5.2% in August, much weaker than expected in the August Report. Services CPI inflation rose from 7.2% in June to 7.4% in July but declined to 6.8% in August, 0.3 percentage points lower than expected in the August Report.

Arlingclose View:

4.5 Q2 GDP growth surprised to the upside, with the office for national statistics (ONS) revising the first estimate of -0.1% to +0.2%, driven by upward revisions to household and government spending. While the revision suggests that the UK economy has avoided a technical recession so far, growth remains soft and is on a downward track. We expect growth to be negative in Q3 and thereafter due to the heightened impact of the rising cost of living, higher interest rates and slowing global growth. However, this will not stop the BoE tightening monetary policy further to combat perceived inflationary pressures.

Borrowing

4.6 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 decisions that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the council.

4.7 Public Works Loan Board (PWLB) loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council intends to avoid this activity to retain its access to PWLB loans.

4.8 The 2023/24 Treasury Management Strategy sets out an operational borrowing limit of £383.4m and maximum borrowing limit of £533.9m for the year. As at 30th September there is still a potential for the Council to borrow up to a further £115.8m, this level of borrowing has been revised due the current level of capital programme slippage. This matter is being closely monitored through the Council's 5-year capital programme model and the cash flow model.

4.9 As outlined in the treasury strategy, 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.

4.10 The Council retains flexibility to renegotiate loans should the Council's long-term plans change. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

4.11 A new PWLB HRA rate which is 0.4% below the certainty rate was made available from 15th June 2023. Initially available for a period of one year, this discounted rate is to support local authorities borrowing for the Housing Revenue Account (HRA) and for refinancing existing HRA loans, providing a window of opportunity for HRA-related borrowing and to replace the Council's loans relating to the HRA maturing during this time frame.

4.12 In keeping with these objectives, the strategy is to replace the HRA maturing debt of £8m, borrow additional sums to fund the existing capital programme and the purchase of ex-right to buy properties in line with the authorised borrowing limits. This strategy enabled the Council to reduce net borrowing costs and reduce overall treasury risk.

Borrowing Update

4.13 The Council currently holds £267.5 million of loans, a reduction of £18.06 million from the previous year, as in line with the strategy to borrow only if required hence use internal resources in lieu of borrowing despite the increase in rates. During this half year the Council considered it to be more cost effective in the near term to either use internal resources and short to medium term borrowing to minimise the “cost of carry”. Outstanding loans on 30th September 2023 are summarised in Table 3 below:

Table 3: Borrowing Position

	31.3.23 Balance £m	Net Movement £m	30.9.23 Balance £m	30.9.23 Weighted Average Rate %	30.9.23 Weighted Average Maturity (years)
Public Works Loan Board	234.606	(8.062)	226.544	4.1465	19.92
Local authorities (long-term)	31.000	(10.000)	21.000	1.8595	1.33
Local authorities (short-term)	20.000	(0.000)	20.000	5.3000	0.22
Total borrowing	**285.606**	**(18.062)**	**267.544**	**4.0532**	**16.99**

4.14. The Council’s short-term borrowing cost has continued to increase with the rise in line with the Bank and England base rate and short-dated market rates. The average rate on the Council’s short-term loans at 30th September 2023 of £20m was 5.3%.

4.15 There was a substantial rise in the cost of both short- and long-term borrowing over the last 18 months. The base rate rose by 1% from 4.25% at the beginning of April to 5.25% at the end of September. The base rate was 2% higher than at the end of September 2022.

4.16 UK gilt yields were volatile, mainly facing upward pressure since early April following signs that UK growth had been more resilient, inflation stickier than expected, and that the Bank of England saw persistently higher rates through 2023/24 as key to dampening domestic demand. Gilt yields, and consequently PWLB borrowing rates, rose and broadly remained at elevated levels. On 30th September, the PWLB certainty rates for maturity loans were 5.26% for 10-year loans, 5.64% for 20-year loans and 5.43% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41% respectively.

Forward starting loans

4.17 To enable certainty of cost to be achieved without suffering a cost of carry in the intervening period, the Council may arrange forward starting loans with fixed interest rates of for the delivery of cash a specified future year date. The Council has not actively pursued this option currently and does not seem prudent with rates at their current levels.

4.18 There remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields + 0.80%. The Authority will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.

Other Debt Activity

4.19 After £4.5m repayment in 2022/23 of Private Finance Initiative liabilities, total debt other than borrowing stood at £77.6m on 31st March 2023.

Treasury Investment Activity

4.20 CIPFA revised TM Code defines treasury management investments as those which arise from the Council'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.

4.21 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Council's investment balances ranged between £54 million and £110 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.23 Balance £m	**Net Movement £m**	**30.9.23 Balance £m**	**30.9.23 Income Return %**
Government (incl. local authorities)	53.7	(8.5)	45.2	4.09
MMF	0.0	29.0	29.0	5.28
UK Banks	0.0	0.0	0.0	0.00
Total investments	**53.7**	**20.5**	**74.2**	**4.56**

4.22 Both the CIPFA Code and government guidance require the Authority 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.

4.23 The Council expects to be a long-term borrower and new treasury investments therefore primarily made to manage day-to-day cash flows short-term low risk instruments where limited additional risk is accepted in return for higher investment income to support local public services.

4.24 Bank of England base rate increased by 1%, from 4.25% at the beginning of April to 5.25% by the end of September. Short-dated cash rates rose commensurately, with 3-month rates rising to around 5.25% and 12-month rates to nearly 6%. The rates on DMADF deposits also rose, ranging between 4.8% and 5.4% and Money Market Rates between 5.22% and 5.35%.

4.25 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 (days)**	**Rate of Return %**
30.09.2023	4.62	A+	39%	95	4.54
30.09.2022	4.73	A+	19%	154	1.12
Similar LAs	**4.54**	**A+**	**67%**	**48**	**4.94**
All LAs	**4.47**	**AA-**	**59%**	**50**	**4.79**

Non-Treasury Investment

4.26 The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Council as well as other non-financial assets which the Council 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).

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

4.28 The Council lends money to its subsidiaries, local businesses, local charities, local residents and its employees to support local public services and stimulate local economic growth.

4.29 As at 31/03/2023, the Council had lent £0.639m (including accrued interest) to three private companies responsible for managing schools under the Building Schools for the Future programme (Transform Islington Phase 1 Holdings Limited, Transform Islington Phase 2 Holdings Limited and Transform Islington Limited). All loans were issued at market rates. Where loans are advanced at below market rates they are classed as ‘soft loans. As at 31/3/2023 the Council had also issued around £1.302m of soft loans, mainly to employees (e.g., travel season ticket, gym membership, home computer loans).

4.30 The Council invests in the shares of its subsidiaries and local businesses to support local public services and stimulate local economic growth. The Council holds equity investments in Islington Limited (iCo), a wholly owned subsidiary providing local services, and minority (10%) equity investments in three private companies responsible for managing schools under the Building Schools for the Future programme (Transform Islington Phase 1 Holdings Limited, Transform Islington Phase 2 Holdings Limited and Transform Islington Limited). The fair value of these shares is nil, and the shares are not traded in an active market. The Council has no current plans to dispose any of these shareholdings.

4.31 The Council holds investments in local and regional, commercial property with any profits spent on local public services. The Council does not actively invest in these markets currently. The market value of all such properties as at 31/3/2023 was £43.6m. In 2022/23, rental income from investment property was £1.6m against direct operating expenditure arising from investment property of £0.3m.

4.32 The Council also made a loan to the Highbury Roundhouse Association which is valued at £78k on the balance sheet (31/03/23).

Compliance

4.33 The Corporate Director of Resources reports that all treasury management activities undertaken during the period 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 7 below.

4.34 Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 7: Debt Limits

	H1 Forecasted	**30.9.23 Actual**	**2023/24 Operational Boundary £m**	**2023/24 Authorised Limit £m**	**Complied?** Yes/No
Borrowing	345.848	267.5	383.393	533.860	Yes
PFI and Finance Leases			74.973	79.973	

Total debt			458.366	608.833	Yes

4.35 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.

Treasury Management Indicators

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

4.37 **Security:** The Authority 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 8: Credit Ratings

	30.9.23 Actual	2023/224 Target	Complied?
Portfolio average credit rating	A+	A+	Yes

4.38 **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 one-month period, without additional borrowing.

Table 9: Liquidity of investments

	30.9.23 Actual	2023/24 Target	Complied?
Total cash available within 1 months	£48m	£25m	Yes

4.39 **Interest Rate Exposures**: 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 10: Interest Rate risk (income)

Interest rate risk indicator	30.9.23 Actual	2023/24 Limit	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£0.530m	£2.6m	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0m	£1.6m	Yes

4.40 The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

4.41 **Maturity Structure of Borrowing:** This indicator is set to control the Councils exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

Table 11: Maturity Structure

Refinancing rate risk indicator	30.9.23 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	18%	30%	0%	Yes
12 months and within 2 years	5%	35%	0%	Yes
24 months and within 5 years	6%	40%	0%	Yes
5 years and within 10 years	19%	40%	0%	Yes
10 years and within 20 years	9%	50%	0%	Yes
20 years and above	43%	100%	40%	Yes

4.42 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.

4.43 **Principal Sums Invested for Periods Longer than a year:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

Table 12: Amounts invested for more than one year

	2022/23	2023/24	2024/25
Actual principal invested beyond year end	£10m	£10m	£0
Limit on principal invested beyond year end	£30m	£20m	£20m
Complied?	Yes	Yes	Yes

5. Implications

5.1. **Financial Implications**

5.1.1. The report is wholly financial in nature.

5.2. **Legal Implications**

5.2.1. Treasury risk management at the Council is conducted within the framework of the CIPFA Code, which requires the Council to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

5.2.2. In addition, Section 151 of the Local Government Act 1972 states that: "without prejudice to section 111, every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs". Good Treasury Management supports the discharge of this responsibility.

5.3. **Environmental Implications and contribution to achieving a net zero carbon Islington by 2030**

5.3.1. There are no environmental considerations.

5.4. **Equalities Impact Assessment**

5.4.1. The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The council must have due regard to the need to tackle prejudice and promote understanding.

5.4.2. An Equalities Impact Assessment is not required in relation to this report, as it does not impact individuals.

Appendices:

Appendix 1: External context

Appendix 2: Interest Rate Forecast

Final report clearance:

Authorised by: Executive Member for Finance, Planning and Performance

Date: 13 December 2023

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Appendix 1

External Context from Arlingclose

Economic background

UK inflation remained stubbornly high over much the period compared to the US and euro zone, keeping expectations elevated of how much further the Bank of England (BoE) would hike rates compared to the regions. However, inflation data published in the latter part of the period undershot expectations, causing financial markets to reassess the peak in BoE Bank Rate. This was followed very soon after by the BoE deciding to keep Bank Rate on hold at 5.25% in September, against expectation for another 0.25% rise.

Economic growth in the UK remained relatively weak over the period. In calendar Q2 2023, the economy expanded by 0.2%. However, monthly GDP data showed a 0.5% contraction in July, the largest fall to date in 2023 and worse than the 0.2% decline predicted which could be an indication the monetary tightening cycle is starting to cause recessionary or at the very least stagnating economic conditions.

July data showed the unemployment rate increased to 4.3% (3mth/year) while the employment rate rose to 75.5%. Pay growth was 8.5% for total pay (including bonuses) and 7.8% for regular pay, which for the latter was the highest recorded annual growth rate. Adjusting for inflation, pay growth in real terms were positive at 1.2% and 0.6% for total pay and regular pay respectively.

Inflation continued to fall from its peak as annual headline CPI declined to 6.7% in July 2023 from 6.8% in the previous month against expectations for a tick back up to 7.0%. The largest downward contribution came from food prices. The core rate also surprised on the downside, falling to 6.2% from 6.9% compared to predictions for it to only edge down to 6.8%.

The Bank of England's Monetary Policy Committee continued tightening monetary policy over most of the period, taking Bank Rate to 5.25% in August. Against expectations of a further hike in September, the Committee voted 5-4 to maintain Bank Rate at 5.25%. Each of the four dissenters were in favour of another 0.25% increase.

Financial market Bank Rate expectations moderated over the period as falling inflation and weakening data gave some indication that higher interest rates were working. Expectations fell from predicting a peak of over 6% in June to 5.5% just ahead of the September MPC meeting, and to then expecting 5.25% to be the peak by the end of the period.

Following the September MPC meeting, Arlingclose, the authority's treasury adviser, modestly revised its interest forecast to reflect the central view that 5.25% will now be the peak in Bank Rate. In the short term the risks are to the upside if inflation increases again, but over the remaining part of the time horizon the risks are to the downside from economic activity weakening more than expected.

The lagged effect of monetary policy together with the staggered fixed term mortgage maturities over the next 12-24 months means the full impact from Bank Rate rises are still yet to be felt by households. As such, while consumer confidence continued to improve over the period, the GfK measure hit -21 in September, it is likely this will reverse at some point. Higher rates will also impact business and according to S&P/CIPS survey data, the UK manufacturing and services sector contracted during the quarter with all measures scoring under 50, indicating contraction in the sectors.

The US Federal Reserve increased its key interest rate to 5.25-5.50% over the period, pausing in September following a 0.25% rise the month before, and indicating that it may have not quite completed its monetary tightening cycle.

Having fallen throughout 2023, annual US inflation started to pick up again in July 2023, rising from 3% in June, which represented the lowest level since March 2021, to 3.2% in July and then jumping again to 3.7% in August, beating expectations for a rise to 3.6%. Rising oil prices were the main cause of the increase. US GDP growth registered 2.1% annualised in the second calendar quarter of 2023, down from the initial estimate of 2.4% but above the 2% expansion seen in the first quarter.

The European Central Bank increased its key deposit, main refinancing, and marginal lending interest rates to 4.00%, 4.50% and 4.75% respectively in September, and hinted these levels may represent the peak in rates but also emphasising rates would stay high for as long as required to bring inflation down to target.

Although continuing to decline steadily, inflation has been sticky, Eurozone annual headline CPI fell to 5.2% in August while annual core inflation eased to 5.3% having stuck at 5.5% in the previous two months. GDP growth remains weak, with recent data showing the region expanded by only 0.1% in the three months to June 2023, the rate as the previous quarter.

Financial markets

Financial market sentiment and bond yields remained volatile, with the latter generally trending downwards as there were signs inflation, while still high, was moderating and interest rates were at a peak.

Gilt yields fell towards the end of the period. The 5-year UK benchmark gilt yield rose from 3.30% to peak at 4.91% in July before trending downwards to 4.29%, the 10-year gilt yield rose from 3.43% to 4.75% in August before declining to 4.45%, and the 20-year yield from 3.75% to 4.97% in August and then fell back to 4.84%. The Sterling Overnight Rate (SONIA) averaged 4.73% over the period.

Credit review: Having completed a review of its credit advice on unsecured deposits at UK and non-UK banks following concerns of a wider financial crisis after the collapse of Silicon Valley Bank purchase of Credit Suisse by UBS, as well as other well-publicised banking sector issues, in March Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days. This stance continued to be maintained at the end of the period.

During the second quarter of the period, Moody’s revised the outlook on Svenska Handelsbanken to negative from stable, citing concerns around the Swedish real estate sector.

Having put the US sovereign rating on Rating Watch Negative earlier in the period, Fitch took further action in August, downgrading the long-term rating to AA+, partly around ongoing debt ceiling concerns but also an expected fiscal deterioration over the next couple of years.

Following the issue of a Section 114 notice, in September Arlingclose advised against undertaking new lending to Birmingham City Council, and later in the month cut its recommended duration on Warrington Borough Council to a maximum of 100 days.

Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress and although no changes were made to recommended durations over the period, Northern Trust Corporation was added to the counterparty list.

Heightened 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.

Appendix 2

Arlingclose’s Economic and Interest Rate Forecast as at 25th September 2023

	Current	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26
Official Bank Rate													
Upside risk	0.00	0.25	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.00
Central Case	5.25	5.25	5.25	5.25	5.00	4.75	4.25	4.00	3.75	3.50	3.25	3.00	3.00
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
3-month money market rate													
Upside risk	0.00	0.25	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.00
Central Case	5.40	5.40	5.40	5.30	5.15	4.80	4.30	4.10	3.80	3.50	3.25	3.05	3.05
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
5yr gilt yield													
Upside risk	0.00	0.50	0.70	0.70	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	4.38	4.50	4.50	4.40	4.25	4.00	3.75	3.50	3.40	3.30	3.30	3.30	3.35
Downside risk	0.00	-0.50	-0.70	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
10yr gilt yield													
Upside risk	0.00	0.50	0.70	0.70	0.80	0.90	1.00	1.10	1.20	1.20	1.20	1.20	1.20
Central Case	4.27	4.40	4.35	4.30	4.25	4.15	4.00	3.80	3.75	3.65	3.60	3.65	3.70
Downside risk	0.00	-0.50	-0.70	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
20yr gilt yield													
Upside risk	0.00	0.50	0.70	0.70	0.80	0.90	1.00	1.10	1.20	1.20	1.20	1.20	1.20
Central Case	4.67	4.65	4.60	4.55	4.45	4.35	4.25	4.20	4.20	4.20	4.20	4.20	4.20
Downside risk	0.00	-0.50	-0.70	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
50yr gilt yield													
Upside risk	0.00	0.50	0.70	0.70	0.80	0.90	1.00	1.10	1.20	1.20	1.20	1.20	1.20
Central Case	4.25	4.25	4.20	4.15	4.10	4.10	4.10	4.10	4.10	4.10	4.10	4.10	4.10
Downside risk	0.00	-0.50	-0.70	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%; PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB HRA Rate (Maturity Loans) = Gilt yield + 0.40%; UKIB Rate (Maturity Loans) = Gilt yield + 0.60%

UK inflation and wage growth remain elevated, but the August CPI data suggested that inflation was falling more rapidly. In a narrow 5-4 vote, the MPC took the opportunity to hold rates at 5.25%, a level we see as the peak. Near-term rate cuts are unlikely, although downside risks will increase as the UK economy inevitability slides into recession.

While the MPC vote was close, and the minutes contained the warning about the need for further tightening if inflationary pressures persist, both the decline in closely-watched inflation measures and confidence that wage growth had peaked, clearly allowed policymakers to focus on the weaker activity data.

The UK economy has so far been resilient. However, recent data indicates a further deceleration in business and household activity growth as higher interest rates start to bite. Global demand will be soft, so offer little assistance in offsetting weakening domestic demand. A recession remains a likely outcome.

Employment demand has weakened and unemployment has increased, although the tight labour market has resulted in higher nominal wage growth. Anecdotal evidence suggests slowing recruitment and wage growth, and we expect unemployment to rise.

Consumer confidence has improved due to signs of real wage growth amid strength in the labour market, but household spending will remain weak as mortgaged households suffer higher interest payments and unemployment rises. Business investment/spending will fall back due to higher borrowing costs and weaker demand.

Inflation will fall continue to fall over the next 12 months, albeit with upside risk. The MPC's attention will remain on underlying inflation measures and wage data. Policy rates will remain at the peak for another 10-12 months, until the MPC is comfortable the risk of further second round effects have diminished.

Maintaining monetary policy in restrictive territory for so long, when the economy is already struggling (as the recent PMI data indicate), will require significant policy loosening in the future to boost demand and inflation.

Global bond yields remain volatile. Like the UK, the Federal Reserve and other central banks see persistently higher policy rates through 2023/2024 as key to dampening domestic inflationary pressure. Data points will therefore prompt changes in bond yields as global interest rate expectations shift.