Finance Department
7 Newington Barrow Way
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Report of: Corporate Director of Resources

Meeting of: Council

Date: 8 December 2022

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 2022. 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 statement with the exception of one, the short term borrowing indicator. 7% of the Authority's borrowing was due in under 12 months as apposed to the minimum 12% set out in the prudential indicators. This is detailed in paragraphs 4.38 – 4.42.

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. Recommendations

2.1. To note the Treasury Mid-Year Review

2.2. To note the prudential indicator breach

3. Background

3.1 In February 2002, Islington 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 us to approve treasury management semi-annual and annual reports.

3.2 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 2017 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.

3.3 The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 3rd March 2022.

4. Detailed Report

4.1 On 31st March 2022, the Authority had net borrowing of £148.77m 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.

Table 1: Balance Sheet

	31.3.22 Actual £m
General Fund CFR	
HRA CFR	
Total CFR	**709.80**
Less: *Other debt liabilities	(82.73)
Loans CFR	**627.07**

External borrowing	(274.27)
Internal (over) borrowing	352.80
Less: Usable reserves	(312.17)
Less: Working capital	(163.40)
Net [borrowing / investments]	**(148.77)**

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

4.2 On 30th September 2022, the Council had net borrowing of £141.0m arising from its revenue and capital income and expenditure. The treasury management position as at 30th September 2022, the change over the six months is shown in Table 2.

Table 2: Treasury Management Summary

	31.3.22 Balance £m	**Movement £m**	**30.9.22 Balance £m**	**30.9.22 Rate %**
Long-term borrowing Short-term borrowing	264.27 10.000	1.000 (10.00)	265.60 0.000	4.05 0.00
Total borrowing	**274.27**	**(11.00)**	**265.60**	**4.05**
Long-term investments Short-term investments	10.000 115.500	10.00 (17.00)	20.000 98.500	0.55 1.40
Total investments	**125.500**	**34.900**	**118.500**	**1.35**
Net [borrowing / investments]	**148.774**	**(30.000)**	**141.009**	**3.08**

Economic Background

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 21 September 2022, the MPC voted to increase the Bank of England Base Rate by 0.5 percentage points, to 2.25%. Five members voted to raise the Bank Rate by 0.5 percentage points, three members preferred to increase the Bank Rate by 0.75 percentage points, to 2.5%, and one member preferred to increase the Bank Rate by 0.25 percentage points, to 2%. The Committee also voted unanimously to reduce the stock of purchased UK government bonds, financed by the issuance of central bank reserves, by £80 billion over the next twelve months, to a total of £758 billion, in line with the strategy set out in the minutes of the August MPC meeting.

4.4 Twelve-month CPI inflation fell slightly from 10.1% in July to 9.9% in August, with the release triggering the exchange of open letters between the Governor and the Chancellor of the Exchequer that is being published alongside this monetary policy announcement. Given the Energy Price Guarantee, the peak in measured CPI inflation is now likely to be lower than projected in the August Report, at just under 11% in October. Nevertheless, energy bills will still go up and, combined with the indirect effects of higher energy costs, inflation is expected to remain above 10% over the following few months, before starting to fall back.

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 Authority.

4.7 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.

4.8 The 2022/23 Treasury Management Strategy sets out an operational borrowing limit of £413.5m and maximum borrowing limit of £463.7m for the year. As at 30th September there is still a potential for the Council to borrow up to a further £147m, 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 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, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

4.10 Over the April-September period short term PWLB rates rose dramatically, particular in late September after the Chancellor's 'mini-budget' prompted a fall in sterling and rise in market interest rate expectations. PWLB 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%. Although interest rates across the board have risen, short-term borrowing from other local authorities remains at lower interest rates than long term borrowing.

4.11 In keeping with these objectives, £20m new long term borrowing was undertaken, while £18.67m of existing long term loans allowed to mature without replacement, in addition to £10m of short term borrowing that matured. This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

4.12 The £20m of borrowing was undertaken in June, before the significant PWLB rate hikes, at a rate of 3.26% over 50 years. This proactive borrowing decision saved the authority £330k per annum in interest expense compared with the latest available rate of 4.91%.

4.13 The Council has an increasing CFR due to the capital programme and an estimated borrowing requirement as determined by the Liability Benchmark which also takes into account usable reserves and working capital. Having considered the appropriate duration and structure of the Council's borrowing need based on realistic projections, the Council has not taken on any new long-term loans because of its considerable cash balance.

Borrowing Update

4.14 The Authority currently holds £265.6 million of loans, a reduction of £8.67 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 the half year the Authority 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 2022 are summarised in Table 3 overleaf:

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	223.274	11.332	234.606	4.3434	20.23
Banks (LOBO)	0.000	0.000	0.000	0.0000	0.00
Banks (fixed-term)	0.000	0.000	0.000	0.0000	0.00
Local authorities (long-term)	41.000	(10.000)	31.000	1.7919	1.76
Local authorities (short-term)	10.000	(10.000)	0.000	0.0000	0.00
Total borrowing	**274.274**	**(8.668)**	**265.606**	**4.0456**	**18.07**

4.15 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.

Forward starting loans

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

Other Debt Activity

4.17 After £13.3m repayment of prior years' Private Finance Initiative liabilities, total debt other than borrowing stood at £82.3m on 30th September 2021, taking total debt to £347.9.

Treasury Investment Activity

4.18 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.

4.19 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £100 and £150 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.22 Balance £m	Net Movement £m	30.9.22 Balance £m	30.9.22 Income Return %
Government (incl. local authorities)	125.5	(29.0)	96.5	1.01
MMF	0.00	17.0	17.0	2.05
UK Banks	0.0	5.0	5.0	4.30
Total investments	**125.5**	**(7.0)**	**118.5**	**1.35**

4.20 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 Authority'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.

4.21 The increases in the 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.

4.22 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 0.9% - 1.1% p.a. in early April and between 1.8% and 2.05% at the end of September.

4.23 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 %
31.03.2022	4.28	AA-	0%		0.28
30.06.2021	4.61	A+	9%	157	0.36
Similar LAs	**4.38**	**A+**	**71%**	**32**	**1.01**
All LAs	**4.39**	**AA-**	**64%**	**16**	**0.92**

Non-Treasury Investment

4.24 The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Authority 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).

4.25 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.

4.26 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.

4.27 The Council has lent £0.050m to its wholly owned subsidiary, Islington Limited (iCo), at market rate. The loan serves to support the working capital of iCo where the timings of its payments and receipts do not coincide. In addition, as at 31/03/2022, the Council had lent £0.642m (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 31/3/2022 the Council had also issued around £1.204m of soft loans, mainly to employees (e.g., travel season ticket, gym membership, home computer loans).

4.28 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.

4.29 The Council invests in local and regional, commercial property with the intention of making a profit that will be spent on local public services. The market value of all such properties as at 31/3/2022 was £39.2m. In 2021/22, rental income from investment property was £2m against direct operating expenditure arising from investment property of £0.8m.

Compliance

4.30 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 Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 7 below.

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

Table 7: Debt Limits

	H1 Forecasted	**30.9.22 Actual**	**2022/23 Operational Boundary £m**	**2022/23 Authorised Limit £m**	**Complied?** Yes/No
Borrowing	363.7	265.6	413.526	463.526	Yes
PFI and Finance Leases	82.36	82.36	83.461	88.461	Yes
Total debt	**446.06**	**347.96**	**496.987**	**552.021**	Yes

4.32 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

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

4.34 **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

	30.9.22 Actual	**2022/223 Target**	**Complied?**
Portfolio average credit rating	A+	A+	Yes

4.35 **Liquidity:** The Authority 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

	30.9.22 Actual	2022/23 Target	Complied?
Total cash available within 1 months	£32m	£25m	Yes

4.36 **Interest Rate Exposures**: This indicator is set to control the Authority'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	30.9.22 Actual	2022/23 Limit	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£0.7m	£5.904m	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0.3m	£2.503m	Yes

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

4.38 **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 all borrowing were:

Table 11: Maturity Structure

Refinancing rate risk indicator	30.9.22 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	7%	100%	12%	No
12 months and within 24 months	6%	100%	5%	Yes
24 months and within 5 years	17%	100%	16%	Yes
5 years and within 10 years	11%	100%	7%	Yes
10 years and above	59%	100%	20%	Yes

4.39 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.

4.40 Although the treasury indicators are in breach due to the minimum levels of short-term borrowing not being reached, this has been a deliberate strategic decision to the benefit of the Authority. As in line with the strategy to borrow only if required, there was very little requirement to borrow due to the increased availability of internal resources. No short-term borrowing was necessary due to robust cashflow monitoring.

4.41 Heightened interest rate levels have led to a preference to avoid short-term borrowing during the year compared with the forecasts from earlier this year. Borrowing an additional £15m to meet the indicator would cost the Authority in excess of £600k per annum.

4.42 Given the current volatile interest rate environment, officers will review the indicators for 2023/24. A more suitable set of benchmarks will be used to appropriately manage refinancing risk without leading to adverse financial outcomes, which will likely include reducing this indicator to zero.

4.43 **Principal Sums Invested for Periods Longer than a year:** The purpose of this indicator is to control the Authority'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	£0	£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. Environmental Implications and contribution to achieving a net zero carbon Islington by 2030

5.2.1. There are no environmental considerations.

5.3. Equalities Impact Assessment

5.3.1. 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.

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

Appendices:

Appendix 1: External context

Final report clearance:

Signed by:

Corporate Director of Resources

Date: 06 October 2022

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Appendix 1

External Context

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 likely 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%.

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.

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.

Appendix 2

Arlingclose's Economic Outlook for the remainder of 2022/23 (based on 26th September 2022 interest rate forecast)

	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 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 blank cheque 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 short- to medium-term outlook for the UK economy is relatively bleak.

Global bond yields have jumped as investors focus on higher and stickier 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.