Follow-up Written Answer from Overview and Scrutiny Committee

20 January 2022

Agenda Item 6 – Budget 2022/23 Update for O&S

Question 1:

The Committee asked for further information to understand the likely impact of inflation on utility costs and associated risks for the Budget 2022/23.

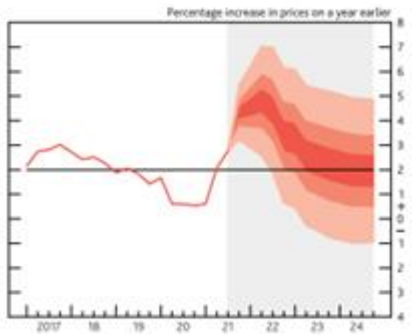
Answer:

INFLATIONARY PRESSURES

1. The outlook for inflation remains above the Government's 2% target and the Consumer Prices Index (CPI) rose by 5.4% in the 12 months to December 2021, up from 5.1% in November.

2. The Bank of England's most recent forecast for CPI was:

Chart 1.4: CPI inflation projection based on market interest rate expectations, other policy measures as announced



3. Their commentary included the following:

- spending, jobs and incomes have continued to recover from the effects of COVID and the size of the UK economy is getting close to where it was before the pandemic. Unemployment has fallen, although it is higher than it was before the pandemic.

- Inflation has risen in many countries. As economies reopened, demand for some goods increased sharply. Some businesses have struggled to meet this extra demand, held back by, for example, shortages of materials and workers. That pushes up costs and prices. Energy prices have also risen, pushing up inflation. These effects are likely to continue pushing inflation up in the coming months.

- We expect inflation to rise to around 5% in the spring next year. We expect these high rates of inflation to be temporary. We don't think that demand will continue to rise as fast, and many of the shortages that are currently making it difficult for businesses to produce their products should ease.

- We expect inflation to fall back from the middle of next year, and to be close to our target in two years' time.

- We expect interest rates will need to rise modestly to return inflation to our 2% target.

IMPLICATIONS FOR 2022/23 BUDGET-SETTING

4. A key element of 2022/23 budget preparation has been assessing the potential risks relating to price inflation during the year to March 2023.

5. The first risk relates to salary budgets which are the most significant element of overall council spending. The recommended budget for 2022/23 includes provision for the 1.3% pay award that has been offered. If the final negotiated pay settlement exceeds this provision then either offsetting savings will need to be found elsewhere in the budget during the year or the additional costs will have to be funded from a call on Reserves. A 1% pay increase equates to £235k additional costs based on the current pay budget.

6. Another risk relates to non-pay revenue budget spending. In the majority of cases, services are firstly expected to accommodate non-pay inflation within existing departmental budgets. A growth bid can be submitted during service & financial planning where this is not possible. For example a growth bid of £120k was included in the November Budget Report for business rate increases for council properties.

7. A third risk relates to energy costs inflation where there is currently considerable uncertainty and volatility. The annual budget for electricity and gas is currently £350k so a 1% increase would be c£3.5k. The council is a member of a purchasing consortium that is tasked with sourcing the best available prices when contracts come up for renewal and has the benefit of being able to call on expert advice about the tariffs on offer. Spending on energy costs will be subject to regular review throughout 2022/23; forecast budget pressures and mitigating actions will be reported through the quarterly budget monitoring updates.

8. Energy inflation also presents potential risks to delivery of the Capital Programme due to the high energy intensity involved in the manufacture of bricks, glass, cement and concrete. This follows steep price increases and shortages last year for raw materials such as metals and timber. These risks are less likely to impact on Capital Programme projects that are already in progress where materials have been ordered in advance and prices are already fixed; but it may well have implications when tendering for new projects if bids exceed allocated budgets.

9. Another area where there are potential impacts relates to the treasury management function where there are likely to be both opportunities and risks with regard to the returns received on balances and the cost of borrowing. These will be addressed through the established treasury management processes, calling on

advice from the Council's Treasury Management advisors LINK Group to help ensure that risks are managed effectively.

10. The final impacts relate to the wider effects of price inflation on local households and businesses that may result in increased demand on council services for support. The budget proposals for 2022/23 include a degree of flexibility to accommodate typical fluctuations in service requests but significant increases in caseloads would put this capacity under pressure without additional funding support from Government.

11. In summary, inflationary pressures remain a financial risk to the authority's budgets, but this is expected to be manageable within the overall context of the budget recommendations and level of Reserves.