ANNEX 1

ANNUAL TREASURY MANAGEMENT OUTTURN REPORT 2021/22

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1. Purpose

The purpose of this report is to present the Council's Annual Treasury Management Outturn report for 2021/22.

The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for the previous financial year as reported at Appendix 1. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

During 2021/22, the minimum reporting requirements were that Council should receive the following reports:

1. The Treasury Management Strategy Statement (TMSS) Report;
2. A mid-year, (minimum), Treasury Update report.
   This is presented to Council in February each year and updates Members on the Treasury Management activity of the authority with the context of the approved TMSS; and
3. An Annual Review following the end of the year (this report).

The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is important in that regard, as it provides details of the outturn position for treasury activities and highlights compliance with the policies previously approved by Council. It will also be presented to the Audit Committee for scrutiny and review.

Member training on treasury management was undertaken in March 2022 in order to support them in their scrutiny and oversight role.

Link Asset Management continued to provide services as the Council's treasury advisors. Their latest commentary is attached at Appendix 2.

2. Summary

During 2021/22, the Council complied with legislative and regulatory requirements. The key prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are set out below:

Table 1: PRUDENTIAL AND TREASURY INDICATORS	2020/21 Actual £000	2021/22 Original Budget £000	2021/22 Actual £000
Capital Expenditure:			
General Fund (see Table 2)	25,786	41,279	35,683

Table 1: PRUDENTIAL AND TREASURY INDICATORS	2020/21 Actual £000	2021/22 Original Budget £000	2021/22 Actual £000
Total	**25,786**	**41,279**	**35,683**
Capital Financing Requirement: In year change			
General Fund	22,108	35,729	20,541
Total	**22,108**	**35,729**	**20,541**
Gross Borrowing:			
Long Term credit arrangements	-	-	-
External Debt	9,000	-	-
Total	**9,000**	**-**	**-**
Investments:			
Under 1 year	36,000	-	19,300
Longer than 1 year	-	-	-
Total	**36,000**	**-**	**19,300**
Net Borrowing / (Net Investment)	**(27,000)**	**-**	**(19,300)**

The Chief Finance Officer confirms that borrowing was only undertaken for a capital purpose and that the statutory borrowing limit, (the Authorised Limit), was not breached.

3. Introduction and Background

This report provides a summary of the Council's treasury management position for the year with regard to borrowing and investments, including:

- Capital investment activity and the impact of this activity on the Council's underlying indebtedness (the 'Capital Financing Requirement' - CFR); and
- Performance against Prudential and Treasury Management indicators (Appendix 1).

4. Treasury Management Audit

The Council's treasury management function is audited on a cyclical basis by the Southern Internal Audit Partnership (SIAP) as part of the Audit Plan. The most recent audit took place in 2020/21 and the audit report was issued in May 2021.

The audit objective was to confirm the effectiveness of key controls in the following areas:

- Treasury Management arrangements are formalised through effective strategies, policies and procedures, and roles and responsibilities are clearly documented and understood, with the segregation of duties considered wherever possible throughout the Treasury Management process.
- Investment and borrowing decisions are based upon sound information, and are clearly documented, together with the rationale and are approved.
- Investment and borrowing transactions are made accurately, and securely, and appropriately recorded and accounted for.
- Management information enables adequate Treasury Management monitoring and reporting.

At the outcome of the audit SIA reported a Reasonable Assurance opinion and concluded that: *'There is a generally sound system of governance, risk management and control in place. Some issues, non-compliance or scope for improvement were identified which may put at risk the achievement of objectives in the area audited'.*

Two low priority management actions were reported and were completed by 31 May 2021. They both related to adding reviewer comments and signature to the bank reconciliation control sheet to help evidence that the review had been carried out.

The audit has therefore confirmed that there are no identified control weaknesses in the systems and processes that have been used to produce the information in this report.

5. Capital Expenditure and Financing

The Council undertakes capital expenditure to acquire or create long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing requirement.

The table below sets out the capital expenditure during 2021/22 and how it was financed.

Table 2: CAPITAL FINANCING	**2020/21 Actual £000**	**2021/22 Original Budget £000**	**2021/22 Actual £000**
Total Capital Expenditure	25,786	41,279	35,683
Financed By:			
Capital Grants	1,957	4,187	2,812
Capital Receipts	1,476	2,385	11,764
Revenue Contribution	-	9,520	-

Table 2: CAPITAL FINANCING	2020/21 Actual £000	2021/22 Original Budget £000	2021/22 Actual £000
Capital Reserves	-	-	-
Total Grants & Receipts	**3,433**	**16,092**	**14,577**
unfinanced capital expenditure	22,353	25,187	21,106
Total Finance	**25,786**	**41,279**	**35,683**

6. Overall Borrowing Need

The underlying need to borrow for capital expenditure is the 'Capital Financing Requirement' (CFR). The CFR increase within any net financing need for the year and reduces through the application of resources, including an annual charge to revenue budget, the Minimum Revenue Provision (MRP).

The Council's CFR for the year is set out below and represents a key prudential indicator.

Table 3: CAPITAL FINANCING REQUIREMENT (CFR)	2020/21 Actual £000	2021/22 Original Budget £000	2021/22 Outturn £000
Opening balance	31,105	49,875	53,214
Add unfinanced capital expenditure	22,353	36,023	21,106
Less MRP	(245)	(294)	(565)
Less PFI & finance lease repayments	-	-	-
In year change in CFR	**22,108**	**35,729**	**20,541**
Cumulative Capital Financing Requirement (CFR)	**53,214**	**85,604**	**73,754**

The Council's treasury team ensures that sufficient cash is available to meet capital expenditure plans and cash flow requirements. This may be sourced through borrowing from external bodies, such as the Government's Public Works Loan Board (PWLB), other local authorities or private sector lenders, or by utilising available cash balances on a temporary basis.

Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that the costs of borrowing to fund capital assets are charged to the revenue budget over the life of the asset. In order to achieve this the Council is required to make an annual charge to the revenue budget, the Minimum Revenue Provision (MRP) to reduce its CFR. This is effectively a provision for

repayment of the associated borrowing.

The CFR can also be reduced by:

- the application of additional capital financing resources, (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The 2021/22 MRP Policy (as required by MHCLG Guidance) was approved by Council as part of the Treasury Management Strategy for 2021/22 on 8 April 2021.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and that borrowing is only used for a capital purpose, the Council has to ensure that its gross external borrowing does not, except in the short term, exceed the total of the CFR in the preceding year (2020/21) plus the estimates of any additional capital financing requirement for the current (2021/22) and next two financial years. This confirms that the Council is not borrowing to support revenue expenditure. The table below sets out the Council's gross borrowing position against its CFR and confirms that the Council has complied with this prudential indicator.

Table 4: GROSS BORROWING POSITION	2020/21 Actual £000	2021/22 Original Budget £000	31 March 2022 (2021/22) Actual £000
Gross External Borrowing Position (Table 1)	**9,000**	-	-
Cumulative CFR (Table 3)	53,214	85,604	73,754
(Under) / Over Funding of CFR	**(44,214)**	**(85,604)**	**(73,754)**

The Authorised Limit - the Authorised Limit is the 'affordable borrowing limit' required by section 3 of the Local Government Act 2003. Once this has been approved, the Council does not have authority to borrow above this level without formal adoption of a revised Limit. The table below confirms that the Council has maintained gross borrowing within its Authorised Limit during 2021/22

The Operational Boundary – the Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary are acceptable subject to the Authorised Limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator confirms the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the 'Net Revenue Stream' (the Council's revenue budget).

TABLE 5: COST of CAPITAL AGAINST NET REVENUE STREAM	2021/22
Authorised Limit	£123m
Maximum gross borrowing position during the year	-

TABLE 5: COST of CAPITAL AGAINST NET REVENUE STREAM	2021/22
Operational Boundary	£113m
Average gross borrowing position	-
Net financing costs as a proportion of Net Revenue Stream	(2.63)%

7. Treasury Position at 31 March 2022

The Council's debt and investment position is organised by the treasury management team in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks across all treasury management activities. Procedures and controls to achieve these objectives are well established both through officer and Member reporting and through officer activity as set out in the Council's Treasury Management Practices. At the end of 2021/22 the Council's treasury position was as follows:

Table 6: DEBT PORTFOLIO	**31 March 2021 Principal £000**	**Rate / Return %**	**Average Life (years)**	**31 March 2022 Principal £000**	**Rate / Return %**	**Average Life (years)**
Fixed rate funding:						
PWLB	-	-	-	-	-	-
Portsmouth City Council	5,000	1.20%	3 months	-	-	-
Elmbridge Borough Council	4,000	1.70%	9 months	-	-	-
Total	**9,000**	**1.45%**	-	-	-	
Variable Rate Funding:						
PWLB	-	-	-	-	-	-
Market Loans	-	-	-	-	-	-
Total Debt	**9,000**	**1.45%**	-	-	-	-
CFR (Table 3)	53,214	-	-	73,754	-	-
Over / (Under) Borrowing	**(44,214)**	-	-	**(73,754)**	-	-

The maturity structure of the debt portfolio is set out below:

<table>
<tr><th colspan="3">Table 7: MATURITY STRUCTURE OF BORROWING 2021/22</th></tr>
<tr><th>Fixed & Variable Rate Borrowing</th><th>Lower</th><th>Upper</th></tr>
<tr><td>Under 12 months</td><td colspan="2" rowspan="8">100%</td></tr>
<tr><td>12 months to 2 years</td></tr>
<tr><td>2 years to 5 years</td></tr>
<tr><td>5 years to 10 years</td></tr>
<tr><td>10 years to 20 years</td></tr>
<tr><td>20 years to 30 years</td></tr>
<tr><td>30 years to 40 years</td></tr>
<tr><td>40 years to 50 years</td></tr>
</table>

The authority does not currently have any external borrowing; the limit will be reviewed and

refined as borrowing takes place.

Table 8: INVESTMENT PORTFOLIO	31 March 2021 Principal £000	Rate/ Return %	Average Life (years)	31 March 2022 Principal £000	Rate/ Return %	Average Life (years)
Investments:						
- In-House	23,000	0.01%	1 year	19,300	0.03%	1 year
- With Brokers	13,000	1.58%	5 months	-	-	-
Total Investments	**36,000**	**0.69%**	**0.75 years**	**19,300**	**0.03%**	**1 years**

Table 9: INVESTMENT PORTFOLIO	Actual 31 March 2021 £000	Actual 31 March 2021 %	Actual 31 March 2022 £000	Actual 31 March 2022 %
Treasury investments				
Banks	-	-	800	4%
Building Societies - rated	13,000	36%	-	-
Local authorities	-	-	-	-
Money Market Funds	23,000	64%	18,500	96%
Total	**36,000**	**100%**	**19,300**	**100%**
Bond funds	-	-	-	-
Property funds	-	-	-	-
Total managed externally	**-**	**-**	**-**	**-**
TOTAL TREASURY INVESTMENTS	**36,000**	**100%**	**19,300**	**100%**

Table 10: INVESTMENT PORTFOLIO	Actual 31 March 2021 £000	Actual 31 March 2021 %	Actual 31 March 2022 £000	Actual 31 March 2022 %
Non-Treasury Investments				
Third party loans[1] & share capital:				
Subsidiaries – Greensand Property Holdings Ltd	14,410	15%	15,223	20%
Companies – Horley Business Park Development LLP	877	1%	975	1%
Associate – Pathway for Care Ltd	1,100	1%	1,100	1%
Investment Property	43,373	45%	40,989	53%
Non-Treasury Investment Total	**59,760**	**62%**	**58,287**	**75%**
Treasury investments	36,000	38%	19,300	25%
TOTAL – ALL INVESTMENTS	**95,760**	**100%**	**77,587**	**100%**

NOTE1: principal plus accrued interest

The maturity structure of the investment portfolio is set out below:

Table 11: ALL TREASURY INVESTMENTS	2020/21 Actual £000	2021/22 Budget £000	2021/22 Actual £000
Investments:			
Up to 1 year	36,000	-	19,300
Longer than 1 year	-	-	-
Total	**36,000**	**-**	**19,300**

8. Borrowing Outturn 2021/22

No external borrowing was undertaken in 2021/22. The Council has maintained an internal borrowing strategy for 2021/22, using its cash balances to fund capital expenditure and avoid borrowing costs. This will be kept under review to plan for the time when the Authority may not be able to avoid new borrowing to finance its capital expenditure plans.

9. Investment Outturn 2021/22

Investment Policy – the Council's investment policy is governed by MHCLG investment guidance and was implemented in the Treasury Management Strategy approved by the Council on 8 April 2021. The Policy sets out the approach for choosing investment counterparties based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, such as rating outlooks, credit default swaps and bank share prices etc.

Investment activity during the year conformed to the approved Policy and the Council experienced no liquidity difficulties.

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. Core cash resources comprised usable reserves as follows:

Table 13: USABLE RESERVES	2020/21 Actual £000	2021/22 Actu.al £000
General Fund Balance	3,000	3,000
Earmarked Reserves	49,172	37,978
Usable Capital Receipts	5,885	7,271
Capital Grants Unapplied Reserve	27,912	27,912
Total	**85,968**	**76,161**

Investments - the Council maintained an average balance of £19.3m of investments in 2021/22 which earned an average rate of return of 0.03%. The comparable external performance indicator is the average 12-month SONIA rate, which was 1.64%. The Council's average rate of return of 0.03% was mainly driven by the money market fund investments made during the pandemic where interest rates were less favourable.

10. Other Treasury Management Matters

Pooled Investment Funds. The Council had no pooled investment funds during the year.

Non-treasury management investments. The Council's current approach to making property investment decisions is set out in its Capital Investment Strategy which explains how investment decisions are made, how delivery is approached and how risks are managed. In order to support investment decisions, the Council relies on the principles established in its Commercial Investment Strategy and powers under the Localism Act 2011.

APPENDIX 1

PRUDENTIAL AND TREASURY INDICATORS

1.1 PRUDENTIAL INDICATORS	2020/21 Actual £000	2021/22 Original Budget £000	2021/22 Actual £000
Capital Expenditure (Table 2)			
General Fund	25,786	41,279	35,683
Ratio of net financing costs to net revenue stream (Table 5)			
General Fund	(2.76) %	(4.13) %	(2.63) %
Gross Debt (Table 4)			
Brought forward 1 April	12,000	9,000	9,000
Carried forward 31 March	9,000	-	-
In year borrowing requirement	(3,000)	(9,000)	(9,000)
Capital Financing Requirement (Table 3)			
Opening CFR	31,105	49,875	53,214
In year CFR change	22,108	35,729	20,541
Closing CFR	53,214	106,029	73,754
Annual change in Capital Financing Requirement (Table 3)			
General Fund	22,108	35,729	20,541

1.2 TREASURY MANAGEMENT INDICATORS	2020/21 Actual £000	2021/22 Original Budget £000	2021/22 Actual £000
Authorised Limit for External Debt			
Borrowing	115,735	122,566	122,566
Other long-term liabilities	500	500	500
Total	**116,235**	**123,066**	**123,066**
Operational Boundary for External Debt			
Borrowing	105,735	112,566	112,566
Other long-term liabilities	500	500	500
Total	**106,235**	**113,066**	**113,066**
Actual External Debt	**9,000**	**-**	**-**

APPENDIX 2

LINK TREASURY SERVICES COMMENTARY

ECONOMIC UPDATE (June 2022)

The second quarter of 2022 saw:

- *GDP fall by 0.1% m/m in March and by 0.3% m/m in April;*
- *An easing rather than a collapse in the composite Purchasing Managers Index (PMI);*
- *A further rise in Consumer Price Index (CPI) inflation to a new 40-year high of 9.1% in May;*
- *The first signs that the weakening in economic activity is filtering into a slightly looser labour market;*
- *Bank Rate rise to 1.25%, taking it to its highest level since the Global Financial Crisis;*
- *Gilt yields caught up in the global surge in bond yields triggered by May's strong rise in US inflation;*
- *Rising global bond yields and concerns over growth drive a global sell-off in equity markets.*
- *Following the 0.1% m/m fall in GDP in March and the 0.3% m/m contraction in April, the economy is now moving towards a recession (two quarters of falling output in a row). Indeed, GDP would need to rise by 0.4-0.5% m/m in both May and June to prevent the economy from contracting in Q2 as a whole. That said, without the joint wind down of the COVID-19 Test and Trace and vaccination programme, GDP would have risen by 0.2% m/m and 0.1% m/m in March and April respectively. That's hardly strong, but it suggests the underlying momentum is not quite as weak as the headline figures imply.*
- *There is not much evidence that higher inflation and higher interest rates have yet become a big drag on activity. Services output did fall by 0.3% m/m in April. But output in consumer-facing services, conversely, rose by a solid 2.3% m/m in April. And although the Office for National Statistics (ONS) said that some of the 1.0% m/m fall in manufacturing output was linked to the drag on activity from higher prices, it also said that some of the 0.4% m/m drop in construction output in April was a drop back after the boost in the wake of February's Storm Eunice.*
- *The fact that the composite PMI didn't fall in June also suggests that in Q2 (Apr – June) real GDP has softened rather than collapsed. The S&P Global/CIPS all-sector PMI for June was unchanged from its level of 53.1 in May, signalling tepid but positive growth. According to the Lloyd's barometer, business confidence in May also remained remarkably resilient.*
- *Despite the fall in the GfK composite measure of consumer confidence to a new record low of -41 in June, April's £1.4bn rise in consumer credit suggests households appear to have turned to credit to support their spending as the cost-of-living squeeze has intensified. Meanwhile, the household saving rate held steady at 6.8% in Q1 in line with its long-term average and we expect households to lower their saving rate further when the bigger falls in real incomes come in Q2 and Q3 to cushion the blow to spending.*
- *The Chancellor's latest fiscal support of £10.3bn (0.5% of GDP), which comprised £15.3bn of handouts to households, partly funded by a £5bn tax on the profits of oil and gas producers, will help support GDP in the second half of the year. And with the Prime Minister and the Chancellor desperately needing to boost their popularity, some tax cuts may be announced in the Autumn Budget.*
- *There have been early signs that the recent weakening in economic activity is filtering through into a slightly looser labour market. The unemployment rate edged up from 3.7% in the three months to March to 3.8%. The single-month data showed that employment fell by 254,000 in April and the unemployment rate rose from 3.5% to 4.2%. And the upward march in the number of job vacancies slowed, with the three-month average only rising from 1.296m in April to 1.300m in May. A seasonal adjustment of the single-month data implies that vacancies fell in May for the first time since COVID-19 was rife in December.*

- *At the same time, a 1.8% m/m fall back in average earnings in April meant that the 3myy rate of earnings eased from 7.0% in March to 6.8% in April. And a lot of the 0.5% m/m rise in earnings excluding bonuses was probably due to the 6.6% rise in the National Living Wage on 1st April. The 3myy rate of earnings excluding bonuses stayed at 4.2%.*

- *That said, conditions in the labour market remain exceptionally tight. The unemployment rate is still close to its recent 47-year low, and there is the same number of unemployed people as job vacancies and at 6.8% in April, the 3myy rate of average earnings is at a 10-year high (although it is still falling in real terms) and is well above the 3.0-3.5% that is broadly consistent with the 2.0% inflation target (assuming that productivity growth is 1.0-1.5%).*

- *CPI inflation rose from 9.0% in April to a new 40-year high of 9.1% in May and it is not yet close to its peak. The increase in CPI inflation in May was mainly due to a further leap in food price inflation from 6.7% to a 13-year high of 8.5%. With the influence of increases in agricultural commodity prices yet to fully feed into prices on the supermarket shelves, we think that food price inflation will rise above 10% in September. And with two-thirds of the observation period for the Ofgem price cap having now passed, something like a 40% rise in utility prices is pretty much baked in the cake for October. The further rise in core producer price inflation, from 13.9% to 14.8%, suggests that core goods CPI inflation will probably rise to 14% before long. We think that will take CPI inflation to a peak of around 10.5% in October.*

- *The rise in services CPI inflation from 4.7% in April to 4.9% in May suggests that domestic price pressures are still strengthening.*

- *There now seems to be an even greater likelihood that second-round effects, whereby high inflation feeds back into higher price and wage expectations, keep inflation higher for longer. For some time, the Monetary Policy Committee (MPC) has placed a lot of weight on the results of the Bank of England's monthly Decision Maker Panel which asks businesses how they expect to change their prices and wages over the next year. May's survey revealed that businesses still expect to raise their selling prices by 6.0% and their wages by 4.8% over the next year. Meanwhile, XpertHR said that pay settlements across the economy stayed at a 30-year high of 4.0% in May. The government appears to be contemplating raising public sector pay by up to 5%. And the 7.1% pay rise granted to some railway workers sets a high bar for the negotiations that led to train strikes across large parts of the country in mid-June.*

- *The MPC has now increased interest rates five times in as many meetings and raised rates to their highest level since the Global Financial Crisis. Even so, coming after the Fed raised rates by 75 basis points (bps) in June and a handful of other central banks have recently raised rates by 50bps, the Bank of England's action is relatively dovish. The MPC's decision not to follow the Fed and raise rates by more makes some sense. The UK's status as a larger importer of commodities, which have jumped in price, means that households in the UK are now facing a much larger squeeze on their real incomes.*

- *But the MPC's new guidance is that if there are signs of "more persistent inflationary pressures" it will, "if necessary act forcefully in response". We expect the MPC to continue to raise rates in steps of 25bps rather than 50bps. We think the MPC will raise rates from 1.25% now to a peak of 2.75% next year. That's higher than the peak of 2.00% forecast by economists, but lower than the peak priced into the financial markets.*

- *Gilt yields have been caught up in the global surge in bond yields triggered by the surprisingly strong rise in CPI inflation in the US in May. The rises in two-year gilt yields (to a peak of 2.37% on 21st June) and 10-year yields (to a peak of 2.62%) took them to their highest level since 2008 and 2014 respectively. And in response to signs that central banks (particularly the US Fed) are going to raise interest rates faster to get on top of inflation, we now think that 10-year gilt yields will reach a peak of 2.70% (up from 2.39% currently) this year and into 2023.*

- *While the S&P 500 is 8.4% below its level a month ago, the FTSE 100 is 5.7% below it. Part of the sell-off has been driven by the rapid rise in global bond yields and the resulting downward pressure on equity valuations as well as concerns over economic growth.*

- *Finally, the pound has already weakened from \$1.37 and €1.21 earlier this year to \$1.21 and €1.16. A lot of these moves have been driven by concerns over the outlook for the global economy and the resulting poor performance of risky assets, which has increased the demand for the dollar relative to sterling. If*

interest rates rise faster and further in the US than in the UK, rate differentials and a worsening in risk appetite will push the pound even lower, from $1.21 now to $1.18 by the end of 2022. We don't expect the pound to fall by as much against the euro (from €1.16 to €1.14 next year). But once global inflation and global interest rates peak, the pound will probably benefit from the return of risk appetite. It may rise to $1.25 by the end of 2023 and to $1.30 by the end of 2024.

INTEREST RATE FORECAST (August 2022)

Comparison of forecasts for Bank Rate today v. previous forecast													
Bank Rate	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
09.08.22	2.25	2.50	2.75	2.75	2.75	2.50	2.50	2.25	2.25	2.25	2.25	2.25	2.00
21.06.22	1.75	2.25	2.75	2.75	2.75	2.75	2.50	2.50	2.25	2.25	2.25	2.25	
Change	0.50	0.25	0.00	0.00	0.00	-0.25	0.00	-0.25	0.00	0.00	0.00	0.00	-

- *Since our last update in June, central banks in the developed economies have significantly quickened the pace of their monetary policy tightening. Although their policies are bespoke and reflect the economic backdrop in each of their countries, that is not to say there has not been a similar approach to dampening inflationary pressures that are still spiking upwards. In that respect, the US FOMC has led with increases of 225bps in the year to date, whilst the Bank of England's MPC has increased its Bank Rate by 150bps to 1.75%.*

- *The latest Bank Rate increase was implemented last Thursday. After an 8-1 vote in favour, Bank Rate shifted up 50bps from 1.25% to 1.75%, but the MPC was careful to keep its options open regarding future decision-making (also note that one vote was for only a 25bps increase). It tweaked its forward guidance in a couple of ways. First, it added that "policy is not on a pre-set path" and that the MPC will decide the "appropriate level of Bank Rate at each meeting". Second, it now says that "further changes" rather than "further increases" in Bank Rate "will reflect the Committee's assessment of the economic outlook and inflationary pressures". The first change suggests that rates will not automatically rise by 50bps at the next few meetings and that the higher rates go, the more important the level. The second change appears to open the door to rate cuts further ahead.*

- *In addition, the MPC surprised the market with its candidness in respect of its UK economic growth forecast assumptions. It stated that the UK is in for five quarters of recession starting in Q4 2022 and running all the way through to the end of 2023. In the interim, it is projected that CPI inflation will exceed 13% in Q4 2022. Half of this increase can be attributed directly to gas/electricity price inflation and a further 2% - 2.5% to the indirect knock-on effects of higher energy on production/services.*

- *Furthermore, the MPC said that it is "provisionally minded" to commence gilt sales of £10bn per quarter from the end of September. That means the balance sheet will soon start to shrink at a faster pace.*

- *However, that said, the MPC appeared also to be sending dovish signals further ahead as the forecast recession involves a 2.2% decline in GDP and if interest rates rise to 3.00%, as the markets currently expect, inflation will be below the 2% target in three years' time. That appears to imply that rates don't need to rise as far as 3.00% and/or that at some point in the next three years rates will need to be cut again to boost inflation.*

- *The Bank also acknowledged it has not taken account of the prospect of a change in Government policy regarding the potential tax cuts offered up by both Conservative leadership candidates vying to be the next Prime Minister. If this policy change occurs, regardless of whether it is to a lesser or greater extent, it is likely to add to inflationary pressures and will be an additional issue for the MPC to consider in full at its November meeting.*

- *You will already have concluded there is a lot to digest from what the MPC has said and done but as has been apparent for some time, there is also a huge influence on UK gilt yields and their movements emanating from what happens with US Treasuries. Therefore, in putting together our interest rate forecasts it is worth noting that should US inflation continue to be stubbornly high (currently the CPI reading is 9.1%) and the jobs reports continue to surprise on the upside (528,000 new jobs reported on Friday and unemployment at a record low of 3.5%), there is the prospect that any downward momentum in UK yields could be offset by Treasury yields shifting higher. Conversely, yield falls could also be supported by the Fed's determination to get inflation down in the US through robust monetary policy tightening.*

- *So, what revisions have we made to our forecasts? First, overall, we have quickened the pace of the Bank Rate increases. We still have a peak of 2.75% in Q1 2023 but that is now based on a 50bps hike in September followed by two 25bps increases in Q4 and Q1. At this juncture, we feel the MPC will want to be seen to be remaining tough on inflation, but they will also be cognisant of the cost-of-living squeeze accelerating, following 60%+ gas/electricity price increases in October. Therefore, after Bank Rate moves up to 2.25% in September, we forecast the pace of rate increases will fall back again from Q4. However, the MPC could also reach 2.5% at the end of the year by implementing equal 25bps hikes in September, November and December. A further 25bps increase in Q1 2023 is our best estimate, but by then we should have a better understanding of whether inflation has peaked, how fast it is falling and what is happening in the broader economy following the important Christmas retail sales data and monthly jobs and wages data.*

- *Regarding gilt yields, these have been on a march upwards since the turn of the year, but that march has been accompanied by significant bouts of volatility that have sometimes been not only hard to explain but also difficult to predict, including the direction of travel. Our best judgment is that gilt yields across the curve have a little further to rise but only by 20 – 30bps, so a lower peak than we were forecasting back in June.*

- *However, given the volatility we have witnessed in recent months, we are forecasting more of the same over the next couple of quarters at least. So, those clients looking to borrow will need to ensure they can act nimbly when the opportunity arises for locking out some interest rate certainty at attractive levels, whilst those looking to repay borrowing should take advantage of upward momentum in yields when that arises.*

- *In terms of our forecast, LIBOR and LIBID rates ceased at the end of 2021. In a continuation of our previous forecasts, our money market yield forecasts are based on expected average earnings by local authorities for 3 to 12 months.*

- *Our forecasts for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short-term cash at any one point in time.*

- *Our current and previous PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.*

Link Group Interest Rate View 09.08.22													
	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
BANK RATE	2.25	2.50	2.75	2.75	2.75	2.50	2.50	2.25	2.25	2.25	2.25	2.25	2.00
3 month ave earnings	2.50	2.80	3.00	2.90	2.80	2.50	2.40	2.30	2.30	2.30	2.20	2.20	2.20
6 month ave earnings	2.90	3.10	3.10	3.00	2.90	2.80	2.70	2.60	2.50	2.50	2.40	2.30	2.30
12 month ave earnings	3.20	3.30	3.20	3.10	3.00	2.90	2.80	2.70	2.40	2.40	2.40	2.40	2.40
5 yr PWLB	2.80	3.00	3.10	3.10	3.00	3.00	2.90	2.90	2.80	2.80	2.80	2.70	2.70
10 yr PWLB	3.00	3.20	3.30	3.30	3.20	3.10	3.10	3.00	3.00	3.00	2.90	2.90	2.80
25 yr PWLB	3.40	3.50	3.50	3.50	3.50	3.40	3.40	3.30	3.30	3.20	3.20	3.20	3.10
50 yr PWLB	3.10	3.20	3.20	3.20	3.20	3.10	3.10	3.00	3.00	2.90	2.90	2.90	2.80

Link Group Interest Rate View 21.06.22												
	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
BANK RATE	1.75	2.25	2.75	2.75	2.75	2.75	2.50	2.50	2.25	2.25	2.25	2.25
3 month ave earnings	2.00	2.50	2.80	2.80	2.80	2.80	2.60	2.50	2.30	2.30	2.20	2.20
6 month ave earnings	2.50	2.80	3.00	3.00	2.90	2.90	2.80	2.70	2.60	2.50	2.40	2.30
12 month ave earnings	3.10	3.20	3.20	3.20	3.00	2.90	2.80	2.60	2.50	2.40	2.40	2.40
5 yr PWLB	3.20	3.30	3.30	3.30	3.30	3.20	3.10	3.00	3.00	3.00	2.90	2.90
10 yr PWLB	3.40	3.50	3.50	3.50	3.50	3.40	3.30	3.20	3.20	3.20	3.10	3.10
25 yr PWLB	3.70	3.70	3.70	3.70	3.70	3.70	3.60	3.50	3.50	3.40	3.40	3.30
50 yr PWLB	3.40	3.40	3.50	3.50	3.40	3.40	3.30	3.20	3.20	3.10	3.10	3.00

SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

- *Our central forecast for interest rates was previously updated on 21 June and reflected a view that the MPC will be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases, including in August. Now we expect a further 0.5% increase in September; another 0.25% increase in November and a further 0.25% hike in February. But the timing and size of the hikes will be data dependent and, potentially, influenced by the actions of the US FOMC.*

- *Further down the road, we anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us – but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and the forecast recession may be prolonged.*

- *The CPI measure of inflation will peak at upwards of 13% in Q4 2022 and the MPC will note the influence gas/electricity price hikes have on this number, and whether wages data is behaving itself. Currently wages are rising at above 4%, excluding bonuses, and above 6%, including bonuses. Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market, where employers are out-bidding each other to ensure they have the pick of a limited labour pool.*

- *Regarding the "provisional" plan to sell £10bn of gilts back into the market each quarter, starting in September, this will undoubtedly have an impact on the pricing of gilts to some degree, but we believe it will pale into insignificance against the other factors we have already outlined as influencing gilt yields.*

- *Notwithstanding the MPC's clear desire to increase Bank Rate through the remainder of 2022, negative real earnings, the upcoming 60%+ hike in the Ofgem energy price cap from October (to be followed by a potential 10%+ further increase from January), at the same time as employees (and employers) have incurred a 1.25% Health & Social Care Levy, growing commodity and food price inflation plus council tax rises - all these factors will hit households' finances hard. However, lower income families will be hit disproportionately hard despite some limited assistance from the Government to postpone the full impact of rising energy costs.*

- *In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies, but the on-going conflict between Russia and Ukraine, including the manner in which the West and NATO respond through sanctions and/or military intervention. Currently, oil, gas, wheat and other mainstream commodities have risen significantly in price and central banks will have to balance whether they prioritise economic growth or try to counter supply-side shock induced inflation. (More recently, the heightened tensions between China/Taiwan/US also have the potential to have a wider and negative economic impact.)*

- *On the positive side, consumers are still estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above increases. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income before these increases hit and have few financial reserves.*

PWLB RATES:

- *The yield curve has fluctuated since our June update and PWLB 5 to 50 years Certainty Rates are, generally, in the range of 2.5% to 3.25%.*

- *We view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the poor inflation outlook.*

- *It is difficult to say currently what effect the Bank of England starting to sell gilts at a rate of £10bn per quarter, from September, will have. But our judgment is that US Treasury yield influences (driven by inflation and jobs/pay data) will affect gilt yields more than the gilt sales.*

BALANCE OF RISKS TO THE UK ECONOMY:

- *The overall balance of risks to economic growth in the UK is to the downside.*

Downside risks to current forecasts for UK gilt yields and PWLB rates include:

- ***Labour and supply shortages*** *prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields).*

- ***The Bank of England*** *acts too quickly, or too far, over the next two years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.*

- ***UK / EU trade arrangements*** *– if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.*

- ***Geopolitical risks,*** *for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.*

Upside risks to current forecasts for UK gilt yields and PWLB rates:

- *The* ***Bank of England is too slow*** *in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates an even more rapid series of increases in Bank Rate faster than we currently expect.*

- ***The Government*** *acts too quickly to cut taxes and/or increases expenditure in the light of the cost-of-living squeeze.*

- ***The pound weakens on the back of UK/EU trade friction*** *resulting in investors pricing in a risk premium for holding UK sovereign debt.*

- *Longer term* ***US treasury yields*** *continue to rise strongly and pull gilt yields up higher than forecast.*

LINK GROUP FORECASTS:

- *We now expect the MPC to swiftly increase Bank Rate during the remainder of 2022 and into Q1 2023 to combat the sharp increase in inflationary pressures. We do not think that the MPC will embark on a series of increases in Bank Rate that would take it to more than 2.75%, but it is possible.*

GILT YIELDS AND PWLB RATES:

- *The general situation is for volatility in bond yields to endure as investor fears and confidence ebb and flow between favouring relatively more "risky" assets i.e., equities, or the safe haven of government bonds, despite material inflationary concerns. The overall longer-run trend is for gilt yields and PWLB rates to rise moderately in the near-term, given the extent to which market expectations are already priced in and then to fall back once inflation starts to fall through 2023.*

- *Our target borrowing rates and the current PWLB (certainty) borrowing rates are set out below:-*

PWLB debt	Current borrowing rate as at 09.08.22 a.m.	Target borrowing rate now (end of Q3 2022)	Target borrowing rate previous (end of Q3 2022)
5 year	2.61%	2.80%	3.20%
10 year	2.81%	3.00%	3.40%
25 year	3.23%	3.40%	3.70%
50 year	2.99%	3.10%	3.40%

BORROWING ADVICE:

Our long-term (beyond 10 years) forecast for Bank Rate stands at 2.25%. As all PWLB certainty rates are now above this level, borrowing strategies will need to be reviewed in that context. Better value can generally be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered out to 5 years. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive as part of a balanced debt portfolio.

- *In addition, there are also some alternative sources of long-term borrowing if a client is seeking certainty within their portfolio and wishes to avoid a "cost of carry", or simply wishes to mitigate future re-financing risk. Please speak to your CRM to discuss options.*

- *Our suggested budgeted earnings rates for investments up to about three months' duration in each financial year are as follows:*

Average earnings in each year	Now	Previously
2022/23	2.40%	2.20%
2023/24	2.70%	2.75%
2024/25	2.30%	2.30%
2025/26	2.15%	2.10%
Years 6 to 10	2.15%	2.00%
Years 10+	2.30%	2.25%

- *As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts. The general expectation for a trend of moderately rising gilt yields is unchanged.*

- *Our interest rate forecast for Bank Rate is in steps of 25 bps, whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps. Naturally, we continue to monitor events and will update our forecasts as and when appropriate.*