ANNEX

CABINET – 16TH NOVEMBER 2023

Report of the Head of Finance

Lead Member: Councillor Ashcroft

Part A

TREASURY MANAGEMENT UPDATE MID-YEAR REVIEW FOR THE 6 MONTHS APRIL-SEPTEMBER 2023

Purpose of Report

This report reviews the Treasury Management Strategy and the Annual Investment Strategy, plus the various Prudential Borrowing and Treasury Indicators for the first six months of 2023/24.

Recommendation

That it be recommended to Council to note this mid-year review of the Treasury Management Strategy Statement, Prudential Borrowing and Treasury Indicators plus the Annual Investment Strategy, as set out in Part B.

Reason

To ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the Revised CIPFA Treasury Management in the Public Services Code of Practice, Guidance Notes and Treasury Management Policy Statement, that funding of capital expenditure is taken within the totality of the Council's financial position, and that borrowing and Investment is only carried out with proper regard to the Prudential Code for Capital Finance in Local Authorities.

Policy Justification and Previous Decisions

The Capital Strategy including the Treasury Management Strategy, Annual Investment Strategy and Minimum Revenue Provision Policy, Prudential & Treasury Indicators must be approved by Council each year and reviewed half yearly. This review is set out in the attached report as Part B. The Strategy for the year was approved by Council on 27th February 2023.

Implementation Timetable including Future Decisions and Scrutiny

This report will be presented to Cabinet on 16th November 2023 for onward recommendation to the full Council meeting of 15th January 2024.

The report is available for scrutiny by the Scrutiny Committee at the regular meeting scheduled for 13th November 2023 if required.

Report Implications

The following implications have been identified for this report.

Financial Implications

There are no direct financial implications arising from this report.

Risk Management

There are no direct risks arising from the recommendation in this report. Risks associated with the Treasury Policy, etc and in general are set out within Part B.

Key Decision:	No
Background Papers:	None
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1. Background

1.1 Capital Strategy

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities have been required to prepare a Capital Strategy which is to provide the following: -

a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services.

an overview of how the associated risk is managed;

the implications for future financial sustainability.

1.2 Treasury Management

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer-term cash may involve arranging long or short-term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

> "The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.3 Regulatory Framework

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

3. Receipt by the full council of an annual Treasury Management Strategy Statement

   - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during the previous year.

4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Audit Committee:

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

1. An economic update for the first part of the 2023/24 financial year;
2. A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
3. The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
4. A review of the Council's investment portfolio for 2023/24;
5. A review of the Council's borrowing strategy for 2023/24;
6. A review of any debt rescheduling undertaken during 2023/24;
7. A review of compliance with Treasury and Prudential Limits for 2023/24.

2. Economics and Interest Rates

2.1 Economics Update – (Appendix 4)

Summary of the first half of 2023/24 saw:

Interest rates rise by a further 100bps, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.

Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.

A 0.5% m/m decline in real GDP in July, mainly due to more strikes.

CPI inflation falling from 8.7% in April to 6.7% in August, its lowest rate since February 2022, but still the highest in the G7.

Core CPI inflation declining to 6.2% in August from 7.1% in April and May, a then 31 years high.

A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3myy growth of average earnings rose to 7.8% in August, excluding bonuses).

2.2 Interest Rate Forecasts

The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The 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.

The latest forecast on 25th September sets out a view that short, medium and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy.

Our PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps, calculated as gilts plus 80bps) which has been accessible to most authorities since 1st November 2012.

Link Group Interest Rate View	25.09.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.00	2.75	2.75	2.75	2.75	2.75
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.00	2.80	2.80	2.80	2.80	2.80
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.10	2.90	2.90	2.90	2.90	2.90
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.20	3.00	3.00	3.00	3.00	3.00
5 yr PWLB	5.10	5.00	4.90	4.70	4.40	4.20	4.00	3.90	3.70	3.70	3.60	3.60	3.50
10 yr PWLB	5.00	4.90	4.80	4.60	4.40	4.20	4.00	3.80	3.70	3.60	3.60	3.50	3.50
25 yr PWLB	5.40	5.20	5.10	4.90	4.70	4.40	4.30	4.10	4.00	3.90	3.80	3.80	3.80
50 yr PWLB	5.20	5.00	4.90	4.70	4.50	4.20	4.10	3.90	3.80	3.70	3.60	3.60	3.60

3. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement, (TMSS), for 2023/24 was approved by Council on 27th February 2023. There have been no policy changes to the TMSS since that approval; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

To note the current Operational Boundary borrowing limits and the Authorised Limits are part of the prudential guidelines and these remain as they were previously reported in the TMSS for 2023/24.

The Operational Boundary is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be similar to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under borrowing by other cash resources.

Operational Boundary	2023/24 Budget £'000	2023/24 Actual £'000
Debt	108,090	81,190
Expected Change in Debt	15,000	0
Total	**123,090**	**81,190**

A further prudential indicator controls the overall level of borrowing. This is **the Authorised Limit** which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised Limit	2023/24 Budget £'000	2023/24 Actual £'000
Debt	120,000	81,190
Expected Change in Debt	15,000	0
Total	**135,000**	**81,190**

4. The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

The Council's capital expenditure plans.
How these plans are being financed;
The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
Compliance with the limits in place for borrowing activity.

4.1 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure	Full Year Budget 2023/24 £’000	Actual Spend 30/09/2023 £’000	Variance 30/09/2023 £’000
Bedford Square	463	166	297
Enterprise Zone	10,000	0	10,000
Regeneration Schemes	5,000	0	5,000
Town Deal Schemes	2,077	232	1,845
Shepshed Public Realm	1,092	1,418	(326)
Carbon Neutral	909	187	722
DFG Grant	1,310	582	728
Other General Fund Schemes	4,041	1,839	2,202
General Fund Total	24,892	4,424	20,468
HRA	13,769	4,817	8,952
Total Capital Expenditure	**38,661**	**9,241**	**29,420**

The Actual Capital spend is slow for the first half of the year, with an underspend on General Fund £20.5m of which £15m relates to provisional Regeneration and Enterprise Zone Schemes which exist in the Capital Plan in the event that opportunities arise in this year and the next two years. It may be noted that a £4.1m forward funding investment in the Enterprise Zone was undertaken in October 2023. A large amount of HRA new contracts commence September 2023. Capital monitoring is reported to Finance and Performance Scrutiny each July, October, January and an outturn report each year.

4.2 Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure Financed By	£’000
S106 Funding	1,394
Other External Funding	3,801
Capital Receipts	4,492
External Borrowing	15,000
Reinvestment Reserve	38
Capital Plan Reserve	167
Total GF Funding	24,892
HRA S106 Funding	1
HRA Financing Fund/MRR	12,223
HRA Capital Receipts	1,545
Total HRA Funding	13,769
Overall Total Funding	**38,661**

4.3 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement
We are on target to achieve the original forecast Capital Financing Requirement.

Capital Financing Requirement	2022/23 Actual £’000	2023/24 Original Budget £’000	2024/25 Original Budget £’000	2025/26 Original Budget £’000
CFR (Fleet Less MRP)	1,789	1,491	1.193	895
CFR (Commercial Activities Less MRP)	22,422	22,119	21.806	21,483
CFR (Regeneration Less MRP)	0	5,000	4,937	4,872
CFR (Enterprise Zone no MRP)	0	10,000	10,000	10,000
CFR (HRA no MRP)	81,820	81,820	78.820	76,820
Total CFR	**106,031**	**120,430**	**116,756**	**114,070**
Movement in CFR Represented By	**(591)**	**14,399**	**(3,674)**	**(2,686)**
Net Financing Need for the Year (Above)	0	15,000	0	0
Repayment of Loans	0	0	(3,000)	(2.000)
Less MRP Charge	(591)	(601)	(674)	(686)
Movement CFR	**(591)**	**14,399**	**(3,674)**	**(2,686)**

The current MRP policy is that a full years MRP will be made in the year after capital expenditure has incurred and when the assets are fully operational. MRP charged £591k for 2022/23 based on the assets purchased in 2020/21 and annual MRP charges will be made based on the table above.

4.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2022/23 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2022/23 Actual £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
External Debt at 1 April	81,190	81,190	96.190	93,190
Expected Change in Debt	0	15,000	(3,000)	(2,000)
External Debt at 31 March	81,190	96,190	93.190	91,190
Capital Financing Requirement	106,031	120,430	116,756	114,070
Under Borrowing	24,841	24,240	23,566	22,880

5. Annual investment strategy

The Treasury Management Strategy Statement (TMSS) for 2023/24, which includes the Annual Investment Strategy, was approved by the Council on 27th February 2023. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

Creditworthiness.
Following the Government's fiscal event on 23rd September, both S&P and Fitch have placed the UK sovereign debt rating on Negative Outlook, reflecting a downside bias to

the current ratings in light of expectations of weaker finances and the economic outlook. Nothing further has evolved in the first half of 2023/24.

Investment Counterparty Criteria
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

CDS (Credit Default Swap) Prices
It is noted that sentiment in the current economic climate can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances. CDS, which can be seen as representing the cost to insure a bank deposit from default, is a key measure of risk.

Investment Balances
The average level of funds available for investment purposes during the first half of the financial year was £54m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

Internal investments portfolio yield is 4.77%, (1.21% the same period in 2022/23) against a benchmark 90 day backward looking compounded SONIA rate of 4.44%, the performance exceeded the benchmark. Actual internal investment income earned to 30th September 2023 is £1.3m.

The interest and rental income earned by the Council's investment in External Property Funds' Lothbury and Federated Hermes as at 30th September 2023 is £78k, net return 1.85%, (£92k, net return 1.4% for the same period in 2022/23) against a benchmark 365 day backward looking compounded SONIA rate of 0.72%.

In summary, the Council's budgeted annual investment return for 2023/24 is £2m, the total interest earned to date is £1.378m including Property Funds. (£402k in the same period in 2022/23), given the Council has been able to take advantage of the increased interest rates on some investments the actual investment income has outperformed the budget to date.

The Head of Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first 6 months of 2023/24.

6. Borrowing

The Council's capital financing requirement (CFR) for 2023/24 is £120.43m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market, (external borrowing) or from internal balances on a temporary basis, (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions; however, Table 4.4 shows the Council has actual borrowings in 2023/24 of £81.190m, this is £2m of an external loan which matures in 2024 and £79.19m total HRA Debt elements of which mature between 2024 and 2062, and has utilised £39.24m of cashflow funds in lieu of borrowing. This is a prudent and cost-effective approach in the current economic climate but will require ongoing monitoring in the event that any upside risk to gilt yields prevails.

Due to the overall financial position and the underlying need to borrow for capital purposes (the CFR), no new external borrowing has been undertaken. The capital programme is being kept under regular review due to the effects of inflationary pressures, shortages of materials and labour. Our borrowing strategy will, therefore, also be regularly reviewed and then revised, if necessary, in order to achieve optimum value and risk exposure in the long-term.

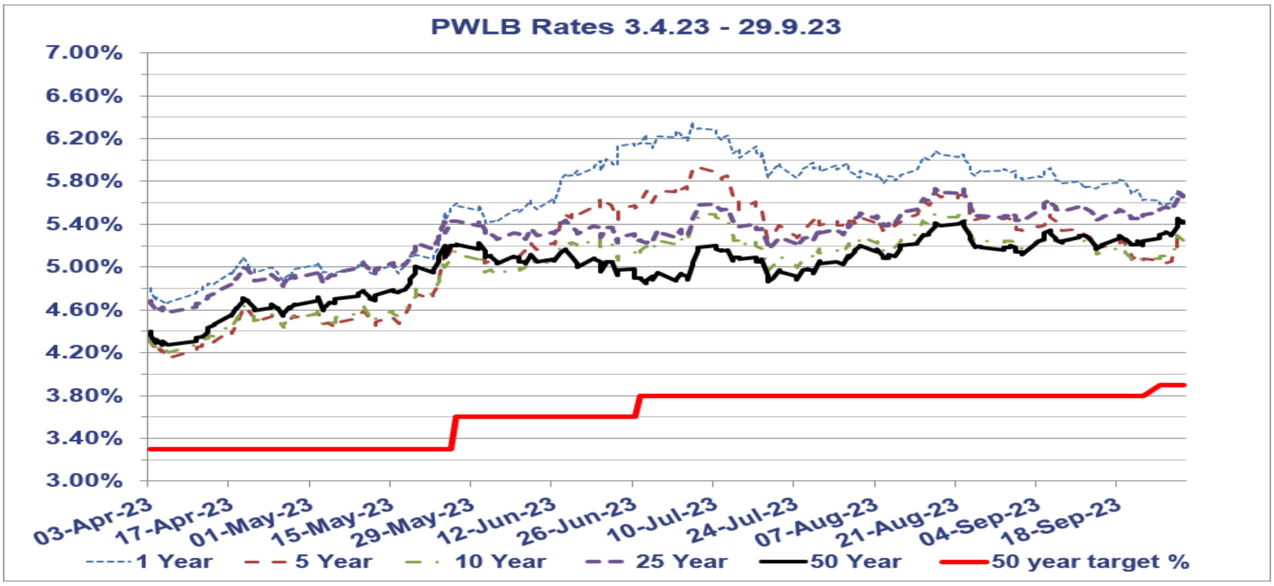
No new external borrowing was undertaken during the first half year. It is anticipated that further borrowing will not be undertaken during the remainder of the financial year.

PWLB maturity certainty rates (gilts plus 80bps) year to date to 29th September 2023

Gilt yields and PWLB certainty rates were on a generally rising trend throughout the first half of 2023/24. At the beginning of April, the 5-year rate was the cheapest part of the curve and touched 4.14% whilst the 25-year rate was relatively expensive at 4.58%.

July saw short-dated rates peak at their most expensive. The 1 year rate spiked to 6.36% and the 5 year rate to 5.93%. Although, in due course, short-dated rate expectations fell, the medium dates shifted higher through August and the 10 year rate pushed higher to 5.51% and the 25 year rate to 5.73%. The 50 year rate was 4.27% on 5th April but rose to 5.45% on 28th September.

Link Asset Services forecast rates to fall back over the next two to three years as inflation dampens. The CPI measure of inflation is expected to fall below 2% in the second half of 2024, and they forecast 50-year rates to stand at 3.90% by the end of September 2025. However, there is considerable gilt issuance to be digested by the market over the next couple of years, as a minimum, so there is a high degree of uncertainty as to whether rates will fall that far.



7. Debt Rescheduling

Debt rescheduling opportunities have increased over the course of the past six months and will be considered if giving rise to long-term savings. However, no debt rescheduling has been undertaken to date in the current financial year. This topic will be considered in more detail as part of the forthcoming Capital Strategy for 2024/25, as both general fund and HRA debt matures.

Appendices

Appendix 1: Portfolio of Investments as at 30th September 2023

Appendix 2: Approved Countries for Investments as at 30th September 2023

Appendix 3: CFR, Liability Benchmark and Borrowing

Appendix 4: Economics Update as at 30th September 2023

Appendix 5: Glossary of Terms

APPENDIX 1:

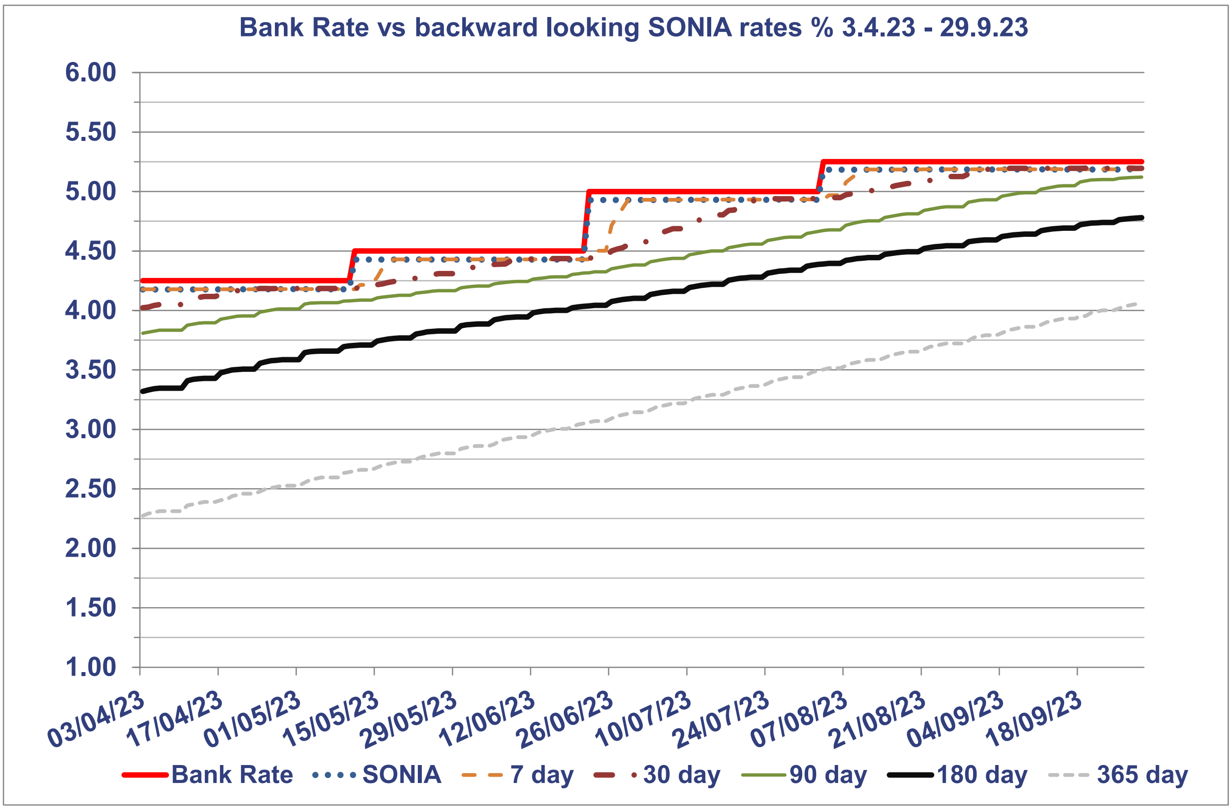
Internal Investment Portfolio

Investments held as at 30 September 2023	**Maturity Date**	**£000**	**Interest Rate**
Lloyds Bank Corporate Markets	02/10/2023	5,000	4.88%
Lloyds Bank Corporate Markets	14/11/2023	3,000	4.99%
Lloyds Bank Corporate Markets	22/01/2024	3,000	5.87%
SMBC Bank International	14/11/2023	3,000	4.84%
Close Brothers	28/11/2023	3,000	5.00%
Close Brothers	26/01/2024	2,000	5.73%
Landesbank Hessen-Thueringen Girozentrale	30/11/2023	5,000	4.47%
Landesbank Hessen-Thueringen Girozentrale	10/05/2024	3,000	5.01%
Standard Chartered Bank – Sustainable Deposit	12/10/2023	3,000	4.72%
Standard Chartered Bank – Sustainable Deposit	02/01/2024	5,000	5.83%
Goldman Sachs International Bank	13/02/2024	5,000	5.89%
Natwest Markets	04/03/2024	5,000	5.81%
Federated Hermes Money Market Fund	1 Day Notice	12,000	5.35%
Insight Money Market Fund	1 Day Notice	2,340	5.25%
Total Managed Internally		**59,340**	
Lothbury Property Fund	n/a	2,500	n/a
Hermes Property Fund	n/a	2,500	n/a
Total Managed Externally		**5,000**	
TOTAL TREASURY INVESTMENTS		**64,340**	

Investment Performance Year to Date as of 30th September 2023 (Excludes Property Funds)

Period	SONIA Benchmark Return	Council Performance	Investment Interest Earned
3 Month	4.44%	4.77%	£1.3m

SONIA: the Sterling Overnight Index Average. Generally, a replacement set of indices (for LIBID) for those benchmarking their investments. The benchmarking option used is a 90 day backward-looking average SONIA uncompounded rate that reflects the investment yield curve at the time an investment decision was taken. This shows that the Council have outperformed this benchmark for the first half of 2023/24.



	Bank Rate	SONIA	7 day	30 day	90 day	180 day	365 day
High	5.25	5.19	5.19	5.20	5.12	4.78	4.06
High Date	03/08/2023	29/09/2023	04/09/2023	27/09/2023	29/09/2023	29/09/2023	29/09/2023
Low	4.25	4.18	4.18	4.02	3.81	3.32	2.27
Low Date	03/04/2023	04/04/2023	11/04/2023	03/04/2023	03/04/2023	03/04/2023	03/04/2023
Average	4.81	4.74	4.71	4.64	4.44	4.10	3.16
Spread	1.00	1.01	1.01	1.17	1.31	1.46	1.79

Property Funds

Property Funds performance table below for the first half year has produced a net return of 1.75% for Lothbury and 1.94% for Federated Hermes. This compares to the benchmark 365 day backward looking compounded SONIA rate for property funds of 0.7195%. Currently both fund returns are higher in the first half of 2023/24.

To note both Property Fund market valuations are currently below the original fund values and whilst current market analysis suggests this will recover, we are closely montoring these two property funds.

Property Funds to 30th September 2023

Property Fund	Date Acquired	Original Cost	Entry Fee	Total Original Cost	Valuation 30/09/2023	Valuation (Gain)/Loss	Gross Interest Received to 30/09/2023	Gross Return on Property Funds 30/09/2023	Management Fees to 30/09/2023	Net Interest Received to 30/09/2023	Net Return on Property Funds to 30/09/2023
		£000	£000	£000	£000	£000	£000	%	£000	£000	%
Lothbury	01/03/2018	2,417	84	2,501	2,001	(416)	46	2.30	11	35	1.75
Federated Hermes	26/07/2018	2,500	119	2,619	2,213	(287)	46	2.08	3	43	1.94
Total		4,917	203	5,120	4,214	(703)	92	2.2	14	78	1.85

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APPENDIX 2: Approved countries for investments as at 30th September 2023

Based on lowest available rating

AAA

- Australia
- Denmark
- Germany
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

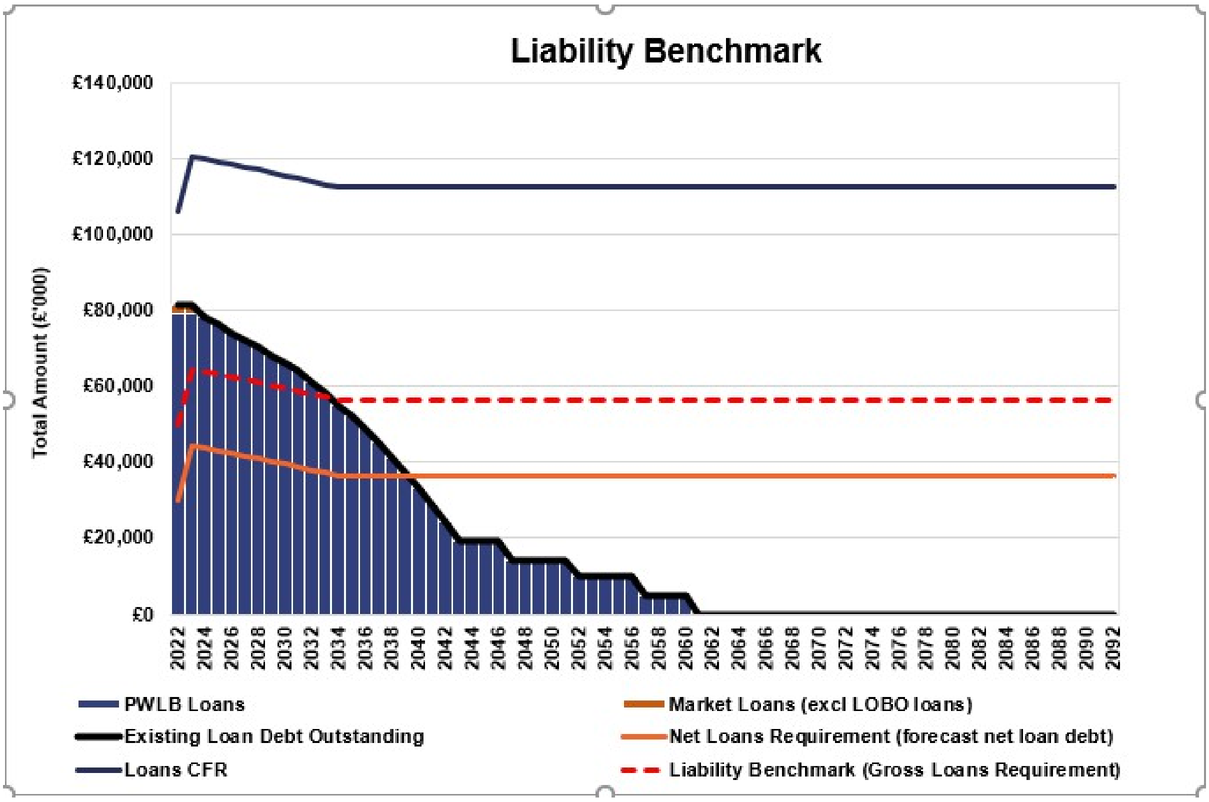
AA

- Abu Dhabi (UAE)

AA-

- Belgium
- France (downgraded by Fitch on 9th May 2023)
- Hong Kong
- Qatar
- **U.K.**

Appendix 3: CFR, Liability Benchmark and Borrowing



The Liability Benchmark perhaps makes more sense when viewed over the longer term. The graph above extrapolates the current situation into the future, and assuming no changes to the underlying metrics, it can be seen that from around 2033 the level of borrowing falls below the Benchmark (red dotted line), implying that the Council would need to increase external borrowing at this time. This also implies that in the short term, the Council has scope to increase internal borrowing, as the current combination of external loans and treasury balances is well above the benchmark.

Appendix 4: Economics Update – Link Asset Services

The 0.5% m/m fall in GDP in July suggests that underlying growth has lost momentum since earlier in the year. Some of the weakness in July was due to there being almost twice as many working days lost to strikes in July (281,000) than in June (160,000). But with output falling in 10 out of the 17 sectors, there is an air of underlying weakness.

The fall in the composite Purchasing Managers Index from 48.6 in August to 46.8 in September left it at its lowest level since COVID-19 lockdowns reduced activity in January 2021. At face value, it is consistent with the 0.2% q/q rise in real GDP in the period April to June, being followed by a contraction of up to 1% in the second half of 2023.

The 0.4% m/m rebound in retail sales volumes in August is not as good as it looks as it partly reflected a pickup in sales after the unusually wet weather in July. Sales volumes in August were 0.2% below their level in May, suggesting much of the resilience in retail activity in the first half of the year has faded.

As the growing drag from higher interest rates intensifies over the next six months, we think the economy will continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year. And with CPI inflation past its peak and expected to decline further, the economy has got through the cost-of- living crisis without recession. But even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. We expect the Bank of England to keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.

The tightness of the labour market continued to ease, with employment in the three months to July falling by 207,000. The further decline in the number of job vacancies from 1.017m in July to 0.989m in August suggests that the labour market has loosened a bit further since July. That is the first time it has fallen below 1m since July 2021. At 3.0% in July, and likely to have fallen to 2.9% in August, the job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth. Meanwhile, the 48,000 decline in the supply of workers in the three months to July offset some of the loosening in the tightness of the labour market. That was due to a 63,000 increase in inactivity in the three months to July as more people left the labour market due to long term sickness or to enter education. The supply of labour is still 0.3% below its pre-pandemic February 2020 level.

But the cooling in labour market conditions still has not fed through to an easing in wage growth. While the monthly rate of earnings growth eased sharply from an upwardly revised +2.2% in June to -0.9% in July, a lot of that was due to the one-off bonus payments for NHS staff in June not being repeated in July. The headline 3myy rate rose from 8.4% (revised up from 8.2%) to 8.5%, which meant UK wage growth remains much faster than in the US and in the Euro-zone. Moreover, while the Bank of England's closely watched measure of regular private sector wage growth eased a touch in July, from 8.2% 3myy in June to 8.1% 3myy, it is still well above the Bank of England's prediction for it to fall to 6.9% in September.

CPI inflation declined from 6.8% in July to 6.7% in August, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.2%. That reverses all the rise since March and means the gap between the UK and elsewhere has shrunk (US core inflation is 4.4% and in the Euro-zone it is 5.3%). Core goods inflation fell from 5.9% to 5.2% and the further easing in core goods producer price inflation, from 2.2% in July to a 29-month low of 1.5% in August, suggests it will eventually fall close to zero. But the really positive development was the fall in services inflation from 7.4% to 6.8%. That also reverses most of the rise since March and takes it below the forecast of 7.2% the Bank of England published in early August.

In its latest monetary policy meeting on 20 September, the Bank of England left interest rates unchanged at 5.25%. The weak August CPI inflation release, the recent loosening in the labour market and the downbeat activity surveys appear to have convinced the Bank of England that it has already raised rates far enough. The minutes show the decision was "finely balanced". Five MPC members (Bailey, Broadbent, Dhingra, Pill and Ramsden) voted for no change and the other four (Cunliffe, Greene, Haskel and Mann) voted for a 25bps hike.

Like the US Fed, the Bank of England wants the markets to believe in the higher for longer narrative. The statement did not say that rates have peaked and once again said if there was evidence of more persistent inflation pressures "further tightening in policy would be required". Governor Bailey stated, "we'll be watching closely to see if further increases are needed". The Bank also retained the hawkish guidance that rates will stay "sufficiently restrictive for sufficiently long".

This narrative makes sense as the Bank of England does not want the markets to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments. A rebound in services inflation, another surge in wage growth and/or a further leap in oil prices could conceivably force it to raise rates at the next meeting on 2nd November, or even pause in November and raise rates in December.

The yield on 10-year Gilts fell from a peak of 4.74% on 17th August to 4.44% on 29th September, mainly on the back of investors revising down their interest rate expectations. But even after their recent pullback, the rise in Gilt yields has exceeded the rise in most other Developed Market government yields since the start of the year. Looking forward, once inflation falls back, Gilt yields are set to reduce further. A (mild) recession over the next couple of quarters will support this outlook if it helps to loosen the labour market (higher unemployment/lower wage increases).

The pound weakened from its cycle high of \$1.30 in the middle of July to \$1.21 in late September. In the first half of the year, the pound bounced back strongly from the Truss debacle last autumn. That rebound was in large part driven by the substantial shift up in UK interest rate expectations. However, over the past couple of months, interest rate expectations have dropped sharply as inflation started to come down, growth faltered, and the Bank of England called an end to its hiking cycle.

The FTSE 100 has gained more than 2% since the end of August, from around 7,440 on 31st August to 7,608 on 29th September. The rebound has been primarily driven by higher energy prices which boosted the valuations of energy companies. The FTSE 100's relatively high concentration of energy companies helps to explain why UK equities outperformed both US and Euro-zone equities in September. Nonetheless, as recently as 21st April the FTSE 100 stood at 7,914.

APPENDIX 5: Glossary of Terms

Capital Financing Requirement
CFR is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of expenditure above, which has not immediately been paid for, will increase the CFR. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

Operational Boundary
The operational boundary is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Authorised Limit for External Debt
A further key prudential indicator represents a control on the maximum level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Gross External Debt
This is the total amount borrowed by the Council at a point in time.

Investments
The budgeted figure is the estimated average funds available for investment during the year. The actual figure is the total amount invested as at 30th September for Internal Investments and 30th June Property Funds.

Net Borrowing
Net borrowing is gross external debt less investments.

Loans
In this mid-year (and previously) interest receivable has exceeded interest payable for the General Fund producing a negative number for net interest payable and a somewhat odd- looking negative ratio; this can be construed as indicating that the Council has no issues servicing General Fund loans at this time.