AUDIT COMMITTEE – 30th January 2024

Report of the Head of Finance

Lead Member: Councillor Ashcroft

Part A

TREASURY MANAGEMENT QUARTER 3 UPDATE REPORT

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 third quarter of the financial year 2023/24.

Recommendations

That it be recommended that Audit Committee note this report as set out in part B.

Reasons

To ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the CIPFA code of practice for Treasury Management 2021. It recommends that members be updated on treasury management activities at least quarterly, the report ensures this Council is implementing best practice in accordance with the code.

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 on a quarterly basis. 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 Audit Committee on 30th January 2024.

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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Treasury Management Update
Quarter Ended 31st December 2023 (Q3 2023/24)

Part B

The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management 2021 recommends that members be updated on treasury management activities at least quarterly. This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

1. Economics Update Summary from Link Asset Services

Summary of the third quarter of 2023/24 saw:

- A 0.3% m/m decline in real GDP in October, potentially partly due to unseasonably wet weather, but also due to the ongoing drag from higher interest rates. Growth for the second quarter, ending 30th September, was revised downwards to -0.1% and growth on an annual basis was also revised downwards, to 0.3%;
- A sharp fall in wage growth, with the headline 3myy rate declining from 8.0% in September to 7.2% in October, although the ONS "experimental" rate of unemployment has remained low at 4.2%;
- CPI inflation continuing on its downward trajectory, from 8.7% in April to 4.6% in October, then again to 3.9% in November;
- Core CPI inflation decreasing from April and May's 31 years' high of 7.1% to 5.1% in November, the lowest rate since January 2022;
- The Bank of England holding rates at 5.25% in November and December;
- A steady fall in 10-year gilt yields as investors revised their interest rate expectations lower.

Detailed Economics Update from Link Asset Services - Appendix 3

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.

Link Group Interest Rate View	07.11.23												
	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	3.25	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.30	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.40	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.50	3.30	3.30	3.30	3.30	3.30
5 yr PWLB	5.00	4.90	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.60	3.50	3.50	3.50
10 yr PWLB	5.10	5.00	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.70	3.60	3.60	3.50
25 yr PWLB	5.50	5.30	5.10	4.90	4.70	4.50	4.30	4.20	4.10	4.10	4.00	4.00	4.00
50 yr PWLB	5.30	5.10	4.90	4.70	4.50	4.30	4.10	4.00	3.90	3.90	3.80	3.80	3.80

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

A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

- Our central forecast for interest rates was previously updated on 7th November and reflected a view that the MPC would be keen to underpin its anti-inflation credentials by keeping Bank Rate at 5.25% until at least H2 2024. We expect rate cuts to start when both the CPI inflation and wage/employment data are unequivocally supportive of such a move, and that there is a strong likelihood of the overall economy enduring tepid growth (at best) or a mild recession (at worst) over the coming months.

- Naturally, timing on this matter will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

- In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine, and Gaza and Israel.

- On the positive side, consumers are still anticipated to be sitting on some excess savings left over from the pandemic, which could cushion some of the impact of the above challenges and may be the reason why the economy is performing a little better at this stage of the economic cycle than may have been expected. Nonetheless, with approximately 400,000 households per quarter facing a mortgage interest reset at higher levels than their current rate, the economy will face on-going headwinds from that source, in addition to lower income households having to spend disproportionately on essentials such as food, energy and rent payments.

PWLB RATES

- As illustrated in the charts in section 1, gilt yields have endured a volatile nine months with yields rising significantly on the back of inflation concerns before retracing much of those increases in November and December. With the market now anticipating rate cuts by H2 2024, the short and medium parts of the curve are now close to where they started 2023/24, but the longer part of the curve is still a little higher. At the time of writing there is c50 basis points difference between the 5 and 50 year parts of the curve.

The 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, could keep gilt yields high for longer).

- The Bank of England has increased Bank Rate too fast and too far over recent months, and subsequently brings about a deeper and longer UK recession 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, the Middle East, China/Taiwan/US, Iran and North Korea, which could lead to increasing safe-haven flows.

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

- Despite the recent tightening to 5.25%, the Bank of England proves too timid in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to remain elevated for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project.

- The pound weakens because of a lack of confidence in the UK Government's pre-election fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.

- Longer-term US treasury yields rise strongly if inflation remains more stubborn there than the market currently anticipates, consequently pulling gilt yields up higher.

- Projected gilt issuance, inclusive of natural maturities and Quantitative Tightening (QT), could be too much for the markets to comfortably digest without higher yields compensating.

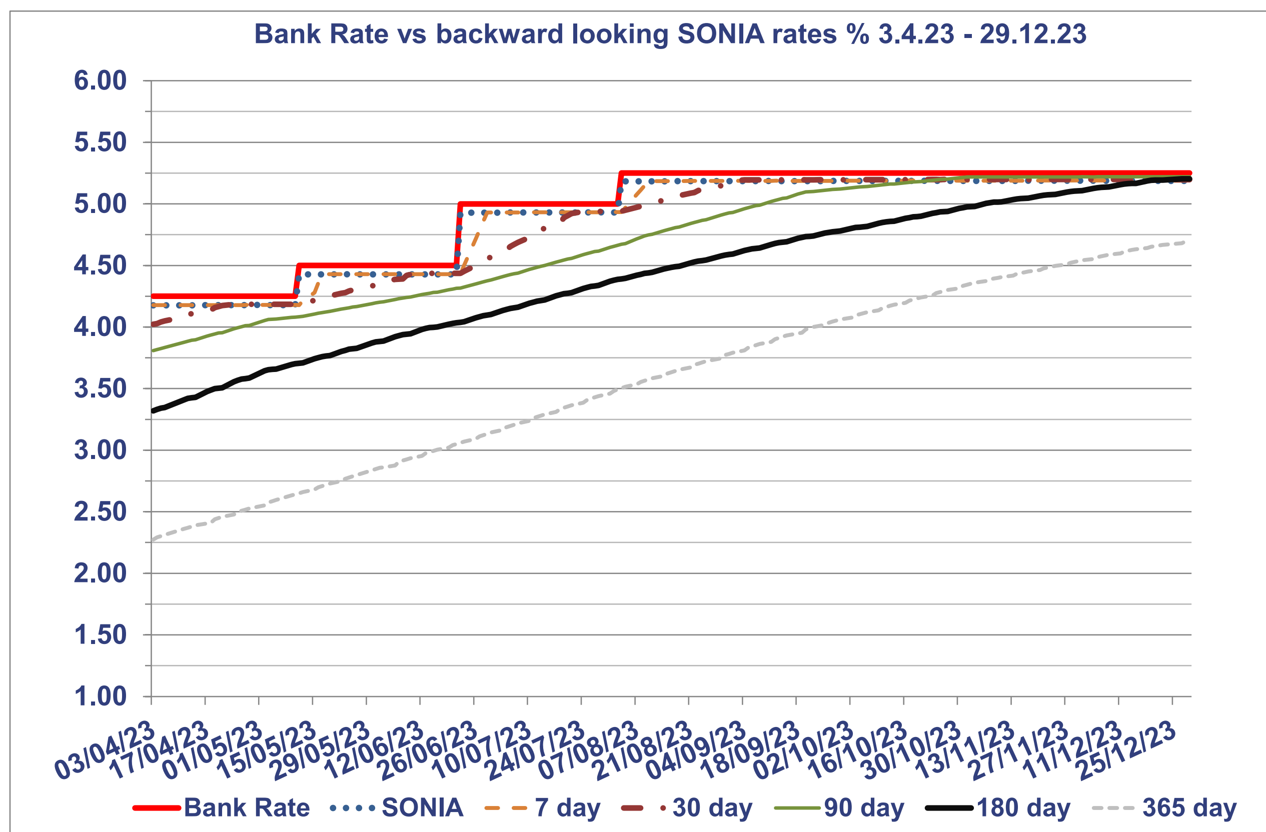
3. Annual Investment Strategy

The Treasury Management Strategy Statement, (TMSS), for 2023/24, which includes the Annual Investment Strategy was approved by this Council on 27th February 2023, in accordance with the CIPFA Treasury Management code of Practice, it sets out the councils' 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, aligned with the Council's risk appetite. In the current economic climate, over and above keeping investments short-term to cover cash flow needs, there is a benefit 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.

As shown by the table below, and the interest rate forecasts in section 2, investment rates have remained elevated during 2023/24 but are now expected to have peaked.



FINANCIAL YEAR TO QUARTER ENDED 29/12/2023							
	Bank Rate	**SONIA**	**7 day**	**30 day**	**90 day**	**180 day**	**365 day**
High	5.25	5.19	5.19	5.20	5.22	5.20	4.70
High Date	03/08/2023	24/11/2023	27/11/2023	12/12/2023	22/12/2023	29/12/2023	29/12/2023
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	4.95	4.89	4.88	4.84	4.71	4.43	3.60
Spread	1.00	1.01	1.01	1.18	1.41	1.88	2.43

Creditworthiness
There have been few changes to credit ratings over the quarter under review. However, officers continue to closely monitor these, and other measures of creditworthiness to ensure that only appropriate counterparties are considered for investment purposes.

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

CDS Prices
For UK banks, there are no underlying negative themes. Prices are not misaligned with other creditworthiness indicators, such as credit ratings. Nevertheless, it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

Investment Balances
The average level of funds available for investment purposes to 31st December 2023 was £57m. These funds are available on a temporary basis, and the level of funds available are mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

Approved Limits
Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 31st December 2023. A full list of investments held as at 31st December 2023 is in appendix 1.

4. Borrowing

No new external borrowing was undertaken during the quarter ended 31st December 2023. It is anticipated that further borrowing will not be undertaken during the remainder of the financial year.

5. Debt Rescheduling

Debt rescheduling opportunities have increased significantly in the current quarter where gilt yields, which underpin PWLB rates and market loans, have risen materially. Members will be advised if there is value to be had by rescheduling or repaying a part of the debt portfolio.

6. Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the quarter ended 31st December 2023*,* the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2023/24. The Director of Finance, Governance and Contracts reports that no difficulties are envisaged for the current or future years in complying with these indicators.

All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

Treasury and Prudential Indicators

The Operational Boundary borrowing limits and the Authorised limits are part of the prudential guidelines and these limits remain as they were previously reported in the Treasury Management Strategy 2023.

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**

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the *quarter ended* 31th December 2023*,* the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2023/24. The Director of Finance, Governance and Contracts reports that no difficulties are envisaged for the current or future years in complying with these indicators.

All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

Prudential Indicator for Capital Expenditure

The Capital Expenditure below is shown as reported to Finance and Performance Scrutiny on 28th November 2023 for April to October, which provides a more up to date position of spend against budget for General Fund and HRA.

The General Fund full year capital budget is £24,892k, period 7 profiled budget is £14,521k compared to spend of £8,962k, 62% with an underspend of £5,559k.

The HRA Full year capital budget is £38,661k, Period 7 profiled budget is £22,522k compared to spend of £12,917k, 57% with an underspend of £9,635k.

Capital Summary	Full Year Budget	Period 7 Budget	Period 7 Actual Spend	Period 7 Variance Under/(Over)	Period 7 % Spend against Budget
General Fund	24,892	14,521	8,962	5,559	62
HRA	13,769	8,032	3,956	4,076	49
Total	**38,661**	**22,552**	**12,917**	**9,635**	**57**
General Fund Split					
GF Live Schemes	17,671	10,309	8,177	2,132	79
GF Provisional Schemes	5,087	2,967	0	2,967	0
GF 3rd Party Schemes	2,134	1,245	785	460	63
Total	**24,892**	**14,521**	**8,962**	**5,559**	**62**

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. 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.

	30th December 2023 £'000
Debt	
General Fund	2,000
HRA	79,190
Total Gross Debt	**81,190**
Less Investments/Cash	(69,740)
Total Net Debt	**11,450**
CFR	**106,031**

The Capital Financing Requirement 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, the table below shows the Council has actual borrowings in 2023/24 of £81,190m, this includes a £2m market loan which is repayable in June 2024 and £79,190 HRA loans, elements of which mature between 2024 and 2062.

The table shows that the Council has complied with the prudential indicator in the current year and does not envisage difficulties in the future.

	2023/24 Budget £'000	***2022/23 Actual £'000***
External Debt at 1 April	81,190	81,190
Expected change in Debt	15,000	0
Actual debt at 31 March	**96,190**	**81,190**
Capital Financing Requirement	120,430	106,031
Under borrowing	**24,240**	**24,841**

6. Debt Rescheduling.

Debt rescheduling opportunities have increased significantly in the current quarter where gilt yields, which underpin PWLB rates and market loans, have risen materially. Members will be advised if there is value to be had by rescheduling or repaying a part of the debt portfolio. No debt rescheduling is planned in the current financial year. No new external borrowing has also been undertaken.

Appendices

Appendix 1: Portfolio of investments as at 31st December 2023

Appendix 2: Approved countries for investments as at 31th December 2023

Appendix 3: Detailed Economics Update from Link Asset Services

Appendix 4: Glossary of Terms

Appendix 1 - Investment Portfolio

Investments 31st December 2023	**Maturity Date**	**£000**	**Interest Rate**
Standard Chartered Bank Sustainable Deposit	02/01/2024	5,000	5.83%
Lloyds Bank Corporate Markets	22/01/2024	3,000	5.87%
Close Brothers	26/01/2024	2,000	5.73%
Goldman Sachs International Bank	13/02/2024	5,000	5.89%
Natwest Markets	04/03/2024	5,000	5.81%
Lloyds Bank Corporate Markets	02/04/2024	5,000	5.66%
SMBC Bank International	11/04/2024	5,000	5.58%
Landesbank Hessen-Thueringen Girozentrale	10/05/2024	3,000	5.01%
SMBC Bank International	14/05/2024	3,000	5.47%
Lloyds Bank Corporate Markets	14/05/2024	3,000	5.50%
Close Brothers	28/05/2024	3,000	5.60%
London Borough of Waltham Forest	16/09/2024	5,000	5.65%
Santander 95 Day Notice Account	95 Day Notice	3,000	5.70%
Santander 180 Day Notice Account	180 Day Noice	3,000	5.80%
Federated Hermes Money Market Fund	1 Day Notice	11,740	5.38%
Total Managed Internally		**64,740**	
Lothbury Property Unit Trust	n/a	2,500	n/a
Federated Hermes Property Unit Trust	n/a	2,500	n/a
Total Managed Externally		**5,000**	
TOTAL TREASURY INVESTMENTS		**69,740**	

Internal Investment performance year to date as at 31th December 2023 (Excludes Property Funds)

Period	SONIA Benchmark 90 Day Average	Council Performance	Investment Interest Earned
Quarter ended 31/12/2023	4.71%	5.03%	£2.2m

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 by 32bps.

Property Funds

The table below shows performance to the third quarter has produced a net return of 2.80% for Lothbury & 3.20% for Federated Hermes. This compares to the property fund benchmark of 365 day backward looking average SONIA compounded rate of 1.40%.

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 both funds.

Property Funds 31/12/2023

Property Fund	Date Acquired	Original Cost	Entry Fee	Total Original Cost	Valuation 31/12/2023	Valuation (Gain)/Loss	Gross Interest Received to 31/12/2023	Gross Return on Property Funds 31/12/2023	Management Fees to 31/12/2023	Net Interest Received to 31/12/2023	Net Return on Property Funds to 31/12/2023
		£000	£000	£000	£000	£000	£000	%	£000	£000	%
Lothbury	01/03/2018	2,417	84	2,501	1,880	(537)	69	3.7	17	52	2.8
Federated Hermes	26/07/2018	2,500	119	2,619	2,128	(372)	72	3.4	4	68	3.2
Total		4,917	203	5,120	4,007	(910)	141	3.5	21	120	3.0

IFRS 9 fair value of investments

Following the consultation undertaken by the Department of Levelling Up, Housing and Communities [DLUHC] on IFRS 9, the Government has extended the mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds to 31st March 2025. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.

Appendix 2 - Approved Countries for Investment as of 31st December 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)
- Qatar
- **U.K.**

Appendix 3 - Detailed Economics Update from Link Asset Services

- The revision of GDP data in Q2 to a 0.1% q/q fall may mean the mildest of mild recessions has begun. Indeed, real GDP in October fell 0.3% m/m which does suggest that the economy may stagnate again in Q3. The weakness in October may partly be due to the unseasonably wet weather. That said, as the weakness was broad based it may also be the case that the ongoing drag from higher interest rates is more than offsetting any boost from the rise in real wages.

- However, the rise in the flash composite activity Purchasing Managers Index, from 50.7 in November to 51.7 in December, did increase the chances of the economy avoiding a contraction in Q3. The improvement was entirely driven by the increase in the services activity balance from 50.9 to 52.7. (Scores above 50 point to expansion in the economy, although only tepid in this instance.) The press release noted that this was primarily driven by a revival in consumer demand in the technological and financial services sectors. This chimes with the further improvement in the GfK measure of consumer confidence in December, from -24 to -22. The services PMI is now consistent with non-retail services output growing by 0.5% q/q in Q3, but this is in stark contrast to the manufacturing sector where the output balance slumped from 49.2 to 45.9 and, at face value, the output balance is consistent with a 1.5% q/q fall in manufacturing output in Q3.

- The 0.3% m/m fall in retail sales volumes in October means that after contracting by 1.0% q/q (which was downwardly revised from -0.8% q/q) in Q2, retail activity remained weak at the start of Q3. That suggests higher interest rates are taking a bigger toll on real consumer spending.

- Higher interest rates have filtered through the financial channels and weakened the housing market but, overall, it remains surprisingly resilient with only marginal falls showing year on year on the Halifax (-1%) and Nationwide (-1.8%) indices. However, the full weakness in real consumer spending and real business investment has yet to come as currently it is estimated that around two thirds to a half of the impact of higher interest rates on household interest payments has yet to be felt.

- Overall, we expect real GDP growth to remain subdued throughout 2024 as the drag from higher interest rates is protracted but a fading of the cost-of-living crisis and interest rate cuts in the second half of 2024 will support a recovery in GDP growth in 2025.

- The labour market remains tight by historical standards, but the sharp fall in wage growth seen in October will reinforce the growing belief in markets that interest rates will be cut mid-2024. Wage growth eased in October much faster than the consensus expected. Total earnings fell by 1.6% m/m, which meant

the headline 3myy rate eased from 8.0% in September to 7.2% in October. This news will be welcomed by the Bank of England. Indeed, the timelier three-month annualised rate of average earnings growth fell from +2.4% to -1.2%. Excluding bonuses, it fell from 5.3% to 2.0%. Furthermore, one of the Bank's key barometers of inflation persistence, regular private sector pay growth, dropped from 7.9% 3myy to 7.3%, which leaves it comfortably on track to fall to 7.2% by December, as predicted by the Bank in November.

- The fall in wage growth occurred despite labour demand being stronger in October than expected. The three-month change in employment eased only a touch from +52,000 in September to +50,000 in October. But resilient labour demand was offset by a further 63,000 rise in the supply of workers in the three months to October. That meant labour supply exceeded its pre-pandemic level for the first time, and the unemployment rate remained at 4.2% in October. In the three months to November, the number of job vacancies fell for the 17th month in a row, from around 959,000 in October to around 949,000. That has reduced the vacancy to unemployment ratio as demand for labour eases relative to supply, which may support a further easing in wage growth in the coming months.

- CPI inflation fell from 6.7% in September to 4.6% in October, and then again to 3.9% in November. Both these falls were bigger than expected and there are clear signs of easing in domestic inflationary pressures. The fall in core CPI inflation from 5.7% to 5.1% in November was bigger than expected (consensus forecast 5.6%). That's the lowest rate since January 2022. Some of the decline in core inflation was due to the global influence of core goods inflation, which slowed from 4.3% to 3.3%. But some of it was due to services inflation falling from 6.6% to 6.3%. The Bank views the latter as a key barometer of the persistence of inflation and it came in further below the Bank's forecast of 6.9% in its November Monetary Policy Report. This will give the Bank more confidence that services inflation is now on a firmly downward path.

- The Bank of England sprung no surprises with its December monetary policy committee (MPC) meeting, leaving interest rates at 5.25% for the third time in a row and pushing back against the prospect of near-term interest rate cuts. The Bank continued to sound hawkish, with the MPC maintaining its tightening bias saying that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures". And it stuck to the familiar script, saying that policy will be "sufficiently restrictive for sufficiently long" and that "monetary policy is likely to need to be restrictive for an extended period of time". In other words, the message is that the MPC is not yet willing to endorse investors' expectations that rates will be cut as soon as May 2024.

- Looking ahead, our colleagues at Capital Economics forecast that the recent downward trends in CPI and core inflation will stall over the next few months before starting to decline more decisively again in February. That explains why

we think the Bank of England won't feel comfortable cutting interest rates until H2 2024.

- The fall in UK market interest rate expectations in December has driven most of the decline in 10-year gilt yields, which have fallen in line with 10-year US Treasury and euro-zone yields. 10-year gilt yields have fallen from 4.68% in October 2023 to around 3.70% at the time of writing, with further declines likely if the falling inflation story is maintained.

- Investors' growing expectations that the Fed will cut interest rates soon has led to an improvement in risk sentiment, which has boosted the pound and other risky assets. In addition, the rise in the pound, from $1.21 in November to $1.27 now, has also been supported by the recent relative decline in UK wholesale gas prices.

- The further fall in 10-year real gilt yields in December has supported the recent rise in the FTSE 100. That said, the index remains 5% below its record high in February. This modest rise in equities appears to have been mostly driven by strong performances in the industrials and rate-sensitive technology sectors. But UK equities have continued to underperform US and euro-zone equities. The FTSE 100 has risen by 2.2% in December, while the S&P 500 has risen by 3.8%. This is partly due to lower energy prices, which have been a relatively bigger drag on the FTSE 100, due to the index's high concentration of energy companies.

MPC meetings 2nd November and 14th December 2023

- On 2nd November, the Bank of England's Monetary Policy Committee (MPC) voted to keep Bank Rate on hold at 5.25%, and on 14th December reiterated that view. Both increases reflected a split vote, the latter by 6 votes to 3, with the minority grouping voting for an increase of 0.25% as concerns about "sticky" inflation remained in place.

- Nonetheless, with UK CPI inflation now at 3.9%, and core inflating beginning to moderate (5.1%), markets are voicing a view that rate cuts should begin in Q1 2024/25, some way ahead of the indications from MPC members. Of course, the data will be the ultimate determinant, so upcoming publications of employment, wages and inflation numbers will be of particular importance, and on-going volatility in Bank Rate expectations and the gilt yield curve can be expected.

- In addition, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has kept short-term rates in the range of 5.25%-5.50%, whilst the ECB has moved its Deposit rate to a probable peak of 4%. Markets currently expect both central banks to start cutting rates in 2024.

Appendix 4 - Glossary of Terms

Capital Financing Requirement - CFR

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 assets 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.

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.