Appendix ‘A’

Treasury Management Update

Quarter 1 Report 2022/23
ended 30 June 2022

East Lindsey District Council

1 Treasury Management Update

Quarter Ended 30 June 2022

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

2 Economic Update

The second quarter of 2022 saw:

- Gross Domestic Product (GDP) fall by 0.1% month on month (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.

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. With two-thirds of the observation period for the Ofgem price cap having now passed, something like a 40% rise in utility prices are expected in 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 Monetary Policy Committee (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 Federal Bank of America 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 Federal bank of America 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.

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.

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.

A detailed commentary is provided by Link Group at **'Appendix A1'**.

3. Interest rate forecasts

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The Public Works Loan Board (PWLB) rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1 November 2012.

The latest forecast on 21 June is compared below to the previous forecast (10 May). A comparison of these forecasts shows that PWLB rates have increased generally and show a speed up in the rate of increase in Bank Rate as inflation is now posing a greater risk. The increase in PWLB rates reflects a broad sell-off in sovereign bonds internationally as inflation concerns abound. To that end, the MPC has tightened short-term interest rates with a view to trying to slow the economy sufficiently to keep the secondary effects of inflation – as measured by wage rises – under control, but without pushing the economy into recession.

10 yr PWLB	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
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

50 yr PWLB	2.70	2.80	2.80	2.90	2.90	2.90	2.80	2.80	2.70	2.70	2.70	2.70	2.70

A detailed commentary around these forecasts by Link Group is shown at **'Appendix A1'.**

PWLB BORROWING RATES

The yield curve has steepened considerably through the quarter and PWLB 5 to 50 years Certainty Rates are, generally, in the range of 2.75% to 3.75%.

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

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, rising gilt yields).

- **The Bank of England** acts too quickly, or too far, over the next three 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, Iran, China, 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 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.

The Treasury Management Strategy Statement for 2022/23, which includes the Annual Investment Strategy, was approved by the Council on 2 March 2022. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. 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 highly 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 interest rate forecasts in section 3, rates have improved dramatically during the first six months of the calendar year and are expected to improve further as Bank Rate continues to increase over the next year or so.

Creditworthiness - Significant levels of downgrades to short and long term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, as economies have reopened, there have been some instances of previous lowering of Outlooks being reversed.

Investment Counterparty Criteria - The current investment counterparty criteria selection approved in the Treasury Management Strategy Statement is meeting the requirement of the treasury management function.

Credit Default Swap (CDS) prices - Although CDS prices (these are market indicators of credit risk) for banks (including those from the UK) spiked at the outset of the pandemic in 2020, they have subsequently returned to near pre-pandemic levels. **However, sentiment can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances**.

Investment performance year to date as at 30 June 2022 –

The Council's 2022/23 budget for investment income is £1.3m. At the end of June 2022 investment income earned was estimated to be approximately £313k. This figure is still an estimate as the actual returns on all property funds to June 2022 are not likely to be known until late October 2022.

The average level of funds available for investment purposes during the first quarter of the financial year was £50.6m excluding property fund investments.

Treasury investments achieved an average rate of 0.682% compared to the benchmark average 3-month Sterling Overnight Index Average (SONIA) rate of 1.212%.

Property fund investments are estimated to have achieved an average net rate of 3.36%.

The combined rate achieved on all investments is estimated to be approximately 1.58%.

The outturn for investment income for 2022/23 is expected to over perform due to the prevailing interest rates that are now available. Where possible, any investments that will mature between now and year end, are also expected to be reinvested at favourable rates. Work is currently being undertaken to model potential income levels and to understand the profiling of any spend and therefore the potential funds available for investment.

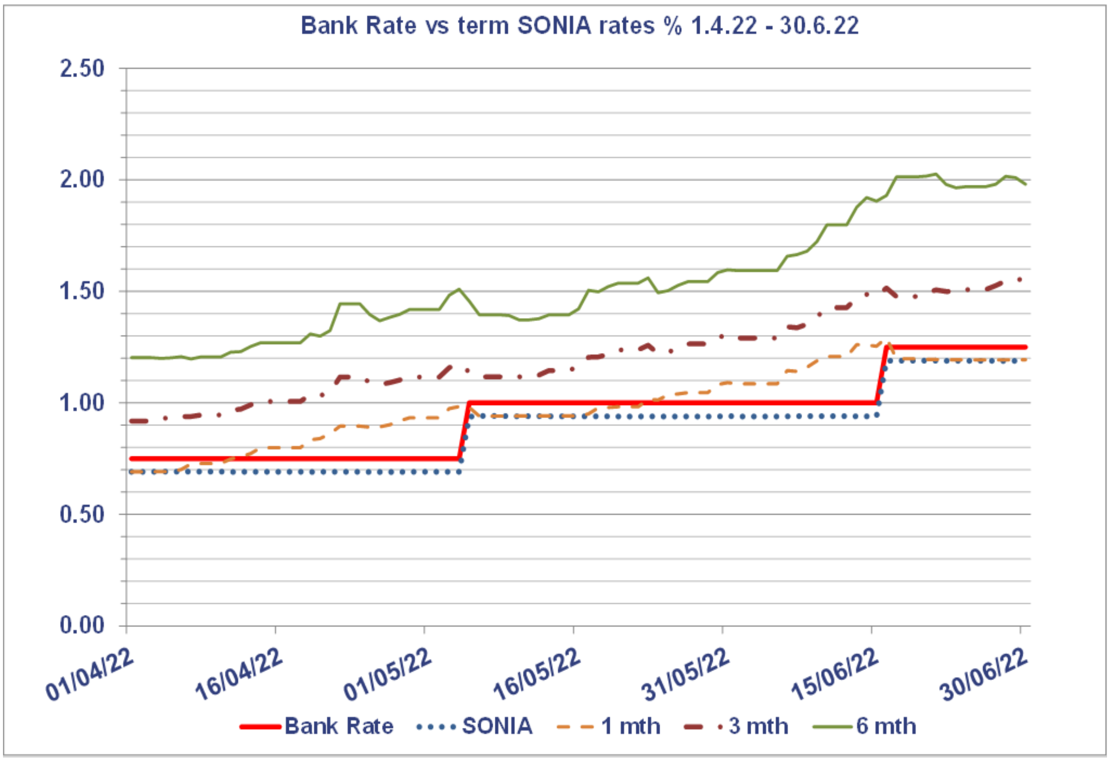
During the financial year the Council has made investments in line with the agreed Treasury Management Strategy.

The following table provides details of the cash investments held by the Council at 30 June 2022. Note this represents the position at this one point in time. The peaks and troughs in cash flow are managed on a daily basis.

Because the Council collects money on behalf of other organisations which are paid out at future dates (e.g. Council Tax and Business Rates) the value of investments held at any point in time does not represent the value of ELDC's own resources.

Financial Institution	Amount (£)	Maturity Date	Yield
Barclays Bank Current Account	3,462,642	01/07/2022	0.00%
Barclays Bank	4,993,838	01/07/2022	1.00%
Handelsbanken Plc	4,947,090	01/07/2022	0.25%
CCLA Money Market Fund	7,500,000	01/07/2022	1.04%
UK Debt Management Office	15,000,000	14/07/2022	1.05%
UK Debt Management Office	5,000,000	18/07/2022	1.05%
First Abu Dhabi Bank	2,500,000	28/07/2022	0.16%
Australia & New Zealand Bank	5,000,000	04/08/2022	1.00%
Goldman Sachs	5,000,000	30/09/2022	1.45%
Standard Chartered Bank	5,000,000	18/11/2022	1.61%
First Abu Dhabi Bank	2,500,000	15/12/2022	2.11%
National Bank of Kuwait	5,000,000	15/12/2022	1.92%
National Bank of Canada	5,000,000	16/12/2022	2.13%
TOTAL	**70,903,570**		

The graph below shows that longer term investment rates have been on a rising trend for the first quarter of the financial year. This was due to the expectation of further Bank of England Base rate rises.



The Council has purchased property fund units and the table below provides a breakdown in relation to the purchase of these units:

Fund	Net Asset Value at Purchase £	Premium/ (Discount) on Purchase £	Premium/ (Discount) on Purchase %	Total Cost £
Federated Hermes Property Unit Trust	3,893,003	106,948	2.75	3,999,951
Schroder UK Real Estate Fund	4,819,418	(19,381)	(0.40)	4,800,037
Threadneedle Property Unit Trust	4,653,444	145,543	3.13	4,798,987
BlackRock UK Property Fund	4,734,550	65,482	1.38	4,800,032
M&G Investments UK Property Fund	1,374,053	105,707	2.25	1,479,760
AEW UK Core Property Fund	4,505,538	294,462	6.54	4,800,000

TOTAL	**23,980,006**	**698,761**	**2.54**	**24,678,767**

The following table provides details in relation to the performance and valuation of these funds as at 30 June 2022.

Financial Institution	Purchase Cost (£)	Estimated Revenue Received 2022/23 (£)	Projected Annualised Distribution Yield 2022/23	Net Asset Value (£)	Total Gain/ (Loss) Since Purchase (£)	2022/23 Quarterly Gain/ (Loss) (£)	2022/23 Annualised Fund Capital Gain/(Loss) Since 1/4/20	2022/23 Estimated Combined Return
Federated Hermes Property Unit Trust	3,999,951	30,870	3.09% Estimate	4,998,406	998,455	215,663	18.08%	21.17%
Schroder UK Real Estate Fund	4,800,037	49,642	4.06% Estimate	5,982,191	1,182,154	93,592	6.37%	10.43%
Threadneedle Property Unit Trust	4,798,987	45,914	3.85% Estimate	5,236,063	437,076	203,079	16.18%	20.03%
BlackRock UK Property Fund	4,800,032	34,590	2.88% Estimate	5,575,015	774,983	124,454	9.16%	12.04%
M&G Investments UK Property Fund	1,479,760	4,066	1.10% Estimate	1,670,241	190,481	3,634	N/A	N/A
AEW UK Core Property Fund	4,800,000	47,223	3.95% Estimate	5,034,820	234,820	156,092	12.83%	16.78%
TOTAL	**24,678,767**	**212,305**		**28,496,736**	**3,817,969**	**796,514**		

The Projected Annualised Distribution Yield is the projected yield for the year based on dividends already received during the current financial year.

The 2022/23 Annualised Fund Capital Gain/Loss is the projected gain/loss in the capital value of the fund since the start of the financial year calculated by reference to the change in the Net Asset Value from 31 March 2022 to the period end.

The estimated combined return is the total of the Projected Dividend Distribution Yield and the Annualised Fund Capital Gain/Loss. Please note that this is the position as at 30 June 2022 and the capital values will fluctuate year on year.

An analysis of dividend distributions received since the purchase of the property funds to 30 June 2022 can be found in the table below:

Financial Institution	Actual Dividend Distributions Received Pre 2022/23	Original Budgeted Distribution for 2022/23	Estimated Dividend Distributions Received 2022/23	Total Distributions Received Since Purchase
Federated Hermes Property Unit Trust	727,525	32,111	30,870	758,395
Schroder UK Real Estate Fund	779,317	38,535	49,642	828,959
Threadneedle Property Unit Trust	703,245	53,601	45,914	749,159
BlackRock UK Property Fund	531,654	39,492	34,590	566,244
M&G Investments UK Property Fund	581,963	44,518	4,066	586,029
AEW UK Core Property Fund	742,212	53,732	47,223	789,435
Total Revenue	**4,065,916**	**261,989**	**212,305**	**4,278,221**

5 Borrowing

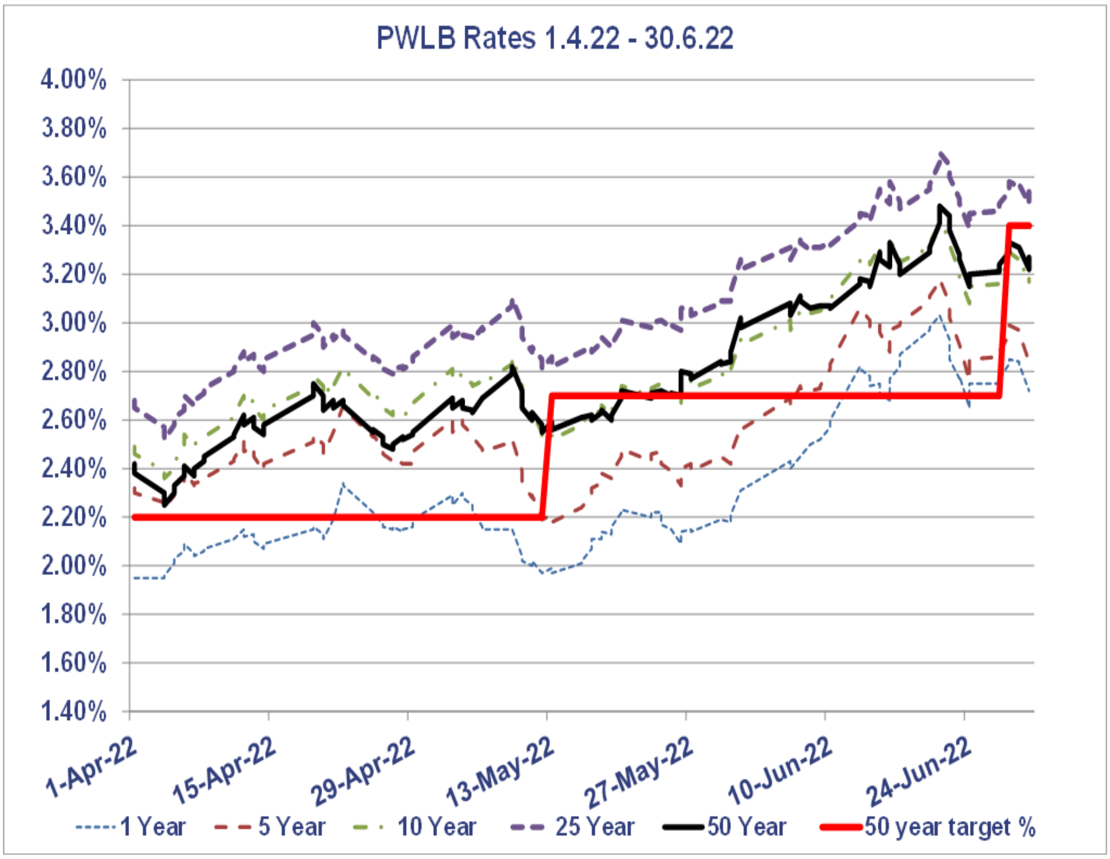
No new borrowing was undertaken during the quarter ended 30 June 2022 and the table below shows the Councils external borrowing position at the quarter end.

Entity	Amount (£)	Start Date	Maturity Date	Rate
Public Works Loan Board	10,000,000	10/12/2018	10/12/2068	2.54%
Public Works Loan Board	10,000,000	13/12/2018	13/12/2068	2.39%
TOTAL	**20,000,000**			**2.465% Average**

Interest costs for 2022/23 on this borrowing are £493,000.

It is anticipated that further borrowing will not be undertaken during this financial year but this may be subject to review.

Gilt yields and PWLB rates were on a rising trend between 1 April and 30 June. The 50 year PWLB target certainty rate for new long-term borrowing started 2022/23 at 2.20% before increasing to 2.70% in May before moving even higher to 3.40% in June.



6 Debt Rescheduling

Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

7 Compliance with Treasury and Prudential Indicators

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council’s approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy Statement.
During the quarter ended 30 June 2022 the Council has operated within the treasury and prudential indicators set out in the Council’s Treasury Management Strategy Statement.

'APPENDIX A1' - Detailed Economic Update and Interest Rate Outlook (commentary from Link Group)

ECONOMIC UPDATE

- The second quarter of 2022 saw:

  - Gross Domestic Product (GDP) fall by 0.1% month on month (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. 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 Standard & Poors (S&P) Global/CIPS (Chartered Institute of Procurement & Supply) 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. With the Prime Minister and the Chancellor desperately needing to boost their popularity, some tax cuts may be announced in the Autumn Budget.

- There has 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 3 month year on year (myy) rate of earnings eased from 7.0% in March to 6.8% in April. 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 1 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. 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.

- 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 21 June) and 10-year yields (to a peak of 2.62%) took them to their highest level since 2008 and 2014 respectively. In response to signs that central banks (particularly the US Federal Bank) 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 Standard & Poors (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.

MPC meetings 5 May and 16 June 2022

- After the Bank of England became the first major western central bank to put interest rates up in this upswing in December, it has quickly followed up its first 0.15% rise by a further four 0.25% rises to 1.25%, in what is very likely to be a series of increases repeated throughout the rest of 2022 and into 2023.

- In May, the MPC voted 6-3 in favour of a 0.25% increase, but not only was this the first time in its 25-year history that the MPC had raised rates at four meetings in a row but also three members (Haskel, Mann and Saunders) wanted a 0.5% hike (up from none in March). However, GDP growth was forecast to drop to -0.25% in 2023 (+1.25% previously) and only +0.25% in 2024 (+1.00% previously). Anyone for a recession?

- Nonetheless, over Q2, it is clear central banks in the developed economies have placed the dampening down of inflation pressures front and centre of their primary objectives, even if it comes at the cost of sluggish growth or, indeed, recession (mild ideally but it is very difficult to micro-manage economic performance). The Monetary Policy Committee (MPC) is in step with this approach although, arguably, the UK economy is dragging its feet to a greater extent than that seen in the US.

- What are the key factors for consideration? First, the CPI measure of inflation is already at 9.1%, and the Bank of England anticipates it will peak near to 11% just before Christmas. With the cost-of-living squeeze in full swing by that juncture, and unemployment likely to be ticking upwards, we judge that the Bank will pause following its March 2023 meeting and judge it has done enough so long as inflation starts to fall, albeit at a slow pace. To that extent, we can envisage the MPC waiting a full year before loosening the reins and starting to cut Bank Rate in spring 2024. However, given the number of geopolitical factors that could push this forecast off track, we would caution against taking a strong view on how interest rate movements evolve and instead focus on optimising balance sheet management and the risk management of investment and debt portfolios.

- Regarding gilt yields, all developed economies have seen a considerable uplift in government bond yields across the whole curve since the start of 2022 and, in many ways, gilts have simply played catch-up of late. To that end, we have revised our PWLB forecasts upward and you will even see we have a 3.7% PWLB rate projected for the 25-year part of the curve in both 2022 and 2023. However, as headline inflation falls back, we project a slow reduction in gilt yields as investors acknowledge that price pressures are gradually coming under control.

- 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 Standard & Poors (S&P) Global/CIPS (Chartered Institute of Procurement & Supply) 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.

- At the 16 June MPC meeting, part of the reason for the Committee only seeing a 0.25% hike as necessary is the prevailing weak economic data. The vote was again 6-3 (the same as in May) but the words were more hawkish with the Bank strengthening its forward guidance. It deleted the previous phrase that "some degree of further tightening…may still be appropriate" and replaced it with "the scale, pace and timing of any further increases in Bank Rate will reflect the Committee's assessment of the economic outlook and inflationary pressures" and that "the Committee will be particularly alert to indications of more persistent inflationary pressures, and will, if necessary, act forcefully in response.

- Whereas in May two members objected to the guidance that rates will rise further, it appears that all members are behind this new, stronger guidance. However, the growing evidence that firms' price and wage expectations have become dislodged from the 2.0% target suggest that the Bank is between a rock and a hard place in navigating the appropriate monetary policy response. As always, the economic data will be key to anticipating whether our assumptions remain sound.

INTEREST RATES FORECASTS

- 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 1 November 2012.

- The latest forecast on 21 June is compared below to the previous forecast (10 May). A comparison of these forecasts shows that PWLB rates have increased generally and show a speed up in the rate of increase in Bank Rate as inflation is now posing a greater risk. The increase in PWLB rates reflects a broad sell-off in sovereign bonds internationally as inflation concerns abound. To that end, the MPC has tightened short-term interest rates with a view to trying to slow the economy sufficiently to keep the secondary effects of inflation – as measured by wage rises – under control, but without pushing the economy into recession.

- London Interbank Borrowing (LIBOR) and London Interbank Bid (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.

A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

- Our central forecast for interest rates was last updated on 21 June and reflected a view that the MPC will be keen to further demonstrate its anti-inflation credentials by delivering a 0.25% increase in Bank Rate in August, September, November, December, February and March i.e., the next six MPC meetings.

- The CPI measure of inflation is now forecast to rise to close to 11% in Q4 2022 and the MPC will be keen to stifle the prospect of average earnings data (6.8% y/y currently including bonuses) providing further upside risk to inflationary factors that are primarily being driven by supply-side shortages.

- When Bank Rate reached 1% in May, the MPC indicated (no earlier than August) that it will also consider the extent to which it implements Quantitative Tightening (QT), primarily the selling of its gilt holdings. However, they are likely to take any such decision cautiously as they are already not refinancing maturing debt.

- Notwithstanding the MPC's clear desire to increase Bank Rate throughout 2022, negative real earnings, the 54% hike in the Ofgem energy price cap from April (to be followed by a potential 40%+ further increase from October), at the same time as employees (and employers) have incurred a 1.25% Health & Social Care Levy, growing commodity and food 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 Chancellor to postpone the full impact of rising energy costs.

- Given the above outlook, it poses a question as to whether the MPC may shift into protecting economic growth if it flatlines or contracts through 2022. Accordingly, we remain tentative about whether the MPC will increase Bank Rate as far as the market is currently pricing in (3.25% in April 2023).

- 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.

- On the positive side, consumers are 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 steepened considerably through the quarter and PWLB 5 to 50 years Certainty Rates are, generally, in the range of 2.75% to 3.75%.

- 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 (although we thought that in May and markets went much further than expected in respect of the gilt market sell-off).

- It is difficult to say currently what effect the Bank of England starting to sell gilts will have on gilt yields now that Bank Rate has gone to above 1%. Nothing will be decided before August, however, but the Bank is likely to act cautiously as it has already started on not refinancing maturing debt. A pure roll-off of the peak £875bn gilt portfolio by not refinancing bonds as they mature, would see holdings fall to about £415bn by 2031, which would be about equal to the Bank's pre-pandemic holding.

- Increases in US treasury yields over the next few months could add further upside pressure on gilt yields as they have done since the turn of the year.