Agenda Item	9a
Report No	RES/25/23

HIGHLAND COUNCIL

Committee: **Corporate Resources Committee**

Date: 6 September 2023

Report Title: **Annual Treasury Management Report – 2022/23**

Report By: Head of Corporate Finance

1. Purpose/Executive Summary

1.1 This report on treasury management for the financial year 2022/23 is prepared in compliance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) revised Code of Practice on Treasury Management in Local Authorities.

1.2 The report highlights the Council's treasury management activities undertaken, provides a commentary on the year and compares activity to the expected activities contained in the annual Treasury Strategy Statement and Investment Statement which was approved by Corporate Resources on 26 January 2022.

1.3 The Prudential Code also requires the Council to report the actual prudential indicators after the financial year end and these are shown in **Appendix 1.**

1.4 This annual report reflects a year of significant and continual increases in the Bank of England interest rates, driven by wider economic turmoil, rising inflation and the war in Ukraine. The report provides context on how these wider economic factors have impacted treasury activity during the year.

2. Recommendations

2.1 Members are asked to:

i. Consider the Annual Treasury Management report for 2022/23.

3. Implications

3.1 Resource implications include the cost of borrowing to fund the capital programme and are covered in section 7 and Risk implications are covered in section 8.

3.2 There are no Legal, Community (Equality, Poverty and Rural), Climate Change/Carbon Clever, Health and Safety (risks arising from changes to plant, equipment, or people) or Gaelic implications arising as a direct result of this report.

4. Background

4.1 The Local Government in Scotland Act 2003 (the Act) and supporting regulations requires the Council to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice. The CIPFA Code of Practice on Treasury Management (November 2009) was adopted by the Council on 4 March 2010.

The Code was further updated in December 2017 and then in December 2021. The new requirements of the 2021 revised Treasury Management and Prudential codes were adopted in the 2023/24 TMSS, agreed by Council in March 23. Therefore the 2017 Treasury Management code applied to financial year 2022/23. The Council fully complies with the Code requirements.

4.2 The primary requirements of the Treasury Management Code are the:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the way in which the Council will seek to achieve those policies and objectives.
- Receipt by the Council of an Annual Strategy Report for the year ahead, a mid–year report and an Annual Review Report of the previous year.
- 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.
- Delegation by the Council of the role of scrutiny of treasury management policies to a specific named body, which in this Council is the Corporate Resources Committee.

4.3 Treasury Management is defined as: "*The management of the local authority's 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*".

4.4 This report sets out:

- An overview of the strategy agreed for 2022/23 considering the economy and interest rates position for the year and incorporating the professional views of the Council's external treasury management advisors (section 5)
- Performance measurement for the year including the Council's treasury position as at 31 March 2023 compared to the previous financial year (section 6)
- A summary of treasury decisions taken and effects on the revenue budget (section 7)
- A commentary on performance and risk (section 8)
- A review of compliance with the Council's procedures and Prudential Indicators (sections 9 and 10)

5. The strategy agreed for 2022/23

5.1 The 22/23 TMSS was agreed in January 2022, before the subsequent economic turmoil and significant rise in interest rates which saw rates increase from 0.75% in April 2022 to 4.25% in March 2023. As a result, the actual economic and interest rate environment during the year, was a significant departure from expectations and previous financial years with markets not having seen Bank of England base rates above 2% since 2008.

5.2 The expectation for interest rates within the strategy for 2022/23 was that investment yields were expected to increase during 2022/23 on a gently rising trend with gradually increasing Public Works Loan Board (PWLB) rates forecast which would continue to 2025, but the increase was markedly more and quicker than expected. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

5.3 The treasury strategy was to continue to use short-term borrowing to fund the capital programme but to consider a strategy of de-risking by taking long term market or PWLB borrowing with the aim of mitigating the risk of increased borrowing cost as interest rates start to rise.

5.4 The narrative in sections 5.4 to 5.9 of this report reflects the view of Link Group, the Council's treasury advisor, as at April 2023.

PWLB rates are based on gilt (UK Government bonds) yields through HM Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. Indeed, in recent years many bond yields up to 10 years in the Eurozone turned negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession.

5.5 However, since early 2022, yields have risen dramatically in all the major developed economies, first as economies opened post-Covid; then because of the inflationary impact of the war in Ukraine in respect of the supply side of many goods. In particular, rising cost pressures emanating from shortages of energy and some food categories have been central to inflation rising rapidly. Furthermore, at present the FOMC, ECB and Bank of England are all being challenged by persistent inflation that is exacerbated by very tight labour markets and high wage increases relative to what central banks believe to be sustainable.

5.6 Gilt yields have been on a continual rise since the start of 2021, peaking in the autumn of 2022. Currently, yields broadly range between 3% and 4.25%. At the close of the day on 31 March 2023, all gilt yields from 1 to 50 years were between 3.64% and 4.18%, with the 1 year being the highest and 6-7.5 years being the lowest yield. Regarding PWLB borrowing rates, the various margins attributed to their pricing are as follows: -

- PWLB Standard Rate is gilt plus 100 basis points (1.0%) (G+100bps)
- PWLB Certainty Rate is gilt plus 80 basis points (0.8%) (G+80bps)
- Local Infrastructure Rate is gilt plus 60bps (0.6%) (G+60bps)

5.7 There is likely to be a fall in gilt yields and PWLB rates across the whole curve over the next one to two years as Bank Rate first rises to dampen inflationary pressures and a tight labour market, and is then cut as the economy slows, unemployment rises, and inflation (on the Consumer Price Index measure) moves closer to the Bank of England's 2% target. As a general rule, short-dated gilt yields will reflect expected movements in

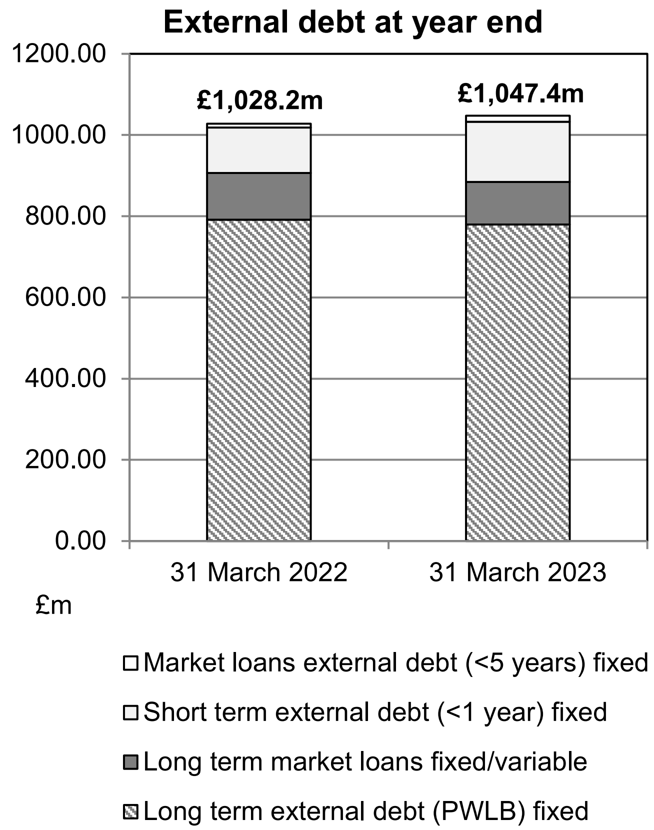
Bank Rate, whilst medium to long-dated yields are driven primarily by the inflation outlook.

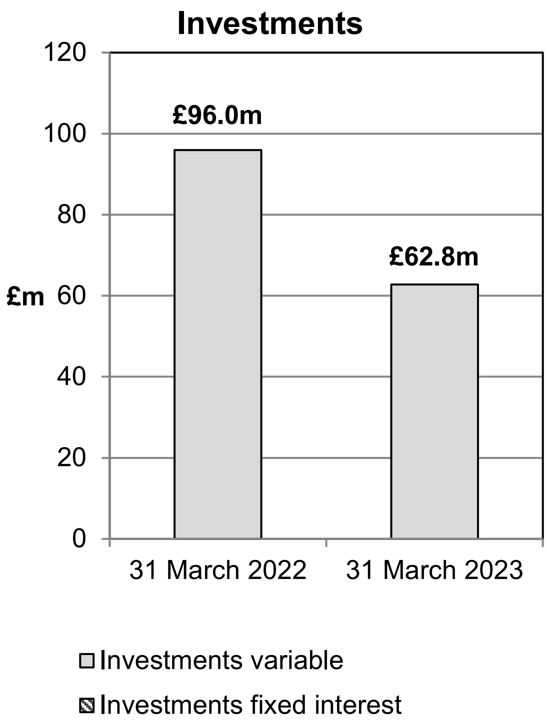
5.8 The Bank of England is also embarking on a process of Quantitative Tightening, but the scale and pace of this has already been affected by the Truss/Kwarteng "fiscal experiment" in the autumn of 2022 and more recently by the financial market unease with some US (e.g., Silicon Valley Bank) and European banks (e.g., Credit Suisse). The gradual reduction of the Bank's original £895bn stock of gilt and corporate bonds will be sold back into the market over several years. The impact this policy will have on the market pricing of gilts, while issuance is markedly increasing, is an unknown at the time of writing.

5.9 Further information on the economy and interest rates during the year can be found at **Appendix 2**.

6. Performance measurement

6.1 The treasury position at the 31 March 2023 compared with the previous year is shown in the graphs below.





Average interest rates comparison	**31/03/22**	**31/03/23**
Short term external debt (<1 year) fixed	0.45%	3.39%
Short term external debt (<1 year) notice	Nil	4.25%
Market loans fixed/variable	4.41%	4.45%
Long term external debt (PWLB) fixed	3.85%	3.78%
Total debt	**3.55%**	**3.81%**

Investments fixed interest	Nil	Nil
Investments variable	0.59%	4.12%
Total investments	**0.59%**	**4.12%**

6.2 The figures show an increase in the average interest rate on external debt borrowings from 3.55% at March 2022 to 3.81% at March 2023 which is due to the increase in the average rate for short-term borrowing which has increased alongside interest rates. The investment return for 2022/23 was higher than the previous year following the bank rate increases (during 2022, 5 May 1.0%, 16 June 1.25%, 4 August 1.75%, 22 September 2.25%, 3 November 3.0%, 15 December 3.5%, during 2023, 2 February 4.0%, 23 March 4.25%).

6.3 In September 2022, there was £20m of PWLB borrowing undertaken at a favourable rate of 3.89%. Details of all PWLB long-term borrowing undertaken and repaid, are in **Appendix 3** and all external borrowing is in **Appendix 4.** The average rate for fixed temporary loans as at 31 March 2023 was 3.39% (31 March 2022 0.45%).

7. Treasury decisions taken and revenue effects

Borrowing requirement and debt

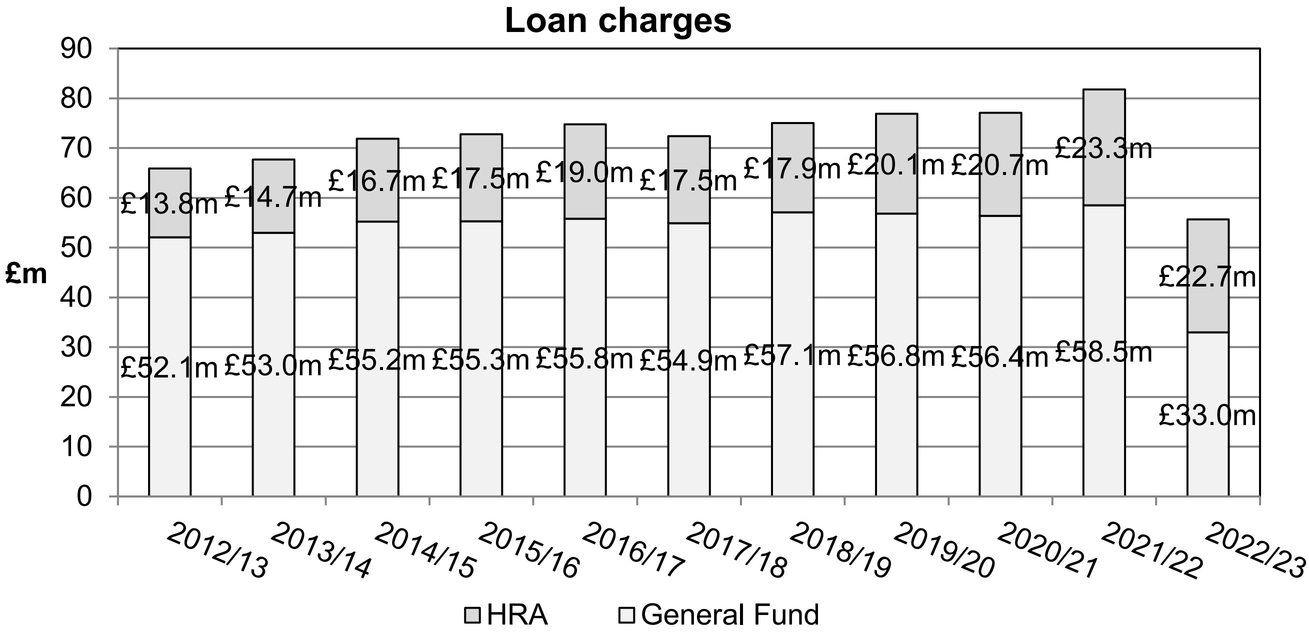
7.1 The Council undertakes capital expenditure on long-term assets which is funded as follows:

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

7.2 The total net capital expenditure for 2022/23 was £101.3m (General Fund £61.6m and HRA £39.7m) against planned net capital expenditure of £97.4m (General Fund £77.5m and HRA £19.9m). Reasons for variations in Service and project capital expenditure for the year are reported to Strategic Committees as part of the final 2022/23 out-turn capital monitoring process. Details of gross and net capital spend for the year and the borrowing requirement against the estimated position are in **Appendix 1**.

7.3 There has been an increase in external debt of £19.2m (see graph at **para 6.1**) which is less than the borrowing requirement of £85.3m and more information on this is at **para 10.2**.

7.4 In terms of the impact on revenue budgets, increased capital expenditure generally increases the level of loan charges the Council incurs. However, in 2022/23 loan charges were much lower as the Council used financial flexibilities set out by Scottish Government finance circular 5-22, to take a Loans Fund Principal Repayment 'holiday' (more information on this is provided at para 7.9). The graph on the next page shows the changes in loans charges over the last 11 years.



7.5 Due to the level of capital expenditure, financing costs (loan charges) are a significant proportion of the Council's net revenue stream. The ratio of financing costs to net revenue stream for the general fund including PPP/NPD is 7.5% (estimate 13.6%) and 38.7% for HRA (estimate 39.0%) (**Appendix 1, prudential indicator 4**). The reason for the general fund ratio being lower than estimated is due to the application of the Loans Fund Principal Repayment 'holiday' and lower net capital expenditure than planned. The HRA ratio is marginally lower than original indicator due to HRA loan charges being lower than forecast.

7.6 Rescheduling

There was no rescheduling completed during 2022/23. While refinancing rates were closely monitored throughout the year no significant opportunities arose to make savings due to breakage costs.

7.7 A summary of outstanding deferred revenue costs attributable to debt rescheduling exercises undertaken in years to date, is provided in the table below. These represent early debt repayment costs (premiums) and discounts, associated with debt rescheduling. It is accounting practice for these to be written off over the periods of the new loans taken as part of the rescheduling and included as part of the annual loan charges.

	Outstanding 31 Mar 2022	**Incurred 2022/23**	**Written off 2022/23**	**Outstanding 31 Mar 2023**
	£000	**£000**	**£000**	**£000**
Premiums	21,567	-	(1,992)	19,575
Discounts	(6,724)	-	37	(6,687)
Net Deferred Revenue Costs	14,843	-	(1,955)	12,888

7.8 Overall performance

The Council's average loans fund borrowing and investment rate for the year was 3.46% compared to 3.47% in 2021/22 with capital expenditure and maturities being funded using £20m of PWLB borrowing and short-term borrowing.

7.9 Loans Fund Principal Repayment 'holiday'

During 2020-21 the Scottish Government worked jointly with the Convention of Local Authorities (COSLA) to identify a package of financial flexibilities for Councils, to address the funding pressures they faced due to the pandemic. One of the financial flexibilities agreed was to allow a local authority to reduce the statutory repayment of debt in either the 2020/21 or 2021/22 financial year.

In the light of the ongoing impact of COVID-19, in October 2021 COSLA requested a further one-year extension to this flexibility for the 2022/23 financial year which was agreed by the Scottish Government, as outline in the finance circular below.

https://www.gov.scot/publications/local-government-finance-circular-5-2022-statutory-repayment-of-debt-short-term-financial-flexibility/#:~:text=The%202022%20Regulations%20amend%20the,of%20these%20three%20financial%20years.

This flexibility allows councils to defer the statutory repayment of debt in 2022/23 (this decision cannot be taken in future years)- in short it means a council can defer the 'principal' element of its 2022/23 loans charges, paying back the amount deferred over the period of the residual asset life or twenty years (whichever is lower).

For Highland Council, taking advantage of this flexibility meant that £29.3m of loans fund principal repayments would not be charged to the revenue budget in 2022/23, effectively creating a significant underspend against the 2022/23 loans charge budget and leading to an increased level of general reserves at financial year end.

The Loans Fund Principal Repayment 'holiday' was agreed by the Council in March 2023 and represents a one-off credit to the 2022/23 position of £29.276m.

https://www.highland.gov.uk/download/meetings/id/81258/item_3_revenue_and_capital_budgets_202324_and_medium-term_financial_outlook

Appendix 8 of the above report to Council in March, outlined the profile for the repayment of that £29.3m over the next twenty years which is calculated based on the same methodology as the calculation of the Council's annual loans charge using the annuity method. The reason for the front loading of the repayments in the early part of the twenty-year period is the requirement for repayments to be made over the residual asset life, which for many assets funded through the loans fund is less than 20 years.

Alongside this, capital grant was received for the pay award from the Scottish Government which was used to fund loan charge principal of £5.459m. Details of the loans fund re-profiling that was undertaken to facilitate the use of this grant, was reported to Council on 29 June 2023 as part of the report on the Council's annual accounts 2022/23.

7.10 Revenue effect: Due to the above Loans Fund Principal Repayment 'holiday' and capital expenditure being lower than forecast, the final position shows an underspend for the General Fund loans charges (£28.5m) and an underspend for HRA (£0.790m) compared to budget for the year. The underspend was also due to lower interest rates for short-term borrowing and replacing PWLB maturities with PWLB borrowing at lower rates.

7.11 Investments held by the Council

The Council's investment policy is governed by the Scottish Government Investment Regulations, and incorporated within the Council's current strategy. This policy sets out the approach for choosing investment categories and counterparties and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

7.12 The Council's policy states the maximum investment period is 2 years. However, during 2022/23 deposits were placed for periods of 1 year or less than 1 year to reflect credit risk.

7.13 The Council maintained an average end of month balance of £97.8m of internally managed funds which earned a weighted average rate of return of 1.93% and rate at 31 March 2023 of 4.12%. The comparable performance indicator is the average 7-day SONIA rate (Sterling Overnight Index Average - is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors), which was 2.23% for 2022/23. No institutions in which investments were made showed any difficulty in repaying the investment and interest in full during the year.

8. Performance and risk

8.1 In the Council's debt portfolio as of 31 March 2023, 74.4% (£779.5m) of the total gross debt is at fixed long-term rates with the PWLB.

8.2 All major borrowing and capital financing requirement (CFR) decisions taken by officers were discussed with the Council's external treasury management advisors.

8.3 Returns on the Council's investments are predominantly determined by short-term variable rates. Whilst this can introduce an element of volatility to returns, it is minimal in terms of the total debt portfolio. Risk, in relation to the potential loss of principal, is minimised through the Council's restricted lending list (using a diversified list of counterparties and based on credit assessment).

8.4 The Council uses several Money Market brokers to facilitate short-term borrowing and investment deals. This ensures competitive market rates are obtained. All brokers charged the same level of commission per transaction and performed satisfactorily. In addition, the Council's treasury management officers have direct lines to some major banks to facilitate direct investment with suitably rated institutions.

8.5 Short term borrowing increased from £112.0m (31/03/22) to £138.0m (31/03/23) though levels of short-term borrowing are likely to remain high to achieve cost savings depending on rates. However, in order to mitigate exposure to interest rate risk, PWLB rates will be monitored, and longer-term borrowing undertaken where rates are favourable.

9. Compliance with the Council's procedures and Prudential Indicators

9.1 The Council complied with its internal procedures and the requirements of the CIPFA Code of Practice on Treasury Management. The Council is bound by best practice requirements, which involve limits to be set and adhered to in relation to short-term borrowing and exposure to variable interest rates and complied with these throughout the year (**Appendix 1, indicator 10**).

10. The Prudential Code – Indicators

10.1 The Council is required by the Prudential Code to report the actual treasury position compared to the prudential indicators at the year-end. **Appendix 1** provides details of all the mandatory, estimated and actual prudential indicators for the year 2022/23.

10.2 Capital Financing Requirement (CFR)

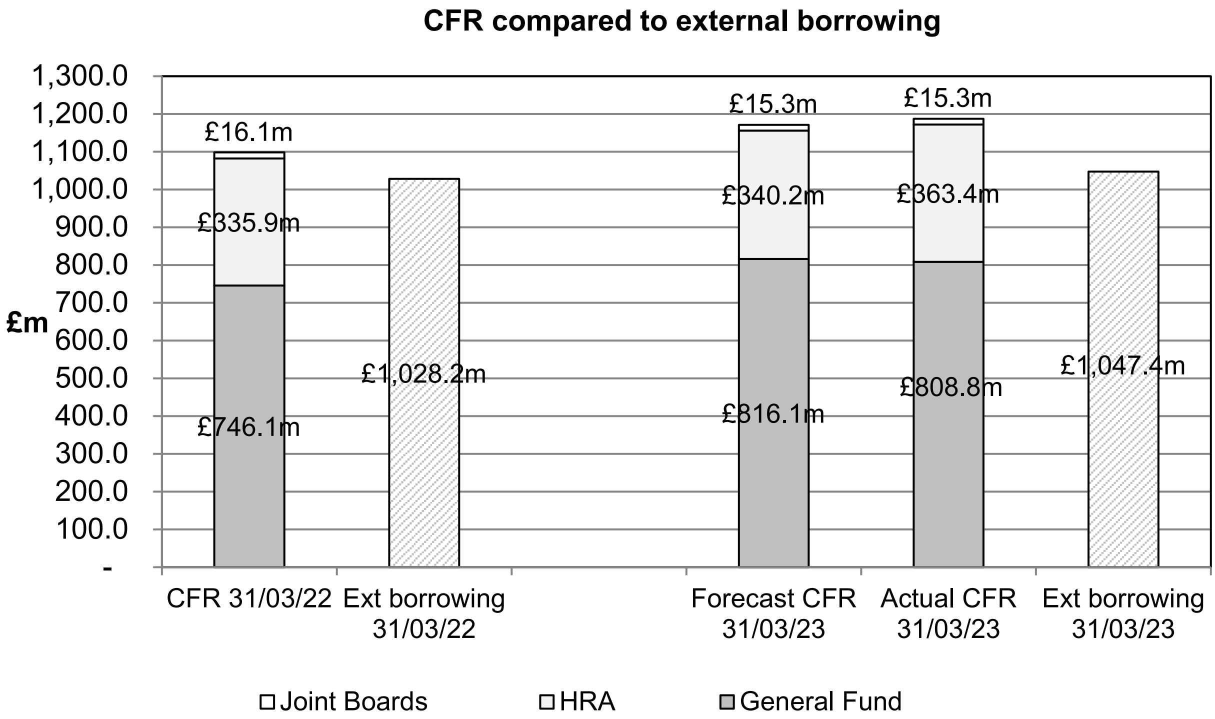
The CFR represents the accumulated net capital expenditure which the Council requires to fund by way of long-term borrowing and other capital financing, until the capital projects, comprising the CFR, are fully written off to revenue (mainly by way of annual loan charges).

10.3 In recent years the Council has been in a position whereby its CFR is greater than its long-term borrowing. This results from the Council using internal cash sources, as well as long-term borrowing to finance the CFR. The use of internal cash sources can represent a more effective and low-cost option for financing, compared to long-term borrowing.

10.4 However, the Council must keep the CFR and long-term borrowing position under regular review, as the use of internal cash sources can result in increased re-financing risk i.e., if internal cash sources are utilised, and the Council has no choice but to borrow, and not necessarily at a time of its choosing, borrowing costs could be impacted.

10.5 The CFR is kept under regular review, and in recent years part of the annual treasury strategy has been to take steps to manage the CFR versus long-term borrowing position to an acceptable level. As shown in the graph below the difference between CFR and external borrowing stood at £140.1m as at 31 March 2023. This position will be kept under regular review as part of the Council's on-going treasury management.

10.6 In order to ensure that over the medium-term borrowing net of investments will only be for a capital purpose, net borrowing should not, except in the short term, exceed the CFR for 2022/23. The graph below shows that the Council has complied with this requirement.



10.7 Borrowing Limits

The Council is required to agree an Authorised Limit for borrowing for the year. This figure provides for estimated contingencies which may require to be funded in the year in addition to planned capital expenditure.

10.8 The Operational Boundary, also approved by the Council in compliance with the Code, is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary are acceptable subject to the Authorised Limit not being breached.

10.9 During 2022/23 the Council complied with both the Authorised Limit and Operational Boundaries and the maximum is reported at **Appendix 1 indicator 5 and 6.**

Designation: Head of Corporate Finance

Date: 11 August 2023

Author: Catriona Stachan, Principal Accountant

Background Papers: Treasury system and financial ledger reports

https://www.highland.gov.uk/download/meetings/id/81326/15_treasury_management_strategy_statement

Appendix 1

Estimated and Actual Treasury Position and Prudential Indicators

		2022/23 Indicator £m	2022/23 Actual £m
1	**Capital expenditure**		
	Gross capital expenditure		
	General Fund including PPP/NPD	149.3	155.1
	Housing Revenue Account	36.5	57.9
	Total gross capital expenditure	**185.8**	**213.0**
	Income		
	General Fund	(71.8)	(93.5)
	HRA	(16.6)	(18.2)
	Total income	**(88.4)**	**(111.7)**
	Net capital expenditure		
	General Fund	77.5	61.6
	HRA	19.9	39.7
	Total net capital expenditure	**97.4**	**101.3**
	Loan charge instalments		
	General Fund	(31.9)	(5.7)
	HRA	(11.0)	(10.3)
	Total instalments	**(42.9)**	**(16.0)**
	Net borrowing for new capital expenditure		
	General Fund	45.6	55.9
	HRA	8.9	29.4
	Total net borrowing for new capital expenditure	**54.5**	**85.3**
2	**Capital Financing Requirement (CFR) at 31 March**		
	General Fund excluding PPP/NPD	816.1	808.8
	Housing Revenue Account	340.2	363.4
	PPP/NPD	130.6	131.7
	Sub-total (as per HC annual accounts)	**1,286.9**	**1,303.9**
	Joint Boards	15.3	15.3
	Total	**1,302.2**	**1,319.2**

	Sub-total excluding PPP/NPD	**1,171.6**	**1,187.5**

		2022/23 Indicator £m	**2022/23 Actual £m**
3	**Treasury Position at 31 March**		
	Borrowing – Long term	982.1	909.4
	Borrowing – Short term	153.4	138.0
	Other Long-Term Liabilities (PPP)	130.6	131.7
	Total Debt	**1,266.1**	**1,179.1**
	Investments	(50.0)	(62.8)
	Net Borrowing	**1,216.1**	**1,116.3**
4	**Ratio of financing costs to net revenue stream**		
	General Fund including PPP	13.6%	7.5%
	Housing Revenue Account	39.0%	38.7%
		Limit	**Maximum**
5	**Authorised Limit for Borrowing**	1,185.2	1,049.3 Max. reached March 23
6	**Operational Boundary for Borrowing**	1,149.2	1,049.3 Max. reached March 23
7	**Interest rate exposures of debt net of investments**		
	Upper Limit (Fixed)	1,171.6	1,000.9 Max. reached March 2023
	Upper Limit (Variable)	410.0	16.4 Max. reached March 2023
8	**Maturity structure of fixed rate borrowing**		
	Under 12 months	30.0%	14.8% Max. reached March 2023
	12 months to 2 years	30.0%	4.3% Max. reached Sept 2022
	2 years to 5 years	40.0%	10.7% Max. reached Dec 2022
	5 years to 10 years	50.0%	10.8% Max. reached June 2022
	10 years and above	100.0%	70.2% Max. reached Aug 2022

9	**Upper limit for the maturing of investments made for periods longer than 364 days (against maximum position)**	£20.0m	Nil
10	**Short term borrowing (net of investments) as a % of outstanding long-term debt (maximum position)**	25.0%	12.3% Max. reached March 2023
	Variable interest debt (net of investments) as a % of outstanding long-term debt (maximum position)	35.0%	3.7% Max. reached Sept 2022

Appendix 2

Economic update provided by the Council's Treasury Advisor (Link Group), April 2023

UK

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022/23.

Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps in 2022. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	Eurozone	US
Bank Rate	4.25%	3%	4.75%-5%
GDP	0.1%q/q Q4 (4.1%y/y)	+0.1%q/q Q4 (1.9%y/y)	2.6% Q4 Annualised
Inflation	10.4%y/y (Feb)	6.9%y/y (Mar)	6.0%y/y (Feb)
Unemployment Rate	3.7% (Jan)	6.6% (Feb)	3.6% (Feb)

Q2 of 2022 saw UK GDP deliver growth of +0.1% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Q4 GDP was positive at 0.1% q/q. Most recently, January saw a 0.3% m/m increase in GDP as the number of strikes reduced compared to December. In addition, the resilience in activity at the end of 2022 was, in part, due to a 1.3% q/q rise in real household disposable incomes. A big part of that reflected the £5.7bn payments received by households from the government under the Energy Bills Support Scheme.

Nevertheless, CPI inflation picked up to what should be a peak reading of 11.1% in October, although hopes for significant falls from this level will very much rest on the movements in the gas and electricity markets, as well as the supply-side factors impacting food prices. On balance, most commentators expect the CPI measure of inflation to drop back towards 4% by the end of 2023. As of February 2023, CPI was 10.4%.

The UK unemployment rate fell through 2022 to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact remains, however, that with many economic participants registered as long-term sick, the UK labour force shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food (up 18.3% y/y in February 2023) and energy that have endured since Russia's invasion of Ukraine on 22 February 2022.

Bank Rate increased steadily throughout 2022/23, starting at 0.75% and finishing at 4.25%.

In the interim, following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and October. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of the 17th of November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have reversed the increases seen under the previous tenants of No10/11 Downing Street, although they remain elevated in line with developed economies generally.

As noted above, GDP has been tepid throughout 2022/23, although the most recent composite Purchasing Manager Indices for the UK, US, EZ and China have all surprised to the upside, registering survey scores just above 50 (below suggests economies are contracting, and above suggests expansion). Whether that means a shallow recession, or worse, will be avoided is still unclear. Ultimately, the MPC will want to see material evidence of a reduction in inflationary pressures and a loosening in labour markets. Realistically, that is an unlikely outcome without unemployment rising and wage settlements falling from their current levels. At present, the bigger rise in employment kept the International Labour Organisation (ILO) unemployment rate unchanged at 3.7% in January. Also, while the number of job vacancies fell for the ninth consecutive month in February, they remained around 40% above pre-pandemic levels.

Our economic analysts, Capital Economics, expect real GDP to contract by around 0.2% q/q in Q1 and forecast a recession this year involving a 1.0% peak-to-trough fall in real GDP.

The £ has remained resilient of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.23. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 4.5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

As for equity markets, the FTSE 100 started 2023 strongly, rising to a record high of 8,014 on 20th February, as resilient data and falling inflation boosted earnings. But global equities fell sharply after concerns over the health of the global banking system emerged early in March. The fall in the FTSE 100 was bigger than the drop in the US S&P 500. Indeed, at around 7,600 now, the FTSE is 5.2% below its record high on 20th February, while the S&P 500 is only 1.9% lower over the same period. That's despite UK banks having been less exposed and equity prices in the UK's financial sector not falling as far. It may be due to the smaller decline in UK interest rate expectations and bond yields, which raise the discounted value of future earnings, compared to the US.

USA

The flurry of comments from Fed officials over recent months suggest there is still an underlying hawkish theme to their outlook for interest rates. Markets are pricing in a further interest rate increases of 25-50bps, on top of the current interest rate range of 4.75% - 5%.

In addition, the Fed is expected to continue to run down its balance sheet once the on-going concerns about some elements of niche banking provision are in the rear-view mirror.

As for inflation, it is currently at c6% but with the economy expected to weaken during 2023, and wage data already falling back, there is the prospect that should the economy slide into a recession of any kind there will be scope for rates to be cut at the backend of 2023 or shortly after.

EU

Although the Euro-zone inflation rate has fallen below 7%, the ECB will still be mindful that it has further work to do to dampen inflation expectations and it seems destined to raise rates to 4% in order to do so. Like the UK, growth has remained more robust than anticipated but a recession in 2023 is still seen as likely by most commentators.

Appendix 3 – PWLB Borrowing undertaken and borrowing repaid 2022/23

PWLB Borrowing undertaken during 2022/23

Month undertaken	Amount	Purpose of borrowing	Duration	Rate
September 2022	£20.0m	Capital programme	4 years	3.890%
Total	**£20.0m**			

PWLB Borrowing repaid during 2022/23

Month repaid	Amount	Purpose of borrowing	Duration	Rate
Sept 2022	£15.000m	Capital programme	11 years	10.375%
Sept 2022	£13.800m	Capital programme	25years	1.210%
Sept 2022	£1.053m	Capital programme	40 years	10.500%
March 2023	£1.200m	Capital programme	6.5 years	7.125%
March 2023	£0.700m	Capital programme	40 years	4.350%
Total	**£31.753m**			

Appendix 4 – External Borrowing at 31 March 2023

Short term external debt (< 1 year) fixed and Notice

Deal Ref	Start Date	Maturity Date	Counterparty	Profile	Rate	Principal O/S (£)
T403446	09/09/22	08/09/23	West Yorkshire Fire & Rescue Authority	Maturity	1.95%	5,000,000.00
T503422	19/07/21	18/07/22	Caerphilly County Borough Council	Maturity	2.10%	5,000,000.00
T503448	15/09/22	15/06/23	Renfrewshire Council	Maturity	2.10%	5,000,000.00
T503449	15/9/22	09/08/23	Oxfordshire County Council	Maturity	2.25%	5,000,000.00
T503450	14/10/22	13/10/23	Renfrewshire Council	Maturity	2.80%	5,000,000.00
T503451	03/10/22	03/04/23	Tendring District Council	Maturity	2.55%	5,000,000.00
T503452	18/10/22	17/10/23	Renfrewshire Council	Maturity	2.80%	5,000,000.00
T503453	12/10/22	03/04/23	Warwickshire County Council	Maturity	2.75%	5,000,000.00
T503454	04/1/22	05/04/23	Solihull Metropolitan Borough Council	Maturity	3.27%	5,000,000.00
T503455	07/11/22	09/05/23	Newcastle Upon Tyne City Council	Maturity	3.70%	5,000,000.00
T503456	17/11/22	10/10/23	Oxfordshire County Council	Maturity	4.30%	5,000,000.00
T503457	02/11/22	25/10/23	West Yorkshire Combined Authority	Maturity	3.85%	10,000,000.00
T503458	18/11/22	17/11/23	South Yorkshire Mayoral Combined Authority	Maturity	3.85%	7,000,000.00
T503459	18/11/22	17/11/23	Sheffield City Council	Maturity	3.85%	3,000,000.00
T503460	05/12/22	05/06/23	Bracknell Forest Borough Council	Maturity	3.20%	3,000,000.00
T503461	21/11/22	13/10/23	Vale of Glamorgan Council	Maturity	3.60%	3,000,000.00
T503462	09/12/22	09/05/23	South Oxfordshire District Council	Maturity	3.19%	4,000,000.00
T503463	14/12/22	09/11/23	West Yorkshire Combined Authority	Maturity	3.80%	5,000,000.00
T503464	14/12/22	13/12/23	Hampshire County Council	Maturity	3.85%	5,000,000.00
T503465	30/01/23	29/01/24	North of Tyne Combined Authority	Maturity	4.00%	5,000,000.00
T503466	10/01/23	10/07/23	Middlesbrough Council	Maturity	3.78%	5,000,000.00
T503467	18/01/23	19/06/23	South Lanarkshire Council	Maturity	3.73%	5,000,000.00
T503468	18/01/23	17/01/24	North Somerset District Council	Maturity	4.00%	5,000,000.00
T503469	25/01/23	24/01/24	West Midlands Combined Authority	Maturity	4.00%	5,000,000.00
T503470	26/01/23	24/05/24	South Oxfordshire District Council	Maturity	3.71%	3,000,000.00
T503472	15/03/23	15/09/23	East Sussex County Council	Maturity	3.71	5,000,000.00
				Average rate	**3.39%**	**128,000,000.00**
T503471	01/03/23		Edinburgh City Council	31 DN	4.25%	10,000,000.00
				Average rate	**4.25%**	**10,000,000.00**

Long term market loans fixed/variable (Lender Option Borrower Option)

Deal Ref	Start Date	Maturity Date	Counterparty	Profile	Rate	Principal O/S (£)
M290045	30/09/02	30/09/42	Bank of Scotland plc	Maturity	4.50%	5,000,000.00
M240007	12/12/90	12/12/50	Nortrust Nominees	Maturity	11.13%	1,000,000.00
M290051	26/10/04	26/10/54	Dexia Public Finance Bank	Maturity	4.34%	8,750,000.00
M290046	14/03/03	16/03/65	Dexia Public Finance Bank	Maturity	4.40%	10,000,000.00
M290047	14/03/03	16/03/65	Dexia Public Finance Bank	Maturity	4.40%	11,740,000.00
				Average rate	4.58%	36,490,000.00

Market loans fixed

Deal Ref	Start Date	Maturity Date	Counterparty	Profile	Rate	Principal O/S (£)
M290050	03/08/04	03/02/65	Barclays Bank plc	Maturity	5.05%	11,900,000.00
M290048	02/12/03	02/12/65	Barclays Bank plc	Maturity	5.00%	25,200,000.00
M290049	02/12/03	02/12/65	Barclays Bank plc	Maturity	5.00%	25,000,000.00
M290052	23/03/06	23/03/66	Barclays Bank plc	Maturity	3.80%	16,216,000.00
M290064	08/02/21	08/02/24	Cornwall Council	Maturity	1.00%	10,000,000.00
M290065	10/03/21	10/03/25	Torbay Council	Maturity	4.20%	5,000,000.00
				Average rate	4.33%	93,316,000.00

Long term external debt (PWLB) fixed

Deal Ref	Start Date	Maturity Date	Counterparty	Profile	Rate	Principal O/S (£)
P469054	18/01/91	30/09/23	PWLB	Maturity	11.25%	400,000.00
P479824	07/08/97	31/03/24	PWLB	Maturity	6.87%	8,793,583.00
P479831	07/08/97	31/03/24	PWLB	Maturity	7.12%	766,648.00
P468141	01/03/90	30/09/24	PWLB	Maturity	10.87%	800,000.00
P499029	27/09/11	30/09/25	PWLB	Maturity	3.92%	20,000,000.00
P552574	26/09/22	30/09/26	PWLB	Maturity	3.89%	20,000,000.00
P479272	01/05/97	31/03/27	PWLB	Maturity	7.75%	25,000,000.00
P479704	17/07/97	31/03/27	PWLB	Maturity	7.00%	25,000,000.00
P508923	22/03/19	30/09/28	PWLB	Maturity	1.90%	7,500,000
P509002	28/03/19	30/09/28	PWLB	Maturity	1.82%	7,500,000
P501784	11/12/12	30/09/27	PWLB	Maturity	3.19%	10,000,000.00
P480402	13/01/98	30/09/27	PWLB	Maturity	6.12%	5,000,000.00
P501996	15/03/13	31/03/30	PWLB	Maturity	3.70%	7,500,000.00
P502022	22/03/13	31/03/30	PWLB	Maturity	3.58%	7,500,000.00
P499165	23/11/11	30/09/30	PWLB	Maturity	3.93%	20,000,000.00
P478594	11/12/96	30/09/31	PWLB	Maturity	7.75%	11,135,901.00
P501895	26/02/13	25/07/32	PWLB	Maturity	3.94%	15,000,000.00
P454211	30/03/84	30/09/33	PWLB	Maturity	10.25%	700,000.00
P488282	02/12/03	30/09/33	PWLB	Maturity	5.00%	3,600,000.00
P502832	07/02/14	31/03/34	PWLB	Maturity	4.17%	10,000,000.00
P503806	10/03/15	30/09/34	PWLB	Maturity	3.30%	10,000,000.00
P464213	25/03/88	30/09/37	PWLB	Maturity	9.12%	702,319.85
P475185	16/02/95	30/09/44	PWLB	Maturity	9.00%	500,000.00
P476150	29/06/95	31/03/45	PWLB	Maturity	8.37%	1,000,000.00
P475184	16/02/95	30/09/45	PWLB	Maturity	8.620%	500,000.00
P475052	26/01/95	30/09/48	PWLB	Maturity	8.75%	500,000.00
P474807	24/10/94	30/09/51	PWLB	Maturity	8.62%	1,000,000.00
P492695	15/01/07	31/03/52	PWLB	Maturity	4.25%	13,500,000.00
P474808	24/10/94	30/09/52	PWLB	Maturity	8.62%	1,000,000.00
P492696	15/01/07	31/03/53	PWLB	Maturity	4.25%	23,300,000.00
P474817	26/10/94	30/09/53	PWLB	Maturity	8.62%	1,000,000.00
P493071	08/03/07	30/09/53	PWLB	Maturity	4.25%	5,000,000.00
P492697	15/01/07	31/03/54	PWLB	Maturity	4.25%	20,000,000.00
P493070	08/03/07	31/03/54	PWLB	Maturity	4.25%	8,600,000.00
P474785	14/10/94	30/09/54	PWLB	Maturity	8.87%	1,000,000.00
P474818	26/10/94	30/09/54	PWLB	Maturity	8.62%	1,000,000.00

Long term external debt (PWLB) fixed (continued)

Deal Ref	Start Date	Maturity Date	Counterparty	Profile	Rate	Principal O/S (£)
P493626	02/08/07	30/09/54	PWLB	Maturity	4.55%	10,000,000.00
P493835	23/08/07	30/09/54	PWLB	Maturity	4.45%	5,000,000.00
P476656	30/11/95	30/09/55	PWLB	Maturity	8.00%	1,000,000.00
P476790	21/12/95	30/09/55	PWLB	Maturity	7.87%	4,000,000.00
P476823	21/12/95	30/09/55	PWLB	Maturity	7.87%	1,000,000.00
P476824	21/12/95	30/09/55	PWLB	Maturity	7.87%	1,000,000.00
P477578	02/05/96	31/03/56	PWLB	Maturity	8.37%	10,000,000.00
P477622	08/05/96	31/03/56	PWLB	Maturity	8.37%	10,000,000.00
P477985	30/08/96	31/03/56	PWLB	Maturity	8.25%	3,000,000.00
P493425	05/07/07	30/09/56	PWLB	Maturity	4.80%	60,000,000.00
P502887	05/03/14	30/09/57	PWLB	Maturity	4.20%	20,000,000.00
P498092	13/10/10	31/03/59	PWLB	Maturity	4.09%	10,000,000.00
P497853	06/09/10	31/03/60	PWLB	Maturity	4.03%	10,000,000.00
P450404	08/12/21	31/03/61	PWLB	Maturity	1.49%	25,000,000.00
P509312	04/06/19	30/09/61	PWLB	Maturity	2.18%	5,000,000.00
P509461	04/07/19	31/03/62	PWLB	Maturity	2.10%	10,000,000.00
P503717	05/02/15	31/03/63	PWLB	Maturity	2.84%	20,000,000.00
P502921	18/03/14	30/09/63	PWLB	Maturity	4.19%	20,000,000.00
P505126	21/06/16	31/03/64	PWLB	Maturity	2.51%	25,000,000.00
P503301	12/09/14	31/03/64	PWLB	Maturity	3.95%	20,000,000.00
P509636	09/08/19	31/03/66	PWLB	Maturity	1.84%	10,000,000.00
P509848	05/09/19	31/03/67	PWLB	Maturity	1.58%	10,000,000.00
P507444	31/05/18	31/03/67	PWLB	Maturity	2.25%	10,000,000.00
P507215	05/04/18	30/09/67	PWLB	Maturity	2.27%	25,000,000.00
P507444	31/05/18	31/03/67	PWLB	Maturity	2.25%	10,000,000.00
P509848	05/09/19	31/03/67	PWLB	Maturity	1.58%	10,000,000.00
P509723	19/08/19	31/03/68	PWLB	Maturity	1.74%	10,000,000.00
P509506	09/07/19	30/09/68	PWLB	Maturity	2.03%	5,000,000.00
P169721	11/03/20	30/09/69	PWLB	Maturity	2.07%	5,000,000.00
P175073	24/03/20	30/09/69	PWLB	Maturity	1.48%	29,800,000.00
P509289	30/05/19	31/03/69	PWLB	Maturity	2.19%	5,000,000.00
P509372	18/06/19	31/03/69	PWLB	Maturity	2.11%	5,000,000.00
P509495	08/07/19	31/03/69	PWLB	Maturity	2.01%	5,000,000.00
P509629	08/08/19	31/03/69	PWLB	Maturity	1.94%	20,000,000.00
P366831	25/06/21	31/03/71	PWLB	Maturity	1.91%	5,000,000.00
P431937	04/11/21	30/09/71	PWLB	Maturity	1.63%	25,000,000.00
P438539	16/11/21	30/09/71	PWLB	Maturity	1.51%	10,000,000.00
P448434	03/12/21	31/03/71	PWLB	Maturity	1.46%	10,000,000.00
P450406	08/12/21	31/03/71	PWLB	Maturity	1.35%	25,000,000.00
					3.78%	779,598,451.85
		External borrowing average rate and total			**3.81%**	**£1,047,404,451.85**