READING BOROUGH COUNCIL

REPORT BY DIRECTOR OF FINANCE

TO:	**AUDIT & GOVERNANCE COMMITTEE**		
DATE:	**24th JANUARY 2023**		
TITLE:	**Treasury Management Strategy Mid-Year Review 2022/23**		
LEAD COUNCILLOR:	**COUNCILLOR BROCK**	**PORTFOLIO:**	**LEADER OF THE COUNCIL**
SERVICE:	**ALL**	**WARDS:**	**BOROUGHWIDE**
LEAD OFFICER:	**STUART DONNELLY**	**TEL:**	**01889 373468**
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1. PURPOSE OF REPORT AND EXECUTIVE SUMMARY

1.1 The Council adopted a Treasury Management Strategy and an Annual Investment Strategy for 2022/23 at its meeting on 23rd February 2022.

1.2 The purpose of this report is to update Members on the activity of the Treasury Management function during the first half of the year for the period 1st April 2022 to 30th September 2022.

1.3 The Council has not taken out any new external long-term borrowing (loans) during 2022/23 as of 30th September 2022.

1.4 The Council has complied with all elements of its Treasury Management Strategy Statement (TMSS) as agreed by Full Council on 23rd February 2022.

1.5 Section 11 of the main body of this report sets out the changes and proposed changes to the Treasury Management Code, Prudential Code, Public Works Loan Board (PWLB) Lending Terms and regulations. This is to ensure strong compliance with the duty of local authorities to make prudent Minimum Revenue Provision each year.

1.6 This report has been prepared with reference to the following documents:

- Treasury Management Strategy 2022/23
- Quarter 2 Performance Report 2022/23

2. RECOMMENDED ACTION

That the Committee note:

2.1 The Treasury Management Mid-Year Report for 2022/23.

Appendix 1 - Link Group Economics Update
Appendix 2 - Investment Criteria & Limits
Appendix 3 - Investment Portfolio

3. INTRODUCTION

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

- An Interest Rates Forecast
- A review of the Treasury Management Strategy Statement (TMSS) and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council's investment portfolio for 2022/23;
- A review of the Council's borrowing strategy for 2022/23;
- A review of any debt rescheduling undertaken during 2022/23;
- A review of compliance with Treasury and Prudential Limits for 2022/23;
- An economic update for the first half of the 2022/23 financial year (Appendix 1).

4 INTEREST RATES FORECAST

4.1 The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council in formulating 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.

4.2 The latest forecast, made on 19th December 2022, sets out a view that both short and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy, whilst the Government is also providing a limited package of fiscal loosening to try and protect households and businesses from the ravages of ultra-high wholesale gas and electricity prices.

4.3 PWLB rates reflect a less elevated yield curve than prevailed under the Truss/Kwarteng government, and the 17th of November Autumn Statement made clear the Government's priority is the establishment and maintenance of fiscal rectitude. In addition, the Monetary Policy Committee 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.

4.4 Current UK interest rate forecasts (including the 20-basis point certainty rate reduction) are outlined in the following table

Table 1. Interest Rate Forecasts

	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
	%	%	%	%	%	%	%	%
Bank Rate	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25
5-year PWLB	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50
10-year PWLB	4.40	4.40	4.30	4.10	4.00	3.90	3.80	3.60
25-year PWLB	4.60	4.60	4.50	4.40	4.20	4.10	4.00	3.90
50-year PWLB	4.30	4.30	4.20	4.10	3.90	3.80	3.70	3.60

The Balance of Risks to the UK

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

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

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields);
- **The Bank of England** acts too quickly, or too far, over the next two years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate;
- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues;
- **Geopolitical risks**, for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.

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

- **The Bank of England** is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project or even necessitates a further series of increases in Bank Rate.
- **The Government** acts too quickly to cut taxes and/or increases expenditure in the light of the cost-of-living squeeze;
- **The pound weakens** because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt;
- **Longer term US treasury yields** rise strongly and pull gilt yields up even higher than currently forecast;
- **Projected gilt issuance, inclusive of natural maturities and Quantitative Tightening**, could be too much for the markets to comfortably digest without higher yields consequently.

5 TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY UPDATE

5.1 The Treasury Management Strategy Statement (TMSS) for 2022/23 was approved by Full Council on 23rd February 2022.

5.2 There are no policy changes required to the TMSS. This report sets out the Council's position compared to the TMSS in light of the updated economic position, budgetary changes already approved and revised in-year forecasts of capital expenditure.

6 THE COUNCIL'S CAPITAL POSITION (PRUDENTIAL INDICATORS)

Prudential Indicators for Capital Expenditure

6.1 The Council is required to ensure that all of its Capital Expenditure, investments and borrowing decisions are prudent and sustainable. The prudential indicators for capital expenditure set out whether or not the Council is delivering within its approved budgets.

6.2 Tables 2 and 3 below show the Council's forecast capital expenditure compared to the Capital Programme agreed in February 2022 (Original Budget) and the Capital Programme as at Quarter 2 (Revised Budget) as approved by Policy Committee as part of the 2022/23 Quarter 2 Performance and Monitoring Report in December 2022.

6.3 The indicators show that the Council is forecasting a positive net variance against the approved Capital Programme budget of £1.201m for the General Fund.

Table 2. General Fund Capital Programme

General Fund	2022/23 Original Budget	2022/23 Revised Budget	2022/23 Forecast (30th September 2022)	Variance
	£m	£m	£m	£m
Adult Social Care & Health Services	0.686	1.818	1.818	0.000
Economic Growth & Neighbourhood Services	60.624	52.558	52.558	0.000
Economic Growth & Neighbourhood Services - Education Schemes	3.148	4.317	4.317	0.000
Resources	19.389	14.219	14.219	0.000
Corporate	8.226	7.115	5.914	(1.201)
Total General Fund	**92.073**	**80.027**	**78.826**	**(1.201)**

6.4 The indicators show that the Council is forecasting an adverse net variance of £0.060m against the HRA Capital Programme as at the end of Quarter 2. A business case has been submitted as part of the 2023/24 budget setting process and built into the HRA 30-year business plan to add additional budget to complete phase 2 of this project which includes addressing this £0.060m variance from 2022/23.

Table 3. HRA Capital Programme

Housing Revenue Account	2022/23 Original Budget	2022/23 Revised Budget	2022/23 Forecast (30th September 2022)	Variance
	£m	£m	£m	£m
Housing Revenue Account	35.442	27.828	27.888	0.060
Total Housing Revenue Account	**35.442**	**27.828**	**27.888**	**0.060**

6.5 Further details on significant variances on individual capital schemes are reported to Policy Committee as part of the Quarterly Performance and Monitoring Reports.

Changes to the Financing of the Capital Programme

6.6 Tables 4 and 5 below identify the expected financing arrangements of the Council's capital expenditure plans. The Borrowing Requirement increases the underlying indebtedness of the Council by increasing the Capital Financing Requirement (CFR), although this will be reduced in part by revenue contributions for the repayment of debt (the Minimum Revenue Provision).

Table 4. Financing of the General Fund Capital Programme

General Fund	2022/23 Original Budget	2022/23 Revised Budget	2022/23 Forecast (30th September 2022)
	£m	£m	£m
Total Capital Expenditure	**92.073**	**80.027**	**78.826**
Financed by:			
Capital Receipts	2.126	4.065	2.864
Capital Grants and other Contributions	39.045	41.288	41.288
Total Financing (excluding Borrowing)	**41.171**	**45.353**	**44.152**
Net Borrowing Requirement	**50.902**	**34.674**	**34.674**

Table 5. Financing of the HRA Capital Programme

Housing Revenue Account	2022/23 Original Budget	2022/23 Revised Budget	2022/23 Forecast (30th September 2022)
	£m	£m	£m
Total Capital Expenditure	**35.442**	**27.828**	**27.888**
Financed by:			
Capital Receipts	0.915	0.915	0.915
Capital Grants and other Contributions	6.074	9.019	9.019
Capital Reserves	16.790	12.161	12.161
Revenue	0.600	0.502	0.562
Total Financing (excluding Borrowing)	**24.379**	**22.597**	**22.657**
Net Borrowing Requirement	**11.063**	**5.231**	**5.231**

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

6.7 Table 6 shows the Council's CFR, which is its total underlying indebtedness. It also shows the maximum expected debt position (the Operational Boundary) over the period as at 23rd February 2022, which was £690.828m. The revised Operational Boundary is £646.262m which has reduced due to the revised expenditure and financing forecasts.

Table 6. Capital Financing Requirement and Operational Boundary

	2022/23 Original Estimate	2022/23 Forecast (30th September 2022)
	£m	£m
Prudential Indicator – Capital Financing Requirement		
CFR – General Fund	463.003	427.620
CFR - HRA	207.825	199.006
Total CFR	**670.828**	**626.626**
Prudential Indicator – Operational Boundary for External Debt		
Borrowing	670.828	626.626
Headroom	20.000	20.000
Operational Boundary	**690.828**	**646.626**

6.8 The Council's current level of external debt (as at 30th September 2022) is £409.156m, as set out in Table 7 below. The Council is therefore operating significantly within its Operational Boundary.

Limits to Borrowing Activity

6.9 Over the medium term, net borrowing (borrowings less investments) should only be for capital purposes. Gross external borrowing should not, except in the short term, exceed the total of the Council's CFR in the preceding year plus the estimates of any additional CFR for 2022/23 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy within the TMSS for borrowing in advance of need which will be adhered to if this proves prudent.

Table 7. Capital Financing Requirement and Actual Borrowing

	2022/23 Original Estimate	2022/23 Current Position (30th September 2022)	2022/23 Forecast (30th September 2022)
	£m	£m	£m
Borrowing	486.703	386.010	399.840
Other Long-Term Liabilities	23.146	23.146	23.146
Total Debt	**509.849**	**409.156**	**422.986**
CFR (year end position)	**670.828**	**626.626**	**626.626**
Over/(under) Borrowing		**(217.470)**	**(203.640)**

6.10 The Authorised Borrowing Limit is the expected maximum borrowing need with some headroom for unexpected movements. This is a statutory limit determined under section 3 (1) of the Local Government Act 2003 and sets the limit beyond which borrowing is prohibited without Member approval. 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. Table 8 below sets out the Authorised Limit. The current level of external debt of £409.156m (as at 30th September 2022) is significantly within the Authorised Limit.

Table 8. Authorised Limit

	2022/23 Original Indicator	2022/23 Forecast (30th September 2022)
	£m	£m
Operational Boundary	690.828	646.626
Headroom	40.000	40.000
Total Authorised Limit	**730.828**	**686.626**

7 BORROWING

7.1 The Council's estimated capital financing requirement (CFR) for 2022/23 as at 30th September 2022 is £626.626m. 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) to fund capital expenditure. The balance of external and internal borrowing is generally driven by market conditions.

7.2 Table 7 above shows that the Council has external borrowing (including prior year borrowing) of £409.156m and has utilised £217.470m of cash flow funds in lieu of borrowing. This is a prudent and cost-effective approach in the current economic climate but will require ongoing monitoring in respect of the Council's cashflow requirements, long-term borrowing requirement and interest rate increases.

7.3 Due to a combination of re-profiling of capital expenditure into future years and additional grant income being received, the Council has not needed to undertake any new long-term PWLB borrowing during 2022/23 as at 30th September 2022.

7.4 It is possible that the Council may need to borrow during Quarter 4 of 2022/23 as cash balances are forecast to reduce during this quarter. This is primarily as a result of £21m of s31 grant re-payments to Central Government (in respect of cashflow support given in respect of 2021/22 additional business rate reliefs, as part of the Business Rate Retention Scheme), falling due during this period. However, the current expectation is that this would be met by temporary or short-term borrowing. The Council's Borrowing Strategy will be reviewed and revised as part of the Treasury Management Strategy Statement 2023/24 in order to achieve optimum value and risk exposure in the long-term.

8 DEBT RESCHEDULING

8.1 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 have impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year. However, now that the whole of the yield curve has shifted higher there may be better opportunities in the future, although only prudent and affordable debt rescheduling will be considered.

8.2 Whilst debt rescheduling has not taken place, two of the Lender Option Borrower Option (LOBO) loans included in the loan balances as at 30th September 2022 were subsequently repaid early in order to benefit from savings on the Council's Capital Financing budgets over future years. At the current time no further external loans have been taken to replace those repaid.

9 COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

9.1 During the half year ended 30th September 2022, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2022/23.

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

10 ANNUAL INVESTMENT STRATEGY

10.1 The Treasury Management Strategy Statement (TMSS) for 2022/23, which includes the Annual Investment Strategy, was approved by the Council on 23rd February 2022. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity;
- Yield.

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

10.3 The Council's Annual Investment Strategy will be reviewed and updated as appropriate for 2023/24 to ensure that there is a greater correlation between the investment counterparty list and the Council's ethical values.

Creditworthiness

10.4 Officers continue to closely monitor credit ratings, and other measures of creditworthiness to ensure that only appropriate counterparties are considered for investment purposes.

Investment Balances

10.5 The average level of funds available for investment purposes during the year to 30th September 2022 was £73.668m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and Capital Programme expenditure. The investment performance set out in Table 9 below excludes the investments made in the CCLA Property Fund and the loans to the Council's wholly owned companies.

Table 9. Investment Performance Year to Date as at 30th September 2022

Period	SONIA Benchmark Return	Council Performance	Investment Interest Earned
	%	%	£m
7 Day	1.22	1.27	0.466

10.6 The Council also has £15.000m invested in the CCLA Property Fund which is a long-term investment and has received an income of £0.363m over the six-month period to 30th September 2022. The total return on the fund is 4.84%.

10.7 In 2018 the Government introduced a statutory override following the adoption of International Financial Reporting Standard 9 (IFRS 9). The statutory override requires authorities to remove the impacts of the fair value movements of pooled investment funds, such as the CCLA Property Fund, from their budgets and record them in an unusable reserve. The statutory override was time-limited to five years and was due to end in March 2023. However, in August 2022 the Government issued a consultation document seeking views regarding the future of the statutory override and announced a further two year extension to 31st March 2025 in December 2022, with the full Government response expected to be published in early 2023.

10.8 Officers can confirm that the approved limits within the Annual Investment Strategy (attached as Appendix 2) were not breached during the quarter ended 30th September 2022.

10.9 The Council's investment position as at 30th September 2022 is detailed at Appendix 3. The portfolio includes loans made to Homes for Reading Ltd where principal repayments due in September 2022 were not made. There is a review underway and refinancing proposals will be reviewed following a board meeting in February/March 2023.

11 2022/23 CONSULTATIONS & GUIDANCE CHANGES

Minimum Revenue Policy (MRP)

11.1 The Department for Levelling Up, Housing and Communities launched a consultation on 30th November 2021 until 8th February 2022, seeking views on proposed changes to regulations to improve enforcement of the duty of local authorities to make prudent Minimum Revenue Provision each year.

11.2 One of these proposals would, if implemented, require councils to provide MRP on any capital loans given to third parties and wholly owned companies. The Council's current MRP Policy would therefore need to be reviewed and additional budgetary provision made within the Council's revenue budget in order to comply with this change, should it materialise.

11.3 The latest information we have is that any changes will take effect from 2024/25 at the earliest; it is not the Government's intention that these changes are applied retrospectively.

12 CONTRIBUTION TO STRATEGIC AIMS

12.1 The Council's vision to ensure that Reading realises its potential – and to ensure that everyone who lives and works in Reading can share the benefits of its success. The Council has three inter-connected themes which contribute to delivering this vision. The themes are:

- Healthy environment;
- Thriving communities;
- Inclusive economy.

12.2 Delivery of the Council's revenue and capital budgets is essential to ensuring the Council meets its strategic aims and remains financially sustainable going forward. The treasury management functions are crucial in ensuring that the Council has access to funds when required and in investing surplus funds in secure investments.

13 ENVIRONMENTAL AND CLIMATE IMPLICATIONS

13.1 None have been identified as arising directly from this report.

14 COMMUNITY ENGAGEMENT AND INFORMATION

14.1 Budget-related communications and consultations will continue to be a priority over the next three years as we work to identify savings.

15 EQUALITY IMPACT ASSESSMENT

15.1 None have been identified as arising directly from this report.

16 LEGAL IMPLICATIONS

16.1 The Council is required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals:

- **Prudential and treasury indicators and treasury strategy -** The first, and most important report is forward looking and covers:
  - the capital plans, (including prudential indicators);
  - a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
  - the treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
  - an investment strategy, (the parameters on how investments are to be managed).

- **A mid-year treasury management report** (this report) – This is primarily a progress report and will update Members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

- **An annual treasury report –** This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

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

17 FINANCIAL IMPLICATIONS

17.1 The financial implications are set out in the body of the report.

18 BACKGROUND PAPERS

18.1 None.

Appendix 1 – Link Group Economics Update

1. The third quarter of 2022/23 saw:

   - A 0.5% m/m rise in Gross Domestic Product (GDP) in October, mostly driven by the reversal of bank holiday effects;
   - Signs of economic activity losing momentum as households increased their savings;
   - Consumer Price Index (CPI) inflation fall to 10.7% in November after peaking at 11.1% in October;
   - A small loosening in the labour market which pushed the unemployment rate up to 3.7% in October;
   - Interest rates rise by 125bps over Q4 2022, taking Bank Rate to 3.50%;
   - Reduced volatility in UK financial markets but a waning in global risk appetite.

2. GDP fell by 0.3% q/q in Q3 2022 (ending 30th September), which probably marked the start of the UK recession. About half of that decline was the effects of the extra bank holiday in September for the Queen's funeral. The unwinding of those bank holiday effects meant that GDP rebounded in October and explained at least 0.3 percentage points (ppts) of the 0.5% m/m rise. Accordingly, if GDP were to avoid falls of more than 0.2% m/m in November and December, then GDP over Q4 as a whole could avoid a contraction, which would prevent a recession in 2022.

3. However, at 49.0 in December, the flash composite activity Purchasing Managers' Index (PMI) stayed below the "boom-bust" level of 50 and pointed to a small 0.1% q/q contraction in GDP in Q4. Consumer confidence was -42 in December and stayed close to its record low of -49 in September. Strike action could be another small drag and may mean that GDP is 0.0% to 0.5% lower than otherwise in December. GDP is projected to contract marginally in Q4 by around 0.1% q/q.

4. Meanwhile, the 0.4% m/m fall in retail sales volumes in November only reversed some of the 0.9% m/m rise in October. That left sales volumes 4.5% below their level at the start of the year. Indeed, the rise in the household saving rate from 6.7% in Q2 to 9.0% in Q3 implied that higher interest rates are encouraging households to save more. And a larger-than-usual £6.2bn rise in cash in household bank accounts in October may imply households have started to increase their precautionary savings.

5. There were signs that the labour market was loosening gradually going into the final quarter of 2022. Although employment in the three months to October rose by 27,000, the fall in the composite PMI employment balance in December took it into contractionary territory and suggests that labour demand will cool. Meanwhile, labour supply improved as inactivity fell by 76,000 in the three months to October. That helped drive a rise in the unemployment rate from 3.6% in September to 3.7% in October. The number of job vacancies in November fell for the sixth consecutive month and were 18% below their peak in May.

6. Crucially, though, wage growth remained resilient. Average earnings growth, excluding bonuses, grew by 0.7% m/m in October, above the 2022 monthly average of 0.5% m/m. That drove the 3m y/y rate up to 6.2%, well above the rates of 3-3.5% consistent with inflation at its 2% target. Wage growth is likely to slow gradually in the coming months as the labour market loosens further but if extensive strike action is successful in achieving large pay increases, then wage growth could be a bit stronger for longer.

7. CPI inflation peaked in October at a 41-year high of 11.1% and fell to 10.7% in November. Goods price inflation, which is driven largely by global factors, has peaked. The sharp rises in energy prices in 2022 mean that energy price inflation will fall sharply in 2023. Meanwhile, the large fall in agricultural prices since May means that food price inflation should start to decline soon. What's more, upward pressure on goods price inflation from global supply shortages is fading quickly.

8. Domestic inflation pressures also eased in Q4. The 0.2% m/m rise in core CPI inflation in November was the smallest monthly gain since August 2020 and drove a fall in core CPI inflation from 6.5% in October to 6.3% in November. Services CPI inflation was stable at 6.3% in November despite the resilience of wage growth. And the easing of price expectations in the Bank of England's Decision Maker Panel survey in November suggests that inflation may become less persistent.

9. The Chancellor's Autumn Statement on 17th November succeeded in restoring the Government's fiscal credibility in the eyes of the financial markets without deepening the recession. The total fiscal consolidation package of £54.9bn (1.8% of GDP) in 2027/28 made the outlook for fiscal policy much tighter than at the beginning of Q4. The package was heavily backloaded, with net handouts of £3.8bn (0.15% of GDP) in 2023/24 and £0.3bn (0.01% of GDP) in 2024/25, and most of the tightening kicking in after 2024/25. The largest fiscal support was the extension of the Energy Price Guarantee for another 12 months, until April 2024, although at a higher price cap of £3,000 from April 2023 rather than £2,500. At the same time, the Chancellor loosened the fiscal rules by requiring debt as a percentage of GDP to be falling in five years' time, rather than three. The Office of Budget Responsibility (OBR) estimated that the Chancellor will meet this new rule with a slim £9.2bn (0.3% of GDP) to spare.

10. With fiscal policy now doing much less to fan domestic inflation pressures, we think Bank Rate will peak at 4.50%, or at least close to that figure. Despite stepping up the pace of policy tightening to a 75-basis point (bps) rate hike in November, taking Bank Rate from 2.25% to 3.00%, the MPC's communication was dovish. The MPC pushed back heavily against market rate expectations, which at the time were for Bank Rate to peak at 5.25%. The Bank's new forecasts predicted a deeper and longer recession than the analyst consensus, of eight quarters and with a peak-to-trough fall in real GDP of 2.9%.

11. The Bank sounded dovish again in December when it slowed the pace of tightening with a 50bps rate rise, from 3.00% to 3.50%. Two members, voted to leave rates unchanged, judging that the current level of Bank Rate was sufficient to bring inflation back to target. That said, the rest of the MPC appeared to suggest that further rate hikes would be necessary. We expect that the majority of the MPC will need to see stronger signs that activity is slowing, the labour market is loosening, and wage growth is slowing before stopping rate rises. As such, we expect that the MPC will deliver three further rate hikes in February, March and May, taking Bank Rate to a peak of 4.50% but with the pace of increase reducing to 25bps in March and May.

12. Gilt yields have fallen sharply since their highs following the "mini-budget" on 23rd September as government fiscal credibility has been largely restored with the fiscal consolidation package announced at the Autumn Statement on 17th November. Indeed, the 10-year yield fell from a peak of 4.55% to about 3.60% now, while the 30-year yield fell from 5.10% to 3.90%. Admittedly, yields rose by around 50bps in December, partially on the back of a global rise in yields. But if we are right in thinking Bank Rate will fall back in 2024 and 2025 then gilt yields will probably fall over the next two years, with the 10-year yield slipping from around 3.60% now to 3.30% by the end of 2023 and to 2.80% by the end of 2024.

13. Lower volatility in gilt markets in Q4 meant that the Bank of England was able to stop its purchases of long-term gilts for financial stability reasons as planned on 14th October. It was also able to begin active gilt sales in November, albeit with a focus on shorter dated gilts. So far quantitative

tightening has had little influence on short-term money markets. But as it is still an experiment, the risk of a widespread tightening in financial conditions remains.

14. The restoration of fiscal credibility boosted the pound and the FTSE 100 early in Q4. While much of the benefit passed in the first half of Q4, sterling continued to rally against a softer dollar. Our colleagues at Capital Economics do not think that the global recession is fully priced into markets, and so expect a further fall in risk appetite to boost safe haven demand for the dollar and weigh on the pound. They are expecting the pound to fall from $1.19 now to $1.10 in mid-2023, before climbing to $1.15 by the end of 2023 as the prospect of lower interest rates and a recovery in global economic growth buoys equity prices.

15. Through December, the rally in the FTSE 100 petered out as investors have become increasingly concerned by the prospect of a global recession. However, the relatively dovish tone of the Bank of England, compared to the Federal Reserve and the ECB meant that UK equities held up better than other developed market indices. Indeed, at 7,452 at the December month end, the FTSE 100 is only marginally below its peak of 7,568 on 5th December, while the S&P 500 is around 4% lower over the same period. Nevertheless, there is a great deal of uncertainty as to which direction markets will move in 2023 and at what pace. Continued volatility is anticipated.

Appendix 2 – Investment Criteria & Limits

	Credit Rating	Cash Limit	Time Limit
Banks and organisations and securities whose lowest long-term credit rating published by Fitch, Moody's or Standard & Poor is:	AAA	£20m each	5 Years
	AA+		3 Years
	AA		
	AA-		2 Year
	A+		
	A		1 Year
	A-		
The Council's current account, Lloyds Bank Plc should circumstances arise when it does not meet above criteria	N/A	£1m (total)	Next Day
UK Building Societies without credit rating	N/A	£10m each	1 Year
UK Government (irrespective of credit rating)	N/A	Unlimited	50 Years
UK Local Authorities (irrespective of credit rating)	N/A	£20m each	50 Years
UK Registered Providers of Social Housing whose published long-term credit rating is A- or higher	A-	£5m each	2 Years
UK Registered Providers of Social Housing whose published long-term credit rating is lower than A- or without a long-term credit rating	N/A	£2m each	1 Year
	Fund rating	**Cash Limit**	**Time**
Money Market Funds	AAA	£20m each	liquid
Pooled Funds (including pooled property funds)	AAA	£30m total	liquid

Other Limits

a) **Non-specified investment limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments at £30m maximum.

b) **Country limit.** The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of *AA-* from Fitch or equivalent.

c) **Other limits.** In addition:

- no more than £20m will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

Upper limit for principal sums invested for longer than 365 days

	2022/23	2023/24	2024/25
Principal sums invested for longer than 365 days	£30m	£30m	£30m

Appendix 3 - Investment Portfolio as at 30th September 2022

Borrower	Amount £m	Interest rate	Start date	Maturity date	LAs Credit Rating	Country
Treasury Investments						
Lloyds Bank Plc (RFB) – current account	9.733	2.15%	N/A	N/A	A+	
SLI Sterling Liquidity/Cl 2	4.580	2.13%	N/A	N/A	AAA	
Federated Prime Rate Sterling Liquidity 4	19.373	2.08%	N/A	N/A	AAA	
CCLA Local Authorities Property Fund	15.000	4.84%	31/03/15	N/A	N/A	
Fixed term deposits:						
Landesbanken Hessen-Thueringen Girozentrale	10.000	2.25%	14/09/22	14/10/22	Non UK A+	Germany
Qatar National Bank	5.000	1.93%	12/07/22	12/10/22	Non UK A	Qatar
SMBC Bank International	10.000	2.22%	14/09/22	14/10/22	A-	UK
Standard Chartered Bank (Sustainable)	15.000	2.18%	01/09/22	01/11/22	A+	UK
Total Treasury Investments	**88.686**					
Non-Treasury Investments						
Brighter Futures for Children Ltd	5.000	1.81%	25/03/21	24/03/26	N/A	
Homes for Reading Ltd	1.100	3.25%	29/09/17	26/09/22	N/A	
Homes for Reading Ltd	0.400	3.38%	23/01/18	26/09/22	N/A	
Homes for Reading Ltd	0.800	3.59%	28/02/18	26/09/22	N/A	
Homes for Reading Ltd	0.700	3.58%	20/03/18	26/09/22	N/A	
Homes for Reading Ltd	0.800	3.62%	25/04/18	24/03/23	N/A	
Homes for Reading Ltd	0.800	3.57%	11/05/18	24/03/23	N/A	
Homes for Reading Ltd	2.000	3.48%	29/08/18	24/03/23	N/A	
Homes for Reading Ltd	3.000	3.41%	24/09/18	24/03/23	N/A	
Homes for Reading Ltd	4.000	3.19%	11/12/18	24/03/23	N/A	
Homes for Reading Ltd	2.000	3.38%	07/02/19	24/03/23	N/A	
Homes for Reading Ltd	1.300	3.51%	29/06/18	24/03/23	N/A	
Homes for Reading Ltd	7.000	3.75%	16/04/19	24/03/29	N/A	
Reading Transport Ltd	4.609	5.00%	30/04/19	30/04/29	N/A	
Reading Transport Ltd	0.500	5.00%	15/08/19	30/07/29	N/A	
Reading Transport Ltd	0.490	5.00%	08/04/18	01/07/23	N/A	
Reading Transport Ltd	0.207	5.00%	03/06/18	01/07/23	N/A	
Reading Transport Ltd	0.164	5.00%	29/07/18	01/07/23	N/A	
Reading Transport Ltd	0.151	5.00%	20/01/20	01/01/24	N/A	
Reading Transport Ltd	0.700	5.00%	21/08/20	01/10/24	N/A	
Total Non-Treasury Investments	**35.721**					
Total Investments*	**124.407**					

*Values above do not include lease agreements with Reading Transport Ltd.