Appendix D

Economic Update

The Monetary Policy Committee (MPC) has recently increased Bank Rate to 3.00% from 2.25%. The increase was made on the 4 November 2022 and reflected a split vote – seven members voting for a 0.75% increase, one for 0.5% and one for a 0.25% increase. The MPC continues to grapple with getting inflation back on track over a three-year horizon.

The MPC has now increased interest rates eight times in as many meetings in 2022 and has raised rates to their highest level since the Global Financial Crisis. Even so, coming after the Fed and ECB raised rates by 0.75% in their most recent meetings, the Bank of England's latest 0.75% hike looks relatively dovish. However, the UK's status as a large 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 UK has a new Prime Minister, Rishi Sunak, a new Chancellor, Jeremy Hunt, and new fiscal policies – to be firmed up on the 17th of November Autumn Statement - that seek to ensure that the public finances are kept on a sound footing and that any projected gaps (possibly £50bn to £60bn) are fully funded from services efficiencies and/or net tax increases.

In the interim period, since the end of September, the Government scrapped the reduction in the basic rate of income tax by 1p in the £; maintained the higher band 45p in the £ income tax rate; did not reduce Corporation Tax to 19% from 25%; only put in place support for businesses and households for 6 months (October to March) regarding caps on the unit costs of gas and electricity. In addition, the Bank of England has had to intervene in the longer part of the gilt market to ensure that pension funds did not have to undertake a "fire sale" of assets to raise cash to pay for margin calls, arising from the sell-off of long-dated gilts (yields rising) in the wake of the former Chancellor's policy to seek to boost growth with unfunded tax cuts.

In recent days, calm has returned to the markets, the £ has risen from a historic low of $1.03 to $1.14, and the cumulative movement in gilt yields since the turn of the year is now broadly in line with that seen in the US and Euro-zone bond markets.

The Bank of England's Quarterly Monetary Policy Report detailed that the UK economy is headed for eight quarters of negative growth based on the market's expectation for Bank Rate to increase to 5.25%. Since then, market expectations have been recalibrated, and now view a peak in Bank Rate of between 4.5% and 4.75%. These views are similar to those held by Link Group's Interest Rate Strategy Group (IRSG). IRSG has reduced its view on the peak of Bank Rate from 5% to 4.5%. However, although we see rates peaking in May of

2023, we now also believe there are several challenges to the Bank that could see them leave rates at this level until early 2024.

The first of those challenges is the tight labour market (unemployment is at a 48 year low 3.5%), which shows no signs of dissipating, and that could mean wage increases continue to be 5% well into 2023 (the Bank would broadly want wages to be in the range of 3% - 3.5%). There is also the prospect that unless the workforce participation rate increases and/or immigration policies are relaxed, there is no clear route that would give rise to sustainable increases in economic growth. And, of course, inflation could be somewhat "sticky" if the Russian invasion of Ukraine remains unresolved and puts continued pressure on global energy prices and staple foods (e.g., wheat), among the many areas negatively impacted.

The impact of the Truss/Kwarteng fiscal experiment has faded in the past month but investors will still remain a little nervous over the UK's future fiscal policy and therefore we have reduced our forecast for near-term PWLB rates across the curve, compared to September's forecast, but have left the longer end of the curve slightly higher to reflect the potential demand by foreign investors for a "confidence premium" in the light of recent market volatility.

The most recent survey by Nationwide Building Society showed house prices starting to fall and the MPC will be very cognisant that affordability could be stretched now that fixed rate mortgages are somewhat higher than they were a few weeks ago. Historically, the MPC has appeared reluctant to tighten monetary policy in a falling housing market, but it may be willing to leave rates less high than the market had been pricing in prior to the 3rd of November Quarterly Monetary Policy Report but keep them there for longer as a compromise of sorts.

A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

- Link's central forecast for interest rates was previously updated on 28th September and reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened but the new Government's policy of emphasising fiscal rectitude will probably mean Bank Rate does not now need to increase to further than 4.5%.
- Further down the road, Link anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us – but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.
- The CPI measure of inflation will peak at close to 11% in Q4 2022. Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market.
- Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started but will focus on the short to medium end of the curve for the present so as to prevent any further disruption to the longer end of the curve following on from the short-lived effects of the previous Chancellor's unfunded dash for growth policy.
- In the upcoming months, Links forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but the on-going conflict between Russia and Ukraine. (More recently, the heightened tensions between China/Taiwan/US also have the potential to have a wider and negative economic impact.)
- On the positive side, consumers are still 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 challenges. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

What happens outside of the UK is also critical to movement in gilt yields. The US FOMC has led with increases of 3.75% in the year to date and is expected to increase rates further before the end of the year, and possibly into 2023. Similarly, the ECB has also started to tighten monetary policy, albeit from an ultra-low starting point, as have all the major central banks apart from Japan. Arguably, though, it is US monetary policies that will have the greatest impact on global bond markets. Geo-political events continue to lead to frequent volatility in equity, bond, commodity and currency markets. And the weather will also play a large part in how high energy prices stay and for how long. Not forgetting developments in Iran, North Korea, Taiwan and China.

Economic Forecast

The Council receives its treasury advice from Link Asset Services. Their latest interest rate forecasts are shown below:

Link Group Interest Rate View	08.11.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.30	4.30	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.50	4.50	4.40	4.30	4.20	4.00	3.90	3.70	3.60	3.50	3.40	3.30	3.20
25 yr PWLB	4.70	4.70	4.60	4.50	4.40	4.30	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.40	3.30	3.20	3.20

As shown in the forecast table above, Bank Rate is projected to peak at 4.50% by June 2023, following an aggressive series of rate increases over the last calendar year. Link forecast a further 0.50% at the December MPC meeting followed by a further 1.00% increase over the first few months in 2023.

Significant risks to the forecasts

- 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.

The overall balance of risks to economic growth in the UK is now to the downside, including inflationary and stagnation risks to the U.K. economy.

Borrowing

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. A list of the approved limits is shown in Appendix B. The Prudential Indicators were not breached during the second quarter of 2022/23 and have not been previously breached. The schedule at Appendix C details the Prudential Borrowing approved and utilised to date.

No new external borrowing has currently been undertaken to date in 2022/23, although discussions are currently being held at the Capital Investment Board where outline business cases are being considered. The schemes being considered are already within the current authorised borrowing limits in place. In the event the authorised borrowing limits need to be amended, this will be reported to Council for approval. The table below illustrates the low and high points across different maturity bands for borrowing rates for the first six months of the financial year

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.35%	5.80%	5.51%
Date	28/09/2022	28/09/2022	28/09/2022	28/09/2022	28/09/2022
Average	2.81%	2.92%	3.13%	3.44%	3.17%
Spread	3.16%	3.26%	2.99%	3.28%	3.26%

Debt Rescheduling

Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. During the first six months of the year no debt rescheduling was undertaken.