EXECUTIVE **20 NOVEMBER 2023**

SUBJECT:	**TREASURY MANAGEMENT AND PRUDENTIAL CODE UPDATE MID-YEAR REPORT – 30 SEPTEMBER 2023**
DIRECTORATE:	**CHIEF EXECUTIVE & TOWN CLERK**
REPORT AUTHOR:	**LAURA SHIPLEY, FINANCIAL SERVICES MANAGER**

1. Purpose of Report

1.1 This report summarises the Council's treasury management activity and the actual prudential indicators for the period 1st April 2023 to 30th September 2023.

2. Executive Summary

2.1 The Treasury Management Strategy for 2023/24 approved by council on 28th February 2023 outlines the Council's capital and investment priorities as follows;

- **Liquidity** of investments
- **Security** of capital / investments
- **Yield** earned on investments

2.2 The strategy includes indicators that help ensure that the Council's capital investment plans are affordable, prudent and sustainable. Setting an integrated Capital and Treasury Management Strategy is a requirement of the CIPFA Code of Practice.

2.3 The position and performance for the 6 months ended 30th September 2023 are set out in the body of this report.

2.4 **Investment Portfolio**

2.4.1 The Council held £41.145m of investments as at 30th September 2023. The investment profile is shown in Appendix A.

2.4.2 Of this investment portfolio 100% was held in low risk specified investments, the requirement for the year being a minimum of 25% of the portfolio to be specified investments. During the 6 months to 30th September on average 93% of the portfolio was held in low risk specified investments and an average of 7% of the portfolio was held in non-specified investments (with other local authorities).

2.4.3 Liquidity – The Council seeks to maintain liquid short-term deposits of at least £5 million available with a week's notice. The weighted average life (WAL) of investments for the year was expected to be 0.11 years (40 days). At 30th September 2023 the Council held liquid short term deposits of £17 million and the WAL of the investment portfolio was 0.21 years (75 days). The WAL of the investment portfolio is higher than expected.

2.4.4 Security - The Council's maximum security risk benchmark for the portfolio as at 30th September 2023 was 0.022%. Based on the historic risk of default of the counterparties and types of accounts in which the council's funds are place – this equates to a potential loss of £0.005m on an investment portfolio of £41m. This represents a very low risk investment portfolio.

2.4.5 Yield – The Council achieved an average return of 4.73% on its investment portfolio for the 6 months ended 30th September 2023. This compares favourably with the prior year's equivalent figure of 1.3% and is in-line with the target SONIA rate at 30th September 2023 of 4.73%.

2.5 External Borrowing

2.5.1 As at 30th September 2023, the Council held £114.353m of external borrowing, of which 100% were fixed rate loans (Appendix A).

2.5.2 As at 30th September 2023, the average rate of interest paid during the first half of the financial year on external borrowing was 3.14%. This is lower than the budgeted rate set in the MTFS 2022-27 of 4.25%; there has been a reduction in external borrowing during the first 6 months of the year as some borrowing has been repaid and internal balances used to fund expenditure.

3. Background

3.1 The prudential system for capital expenditure is well established. One of the requirements of the Prudential Code is to ensure adequate monitoring of the capital expenditure plans, prudential indicators (PIs) and treasury management response to these plans. This report fulfils that requirement and includes a review of compliance with Treasury and Prudential Limits and the Prudential Indicators at 30th September 2023. The Treasury Management Strategy and Prudential Indicators were previously reported to and approved by Council on 28th February 2023.

3.2 This Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector and operates its treasury management service in compliance with this Code and the above requirements. These require that the prime objective of treasury management activity is the effective management of risk, and that its borrowing activities are undertaken in a prudent, affordable and sustainable basis.

3.3 This report highlights the changes to the key prudential indicators, to enable an overview of the current status of the capital expenditure plans. It incorporates any new or revised schemes previously reported to Members. Changes required to the residual prudential indicators and other related treasury management issues are also included.

4. Prudential Indicators

4.1 This part of the report is structured to provide an update on:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and

- Compliance with the limits in place for borrowing.

4.2 Capital Expenditure

The table below shows the revised estimates for capital expenditure that have been approved by or are subject to Executive approval since Council approved the original budget in February 2023.

4.3

Capital Expenditure	2023/24 Original Estimate (MTFS) £000	Original Estimate inc. Year End Adjustments £000	2023/24 Revised Estimate £000
General Fund	14,114	21,252	24,784
HRA	16,462	22,174	16,862
Total	**30,576**	**43,426**	**41,646**

4.4 Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above) and the expected financing arrangements for this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council in the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt.

4.5

Indicators 1&2 Capital Expenditure and Financing	2023/24 Original Estimate £000	2023/24 Revised Estimate £000
Capital Expenditure		
General Fund	14,114	24,784
HRA (including New Build)	16,462	16,862
Total Expenditure	**30,576**	**41,646**
Financed by (General Fund):		
Capital receipts	-	-
Capital grants & contributions	10,484	18,490
Revenue/Reserve Contributions	-	165
Borrowing need (GF)	**3,631**	**6,129**
Financed by (HRA):		
Capital receipts	1,438	2,004
Capital grants & contributions	-	727
Depreciation (HRA only)	9,092	7,601
Revenue/Reserve Contributions	5,152	5,240
Borrowing need (HRA)	**779**	**1,290**

4.6 The principal changes in the financing, from the original estimates approved in February 2023 are a result of the re-profiling of expenditure and budget increases for the Western Growth Corridor and Better Care Fund (DFG’s) funded by grants.

4.7 <u>The Capital Financing Requirement (CFR), External Debt and the Operational Boundary</u>

4.7.1 The table below shows the Capital Financing Requirement, which is the Council's underlying need to borrow for a capital purpose. It also shows the expected debt position over the period, which is termed as the Operational Boundary.

4.7.2 We are on target to achieve the original forecast Capital Financing Requirement. There have been no significant changes.

Indicators 3 & 4 Capital Financing Requirement (CFR)	**2023/24 Original Estimate £000**	**2023/24 Revised Estimate £000**
General Fund – CFR	74,148	74,143
HRA - CFR	78,803	78,511
Total CFR	**152,952**	**152,654**
Net movement in CFR	3,644	6,551

Indicator 5 External Borrowing	**2023/24 Original Estimate £000**	**2023/24 Revised Estimate £000**
Borrowing	109,897	109,897
Other long term liabilities *	0	0
Total Debt 31 March	**109,897**	**109,897**

* Other long term liabilities includes Finance leases- a change in accountancy practice is currently estimated to result in finance liabilities in 24/25 onwards which will be reported in the Treasury Management Strategy

4.7.3 The Council is currently under-borrowed against the CFR and will utilise cash balances / internal resources until cash flow forecasts indicate the need for additional borrowing. PWLB borrowing rates have increased and forecasts show that they will remain elevated for some little while. No short term borrowing has been undertaken during the period. Over £12m of borrowing is maturing in 2023/24 with a view to not being replaced in the current climate whilst balances and interest rates remain high.

4.7.4 The HRA borrowing requirement is considered independently from that of the General Fund. Further borrowing is anticipated and will be reported as part of the MTFS and Treasury Management Strategy.

4.8 <u>Limits to Borrowing Activity</u>

4.8.1 The first key control over the Council's borrowing activity is a prudential indicator to ensure that over the medium term, net borrowing will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of 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 for borrowing in advance of need, which will be adhered to if this proves prudent.

Indicator 6 – Gross Debt and the CFR	2023/24 Original Estimate £000	2023/24 Revised Estimate £000
Gross Borrowing	109,897	109,897
CFR	152,952	152,654
Net borrowing is below CFR	**43,055**	**42,757**

4.8.2 Due to changes in accounting practice the CFR in future years will include lease liabilities that are currently not recognised on the balance sheet. The council is engaged in establishing the amounts of these liabilities (previously treated as operating leases and treated as rental expenditure) and estimates will be made in the Treasury Management Strategy.

4.8.3 The Chief Finance Officer reports that no difficulties are envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in the budget report.

4.8.4 A breakdown of the loans and investments profile is provided in Appendix A.

A further two prudential indicators control the overall level of borrowing. These are:

1. The Authorised Limit – This represents the limit beyond which borrowing is prohibited and needs to be set and revised by members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

2. The Operational Boundary – This indicator is based on the probable external debt during the course of the year; it is not a limit and actual borrowing could vary around this boundary for short times during the year. CIPFA anticipate that this should act as an indicator to ensure the authorised limit is not breached.

Indicator 7 – Authorised limit for external debt*	2023/24 Original Estimate £000	2023/24 Current Position £000	2023/24 Revised Estimate £000
Borrowing	124,262	114,353	124,005
Other long-term liabilities**	1,380	0	1,380
Total Authorised limit	**125,642**	**114,353**	**125,385**

Indicator 8 – Operational boundary for external debt*	**2023/24 Original Estimate £000**	**2023/24 Current Position £000**	**2023/24 Revised Estimate £000**
Borrowing	119,897	114,353	119,897
Other long-term liabilities**	1,200	0	1,200
Total Operational Boundary	**121,097**	**114,353**	**121,097**

* The highest level of external debt during the first half of 2023/24 was £121.962m.

** Other long-term liabilities include Finance leases.

4.8.5 There have been revisions to the capital programme since the Medium-Term Financial Strategy was set in February 2023 which have impacted on authority's capital financing requirement and as a result, to the figures calculated for the operational boundary for borrowing. The limits for the Operational Boundary allow for previous use of internal borrowing to be replaced by external borrowing should the Chief Finance Officer decide that it is appropriate and prudent to do so.

4.9 **Other Prudential Indicators**

Appendix B details the updated position on the remaining prudential indicators and the local indicators.

5. Economic Update

5.1 The current economic update from the Council's treasury advisors (LINK) can be found in Appendix C.

5.2 Interest Rate Forecast

Current medium term interest rate forecasts are shown below:

Link Group Interest Rate View	25.09.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.00	2.75	2.75	2.75	2.75	2.75
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.00	2.80	2.80	2.80	2.80	2.80
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.10	2.90	2.90	2.90	2.90	2.90
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.20	3.00	3.00	3.00	3.00	3.00
5 yr PWLB	5.10	5.00	4.90	4.70	4.40	4.20	4.00	3.90	3.70	3.70	3.60	3.60	3.50
10 yr PWLB	5.00	4.90	4.80	4.60	4.40	4.20	4.00	3.80	3.70	3.60	3.60	3.50	3.50
25 yr PWLB	5.40	5.20	5.10	4.90	4.70	4.40	4.30	4.10	4.00	3.90	3.80	3.80	3.80
50 yr PWLB	5.20	5.00	4.90	4.70	4.50	4.20	4.10	3.90	3.80	3.70	3.60	3.60	3.60

6. Borrowing

6.1 The Council's capital financing requirement (CFR) for 2023/24 is £152.952m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing), or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The Council has projected borrowing at the end of 2023/24 of £109.897 million and has utilised £43.055m 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 if further upside risk to gilt yields prevails.

6.2 Due to increases in interest rates the Council has employed a policy of utilising internal resources to reduce the overall debt liability, choosing not to renew loans ending during the financial year (£12m). The capital programme is being kept under regular review due to the effects of inflationary pressures and shortages of materials and labour. The borrowing strategy will therefore also be regularly reviewed and revised, to achieve optimum value and risk exposure in the long-term.

6.3 It is anticipated that further borrowing will not be undertaken during this financial year.

6.4 Debt rescheduling opportunities have increased over the course of the past six months and will be considered if giving rise to long-term savings. However, no debt rescheduling has been undertaken to date in the current financial year.

7. Strategic Priorities

7.1 One Council

Through its Treasury Management Strategy, the Council seeks to reduce the amount of interest it pays on its external borrowing and maximise the interest it achieves on its investments.

8. Organisational Impacts

8.1 Finance (including whole life costs where applicable)

The financial implications are covered in the main body of the report.

8.2 Legal Implications including Procurement Rules

The powers for a local authority to borrow and invest are governed by the Local Government Act 2003 (LGA 2003) and associated Regulations. A local authority may borrow or invest for any purpose relevant to its functions, under any enactment, or for the purpose of the prudent management of its financial affairs. The Regulations also specify that authorities should have regard to the CIPFA Treasury Management Code and the MHCLG Investment Guidance when carrying out their treasury management functions.

8.3 Equality, Diversity and Human Rights

The Public Sector Equality Duty means that the Council must consider all individuals when carrying out their day-to-day work, in shaping policy, delivering services and in relation to their own employees.

It requires that public bodies have due regard to the need to:

- Eliminate discrimination
- Advance equality of opportunity
- Foster good relations between different people when carrying out their activities

Due to the nature of the report, no specific Equality Impact Analysis required.

9. Risk Implications

9.1 The Local Government Act 2003, the Prudential Code and the Treasury Management Code of Practice include a key principal that an organisations appetite for risk is included in their annual Treasury Management Strategy and this should include any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing.

10. Recommendation

10.1 It is recommended that Executive note the Prudential and Local Indicators and the actual performance against the Treasury Management Strategy 2023/24 for the half-year ended 30th September 2023.

Is this a key decision?	No
Do the exempt information categories apply?	No
Does Rule 15 of the Scrutiny Procedure Rules (call-in and urgency) apply?	No
How many appendices does the report contain?	Three
List of Background Papers:	Treasury Management Strategy 2023/24 (Approved by Council February 2023)
Lead Officer:	Laura Shipley, Financial Services Manager Email address: **laura.shipley@lincoln.gov.uk**

Appendix A

Borrowing Profile at 30th September 2023

	Long term borrowing	
	Fixed rate	Variable rate
	£ 000	£ 000
PWLB loans	91,353	0
Other Market loans	16,000	0
Local Authority loans	7,000	0
TOTAL	**114,353**	**0**

Investment Profile at 30th September 2023

	Total Principal Invested	Short term	
		Fixed rate	Variable rate
	£ 000	£ 000	£ 000
UK Banks & Building societies (including Call accounts)	**21,000**	21,000	0
UK Money Market Funds	**17,145**	0	17,145
Local Authority	**3,000**	3,000	
TOTAL	**41,145**	**24,000**	**17,145**

Appendix B

Updated Position on the Remaining Prudential and Local Indicators

Affordability Prudential Indicators

Actual and estimates of the ratio of financing costs to net revenue stream – This indicator identifies the trend in the cost of capital (borrowing costs net of interest and investment income) against the net revenue stream.

Ratio of Financing Costs to Net Revenue Stream

Indicators 9 & 10	2023/24 Original Estimate £000	2023/24 Current Position £000
General Fund	14.4%	15.4%
HRA	28.3%	30.8%

The ratios are broadly in line with expectations.

Treasury Management Prudential Indicators

The first treasury indicator requires the adoption of the CIPFA Code of practice on Treasury Management. This Council adopted the Code of Practice on Treasury Management on 1st March 2011 (revised 2021), and as a result adopted a Treasury Management Policy & Practices statement.

There are two further indicators:

Upper Limits On Variable Rate Exposure – This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments.

Upper Limits On Fixed Rate Exposure – Similar to the previous indicator this covers a maximum limit on fixed interest rates.

These indicators are complemented by four local indicators:

- Limit on fixed interest rate investments
- Limit on fixed interest rate debt
- Limit on variable rate investments
- Limit on variable rate debt

During the first half of the year the highest and lowest exposure to fixed and variable rates were as follows:

Indicators 11 & 12	2023/24 Limit (Upper) £million	2023/24 Max Q1 & Q2 £million	2023/24 Min Q1 & Q2 £million
Upper limits on interest rate exposures			
Upper limits on fixed interest rates	116.9	100	86
Upper limits on variable interest rates	48.0	(24)	(9)

*Indicators are negative as they relate to investments only – the council has no variable rate debt

	2023/24 Limit %	2023/24 Max Q1 & Q2 %
Local indicator limits based on debt only		
Limits on fixed interest rates	100%	100%
Limits on variable interest rates	40%	0%
Local indicator limits based on investments only		
Limits on fixed interest rates	100%	75%
Limits on variable interest rates	75%	56%

The 75% limit on variable rate investments was exceeded on nil days between April and September.

Maturity Structures Of Borrowing – These gross limits are set to reduce the Council's exposure to large fixed rate loans (those instruments which carry a fixed interest rate for the duration of the instrument) falling due for refinancing.

Indicator 13	2022/23 Original Estimate £000	2022/23 Revised Estimate £000
Maturity Structure of fixed borrowing (Upper Limits)		
Under 12 months	40%	40%
12 months to 2 years	40%	40%
2 years to 5 years	60%	60%
5 years to 10 years	80%	80%
10 years and above	100%	100%
Maturity Structure of fixed borrowing (Lower Limits)		
Under 12 months	0%	0%
12 months to 2 years	0%	0%
2 years to 5 years	0%	0%
5 years to 10 years	0%	0%
10 years and above*	10%	10%

As at 30th September 2023 the maturity structure of borrowing during the first half of the year was as follows:

Indicator 13 Maturity Structure of fixed borrowing	At 30/9/2023 %	At 31/3/2024 %
Under 12 months	4%	2%

12 months to 2 years	3%	1%
2 years to 5 years	4%	5%
5 years to 10 years	10%	11%
10 years and over	78%	82%

Total Principal Funds Invested – These limits are set to reduce the need for early sale of an investment, and are based on the availability of investments after each year-end.

Indicator 14	2023/24 Original Estimate £000	2023/24 Revised Estimate £000	2024/25 Original Estimate £000	2024/25 Revised Estimate £000	2025/26 Original Estimate £000	2025/26 Revised Estimate £000
Maximum principal sums invested > 1 year	£7m	£0m	£7m	£0m	£7m	£0m

As at 30th September 2023, there were no principal funds invested over 1 year.

Local Prudential Indicators

In addition to the statutory and local indicators listed above the Chief Finance Officer has set four additional local indicators aimed to add value and assist in the understanding of the main indicators. These are:

1. Debt – Borrowing rate achieved against SONIA rate

	2023/24 Target %	2023/24 Actual – 30th September %
Debt – borrowing rate achieved (i.e. temporary borrowing of loans less than 1 year)	Less than SONIA rate	No temporary loans taken

2. Investments – Investment rate achieved against SONIA rate

2023/24 Target %	2023/24 Average Actual – 30th September %	2023/24 Investment Interest Earned – 30th September £'000
Greater than SONIA rate	Achieved average 4.73% compared to 4.73% SONIA rate	939

The interest rate achieved on investments compares favourably to the SONIA rate due to the use of fixed term, fixed rate investments, plus the greater use of semi-fixed rate call accounts and money market funds.

3. Average rate of interest paid on the Council's debt during the year (this will evaluate performance in managing the debt portfolio to release revenue savings).

	2023/24 Target %	**2023/24 Average Q1&Q2 %**
Average rate of interest paid on Council debt	4.25%	3.14%

4. The amount of interest on debt as a percentage of gross revenue expenditure. The results against this indicator will be reported at the year-end.

Appendix C

Economic Update from LINK (the Council's treasury advisors)

The first half of 2023/24 saw:

- Interest rates rise by a further 100bps, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.
- Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.
- A 0.5% m/m decline in real GDP in July, mainly due to more strikes.
- CPI inflation falling from 8.7% in April to 6.7% in August, its lowest rate since February 2022, but still the highest in the G7.
- Core CPI inflation declining to 6.2% in August from 7.1% in April and May, a then 31 years high.
- A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3myy growth of average earnings rose to 7.8% in August, excluding bonuses).

The 0.5% m/m fall in GDP in July suggests that underlying growth has lost momentum since earlier in the year. Some of the weakness in July was due to there being almost twice as many working days lost to strikes in July (281,000) than in June (160,000). But with output falling in 10 out of the 17 sectors, there is an air of underlying weakness.

The fall in the composite Purchasing Managers Index from 48.6 in August to 46.8 in September left it at its lowest level since COVID-19 lockdowns reduced activity in January 2021. At face value, it is consistent with the 0.2% q/q rise in real GDP in the period April to June, being followed by a contraction of up to 1% in the second half of 2023.

The 0.4% m/m rebound in retail sales volumes in August is not as good as it looks as it partly reflected a pickup in sales after the unusually wet weather in July. Sales volumes in August were 0.2% below their level in May, suggesting much of the resilience in retail activity in the first half of the year has faded.

As the growing drag from higher interest rates intensifies over the next six months, we think the economy will continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year. And with CPI inflation past its peak and expected to decline further, the economy has got through the cost-of- living crisis without recession. But even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. We expect the Bank of England to keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.

The tightness of the labour market continued to ease, with employment in the three months to July falling by 207,000. The further decline in the number of job vacancies from 1.017m in July to 0.989m in August suggests that the labour market has loosened a bit further since July. That is the first time it has fallen below 1m since July 2021. At 3.0% in July, and likely to have fallen to 2.9% in August, the job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth. Meanwhile, the 48,000 decline in the supply of workers in the three months to July offset some of the loosening in the tightness of the labour market. That was due to a 63,000 increase in inactivity in the three months to July as more people left the labour market due to long term sickness or to enter education. The supply of labour is still 0.3% below its pre-pandemic February 2020 level.

But the cooling in labour market conditions still has not fed through to an easing in wage growth. While the monthly rate of earnings growth eased sharply from an upwardly revised +2.2% in June to -0.9% in July, a lot of that was due to the one-off bonus payments for NHS staff in June not being repeated in July. The headline 3myy rate rose from 8.4% (revised up from 8.2%) to 8.5%, which meant UK wage growth remains much faster than in the US and in the Euro-zone. Moreover, while the Bank of England's closely watched measure of regular private sector wage growth eased a touch in July, from 8.2% 3myy in June to 8.1% 3myy, it is still well above the Bank of England's prediction for it to fall to 6.9% in September.

CPI inflation declined from 6.8% in July to 6.7% in August, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.2%. That reverses all the rise since March and means the gap between the UK and elsewhere has shrunk (US core inflation is 4.4% and in the Euro-zone it is 5.3%). Core goods inflation fell from 5.9% to 5.2% and the further easing in core goods producer price inflation, from 2.2% in July to a 29-month low of 1.5% in August, suggests it will eventually fall close to zero. But the really positive development was the fall in services inflation from 7.4% to 6.8%. That also reverses most of the rise since March and takes it below the forecast of 7.2% the Bank of England published in early August.

In its latest monetary policy meeting on 20 September, the Bank of England left interest rates unchanged at 5.25%. The weak August CPI inflation release, the recent loosening in the labour market and the downbeat activity surveys appear to have convinced the Bank of England that it has already raised rates far enough. The minutes show the decision was "finely balanced". Five MPC members (Bailey, Broadbent, Dhingra, Pill and Ramsden) voted for no change and the other four (Cunliffe, Greene, Haskel and Mann) voted for a 25bps hike.

Like the US Fed, the Bank of England wants the markets to believe in the higher for longer narrative. The statement did not say that rates have peaked and once again said if there was evidence of more persistent inflation pressures "further tightening in policy would be required". Governor Bailey stated, "we'll be watching closely to see if further increases are needed". The Bank also retained the hawkish guidance that rates will stay "sufficiently restrictive for sufficiently long".

This narrative makes sense as the Bank of England does not want the markets to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments. A rebound in services inflation, another surge in wage growth and/or a further leap in oil prices could conceivably force it to raise rates at the next meeting on 2nd November, or even pause in November and raise rates in December.

The yield on 10-year Gilts fell from a peak of 4.74% on 17th August to 4.44% on 29th September, mainly on the back of investors revising down their interest rate expectations. But even after their recent pullback, the rise in Gilt yields has exceeded the rise in most other Developed Market government yields since the start of the year. Looking forward, once inflation falls back, Gilt yields are set to reduce further. A (mild) recession over the next couple of quarters will support this outlook if it helps to loosen the labour market (higher unemployment/lower wage increases).

The pound weakened from its cycle high of $1.30 in the middle of July to $1.21 in late September. In the first half of the year, the pound bounced back strongly from the Truss debacle last autumn. That rebound was in large part driven by the substantial shift up in UK interest rate expectations. However, over the past couple of months, interest rate expectations have dropped sharply as inflation started to come down, growth faltered, and the Bank of England called an end to its hiking cycle.

The FTSE 100 has gained more than 2% since the end of August, from around 7,440 on 31st August to 7,608 on 29th September. The rebound has been primarily driven by higher energy prices which boosted the valuations of energy companies. The FTSE 100's relatively high concentration of energy companies helps to explain why UK equities outperformed both US and Euro-zone equities in September. Nonetheless, as recently as 21st April the FTSE 100 stood at 7,914.