Treasury Management Half Year Report 2022-23

Introduction

The Authority has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports. This report provides an additional update.

The Authority's treasury management strategy for 2022/23 was approved at a meeting on Wednesday 23rd February 2022 The Authority borrows and invests substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.

CIPFA published its revised Treasury Management Code of Practice [the TM Code] and Prudential Code for Capital Finance in December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments. The principles within the two Codes took immediate effect although local authorities could defer introducing the revised reporting requirements within the revised Codes until the 2023/24 financial year if they wish which the Authority has elected to do.

Treasury risk management at the Authority is conducted within the framework of the TM Code. This Code now also includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version.

External Context

Economic background: The ongoing conflict in Ukraine has continued to put pressure on global inflation and the economic outlook for UK and world growth remains weak. The UK political situation towards the end of the period following the 'fiscal event' increased uncertainty further.

The economic backdrop during the April to September period continued to be characterised by high oil, gas and commodity prices, ongoing high inflation and its impact on consumers' cost of living, no imminent end in sight to the Russia-Ukraine hostilities and its associated impact on the supply chain, and China's zero-Covid policy.

Central Bank rhetoric and action remained robust. The Bank of England, Federal Reserve and the European Central Bank all pushed up interest rates over the period and committed to fighting inflation, even when the consequences were in all likelihood recessions in those regions.

UK inflation remained extremely high. Annual headline CPI hit 10.1% in July, the highest rate for 40 years, before falling modestly to 9.9% in August. RPI registered 12.3% in both July and August. The energy regulator, Ofgem, increased the energy price cap by 54% in April, while a further increase in the cap from October, which would have seen households with average energy consumption pay over £3,500 per annum, was dampened by the UK government stepping in to provide around £150 billion of support to limit bills to £2,500 annually until 2024.

The labour market remained tight through the period but there was some evidence of easing demand and falling supply. The unemployment rate 3m/year for April fell to 3.8% and declined further to 3.6% in July. Although now back below pre-pandemic levels, the recent decline was driven by an increase in inactivity rather than demand for labour. Pay growth in July was 5.5% for total pay (including bonuses) and 5.2% for regular pay. Once adjusted for inflation, however, growth in total pay was -2.6% and –2.8% for regular pay.

With disposable income squeezed and higher energy bills still to come, consumer confidence fell to a record low of –44 in August, down –41 in the previous month. Quarterly GDP fell -0.1% in the April-June quarter driven by a decline in services output, but slightly better than the 0.3% fall expected by the Bank of England.

The Bank of England increased the official Bank Rate to 2.25% over the period. From 0.75% in March, the Monetary Policy Committee (MPC) pushed through rises of 0.25% in each of the following two MPC meetings, before hiking by 0.50% in August and again in September. August's rise was voted by a majority of 8-1, with one MPC member preferring a more modest rise of 0.25%. the September vote was 5-4, with five votes for an 0.5% increase, three for an 0.75% increase and one for an 0.25% increase. The Committee noted that domestic inflationary pressures are expected to remain strong and so given ongoing strong rhetoric around tackling inflation further Bank Rate rises should be expected.

On 23rd September the UK government, following a change of leadership, announced a raft of measures in a 'mini budget', loosening fiscal policy with a view to boosting the UK's trend growth rate to 2.5%. With little detail on how government borrowing would be returned to a sustainable path, financial markets reacted negatively. Gilt yields rose dramatically by between 0.7% - 1% for all maturities with the rise most pronounced for shorter dated gilts. The swift rise in gilt yields left pension funds vulnerable, as it led to margin calls on their interest rate swaps and risked triggering large scale redemptions of assets across their portfolios to meet these demands. It became necessary for the Bank of England to intervene to preserve market stability through the purchase of long-dated gilts, albeit as a temporary measure, which has had the desired effect with 50-year gilt yields falling over 100bps in a single day.

Bank of England policymakers noted that any resulting inflationary impact of increased demand would be met with monetary tightening, raising the prospect of much higher Bank Rate and consequential negative impacts on the housing market.

After hitting 9.1% in June, annual US inflation eased in July and August to 8.5% and 8.3% respectively. The Federal Reserve continued its fight against inflation over the period with a 0.5% hike in May followed by three increases of 0.75% in June, July and September, taking policy rates to a range of 3% - 3.25%.

Eurozone CPI inflation reached 9.1% y/y in August, with energy prices the main contributor but also strong upward pressure from food prices. Inflation has increased steadily since April from 7.4%. In July the European Central Bank increased interest rates for the first time since 2011, pushing its deposit rate from –0.5% to 0% and its main refinancing rate from 0.0% to 0.5%. This was followed in September by further hikes of 0.75% to both policy rates, taking the deposit rate to 0.75% and refinancing rate to 1.25%.

Financial markets: Uncertainty remained in control of financial market sentiment and bond yields remained volatile, continuing their general upward trend as concern over higher inflation and higher interest rates continued to dominate. Towards the end of September, volatility in financial markets was significantly exacerbated by the UK government's fiscal plans, leading to an acceleration in the rate of the rise in gilt yields and decline in the value of sterling.

Due to pressure on pension funds, the Bank of England announced a direct intervention in the gilt market to increase liquidity and reduce yields.

Over the period the 5-year UK benchmark gilt yield rose from 1.41% to 4.40%, the 10-year gilt yield rose from 1.61% to 4.15%, the 20-year yield from 1.82% to 4.13% and the 50-year yield from 1.56% to 3.25%. The Sterling Overnight Rate (SONIA) averaged 1.22% over the period.

Credit review:

In July, Fitch and Moody's changed the outlook on a variety of bank and counterparties, with various counterparties changing from a stable to a negative outlook due to the increasing economic pressures coupled with higher inflation and interest rates.

The Council's treasury advisors Arlingclose continue to advise that the authority does not change the counterparties for any of its current investments, none of the counterparties have had any financial warnings or unexpected changes in investment balances and operations.

The only exception to this in the CCLA Property Fund (LAMIT). As a property fund, to prevent a lowering in interest rates for the fund due to the current economic fear, CCLA have imposed a six month notice period on the withdrawal of any funds. Previously this was two months in line with most other investment counterparties. Due to CCLA Property Fund providing one of the highest returns of all current investment options, current advice is not to carry out any action following this change. The Council currently has £5m invested with this fund out of a total of £32 of Pooled Fund investment. This fund provides an interest rate of 5.01% as of the 30th September 2022.

Arlingclose continued to monitor and assess credit default swap levels for signs of credit stress but made no changes to the counterparty list or recommended durations. Nevertheless, increased market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list remains under constant review.

Local Context

On 31st March 2022, the Authority had net investments of £45.28m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment.

The treasury management position on 30th September 2022 and the change over the six months is shown in Table 2 below.

Treasury Management Summary

	31.3.22 Balance £m	Movement £m	30.9.22 Balance £m	30.9.22 Rate %
Long-term borrowing	0.000	0.000	0.000	0.00
Short-term borrowing	13.000	-6.000	7.000	3.01
Total borrowing	**13.000**	**-6.000**	**7.000**	**3.01**
Long-term investments	32.000	0.000	32.000	3.86
Short-term investments	10.770	-9.570	1.200	2.09
Total investments	**42.770**	**-9.570**	**33.200**	**3.80**
Net Investments	**29.770**	**-3.570**	**26.200**	**0.79**

The amount of short-term investments is significantly lower than as at the end of March 2022. This is because short term cash has been used to pay off borrowing from previous financial year. There was a large amount of borrowing at the end of the 2021-22 financial year due to the Council's requirement to repay £8.9m of COVID grant funding to central government.

Although excess borrowing has now been paid off. The Council still holds an amount of short-term borrowing, there is a constant requirement of approximately £5m of short term borrowing that is required for the Council's regular day to day operation.

The Finance team is currently undergoing a review of its Pooled Funds holdings to determine whether some long term investments should be sold to finance some, or all, of this short term borrowing requirement. This position is also determined by how much Council Tax and Business Rates is due for repayment to Norfolk County Council in the 2023-24 financial year, these repayment figures will not be known until January 2023 so a decision is not expected to be made before this time. An additional consideration to these Pooled funds will be whether the current accounting statutory over-ride continues past 31-03-2023, this over-ride results in any gains or losses in these Pooled funds to be outside of the General Fund and therefore an accounting entry rather then a real cash impact until such time the funds are actually withdrawn. This over-ride is currently under consultation and the results will be considered along with the overall review of the Pooled funds invested, in order to minimise the risk to the Councils general fund.

Due to the economic changes outlined in the **Local Context** above interest rates, it can be seen from the above table that borrowing rates have increased significantly (previously 0.36% as at 31/03/2022, increase of 2.65%). The Council's interest rates have also increased (previously 2.25% as at 31/03/2022, an increase of 1.55%).
As can be seen from the above, borrowing rates are rapidly increasing due to changes by in the Base Rate by The Monetary Policy Committee (MPC). The base rate is increasing at a rate of 0.5-0.75% every two months with the current economic crisis. Interest rates will increase too, but at a slower pace than the borrowing rate.

With the gap between the borrowing and interest rates narrowing, the current recommendation from the Council's Treasury Advisors is to hold back on any unnecessary capital expenditure, and instead focus on maintaining normal functions plus budgeting for increases in revenue costs around pay scales and energy usage. The current prediction is for rates to start to recover from May 2023, with more "normal" rates being assumed by December 2023.

Borrowing

CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority.

PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield the Authority does not intends to invest for yield or obtain commercial assets, and therefore will retain its access to PWLB loans if required.

The Council mainly sources its borrowing through brokers (Arlingclose and Tradition) to borrow only from other Local Government Authorities / Police Authorities / Pension Funds and Fire Services. The Council takes measures to blacklist any of the above that are deemed to be at financial risk.

Borrowing Strategy and Activity

As outlined in the treasury strategy, the Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

Over the April-September period short term PWLB rates rose dramatically, particularly in late September after the Chancellor's 'mini-budget', included unfunded tax cuts and additional borrowing to fund consumer energy price subsidies. Exceptional volatility threatened financial stability, requiring Bank of England intervention in the gilt market. Over a twenty-four-hour period some PWLB rates increased to 6%, before the intervention had the desired effect, bringing rates back down by over 1% for certain maturities. A truly wild and unprecedented period in fixed income markets, with a direct impact on PWLB rates.

Interest rates rose by over 2% during the period in both the long and short term. As an indication the 5-year maturity certainty rate rose from 2.30% on 1st April to 5.09% on 30th September; over the same period the 30-year maturity certainty rate rose from 2.63% to 4.68%

The impact of the increased borrowing rates for the Council has been explained above under the Treasury Management Strategy.

At 30th September the Authority held £7m of short-term loans, a decrease of £6m from 31st March 2022, as part of its strategy for funding the current years' capital programme. Outstanding short-term loans on 30th September are summarised in the table below.

Borrowing Position

	31.3.21 Balance £m	Net Movement £m	31.3.22 Balance £m	31.3.22 Weighted Average Rate %	31.3.22 Weighted Average Maturity (years)
Local authorities (short-term)	13.00	-6.00	7.00	3.01	<1
Total borrowing	**13.00**	**-6.00**	**7.00**	**3.01**	**<1**

The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short-term borrowing was maintained with no long-term borrowing.

At the current time, it is still believed that short term borrowing from other government bodies provides the required funds at the lowest interest rates available without having to lock in borrowing for an extended period of time, which would result in a higher overall cost of borrowing. Therefore the treasury function will continue to borrow as it has done for the previous financial years.

With the lower amount of liquidity during the current financial year, borrowing has been the main source of funding additional payments outside of the approved budgets. As outlined above, the Council is considering selling Pooled Funds if levels of liquidity are not predicted to increase through general operations during the next financial year.

Treasury Investment Activity

CIPFA revised TM Code defines treasury management investments as those which arise from the Authority's cash flows or treasury risk management activity that ultimately represents balances which need to be invested until the cash is required for use in the course of business.

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £35.4 and £54.3 million due to timing differences between income and expenditure. The investment position is shown in the table below.

Treasury Investment Position

	31.3.22 Balance £m	Net Movement £m	30.9.22 Balance £m	31.9.22 Income Return %
Money market Funds	10.770	-9.570	1.200	2.09
Other Pooled Funds.				
- *Cash plus funds*	3.000	0.000	3.000	0.98
- *Short-dated bond funds*	3.000	0.000	3.000	0.51
- *Strategic bond funds*	5.000	0.000	5.000	2.71
- *Equity income funds*	8.000	0.000	8.000	5.01
- *Property funds*	5.000	0.000	5.000	5.01
- *Multi asset income funds*	8.000	0.000	8.000	5.07
Total investments	**42.770**	**-9.570**	**33.200**	**3.80**

Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

The increases in Bank Rate over the period under review, and with the prospect of more increases to come, short-dated cash rates, which had ranged between 0.7% - 1.5% at the end of March, rose by around 1.5% for overnight/7-day maturities and by nearly 3.5% for 9-12 month maturities.

By end September, the rates on DMADF deposits ranged between 1.85% and 3.5%. The return on the Council's sterling low volatility net asset value (LVNAV) Money Market Funds was 0.5% in early April and reached 2.09% at the end of September

The Council has maintained using Money Market Funds as its main investment option for day to day funds, these have allowed for flexibility with the treasury funds available whilst still allowing for some interest to be earnt.

Following the Council's treasury advisors mid-term review of its local authorities financial positions, North Norfolk District Council has maintained its gold standard, meaning it is still in the top 5% of authorities for cash and investment management.

Financial Strength Rating

Debt	0.4
Interest	1.3
Income	0.1
Reserves	0.8
Budget	1.2
Financial Strength	Gold

Updated: 29/09/2022

Externally Managed Pooled Funds: £32m of the Authority's investments is invested in externally managed strategic pooled equity, property and bank funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generated a total return of £620k with an average rate of 3.86%. This return accounts for 86% of the Council's total investment income, with £48.2k being earnt by Money Market Funds (6.7% of total investment income) and £46k being earnt by non-treasury investments (6.4% of total investment income).

The April-September period was a very difficult environment for bonds engendered by global central banks' determination to bring high and persistent inflation under control through increases in policy rates and strong rhetoric. The sell-off in gilts, other sovereign bonds and corporate bonds with a rise in gilt/bond yields (i.e. a fall in price) was reflected in the Authority's investments. The increase in policy rates in the UK, US and Eurozone and the prospect of low to no growth and a recessionary period ahead was also a challenging period for equities, the FTSE All Share index falling from 4187 on 31st March to 3763 on 30th September, whilst the MSCI World Index fell from 3053 to 2378 over the same period.

Significant financial market volatility and uncertainty remain due to stagflation fears, little sight of the war in Ukraine ending soon and ongoing supply chain issues, a lingering problem over the past 30 months, yet to be fully resolved.

Because these funds have no defined maturity date, but are available for withdrawal after a notice period (typically 100 days, apart from the LAMIT which has increased to six months from 26th September 2022) their performance and continued suitability in meeting the Authority's medium- to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates.

The Authority had budgeted £532k income from Pooled Fund investments in 2022/23. Income received to the end of period six is £620k.

Non-Treasury Investments

The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) and Welsh Government also includes within the definition of investments all such assets held partially or wholly for financial return.

The Authority also held £2.850m of such investments in:

- Directly owned property £0.390m
- loans to housing associations £2.460m

A full list of the Authority's non-treasury investments is below:

- Grove Lane Depot, Holt, Norfolk – Valued at £389,700 (4.49% fixed interest rate)
- Loan to Broadland Housing Association – Outstanding value of £2,288,465 (3.80%)
- Loan to Homes for Wells – Outstanding value of £171,645 (3.00%)

These investments have generated £46,055.68 of investment income for the Authority, representing a rate of return of 3.74%.

Treasury Performance

The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in the table below.

Performance

	Actual £m	Budget £m	Over/ under	Avg. Interest Rate %	Over/ under
Short-term Borrowing from other LAs	0.0053	0.0073	Under	3.01	Under
Long-term Borrowing	0.0000	0.0000	Under	N/A	Under
Total borrowing	**0.0077**	**0.1546**	**Under**	**0.36**	**Under**
Money Market Fund	0.0048	0.0001	Over	2.09	Over
Pooled Funds	0.6200	0.5320	Over	3.86	Over
Total treasury investments	**0.6683**	**0.5324**	**Over**	**3.80**	**Over**

Compliance

The Temporary s151 officer reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in the table below.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in the table below.

Debt Limits

	2022/23 (Half Year) Maximum £	30.9.22 Actual £	2022/23 Operational Boundary £	2022/23 Authorised Limit £	Complied? Yes/No
Borrowing	13.000m	7.000m	23.530m	28.400m	Yes
Total debt	**13.000m**	**7.000m**	**23.530m**	**28.400m**	Yes

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

Investment Limits

	2022/23 Half-Year Maximum	30.9.22 Actual	2022/23 Limit	Complied? Yes/No
Local authorities & other government entities	nil	nil	Unlimited	Yes
Secured investments	nil	nil	Unlimited	Yes
Banks (unsecured)	nil	nil	£5m	Yes
Building societies (unsecured)	nil	nil	£5m	Yes
Registered providers (unsecured)	nil	nil	£10m	Yes
Money market funds	£20m	£1.2m	£20m	Yes
Strategic pooled funds	£32m	£32m	Unlimited	Yes
Real estate investment trusts	nil	nil	£10m	Yes
The UK Government	nil	nil	Unlimited	Yes
Other investments	nil	nil	£5m	Yes
Any group of pooled funds under the same management	£7m	£7m	£15m	Yes

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	30.9.22 Actual	2022/23 Target	Complied?
Portfolio average credit score	4.71 (A+)	6.0	Yes

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	30.9.22 Actual	2022/23 Target	Complied?
Total sum borrowed in past 3 months without prior notice	£0	£10m	Yes

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	30.9.22 Actual	2022/23 Limit	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£332k	£600k	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£332k	£600k	£Yes

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	30.9.22 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	100%	100%	0%	Yes
12 months and within 24 months	0%	100%	0%	Yes
24 months and within 5 years	0%	100%	0%	Yes
5 years and within 10 years	0%	100%	0%	Yes
10 years and above	0%	100%	0%	Yes

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment

Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2022/23	**2023/24**	**2024/25**
Actual principal invested beyond year end	£32m	£32m	£32m
Limit on principal invested beyond year end	£50m	£50m	£50m
Complied?	Yes	Yes	Yes

Arlingclose's Economic Outlook for the remainder of 2022/23 (based on 26th September 2022 interest rate forecast)

	Current	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	2.25	4.25	5.00	5.00	5.00	5.00	5.00	5.00	5.00	4.75	4.25	3.75	3.25
Downside risk	0.00	-1.00	-1.00	-0.75	-0.50	-0.50	-0.50	-0.75	-1.25	-1.50	-1.75	-1.75	-1.75

Arlingclose expects Bank Rate to rise further during 2022/23 to reach 5% by the end of the year.

The MPC is particularly concerned about the demand implications of fiscal loosening, the tight labour market, sterling weakness and the willingness of firms to raise prices and wages.

The MPC may therefore raise Bank Rate more quickly and to a higher level to dampen aggregate demand and reduce the risk of sustained higher inflation. Arlingclose now expects Bank Rate to peak at 5.0%, with 200bps of increases this calendar year. This action by the MPC will slow the economy, necessitating cuts in Bank Rate later in 2024.

Gilt yields will face further upward pressure in the short term due to lower confidence in UK fiscal policy, higher inflation expectations and asset sales by the BoE. Given the recent sharp rises in gilt yields, the risks are now broadly balanced to either side. Over the longer term, gilt yields are forecast to fall slightly over the forecast period.

Background:

Monetary policymakers are behind the curve having only raising rates by 50bps in September. This was before the "Mini-Budget", poorly received by the markets, triggered a rout in gilts with a huge spike in yields and a further fall in sterling. In a shift from recent trends, the focus now is perceived to be on supporting sterling whilst also focusing on subduing high inflation.

There is now an increased possibility of a special Bank of England MPC meeting to raise rates to support the currency. Followed by a more forceful stance over concerns on the looser fiscal outlook. The MPC is therefore likely to raise Bank Rate higher than would otherwise have been necessary given already declining demand. A prolonged economic downturn could ensue.

Uncertainty on the path of interest rates has increased dramatically due to the possible risk from unknowns which could include for instance another Conservative leadership contest, a general election, or further tax changes including implementing windfall taxes.

The government's blank cheque approach to energy price caps, combined with international energy markets priced in dollars, presents a fiscal mismatch that has contributed to significant decline in sterling and sharp rises in gilt yields which will feed through to consumers' loans and mortgages and business funding costs.

UK government policy has mitigated some of the expected rise in energy inflation for households and businesses flattening the peak for CPI, whilst extending the duration of elevated CPI. Continued currency weakness could add inflationary pressure. The UK economy already appears to be in recession, with business activity and household spending falling. The short- to medium-term outlook for the UK economy is relatively bleak.

Global bond yields have jumped as investors focus on higher and stickier US policy rates. The rise in UK government bond yields has been sharper, due to both an apparent decline in investor confidence and a rise in interest rate expectations, following the UK government's shift to borrow to loosen fiscal policy. Gilt yields will remain higher unless the government's plans are perceived to be fiscally responsible. The housing market impact of increases in the Base Rate could act as a "circuit breaker" which stops rates rising much beyond 5.0%, but this remains an uncertainty.