Audit and Governance Committee
30th July 2026

EXECUTIVE HEAD OF FINANCE
REPORT NO: FIN2616

TREASURY MANAGEMENT AND NON-TREASURY INVESTMENT OPERATIONS 2026/27 – Quarter 1

SUMMARY:
This report sets out the activities of the Treasury Management and non-Treasury Investment Operations for quarter 1 in the financial year 2026/27, and reports on compliance with Prudential Indicators.

RECOMMENDATIONS:
Members are requested to:

(i) Make any recommendations, as appropriate, to the Cabinet on the contents of this report in relation to the treasury management and non-treasury investment operations carried out.

1. INTRODUCTION

1.1 This report sets out the Treasury Management and Non-Treasury Investment operation performance for Quarter 1 2026/27. This report is a statutory requirement under the CIPFA Code of Practice on Treasury Management.

1.1 Full Council approved the Annual Treasury Management Strategy and Non-Treasury Investment Strategy for the financial year 2026/27 in February 2026. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management 2021 ("the Code") and is fully incorporated into the Council's adopted strategy.

2. PURPOSE

2.1 This report sets out compliance with the strategy and performance against Prudential Indicators to the end of June 2025/26 within appendices (1-4):

<u>**Appendix 1**</u>

- The **Treasury Management operations** which sets out how the Council's treasury service operated during the period to June 2026;
- The **Treasury Management Borrowing** which sets out the Council's borrowing during the period to June 2026, and;
- The **Treasury Management Investments** which sets out the Council's Treasury Management investment operations for the period to June 2026.

Appendix 2

- the **Prudential indicators** performance is compared to the indicators set out in the Annual Capital Strategy for the year 2026/27.

Appendix 3

- The list of borrowing counterparties as at end of June 2026.

Appendix 4

- Market commentary regarding from the Council's treasury management advisors Arlingclose

3 BACKGROUND

3.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) have issued guidance on the aims and requirements of a Capital Strategy focusing on a whole organisation approach to prudent, sustainable, and resilient local government investment.

3.2 CIPFA have also issued two professional Codes of Practice to which the Council is required to "have regard to". These Codes provide frameworks that are designed to support local strategic planning, local asset management planning and proper option appraisal:

- The Prudential Code – developed to support local authorities in taking decisions around their capital investment programmes. The objectives of the Prudential Code are to ensure, within a clear reporting framework, that a local authority's capital expenditure plans and investment plans are affordable and proportionate; that all external borrowing and other long-term liabilities are within prudent and sustainable levels; that the risks associated with investments for commercial purposes are proportionate to their financial capacity; and that treasury management decisions are taken in accordance with good professional practice.
- The Treasury Management Code - Treasury Management is defined as 'The management of the organisation's borrowing, investments, and cash flows, including its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks'.

3.3 The primary purpose of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed to deliver the Councils services. The secondary function of the treasury management operation is the funding of the Council's capital programme and manage cashflow requirements over a longer-term period.

3.4 Non-treasury investment operations should ensure that all investments made primarily for service reasons. Then, second to this, the function of investment management is to generate returns.

3.5 This quarterly report provides an additional update and includes the requirement in the 2021 Code of quarterly reporting of the treasury management prudential indicators.

4 CONCLUSIONS ON THE TREASURY MANAGEMENT AND NON-TREASURY INVESTMENT OPERATIONS DURING Q1 2026/27

4.1 All treasury activity was conducted within the approved Treasury Management Practices (TMP's).

4.2 Borrowing maturity has now moved towards longer term to give cost certainty and lower interest rate exposure risk, providing more interest rate stability on borrowing.

5 KEY RISKS

5.1 The Council has borrowed 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.

5.2 The key risks to the Councils delivery of successful treasury and non-treasury investment options include:

- Inflation levels
  Inflation rates are now reducing after a prolonged period of increased levels.
- Bank of England Base rate
  Base rate is at 3.75% with a change in predictions recently from a slow reduction to maintaining this level if not having a slight increase.
- Delivery of Capital Programme
  Will impact borrowing requirements and timing will impact rates achievable for both borrowing and investments during the years

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Treasury Management Report Q1- 2026/27

Introduction

The Council applies the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code). This quarterly report provides an update of the treasury management prudential indicators. The non-treasury prudential indicators are included in Appendix 2.

The Council's treasury management strategy for 2026/27 was approved at the Council meeting on 26th February 2026. The Council has borrowed and invested 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 Council's treasury management strategy.

Local Context

On 31st March 2026, the Council had net borrowing of £149m 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), in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.26 Actual £m**	**31.3.27 Forecast £m**
General Fund CFR	174.1	157.1
Less: Other debt liabilities (leases)	0.3	0.3
Borrowing CFR	**173.8**	**156.8**
External borrowing*	149.0	100.0

* shows only loans to which the Authority is committed and excludes optional refinancing.

** Actual figures are subject to change until the accounts are signed off by the external auditors, EY.

The treasury management position at 30th June 2026 and the change over the quarter is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.26 Balance £m	Movement £m	30.06.26 Balance £m	30.06.26 Rate %
Long-term borrowing				
- Other (local authorities)	10.0	20.0	30.0	4.46
- PWLB	65.0	-	65.0	4.58
Short-term borrowing				
- Other (local authorities)	12.0	(12.0)	-	N/A
- PWLB	62.0	(30.0)	32.0	4.90
Total borrowing	**149.0**	**(22.0)**	**127.0**	
Long-term investments	13.0	-	13.0	7.52
Short-term investments	13.0	(13.0)	-	N/A
Cash and cash equivalents	8.0	2.4	10.4	3.51
Total investments	**34.0**	**(10.6)**	**23.4**	
Net borrowing	**115.0**	**(11.4)**	**103.6**	

Borrowing Strategy and Activity

As outlined in the treasury strategy, the Authority's chief objective when borrowing has been to strike an appropriate risk balance between securing lower 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.

Gilt yields have moved about during the period but overall have decreased slightly. Oil prices have reduced and inflationary figures in the UK have not risen by as much as markets initially expected. Concerns about the tepid UK economy have also lessened expectations of future rate rises which has lowered gilt yields.

The PWLB certainty rate for 5-year maturity loans was 5.16% at the beginning of the period and 5.07% at the end. The lowest available 5-year maturity certainty rate was 5.04% and the highest was 5.49%. In contrast rates for 20-year maturity loans ranged from 6.02% to 6.50% during the period, and 50-year maturity loans from 5.89% to 6.35%. After coming down from a characteristic spike seen around financial year end, the cost of short-term borrowing from other local authorities has remained a little above Base Rate, at between 4.0% and 4.5%, throughout the period.

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 unless these loans are for refinancing purposes. The Authority has no new plans to borrow to invest primarily for financial return.

The Council currently holds £132m in commercial property investments of which the majority were primarily for financial return and were purchased prior to the change in the CIPFA Prudential Code. Before undertaking further additional borrowing the Council will review the options for exiting these investments.

Loans Portfolio

At 30th June 2026 the Council held £127m of loans, (a decrease of £22m on 31st March 2026), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30th June 2026 are summarised in Table 3A below.

Table 3A: Borrowing Position

	31.3.26 Balance £m	Net Movement £m	30.06.26 Balance £m	30.06.26 Weighted Average Rate %
Local authorities (long-term)	10.0	20.0	30.0	4.46
Local authorities (short-term)	12.0	(12.0)	-	N/A
PWLB (short-term)	62.0	(30.0)	32.0	4.90
PWLB (long-term)	65.0		65.0	4.58
Total borrowing	**149.0**	**22.0**	**127.0**	

The average rate on the Council's short-term loans at 30th June 2026 4.90%, this compares with 4.58% 3 months ago.

Table 3B: Long-dated Loans borrowed

	Amount £m	Rate %	Period (Years)
Torbay Borough Council	5.0	4.50	4
PWLB Maturity Loan	65.0	4.58	1.5-4
Basingstoke and Deane Borough Council	10.0	4.50	2
West Midlands Combined Authority	10.0	4.50	2
South Yorkshire Mayoral Combined Authority	5.0	4.45	3
Total borrowing	**95.0**		

The Council's new borrowing decisions to replace existing borrowing as current loans mature are determined by a cashflow projection.

Forward starting loans

No forward starting loans have been arranged this quarter.

There remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields + 0.80%. The Authority will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.

Treasury Investment Activity

The CIPFA Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (revised in 2021) defines treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

The Council holds some invested funds, representing income received in advance of expenditure plus balances and reserves held. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.26 Balance £m	Net Movement £m	30.06.26 Balance £m	30.06.26 Income Return %
Banks & building societies	0.1	-	0.1	3.51
Local authorities	13.0	(13.0)	-	N/A
Money Market Funds	5.9	4.4	10.3	3.81
Other Pooled Funds				
- *Strategic bond funds*	6.0	-	6.0	4.91
- *Equity income funds*	5.0	-	5.0	10.45
- *Multi asset income funds*	2.0	-	2.0	6.64
Total investments	**32.0**	**(8.6)**	**23.4**	

Both the CIPFA Code and government guidance require the Council 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 Council'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.

As demonstrated by the liability benchmark in this report, the Council expects to be a long-term borrower and new treasury investments are therefore primarily made to manage day-to-day cash flows using short-term low risk instruments. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different sectors and boost investment income.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2026 30.06.2026	4.66 4.72	A+ A+	32% 100%	9 1	7.10 7.07
Similar LAs **All LAs**	**4.61** **4.59**	**A+** **A+**	**65%** **66%**	**47** **11**	**4.37** **4.21**

Externally Managed Pooled Funds
£13m of the Council's investments is invested in externally managed strategic pooled funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability.

Most major asset classes delivered positive returns over quarter 1 of 2026/27, although markets remained volatile and sensitive to geopolitical developments, energy prices and changing expectations for interest rates. The quarter generally represented a recovery from the weakness seen towards the end of 2025/26, when markets were unsettled by the escalation of conflict between the US, Israel and Iran. As tensions in the Middle East began to ease and oil prices fell back, investor sentiment improved and most asset prices recovered.

The Council has budgeted £850k income from these investments in 2026/27. Income received up to 30th June was £225k. The change in the Authority's funds' capital values and income return over the 3-month period is shown in Table 4.

Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council'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 minimum period total returns will exceed cash interest rates.

Statutory override

Further to consultations in April 2023 and December 2024 MHCLG wrote to finance directors in England in February 2025 regarding the statutory override on accounting for gains and losses in pooled investment funds. On the assumption that when published regulations follow this policy announcement, the statutory override will be extended up until the 1st April 2029 for investments already in place before 1st April 2024. The override will not apply to any new investments taken out on or after 1st April 2024. The Authority had set up a reserve of £1m to mitigate the impact of the statutory override not being extended. Given current budgetary pressures and the extension of the override the authority decided to release this reserve in the prior financial year.

Non-Treasury Investments

The definition of investments in the Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council 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 Ministry of Housing, Communities and Local Government (MHCLG) also broadens the definition of investments to include all such assets held partially or wholly for financial return.

The Council also held £138.8m of such investments in:

- directly owned property £132m
- loans to local businesses and landlords £4.5m
- subsidiaries £2.3m

A full list of the Council's non-treasury investments is available.

Treasury Performance

The Council 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.

Compliance

The S151 Officer reports that all treasury management activities undertaken during the year complied fully with the principles in the Treasury Management Code and the Council's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 6 below.

Table 6: Investment Limits

	30.06.26 Actual	2026/27 Limit	Complied?
Any group of pooled funds under the same management	0	15	Yes
Negotiable instruments held in a broker's nominee account	0	15	Yes
Limit per foreign countries	0	6	Yes

Compliance with the Authorised Limit and Operational Boundary for external debt is demonstrated in table 7 below.

Table 7: Debt and the Authorised Limit and Operational Boundary

	30.06.26 Actual	2026/27 Operational Boundary	2026/27 Authorised Limit	Complied?
Borrowing	127	150	180	Yes
Leases	0.6	1.8	2	Yes
Total debt	**127.6**	**151.8**	**182**	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.

Treasury Management Prudential Indicators

As required by the 2021 CIPFA Treasury Management Code, the Council monitors and measures the following treasury management prudential indicators.

1. Liability Benchmark

This indicator compares the Council's actual existing borrowing against a liability benchmark that has been calculated to show the lowest risk level of borrowing. The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. It represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level of £18m. This incorporates £13m invested in strategic pooled funds, that cannot be sold at short notice, and an additional £5m liquidity buffer to manage day-to-day cash flow requirements.

	31.3.26 Actual	31.3.27 Forecast	31.3.28 Forecast
Loans CFR	173.8	156.8	156.9
Less: Balance sheet resources	(41.1)	(39.8)	(40.3)
Net loans requirement	132.7	117.0	116.6
Plus: Liquidity allowance	18	18	18
Liability benchmark	**150.7**	**135.0**	**134.6**
Existing borrowing	**149.0**	**100.0**	**90.0**

The Liability Benchmark indicated the minimum amount of external borrowing required each year to ensure the council has sufficient money to pay its bills. Actual borrowing is usually above the liability benchmark to account for variation in the councils cashflow requirements, borrowing will also be taken out in advance of maturing debt when interest rates are favourable.

2. Maturity Structure of Borrowing

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

	Upper Limit	Lower Limit	30.06.26 Actual	Complied?
Under 12 months	100%	0%	25%	Yes
12 months and within 24 months	100%	0%	47%	Yes
24 months and within 5 years	100%	0%	28%	Yes
5 years and within 10 years	100%	0%	0%	Yes
10 years and above	100%	0%	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.

3. Long-term Treasury Management Investments

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management limits are:

	2026/27	2027/28	2028/29
Limit on principal invested beyond year end	£30m	£30m	£20m
Actual principal invested beyond year end	£13m	£13m	£13m
Complied?	Yes	Yes	Yes

Long-term investments with no fixed maturity date include strategic pooled funds, real estate investment trusts and directly held equity but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

Additional indicators

Security

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating and 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.

	2026/27 Target	30.06.26 Actual	Complied?
Portfolio average credit rating	A+	A+	Yes
Portfolio average credit score	5.0	4.64	Yes

Liquidity

The Council 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.

	30.06.26 Actual	2026/27 Target	Complied?
Total cash available within 3 months	£10.4m	£5m	Yes

Interest Rate Exposures

This indicator is set to control the Authority's exposure to interest rate risk.

Interest rate risk indicator	2026/27 Target	30.6.26 Actual	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£2m	£1.2m	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£2m	£1.2m	Yes

For context, the changes in interest rates during the quarter were:

	01/04/26	30/06/26
Bank Rate	3.75%	3.75%
1-year PWLB certainty rate, maturity loans	4.93%	4.77%
5-year PWLB certainty rate, maturity loans	5.16%	5.07%
10-year PWLB certainty rate, maturity loans	5.62%	5.55%
20-year PWLB certainty rate, maturity loans	6.14%	6.09%
50-year PWLB certainty rate, maturity loans	6.00%	5.98%

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

APPENDIX 2

Prudential Indicators Q1 - 2026/27

The Authority measures and manages its capital expenditure and borrowing with references to the following indicators.

It is now a requirement of the CIPFA Prudential Code that these are reported on a quarterly basis.

Capital Expenditure
The Authority has undertaken and is planning capital expenditure as summarised below:

	2025/26 Actual	2026/27 Budget	2027/28 Forecast	2028/29 Forecast
Capital expenditure	5.6	3.6	2.7	2.5

The main General Fund capital projects to date have included Union Yard, and Aldershot Crematorium.

Capital Financing Requirement
The Authority's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt.

	31.3.2026 actual	31.3.2027 forecast	31.3.2028 forecast
CFR	174.1	157.1	157.2

Gross Debt and the Capital Financing Requirement
Statutory guidance is that debt should remain below the capital financing requirement, except in the short term. The Authority has complied and expects to continue to comply with this requirement in the medium term as is shown below.

	31.3.2026 actual	31.3.2027 forecast	31.3.2028 forecast	Debt at 30.06.2026
Debt (incl. leases)	149.3	100.3	90.3	127.0
Capital Financing Requirement	174.1	157.1	157.2	

In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

	Debt at 30.6.26	2026/27 Authorised Limit	2026/27 Operational Boundary	Complied?
Borrowing	127	180.0	150.0	Yes
Leases	0.3	2.0	1.8	Yes
Total debt	**127.3**	**182.0**	**151.8**	

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

Net Income from Commercial and Service Investments to Net Revenue Stream
The Authority's income from commercial and service investments as a proportion of its net revenue stream has been and is expected to be as indicated below.

	2025/26 actual	2026/27 forecast	2027/28 forecast
Total net income from service and commercial investments	8.9	7.9	7.6
Proportion of net revenue stream	67.27%	44.08%	50.60%

Proportion of Financing Costs to Net Revenue Stream
Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue.

The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

	2025/26 actual	2026/27 forecast	2027/28 forecast
Financing costs (£m)	7.1	6.0	6.0
Proportion of net revenue stream	68.72%	43.21%	40.00%

Treasury Management Indicators: These indicators (Liability Benchmark, Maturity Structure of Borrowing, Long-Term Treasury Management Investments) are within the Treasury Management Report Outturn 2024/25 at Appendix 1.

APPENDIX 3

LIST OF DEBT COUNTERPARTIES AS AT 30 JUNE 2026

	Amount
PWLB	5,000,000
PWLB	5,000,000
South Yorkshire Mayoral Combined	5,000,000
PWLB	10,000,000
PWLB	15,000,000
PWLB	10,000,000
Torbay Borough Council	5,000,000
PWLB	12,000,000
PWLB	20,000,000
PWLB	15,000,000
PWLB	5,000,000
West Midlands Combined Authority	10,000,000
Basingstoke and Deane Borough Council	10,000,000
	127,000,000

External Context

Economic background

The main story for the quarter was the continuation of the Middle East conflict, started on 28th February with strikes by Israel and the US on Iran. The conflict led to the closure of the Hormuz Strait, a waterway through which around 20% of the world's oil and liquified natural gas flows, resulting in sharp rises in energy and other commodity prices. Towards the end of the quarter, the US and Iran came to an agreement to negotiate a peace settlement, which prompted a reduction in energy commodity prices, albeit remaining higher than pre-war.

Coming close on the heels of the last energy price shock in 2022 following Russia's invasion of UK, central bank policymakers and financial markets reacted quickly to reflect the new reality for monetary policy. In the UK, the headline consumer price inflation (CPI) rate was widely expected to fall back to 2% in April, with changes to government energy policy announced in the budget reducing energy bills and therefore headline inflation rates. Instead, the sharp rise in petrol prices occurring from the war maintained the CPI rate well above target at 2.8%.

Having been expected to cut Bank Rate from 3.75%, the Bank of England's Monetary Policy Committee (MPC) instead held Bank Rate steady throughout the quarter. Despite sending hawkish signals with each monetary policy decision, and the voting split changing from a 9-0 hold in March to a 7-2 hold in June, the majority of committee members appear to believe the UK economy and labour market were soft enough to absorb the price shock without producing the persistent inflationary conditions seen in 2022, which led to Bank Rate rising to 5.25%. This appears to be backed up by business surveys towards the end of the quarter suggesting that business pricing pressures, while elevated, are abating.

Against expectations, UK headline CPI decreased over the quarter, from an annual rate of 3.3% in March to 2.8% in May, but still well above the Bank of England's 2% target. The core measure of CPI inflation also decreased, from 3.1% to 2.6% over the same period. Upside pressure in inflation generally reflected fuel prices, but many other categories experienced disinflation, providing some evidence that higher energy prices were not immediately feeding into a wider subset of products.

Inflation will rise from July, however, as the retail energy price cap is increased by 13%. Expectations range from inflation rising to 3.5% to 4.0% and the MPC's resolve to maintain Bank Rate at 3.75% will likely be tested as this point.

Data released during the period showed the UK economy expanded by 0.6% in the first quarter of the calendar year, following three previous quarters of weaker growth. However, monthly GDP data showed a contraction of 0.1% in April as weaker confidence affected spending and investment decisions. Purchasing managers' index (PMI) data indicated that softer growth was also likely in May and June, with the services PMI denoting a small contraction in activity from both months.

Labour market data showed a continued softening in employment conditions, as weaker private sector earnings growth was reported for the period February to April 2026. The unemployment rate for April was 4.9%, PAYE employment was down over the year, and the number of vacancies continued to fall. The looser labour market is supporting the MPC's decision not to tighten monetary policy, with the likelihood of wage growth rising in line with inflation appearing remote.

Arlingclose, the authority's treasury adviser, maintained its central view that Bank Rate remain at 3.75%, and that the Bank of England would focus on the spare capacity in the economy, notably the labour market, rather than the upside risk of persistent inflation. The balance of risks over the near term, however, is deemed to be to the upside as signs of second round inflationary effects will prompt policymakers to raise interest rates. Over the medium term, the balance of risk for Bank Rate shifts to the downside, with tighter monetary policy, higher prices and weaker growth presenting downside risks for inflation.

The US Federal Reserve also held interest rates steady the period, maintaining the Fed Funds Rate at 3.50%-3.75%. The decision in June was the sixth consecutive month where no changes were made to the main interest rate. US CPI jumped to 4.2% in May on the back of higher gasoline prices, raising the possibility that policy under new Fed Chair Kevin Warsh may lead to higher rather than lower rates.

The European Central Bank (ECB) hiked rates in June, the first rise since September 2023. The ECB noted heightened uncertainty in the near-term from the effects of the war, including higher inflation and potentially weaker growth. The June hike to 2.40% represented an insurance move to maintain inflation around the 2% target.

Financial markets

After the sharp deterioration early in the quarter, sentiment in financial markets showed signs of improvement during the period as hopes for an end to the US/Israel war with Iran increased. However, bond and equity markets remained volatile. Early in the period bond yields rose sharply due to tighter monetary policy expectations, but yields steadily declined as it became apparent central banks, including the Bank of England, were not going to immediately hike policy rates. Equity markets sold off sharply in March but gained back some of the previous declines, particularly in US markets, where AI-related sentiment remained strong.

Political uncertainty in the UK due to poor local election results for the Labour party placed upward pressure on medium and longer-term gilt yields. The eventual resignation of Keir Starmer and likely accension of Andy Burnham reduced some uncertainty and prompted a decline in yields.

Over the quarter, the 10-year UK benchmark gilt yield started at 4.86% and ended at 4.77% having hit 5.20% in late April. The 20-year gilt yield was slightly more stable, starting at 5.45% and finished at 5.42%, after peaking at 5.79% in May. The Sterling Overnight Rate (SONIA) averaged 3.73% over the quarter to 30th June.

Credit review

Arlingclose maintained its advised recommended maximum unsecured duration limit on the majority of the banks on its counterparty list at 6 months. Other banks remain on 100 days.

During the quarter, Fitch upgraded numerous banks due to a rating methodology change, which placed greater emphasis on resolution regimes, loss-absorbing debt buffers and depositor protection. It also changed the reference obligations used for Issuer Default Ratings and introduced more differentiated notching between deposits, senior preferred, senior unsecured and senior non-preferred debt ratings.

Moody's also made changes to the ratings of European banks following the passing of EU legislation introducing full depositor preference across the bloc which places deposits ahead of senior unsecured debt in the creditor hierarchy. This resulted in upgrades to the ratings to several counterparties on Arlingclose's recommended list.

Credit default swap (CDS) prices on UK banks spiked through late March/early April following escalation in the Iran war but eased back over the rest of the quarter to end at broadly pre-conflict levels.

European banks' CDS prices followed a similar pattern, albeit some German banks were modestly higher compared to the previous quarter. Trade tensions between Canada and the US caused

Canadian bank CDS prices to rise over the quarter and remain elevated compared to earlier Q1 2026 while Australian and Singaporean lenders were broadly unchanged.

Overall, at the end of the period CDS prices for all banks on Arlingclose's counterparty list remained within limits deemed satisfactory for maintaining credit advice at current durations.

Financial market volatility is expected to remain a feature, at least in the near term, and credit default swap levels will be monitored for signs of ongoing credit stress. As ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remain under constant review.