Treasury Management Strategy Statement and Prudential Indicators Mid-Year Monitoring Report 2021/22

1 Background

1.1 Treasury Management

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short-term loans or using longer term cash flow surpluses and on occasion, any debt previously drawn, may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

> *"The management of local authority's borrowing, investments and cash flows, 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."*

2. Introduction

This report has been written in accordance with the requirements of the CiPFA Code of Practice on Treasury Management (revised 2017).

The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the way the Council will seek to achieve those policies and objectives.
- Receipt by the full council of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy – for the year ahead, a Mid-Year Review

Report and an Annual Report (stewardship report) covering activities during the previous year.

- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specified named body. For this Council the delegated body is the Budget and Corporate Scrutiny Management Board.

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

- An economic update for the first part of 2021/22 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- A review of the Council's investment portfolio for 2021/22;
- A review of the Council's borrowing strategy for 2021/22;
- A review of any debt rescheduling undertaken during 2021/22;
- A review of compliance with Treasury and Prudential Limits for 2021/22.

3. Economics and Interest Rates

3.1 UK Summary Economic Update

UK GDP grew by 3.6% in the three months to July 2021, down from a 4.8% expansion in the previous three-month period. The y/y figure grew by 7.5% for July 2021 compared to the expansion of 15.2% y/y growth in June 2021. The Monetary Policy Committee voted unanimously to keep interest rates on hold at 0.1% and the stock of sterling non-financial investment-grade corporate bond purchases at £20bn. Bank Rate is likely to be unchanged at 0.10% until 2023. It will probably take that long for spare capacity in the UK economy to be eroded and for inflationary forces to become sufficient for the MPC to take action to raise Bank Rate.

The IHS Markit/CIPS UK Composite PMI was revised down to 54.1 in September 2021, slightly below forecasts of 54.5 and below 54.8 in August. The reading pointed to the slowest growth in private sector activity since February.

The consumer price inflation rate in the UK jumped to 3.2% in August of 2021, the highest since March 2021, from 2% in July and above market forecasts of 2.9%. A low base effect from last year had the biggest impact, because, in part, of discounted restaurant and café prices in August 2020 resulting from the government's Eat Out to Help Out scheme and, to a lesser extent, reductions in Value Added Tax across the same sector.

The number of people in work in the UK rose by 183 thousand on quarter to 32.36 million in the three months to July 2021, the fourth increase in this measure since the initial outbreak of COVID-19 after a 95,000 figure in the three months to June. The UK unemployment rate fell to 4.6 percent in the three months to July 2021, the lowest level since the June-August 2020 period and in line with market expectations. The number of people claiming for unemployment benefits in the United Kingdom fell by 58,600 in August, after falling by 7,800 in July, which is the sixth consecutive month of declining joblessness. Average weekly earnings, excluding bonuses, rose by 6.8% y/y in the three months to July compared to a 7.3% y/y rise in the three months to June. Including bonuses, earnings eased to 8.3% from 8.8% in the previous period.

The Halifax House Price Index rose 7.1% y/y in August. On a monthly basis, prices were up 0.7%, the smallest gain in house prices since March as much of the impact from the stamp duty holiday faded.

3.2 Interest Rate Movements and Expectations

The table below shows interest rate forecasts provided by Link Asset Services, as the Council's advisor for treasury management, incorporating the Public Works Loans Board (PWLB) certainty rates:

Link Group Interest Rate View 29.9.21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75
3 month ave earnings	0.10	0.10	0.20	0.20	0.30	0.40	0.50	0.50	0.60	0.70
6 month ave earnings	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.60	0.70	0.80
12 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.70	0.80	0.90	1.00
5 yr PWLB	1.40	1.40	1.50	1.50	1.60	1.60	1.60	1.70	1.70	1.70
10 yr PWLB	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10
25 yr PWLB	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.60
50 yr PWLB	2.00	2.00	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.40

The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut the Bank Rate to 0.10%, it left the Bank Rate unchanged at its subsequent meetings.

As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 2 of 2022/23, a second increase to 0.50% in quarter 2 of 2023/24 and a third one to 0.75% in quarter 4 of 2023/24.

Significant risks to the forecasts

- COVID vaccines do not work to combat new mutations and/or new vaccines take longer than anticipated to be developed for successful implementation.
- The pandemic causes major long-term scarring of the economy.
- The Government implements an austerity programme that supresses GDP growth.
- The MPC tightens monetary policy too early – by raising Bank Rate or unwinding QE.

- The MPC tightens monetary policy too late to ward off building inflationary pressures.
- Major stock markets e.g. in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the "moral hazard" risks of having to buy shares and corporate bonds to reduce the impact of major financial market sell-offs on the general economy.
- Geo-political risks are widespread e.g. German general election in September 2021 produces an unstable coalition or minority government and a void in high-profile leadership in the EU when Angela Merkel steps down as Chancellor of Germany; on-going global power influence struggles between Russia/China/US.

The balance of risks to the UK

- The overall balance of risks to the economic growth in the UK is now to the downside, including residual risks from Covid and its variants – both domestically and their potential effects worldwide.

4. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement (TMSS) for 2021/22 was approved by this Council on 24 February 2021.

The underlying TMSS approved previously requires revision in the light of economic and operational movements during the year. The proposed changes and supporting detail for the changes are set out below:

	2021/22	
	Original Estimate £'m	**Revised Prudential Indicator £'m**
Authorised Limit	786.001	859.111
Operational Boundary	586.702	781.010
Capital Financing Requirement	786.001	781.010

5. The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- 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 activity

5.1. Prudential Indicator for Capital Expenditure

This table shows the projected outturn for capital expenditure based on projections at period 6, along with the expected financing arrangements against the original indicators set at the time the capital programme was agreed in February 2021.

	2021/22	
	Original Estimate £'m	**Projected Outturn £'m**
Capital Expenditure		
General Fund	94.804	92.734
HRA	70.808	76.541
Total	**165.612**	**169.275**
Resourced by:		
Capital Receipts	32.836	25.630
Capital Grants & Contributions	44.591	53.902
Revenue	18.536	25.058
Capital Expenditure Financed from Borrowing	**69.649**	**64.685**

There has been an overall reduction in the projected level of expenditure to be financed from borrowing. This is due to the reduced spending activity within the General Fund programme.

The borrowing need underlines the indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt known as the Minimum Revenue Provision (MRP). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

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

The table shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed as the Operational Boundary.

	2021/22					
	Original Estimate			Projected Outturn		
	HRA	General Fund	Total	HRA	General Fund	Total
	£'m	£'m	£'m	£'m	£'m	£'m
Opening Capital Financing Requirement	**442.251**	**299.833**	**742.084**	**442.244**	**299.833**	**742.077**
add: Capital Expenditure funded from Borrowing	53.721	15.928	69.649	50.213	14.472	64.685
less: MRP	-10.000	-10.449	-20.449	-10.000	-10.470	-20.470
add: Movement on Other Long Term Liabilities	-1.324	-3.959	-5.283	-1.323	-3.959	-5.282
Closing Capital Financing Requirement	**484.648**	**301.353**	**786.001**	**481.134**	**299.876**	**781.010**
External Debt / Operational Boundary						
Borrowing			520.645			535.661
Other Long Term Liabilities*			66.057			64.651
Total Debt at 31 March (Operational Boundary)			**586.702**			**600.312**

* - Represents the estimated finance lease creditors liability as at 31 March 2021 in relation to 'on balance sheet' PFI schemes and the assets included within the Serco waste contract which have been included on the balance sheet in accordance with International Financial Reporting Standards.

5.3. Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and the 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.

	2021/22	
	Original Estimate £'m	Projected Outturn £'m
Gross Borrowing	520.645	535.661
add: Other Long Term Liabilities*	66.057	64.651
Total Debt	**586.702**	**600.312**
CFR (Year end position)	**786.001**	**781.010**

* Includes on balance sheet PFI schemes and finance leases etc.

The Section 151 Officer can report that there are no difficulties envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which 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.

	2021/22	
	Original Estimate £'m	Projected Outturn £'m
Borrowing	719.944	716.359
add: Other Long Term Liabilities*	66.057	64.651
Total Operational Limit	**786.001**	**781.010**
Total Authorised Limit	**786.001**	**859.111**

* Includes on balance sheet PFI schemes and finance leases etc.

6. Borrowing / Debt Activity during 2021/22

This table shows the Council's actual external debt and anticipated need against the underlying capital borrowing need (the CFR), highlighting any under or over borrowing.

	2021/22	
	Original Estimate £'m	Projected Outturn £'m
External Debt as at 1 April	520.645	535.661
Expected need to 31 March	0.000	0.000
Other Long Term Liabilities*	66.057	64.651
Estimated Debt as at 31 March	**586.702**	**600.312**
Capital Financing Requirement	**786.001**	**781.010**
(-)Under / (+)Borrowed	-199.299	-180.698
Investment as at 31 March	-25.000	-25.000
Net Debt Position as at 31 March	**561.702**	**575.312**

* - Includes on balance sheet PFI schemes and finance leases etc.

No new long-term loans have been taken out during the first six months of 2021/22. Officers will continue to consider the Council's borrowing requirement during the remainder of the year to ensure it has adequate resources to maintain its capital programme.

The Council is currently under borrowed to address investment counterparty risk and the cost of carry on investments (investment yield up to 0.011%, long term borrowing rates are approximately 2.41%). There is interest rate risk, as longer-term borrowing rates may rise; this position is being carefully monitored.

The revised budget position for debt charges is shown in the table below:

	2021/22	
	Original Estimate £'m	Projected Outturn £'m
Debt Charges	45.155	44.740

The reduction in debt charges is due to a reduction in MRP costs within the HRA.

6.1. Debt Rescheduling
Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010, no debt rescheduling has therefore been undertaken to date, in the current financial year.

7. Investment Strategy 2021/22 – 2025/26

Key Objectives
In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As shown by the forecasts in section 3.2, it is now impossible to earn the level of interest rates commonly seen in previous decades as all investment rates up to 12 months are either negative or barely above zero now that Bank Rate is at 0.10%. Given this risk environment and the fact that increases in Bank Rate are unlikely to occur before the end of the current forecast horizon of 31st March 2023, investment returns are expected to remain low.

Current Investment Position
The Council held £101.630m of investments at 30 September 2021 with the structure of the portfolio being detailed below and in line with IFRS9. This table also highlights the 'historic risk of default' on these investments. As at 30 September 2021 the Council is reporting a risk of default percentage of 0.000%:

	Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest LT / Fund Rating	Historic Risk of Default
	Bank of Scotland Plc (RFB)	0	0.65%		Call	A+	0.000%
	First Abu Dhabi Bank PJSC	0	0.43%		Call	AA-	0.000%
	Santander UK PLC	0	0.40%		Call	A	0.000%
	Shinhan Bank	0	0.45%		Call	A	0.000%
	The Royal Bank of Scotland Plc (RFB)	679,810	0.01%		Call	A	0.000%
	MMF Aberdeen Standard Investments	10,000,000	0.01%		MMF	AAAm	
	MMF Aviva	10,700,000	0.01%		MMF	AAAm	
	MMF BlackRock	20,000,000	0.01%		MMF	AAAm	
	MMF BNP Paribas	20,000,000	0.00%		MMF	AAAm	
	MMF CCLA	10,000,000	0.02%		MMF	AAAm	
	MMF Federated Investors (UK)	10,000,000	0.01%		MMF	AAAm	
	MMF Fidelity	10,000,000	0.01%		MMF	AAAm	
	MMF Invesco	10,000,000	0.01%		MMF	AAAm	
*	6 Towns Credit Union	250,000	1.49%	13/11/2017	14/11/2022	Not Rated	
	Total Investments	**£101,629,810**	**0.01%**				0.000%

The section 151 Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the 6 months of 2021/22.

The revised budget position for investment income is shown in the table below; it shows the estimated interest earned based on average temporary deposits of £78.324m (placed between 1 April 2021 and 30 September 2021), the estimated interest accrued by non-general fund deposits and HRA estimated internal borrowing interest for 2021/22:

	2021/22	
	Original Estimate £'m	**Projected Outturn £'m**
Interest on Temporary Deposits	0.040	0.007
Interest Payable on Non GF Deposits	-0.062	-0.006
Interest on HRA Internal Borrowing	2.486	2.040
Interest Receivable	**2.464**	**2.041**

Risk Benchmarking

A regulatory development is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements to Member reporting, although the application of these is more subjective in nature.

The current position against the originally approved benchmarks is reported below;

% Benchmarks	7 Day	1 Month	3 Month	6 Month	12 Month
Benchmark Return (LIBID Uncompounded)	-0.08%	-0.07%	-0.05%	-0.02%	0.07%

Liquidity

In respect of this area, the Council set liquidity facilities / benchmarks to maintain:

- Bank overdraft - £2m
- Liquid short-term deposits of at least £21m available within a week's notice.

The Section 151 Officer can report that liquidity arrangements have been adequate during the year to date.

Yield
Local measures of yield benchmarks are:

- Investments – Internal returns to be above the 7-day LIBID rate

The Director of Resources can report that the return to date has averaged 0.011%, against an average 7-day LIBID at 30 September 2021 of -0.08%.

8. Other

8.1 Compliant with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the half year ended 30th September 2021, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2021/22. The Director of Finance reports that no difficulties are envisaged for the current or future years in complying with these indicators.

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

8.2 Full Economic Update

The Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures.

There was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August which had majored on indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in Bank Rate. In his press conference after the August MPC meeting, Governor Andrew Bailey said, "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures." In other words, it was flagging up a potential danger that labour shortages could push up wage growth by more than it expects and that, as a result, CPI inflation would stay above the 2% target for longer. It also discounted sharp increases in monthly inflation figures in the pipeline in late 2021 which were largely propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system: in other words, the MPC had been prepared to look through a temporary spike in inflation.

So, in August the country was just put on alert. However, this time the MPC's words indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October and due again next April, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected. Indeed, to emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement; this suggested that it was now willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year. This is a reversal of its priorities in August and a long way from words at earlier MPC meetings which indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. Indeed, whereas in August the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021, now its primary concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.

Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in February 2022, but this looks ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment once furlough ends at the end of September. At the MPC's meeting in February it will only have available the employment figures for November: to get a clearer picture of employment trends, it would need to wait until the May meeting when it would have data up until February. At its May meeting, it will also have a clearer understanding of the likely peak of inflation.

The MPC's forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -

- Placing the focus on raising Bank Rate as "the active instrument in most circumstances".
- Raising Bank Rate to 0.50% before starting on reducing its holdings.
- Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
- Once Bank Rate had risen to at least 1%, it would start selling its holdings.

COVID-19 vaccines. These have been the game changer which have enormously boosted confidence that life in the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.

US. See comments below on US treasury yields.

EU. The slow role out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction in GDP of -0.3% in Q1, Q2 came in with strong growth of 2%, which is likely to continue into Q3, though some countries more dependent on tourism may struggle. Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the ECB is likely to see these as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time. German general election. With the CDU/CSU and SDP both having won around 24-26% of the vote in the September general election, the composition of Germany's next coalition government may not be agreed by the end of 2021. An SDP-led coalition would probably pursue a slightly less restrictive fiscal policy, but any change of direction from a CDU/CSU led coalition government is likely to be small. However, with Angela Merkel standing down as Chancellor as soon as a coalition is formed, there will be a hole in overall EU leadership which will be difficult to fill.

China. After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of the year; this enabled China to recover all the initial contraction. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021. However, the pace of economic growth has now fallen back after this initial surge of recovery from the pandemic and China is now struggling to contain the spread of the Delta variant through sharp local lockdowns - which will also depress economic growth. There are also questions as to how effective Chinese vaccines are proving. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

Japan. 2021 has been a patchy year in combating Covid. However, after a slow start, nearly 50% of the population are now vaccinated and Covid case numbers are falling. After a weak Q3 there is likely to be a strong recovery in Q4. The Bank of Japan is continuing its very loose monetary policy but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon: indeed, inflation was negative in July. New Prime Minister Kishida has promised a large fiscal stimulus package after the November general election – which his party is likely to win.

World growth. World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.

Supply shortages. The pandemic and extreme weather events have been highly disruptive of extended worldwide supply chains. At the current time there are major queues of ships unable to unload their goods at ports in New York, California and China. Such issues have led to mis-distribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves.

Forecasts for Bank Rate

Bank Rate is not expected to go up fast after the initial rate rise as the supply potential of the economy has not generally taken a major hit during the pandemic, so should be able to cope well with meeting demand without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the surge to around 4% towards the end of 2021. Three increases in Bank rate are forecast in the period to March 2024, ending at 0.75%. However, these forecasts may well need changing within a relatively short time frame for the following reasons: -

- There are increasing grounds for viewing the economic recovery as running out of steam during the summer and now into the autumn. This could lead into stagflation which would create a dilemma for the MPC as to which way to face.
- Will some current key supply shortages e.g., petrol and diesel, spill over into causing economic activity in some sectors to take a significant hit?
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation. Then we have the Government's upcoming budget in October, which could also end up in reducing consumer spending power.
- On the other hand, consumers are sitting on around £200bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?

- There are 1.6 million people coming off furlough at the end of September; how many of those will not have jobs on 1st October and will, therefore, be available to fill labour shortages in many sectors of the economy? So, supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months or so and alleviate the MPC's current concerns.
- There is a risk that there could be further nasty surprises on the Covid front, on top of the flu season this winter, which could depress economic activity.

In summary, with the high level of uncertainty prevailing on several different fronts, it is likely that these forecasts will need to be revised again soon - in line with what the new news is.

It also needs to be borne in mind that Bank Rate being cut to 0.10% was an emergency measure to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away that final emergency cut from 0.25% to 0.10% on the grounds of it no longer being warranted and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

Forecasts for PWLB rates and gilt and treasury yields

As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US.

There is likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields?
- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures turn out to be in both the US and the UK and so impact treasury and gilt yields?
- How will central banks implement their new average or sustainable level inflation monetary policies?
- How well will central banks manage the withdrawal of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the "taper tantrums" in the US in 2013?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within our forecasting period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

Gilt and treasury yields

Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates. During the first part of the year, US President Biden's, and the Democratic party's determination to push through a $1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic was what unsettled financial markets. However, this was in addition to the $900bn support package already passed in December 2020 under President Trump. This was then followed by additional Democratic ambition to spend further huge sums on infrastructure and an American families plan over the next decade which are caught up in Democrat / Republican haggling. Financial markets were alarmed that all this stimulus, which is much bigger than in other western economies, was happening at a time in the US when: -

- A fast vaccination programme has enabled a rapid opening up of the economy.
- The economy had already been growing strongly during 2021.
- It started from a position of little spare capacity due to less severe lockdown measures than in many other countries. A combination of shortage of labour and supply bottle necks is likely to stoke inflationary pressures more in the US than in other countries.
- And the Fed was still providing monetary stimulus through monthly QE purchases.

These factors could cause an excess of demand in the economy which could then unleash stronger and more sustained inflationary pressures in the US than in other western countries. This could then force the Fed to take much earlier action to start tapering monthly QE purchases and/or increasing the Fed rate from near zero, despite their stated policy being to target average inflation. It is notable that some Fed members have moved forward their expectation of when the first increases in the Fed rate will occur in recent Fed meetings. In addition, more recently, shortages of workers appear to be stoking underlying wage inflationary pressures which are likely to feed through into CPI inflation. A run of strong monthly jobs growth figures could be enough to meet the threshold set by the Fed of "substantial further progress towards the goal of reaching full employment". However, the weak growth in August, (announced 3.9.21), has spiked anticipation that tapering of monthly QE purchases could start by the end of 2021. These purchases are currently acting as downward pressure on treasury yields. As the US financial markets are, by far, the biggest financial markets in the world, any trend upwards in the US will invariably impact and influence financial markets in other countries. However, during June and July, longer term yields fell sharply; even the large non-farm payroll increase in the first week of August seemed to cause the markets little concern, which is somewhat puzzling, particularly in the context of the concerns of many commentators that inflation may not be as transitory as the Fed is expecting it to be. Indeed, inflation pressures and erosion of surplus economic capacity look much stronger in the US than in the UK. As an average since 2011, there has been a 75% correlation between movements in 10-year treasury yields and 10 year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.

There are also possible DOWNSIDE RISKS from the huge sums of cash that the UK populace have saved during the pandemic; when savings accounts earn little interest, it is likely that some of this cash mountain could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will interplay with the Bank of England eventually getting round to not reinvesting maturing gilts and then later selling gilts, will be interesting to keep an eye on.

The balance of risks to medium to long term PWLB rates: -
There is a balance of upside risks to forecasts for medium to long term PWLB rates.

A new era – a fundamental shift in central bank monetary policy
One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum" employment in its entirety' in the US before consideration would be given to increasing rates.

- The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.
- The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' and the ECB now has a similar policy.
- For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.
- Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.
- Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national

debt; (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

8.3 Changes in Risk Appetite

There is no change to the Council Risk appetite at present however, the authority is currently assessing the potential rewards and risks of investing in property funds.