

# Mid-Year Treasury Management Report 2021/22

AC as at 26/10/21 - GB



## 1. Introduction and Background

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 maximising 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.

As a consequence treasury management is defined as:

“The management of the 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.”

The Council has adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. 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.
4. 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.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Scrutiny (Audit and Value for Money Council Services) Committee.

## 2. This Mid-Year Treasury Report Covers

This mid-year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for 2021/22
- 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
- Other treasury matters

## 3. Economic Update

### 3.1 MPC meeting 24.9.21

- The September 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.

- As at the end of September 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: -
  1. Placing the focus on raising Bank Rate as "the active instrument in most circumstances".
  2. Raising Bank Rate to 0.50% before starting on reducing its holdings.
  3. Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
  4. 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.

- **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.

3.2 For information in relation to the global economic outlook is set out in **Annex 3**.

### 3.3 **Interest rate forecasts**

The Council's treasury advisor, Link Asset Services, have provided the interest rate forecasts and commentary, which is attached at **Annex 4**.

## 4. **The Treasury Management Strategy and Annual Investment Strategy Update**

### 4.1 Background

The Treasury Management Strategy Statement (TMSS) for 2021/22 was approved by this Council in February 2021. The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

- Security of capital
- Liquidity

The Council will also aim to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

As shown by the interest rate forecasts in **Annex 4**, it is now impossible to earn the level of interest rates commonly seen in previous decades as all short-term money market investment rates have only risen weakly since the Bank Rate was set at 0.10% in March 2020. Given this environment and the fact that Bank Rate may only rise marginally, or not at all, before the second half of 2023, investment returns at the end of September were expected to remain very low.

## 4.2 Creditworthiness

Significant levels of downgrades to Short and Long Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, as economies are beginning to reopen, there have been some instances of previous lowering of Outlooks being reversed.

## 4.3 Overview

The Council held £60.8m of investments as at 30 September 2021 (£42.1m at 30 September 2020 and £36.4m at 30 September 2019) and the investment portfolio yield for the first six months of the year is 0.06% (0.32% 2020/21 & 0.82% 2019/20). A breakdown of the Council's investment portfolio is shown at **Annex 2** of this report.

The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2021/22.

The current investment counterparty criteria selection approved in the Treasury Management Strategy Statement is meeting the requirements of the treasury function.

## 5. **Investment Portfolio**

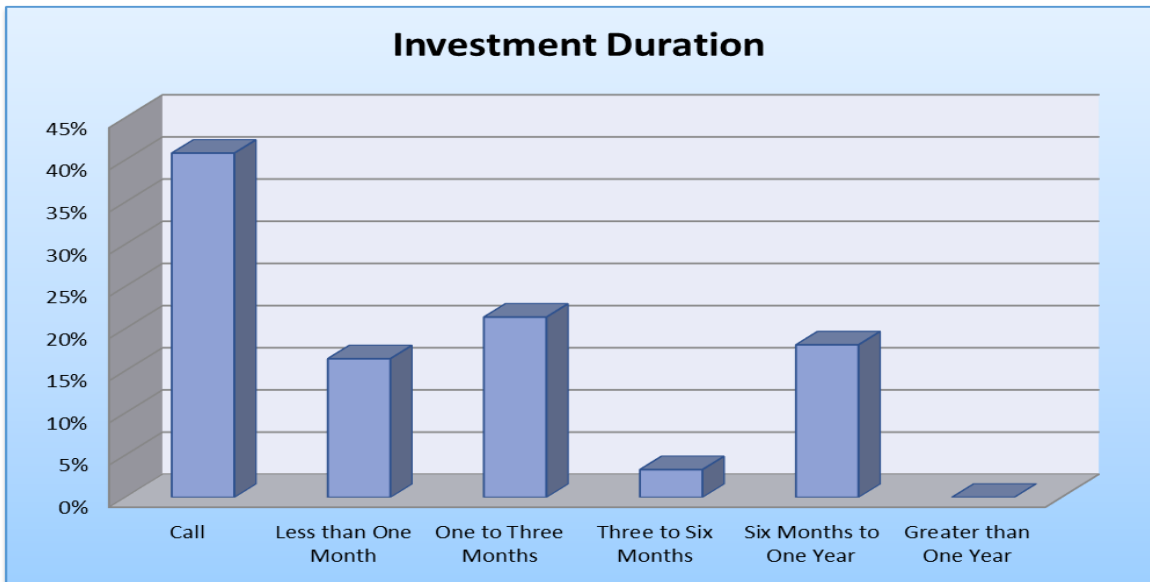
5.1 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

5.2 The investment portfolio yield for the first six months of the year is 0.06%.

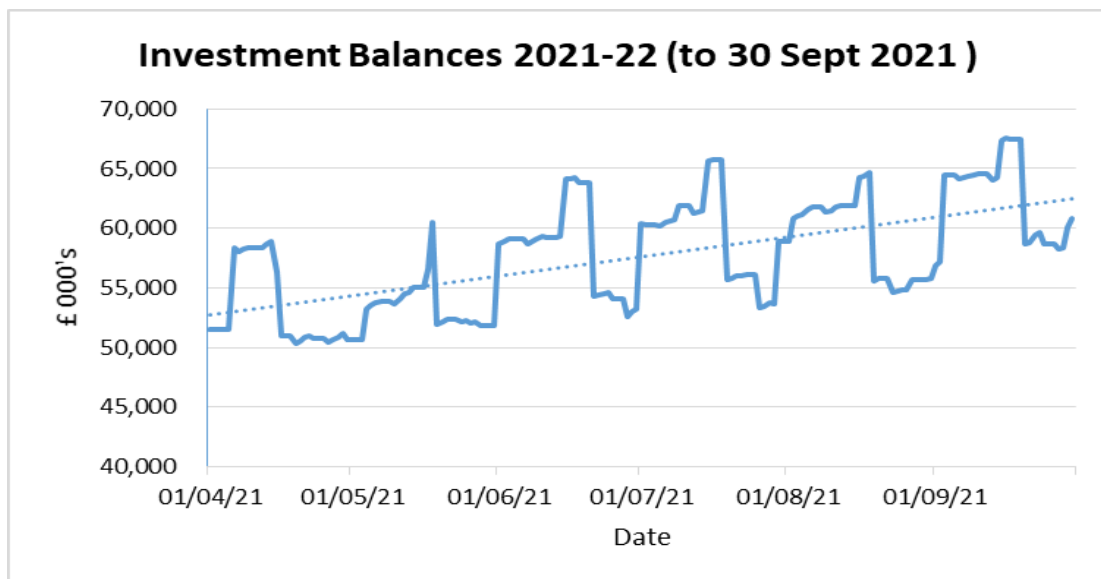
	<i>Average Rate Year to 30/09/21</i>
ESBC	0.06%
LIBID – 6 month	-0.02%
Base Rate	0.10%

The above table shows that the authority has underperformed against the Bank of England base rate, which reflects current market conditions, but has performed above the average 6 month LIBID benchmark. The Council's budgeted investment return for 2021/22 is 0.07%. Current performance is therefore slightly lower than the budgeted rate of return, however, average investment balances are currently higher than forecast (see comments below).

5.3 A full list of investments held as at 30th September 2021, totalling £60.8m is shown in **Annex 2**. The graph below demonstrates the maturity profile of these investments. The investment listing includes fixed deposits and call accounts held with a number of UK banks and other local authorities, as well as UK Government Treasury Bills/Deposit account and AAA rated money market funds. These instruments offer significant counterparty strength as well as diversification of the portfolio.



5.4 Average cash balances in the first six months of 2021/22 were £57.6m (£48.2m Apr to Sept 2020-21). The graph below demonstrates how these balances have fluctuated so far this year which follows the “normal pattern” as Council Tax and NNDR receipts are received and then precept payments are paid out. The main differences in investment levels relates to the impact from Covid 19 funding arrangements by central government.



## 6. Borrowing

6.1 The Council's Capital Financing Requirement (CFR) as at 31<sup>st</sup> March 2022 is estimated to be £14m (£13m as at 31<sup>st</sup> March 2021). The forecast net increase in the year is the acquisition of the new waste collection vehicles offset by the annual debt repayments through the Minimum Revenue Provision and voluntary repayments.

The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

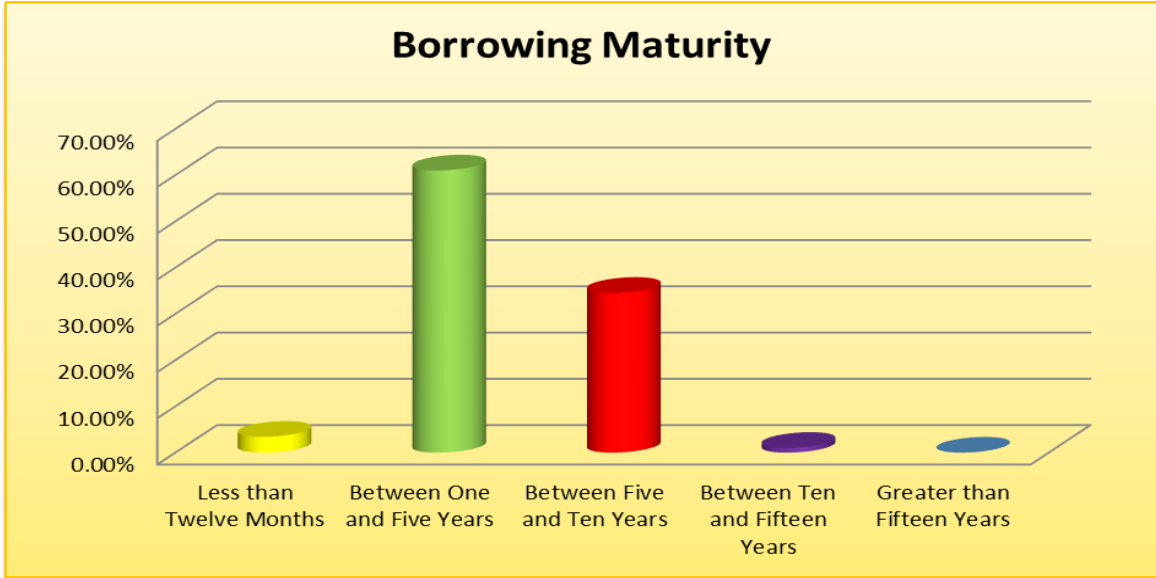
6.2 The forecast CFR is now higher than when the budget and treasury management strategy was set (**see Annex 1**), this reflects the latest information in relation to the timing of capital receipts that are planned to be utilised to repay internal debt, which in turn will deliver savings to the revenue budget. There remains an ongoing risk that this could impact on the MTFs in 2021/22 and beyond.

6.3 Consistent with the strategy, no new borrowing has been undertaken during the first half of 2021/22. The current borrowing levels and maturity profile are set out in the tables and graph below.

Debt Type	Principal Outstanding (£)	Average Rate
<b>Total Fixed Debt</b>		
PWLB Maturity	5,700,000	4.646%
PWLB Annuity	434,028	8.763%
<b>Total Variable Debt</b>		
Market	4,500,000	5.914%
GBSLEP Loan	375,000	
<b>Total External Debt</b>	<b>11,009,028</b>	<b>5.351%</b>

Maturity Structure - Fixed Rate Borrowing	%	Balance
Less than Twelve Months	3.41%	375,796
Between One and Five Years	61.01%	6,716,995
Between Five and Ten Years	34.55%	3,803,085
Between Ten and Fifteen Years	1.03%	113,151
Greater than Fifteen Years	0.00%	-
	<b>100.00%</b>	<b>11,009,028</b>

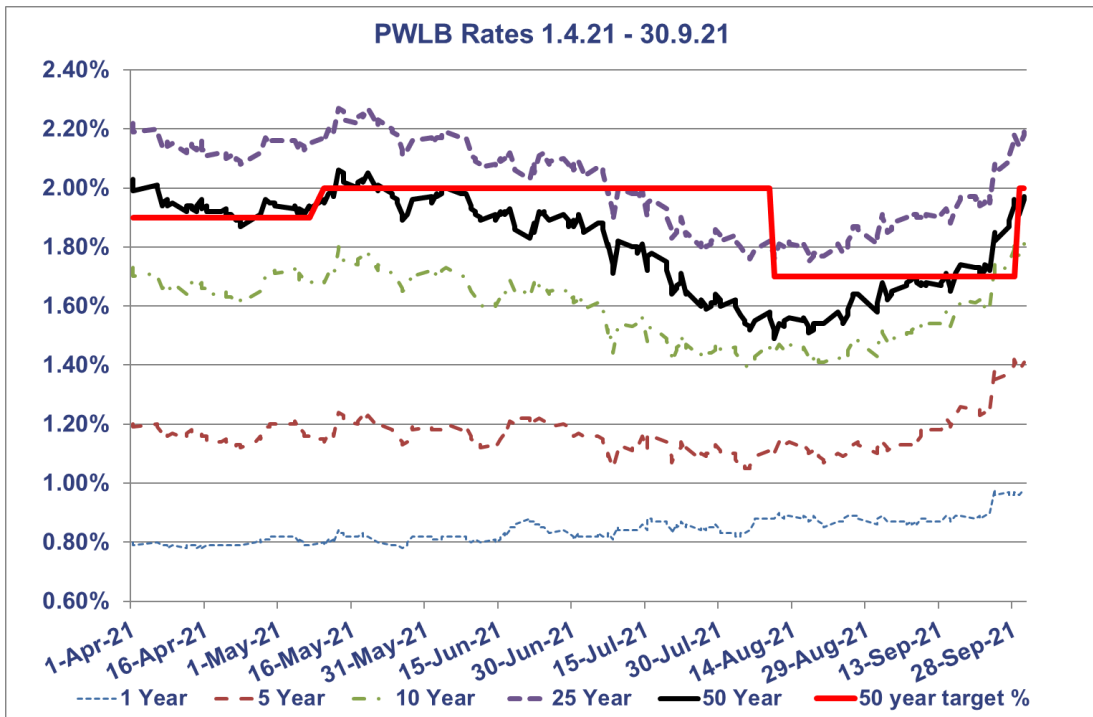




**6.4 PWLB maturity certainty rates year to date to 30th September 2021**

The graph and table below show the movement in PWLB certainty rates for the first six months of the year to date. Gilt yields and PWLB rates were on a falling trend between May and August. However, they rose sharply towards the end of September.

The 50 year PWLB target certainty rate for new long-term borrowing started 2021/22 at 1.90%, rose to 2.00% in May, fell to 1.70% in August and returned to 2.00% at the end of September after the MPC meeting of 23<sup>rd</sup> September.



6.5 As set out in the Treasury Management Strategy Statement for 2021/22, it is not currently planned for any external borrowing to be undertaken in the financial year. Nevertheless, the Financial Management Unit will continue to monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances, including the possibility of early repayment and any decisions will be reported to the appropriate decision making body at the next available opportunity.

## 7. Debt Re-Scheduling

Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. As a consequence there has not been any re-scheduling undertaken. Nevertheless any opportunities for early repayment will be assessed in light of changing circumstances and economic forecasts.

## 8. Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the “Affordable Borrowing Limits”. Council’s approved Treasury and Prudential Indicators (affordability limits) are outlined in the approved TMSS.

During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council’s Treasury Management Strategy Statement and in compliance with the Council’s Treasury Management Practices. The Prudential and Treasury Indicators are shown in **Annex 1**.

## 9. Other Treasury Matters

### Icelandic Deposit/Administration

At 1 April 2021 the Council had an outstanding balance £0.264m of investments frozen in the Icelandic bank (KSF). During the year we have received further dividend payments of £5k reducing the balance to £0.259m. The last dividend payment made in August 2021 was declared to be the 23<sup>rd</sup> and final dividend payment. This takes the overall repayment received to £1.741m which is 87% of the original investment of £2m.

The Council has prudently impaired this investment within its accounts, effectively writing down the investment balance to cover the expected loss. This final dividend payment is consistent with this provision and means that the overall net impairment on the investment is £0.252m (£0.259m less interest received £0.007m).

## Annex 1: Prudential and Treasury Indicators

PRUDENTIAL INDICATOR	2020/21	2021/22	2021/22
	Outturn	Original Estimate	Probable
	£'000	£'000	£'000
<b>Capital Expenditure</b>	5,916	9,239	<b>5,351</b>
<b>Ratio of financing costs to net revenue stream</b>	9.98%	7.6%	<b>7.83%</b>
<b>Capital Financing Requirement #</b>	13,070	14,240	<b>15,146</b>
<b>External Debt</b> (including finance leases)	11,172	10,706	<b>11,081</b>

*# forecast higher due to timing of capital receipts to repay debt.*

## Annex 1: Prudential and Treasury Indicators

	2020/21	2021/22	2021/22
<b>(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS</b>	<b>Outturn</b>	<b>Estimate</b>	<b>Probable</b>
<b>Authorised Limit for external debt</b>			
borrowing	16,500	18,000	18,000
other long term liabilities	3,000	1,500	1,500
<b>TOTAL</b>	<b>19,500</b>	<b>19,500</b>	<b>19,500</b>
<b>Operational Boundary for external debt -</b>			
borrowing	15,500	17,000	17,000
other long term liabilities	2,000	500	500
<b>TOTAL</b>	<b>17,500</b>	<b>17,500</b>	<b>17,500</b>
<b>Upper limit for total principal sums invested for over 1 year</b>	5,000	5,000	<b>5,000</b>

## Annex 2: Investments as at 30<sup>th</sup> September 2021

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date
<b>Call Accounts and Money Market Funds</b>				
RBS SIBA	1,324,468	0.01%		
Barclays	43	0.05%		
Santander 95 day notice account	3,500,000	0.20%		95 day notice
Bank of Scotland 95 Day Notice Account	2,500,000	0.05%		95 day notice
Lloyds 95 Day Notice Account	3,500,000	0.05%		95 day notice
MMF Insight	-	0.00%		Call
MMF Aberdeen	4,000,000	0.01%		Call
MMF Federated	4,000,000	0.01%		Call
MMF Blackrock	2,000,000	0.01%		Call
MMF CCLA	4,000,000	0.02%		Call
<b>Fixed Deposits / Certificates of Deposit</b>				
National Westminster Bank CD	1,000,000	0.13%	25/11/2020	24/11/2021
National Westminster Bank CD	1,000,000	0.14%	30/03/2021	30/12/2021
National Westminster Bank CD	2,000,000	0.09%	18/02/2021	18/02/2022
National Westminster Bank CD	1,000,000	0.15%	19/08/2021	18/08/2022
UK Treasury Bill	5,000,000	0.03%	01/06/2021	29/11/2021
DMO (UK Debt Management)	2,000,000	0.01%	27/08/2021	19/10/2021
DMO (UK Debt Management)	8,000,000	0.01%	03/09/2021	19/10/2021
DMO (UK Debt Management)	2,500,000	0.01%	15/09/2021	22/11/2021
DMO (UK Debt Management)	1,500,000	0.01%	20/09/2021	22/11/2021
DMO (UK Debt Management)	2,000,000	0.01%	29/09/2021	22/11/2021
Basildon BC	5,000,000	0.10%	22/06/2021	21/06/2022
Merseyside PCC	5,000,000	0.07%	20/09/2021	15/07/2022

Borrower - Icelandic Exposure	Principal (£)	Interest Rate	Start Date	Maturity Date
Singer	-	0.00%		

Investments rate of interest as at 30 Sept 2021	Principal (£)	Interest Rate
Total Investments	60,824,510	
Total Investments - Excluding Icelandic Exposure	60,824,510	0.05%
Total Investments - Icelandic Exposure Only	-	0.00%

Average rate of interest (Year to date)	Principal (£)	Interest Rate
Total Investments	54,967,495	
Total Investments - Excluding Icelandic Exposure	54,967,495	0.06%
Total Investments - Icelandic Exposure Only	-	0.00%

## Annex 3: Global Economic Outlook

- **EU.** The slow roll 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 SPD 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 SPD-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.
- **US.** 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. 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 was happening at a time when: -

- A fast vaccination programme has enabled a rapid opening up of the economy.
- The economy has 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.
- And the Fed was still providing stimulus through monthly QE purchases.

These factors could cause an excess of demand in the economy which could then unleash strong inflationary pressures. This could then force the Fed to take much earlier action to start increasing the Fed rate from near zero, despite their stated policy being to target average inflation. It is notable that in the September Fed meeting, Fed members again moved forward their expectation of when the first increases in the Fed rate will occur. In addition, shortages of workers appear to be stoking underlying wage inflationary pressures which are likely to feed through into CPI inflation. A run of stronger jobs growth figures could be enough to meet the threshold set by the Fed of “substantial further progress towards maximum employment” for a first increase in the Fed rate.

A further concern in financial markets is when will the Fed end QE purchases of treasuries and how will they gradually wind them down. These purchases are currently acting as a downward pressure on treasury yields. In his late August speech at the Jackson Hole conference, Fed Chair Powell implied that the central bank plans to start tapering its asset purchases before the end of this year. But the plan is conditional on continued improvement in the labour market, which the August employment report suggests is proceeding more slowly than the Fed anticipated. That may mean that any announcement of tapering is pushed back, possibly even into early 2022.

As the US financial markets are, by far, the biggest financial markets in the world, any upward trend in treasury yields will invariably impact and influence financial markets in other countries. Inflationary pressures and erosion of surplus economic capacity look much stronger in the US compared to those in the UK, which would suggest that Fed rate increases are likely to be faster and stronger than Bank Rate increases in the UK. Nonetheless, any upward pressure on treasury yields could put upward pressure on UK gilt yields too.

- **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.

## Annex 4: Interest Rate Forecasts

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.

The latest forecast on 29<sup>th</sup> September is compared below to the previous forecast on 10<sup>th</sup> May. A comparison of these forecasts shows that some PWLB rates have increased marginally and there are now three increases in Bank Rate, to end at 0.75%, instead of one to only 0.25%. However, many PWLB rates were significantly lower than forecast during the earlier part of quarter 2.

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

Link Group Interest Rate View		10.5.21										
	Jun-21	Sep-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	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.25	0.25	0.25
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.30	0.30	0.30
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.20	0.30	0.40	0.40	0.40
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.40	0.50	0.50	0.50
5 yr PWLB	1.20	1.20	1.30	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50
10 yr PWLB	1.70	1.70	1.70	1.80	1.80	1.90	1.90	1.90	2.00	2.00	2.00	2.00
25 yr PWLB	2.20	2.20	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50	2.50	2.60
50 yr PWLB	2.00	2.00	2.10	2.20	2.20	2.20	2.30	2.30	2.30	2.30	2.30	2.40

Additional notes by Link on this forecast table: -

- LIBOR and LIBID rates will cease from the end of 2021. Work is currently progressing to replace LIBOR with a rate based on SONIA (Sterling Overnight Index Average). In the meantime, our forecasts are based on expected average earnings by local authorities for 3 to 12 months.
- Our forecasts for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short term cash at any one point in time.



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 Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings.

### **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 1<sup>st</sup> 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

**The current PWLB rates are set as margins over gilt yields as follows: -.**

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

**Gilt yields.** Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. During September, gilt yields from 5 – 50 years have steadily risen and rose further after the hawkish tone of the MPC's minutes last week. Our forecasts show a steady, but slow, rise in both Bank Rate and gilt yields during the forecast period to March 2024.

While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in America could have on gilt yields. **As an average since 2011, there has been a 75% correlation between movements in US 10 year treasury yields and UK 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.**

### 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 suppresses 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 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 economy: -

- The overall balance of risks to 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.

### 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.