REPORT TO:	General Purposes and Audit Committee 25 November 2021
SUBJECT:	Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review 2021/2022
LEAD OFFICER:	Richard Ennis, Interim Director of Finance, Investment and Risk (S151 Officer)
CABINET MEMBER	Councillor Callton Young Cabinet Member for Resources and Financial Governance
WARDS:	All
CORPORATE PRIORITY/POLICY CONTEXT: This Report details the Council's Treasury Management activities during the first half of 2021/2022 and its compliance with the 2017 Prudential Code for Capital Finance.	
FINANCIAL SUMMARY: This Report details the Council's Treasury Management activities during the first half of 2021/2022 and demonstrates its compliance with the 2017 Prudential Code for Capital Finance.	
FORWARD PLAN KEY DECISION REFERENCE NO.: N/A	

1. RECOMMENDATION

1.1 The Committee are asked to note the contents of this report.

2. EXECUTIVE SUMMARY

2.1 This Report is prepared in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) codes of practice in respect of capital finance and treasury management. The Codes recommend that members are advised of treasury management activities of the first six months of each financial year and of compliance with various strategies and policies agreed by the Council. The report:

- Reviews compliance with the Treasury Management Strategy Statement, Capital Strategy and Annual Investment Strategy as agreed by Council on 8 March 2021 (Minute 19/21 applies);
- Reviews treasury borrowing and investment activity for the period 1 April 2021 to 30 September 2021; and
- Demonstrates compliance with agreed Prudential Indicators;

3 DETAIL

3.1 Background

3.1.1 In December 2017, CIPFA issued these two Codes of Practice:

- The Prudential Code for Capital Finance in Local Authorities; and
- Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.

3.1.2 Under the Prudential Code, from 2019/20, all local authorities are required to prepare a Capital Strategy which is to provide the following:

- A high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- An overview of how the associated risk is managed;
- The implications for future financial sustainability.

3.1.3 As regards Treasury Management, the primary requirements of the Code are:

- 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 manner in which 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 specific named body. For this Council the delegated body is the General Purposes and Audit Committee.

3.1.4 This mid-year report has been prepared in compliance with the Codes and covers the following:

- An economic update for the first half of the 2021/22 financial year (Section 3.2);
- A medium term interest rates forecast (Section 3.3);
- A review of the Council's Treasury Management Strategy Statement and Annual Investment Strategy (Section 3.4);
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators (Section 3.5);

- A review of the Council's borrowing strategy (Section 3.6);
- A review of the Council's investment strategy (Section 3.7); and
- A review of any debt re-scheduling undertaken (Section 3.8).

3.2 Economic update

3.2.1 A commentary provided by the Council's independent treasury advisers Link Asset Services (Link) in the first week of September 2021 is included as Appendix A.

3.3 Interest rate forecasts

3.3.1 Link have provided forecasts of key interest rates as detailed in Table 1. These inform decisions as to the timing and duration of borrowing decisions.

Table 1 Interest rates forecast

Link Group Interest Rate View	10.8.21										
	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	0.25	0.25	0.25	0.50
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.30	0.30	0.30	0.50
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.20	0.30	0.40	0.50	0.50
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.70
5 yr PWLB	1.20	1.20	1.20	1.30	1.30	1.30	1.40	1.40	1.40	1.50	1.50
10 yr PWLB	1.60	1.60	1.70	1.70	1.80	1.80	1.90	1.90	1.90	2.00	2.00
25 yr PWLB	1.90	2.00	2.10	2.20	2.30	2.30	2.30	2.40	2.40	2.40	2.50
50 yr PWLB	1.70	1.80	1.90	2.00	2.10	2.10	2.10	2.20	2.20	2.20	2.30

3.3.2 A commentary by Link is included as Appendix B.

3.4 Treasury Management Strategy Statement and Annual Investment Strategy

3.4.1 The Treasury Management Strategy Statement and Annual Investment Strategy for 2021/2022 were approved by full Council on 8 March 2021 (Minute 19/21 applies). No changes are recommended.

3.5 Capital Strategy and Prudential Indicators

3.5.1 Table 2 below shows the original capital budget as agreed by full Council on 8 March 2021 (Minute 18/21 applies) and the revised approved budget and the estimated outturn at month 6. Members are advised to refer to this latter report for a commentary on these changes.

Table 2 Capital expenditure by service

	Original Estimate £m	Approved Budget £m	Outturn Projection £m

Adults Health and Social Care		0.8	0.8
Gateway and Housing	4.0	7.4	4.0
Children, Families and Education	13.7	26.1	16.6
Place	33.6	78.1	54.2
Resources	11.2	26.3	14.3
Capitalisation Direction	50.0	50.0	50.0
HRA	81.5	183.2	97.0
Total	**194.0**	**371.9**	**236.9**

3.5.2 The table below details the funding sources of the capital programme. The borrowing element of the table increases the underlying need to borrow for capital purposes by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision).

Table 3 Financing of capital expenditure

	Original Estimate £m	Revised Estimate £m	Outturn Projection £m
Capital grants	22.9	30.9	22.2
Community Infrastructure Levy	6.8	6.8	6.8
Capital reserves	19.8	19.8	19.8
Section 106 receipts	0.8	0.8	0.8
Major Repairs Allowance	13.7	13.7	13.7
Revenue	8.2	8.2	8.2
Total financing	**72.2**	**80.2**	**71.5**
Borrowing requirement	**121.8**	**291.7**	**165.4**

3.5.3 The key controls over treasury management activity are prudential indicators to ensure that, over the medium term, borrowing will only be for a capital purposes. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for the current year and the next two financial years. This allows some flexibility for limited early borrowing for future years. Full Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent. The table below shows changes in the CFR and borrowing requirements arising from the changes in the capital programme described above.

Table 4 Borrowing and CFR

	Original Estimate £m	Outturn Projection £m
Borrowing	1,591.7	1,611.9
Other long term liabilities	75.8	71.5
Total debt	1,667.5	1,683.4
CFR (year end position)	1,664.7	1,802.9

3.5.4 The Prudential Indicators relevant to the capital programme and its borrowing implications are the Operational Boundary (the expected debt position) and the Authorised Limit (the limit beyond which borrowing is prohibited).

Table 5 Operational Boundary and Authorised Limit

	Original Estimate £m	Outturn Projection £m
Operational Boundary	1,987.8	1,683.4
Authorised Limit	2,037.8	1,733.4

3.5.5 The Authorised Limit includes a buffer of £50m to cover unexpected cash-flow shortages.

3.6 Borrowing Strategy

3.6.1 During 2021/22 the Council has been operating in accordance with the borrowing limits approved by full Council on 8 March 2020. As discussed above, the current limits for the year are:

- Operational Boundary - £1,987.8m
- Authorised Limit - £2,037.8m

3.6.2 The level of the Council's borrowing, which is measured against the limits, was £1,446.5m and the level of long term liabilities was £73.6m as at 1 April 2021. At 30 September 2021 the level of borrowing had decreased by £22m to £1,424.5m and the level of long term liabilities remained at £73.6m. This means that to date the Council has not had to borrow in order to finance the Capitalisation Direction.

3.6.3 Borrowing will be taken up as required based on a continuing analysis of actual and projected expenditure over the different components of the capital programme and interest rates forecasts. It is likely that the Council will use a mixture of long term borrowing from the PWLB, short term borrowing from other local authorities and internal balances. Borrowing will be undertaken to fit into the Council's existing debt maturity profile to move towards a more even distribution of maturities. Appendix C shows the movements in PWLB interest rates for various loan periods during the first six months of the financial year.

3.6.4 At 30 September 2021, the Council had long term debt of £1,042.5m with an average rate of interest payable of 3.1% and debt due to mature within one year of £382m with an average interest rate of 0.9%.

3.7 Investment Strategy

3.7.1 From time to time, under Section 15 (1) of the Local Government Act 2003 the Secretary of State issues statutory guidance on local government investments to which local authorities are required to "have regard." This guidance was taken into account in the investment policy parameters set within the Council's Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy as approved by full Council on 8 March 2021 Minute 19/21 applies).

3.7.2 The current guidance defines investments as "Specified" and "Non-specified"

3.7.3 An investment is a specified investment if all of the following apply:

- the investment and any associated payments or repayments are denominated in sterling;
- the investment has a maximum maturity of one year;
- the investment is not defined as capital expenditure; and
- the investment is made with a body or in an investment scheme described as high quality or with the UK Government, a UK local authority or a parish or community council.

3.7.4 A non-specified investment is any investment that does not meet all the conditions in paragraph 3.7.3 above.

3.7.5 It is the Council's priority when undertaking treasury activities to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. Investment instruments identified for use by the Council during 2021/2022 as advised in the current Treasury Management Strategy are detailed in Appendix D.

3.7.6 As regards investment returns, Link advise as follows:

As shown by the interest rate forecasts in section 3.3, 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 Bank Rate was cut to 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 are expected to remain low.

3.7.7 Investment activity in the first half of the year conformed to the approved strategy with an average monthly balance of £68.2m being maintained in temporary investments.

3.7.8 The Interim Director of Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2021/2022.

3.8 Repayment of Debt and Debt Rescheduling

3.8.1 With Public Works Loans Board rates low during the first half of 2021/2022 and with high premiums being attached to the premature repayment of existing debt, opportunities for debt restructuring were minimal and none were taken.

3.8.2 During the first half of the year the Council has refinanced existing maturing debt on a short term basis using other Local authorities. Rates achieved have been significantly lower than the PWLB. Going forward the Council will look to refinance a portion of maturing debt over a longer term in order to limit the risk associated with the impact of increasing interest rates. This should be achievable as a portion of debt maturing over the next year is at rates which are higher than current and forecast long term rates for PWLB.

4. FINANCIAL CONSIDERATIONS

4.1 There are no additional financial considerations arising from this report.

Approved by: Richard Ennis, Interim Director of Finance, Investment and Risk, S. 151 Officer.

5. OTHER CONSIDERATIONS

5.1 There are no Customer Focus, Equalities, Environment and Design, Crime and Disorder or Human Rights considerations arising from this report

6. COMMENTS OF THE SOLICITOR TO THE COUNCIL

6.1 The Head of Litigation and Corporate Law comments on behalf of the interim Director of Law and Governance that the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended) made pursuant to the Local Government Act 2003 requires the Council to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities ("The Prudential Code"). Regulations 23 and 24 provide respectively that capital receipts may only be used for specified purposes and that in carrying out its capital finance functions, a local authority must have regard to the code of practice in "Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (2017 Edition)" ("The Treasury Code") issued by CIPFA.

6.2 In relation to the Annual Investment Strategy, the Council is required to have regard to the Guidance issued by the Secretary of State under section 15(1)(a) of the Local Government Act 2003 entitled "Statutory guidance on Local Government Investments 3rd Edition" which is applicable from and effective for financial years commencing on or after 1 April 2018.

6.3 In addition, two codes of practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) contain investment guidance which complements the Ministry of Housing Communities and Local Government (MHCLG) guidance. These publications are:

- Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes
- The Prudential Code for Capital Finance in Local Authorities

6.4 Local authorities are required to have regard to the current editions of the CIPFA codes by regulations 2 and 24 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 as amended.

6.5 Under the provisions of Section 3(1) and (8) of the Local Government Act 2003, the Council shall determine and keep under review how much money it can afford to borrow, and the function of determining and keeping these levels under review is a reserved function of Full Council.

6.6 In determining the Annual Minimum Reserves and the recommended policy around such reserves, the Council shall have regard to the Guidance issued by the Secretary of State under Section 21(1A) of the Local Government Act 2003 entitled "Statutory guidance on minimum revenue provision"

6.7 The requirement for a Capital Strategy Statement stems from the provisions of the Prudential Code which was most recently updated in December 2017. The Prudential Code requires authorities to look at capital expenditure and investment plans in the light of overall organisational strategy and resources and ensure that decisions are made with sufficient regard to the long run financing implications and potential risks to the authority. The Prudential Code sets out that in order to demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability, authorities should have in place a capital strategy.

Approved by: Sandra Herbert, Head of Litigation and Corporate Law on behalf of the interim Director of Law and Governance & Deputy Monitoring Officer

7. FREEDOM OF INFORMATION

7.1 This report contains only information that can be publicly disclosed.

8 DATA PROTECTION IMPLICATIONS

8.1 Will the subject of the report involve the processing of ‘personal data’?

No.

Has a data protection impact assessment (DPIA) been completed?

No. This report relates to matters relating to the administration of the LGPS and the Croydon Pension Fund.

Approved by: Richard Ennis, Interim Director of Finance, Investment and Risk, S151 Officer

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BACKGROUND DOCUMENTS:	None
APPENDICES:	A Economic update B Interest rate forecast update C PWLB rates D Investment instruments

APPENDIX A

Economic update (as prepared by Link Asset Services in the first week of September 2021)

MPC meeting 5.8.21

- 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; only one MPC member voted to stop these purchases now to leave total purchases £45bn short of the total target.
- While that was all very much unchanged from previous MPC decisions over the last year, there was a major shift from indicating no expected tightening any time soon to now flagging up that **interest rate increases were now on the horizon.** There was disagreement among MPC members, some of whom felt that the forward guidance that the MPC won't tighten policy until inflation "is achieving the 2% inflation target sustainably", had already been met. Although other MPC members did not agree with them, they did all agree that **"some modest tightening of monetary policy over the forecast period was likely to be necessary to be consistent with meeting the inflation target sustainably in the medium term".**
- The MPC was more upbeat in its new 2-3 year forecasts so whereas they had expected unemployment to peak at 5.4% in Q3, the MPC now thought that the peak had already passed. (It is to be noted though, that the recent spread of the Delta variant has damaged growth over the last couple of months and has set back recovery to the pre-pandemic level of economic activity till probably late 2021.)
- We have been waiting for the MPC to conclude a **review of its monetary policy** as to whether it should raise Bank Rate first before reducing its balance sheet (quantitative easing) holdings of bonds. This review has now been completed so we learnt that it will start to tighten monetary policy by: -
    1. Placing the focus on raising Bank Rate as "the active instrument in most circumstances".
    2. Raising Bank Rate to 0.50% (1.50% previously), 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.
- What the MPC did not give us was any indication on when it would start raising Bank Rate. Inflation is currently expected to peak at over 4% during 2021. **The key issue** then is whether this is just going to be transitory inflation or whether it will morph into inflation which will exceed the MPC's 2% target <u>on an ongoing basis</u>. In his press conference, 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's worried that labour shortages will push up wage growth by more than it expects and that, as a result, CPI inflation will stay above the 2% target for longer. Which then raises an interesting question as to whether the million or so workers who left the UK during the pandemic, will come back to the UK and help to relieve wage inflation pressures. We also have an unknown as to how trade with the EU will evolve once the pandemic distortions have dissipated now that the UK no longer has tariff free access to EU markets.
- At the current time, the MPC's forecasts are showing inflation close to, but just below, its 2% target in 2 to 3 years' time. The initial surge in inflation in 2021 and 2022 is due to a combination of base effects, one off energy price increases and a release of pent-up demand, particularly from consumers who have accumulated massive savings during the pandemic, hitting supply constraints. However, these effects will gradually subside or fall out of the calculation of inflation. The issue for the MPC will, therefore, turn into a question of **when the elimination of spare capacity in the economy** takes over as being the main driver to push inflation upwards and this could then mean that the MPC will not start tightening policy until 2023. Remember, the MPC has sets its policy as being wanting to see inflation coming in <u>sustainably</u> over 2% to counteract periods when inflation was below 2%. While financial markets have been pricing in a hike in Bank Rate to 0.25% by mid-2022, and to 0.50% by the end of 2022, they appear to be getting ahead

of themselves. The first increase to 0.25% is more likely to come later; our forecast shows the first increase in Q1 of 23/24 and the second to 0.50% in Q4 of 23/24. The second increase would then open the way for the Bank to cease reinvesting maturing bonds sometime during 2024.

Gilt and treasury yields

Since the start of 2021, we have seen 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: -

1. A fast vaccination programme has enabled a rapid opening up of the economy.
2. The economy had already been growing strongly during 2021.
3. 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.
4. 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.

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 <u>above</u> 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. Although there are nuances between the monetary policy of all three banks, the overall common ground is allowing the inflation target to be symmetrical so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time. ***For local authorities, this means that interest 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.

Globally, our views on economies are as follows: -

- **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 of -0.3% in Q1, Q2 came in with strong growth of 2.2% which is likely to continue into Q3, though some countries more dependent on tourism may struggle. There is little sign that underlying inflationary pressures are building to cause the ECB any concern.

- **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. 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 2021. However, the pace of economic growth will fall back after this initial surge of recovery from the pandemic. China is also now struggling to contain the spread of the Delta variant through sharp local lockdowns which will damage economic growth. There are also questions as to how effective Chinese vaccines are proving.

- **Japan.** After declaring a second state of emergency on 7th January, which depressed growth in Q1 2021, the economy was expected to make a strong recovery to pre-pandemic GDP levels in the rest of the year as the slow role out of vaccines eventually gathers momentum. However, the Delta variant has now raised questions as to whether lockdowns will be needed to contain it and to protect the health service from being overwhelmed.

- **World growth.** Further progress on vaccine rollouts, continued policy support, and the re-opening of most major economies should mean that global GDP growth in 2021 will grow at its fastest rate since 1973. The spread of the Delta variant poses the greatest risk to this view, particularly in large parts of the emerging world where vaccination coverage is typically lower than in advanced economies. Continued strong recovery will be accompanied by higher inflation. While most of the arithmetic and commodity price effects boosting inflation in recent months are behind us, goods shortages will last well into 2022 as order backlogs are worked through and inventories are replenished. What's more there is mounting evidence that rapid re-opening of economies generates labour shortages, which could exert further upward pressure on firms' costs. So, global inflation is unlikely to drop back until next year.

APPENDIX B

Interest rate forecast update (as prepared by Link Asset Services in the first week of August 2021)

The Council's treasury advisor, Link Group, provided the following forecasts on 10th August 2021 (PWLB rates are certainty rates, gilt yields plus 80bps):

Link Group Interest Rate View			10.8.21								
	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	0.25	0.25	0.25	0.50
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.30	0.30	0.30	0.50
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.20	0.30	0.40	0.50	0.50
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.70
5 yr PWLB	1.20	1.20	1.20	1.30	1.30	1.30	1.40	1.40	1.40	1.50	1.50
10 yr PWLB	1.60	1.60	1.70	1.70	1.80	1.80	1.90	1.90	1.90	2.00	2.00
25 yr PWLB	1.90	2.00	2.10	2.20	2.30	2.30	2.30	2.40	2.40	2.40	2.50
50 yr PWLB	1.70	1.80	1.90	2.00	2.10	2.10	2.10	2.20	2.20	2.20	2.30

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.*
- *We will maintain continuity by providing clients with LIBID investment benchmark rates on the current basis.*

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, although some forecasters had suggested that a cut into negative territory could have happened prior to more recent months when strong recovery started kicking in. However, the minutes of the Monetary Policy Committee in February 2021 made it clear that commercial banks could not implement negative rates within six months; by that time the economy would be expected to be recovering strongly and so there would be no requirement for negative rates. As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 1 of 2023/24 and another increase to 0.50% in quarter 4 of 23/24, as an indication that the Bank of England will be starting monetary tightening during this year.

PWLB RATES. There was much speculation during the **second half of 2019** that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been **the gradual lowering of the overall level of interest rates and bond yields in financial markets.** Over the year prior to the coronavirus crisis, this resulted in many bond yields up to 10 years turning negative in the Eurozone. In addition, there was, at times, an inversion of bond yields in the US whereby 10 year yields fell below shorter-term yields. In the past, this has been a precursor of a recession.

Gilt yields had, therefore, already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020 which caused gilt yields to spike up. However, yields then fell sharply in response to major western central banks taking rapid policy action to deal with excessive stress in financial markets during March and starting massive quantitative easing driven purchases of government bonds: these actions also acted to put downward pressure on government bond yields at a time when there was a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in "normal" times would have caused bond yields to rise sharply.

At the start of January 2021, all gilt yields from 1 to 8 years were negative: however, since then all gilt yields have become positive and rose sharply, especially in medium and longer-term periods, until starting a significant decline since May. The main driver of the increases was investors becoming progressively more concerned at the way that inflation was expected to rise sharply in major western economies during 2021 and 2022. However, repeated assurances by the Fed in the US, and by other major world central banks, that inflation would spike up after Covid restrictions were abolished, but would only be transitory, have eventually allayed those investor fears. **However, there is an alternative view that the US Fed is taking a too laid-back view that inflation pressures in the US are purely transitory and that they will subside without the need for the Fed to take any action to tighten monetary policy. This could mean that US rates will end up rising faster and sharper if inflationary pressures were to escalate; the consequent increases in treasury yields could well spill over to cause (lesser) increases in gilt yields.**

As the interest forecast table for PWLB certainty rates, (gilts plus 80bps), above shows, there is likely to be an unwinding of the currently depressed levels of PWLB rates and 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.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is now to the upside though there are still residual risks from Covid variants - both domestically and their potential effects worldwide, and from various shortages.
-
- There is relatively little domestic risk of increases in Bank Rate exceeding 0.50% in the next two to three years and, therefore, in shorter-term PWLB rates.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- **Mutations** of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, resulting in further national lockdowns or severe regional restrictions.

- **MPC** acts too quickly in unwinding QE or increasing Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
  -
- The Government implements an **austerity programme** that supresses GDP growth.

- **Labour and material shortages** do not ease over the next few months and further stifle economic recovery.

- The lockdowns cause major long-term **scarring of the economy.**

- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- A resurgence of the **Eurozone sovereign debt crisis.** The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for "weaker" countries. In addition, the EU agreed a €750bn fiscal support package which has still to be disbursed. These actions will help shield weaker economic regions in the near-term. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.

- Weak capitalisation of some **European banks**, which could be undermined further depending on the extent of credit losses resulting from the pandemic.

- **German minority government & general election in September 2021.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, because of the rise in popularity of the anti-immigration AfD party. Subsequently, the CDU has done badly in state elections, but the SPD has done even worse. Angela Merkel has stepped down from being the CDU party leader but remains as Chancellor until the general election in 2021. Her appointed successor has not attracted wide support from voters and the result of the general election could well lead to some form of coalition government, though there could be a question as to whether the CDU will be part of it which, in turn, could then raise an issue over the tenure of her successor. This then leaves a question mark over who the major guiding hand and driver of EU unity will be.

- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile and, therein, impact market confidence/economic prospects and lead to increasing safe-haven flows.
- **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 selloffs on the general economy.
- **Geopolitical risks,** for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe-haven flows.

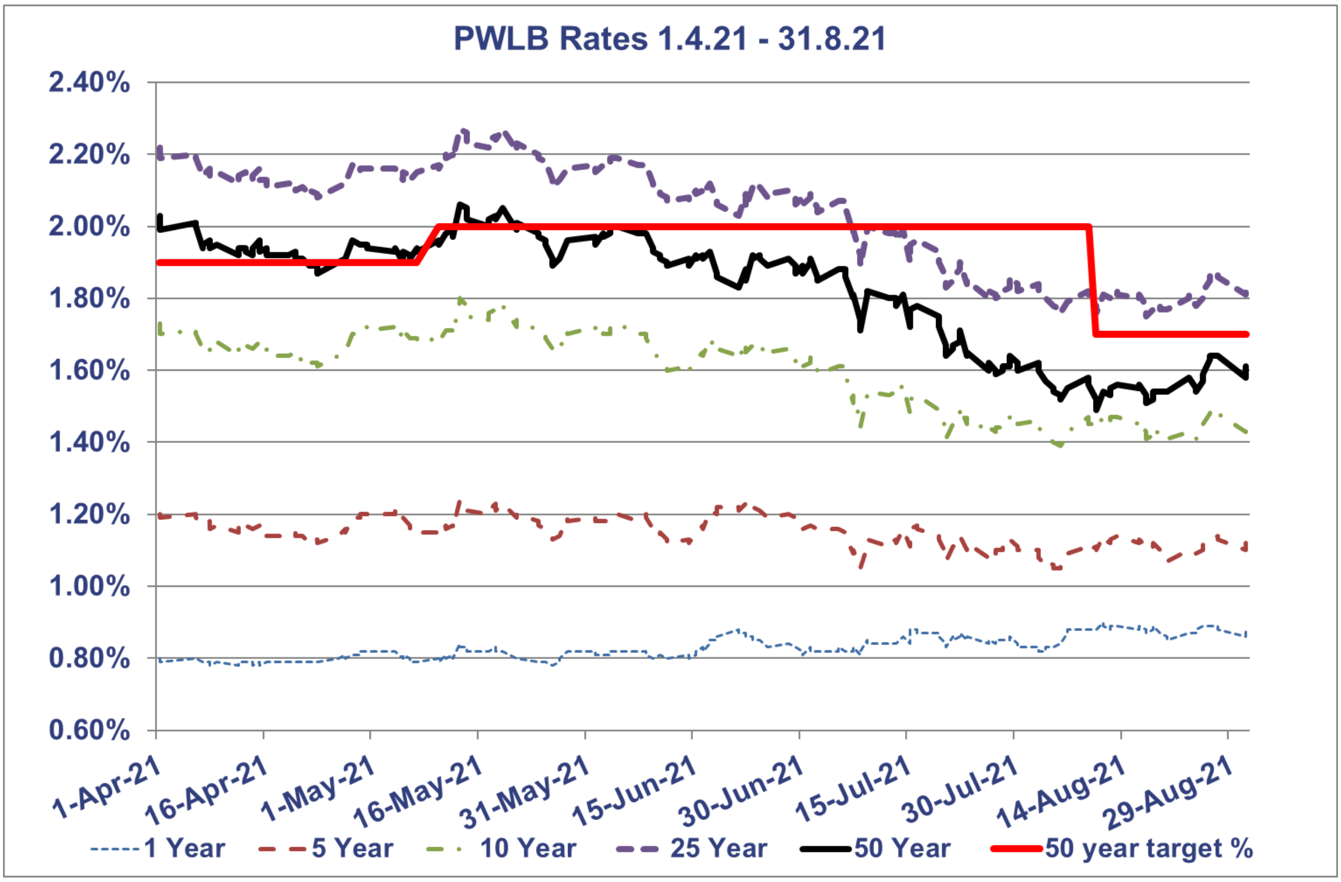
Upside risks to current forecasts for UK gilt yields and PWLB rates: -

- Longer term **US treasury yields** rise strongly and pull UK gilt yields up higher than forecast.

- **Vaccinations** are even more successful than expected and eradicate hesitancy around a full return to normal life, which leads into a stronger than currently expected recovery in UK and/or other major developed economies.

- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

APPENDIX C



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.78%	1.05%	1.39%	1.75%	1.49%
Date	08/04/2021	08/07/2021	05/08/2021	17/08/2021	10/08/2021
High	0.90%	1.24%	1.80%	2.27%	2.06%
Date	11/08/2021	13/05/2021	13/05/2021	13/05/2021	13/05/2021
Average	0.83%	1.15%	1.59%	2.03%	1.82%
Spread	0.12%	0.19%	0.41%	0.52%	0.57%

APPENDIX D

Investment instruments

Specified investments

AAA rated money market funds - limit £20m
Debt Management Office – no limit
Royal Bank of Scotland* – limit £25m
Duration of up to one year.

*Royal Bank of Scotland is included as a specified investment since it is the Council's banker and the UK Government holds a majority stake.

Non-specified investments

All institutions included on Link Asset Services' weekly "Suggested Credit List" – limit £10m
All UK local authorities – limit £10m
Duration to be determined by the "Suggested Credit List" from Link