REPORT TO:	**AUDIT COMMITTEE**		
DATE:	28 February 2022		
TITLE:	**MID YEAR REVIEW TREASURY REPORT 2021/2022**		
TYPE OF REPORT:	Review		
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OPEN/EXEMPT	Open	WILL BE SUBJECT TO A FUTURE CABINET REPORT:	No

Date of meeting: 28 February 2022

MID YEAR TREASURY OUTTURN REPORT 2021/2022

Summary

The Council has formally adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017) and remains fully compliant with its requirements. One of the primary requirements of the Code is receipt by Council of a Mid-Year Review Report.

The Mid-Year Review Report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- A review of the Treasury Management Strategy;
- The Council's capital expenditure (prudential indicators);
- An economic update for the first six months of 2021/2022.

Additional Supporting Information
Appendix 1 – Economic Outlook
Appendix 2 – Investments as at 31 October 2021
Appendix 3 – Borrowing as at 31 October 2021
Appendix 4 – Prudential Indicators

Recommendation

Audit Committee is asked to note the report and the treasury activity.

Reason for Recommendation

The Council has formally adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017) and remains fully compliant with its requirements. One of the primary requirements of the Code is, receipt by Audit Committee of a Mid-Year Review Report.

1. The Treasury Management Mid-Year Review 2021/2022

1.1 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

1.2 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 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 Audit Committee.

1.3 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 the 2021/22 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- 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. Appendix 3.

2. Economic Update

2.1 An update reporting a number of factors that could be influencing the economy at the mid-year point is included at Appendix 1. Since that update was reported UK inflation, as measured by the Consumer Price Index (CPI), jumped to 5.1% year on year in November from 4.2% in October, reaching its highest rate since December 2011. This saw the Monetary Policy Committee (MPC) raise the Bank Rate to 0.25% in December 2021 and to 0.5% in February 2022 demonstrating an increase sooner than had been forecast in the table below. Appendix 1 is provided for information, but it is recognised that changes in inflation and the bank rate have occurred since and this is reflected in the Treasury Management Strategy 2022/2023 as reported to Cabinet on 9 February 2022.

Bank Rate Forecast (Link Group 20 December 2021)

Dec 2021	Mar 2022	Jun 2022	Sep 2022	Dec 2022	Mar 2023	Jun 2023	Sep 2023	Dec 2023	Mar 2024	Jun 2024
0.25%	0.25%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%

3. Treasury Management Strategy Statement and Annual Investment Strategy Update

3.1 The Treasury Management Strategy Statement, (TMSS), for 2021/22 was approved by this Council on 2 February 2021.

3.2 There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

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

4.1 This section of the report provides an update on:

- 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.

4.2 Prudential Indicator for Capital Expenditure

4.2.1 The table below shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at full Council on 16 March 2021.

Capital Expenditure	2021/22 Original Estimate	2021/22 Actual as at 31 Oct 21	2021/22 Revised Estimate
	£'000	£'000	£'000
Major Projects	41,288	993	37,315
Operational Schemes:			
Community and Partnerships	2,752	1,118	2,695
Resources	431	24	431
Property and Projects	94	0	66
Operational and Commercial Services	2,899	734	1,358
Leisure and Community Facilities	1,261	0	198
Exempt Schemes	22,584	3,407	15,431
Total Capital Expenditure	**71,309**	**6,276**	**57,494**

4.3 **Changes to the Financing of the Capital Programme**

4.3.1 The table below shows how the capital expenditure is expected to be financed in the year. The borrowing requirement shown at the bottom of the table increases the underlying 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 (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by needing to replace maturing debt and other treasury requirements.

Financing Capital Expenditure	2021/22 Original Estimate	2021/22 Actual as at 31 Oct 21	2021/22 Revised Estimate
	£'000	£'000	£'000
Total Capital Expenditure	71,309	6,276	57,494
Capital Receipts	1,709	46	13,099
Capital Grants	1,775	2,300	3,337
Capital Reserves	889	75	2,777
Revenue	5,757	3,286	1,725
Total financing	**10,130**	**5,708**	**20,938**
Borrowing requirement	**61,179**	**568**	**36,556**

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

4.5 The first table below shows the CFR, which is the underlying need to borrow for a capital purpose (i.e. capital expenditure which has not been financed immediately through the use of capital receipts, capital grants or revenue contributions and is still to be financed). It also shows the expected debt position over the period, which is termed the Operational Boundary.

4.6 **Prudential Indicator – Capital Financing Requirement**

The council is on target to achieve the original forecast CFR.

4.7 **Prudential Indicator – The Operational Boundary for External Debt**

Capital Financing Requirement (CFR)	2021/22 Original Estimate	2021/22 Actual as at 31 Oct 21	2021/22 Revised Estimate
	£'000	£'000	£'000
Prudential Indicator – Capital Financing Requirement			
CFR	77,198	61,115	61,115
Net Movement in CFR			
Prudential Indicator – the Operational Boundary for External Debt			
Borrowing	10,000	10,000	10,000
Total Debt (Year End Position)	**67,198**	**51,115**	**51,115**
External Debt for Commercial activities	**2021/22 Original Estimate**	**2021/22 Actual as at 31 Oct 21**	**2021/22 Revised Estimate**
	£'000	£'000	£'000
Actual debt at 31 March £m	4,788	0	0
Percentage of total external debt %	7%	0%	0%

4.8 **Limits to Borrowing Activity**

4.9 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 CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and 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.

Operational Boundary	2021/22 Original Estimate	2021/22 Actual as at 31 Oct 21	2021/22 Revised Estimate
	£'000	£'000	£'000
Borrowing	77,000	61,000	61,000
Other Long-Term Liabilities	1,000	1,000	1,000
Commercial Activities	10,000	10,000	10,000
Total Debt (Year End Position)	**88,000**	**72,000**	**72,000**
CFR * (Year End Position)	**77,198**	**61,115**	**61,115**

4.10 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

Authorised Boundary	2021/22 Original Estimate	2021/22 Actual as at 31 Oct 21	2021/22 Revised Estimate
	£'000	£'000	£'000
Borrowing	82,000	66,000	66,000
Other Long-Term Liabilities	1,000	1,000	1,000
Commercial Activities	10,000	10,000	10,000
Total Debt	**93,000**	**77,000**	**77,000**

5. Investment Portfolio 2021/22

5.1 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and then to obtain an appropriate level of return which is consistent with the Council's risk appetite. As shown by forecasts in section 2.1, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.10% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short-term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

5.2 The Council held £42.685m of investments as at 31 October 2021 (£16.038m at 31 March 2021) and the investment portfolio yield for the first 6 months of the year is 0.13% against a benchmark 7 day LIBID rate of negative 0.06%.

5.3 A full list of investments held as at 31 October 2021 is in appendix 1:

5.4 The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first 7 months of 2021/22.

5.5 The Council's budgeted investment return for 2021/22 is £10,450, and performance for the year to date is £5,427 which is £5,023 below budget.

6. Borrowing

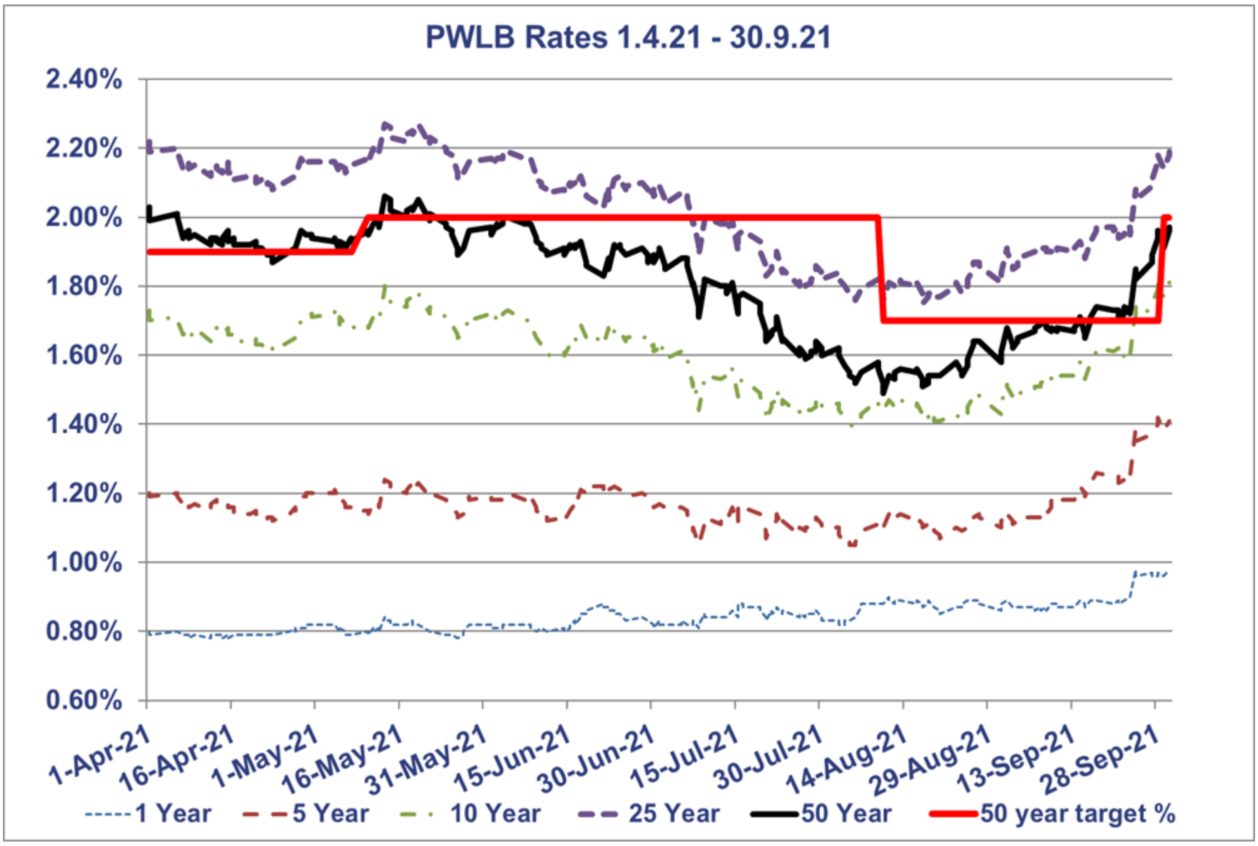
6.1 The Council's capital financing requirement (CFR) for 2021/22 is £61.115m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The table in paragraph 4.7 above shows the Council has borrowings of £10m and has utilised £51.115m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

6.2 It is anticipated that further borrowing will not be undertaken during this financial year.

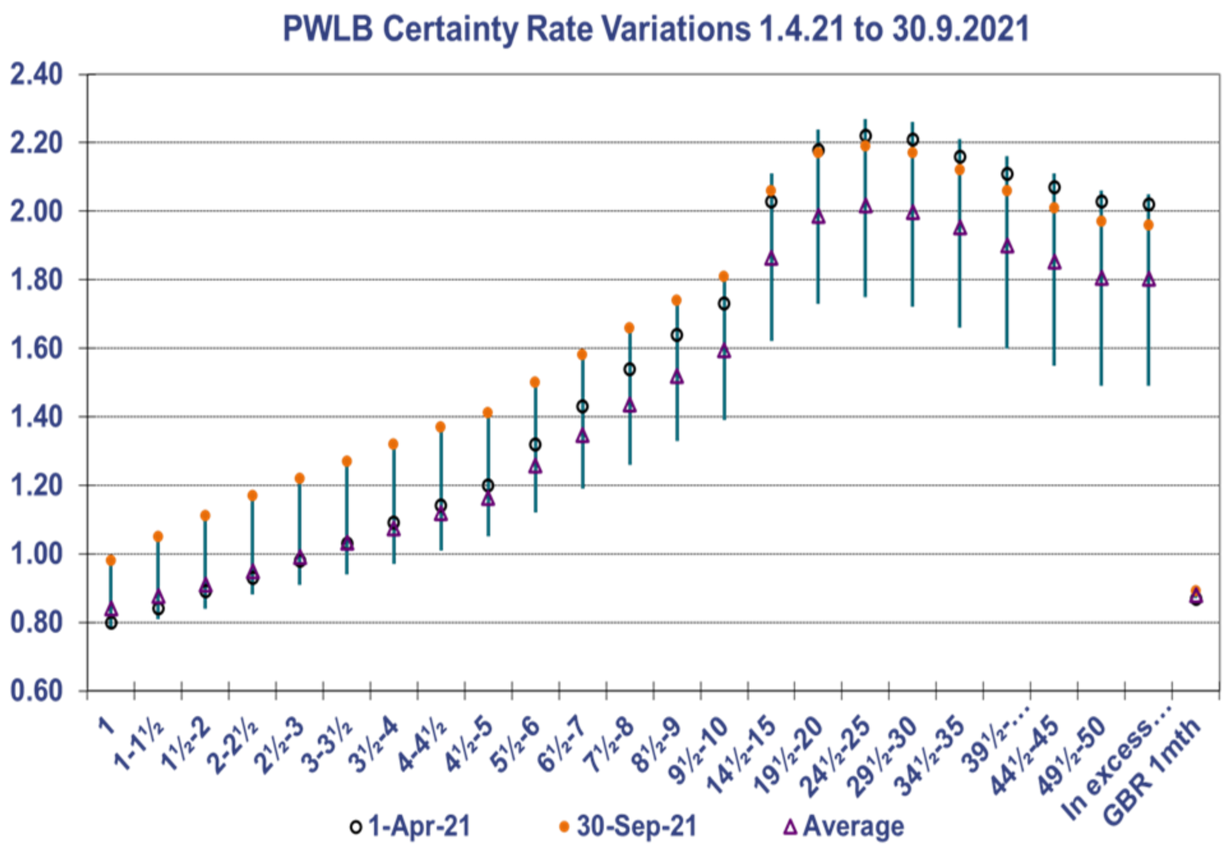
6.3 The graph and table below show the movement in PWLB certainty rates for the first six months of the year to date. A full list of borrowing can be found in Appendix 2

6.4 PWLB rates were on a falling trend between May and August. However, they rose sharply towards the end of September before falling again during quarter 3 until rising once more in the last ten days of the year.

6.5 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, returned to 2.00% at the end of September after the MPC meeting of 23rd September.



	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	0.98%	1.42%	1.81%	2.27%	2.06%
Date	24/09/2021	28/09/2021	28/09/2021	13/05/2021	13/05/2021
Average	0.84%	1.16%	1.60%	2.02%	1.81%
Spread	0.20%	0.37%	0.42%	0.52%	0.57%



7. 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.

8. Compliance with Treasury and Prudential Limits

8.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. To the period ended 31st December 2021, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2021. The Assistant Director of Finance reports that no difficulties are envisaged for the current or future years in complying with these indicators

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

9. Annual Investment Strategy

9.1 The Treasury Management Strategy Statement (TMSS) for 2021/22, which includes the Annual Investment Strategy, was approved by the Council on 16 March 2021. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital

- Liquidity
- Yield

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. 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 section 2, it is currently impossible to earn the level of interest rates commonly seen in previous decades. However, rates have improved during quarter 3 of 21/22 and are expected to improve further as Bank Rate continues to increase over the next two years.

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.

Investment Counterparty criteria
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

CDS prices
Although CDS prices (these are market indicators of credit risk) for banks (including those from the UK) spiked at the outset of the pandemic in 2020, they have subsequently returned to near pre-pandemic levels. **However, sentiment can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.**

10. Financial Implications

10.1 The financial implications of the borrowing and investment strategy are reflected in the financing adjustment figure included in the Financial Plan 2020/2025 approved at Council on 16 March 2021 and updated as reported in the Budget Monitoring reports.

11. Risk Management Implications

11.1 There are elements of risk in dealing with the treasury management function although the production and monitoring of such controls as prudential indicators and the treasury management strategy help to reduce the exposure of the Council to the market. The costs and returns on borrowing and investment are in themselves a reflection of risk as seen by the market forces.

12. Policy Implications

12.1 There are no changes in the Treasury Management policy at present.

13. Statutory Considerations

13.1 The Council must set prudential indicators and adopt a Treasury Management Strategy and Annual Investment Strategy.

14. Access to Information

The Budget 2020/2025 – The Financial Plan
Capital Programme 2020/2025
Treasury Management Strategy and Annual Investment Strategy 2021/2022
Budget Monitoring reports 2021/2022
Investment Portfolio Benchmarking Analysis
Capital Strategy 2021/2022

Economic Outlook (Link Group) **Appendix 1**

MPC meeting 24 September 2021

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.

Interest Rate Forecasts

The Council's treasury advisor, Link Group, provided the following forecasts on 29th September 2021 (PWLB rates are certainty rates, gilt yields plus 80bps):

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

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.

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 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.

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: -

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.

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.

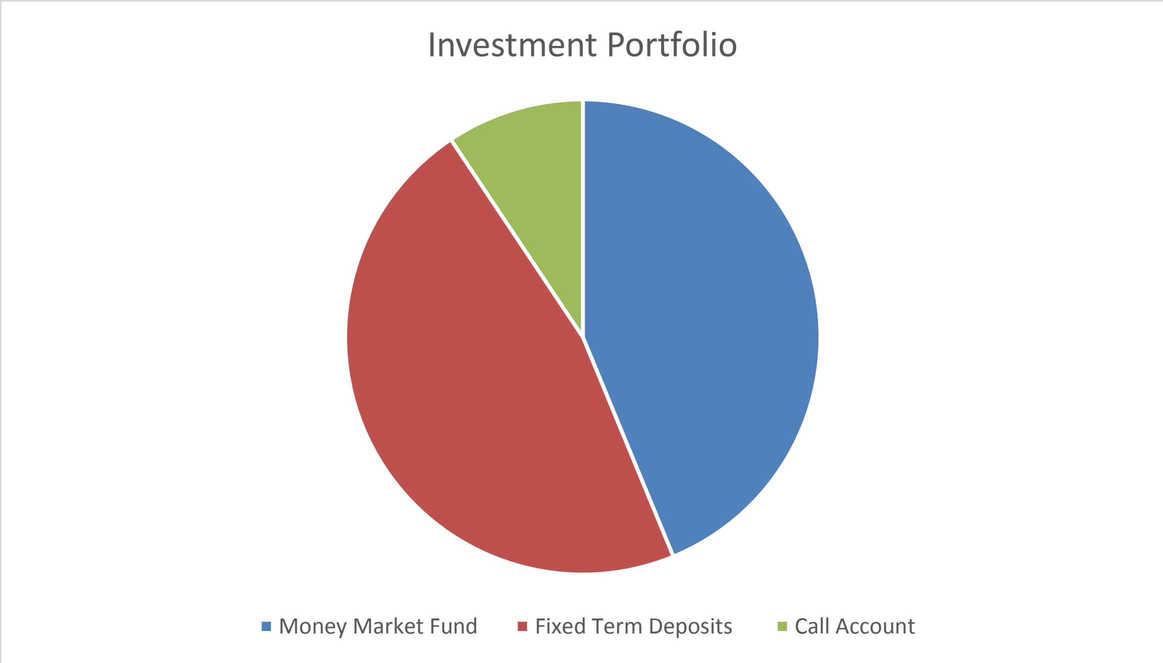
A new era – a fundamental shift in central bank monetary policy

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 <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.

- 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.
- ***<u>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.</u>***
- 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.

Investment Portfolio as at 31 October 2021 **APPENDIX 2**



Institution	Type	Principal £	Start Date	End Date	Rate %	Lowest Long Term Rating
Aberdeen Liquidity	Money Market Fund	4,000,000	N/A	N/A	0.010	AAA
BNP (Banque Nationale de Paris)	Money Market Fund	4,000,000	N/A	N/A	0.021	AAA
Federated PR	Money Market Fund	4,000,000	N/A	N/A	0.010	AAA
HSBC Liquidity	Money Market Fund	2,685,000	N/A	N/A	0.010	AAA
Blackpool Borough Council	Fixed Term Deposits	4,000,000	06/10/2021	06/04/2022	0.040	AA-
Goldman Sachs	Fixed Term Deposits	4,000,000	13/09/2021	11/03/2022	0.450	A+
Handlesbanken	Money Market Fund	4,000,000	N/A	N/A	0.000	AA-
National Bank of Kuwait	Fixed Term Deposits	4,000,000	14/10/2021	14/04/2022	0.240	AA-
Santander - Call Account	Call Account	4,000,000	01/06/2021	N/A	0.450	A+
SMBC Bank International	Fixed Term Deposits	4,000,000	14/10/2021	14/04/2022	0.160	A
Standard Chartered Bank	Fixed Term Deposits	4,000,000	16/07/2021	17/01/2022	0.110	A+
Total Investments		**42,685,000**				

*MMF – denotes Money Market Fund used for daily cash flow purposes.

Borrowing Portfolio as at 31 October 2021 **APPENDIX 3**

Institution	Principal £	Start Date	End Date	Rate
Barclays	5,000,000	22/03/2007	21/03/2077	3.81%
Barclays	5,000,000	12/04/2007	14/04/2077	3.81%
Total Long Term	**10,000,000**			

Prudential Indicators: **APPENDIX 4**

Net borrowing and the CFR	31/03/2021 Actual £m	31/10/2021 Actual £m
Borrowing	10.00	10.00
Investments	(16.00)	(42.69)
Net Position	**(6.00)**	**(32.69)**
Capital Financing Requirement	**38.57**	**61.12***
		*(Estimate for 2021/2022 year end)

In order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2020/2021. This essentially means that the Council is not borrowing to support revenue expenditure. The Council has complied with this prudential indicator.

The Council's Capital Position and Associated Prudential Indicators

The capital programme 2021/2022 was updated for rephasing and amendments as part of the closedown of the accounts 2020/2021. The Capital Programme 2020/2021 was updated at Cabinet on 21st September 2021 and revised estimates are shown in the table below.

	Capital Programme 2021/22	Revised Budget as at 31st Oct 21	Actual as at 31st Oct 21
	£000	**£000**	**£000**
Major Projects	41,288	37,315	993
Community and Partnerships	2,752	2,695	1,118
Resources	431	431	24
Property and Projects	94	66	0
Operational and Commercial Services	2,899	1,358	734
Leisure and Community Facilities	1,261	198	0
Exempt Schemes	22,584	15,431	3,407
Total Including Exempt	**71,309**	**57,494**	**6,276**

Budget Related Prudential Indicators - Revised

	2021/22 Revised Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
Capital Expenditure	57,494	71,349	35,174	21,139
Capital Financing Requirement (CFR) as at 31 March	61,115	87,802	89,226	100,126

Ratio of financing costs to net revenue stream (Equals net treasury cost ie cost of borrowing less the income from investments divided by the total of Government grant and total council tax)	4.03	4.70	4.80	4.63

Authorised / Operational Limit for external debt

	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
Authorised /Operational Limit for external debt	66,000	68,000	80,000	79,000
Operational Boundary for external debt	61,000	63,000	75,000	74,000

- The Authorised Limit represents the maximum limit beyond which borrowing is prohibited and needs to be set and revised by Members.
- The Operational Boundary for External Debt is a working practice limit that is set lower than the Authorised Limit. In effect the authorised limit includes a degree of contingency in case of circumstances arising that take the limit above the operational limit.

Interest Rate Exposures (Limit on fixed and variable rate borrowing)

	2021/22 Upper %	2022/23 Upper %	2023/24 Upper %	2024/25 Upper %
Limits on fixed interest rates based on net debt	100%	100%	100%	100%
Limits on variable interest rates based on net debt	40%	40%	40%	40%

Maturity Structure of fixed interest rate borrowing

	Lower	Upper	Portfolio Position as at 31 Oct 21
Under 12 months	0%	100%	0%
12 months to 2 years	0%	100%	0%
2 years to 5 years	0%	100%	0%
5 years to 10 years	0%	100%	0%
10 years and above	0%	100%	100.00%