

## **REPORT FOR: CABINET**

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<b>Date of Meeting:</b>	15 <sup>th</sup> July 2021
<b>Subject:</b>	Treasury Management Annual Report 2020/21
<b>Key Decision:</b>	No
<b>Responsible Officer:</b>	Dawn Calvert, Director of Finance and Assurance
<b>Portfolio Holder:</b>	Councillor Natasha Proctor, Deputy Leader and Portfolio Holder for Finance and Resources.
<b>Exempt:</b>	No
<b>Decision subject to Call-in:</b>	No
<b>Wards affected:</b>	All wards
<b>Enclosures:</b>	Appendix 1 Link Group Economic Commentary Appendix 2 Borrowing and Investment Rate Summary 2020/21

# Section 1 – Summary and Recommendations

This report sets out the Treasury Management Outturn position for 2020/21.

## **Recommendations:**

Cabinet is requested to:

1. Note the Treasury Management outturn position for 2020/21.
2. Refer this report to the Governance, Audit, Risk Management and Standards Committee for review.

## **Reason: (for recommendations)**

- a) To promote effective financial management and comply with regulations issued under the the Local Government Act 2003, the CIPFA Code of Practice on Treasury Management, and the CIPFA Prudential Code for Capital Finance, along with meeting the requirements of the Council's Financial Regulations.
- b) To keep Members informed of Treasury Management activities and performance for 2020/21.

# Section 2 – Report

## 1.0 Background

1.1 The purpose of this report is to present the Council's Annual Treasury Management outturn position for 2020/21 in accordance with the Council's Treasury Management Practices and in compliance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Code of Practice. The Council has complied with all elements of the Treasury Management Strategy Statement (TMSS) as the treasury management function.

1.2 Treasury management comprises:

- Managing the Council's borrowing to ensure funding of the Council's current and future Capital Programme is at optimal cost;
- Investing surplus cash balances arising from the day-to-day operations of the Council to obtain an optimal return while ensuring security of capital and liquidity.

1.3 The annual revenue budget includes the revenue costs that flow from capital financing decisions. Under the CIPFA Treasury Management Code of Practice and the CIPFA Prudential Code, increases in capital expenditure should be limited to levels whereby increases in interest charges and running costs are affordable within the Council's revenue account.

- 1.4 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation to ensure the security and liquidity of the Council's treasury investments.
- 1.5 The Council recognises that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of the CIPFA Treasury Management Code of Practice.

## 2.0 **Reporting Requirements**

- 2.1 The Council and/or Cabinet are required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

**Treasury Management Strategy Statement Report** – The first, and most important report is presented to the Council in February and covers:

- The Treasury Management Strategy Statement (TMSS), which details how the investments and borrowings for capital expenditure are to be organised, including Treasury Limits and Prudential Indicators.
- The Annual Investment Strategy which forms part of the TMSS, (the parameters on how investments are to be managed).
- the MRP Policy (how capital expenditure is charged to revenue over time).

**The 2020/21 TMSS was presented to Council on 13<sup>th</sup> February 2020.**

**Mid-Year Review Report** – This is presented to Cabinet in December/January and updates Members on the progress of the Capital Programme, reporting on Prudential Indicators to give assurance that the treasury management function is operating within the Treasury Limits and Prudential Indicators set out in the TMSS.

**The 2020/21 Mid-Year Report was presented to Cabinet on 21<sup>st</sup> January 2020/21**

**Treasury Management Outturn Report** – This report, typically presented to Cabinet in June/July, provides details of a selection of actual Prudential and Treasury Indicators and actual treasury operations compared to the estimates within the TMSS.

This report fulfills this reporting requirement.

- 2.2 **Scrutiny** – The above reports are required to be adequately scrutinised, normally before being recommended to Cabinet / Council, with the role being undertaken by the Governance, Audit, Risk Management and Standards Committee (GARMS). The Council has complied with the CIPFA Treasury Management Code of Practice to the extent that all Treasury Management reports have been scrutinised though the efficient conduct of the Council's business may require

consideration by GARMS subsequent to consideration by Cabinet/Council due to the practicalities of the committee timetable.

2.3 The Council has delegated responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Section 151 Officer. The Section 151 Officer chairs the Treasury Management Group (TMG), which monitors the treasury management activity and market conditions monthly.

### 3.0 **Matters covered in the Report**

3.1 The Treasury Management Outturn Report for 2020/21 includes a summary of the actual positions in respect of the Authority's:

- Capital Expenditure, Financing and Limits
- Treasury Position as at 31st March 2021
- Summary of 2020/21 Strategy
- Economic update and Interest Rate Forecast for 2020/21 (Appendix 1)
- Borrowing and Investment Rate Summary for 2020/21 (Appendix 2)

### 4.0 **Options considered**

4.1 The report is in accordance with the reporting requirements of the CIPFA Treasury Management Code of Practice.

### 5.0 **Treasury Management Outturn Report 2020/21**

5.1. The Treasury Management Strategy Statement, (TMSS), for 2020/21 was approved by Council in February 2020 . It stated that for the next three years the Capital Programme would continue to be funded from grants and revenue resources but that substantial borrowing would also be required.

### 6.0 **The Council's Capital Expenditure and Financing**

6.1. The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

6.2. The actual capital expenditure forms one of the required prudential indicators. The tables below show the actual capital expenditure for 2020/21 against that budgeted and how this was financed.

Table 1: Capital Expenditure

Capital expenditure	2019/20	2020/21	2020/21	2020/21	Variance Analysis	
	Actual	Budget	Actual	Variance	Slippage to	Underspend
	£'000	£'000	£'000	£'000	2021/22	£'000
- Resources and Commercial	36,269	14,981	10,044	4,937	4,930	7
- People's	4464	5,011	1,645	3,366	3,357	9
- Community	40,369	52,272	30,371	21,901	12,397	9,504
<b>General Fund</b>	<b>81,102</b>	<b>72,264</b>	<b>42,060</b>	<b>30,204</b>	<b>20,684</b>	<b>9,520</b>
<b>HRA</b>	<b>9,483</b>	<b>22,578</b>	<b>12,537</b>	<b>10,041</b>	<b>8,941</b>	<b>1,100</b>
<b>Total</b>	<b>90,585</b>	<b>94,842</b>	<b>54,597</b>	<b>40,245</b>	<b>29,625</b>	<b>10,620</b>

Table 2: Financing of Capital Expenditure

Financing of capital expenditure	2019/20 Actual £'000	2020/21 Actual £'000
Capital Receipts	2,530	1,602
Grants	13,170	10,257
S106/S20 Contributions	0	880
Community Infrastructure Levy (CiL)	3612	3095
Revenue	5,158	8,904
<b>External Funding</b>	<b>24,470</b>	<b>24,738</b>
<b>Net Financing need for the year (Borrowing)</b>	<b>66,115</b>	<b>29,859</b>

6.3. Further details of the capital expenditure position were included within the Revenue and Capital Outturn Report 2020/21 which was submitted to Cabinet in June 2021.

## 7.0 The Councils Overall Borrowing Need

7.1. The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). The CFR increases within any net financing need for the year and reduces through the application of resources, including an annual charge to the revenue budget, the Minimum Revenue Provision (MRP).

### Gross Debt and the CFR

7.2. In order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external debt (borrowing plus other long term liabilities such as PFI and Finance Leases) does not, except in the short term, exceed the total CFR in the preceding year (2020/21) plus the estimates of any additional borrowing requirement for the current (2021/22) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. The table below highlights the Council's gross debt position against the CFR in 2019/20. The Council has complied with this Prudential Indicator.

Table 3: Gross Debt and CFR

<b>CFR £'000</b>	<b>2019/20 Actual</b>	<b>2020/21 Actual</b>
General Fund	410,978	422,193
HRA	150,683	150,674
<b>Total CFR</b>	<b>561,661</b>	<b>572,867</b>
<b>Gross Debt</b>	<b>440,781</b>	<b>439,832</b>
<b>Under/(Over) Borrowing</b>	<b>120,880</b>	<b>133,035</b>

### Financing Costs to Net Revenue Stream

- 7.3. This Prudential Indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income), against the net revenue stream. The actual financing costs as a proportion of net revenue stream for 2020/21 compared to 2019/20 is included within table 4 below.

Table 4: Financing costs as a proportion of net revenue stream

<b>Ratio of financing costs to net revenue stream %</b>	<b>2019/20 Actual</b>	<b>2020/21 Actual</b>
General Fund	18%	18%
HRA	20%	20%
<b>Total</b>	<b>19%</b>	<b>18%</b>

### The Authorised Limit

- 7.4. The Authorised Limit is the “Affordable Borrowing Limit” required by S3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level.
- 7.5. In the 2021/22 TMSS, in light of the revised capital programme, the 2020/21 Authorised Limit was revised down to £653m consisting of £624m (borrowing) and £29m (other long term liabilities). Within the 2020/21 TMSS the Authorised Limit was set at a total of £812m for borrowing and other long term liabilities.
- 7.6. The table below demonstrates that during 2020/21 the Council has maintained gross borrowing within its Authorised Limit.

Table 5: Authorised Limit

<b>Authorised Limit £'000</b>	<b>2020/21 TMSS</b>	<b>2021/22 TMSS</b>
	<b>2020/21</b>	<b>2020/21</b>
Borrowing		624,393
Other long term liabilities		28,520
<b>Total</b>	<b>811,705</b>	<b>652,913</b>

### The Operational Boundary

- 7.7. The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the Authorised Limit not being breached. The Council entered into new finance leases of vehicles and machinery in 2019/20 with a liability of £3.6m. Together with the existing PFI liabilities this resulted in total long term liabilities of £18.5m, in excess of the Operational Boundary for this category of debt.

- 7.8. The Operational Boundary was originally set as part of the 2020/21 TMSS at a total of £671m. This was revised to reflect both the additional finance lease liabilities and the revised capital programme as part of the 2021/22 TMSS to total £613m, consisting of £594m (borrowing) and £19m (other long term liabilities).

Table 6: Operational Boundary

Operational boundary £'000	2020/21 TMSS	2021/22 TMSS
	2020/21	2020/21
Borrowing	656,656	594,393
Other long term liabilities	14,827	18,520
<b>Total</b>	<b>671,483</b>	<b>612,913</b>

## 8.0 Treasury Position as at 31 March 2021

### Borrowing Outturn (excluding borrowing by PFI and finance leases)

- 8.1. The Council has maintained an internal borrowing strategy for a number of years, forgoing lost investment income on investments to use its cash balances to temporarily fund capital expenditure and avoid external borrowing costs. This has proved efficient given the differential between short term investment returns and borrowing costs. Table 3 shows that internal (or under) borrowing as at 31<sup>st</sup> March 2021 was £133m (£121m as at 31<sup>st</sup> March 2020).
- 8.2. No additional external borrowing was undertaken during 2020/21, and the Authority's underlying need to borrow, measured by the increase in the Capital Financing Requirement, only showed a relatively small increase of £11m. During 2019/20 the Council took £100m of new PWLB loans and a further £20m market loan to refinance temporary borrowing and market debt and fund its CFR. Therefore, given the relatively small increase in the CFR position during 2020/21, it was deemed that no additional borrowing was required during the year.
- 8.3. The borrowing portfolio remained unchanged in 2020/21, at £422m split between £348m of PWLB loans and £74m of Market loans, and at the 31<sup>st</sup> March 2021 the portfolio was running at an average interest rate of 3.46% and an average life of 37 years.

Table 7: Borrowing Portfolio

Borrowing Portfolio £'000	31-Mar-20			31-Mar-21		
	Principal	Average Rate (%)	Average Life (yrs)	Principal	Average Rate (%)	Average Life (yrs)
- PWLB	348,461	3.45%	37.04	348,461	3.45%	36.04
- Market	73,800	3.52%	42.69	73,800	3.52%	41.69
<b>Total borrowing</b>	<b>422,261</b>	<b>3.46%</b>	<b>38.02</b>	<b>422,261</b>	<b>3.46%</b>	<b>37.02</b>

- 8.4. The maturity structure of the debt portfolio remained within the Prudential Indicator limits set as part of the 2020/21 Treasury Management Strategy. The maturity structure table below includes one Lenders Option Borrowers Option (LOBO) market loan at its next call date, which is the earliest date the lender can require repayment. Table 8 reflects this position in respect of the maturity profile of the debt portfolio.

Table 8: Maturity Structure of Borrowing

<b>Maturity structure of borrowing</b>	<b>Lower</b>	<b>Upper</b>	<b>Actual 31.03.20</b>	<b>Actual 31.03.21</b>
Under 12 months	0%	40%	5%	5%
12 months to 2 years	0%	30%	1%	1%
2 years to 5 years	0%	30%	0%	0%
5 years to 10 years	0%	40%	5%	5%
10 years and above	30%	100%	89%	89%

8.5. Appendix 2 provides a summary of PWLB maturity loan certainty rates across 2020/21 over various durations from 1-50 years.

#### Investment Outturn

8.6. The Council made investments throughout 2020/21 in accordance with the Treasury Management Strategy approved by Full Council in February 2020.

8.7. Due to the internal borrowing strategy being undertaken by the Council, cash balances continued to be held on a short term basis for liquidity purposes, in Money Market Funds and banks throughout 2020/21. Adding to the need to maintain liquid investment balances was the uncertainty surrounding the response to the Covid-19 pandemic and the role of the Authority in relation to supporting the Governments response to businesses.

8.8. Investment returns which had been low during 2019/20 dropped even further during 2020/21 as the response to the Covid-19 pandemic led to the Bank of England Base Rate reducing to 0.1%. The subsequent effect on short term investments rates resulted in near zero returns and at points during the year negative interest rates were offered from market providers. Appendix 2 illustrates the highs and lows for money market investment rates for periods out to 12 months.

8.9. While the Authority avoided making any investments at negative interest rates, returns from short term investments with MMFs and banks have been at or near zero and at the 31<sup>st</sup> March 2021 the biggest return within the portfolio was the 32 day notice account with Lloyds which was returning 0.03%.

8.10. The Authority's average monthly investment balance was £89m across 2020/21, returning an average rate of return of 0.04% (£79m at 0.5% in 2019/20).

8.11. The investment portfolio remained highly liquid throughout 2020/21. Investments increased from £65m to £82m over the year while the average rate of interest reduced from 0.19% as at 31st March 2020 to 0.01% as at 31st March 2021.

Table 9: Investment Portfolio

Investment Portfolio	31-Mar-20			31-Mar-21		
	Principal (£'000)	Average Rate (%)	Average Life (days)	Principal (£'000)	Average Rate (%)	Average Life (days)
- MMFs	1,615	0.35%	1	1,616	0.00%	1
- Banks	62,917	0.18%	4	80,838	0.01%	3
<b>Total Investments</b>	<b>64,532</b>	<b>0.19%</b>	<b>4</b>	<b>82,454</b>	<b>0.01%</b>	<b>3</b>

## 9.0. Treasury Management Strategy for 2020/21

### Investment strategy and control of interest rate risk

- 9.1. Investment returns which had been low during 2019/20, fell during 2020/21 to near zero or even into negative territory, particularly in short term durations.
- 9.2. The expectation for interest rates within the treasury management strategy for 2020/21 was that Bank Rate would continue at the start of the year at 0.75% before rising to end 2022/23 at 1.25%. This forecast was invalidated by the impact of the Covid-19 pandemic which caused the Monetary Policy Committee to cut the Bank of England Base Rate in March 2020, first to 0.25% and then to 0.10%, in order to counter the hugely negative impact of the national lockdown on large swathes of the economy. The Bank of England and the Government also introduced new programmes of supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the lockdown.
- 9.3. The Government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates plummeted.
- 9.4. The Authority's continuing internal borrowing strategy means that investments are kept liquid, with balances expected to be minimised through the use of reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional revenue cost, due to the differential between borrowing and investment rates. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets than would be the case if the Authority had borrowed up to its CFR.

### Borrowing strategy and control of interest rate risk

- 9.5. During 2020/21 the Council maintained an internal borrowing position and no new external borrowing was taken during the year. The Covid-19 pandemic impacted on the delivery of the Authority's capital programme, and the expected movement in the measure of its borrowing requirement, the CFR. The CFR increased by a relatively small £11m during 2020/21, which with a reduction in other long term liabilities collectively resulted in the internal borrowing position of the Authority increasing from £121m to £133m. This additional borrowing requirement was met through increasing the internal borrowing position through the temporary use of resources available on the balance sheet rather than through additional external borrowing.

- 9.6. This means that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow has continued to be used as an interim measure.
- 9.7. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this has been kept under review to avoid incurring higher borrowing costs in the future when the Authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt. New long term borrowing decisions taken in 2019/20 with respect to an additional £100m of PWLB and £20m of market loans were made within this context given the relatively low levels of investments in place as at 31st March 2019 and the anticipated increase in the CFR required to fund the future capital programme at that time.
- 9.8. Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2020/21 and the two subsequent financial years. The impact of the Covid-19 pandemic resulted in lower interest rate expectations throughout 2020/21. Link Group's economic review of 2020/21 and their associated interest rate forecasts at the start and close of the year are contained in Appendix 1.

#### PWLB Consultation

- 9.9. In response to concerns about commercial activity being undertaken by local authorities supported through borrowing from the PWLB HM Treasury increased the margin over the Gilt applied to all PWLB borrowing on the 9th October 2019 from 0.8% to 1.8% above the Gilt.
- 9.10. In March 2020 HM Treasury reversed this for HRA borrowing (with reference to the HRA CFR) and announced a consultation on the future lending terms of the PWLB. The Government's response to the consultation was published in November 2020, and reversed the additional 1% margin imposed on General Fund borrowing subject to local authority's confirming that they have no purely commercial activity within their three year capital programme, which will come from data submissions of the capital programme accompanied by an assurance from the s151 officer. Subject to this criteria being met borrowing for both the General Fund and HRA is now back at a margin of 80bps above the Gilt.

### **10.0. Risk Management Implications**

- 10.1 This report is for noting and Cabinet are not being asked to make any decisions hence there are no direct risk management implications to this report.'

### **11.0. Procurement Implications**

There are no procurement implication arising from this report

### **12.0. Legal Implications**

- 12.1 The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure

that the Council's capital investment plans are affordable, prudent and sustainable. These are contained within this report. The Act requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. This report assists the Council in fulfilling its statutory obligation under the Local Government Act 2003 to monitor its borrowing and investment activities.

### **13.0. Financial Implications**

13.1 In addition to supporting the Council's revenue and capital programmes the Treasury Management interest budget is an important part of the revenue budget. Any savings achieved, or overspends incurred, have a direct impact on the financial performance of the budget

### **14.0. Equalities implications / Public Sector Equality Duty**

14.1 There are no direct equalities impact. Compliance with s.149 of the Equality Act is integral to all aspects decision-making.

### **15.0. Council Priorities**

15.1 This report deals with the Treasury Management Strategy which plays a significant part in supporting the delivery of all the Council's corporate priorities.

## **Section 3 - Statutory Officer Clearance**

**Statutory Officer: Dawn Calvert**

Signed by the Chief Financial Officer

**Date: 5<sup>th</sup> July 2021**

**Statutory Officer: Rashmi Chopra**

Signed on behalf of the Monitoring Officer

**Date: 5<sup>th</sup> July 2021**

**Chief Officer: Charlie Stewart**

Signed off by the Corporate Director

**Date: 5<sup>th</sup> July 2021**

**Head of Procurement: Nimesh Mehta**

Signed by the Head of Procurement

**Date: 5<sup>th</sup> July 2021**

**Head of Internal Audit: Susan Dixson**

Signed by the Head of Internal Audit

**Date: 5<sup>th</sup> July 2021**

### **Mandatory Checks**

Ward Councillors notified: **NO** as it impacts on all Wards

EqIA carried out: **NO**

## **Section 4 - Contact Details and Background Papers**

**Contact: Sharon Daniels, Head of Strategic and Technical Finance  
(Deputy S151), Telephone 020 8424 1332, Sharon  
Daniels@harrow.gov.uk**

**Background Papers: N/A**

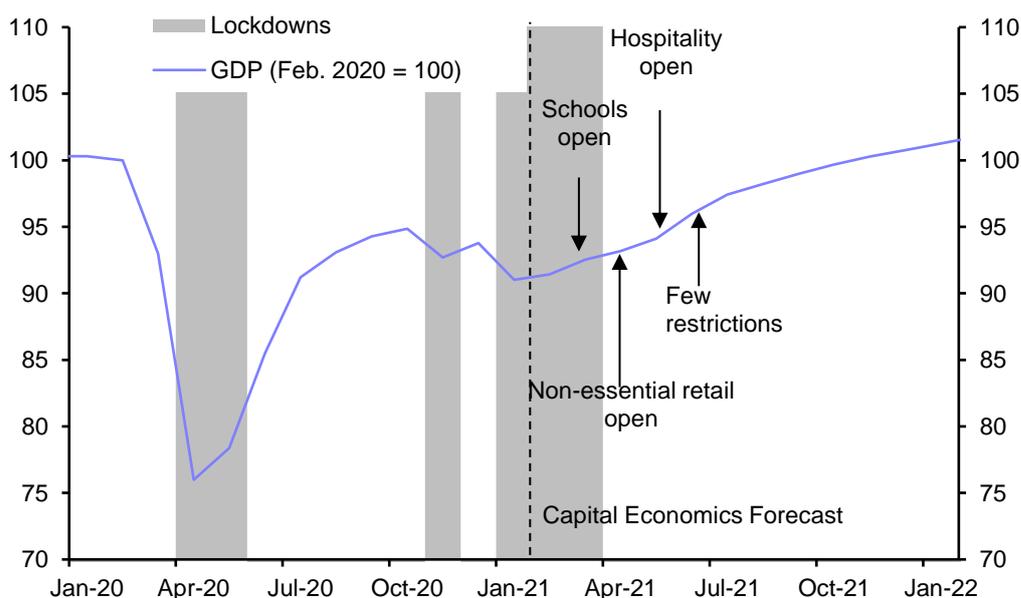
**Call-In Waived by the Chair of Overview and Scrutiny Committee**

**No**

# Appendix 1: Link Group Economic Commentary

## The Economy and Interest Rates

- 1.1. **UK. Coronavirus.** The financial year 2020/21 will go down in history as being the year of the pandemic. The first national lockdown in late March 2020 did huge damage to an economy that was unprepared for such an eventuality. This caused an economic downturn that exceeded the one caused by the financial crisis of 2008/09.
- 1.2. A short second lockdown in November did relatively little damage but by the time of the third lockdown in January 2021, businesses and individuals had become more resilient in adapting to working in new ways during a three month lockdown so much less damage than was caused than in the first one.
- 1.3. The advent of vaccines starting in November 2020, were a game changer. The way in which the UK and US have led the world in implementing a fast programme of vaccination which promises to lead to a return to something approaching normal life during the second half of 2021, has been instrumental in speeding economic recovery and the reopening of the economy.
- 1.4. In addition, the household saving rate has been exceptionally high since the first lockdown in March 2020 and so there is plenty of pent-up demand and purchasing power stored up for services in the still-depressed sectors like restaurants, travel and hotels as soon as they reopen. It is therefore expected that the UK economy could recover its pre-pandemic level of economic activity during quarter 1 of 2022.



- 1.5. Both the Government and the Bank of England took rapid action in March 2020 at the height of the crisis to provide support to financial markets to ensure their proper functioning, and to support the economy and to protect jobs.
- 1.6. The **Monetary Policy Committee** cut Bank Rate from 0.75% to 0.25% and then to 0.10% in March 2020 and embarked on a £200bn programme of quantitative

easing QE (purchase of gilts so as to reduce borrowing costs throughout the economy by lowering gilt yields). The MPC increased then QE by £100bn in June and by £150bn in November to a total of £895bn. While Bank Rate remained unchanged for the rest of the year, financial markets were concerned that the MPC could cut Bank Rate to a negative rate; this was firmly discounted at the February 2021 MPC meeting when it was established that commercial banks would be unable to implement negative rates for at least six months – by which time the economy was expected to be making a strong recovery and negative rates would no longer be needed.

- 1.7. **Average inflation targeting.** This was the major change adopted by the Bank of England in terms of implementing its inflation target of 2%. The key addition to the Bank's forward guidance in August was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and **achieving the 2% target sustainably**". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. This sets a high bar for raising Bank Rate and no increase is expected by March 2024, and possibly for as long as five years. Inflation has been well under 2% during 2020/21; it is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short lived factor and so not a concern to the MPC.
- 1.8. **Government support.** The Chancellor has implemented repeated rounds of support to businesses by way of cheap loans and other measures, and has protected jobs by paying for workers to be placed on furlough. This support has come at a huge cost in terms of the Government's budget deficit ballooning in 20/21 and 21/22 so that the Debt to GDP ratio reaches around 100%. The Budget on 3rd March 2021 increased fiscal support to the economy and employment during 2021 and 2022 followed by substantial tax rises in the following three years to help to pay the cost for the pandemic. This will help further to strengthen the economic recovery from the pandemic and to return the government's finances to a balanced budget on a current expenditure and income basis in 2025/26. This will stop the Debt to GDP ratio rising further from 100%. An area of concern, though, is that the government's debt is now twice as sensitive to interest rate rises as before the pandemic due to QE operations substituting fixed long-term debt for floating rate debt; there is, therefore, much incentive for the Government to promote Bank Rate staying low e.g. by using fiscal policy in conjunction with the monetary policy action by the Bank of England to keep inflation from rising too high, and / or by amending the Bank's policy mandate to allow for a higher target for inflation.
- 1.9. **BREXIT.** The final agreement on 24th December 2020 eliminated a significant downside risk for the UK economy. The initial agreement only covered trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. There was much disruption to trade in January as form filling has proved to be a formidable barrier to trade. This appears to have eased somewhat since then but is an area that needs further work to ease difficulties, which are still acute in some areas.

- 1.10. **USA.** The US economy did not suffer as much damage as the UK economy due to the pandemic. The Democrats won the presidential election in November 2020 and have control of both Congress and the Senate, although power is more limited in the latter. This enabled the Democrats to pass a \$1.9trn (8.8% of GDP) stimulus package in March on top of the \$900bn fiscal stimulus deal passed by Congress in late December. These, together with the vaccine rollout proceeding swiftly to hit the target of giving a first job to over half of the population within the President's first 100 days, will promote a rapid easing of restrictions and strong economic recovery during 2021. The Democrats are also planning to pass a \$2trn fiscal stimulus package aimed at renewing infrastructure over the next decade. Although this package is longer-term, if passed, it would also help economic recovery in the near-term.
- 1.11. After Chair Jerome Powell spoke on the **Fed's adoption of a flexible average inflation target** in his Jackson Hole speech in late August 2020, the mid-September meeting of the Fed agreed a new inflation target - that *"it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time."* This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. There is now some expectation that where the Fed has led in changing its policy towards implementing its inflation and full employment mandate, other major central banks will follow, as indeed the Bank of England has done so already. The Fed expects strong economic growth during 2021 to have only a transitory impact on inflation, which explains why the majority of Fed officials project US interest rates to remain near-zero through to the end of 2023. The key message is still that policy will remain unusually accommodative – with near-zero rates and asset purchases – continuing for several more years. This is likely to result in keeping treasury yields at historically low levels. However, financial markets in 2021 have been concerned that the sheer amount of fiscal stimulus, on top of highly accommodative monetary policy, could be over-kill leading to a rapid elimination of spare capacity in the economy and generating higher inflation much quicker than the Fed expects. They have also been concerned as to how and when the Fed will eventually wind down its programme of monthly QE purchases of treasuries. These concerns have pushed treasury yields sharply up in the US in 2021 and is likely to have also exerted some upward pressure on gilt yields in the UK.
- 1.12. **EU.** Both the roll out and take up of vaccines has been disappointingly slow in the EU in 2021, at a time when many countries are experiencing a sharp rise in cases which are threatening to overwhelm hospitals in some major countries; this has led to renewed severe restrictions or lockdowns during March. This will inevitably put back economic recovery after the economy had staged a rapid rebound from the first lockdowns in Q3 of 2020 but contracted slightly in Q4 to end 2020 only 4.9% below its pre-pandemic level. Recovery will now be delayed until Q3 of 2021 and a return to pre-pandemic levels is expected in the second half of 2022.

- 1.13. Inflation was well under 2% during 2020/21. **The ECB** did not cut its main rate of -0.5% further into negative territory during 2020/21. It embarked on a major expansion of its QE operations (PEPP) in March 2020 and added further to that in its December 2020 meeting when it also greatly expanded its programme of providing cheap loans to banks. The total PEPP scheme of €1,850bn is providing protection to the sovereign bond yields of weaker countries like Italy. There is, therefore, **unlikely to be a euro crisis** while the ECB is able to maintain this level of support.
- 1.14. **China.** After a concerted effort to get on top of the virus outbreak in Q1 of 2020, economic recovery was strong in the rest of the year; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth.
- 1.15. **Japan.** Three rounds of government fiscal support in 2020 together with Japan's relative success in containing the virus without draconian measures so far, and the roll out of vaccines gathering momentum in 2021, should help to ensure a strong recovery in 2021 and to get back to pre-virus levels by Q3.
- 1.16. **World growth.** World growth was in recession in 2020. Inflation is unlikely to be a problem in most countries for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.
- 1.17. **Deglobalisation.** Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last 30 years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. In March 2021, western democracies implemented limited sanctions against a few officials in charge of government policy on the Uighurs in Xinjiang; this led to a much bigger retaliation by China and is likely to mean that the China / EU investment deal then being negotiated, will be torn up. After the pandemic exposed how frail extended supply lines were around the world, both factors are now likely to lead to a sharp retrenchment of economies into two blocs of western democracies v. autocracies. It is, therefore, 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.
- 1.18. **Central banks' monetary policy.** During the pandemic, the governments of western countries have provided massive fiscal support to their economies which has resulted in a big increase in total government debt in each country. It is therefore very important that bond yields stay low while debt to GDP ratios slowly subside under the impact of economic growth. This provides governments with a good reason to amend the mandates given to central banks to allow higher average levels of inflation than we have generally seen over the last couple of decades. Both the Fed and Bank of England have already changed their policy towards implementing their existing mandates on inflation, (and full employment), to hitting an average level of inflation. Greater emphasis could also be placed on hitting subsidiary targets e.g. full employment before raising rates. Higher average

rates of inflation would also help to erode the real value of government debt more quickly.

1.19. Link Group’s Interest Rate Strategy Group (IRSG) formulate their interest rate forecast and update clients to changes throughout the year. The forecast at the time of the approval of the 2020/21 TMSS was:

Link Group Interest Rate Forecast: 31/01/20

Link Asset Services Interest Rate View													
	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	0.90	0.90	1.00	1.10	1.20	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.30	2.40	2.40	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.50	2.50	2.60	2.60	2.70	2.80	2.90	3.00	3.10	3.10	3.20	3.20	3.30
25yr PWLB Rate	3.00	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.70	3.80	3.80	3.90	3.90
50yr PWLB Rate	2.90	2.90	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.80

1.20. During 2020/21 the interest rate forecast was updated to reflect the changing economic environment. The latest update in 2020/21 was:

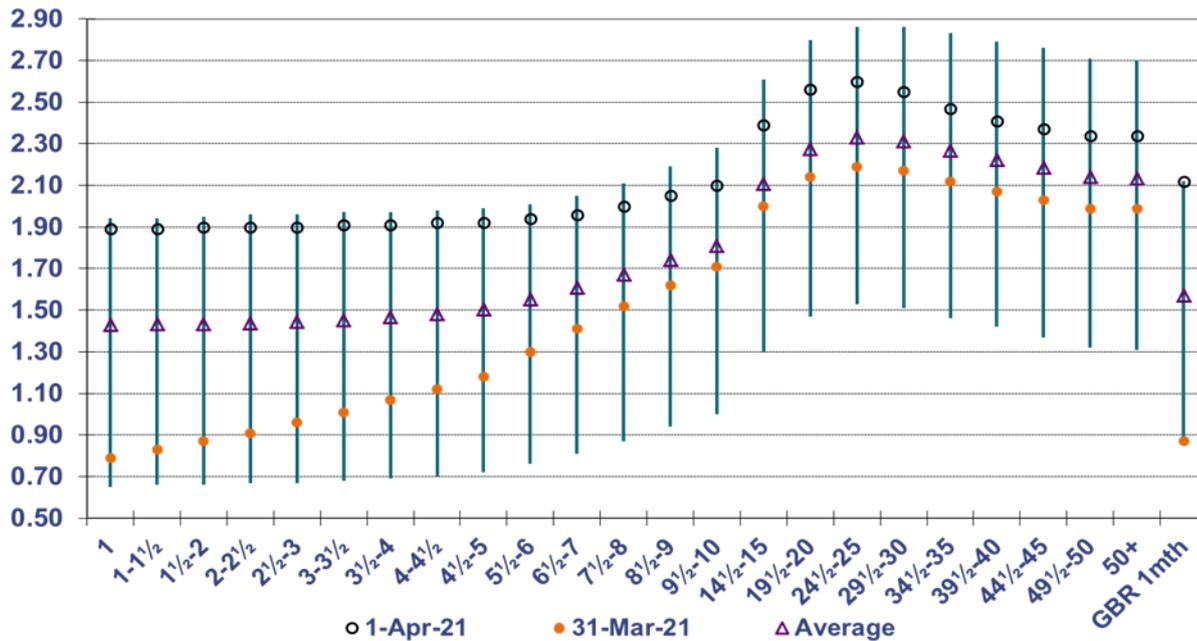
Link Group Interest Rate Forecast: 08/03/21

Link Group Interest Rate View 8.3.21													
	Mar-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	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.40	1.40	1.40	1.40
10 yr PWLB	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.90	1.90	1.90	1.90
25 yr PWLB	2.10	2.10	2.10	2.20	2.30	2.30	2.30	2.40	2.40	2.50	2.50	2.50	2.50
50 yr PWLB	1.90	1.90	1.90	2.00	2.10	2.10	2.10	2.20	2.20	2.30	2.30	2.30	2.30

## Appendix 2 Borrowing and Investment Rate Summary 2020/21

### PWLB borrowing rates

PWLB Certainty Rate Variations 1.4.20 to 31.3.2021



	1 Year	5 Year	10 Year	25 Year	50 Year
<b>Low</b>	0.65%	0.72%	1.00%	1.53%	1.32%
<b>Low date</b>	04/01/2021	11/12/2020	11/12/2020	11/12/2020	11/12/2020
<b>High</b>	1.94%	1.99%	2.28%	2.86%	2.71%
<b>High date</b>	08/04/2020	08/04/2020	11/11/2020	11/11/2020	11/11/2020
<b>Average</b>	1.43%	1.50%	1.81%	2.33%	2.14%
<b>Spread</b>	1.29%	1.27%	1.28%	1.33%	1.39%

#### a) Money market investment rates and forecasts 2020/21

	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
<b>High</b>	0.10	0.00	0.14	0.56	0.62	0.77
<b>High Date</b>	01/04/2020	02/04/2020	20/04/2020	08/04/2020	14/04/2020	21/04/2020
<b>Low</b>	0.10	-0.10	-0.11	-0.10	-0.10	-0.05
<b>Low Date</b>	01/04/2020	31/12/2020	29/12/2020	23/12/2020	21/12/2020	11/01/2021
<b>Average</b>	0.10	-0.07	-0.05	0.01	0.07	0.17
<b>Spread</b>	0.00	0.10	0.25	0.66	0.73	0.83