

Report to:	Audit and Standards Committee
Date:	17 January 2022
Title:	Treasury Management
Report of:	Chief Finance Officer
Ward(s):	All
Purpose of report:	To present details of recent Treasury Management activity.
Officer recommendation(s):	To note and recommend that Cabinet accepts that Treasury Management Activity for the period 1 November to 31 December 2021 has been in accordance with the approved Treasury Strategies.
Reasons for recommendations:	Requirement of CIPFA Treasury Management in the Public Sector Code of Practice (the Code) and this has to be reported to Full Council.
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1. Introduction

- 1.1 The Council's approved Treasury Strategy Statement requires the Audit and Standards Committee to review details of Treasury Strategy transactions against the criteria set out in the Strategy and make observations to Cabinet as appropriate.
- 1.2 The Treasury Strategy Statement also requires the Audit and Standards Committee to review a formal summary report detailing the recent Treasury Management activity before it is considered by Council, in accordance with best practice and guidance issued by the Chartered Institute of Public Finance and Accountancy.
- 1.3 This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit & Standards Committee before they were reported to the full Council.
- 1.4 Treasury Management is an integral part of the Council's overall finances and the performance of this area is very important. Whilst individual years obviously matter, performance is best viewed on a medium / long term basis. The action taken in respect of the debt portfolio in recent years has been extremely beneficial and has resulted in savings. Short term gains might, on occasions, be sacrificed for longer term certainty and stability.
- 1.5 The criteria for lending to Banks are derived from the list of approved counter parties provided by the Council's Treasury Management advisors, Link Asset Services. The

list is amended to reduce the risk to the Council by removing the lowest rated counterparties and reducing the maximum loan duration.

2. Treasury Management Activity

2.1 The timetable for reporting Treasury Management activity in 2021/22 is shown in the table below. This takes into account the timescale for the publication of each Committee agenda and is on the basis that it is preferable to report on activity for complete months. Any extraordinary activity taking place between the close of the reporting period and the date of the Audit and Standards Committee meeting will be reported verbally at that meeting.

Meeting date	Reporting period for transactions
26 July 2021	2020/21 Annual Report (up to 31 March 2021)
27 September 2021	1 April to 31 July 2021
15 November 2021	1 August to 31 October 2021
17 January 2022	1 November to 31 December 2021
8 March 2022	1 January to 28 February 2022

2.2 Fixed Term Deposits pending maturity

The following table shows the fixed term deposits held between 1 November to 31 December 2021 and identifies the long-term credit rating of counterparties at the date of investment. It is important to note that credit ratings are only one of the criteria that are taken into account when determining whether a potential counterparty is suitable. All the deposits met the necessary criteria the minimum rating required for deposits made in terms of long-term A- (Fitch).

Ref	Counterparty	Date From	Date To	Days	Principal £	Int Rate %	Long-term Rating
252021	Royal Borough of Windsor & Maidenhead	29 Oct 21	28 Feb 22	122	5,000,000	0.03	*
252421	DMO	02 Nov 21	02 Feb 22	92	11,700,000	0.05	*
252521	Link – Standard Charter	01 Dec 21	01 Mar 22	90	5,000,000	0.11	A+
252621	DMO	02 Dec 21	02 Mar 22	90	1,500,000	0.02	*
252721	Link – Bayerische Landesbank	07 Dec 21	07 Mar 22	90	5,000,000	0.08	A-
252821	DMO	17 Dec 21	17 Jan 22	31	4,000,000	0.05	*

*UK Government body and therefore not subject to credit rating

2.3 Fixed Term Deposits which have matured in the reporting period

The table below shows the fixed term deposits which have matured between 1 November to 31 December 2021, in maturity date order. It is important to note that the table includes sums reinvested and that in total the Council's investments have not increased by £15m over this period.

Ref	Counterparty	Date From	Date To	Days	Principal £	Int. Rate %	Long-term rating
252121	Debt Management Office	18 Oct 21	01 Nov 21	14	2,000,000	0.01%	*
252221	Debt Management Office	25 Oct 21	08 Nov 21	14	8,000,000	0.01%	*
252321	Debt Management Office	29 Oct 21	03 Dec 21	35	5,000,000	0.02%	*
Total					<u>15,000,000</u>		

*UK Government body and therefore not subject to credit rating

At no stage did the total amount held by any counterparty exceed the approved limit set out in the Investment Strategy. The average rate of interest earned on deposits held in the period 1 November to 31 December 2021 was 0.04%, which was below the average bank base rate for the period of 0.13%.

2.4 Use of Deposit accounts

In addition to the fixed term deposits, the Council has made use of the following interest bearing accounts in the period covered by this report, with the average amount held being £3.940m generating interest of approximately £0.2k.

	Balance at 31 December 2021 £'000	Average balance £'000	Current interest rate %
Santander Business Reserve Account	£5,000	£5,000	0.02
Lloyds Bank Corporate Account	£1,039	£3,686	0.00
Lloyds Bank Call Account	£2,110	£3,134	0.01

2.5 Use of Money Market Funds

Details of the amounts held in the two Money Market Fund (MMF) accounts used by the Council are shown below. The approved Investment Strategy allows a maximum investment of £10m in each fund, and at no time was this limit exceeded.

	Balance at 31 December 2021 £'000	Average balance £'000	Average return %
Goldman Sachs Sterling Liquid Res. Fund	£0,000	0,000	0.00
Deutsche Managed Sterling Fund	£0,001	0,001	0.00

2.6 Treasury Bills (T-Bills)

There were no Treasury Bills held as at 31 December 2021, and there was no activity in the period.

2.7 Secured Investments

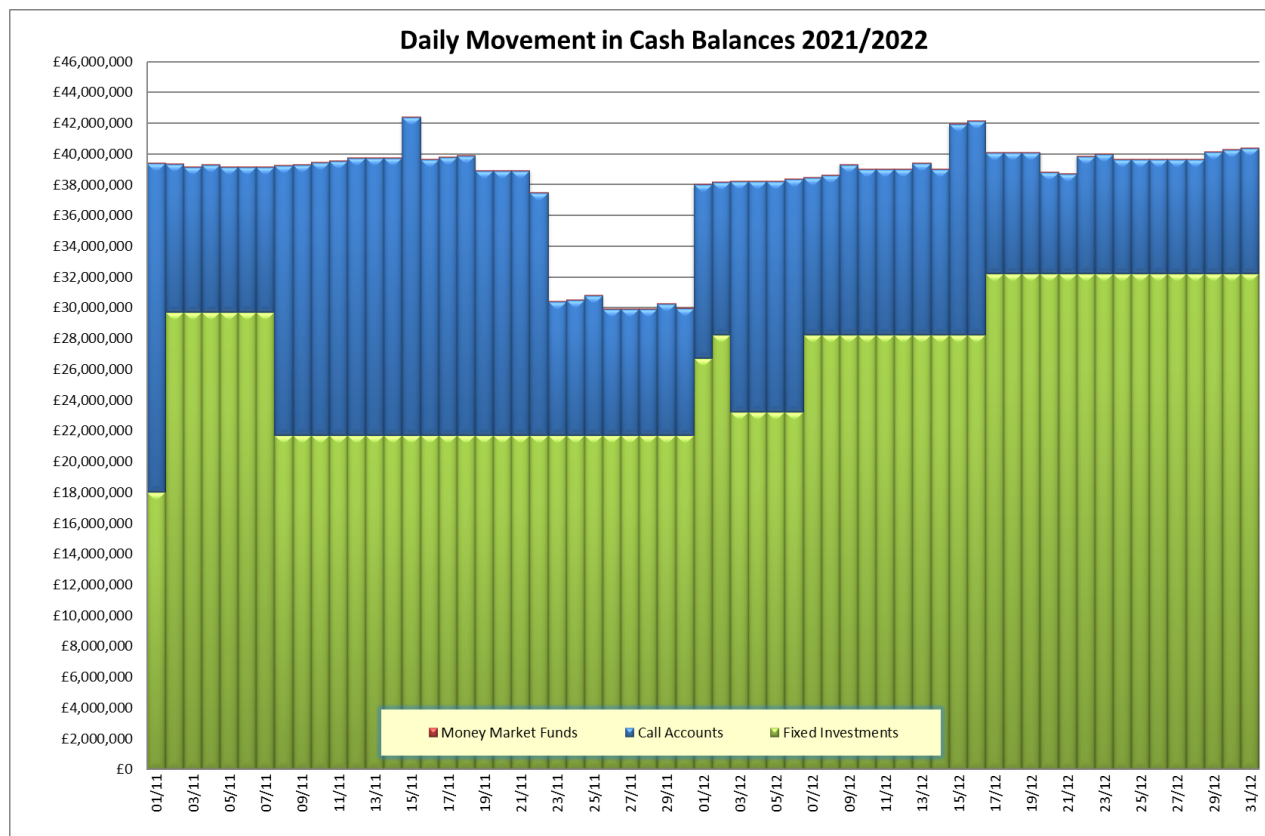
There were no Secured Investments as at 31 December 2021.

2.8 Tradeable Investments

There were no Tradeable Investments as at 31 December 2021, and there was no activity in the period.

3. Overall investment position

3.1 The chart below summarises the Council's investment position over the period 1 November to 31 December 2021. It shows the total sums invested each day as Fixed Term deposits, amounts held in Deposit/call accounts.



3.2 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

3.3 In the light of the pandemic crisis and the likelihood of unexpected calls on cash flow the Council continues to hold significant balances in bank call accounts, which have same day availability. This liquid cash was diversified over several fixed term deposit/call accounts to manage both credit and liquidity risks.

4. Annual Investment Strategy

4.1 CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2021. These define treasury management investments as investments that arise from the organisation's

cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business

4.2 The Treasury Management Strategy Statement (TMSS) for 2021/22 which includes the Annual Investment strategy, was approved by the Full Council on Monday, 22 February 2021. It sets out the Council's investment priorities as being:

- Security of Capital;
- Liquidity;
- Yield.

Approved limits within the Annual Investment Strategy were not breached during the period ending 31 December 2021, except for the balance held with Lloyds Bank, which exceeded the £5m limit for 23 days during the period.

4.3 Investment rates available in the market have continued at historically low levels. 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.

4.4 As shown by the interest rate forecasts in section 5.2, it is now difficult 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%. Given this environment and the fact that Bank Rate may only rise marginally before the second half of 2023, investment returns are expected to remain low.

4.5 As for money market funds (MMFs) and the Inter-local authority lending, borrowing rates have declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur.

5. Borrowing

5.1 The current account with Lloyds Bank generally remained within credit limits throughout most of the period and the Council's long term borrowing in the reporting period is £56.673m.

Interest Rate Forecast

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

5.3 The latest forecast on 20th December is compared below to the last forecast (29th September) in the previous quarter. A comparison of these forecasts shows that PWLB rates have fallen, more so in the longer maturities, and show a speed up in the rate of increase in Bank Rate as inflation is now posing a greater risk.

Link Group Interest Rate View 20.12.21														
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30

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				

5.4 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, Link forecasts are based on expected average earnings by local authorities for 3 to 12 months.
- Link 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.

5.5 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 until it raised it from 0.10% to 0.25% at the MPC meeting of 16th December 2021.

5.6 **A summary overview of the future path of Bank Rate**

- In December 2021, the Bank of England became the first major western central bank to put interest rates up in this upswing in the current business cycle in western economies as recovery progresses from the Covid recession of 2020.
- The next increase in Bank Rate could be in February or May, dependent on how severe an impact there is from Omicron.

- If there are lockdowns in January, this could pose a barrier for the MPC to putting Bank Rate up again as early as 3rd February.
- With inflation expected to peak between 5 and 6% in April, the MPC may want to be seen to be active in taking action to counter inflation on 5th May, the release date for its Quarterly Monetary Policy Report.
- However, rising gas and electricity prices last 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 inflationary pressures.
- On the other hand, consumers are sitting on around £160bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?
- The December 2021 MPC meeting was more concerned with combating inflation over the medium term than supporting economic growth in the short term.
- Bank Rate increases beyond May are difficult to forecast as inflation is likely to drop sharply in the second half of 2022.
- However, the MPC will want to normalise Bank Rate over the next three years so that it has its main monetary policy tool ready to use in time for the next downturn; all rates under 2% are providing stimulus to economic growth.
- We have put year end 0.25% increases into Q1 of each financial year from 2023 to recognise this upward bias in Bank Rate - but the actual timing in each year is difficult to predict.
- Covid mutations remain a major potential downside threat in all three years as we ARE likely to get further mutations. How quickly can science come up with a mutation proof vaccine, or other treatment, – and for them to be widely administered around the world?

Forecasts for PWLB rates and gilt and treasury yields

- 5.7 The current PWLB rates are set as margins over gilt yields as follows: -
- PWLB Standard Rate is gilt plus 100 basis points (G+100bps)
 - PWLB Certainty Rate is gilt plus 80 basis points (G+80bps)
 - PWLB HRA Standard Rate is gilt plus 100 basis points (G+100bps)
 - PWLB HRA Certainty Rate is gilt plus 80bps (G+80bps)
 - Local Infrastructure Rate is gilt plus 60bps (G+60bps)
- 5.8 Gilt yields. Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. Our forecasts show a steady, but slow, rise in both Bank Rate and PWLB rates during the forecast period to March 2025 but there will doubtless be a lot of unpredictable volatility during this forecast period.
- 5.9 Upside risk to gilt yield forecasts. While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in America could have on our gilt yields. As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury yields and UK 10-year gilt yields. This is a significant upward risk exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.

5.10 Downside risk to gilt yield forecasts. 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 monitor.

5.11 Significant risks to the forecasts

- COVID vaccines do not work to combat new mutations and/or new vaccines take longer than anticipated to be developed for successful implementation.
- The pandemic causes major long-term scarring of the economy.
- The Government implements an austerity programme that suppresses GDP growth.
- The MPC tightens monetary policy too early – by raising Bank Rate or unwinding QE.
- The MPC tightens monetary policy too late to ward off building inflationary pressures.
- Major stock markets e.g., in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the “moral hazard” risks of having to buy shares and corporate bonds to reduce the impact of major financial market sell-offs on the general economy.
- Geo-political risks - on-going global power influence struggles.
- 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.

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

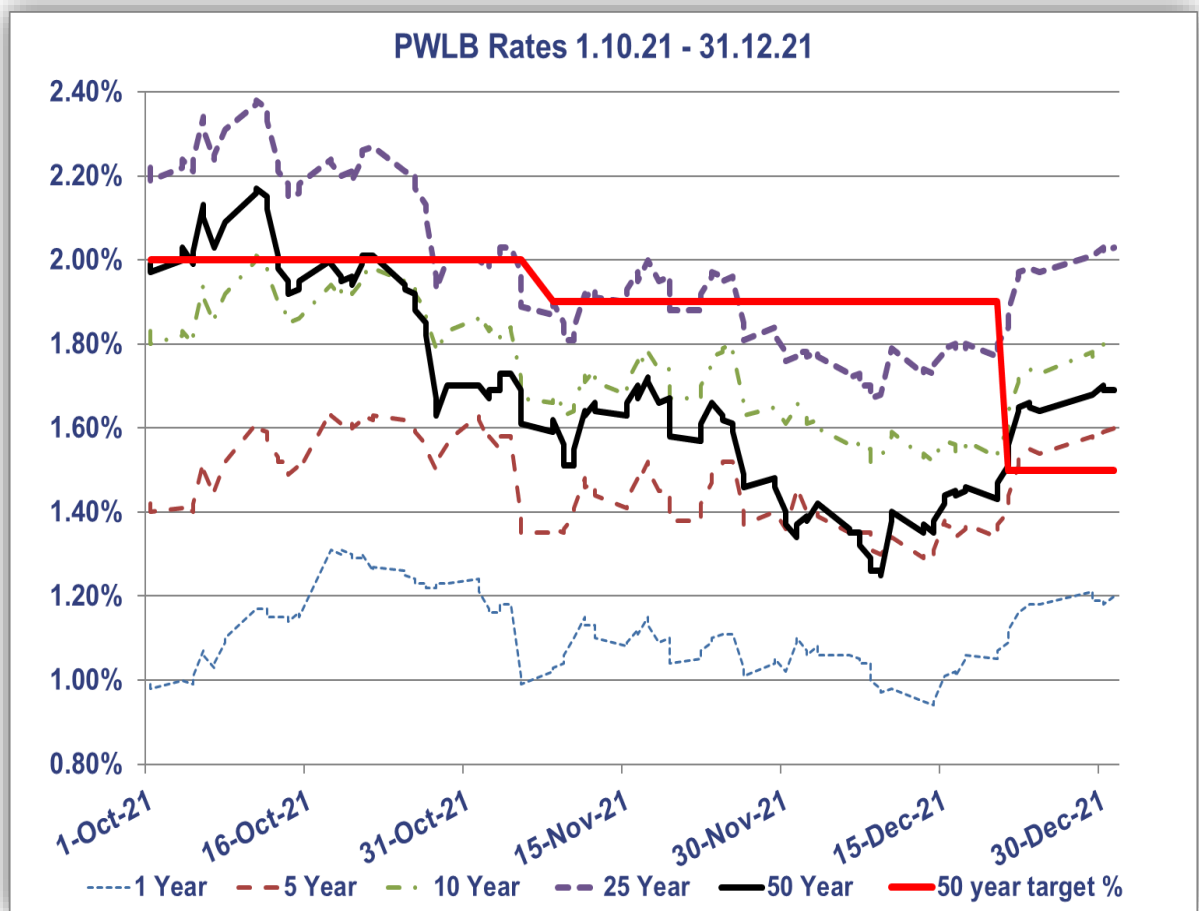
One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as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

- The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.
- The Bank of England has also amended its target for monetary policy so that inflation should be ‘sustainably over 2%’ and the ECB now has a similar policy.
- For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.

PWLB maturity certainty rates year to date to 31st December 2021

- 5.13 Gilt yields and 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. 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 until falling to 1.90% in early November and then falling again to 1.50% in December

Quarter to 31st December 2021



Debt Rescheduling

- 5.14 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. As short-term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt.

5.15 However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred). The reasons for any rescheduling to take place will include:

- The generation of cash savings and / or discounted cash flow savings.
- Helping to fulfil the treasury strategy.
- Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt. No debt rescheduling has therefore been undertaken to date in the current financial year.

6. Compliance with Treasury and Prudential Limits

6.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved TMSS. As at 31 December 2021, the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

Treasury Prudential Indicators	2021/22 Estimate Indicator	2021/22 Projected Outturn	RAG Status/Reason
Authorised limit for external debt (CS 4.2.4)	£143.3m	£143.3m	GREEN
Operational boundary for external debt (CS 4.2.4)	£130.2m	£130.2m	GREEN
Gross external debt (CS 4.2.2)	£91.7m	£56.67m	GREEN
Capital Financing Requirement (CS 2.3.4)	£119.7m	£89.9m	GREEN
Debt vs CFR under/(over) borrowing	£28.0m	£33.23m	GREEN
Investments (Average)	£2.9m	£3.9m	GREEN
Investment returns expectations	0.10%	0.04%	AMBER
Upper limit for principal sums invested for longer than 365 days			
<i>Maturity structure of fixed rate borrowing - upper limits:</i>			
Under 12 months	25%	25%	GREEN
12 months to 2 years	40%	40%	GREEN
2 years to 5 years	50%	50%	GREEN

Treasury Prudential Indicators	2021/22 Estimate Indicator	2021/22 Projected Outturn	RAG Status/Reason
5 years to 10 years	75%	75%	GREEN
10 years and above	100%	100%	GREEN
Capital expenditure (CS 2.1.3)			
General Fund	£11.1m	8.2m	GREEN
HRA	£23.8m	6.5m	GREEN
Commercial Activities/ non- financial investments	£15.9m	8.0m	GREEN
<i>Ratio of financing costs to net revenue stream (CS 8.1.1):</i>			
Proportion of Financing Costs to Net Revenue Stream (General Fund)	5.9%	5.9%	GREEN
Proportion of Financing Costs to Net Revenue Stream (HRA)	10.08%	10.08%	GREEN

Key: CS – 2021/22 Capital Strategy Appendix 1

Revisions to CIPFA Codes

6.2 CIPFA published revised Prudential and Treasury Management Codes in December 2021. The Prudential Code takes immediate effect although detailed reporting requirements may be deferred until the 2023/24 financial year. The main changes from previous codes include:

- Additional reporting requirements for the Capital Strategy.
- For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the Authority's overall financial capacity.
- Forward looking prudential code indicators must be monitored and reported to members at least quarterly.
- A new indicator for net income from commercial and service investments to net revenue stream.
- Inclusion of the liability benchmark as a treasury management prudential indicator.
- Excluding investment income from the definition of financing costs.
- Credit and counterparty policies should set out the Authority's policy and practices relating to Environmental, Social and Governance (ESG) investment considerations.
- Additional focus on the knowledge and skills of officers and elected members involved in decision making.

7. Non-treasury investments

7.1 The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus

cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return). The non-treasury investment activity includes loans to Council-owned companies or the purchase of property assets for the purpose of income generation.

- 7.2 **Lewes Housing Investment Company** - a wholly owned subsidiary of the Council. Incorporated in July 2017, LHIC was set up to acquire, improve and let residential property at market rents. The 2021/22 Capital programme includes £2.4m as commercial loan funding to facilitate property purchases. At 31 December 2021, there had been no draw drawn of the loan facility.

A working capital facility of £100,000 has been agreed, at an interest rate of 2% above Base Rate. At 31 December 2021, £1,065 of the working capital facility had been drawn down to cover administrative expenses.

- 7.3 **Aspiration Homes LLP** - a limited liability Partnership owned equally by Lewes District Council and Eastbourne Borough Council. Incorporated in June 2017, AH has been set up for the purpose of developing housing to be let at affordable rent. The Capital programme includes £17.4m as commercial loan funding to AH to facilitate the purchase and construction of property. At 31 December 2021, £3,175,990 had been drawn down.

A working capital facility of £100,000 has been agreed, at an interest rate of 2% above Base Rate. At 31 December 2021, £20,000 of the working capital facility had been drawn down.

8. **Environmental, Social and Governance Investment - update**

- 8.1 The Cabinet at its meeting on 4 February 2021 approved the 2021/22 Treasury Management and Investment Strategy, which include Non-Specified investments in Green Energy Bonds and/or other ESG products that met the Council's internal and external due diligence criteria.
- 8.2 While a wide range of ESG investment are currently limited, there are expectation that more banks and funds providing specific products over the coming years. As this area continues to develop and become more prominent, the Council in conjunction with the treasury management advisor (Link Asset Services) will continue to monitor ESG investment opportunities within the parameters of the Council's counterparty criteria and in compliance with the MHCLG Investment Guidance (i.e., prioritising security, liquidity before yield).
- 8.3 Potential Approach to ESG Investing - The Council might consider options for various investments in short/medium-term investments with institutions that will ring fence the use of such funds for ESG related matters and/or continue to explore alongside its treasury advisors other ethical investing options, including -
- Green Bond Purchasing Programme.
 - Green and Sustainable Product Framework.
 - Sustainability Notice Account - a deposit comprising the green and social projects.
 - Multi-asset pooled funds - 'all in one' solution for most long-term investors.

9. Economic Background

- 9.1 As expected, the Bank of England's Monetary Policy Committee kept Bank Rate unchanged and a detailed economic commentary on developments during period ended 31 December 2021 is attached as **Appendix A**.

10. Financial Appraisal

- 10.1 All relevant implications are referred to in the above paragraphs.

11. Risk Management Implications

- 11.1 The risk management implication associated with this activity is explained in the approved Treasury Management Strategy. No additional implications have arisen during the period covered by this report.

12. Equality Analysis

- 12.1 This is a routine report for which detailed Equality Analysis is not required to be undertaken.

13. Legal Implications

- 13.1 There are no legal implications from this report.

14. Environmental sustainability implications

- 14.1 This report notes the treasury management performance of the Council. There are no anticipated environmental implications from this report that would affect the Council's sustainability policy. The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the treasury activities and highlights compliance with the Council's policies previously approved by Members.

15. Appendices

- 15.1 Appendix A – Detailed economic commentary.
- 15.2 Appendix B – Glossary/Local Authority Treasury Management Terms

16. Background Papers

- 16.1 Treasury Strategy Statements 2021/22.

Link Treasury Services Limited - Detailed economic commentary on developments during quarter ended 31 December 2021

During the quarter ended 31st December 2021 (*quarter 3 of financial year 2021/22*):

- GDP rose 0.1% in October as product/labour shortages held back output;
- There were signs of faster GDP growth in November, before surging COVID-19 cases in December hit activity;
- Inflation jumped to a nine-year high of 5.1% in November;
- Bank Rate rose from 0.10% to 0.25% in December;
- Gilt yields and sterling fell, before both turned a corner in recent weeks.

Q4 had a weak start in October, with the economy eking out GDP growth of only 0.1% m/m. That was much lower than the 0.6% m/m growth in September and reflected falls in output in hospitality (-5.6% m/m), energy (-2.8% m/m) and mining (-5.0% m/m). In fact, without the boost from more face-to-face doctor appointments and the vaccine programme, GDP would have contracted in month-on-month terms.

There were some signs that activity gained some momentum in November. That seems to have been driven mainly by faster growth in consumer spending amid stronger-than-usual Black Friday sales and anecdotal reports that households brought forward some of their Christmas shopping. In November, retail sales jumped by 1.4% m/m, households' unsecured borrowing rose by a healthy £1.2bn, and survey data pointed to resilience in other sectors too, despite continued supply chain disruptions and shortages.

But any improvement in activity probably proved short-lived. The surge in COVID-19 cases caused by the Omicron variant prompted the government to impose 'Plan B' restrictions from mid-December, which included guidance to work from home and COVID-19 passports for some hospitality venues. Timely data indicated that households changed their behaviour in response to the risk of infection, even without the imposition of formal restrictions limiting social interactions. For example, restaurant attendance was hit hard in the run-up to Christmas, while journeys on public transport fell. That chimes with the fall in December's flash PMIs, which pointed to a big drop in services output.

That prompted the government to announce a new £1bn support package for consumer-facing businesses in retail and hospitality as those sectors lost earnings over the Christmas period due to heightened virus caution and the 'Plan B' measures. With eligible businesses able to receive grants of up to £6,000, that should have helped to cushion some of the blow. That said, the measures are much less generous than the support offered earlier in the pandemic and crucially don't include a furlough scheme, so businesses are unlikely to have avoided a hit to their balance sheets entirely.

As it stands, our forecast is for GDP growth in December of -0.1% m/m. But we suspect that the fall could be larger than that. Indeed, the flash composite PMI for December was consistent with GDP growth of -1.5% m/m. Although we suspect that is a little pessimistic, a more conservative estimate of -0.5% m/m would pull down our forecast for Q4 as a whole to +0.7% q/q. That would delay the return of GDP to its pre-virus level, pushing it back from January 2022, (as we had expected), into Q2.

Trade flows have continued to recover amid the fading of Brexit trade frictions and some easing in supply chain disruptions. So far, the recovery in exports has lagged imports. But this divergence may be starting to lessen. Excluding oil and erratics, export values grew by 1.6% m/m in October, while import values grew by 0.7% m/m. By contrast, although total trade with the EU remains well below pre-crisis levels, the recovery in export values to the EU has been *faster* than that of imports. Indeed, export values were 5.3% below their Q4 2019 average in October 2021, while imports were 9.6% below. What's more, these data predate the full customs checks for imports that came into force on 1st January 2022. That's one of the reasons why we think that, while Brexit explains some of the shortfall in UK trade, pandemic effects have also played a big role. That implies the underperformance of UK exports may lessen as the pandemic fades.

At the same time, CPI inflation surged to a 10-year high of 5.1% in November. Some of the rise was due to one-off factors, such as the 5.1% m/m increase in fuel prices on the back of the surge in oil prices in October. But there was evidence of more persistent price pressures too. Food inflation added 0.1ppts to overall inflation, which reflected higher costs faced by suppliers. Higher second-hand car inflation and rising housing rents also contributed. Meanwhile, another rise in core producer output price inflation from 7.1% to 7.9% in November suggests that shortages are still boosting prices further up the inflation pipeline.

Our forecast is for inflation to hover near its current level until it peaks at 5.2% in April 2022, before falling back sharply in the second half of next year. But the risks to this forecast are firmly to the upside. The 15% rise in utility prices that we have pencilled in for next April now looks optimistic, with a much bigger rise a real possibility. If the Omicron variant prompts a worsening in global supply chain disruptions, that could mean inflation falls back more slowly than we anticipate.

The end of the furlough scheme on 30th September seems to have had a temporary, limited impact on the labour market. In October, the single-month data showed that LFS employment fell by 240,000 while unemployment rose by 75,000. That nudged up the ILO unemployment rate from 3.9% in September to 4.2%. But the weekly data showed that unemployment was falling again by the end of the month. And the fall in the claimant count and rise in PAYE employment in November suggest the labour market soon strengthened again. Meanwhile, growth in average weekly earnings has fallen in recent months. But we estimate that underlying earnings growth held steady at close to pre-pandemic rates. Admittedly, the hit to consumer-facing services in December may have slowed the labour market recovery as firms struggled with lost earnings in the run-up to Christmas. But we don't expect it to have derailed the recovery entirely.

The Bank of England surprised us and many others with a hike to Bank Rate at the December Monetary Policy Committee (MPC) meeting from 0.10% to 0.25%. We had expected the Bank would wait for more information on the impact of Omicron before raising rates. But a series of strong data releases on the labour market and inflation in the run-up to the meeting seem to have worried the Bank. And the minutes of the meeting indicated that, despite acknowledging the downward impact on GDP from Omicron, the MPC was more concerned about the upside risks to inflation. At the same time, the Bank dropped any reference to inflation being expected to be below the 2% target in two years' time, which it had used at its November meeting to imply that the market pricing of Bank Rate at

that time was too high. That suggests to us that the Bank is now contemplating raising interest rates further than it was at its November meeting. But the Bank retained its guidance that only a “modest tightening” in monetary policy would be needed, so we doubt the shift in its thinking has been dramatic. Assuming that a typical policy tightening cycle involves rates rising by 25bps four times per year, we think that a “modest” tightening will be slower than that. That has prompted us to raise our Bank Rate forecast next year. We expect two more hikes to Bank Rate – the first 25bps in May and the second 25bps in August – taking Bank Rate to 0.75% by the end of the year. While that’s a bit higher than our previous forecast of 0.50%, it is still less than the tightening to almost 1.25% that investors are discounting by end of 2022. That’s because we expect GDP growth in the first half of 2022 to be weaker and inflation to fall back faster in the second half than the Bank expects.

The sharp rise in gilt yields at the start of Q4 on expectations of higher interest rates was quickly reversed following the November MPC meeting after investors’ expectations of a hike to Bank Rate was disappointed. But the 10-year yield has risen again in recent weeks to reach 1.00%, up from roughly 0.70% in mid-December, following encouraging signs that the Omicron variant may not lead to as many hospitalisations as initially feared. We expect the 10-year yield to drift a little higher in the coming years, albeit not by much, to reach 1.25% by end-2023. That’s underpinned by our more dovish Bank Rate forecast compared to investors and our view that **upward pressure on gilts from higher US Treasury yields will be more limited than we previously thought.**

In fact, we have recently revised down our end-2022 and end-2023 forecasts for the 10-year US Treasury yield by 25bp each, to 2.00% and 2.25%, respectively. That’s still marginally more tightening than is discounted by investors, but we think the Fed’s recent hawkish pivot in the face of higher inflation means that the policy rate will not need to rise as far further ahead as we had once assumed. Indeed, the rise in inflation in the US to 6.8% in November, up from 6.2% in October, probably marks the peak.

Meanwhile, sterling weakened throughout most of Q4 as investors discounted the murkier outlook for GDP growth. Admittedly, the pound has strengthened again in the past few weeks. But we suspect this will prove short-lived and forecast a further softening in the pound against both the dollar and the euro to \$1.25 and €1.16 respectively by end-2022 (from \$1.34 and €1.20 currently). That’s mainly based on our view that the Bank will disappoint investors’ rate expectations to a greater extent than the Fed or the ECB.

Finally, the FTSE 100 has risen by nearly 7% since the start of Q4, with much of the gain in the past few weeks prompted by investors’ more optimistic assessment of the risks posed by Omicron. In fact, the extent of the recent rise in the FTSE 100 means that the index is now not far off our end-2022 forecast of 7,600 and could suggest the scope for further gains is limited. Nonetheless, UK equities still look favourably valued compared to gilt yields and the S&P 500, which may prove to be an upside for the FTSE 100.

GLOSSARY

Local Authority Treasury Management Terms

Terms	Descriptions
Bond	A certificate of long-term debt issued by a company, government, or other institution, which is tradable on financial markets
Borrowing	Usually refers to the stock of outstanding loans owed, and bonds issued.
CFR	<p>Capital Financing Requirement. A council's underlying need to hold debt for capital purposes, representing the cumulative capital expenditure that has been incurred but not yet financed.</p> <p>The CFR increases with capital expenditure and decreases with capital finance and MRP.</p>
Capital gain or loss	An increase or decrease in the capital value of an investment, for example through movements in its market price.
Collective investment scheme	Scheme in which multiple investors collectively hold units or shares. The investment assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'pooled funds').
Cost of carry	When a loan is borrowed in advance of need, the difference between the interest payable on the loan and the income earned from investing the cash in the interim.
Counterparty	The other party to a loan, investment or other contract.
Counterparty limit	The maximum amount an investor is willing to lend to a counterparty, in order to manage credit risk.
Covered bond	Bond issued by a financial institution that is secured on that institution's assets, usually residential mortgages, and is therefore lower risk than unsecured bonds.
CPI	Consumer Price Index - the measure of inflation targeted by the Monetary Policy Committee.
Deposit	A regulated placing of cash with a financial institution. Deposits are not tradable on financial markets.
Diversified income fund	A collective investment scheme that invests in a range of bonds, equity and property in order to minimise price risk, and also focuses on investments that pay income.

Appendix B

Terms	Descriptions
Dividend	Income paid to investors in shares and collective investment schemes. Dividends are not contractual, and the amount is therefore not known in advance.
DMADF	Debt Management Account Deposit Facility – a facility offered by the DMO enabling councils to deposit cash at very low credit risk. Not available in Northern Ireland.
DLUHC	Department for Levelling Up, Housing and Communities (<i>formerly known as Ministry of Housing, Communities & Local Government - MHCLG</i>).
DMO	Debt Management Office – an executive agency of HM Treasury that deals with central government's debt and investments.
Equity	An investment which usually confers ownership and voting rights
Floating rate note (FRN)	Bond where the interest rate changes at set intervals linked to a market variable, most commonly 3-month LIBOR or SONIA
FTSE	Financial Times stock exchange – a series of indices on the London Stock Exchange. The FTSE 100 is the index of the largest 100 companies on the exchange, the FTSE 250 is the next largest 250 and the FTSE 350 combines the two
GDP	Gross domestic product – the value of the national aggregate production of goods and services in the economy. Increasing GDP is known as economic growth.
Income Return	Return on investment from dividends, interest and rent but excluding capital gains and losses.
GILT	Bond issued by the UK Government, taking its name from the gilt-edged paper they were originally printed on.
LIBID	London interbank bid rate - the benchmark interest rate at which banks bid to borrow cash from other banks, traditionally 0.125% lower than LIBOR.
LIBOR	London interbank offer rate - the benchmark interest rate at which banks offer to lend cash to other banks. Published every London working day at 11am for various currencies and terms. Due to be phased out by 2022.
LOBO	Lender's Option Borrower's option

Terms	Descriptions
MMF	Money Market Funds. A collective investment scheme which invests in a range of short-term assets providing high credit quality and high liquidity. Usually refers to Constant Net Asset Value (CNAV) and Low Volatility Net Asset Value (LVNAV) funds with a Weighted Average Maturity (WAM) under 60 days which offer instant access, but the European Union definition extends to include cash plus funds
Pooled Fund	Scheme in which multiple investors hold units or shares. The investment assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'pooled funds').
PWLB	Public Works Loan Board – a statutory body operating within the Debt Management Office (DMO) that lends money from the National Loans Fund to councils and other prescribed bodies and collects the repayments. Not available in Northern Ireland.
Quantitative easing (QE)	Process by which central banks directly increase the quantity of money in the economy to promote GDP growth and prevent deflation. Normally achieved by the central bank buying government bonds in exchange for newly created money.
SONIA	Sterling overnight interest average – a benchmark interest rate for overnight deposits.
Short-dated	Usually means less than one year
Total return	The overall return on an investment, including interest, dividends, rent, fees and capital gains and losses.