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| Is this report confidential? | No  |

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| **Report of** | **Meeting** | **Date** |
| Director of Finance and Section 151 Officer | Governance Committee | Tuesday, 30 November 2021 |

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| Is this decision key? | No |

# Treasury Management Activity Mid-Year Review 2021/22

# Purpose of the Report

1. To report on Treasury Management performance in financial year 2021/22 to the end of September.

## Recommendations to Governance Committee

1. That the report be noted.

## Corporate priorities

1. The report relates to the following corporate priorities: (please bold all those applicable):

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| --- | --- |
| **An exemplary council** | Thriving communities |
| A fair local economy that works for everyone | Good homes, green spaces, healthy places |

## Background to the report

1. The Annual Investment Strategy for 2021/22 was included in the Treasury Strategy 2021/22 to 2023/24, which was approved by Council on 24 February 2021. The report emphasised that the Council’s investment priorities will be Security first, portfolio Liquidity second, and only then return (Yield).
2. The Treasury Management Annual Report 2020/21 was presented to Governance Committee on 27 July 2021. The report indicated that an average return on investments of 0.36% had been achieved, which exceeded the target rate of 0.10%.
3. The Code of Practice for Treasury Management requires councils to review their treasury strategies and activities half yearly. This report satisfies that requirement.

## Treasury Activity

1. Investment activity up to the end of September 2021 is summarised in the following table.



1. Given the low (even compared to those more generally available) rates of interest available from the Debt Management Office, this counterparty is usually used only rarely, when the amounts that need to be kept at short notice are greater than what can be accommodated within the approved counterparty limits. However, during the first half of 2021/22, as for 2020/21, the continuing impacts of the Covid 19 pandemic have had an ongoing effect on the Council’s cash flows with significant Covid funding received from central government for onward payment e.g. in the form of Business Grant payments. As this was the case for all councils across the country, there was little demand for councils to borrow, and so for us to place deposits with them as we have done in the past. As a result, larger and more frequent amounts were placed with the Debt Management Office than would normally be the case.
2. The average daily investment of £54.199m continues to be well above the £10m minimum balance invested for the Council to qualify as a professional investor under MiFID II requirements. As noted above, because of the ongoing impacts of cash flows resulting from the Covid 19 pandemic, balances during the year to date have been higher than would otherwise have been the case.
3. A full list of investment counterparties and their associated limits is shown at Appendix A.
4. A full list of investments as at 30 September 2021 is presented as Appendix B. All investments throughout the first six months of the year were within the maximum limits per counterparty permitted by the approved Investment Strategy for 2021/22.
5. The investment durations per bank or building society suggested by Link Asset Services as at November 2021 are presented in Appendix C. The Council receives weekly updates, and suggested durations are checked online at the time of placing any term deposits with banks or building societies. The limit per institution is as approved by Council on 24 February 2021.
6. The average interest earned of 0.11% would normally be measured against a target of the average LIBID 7-day rate plus 15%, but the exceptional market conditions applying in 2020/21 mean that this would produce a negative target figure. Link Asset Services have therefore produced the following table of benchmark returns. That actually achieved by the Council have exceeded these targets. It also exceeds the Link Asset Services suggested earnings rate of 0.10% for 2021/22 (see Table 4 below).
7. The standard target against which investment earnings would previously have been measured is the average LIBID 7-day rate plus 15%, However, the continuing exceptional market conditions applying in the first half of 2021/22 have meant that the LIBID based calculation has produced a negative target figure, as shown in Table 3 below. Link Asset Services have therefore produced a replacement set of benchmark returns, based on a wider view of the market conditions (see Table 4, at paragraph 22). This shows a target of 0.1% for 2021/22.

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| **Table 2 - Benchmark Investment Rates** |
| **Period** | **Benchmark Return** |
| 7 day  | -0.08% |
| 1 month | -0.07% |
| 3 months | -0.05% |
| 6 months | -0.02% |
| 12 months | 0.07% |

1. Performance is expected to continue at or around the same levels throughout the rest of year and the forecast outturn position for interest earned, as contained in the revenue monitoring report received by Cabinet on 17 November 2021, is shown in Table 3 below.

|  |  |  |  |
| --- | --- | --- | --- |
| **Table 3 - Interest Receivable Budget** | **Budget for 2021/22** | **Actual to 30 September 2021** | **Forecast for year** |
|  | **£000** | **£000** | **£000** |
|   |   |  |   |
| Interest earned | 118 | 29 | 55 |
|   |   |  |   |
| **Total** | **200** | **141** | **185** |

1. No long-term borrowing has been undertaken in the first six months of 2021/22. The funding of the Capital Programme for the year requires an element of long-term borrowing and the cost of financing this has been included in the revenue budget for the year. Savings in interest payable may be achieved by delaying external borrowing, or by using the Council’s cash balances as an alternative to taking external loans from the Public Works Loan Board (PWLB) or other sources. Interest earned on cash balances would reduce as a consequence, but the Council would lose interest receivable at approximately 0.10% to 0.20%, while avoiding the relatively higher cost of paying interest to an external lender. For example, the rate on a 40-year annuity loan from the PWLB on 22 November 2021 was 1.94%.
2. No rescheduling of debt has been undertaken in the first six months of the year.
3. All activities in the first half of the year complied with the approved prudential indicators.

## Treasury Consultants Advice

1. Appendix D presents the advice of Link Asset Services in respect of economic matters and interest rates in the first half of 2021/22.
2. In addition, a detailed comparison of interest rate forecasts is presented at Appendix E. Bank rate and PWLB borrowing rate forecasts are given from the December quarter of 2021 through to the March quarter of 2025.
3. The Bank Rate is now forecast to rise from its current level of 0.10% to 0.25% by the end of December 2021, before rising steadily to 1.25% by March 2025.
4. Link's suggested budgeted investment earning rates for investments of up to about three months duration in each financial year are as follows:

|  |
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| **Table 4 - Average Earnings in each financial year** |
|  | **Revised November 2021** | **Revised September 2021** | **Original February 2021** |
|   |   |   |   |
| 2021/22 | N/A | 0.10% | 0.10% |
| 2022/23 | 0.50% | 0.25% | 0.10% |
| 2023/24 | 0.75% | 0.50% | 0.10% |
| 2024/25 | 1.00% | 0.50% | 0.20% |
| 2025/26 | 1.25% | 1.00% | N/A |
| Later years | 2.00% | 2.00% | 2.25% |
|   |   |   |   |

1. The most recent estimate is compared to the estimated earnings rate available at the time the Treasury Management Strategy was presented for approval in February 2021, and Link’s update in September 2021. The suggested earnings rates for the current year have remained unchanged at 0.10%, with any rises in rates not expected to have an impact until late in the year.

## Peer Review

1. In the recent Corporate Peer Challenge of the council, led by the Local Government Association (LGA) over the summer, reference was made to Treasury Management activities in two areas:
2. *‘The peer team heard a range of views from across political groups regarding these financial issues and would encourage the use of external training to support informed political debate on issues such as Treasury Management, CIPFA consultation responses and capital financing to facilitate this. This training will also help to ensure that there is a shared understanding of the council’s financial context across the organisation and support a more dispersed ownership of financial management.’*

**ACTION:** - Training is being arranged for delivery over the next 2-3 months by specialist, Treasury Management consultants to address this recommendation.

1. *Whilst the Treasury Management Strategy has been reviewed; the council is risk averse around its counterparty listing and it has been stated that the policy was implemented following the collapse of the Icelandic Banks. The peer team would therefore invite the council to discuss alternative investments over longer time periods with Link Asset Management* (the council’s Treasury Management Advisors) *to explore whether higher levels of investment income could be received whilst mitigating risk.*

**ACTION:** - Discussions have begun with Link in response to the comment from the peer review team above. Link have reviewed the council’s Treasury Management Strategy and have stated that they believe this is flexible enough and that the approach taken is consistent with that of many councils in prioritising security and liquidity of investment over yield. They have noted that during the pandemic the amount of cash received by councils from central government has been unprecedented, and the need to access this has been less predictable than is usually the case. Going forward however, they believe there is opportunity to increase returns by investing some sums for longer periods of time; we shall seek to develop this approach in line with the council’s Treasury Management Strategy and Prudential Indicators.

## Climate change and air quality

1. The work noted in this report does not impact the climate change and sustainability targets of the Councils Green Agenda and all environmental considerations are in place.

## Equality and diversity

1. This report has no implications in respect of equality and diversity.

## Risk

## There are a number of risks inherent to treasury management activities, both in the security of any investments placed and in managing both investments and borrowing based on actual and forecast interest rates. The Council’s treasury management strategy and policies are designed to ensure the effective control and management of the risks associated with such activities and this report forms part of that overall framework.

## Comments of the Statutory Finance Officer

1. This report complies with the statutory requirement to review treasury strategies and activities half yearly.

## Comments of the Monitoring Officer

1. The Monitoring Officer has no comments.

Background documents

Treasury Management Strategy 2021/22 to 2023/24 (Council 24 February 2021)

## Appendices

Appendix A Investment Counterparties

Appendix B List of Investments as at 30 September 2019

Appendix C Suggested Investment Durations as at November 2019

Appendix D Economics and Interest Rates – Treasury Advisors’ advice

Appendix E Comparison of Interest Rates Forecasts

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| --- | --- | --- | --- |
| Report Author: | Email: | Telephone: | Date: |
| Tony Furber (Principal Financial Accountant) | tony.furber@southribble.gov.uk | 01257 515025 | 22 November 2021 |







**Economics update**

**MPC meeting 24.9.21**

* The Monetary Policy Committee (MPC) voted unanimously to leave the 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: -
	1. Placing the focus on raising Bank Rate as “the active instrument in most circumstances”.
	2. Raising Bank Rate to 0.50% before starting on reducing its holdings.
	3. Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
	4. Once Bank Rate had risen to at least 1%, it would start selling its holdings.
* **COVID-19 vaccines.** These have been the game changer which have enormously boosted confidence that **life in the UK could largely return to normal during the summer** after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.

**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 (0.8%):



*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 the Bank Rate unchanged at its subsequent meetings.

As shown in the forecast table above, one increase in the 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 23/24 and a third one to 0.75% in quarter 4 of 23/24.

**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.

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* 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 above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on ‘achieving broad and inclusive “maximum” employment in its entirety’ in the US before consideration would be given to increasing rates.

* The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.
* The Bank of England has also amended its target for monetary policy so that inflation should be ‘sustainably over 2%’ and the ECB now has a similar policy.
* ***For local authorities, this means that investment interest rates*** ***and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.***
* Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.
* Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

**LINK ASSET SERVICES INTEREST RATE FORECASTS NOVEMBER 2021**

