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CABINET

18 OCTOBER 2022

TREASURY MANAGEMENT OUTTURN ANNUAL REPORT

Portfolio Holder: Councillor Alan Jarrett, Leader of the Council

Report from: Phil Watts, Chief Operating Officer

Author: Jonathan Lloyd, Finance Business Partner – Corporate Services

Summary

This report gives an overview of treasury management activity during 2021/22. Throughout the period the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and treasury indicators	2020/21 Actual £000	2021/22 Per Strategy* £000	2021/22 Actual £000
Capital expenditure			
• Non-HRA	31,124	147,152	76,783
• HRA	7,605	12,306	7,362
• Total	38,730	159,458	84,145
Capital Financing Requirement:			
• Non-HRA	326,975	411,107	371,770
• HRA	40,986	53,790	40,682
External debt (principal only)	280,540	464,897	306,380
Investments:			
• Longer than 1 year (subsidiaries)	15,390	n/a	35,040
• Property Funds (redemption value)	21,535	21,960	25,011
• Under 1 year	17,406	56,393	27,603
• Total	54,331	78,353	87,654
Net borrowing	226,209	386,544	218,726

* Audit Committee January 2021
Investments "per Strategy" are actual values as at 10 December 2020 including property funds at original cost

Other prudential and treasury indicators are to be found in the main body of this report. The Chief Finance Officer also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit, the authorised limit, was not breached. The financial year 2021/22 continued the challenging investment environment of previous years, namely low investment returns.

Work compiling the 2021/22 Statement of Accounts is ongoing and may result is the figures presented in this report being revised at a later date.

1. Budget and Policy Framework

1.1. The Council's Treasury Management Strategy and Policy are approved by Full Council following consideration by Cabinet and Audit Committee. The Audit Committee is responsible for approving the annual treasury outturn. In line with the Constitution an annual report must be taken to Cabinet detailing the Council's treasury management outturn within six months of the close of each financial year. Due to the exceptional circumstances relating to the death of Her Majesty The Queen, the impact of which led to the cancellation of the Cabinet meeting scheduled for September, it was not possible to report the outturn by the end of September, as required by the Constitution. It is therefore being reported at the next earliest opportunity.

2. Background

2.1. This Council is required by regulations issued under the Local Government Act 2003 to produce an annual review of treasury management activities and the actual prudential and treasury indicators for 2021/22. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

2.2. During 2021/22 the minimum reporting requirements were that the full Council should receive the following reports:

- An annual treasury strategy in advance of the year (Council 18 February 2021).
- A mid-year treasury review report (Council 23 September 2021).

2.3. The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

2.4. This Council also confirms that it has complied with the requirements under the Code to give prior scrutiny to all of the above treasury management reports by the Audit Committee before they were reported to the full Council. Member training on treasury management issues was undertaken on 26 September 2019 in order to support members' scrutiny role.

2.5. This annual treasury outturn report summarises:

- Capital activity during the year
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement)

- The actual prudential and treasury indicators
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness and the impact on investment balances
- Summary of interest rate movements in the year
- Detailed debt activity
- Detailed investment activity

3. The Council's Capital Expenditure and Financing

3.1. 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.

3.2. The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure all of which was financed during the year.

£m General Fund	2020/21 Actual £000's	2021/22 Per Strategy £000's	2021/22 Actual £000's
Capital expenditure	52,777	147,152	76,783
Financed in year (from receipts, grants, revenue contributions etc.)	21,641	50,653	30,734
Unfinanced (requiring borrowing)	**31,136**	**96,499**	**46,049**

£m HRA	2020/21 Actual £000's	2021/22 Per Strategy £000's	2021/22 Actual £000's
Capital expenditure	7,605	12,306	7,362
Financed in year	7,281	4,122	7,308
Unfinanced (requiring borrowing)	**324**	**8,184**	**54**

4. The Council's Overall Borrowing Need

4.1. The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2021/22 unfinanced capital expenditure (see above table), and prior years' net of unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

4.2. Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, treasury officers in Finance Strategy and Finance Operations organise the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB], or the money markets), or utilising temporary cash resources within the Council.

4.3. *Reducing the CFR* – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure broadly that capital assets are charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision- MRP to reduce the CFR, this is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need, (there is no statutory requirement to reduce the HRA CFR – though Medway's policy is to provide VRP on HRA borrowing). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

4.4. The total CFR can also be reduced by:

- The application of additional capital financing resources (such as unapplied capital receipts); or
- Charging more than the statutory revenue charge (MRP) each year through Voluntary Revenue Provision (VRP).

4.5. The Council's 2021/22 MRP Policy (as required by MHCLG Guidance), was approved as part of the Treasury Management Strategy 2021/22 on 18 February 2021.

4.6. The Council's CFR for the year is shown below, and represents a key prudential indicator.

CFR (£m): General Fund	2020/21 Actual £000	2021/22 Per Strategy £000	2021/22 Actual £000
Opening balance	297,146	315,862	326,975
Add unfinanced capital expenditure (as above)	31,136	96,499	46,049
Less MRP*	0	0	0
Less KCC Debt Repayment	1,307	1,254	1,254
Closing balance	326,975	411,107	371,770

CFR for 2020/21 has been restated.
*MRP of just £1 is being provided, based on a report by our treasury advisors, Link Asset Services; this identified historic errors in the calculation of CFR and therefore MRP provision. The reduction of MRP over the forthcoming years restores the correct position.

CFR (£m): HRA	2020/21 Actual £000	2021/22 Per Strategy £000	2021/22 Actual £000
Opening balance	41,002	46,017	40,986
Add unfinanced capital expenditure (as above)	324	8,113	54
Less VRP	340	340	358
Closing balance	40,986	53,790	40,682

4.7. Borrowing activity is constrained by prudent indicators for gross borrowing and the CFR and by the authorised limit.

4.8. Gross borrowing and the CFR. 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 borrowing does not, except in the short term, exceed the total capital financing requirement of the preceding year (2021/22) plus the estimates of any additional capital financing requirement for the current (2022/23) and the next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate needs. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2021 Actual £000	31 March 2022 Per Strategy £000	31 March 2022 Actual £000
Gross borrowing position (principal)	280,540	437,110	306,380
CFR	331,606	464,897	412,452
Under- funding of CFR	51,066	27,787	106,072

4.9. The authorised limit. 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. The table in 4.11 below demonstrates that during 2021/22 the Council has maintained gross borrowing within its authorised limit.

4.10. The operational boundary. 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.

4.11. Actual financing costs as a proportion of net revenue stream. This 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.

	2021/22 £000
Authorised limit	623,587
Maximum gross borrowing position during the year	322,539
Operational boundary	566,897
Average gross borrowing position	295,601
Financing costs as a proportion of net revenue stream (General Fund)	5.13%
Financing costs as a proportion of net revenue stream (HRA)	14.49

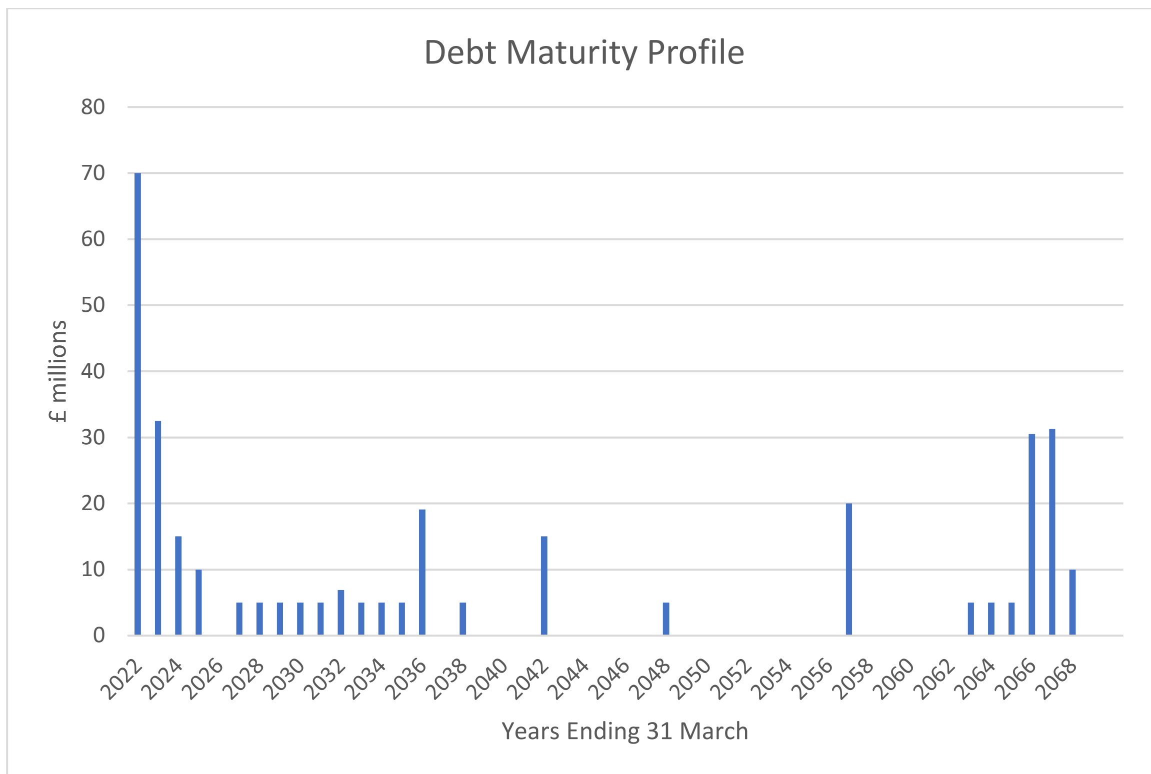
5. Treasury Position as at 31 March 2022

5.1. The Council's treasury management debt and investment position is organised by the treasury management officers to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2021/22 the Council's treasury, was as follows:

Borrowing and investment levels:

	31/03/21 £m	Rate	31/03/22 £m	Rate
Long Term Borrowing – PWLB/LOBO	225.32	3.35%	225.32	3.35%
Long Term Borrowing – Other Local Authority	8.00	1.62%	10.00	0.61%
Long Term Borrowing – Growing Places/Salix/LEP	2.22		1.06	
Short Term Borrowing	45.00	1.28%	70.00	0.80%
Total Debt (Principal)	280.54		306.38	
Capital Financing Requirement (CFR)	331.61		412.45	
(Under)/Over Borrowing	*(49.36)*		*(106.07)*	
Less investments (exc. Property Funds & Loans to Subsidiaries)	17.41	0.12%	27.60	0.34%
Less Loan to Kyndi Ltd	2.50	5.00%	2.30	5.00%
Less Loan to MDC	12.89	8.00%	32.74	8.00%
Less Property Fund Investments *	21.53	2.03%	25.01	17.45%
Net borrowing	226.21		218.73	

* The return on the property fund investments includes the change in capital value.



5.2. Of the £70m repayable in the year ending 31 March 2023 £20m will be replaced by loans contracted to commence later in 2022/23.

5.3. The Ministry of Housing, Communities and Local Government (MHCLG) guidance since 2011 has been to show the maturity date for Lenders Options, Borrowers Options (LOBOs) as the next call date. The table does not follow this guidance because the rates payable on the Council's LOBOs far exceeds current market rates. As such it is considered extremely unlikely that lenders would exercise their rights to vary the interest rate and therefore the Council would not be afforded the opportunity to redeem. LOBOs have therefore been shown as maturing at their full term.

5.4. Upper limits for the proportion of debt maturing within various bands of years were set at the start of the year as shown below. There was no breach of these limits.

Maturity Structure of Fixed rate Borrowing during 2021/22	Upper Limit	Lower Limit
under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	0%

5.5. The investment portfolio is shown below.

INVESTMENT PORTFOLIO	Actual 31/03/21 £000	Actual 31/03/21 %	Actual 31/03/22 £000	Actual 31/03/22 %
Treasury investments				
Banks	16,916	31.13	8,416	9.60
Medway Council Subsidiaries	15,392	28.32	35,040	39.98
Total managed in house	**32,308**	**59.46**	**43,456**	**49.58**
Property funds	21,535	39.63	25,011	28.53
Cash fund managers	490	0.90	19,187	21.89
Total managed externally	**22,025**	**40.54**	**44,198**	**50.42**
TOTAL TREASURY INVESTMENTS	**54,333**	**100**	**87,651**	**100**

5.6. Property fund investment and income are summarised below

	CCLA £000	Lothbury £000	Patriza £000	Total £000
Opening Value	12,069	4,692	4,774	21,535
Revaluation	2,118	683	674	3,475
Closing Value	14,187	5,375	5,448	25,010
Dividend Received	342	105	236	683
Overall Gain/ (Loss)	2,460	788	910	4,158

5.7. All the property funds produced positive returns this year. Members should note however that under The Local Authorities (Capital and Accounting) (England) Regulations 2018 (SI 2028/1207) capital gains and losses are recorded in a Pooled Investment Funds Adjustment Account in the balance sheet and do not impact on revenue. Unless legislation is amended this arrangement is scheduled to end on 31 March 2023, so changes in capital values will need to be added to/netted off dividend income in the revenue account in 2023/24. Following the upward revaluations in 2021/22, the cumulative balance on the Adjustment Account at 31 March 2022 was a credit balance of £4,343,352 so as things stand this amount, subject to subsequent revaluations, will be available for use in 2023/24.

6. The Strategy for 2020/2021

6.1. The strategy for 2020/21 as set out before the start of the year was to aim to smooth out the maturity profile of debt. However, due to the differential between short and long term rates and continued very cheap rates from other local authorities only £10m of new borrowing was taken with durations longer than 12 months.

6.2. Investment strategy and control of interest rate risk

6.2.1. Investment returns remained close to zero for much of 2021/22. Most local authority lending managed to avoid negative rates and one feature of the year was the continued growth of inter local authority lending. The expectation for

interest rates within the treasury management strategy for 2021/22 was that Bank Rate would remain at 0.1% until it was clear to the Bank of England that the emergency level of rates introduced at the start of the Covid-19 pandemic were no longer necessitated.

6.2.2. The Bank of England and the Government also maintained various monetary and fiscal measures, supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the various lockdowns/negative impact on their cashflow. 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 remained low until towards the turn of the year when inflation concerns indicated central banks, not just the Bank of England, would need to lift interest rates to combat the second-round effects of growing levels of inflation (CPI was 6.2% in February).

6.2.3 This authority does not have sufficient cash balances to be able to place deposits for more than a month so as to earn higher rates from longer deposits. While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

6.2.4 Officers aimed to keep Investment balances to a minimum through the agreed strategy of using reserves and balances to support internal borrowing as far as possible. It was not possible to generate a significant return on cash due to the very low investment rates available.

Bank Rate vs backward looking SONIA rates % 1.4.21 - 31.3.22

0.80
0.70
0.60
0.50
0.40
0.30
0.20
0.10
0.00
-0.10
-0.20

01/04/21 01/05/21 01/06/21 01/07/21 01/08/21 01/09/21 01/10/21 01/11/21 01/12/21 01/01/22 01/02/22 01/03/22 01/04/22

Bank Rate · SONIA · 7 day · 30 day · 90 day · 180 day · 365 day

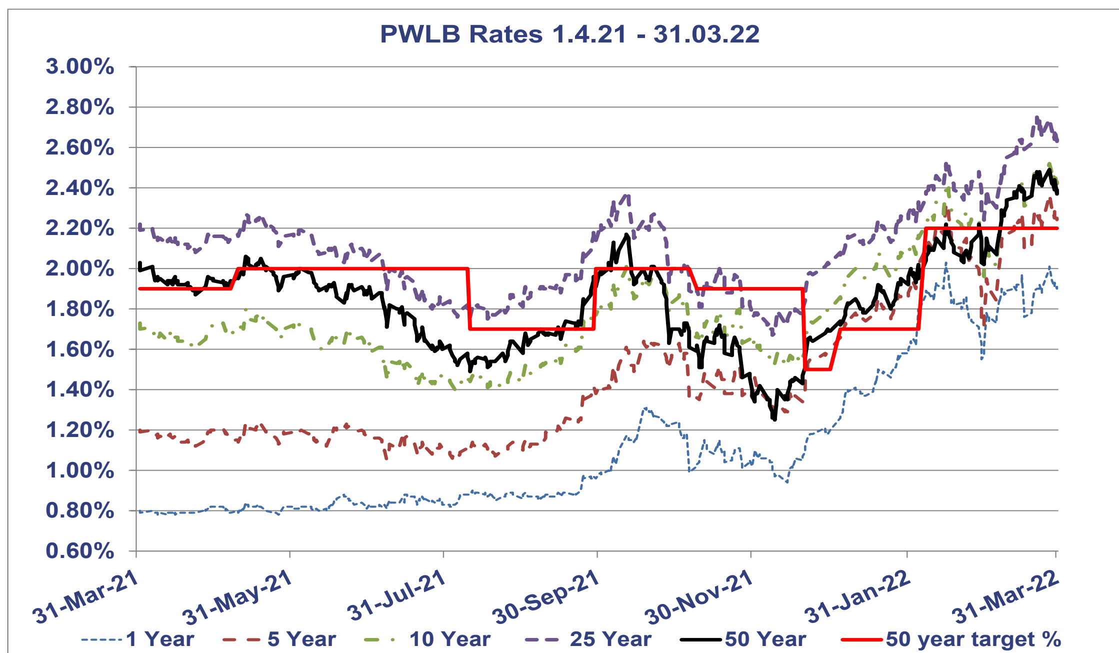
	Bank Rate	SONIA	7 day	30 day	90 day	180 day	365 day
High	0.75	0.69	0.69	0.56	0.39	0.23	0.14
High Date	17/03/2022	18/03/2022	25/03/2022	31/03/2022	31/03/2022	31/03/2022	31/03/2022
Low	0.10	0.05	0.05	0.05	0.05	0.05	0.05
Low Date	01/04/2021	15/12/2021	16/12/2021	16/12/2021	16/12/2021	07/06/2021	13/12/2021
Average	0.19	0.14	0.13	0.12	0.09	0.07	0.06
Spread	0.65	0.65	0.65	0.51	0.34	0.18	0.09

6.3. Borrowing Strategy and control of interest rate risk

6.3.1. During 2020-21, the Council maintained an under-borrowed position. This meant 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 was used as an interim measure. This strategy was prudent as investment returns were low and it also minimised counterparty risk.

6.3.2. A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

6.3.3. The strategy for 2021/22 had been to take longer term loans to reduce interest rate exposure and to smooth the maturity profile of the debt portfolio. However high differential between short and long-term interest rates made long-term borrowing unattractive and the emphasis was placed on borrowing short term where necessary. (See table at 5.1 above). PWLB rates over the year were as follows:



7. Borrowing Outturn for 2021/22

7.1. The borrowing strategy for the Council confirmed the holding of £101.8 million in Lenders Options, Borrowers Options (LOBO) debt. These are debts that are subject to immediate repayment or variation of interest chargeable and the option to repay, on request from the lender on the review dates. However, the lender can only apply this clause once within the lifetime of the LOBO.

7.2. No new long term PWLB loans were taken out and the balance of long term borrowing from other local authorities stood at £10m (31 March 2021 £8m).

7.3. The Council continued to use cash balances to finance new capital expenditure when possible, so as to run down cash balances and minimise counterparty risk incurred on investments. This also maximised treasury management budget savings, as investment rates were much lower than most new borrowing rates. Details of the short-term borrowing at 1 April 2021 is shown in the table below:

Lender	Amount Borrowed £m	Date Commenced	Repayment Date	Annual Interest Rate (inc brokerage)
Hampshire County Council	4	13/10/20	13/4/21	0.35%
Hampshire Fire & Rescue	1	13/10/20	13/4/21	0.35%
LB Barking & Dagenham	10	16/10/18	16/4/21	1.56%
Wokingham BC	10	30/10/20	30/4/21	0.30%
Rugby Borough Council	5	16/3/20	16/3/21	1.86%*
Midlothian Council	15	30/3/20	30/3/22	1.86%
Total Short-Term Borrowing at 1 April 2021	45			

7.4. New loan taken during 2021/22 but repaid before 31 March 2022:

Lender	Amount Borrowed £m	Date Commenced	Repayment Date	Annual Interest Rate (inc brokerage)
West Midlands Combined Authority	10	22/4/21	22/5/21	0.11%

7.5. The following short-term loans were still outstanding at 31 March 2022:

Lender	Amount Borrowed £m	Date Commenced	Repayment Date	Annual Interest Rate (inc brokerage)
Caerphilly County Borough Council	3	25/4/19	25/4/22	1.56%
Greater Manchester Combined Authority	10	25/2/22	25/5/22	0.58%
Kingston Upon Hull City Council	10	20/12/21	20/6/22	0.10%
West Yorkshire Combined	5	14/3/22	14/9/22	1.00%

Authority				
Fylde Borough Council	2	24/3/22	26/9/22	0.80%
Oxfordshire County Council	5	28/2/22	28/11/22	0.75%
West Yorkshire Combined Authority	5	14/3/22	14/12/22	1.15%
West Yorkshire Fire & Rescue Service	5	22/3/22	22/12/22	0.90%
Rugby Borough Council	5	23/1/20	23/1/23	1.66%
Warwickshire County Council	10	24/2/22	23/2/23	0.35%
Cambridgeshire & Peterborough Combined Authority	5	15/3/22	14/3/23	1.20%
Bolton Metropolitan Borough Council	5	14/3/22	23/3/23	1.20%
Total Short-Term Borrowing at 31 March 2022	70			

8. Debt Rescheduling

8.1. No debt restructuring was undertaken during 2021/22 as the average differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

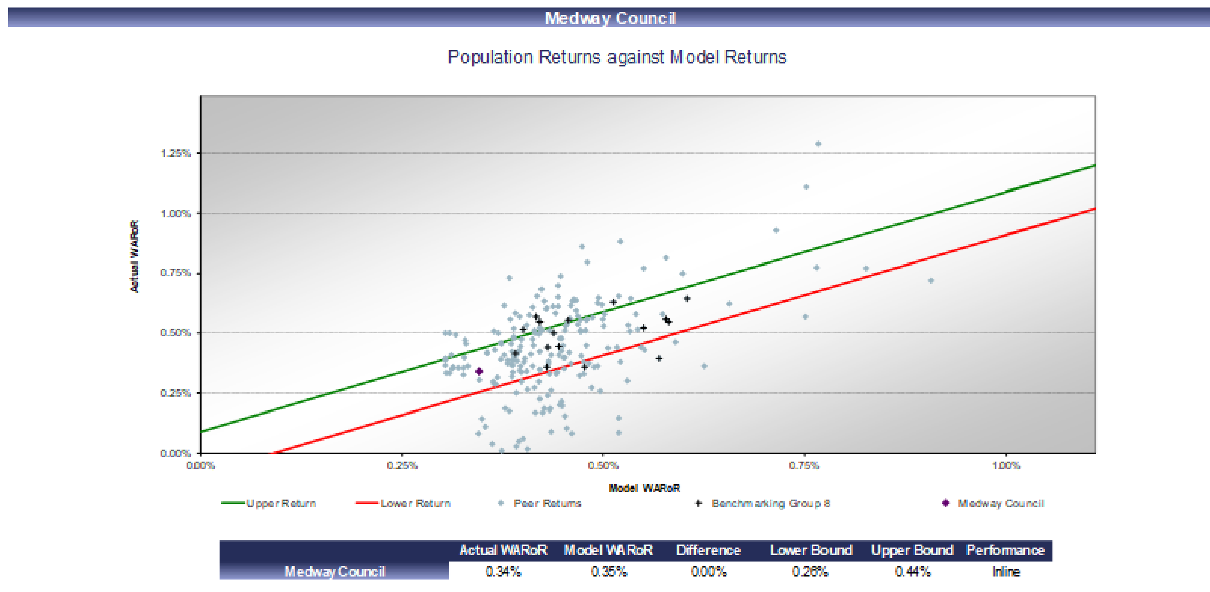
9. Investment Outturn for 2021/22

9.1. Investment Policy – the Council’s investment policy is governed by DLUHC investment guidance, which has been implemented in the annual investment strategy approved by the Council on 18 February 2021. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks and credit default swaps).

9.2. The average balance held in bank accounts and money market funds during the year was £22.1m producing an overall return of 0.094%. This money is held primarily for cash flow purposes and therefore does not benefit from higher rates obtainable for longer term deposits.

9.3. At 31st March 2022 there were no investments with other local authorities.

9.4. The Council’s performance relative to our peer group is shown by the graph below, which is a snapshot produced by Link Asset Services as at March 2022. Medway is the bold about mid-way between the red and green lines.



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Medway Council	0.34%	0.35%	0.00%	0.26%	0.44%	Inline

9.5. Compliance with Treasury Limits

9.5.1. There were no breaches of treasury limits in 2021-22.

10. Risk Management

10.1. Risk and the management thereof is a key feature throughout the strategy and in detail within the treasury management practices (TMP1) within the Treasury Strategy.

11. Financial Implications

11.1. Overall, the Interest and Financing budget made a surplus of £5,451,000 over its targeted budget of £12,171,000.

11.2. A breakdown of the Interest and Financing budget is shown below:

Interest and Finance Budget against spend:

	Budget 2021/22 £000	**Actual 2021/22 £000**	**(Under)/Overspend £000**
Interest Earned	(5,039)	(4,883)	156
Interest Paid	10,359	9,898	(461)
KCC Principal	1,307	1,255	(52)
MRP	5,473	358	(5,115)
Treasury Costs	71	92	21
Total	**12,171**	**6,720**	**(5,451)**

11.3. The underspend on MRP follows a report by Link Asset Services which concluded that provision in previous years had been too high so just £358,000, being equivalent to the HRA contribution, has been charged as MRP in 2021/22 to redress the balance.

11.4. The body of the report outlines the significant financial implications. Any transactions undertaken on either investments or borrowings are governed by the London Code of Conduct, the Council's treasury policy statement, and the CIPFA Code of Practice on Treasury Management in Local Authorities.

12. Legal implications

12.1. For the financial year 2020/21 our investments were managed in compliance with the Codes of Practices, guidance and regulations made under the Local Government Act 2003.

13. Recommendation

13.1. The Cabinet is asked to note the treasury management outturn annual report.

14. Suggested Reason for Decision

14.1. Section 7.1 (e) of the Council's Financial Rules state that the Chief Operating Officer shall report to Cabinet and the Audit Committee not later than September on treasury management activities in the previous year. Due to the exceptional circumstances relating to the death of Her Majesty The Queen, the impact of which led to the cancellation of the Cabinet meeting scheduled for September, it was not possible to report the outturn by the end of September, as required by the Constitution. It is therefore being reported at the next earliest opportunity.

Lead officer contact:

Phil Watts, Chief Operating Officer, Gun Wharf,
Tel (01634) 332220 E-mail phil.watts@medway.gov.uk

Appendices

Appendix 1 Commentary by Link Asset Services on The Economy and Interest Rates
Appendix 2 Glossary of Terms

Background papers

None

Appendix 1

Commentary by Link Asset Services on The Economy & Interest Rates

UK. Economy. Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021, 0.50% at its meeting of 4th February 2022 and then to 0.75% in March 2022.

The UK economy has endured several false dawns through 2021/22, but with most of the economy now opened up and nearly back to business-as-usual, the GDP numbers have been robust (9% y/y Q1 2022) and sufficient for the MPC to focus on tackling the second-round effects of inflation, now that the CPI measure has already risen to 6.2% and is likely to exceed 8% in April.

Gilt yields fell towards the back end of 2021, but despite the war in Ukraine gilt yields have shot higher in early 2022. At 1.38%, 2-year yields remain close to their recent 11-year high and 10-year yields of 1.65% are close to their recent six-year high. These rises have been part of a global trend as central banks have suggested they will continue to raise interest rates to contain inflation.

Historically, a further rise in US Treasury yields will probably drag UK gilt yields higher. There is a strong correlation between the two factors. However, the squeeze on real household disposable incomes arising from the 54% leap in April utilities prices as well as rises in council tax, water prices and many phone contract prices, are strong headwinds for any economy to deal with. In addition, from 1st April 2022, employees also pay 1.25% more in National Insurance tax. Consequently, inflation will be a bigger drag on real incomes in 2022 than in any year since records began in 1955.

Average inflation targeting. This was the major change in 2020/21 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 2020 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 mantra now seems very dated. Inflation is the "genie" that has escaped the bottle, and a perfect storm of supply side shortages, labour shortages, commodity price inflation, the impact of Russia's invasion of Ukraine and subsequent Western sanctions all point to inflation being at elevated levels until well into 2023.

USA. The flurry of comments from Fed officials following the mid-March FOMC meeting – including from Chair Jerome Powell himself – hammering home the hawkish message from the mid-March meeting, has had markets pricing in a further 225bps of interest rate increases in 2022 on top of the initial move to an interest rate range of 0.25% - 0.5%.

In addition, the Fed is expected to start to run down its balance sheet. Powell noted that the rundown could come as soon as the next meeting in May.

The upward pressure on inflation from higher oil prices and potential knock-on impacts on supply chains all argue for tighter policy (CPI is estimated at 7.8% across

Q1), but the hit to real disposable incomes and the additional uncertainty points in the opposite direction.

More recently, the inversion of the 10y-2y Treasury yield spread at the end of March led to predictable speculation that the Fed's interest rate hikes would quickly push the US economy into recession. Q1 GDP growth is likely to be only between 1.0% and 1.5% annualised (down from 7% in Q4 2021). But, on a positive note, the economy created more than 550,000 jobs per month in Q1, a number unchanged from the post-pandemic 2021 average. Unemployment is only 3.8%.

EU. With euro-zone inflation having jumped to 7.5% in March it seems increasingly likely that the ECB will accelerate its plans to tighten monetary policy. It is likely to end net asset purchases in June – i.e., earlier than the Q3 date which the ECB targeted in March. And the market is now anticipating possibly three 25bp rate hikes later this year followed by more in 2023. Policymakers have also hinted strongly that they would re-start asset purchases if required. In a recent speech, Christine Lagarde said "we can design and deploy new instruments to secure monetary policy transmission as we move along the path of policy normalisation."

While inflation has hit the headlines recently, the risk of recession has also been rising. Among the bigger countries, Germany is most likely to experience a "technical" recession because its GDP contracted in Q4 2021, and its performance has been subdued in Q1 2022. However, overall, Q1 2022 growth for the Eurozone is expected to be 0.3% q/q with the y/y figure posting a healthy 5.2% gain. Finishing on a bright note, unemployment fell to only 6.8% in February.

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; however, 2021 has seen the economy negatively impacted by political policies that have focussed on constraining digital services, restricting individual freedoms, and re-establishing the power of the One-Party state. With the recent outbreak of Covid-19 in large cities, such as Shanghai, near-term economic performance is likely to be subdued. Official GDP numbers suggest growth of c4% y/y, but other data measures suggest this may be an overstatement.

Japan. The Japanese economic performance through 2021/22 is best described as tepid. With a succession of local lockdowns throughout the course of the year, GDP is expected to have risen only 0.5% y/y with Q4 seeing a minor contraction. The policy rate has remained at -0.1%, unemployment is currently only 2.7% and inflation is sub 1%, although cost pressures are mounting.

World growth. World growth is estimated to have expanded 8.9% in 2021/22 following a contraction of 6.6% in 2020/21.

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 18% of total world GDP (the USA accounts for 24%), and Russia's recent invasion of Ukraine, has unbalanced the world economy. In addition, 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 (and to a much lesser extent Russia) to supply products and vice versa. This is likely to reduce world growth rates.

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.

Appendix 2

Glossary of Terms

(not all of these abbreviations have been used in this report)

ALMO: an Arm's Length Management Organisation is a not-for-profit company that provides housing services on behalf of a local authority. Usually, an ALMO is set up by the authority to manage and improve all or part of its housing stock.

LAS: Link Asset Services, Treasury solutions – the council's treasury management advisers.

CE: Capital Economics - is the economics consultancy that provides Link Asset Services, Treasury solutions, with independent economic forecasts, briefings, and research.

CFR: capital financing requirement - the council's annual underlying borrowing need to finance capital expenditure and a measure of the council's total outstanding indebtedness.

CIPFA: Chartered Institute of Public Finance and Accountancy – the professional accounting body that oversees and sets standards in local authority finance and treasury management.

CPI: consumer price index – the official measure of inflation adopted as a common standard by countries in the EU. It is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them.

ECB: European Central Bank - the central bank for the Eurozone

EU: European Union

EZ: Eurozone -those countries in the EU which use the euro as their currency

Fed: the Federal Reserve System, often referred to simply as "the Fed," is the central bank of the United States. It was created by the Congress to provide the nation with a stable monetary and financial system.

FOMC: the Federal Open Market Committee – this is the branch of the Federal Reserve Board which determines monetary policy in the USA by setting interest rates and determining quantitative easing policy. It is composed of 12 members--the seven members of the Board of Governors and five of the 12 Reserve Bank presidents.

GDP: gross domestic product – a measure of the growth and total size of the economy.

G7: the group of seven countries that form an informal bloc of industrialised democracies--the United States, Canada, France, Germany, Italy, Japan, and the United Kingdom--that meets annually to discuss issues such as global economic governance, international security, and energy policy.

Gilts: gilts are bonds issued by the UK Government to borrow money on the financial markets. Interest paid by the Government on gilts is called a coupon and is at a rate that is fixed for the duration until maturity of the gilt, (unless a gilt is index linked to

inflation); while the coupon rate is fixed, the yields will change inversely to the price of gilts i.e., a rise in the price of a gilt will mean that its yield will fall.

HRA: housing revenue account.

IMF: International Monetary Fund - the lender of last resort for national governments which get into financial difficulties.

LIBID: the London Interbank Bid Rate is the rate bid by banks on deposits i.e., the rate at which a bank is willing to borrow from other banks. It is the "other end" of the LIBOR (an offered, hence "ask" rate, the rate at which a bank will lend).

MHCLG: the Ministry of Housing, Communities and Local Government -the Government department that directs local authorities in England.

MPC: the Monetary Policy Committee is a committee of the Bank of England, which meets for one and a half days, eight times a year, to determine monetary policy by setting the official interest rate in the United Kingdom, (the Bank of England Base Rate, commonly called Bank Rate), and by making decisions on quantitative easing.

MRP: minimum revenue provision -a statutory annual minimum revenue charge to reduce the total outstanding CFR, (the total indebtedness of a local authority).

PFI: Private Finance Initiative – capital expenditure financed by the private sector i.e. not by direct borrowing by a local authority.

PWLB: Public Works Loan Board – this is the part of H.M. Treasury which provides loans to local authorities to finance capital expenditure.

QE: quantitative easing – is an unconventional form of monetary policy where a central bank creates new money electronically to buy financial assets, such as government bonds, (but may also include corporate bonds). This process aims to stimulate economic growth through increased private sector spending in the economy and also aims to return inflation to target. These purchases increase the supply of liquidity to the economy; this policy is employed when lowering interest rates has failed to stimulate economic growth to an acceptable level and to lift inflation to target. Once QE has achieved its objectives of stimulating growth and inflation, QE will be reversed by selling the bonds the central bank had previously purchased, or by not replacing debt that it held which matures. The aim of this reversal is to ensure that inflation does not exceed its target once the economy recovers from a sustained period of depressed growth and inflation. Economic growth, and increases in inflation, may threaten to gather too much momentum if action is not taken to 'cool' the economy.

RPI: the Retail Price Index is a measure of inflation that measures the change in the cost of a representative sample of retail goods and services. It was the UK standard for measurement of inflation until the UK changed to using the EU standard measure of inflation – CPI. The main differences between RPI and CPI is in the way that housing costs are treated and that the former is an arithmetical mean whereas the latter is a geometric mean. RPI is often higher than CPI for these reasons.

TMSS: the annual treasury management strategy statement reports that all local authorities are required to submit for approval by the full council before the start of each financial year.

VRP: a voluntary revenue provision to repay debt, in the annual budget, which is additional to the annual MRP charge, (see above definition).