Corporate, Resource Management and
Governance Scrutiny Committee Meeting: 23 November 2021

TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT STRATEGY MID-YEAR REVIEW REPORT 2021/22

Report of the Deputy Chief Executive (Section 151 Officer)

Key Highlights

1. Introduction and Purpose of the Report

This report provides Members with a mid-year review of the Council's Treasury Management Strategy Statement (TMSS) and Annual Investment Strategy (AIS) for 2021/22.

2. Interest Rate Forecast

- The Coronavirus outbreak has done enormous economic damage to the UK and economies around the world. After the Bank of England took emergency action in March 2020 to cut the Bank Rate to 0.10%, it has left the Bank Rate unchanged at its subsequent meetings.

- The summary forecasts for Bank Rate, LIBID (investment rates) and Public Works Loan Board (PWLB) rates are given in Section 8 of the main report. PWLB forecasts are based on the Certainty Rate (PWLB standard rate minus 20 basis points or 'bps') and show a generally rising trend over the longer-term.

- Bank Rate forecasts suggest a first increase in Bank Rate from 0.10% to 0.25% in quarter 2 of 2022/23, with a second increase to 0.50% in quarter 2 of 2023/24 and a third one to 0.75% in quarter 4 of 2023/24.

- There is significant upside risk to an earlier Bank Rate rise due to concerns surrounding inflation.

- Gilt yields (on which PWLB lending rates are based) were on a falling trend between May and August, however they have risen more recently due to anxiety over potential interest rate hikes, inflationary pressures, and an unravelling energy crisis. UK gilt yields however dropped after the government announced it would borrow less than expected in this year's Autumn Budget.

- The interest forecast table for PWLB certainty rates 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 throughout the remainder of the financial year.

3. Treasury Management Activity 2021/22

- The overall treasury position as at 30 September 2021 is given in the table below

AGENDA ITEM

Treasury Position	Financial Year 2021/22 (2 Pools)				Financial Year 2020/21 (2 Pools)			
	General Fund		HRA		General Fund		HRA	
	£000	%	£000	%	£000	%	£000	%
	as at 30.09.21		as at 30.09.21		as at 31.03.21		as at 31.03.21	
Fixed Rate Funding:								
PWLB	290,975	3.39%	75,494	4.76%	305,975	3.31%	75,494	4.76%
Market (LOBO)	10,942	4.26%	6,558	4.26%	10,942	4.26%	6,558	4.26%
Market (converted LOBOs)	37,517	3.89%	22,483	3.89%	37,517	3.89%	22,483	3.89%
Market (other long-term loans)	40,000	2.33%	0	0%	40,000	2.33%	0	0%
Market (other LAs +364 days)	0	0%	0	0%	10,000	1.00%	0	0%
Market (short-term)	164,000	0.12%	0	0%	118,000	0.38%	0	0%
Salix loans	4,288	0%	0	0%	3,437	0%	0	0%
Sub-total	547,722		104,535		525,871		104,535	
Variable Rate Funding:								
Market (short-term)	19	0.10%	0	0%	19	0.10%	0	0%
Sub-total	19		0		19		0	
Total Debt	**547,741**	**2.37%**	**104,535**	**4.54%**	525,890	2.57%	104,535	4.54%
Total Investments	**57,525**	**0.16%**	**0**	**0%**	24,275	0.10%	0	0%
Net Debt	**490,216**		**104,535**		501,615		104,535	

4. Investment Portfolio

- Activity is in line with the Annual Investment Strategy (AIS) set out for 2021/22.

- Investment rates have remained low throughout 2021/22, with Bank Rate maintained at 0.10% since March 2020. There has been a marginal pick up in rates out to 12 months given market perception of a possible rise in Bank Rate before the end of 2021, however a glut of money at the short end of the market means short-term rates have remained subdued.

- The average level of funds available for investment purposes during the first half of 2021/22 was £47.454m.

- The Council's return for the first half of 2021/22 was 0.15% on an average weighted investment duration of 59.05 days; this outperforms the 12-month LIBID benchmark by 0.08% (more than double), despite being of much shorter duration (closer to the two-month negative return). The Council has achieved this return largely through careful use of various notice accounts, bank deposits and money market funds. The Council expects to sustain this level of return in the second half of the financial year, however careful planning will be required to maintain a level of investment balances the Council feels is sufficient to counteract any unforeseen liquidity shortages, but not too high as returns earnt may be low or absent.

5. Borrowing Portfolio

- The Council's original Borrowing Requirement was £84.327m (excluding MRP). The revised estimate of the 2021/22 borrowing required to support prudential borrowing within the capital programme is circa £69.206m due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement, CFR). This includes £15m of PWLB borrowing that has matured and required replacing in 2021/22. There has been some significant re-phasing of capital schemes during the first six months of the year. Despite this, the borrowing that the Council will need will also consider the level of investments held and will be greatly influenced by the amount of capital spending during 2021/22.

- With short-term interest rates having been lower than long-term rates for some time, it has been cost effective for the Council to either use internal resources, or to borrow short-term rather than take long-term borrowing to fully fund its Capital Financing Requirement (CFR). Liquidity at the short end of the market has meant loans from other Councils have been plentiful in 2021/22.

- The Capital Programme is being kept under regular review due to the effects of Coronavirus and shortages of materials and labour. The Council's Borrowing Strategy will, therefore, also be regularly reviewed and then revised, if necessary, in order to achieve optimum value and risk exposure in the long-term.

- It is now anticipated that long-term borrowing is less likely to be undertaken during this financial year and the Council will continue to rely on the short-term market and liquid investments.

6. Summary Economic Outlook

- The overall balance of risks to economic growth in the UK is now towards the downside, including residual risks from Covid and its variants, both domestically and their potential effects worldwide.

- In the Monetary Policy Committee's (MPC's) central forecasts, global and UK GDP continue to recover from the effects of Covid-19 in the near term. Growth is somewhat restrained by disruption to supply chains. That disruption, alongside the rapid pace at which global demand for goods has risen, has led to bottlenecks, which have exerted upward pressure on inflation globally, including in the UK. Inflation has also been boosted by higher energy prices, which have risen significantly further in recent months. In the UK, as a result, CPI inflation has risen markedly to over 3%, and is projected to rise further in the near term, peaking at around 5% in April 2022.

- The Committee are also concerned that 'current elevated inflationary pressures could potentially lead to some second-round effects on consumer prices'. Overall, recent developments suggest a strengthened case for a modest Bank rate increase sooner, albeit that there remains uncertainty around the economic outlook.

7. Conclusions and Recommendations

- The Council's Treasury Management Strategy remains relevant and effective at the half year point, with no significant changes required other than revisions to interest rate forecasts to reflect the current economic situation.

Cabinet is asked to recommend the following to the Council meeting:

- Note the report and the treasury activity in the first half of the financial year.
- Note the revised interest rate forecasts for PWLB rates over the short and medium term, which will drive the Council's long-term borrowing strategies going forward.

Meeting: 7 December 2021

TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT STRATEGY MID-YEAR REVIEW REPORT 2021/22

Report of the Deputy Chief Executive (Section 151 Officer)

FULL REPORT

1. INTRODUCTION AND PURPOSE OF REPORT

1.1 This report provides Cabinet with a mid-year review of the Council's Treasury Management Strategy Statement and Annual Investment Strategy for 2021/22, approved by Council on 25 February 2021, and has been prepared in accordance with the CIPFA Code of Practice for Treasury Management in the Public Services.

1.2 The Report provides an economic update for the first six months of 2021/22 and details how this impacts upon the interest rate predictions and outlook provided in the initial strategy. An overview is provided of more recent forecasts and developments in the financial markets and how these are affecting the Council's investment portfolio and borrowing strategies for the current financial year. A review is provided of the Council's capital expenditure prudential indicators and compliance with Treasury and Prudential Limits for 2021/22.

1.3 There are no key changes required to the Treasury Management and Capital strategies for 2021/22, which continue to be relevant and effective.

1.4 The main report is very detailed and provides a full picture of all the variables and circumstances impacting upon the Council's treasury management operation. Consequently, a 'key highlights' summary report containing all of the prevalent points has also been provided. This can be found immediately before this full report for quick reference.

2. BACKGROUND

2.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, providing adequate liquidity initially before considering optimising investment return.

2.2 The second foremost function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, using cash flow surpluses or on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

2.3 Accordingly, treasury management is defined as:
'The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective

control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.'

3. CIPFA REQUIREMENTS

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

3.2 The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by the full Council of an Annual Treasury Management Strategy Statement; including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Corporate, Resource and Governance Scrutiny Committee (CRMG).

4. MID-YEAR TREASURY MANAGEMENT STRATEGY REVIEW FOR 2021/22

The mid-year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- A review of the Council's investment portfolio for 2021/22;
- A review of the Council's borrowing strategy for 2021/22;
- A review of any debt rescheduling undertaken during 2021/22;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of compliance with Treasury and Prudential Limits for 2021/22;
- Any key changes required to the treasury management and capital strategies;
- An economic update for 2021/22;
- Information for Members on other prevalent issues.

5. TREASURY MANAGEMENT STRATEGY STATEMENT (TMSS) & ANNUAL INVESTMENT STRATEGY (AIS) UPDATE 2021/22

5.1 The Treasury Management Strategy Statement (TMSS) for 2021/22 was approved by this Council on 25 February 2021.

5.2 The underlying TMSS approved previously is still relevant and effective; the only revision required at the mid-year point of the financial year centres around adjusted interest rate forecasts (explained in Section 8) engendered by the current economic situation (given in Section 13) of the report, which will give rise to significant implications for the Council's investment returns and borrowing strategies.

6. TREASURY MANAGEMENT ADVISORS

6.1 The Council engages the services of Link Asset Services for its Treasury Management Advice contract.

6.2 Link Asset Services has worked with Stockport MBC for over a decade delivering a comprehensive range of Treasury Management Advisory Services. The core service includes specific advice in respect of an integrated approach to Treasury Management.

7. TREASURY ACTIVITY 2021/22

7.1 The overall treasury position as at 30 September 2021 is given in the table below.

Treasury Position	**Financial Year 2021/22 (2 Pools)**				Financial Year 2020/21 (2 Pools)			
	General Fund		**HRA**		General Fund		HRA	
	£000	**%**	**£000**	**%**	£000	%	£000	%
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Note:

- This table excludes other long-term liabilities included in the tables in 12.4.3.
- The change in total borrowing between periods from £630.425m to £652.276m represents the repayment of a £15m PWLB loan that matured in April 2021 and an increase in short-term borrowing. This has resulted in a slight decrease in the overall borrowing rate from 2.91% to 2.76% representing the relative shift to cheaper short-term funding.
- Temporary investments have increased between periods from £24.275m to £57.525m and have been used to finance cashflow shortages.

8. INTEREST RATE FORECAST UPDATE

8.1 The current interest rate forecast is provided in the table below to March 2024 and is the central forecast for PWLB[1] certainty rates[2]. Link provided the following forecasts on 29.09.21. These are forecasts for Certainty rates, (gilt yields plus 80bps).

	Dec 2021 %	Mar 2022 %	June 2022 %	Sept 2022 %	Dec 2022 %	Mar 2023 %	June 2023 %	Sept 2023 %	Dec 2023 %	Mar 2024 %
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%
5yr PWLB	1.40%	1.40%	1.50%	1.50%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%
10yr PWLB	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%	2.00%	2.10%	2.10%	2.10%
25yr PWLB	2.20%	2.20%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%
50yr PWLB	2.00%	2.00%	2.10%	2.20%	2.20%	2.20%	2.20%	2.30%	2.30%	2.40%

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

8.3 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.

8.4 The Coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it has left Bank Rate unchanged at its subsequent meetings.

8.5 As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 2 of 2022/23, a second increase to 0.50% in quarter 2 of 2023/24 and a third one to 0.75% in quarter 4 of 2023/24.

8.6 The current PWLB forecasts above and current borrowing rates are substantially higher than the forecasts provided in the initial Treasury Management Strategy in February 2021. The following paragraphs provide an explanation of factors at play that have been influencing borrowing rates in the UK, and how this will impact on forecasts for the remaining six months of the financial year.

8.7 Recent events also suggest that the first increase in Bank rate could take place sooner than is indicated above. Global and UK GDP continued to rise in Q3, although growth was weaker than expected as supply constraints weighed on activity. The Bank of England estimate that UK GDP rose by 1.5%, a

[1] PWLB refers to the Public Works Loan Board. The **PWLB** is a statutory body operating within the United Kingdom Debt Management Office, a Cabinet Agency of HM Treasury. PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments

[2] The **PWLB certainty rate** is 20 basis points below the standard PWLB borrowing rate (gilt plus 100 basis points) across all loan types and maturities. This is available to Councils who outline their total proposed new long-term borrowing, as well as any borrowing planned to refinance existing loans, and the value of capital expenditure that will be financed by loans

weaker projection than in their August Report. This change reflected the emergence of supply constraints on output. Inflation expectations have also risen and given rise to concern that 'current elevated inflationary pressures could potentially lead to some second-round effects on consumer prices'. Overall, recent developments suggest a strengthened case for an earlier Bank rate increase.

8.8 As a result, market interest rate expectations are now pricing in the potential for a move to 25bps by the end of 2021, with subsequent levels suggesting a series of increases through 2022, with a year-end position of near 1.25%. While the extent of gains was tempered in the immediate aftermath of the Budget, this proved a temporary shift.

8.9 Link is also evaluating its own view on the Bank rate outlook in light of the Bank of England November MPC meeting, as well as the significant number of recent economic data releases.

8.10 **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 Quantitative Easing (QE)[3].
- 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 selloffs 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.

8.11 **The Balance of Risks to the UK**

The PWLB forecasts are based around a balance of risks. The overall balance of risks to economic growth in the UK is now towards the downside, including residual risks from Covid and its variants, both domestically and their potential effects worldwide.

8.12 **Forecasts for Bank Rate**

8.12.1 Economic forecasts in this report are based on those of the Bank of England.

[3] Quantitative Easing or QE is a form of monetary policy used by central banks as a method of quickly increasing the domestic money supply and spurring economic activity. Quantitative easing usually involves a country's central bank purchasing longer-term government bonds, as well as other types of assets, such as mortgage-backed securities (MBS).

8.12.2 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. It should therefore be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after reaching its peak of 5% in April 2022. Three increases in the 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 whether to combat inflation or support economic growth through keeping rates low.
- 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, together with increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on the Bank Rate to cool inflation.
- 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?
- It is estimated that around 1 million people that came off furlough at the end of September; how many of those will be without a job 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.
- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no deal Brexit.

8.12.3 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.

8.12.4 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.

8.13 **Forecasts for PWLB rates and gilt and treasury yields**

8.13.1 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.

8.13.2 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?

8.13.3 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.

8.14 **Gilt and treasury yields**

8.14.1 Members will be aware that the PWLB on-lends Government borrowing from the capital markets to local authorities to deliver capital investment and this is offered at a fixed margin above the Government's cost of borrowing, as measured by the price/yield of gilts.

8.14.2 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 Democratic party pushed through a $1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic, which largely unsettled financial markets (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:

- A fast vaccination programme has enabled a rapid opening up of the economy.
- The economy had already been growing strongly during 2021.
- 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.
- The Fed was still providing monetary stimulus through monthly QE purchases.

8.14.3 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. 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, 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.

8.14.4 Overall, there is a balance of Upside Risks to forecasts for medium to long term PWLB rates in 8.1 above.

8.14.5 There are also some 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.

8.15. **Fundamental shift in central bank monetary policy**

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

8.15.2 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.

8.15.3 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.

8.15.4 For the Council, 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.

8.15.5 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.

8.15.6 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.

9. ANNUAL INVESTMENT STRATEGY

INVESTMENT PORTFOLIO

9.1 The Treasury Management Strategy Statement (TMSS) for 2021/22, which includes the Annual Investment Strategy, was approved by the Council on 25 February 2021. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

9.2 The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

9.3 As shown by the interest rate forecasts in Section 8, it is now impossible to earn the level of interest rates commonly seen in previous decades. Short-term money market investment rates were close to zero throughout most of 2020 (as the Bank Rate was cut to 0.10% in March 2020) and have only risen weakly since the MPC meeting on 24 September 2021 when 6 and 12-month rates rose in anticipation of Bank Rate going up in 2022. Short-term rates from 3 months out to 12 months have risen more sharply during October as the market is currently pricing in an earlier than expected rise in Bank Rate for reasons discussed earlier in the report, however whether this actually materialises is yet to be seen. Given the current environment and the fact that the Bank Rate may only rise marginally, or not at all, before mid-2023, investment returns are expected, overall, to remain low.

9.4 **Creditworthiness**

Significant levels of downgrades to Short and Long-term credit ratings have not materialised since the Covid-19 crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, as economies are beginning to reopen, there have been some instances of previous lowering of Outlooks being reversed.

9.5 **Investment Counterparty Criteria**

The current investment counterparty criteria selection approved in the TMSS in February 2021 is meeting the requirement of the treasury management function.

9.6 **CDS Prices**

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

9.7 **Investment Balances**

The average level of funds available for investment purposes during the first half of 2021/22 was £47.454m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.

9.8 **Investment Performance**

Investment performance year to date as at 30th September 2021

Combined Investments 2021/22	**Council Performance**			
	Ave Balance Invested		**% Return**	**Weighted Time to Maturity (Days)**
	April 2021	£33.499m	0.08%	32.79
	May 2021	£49.642m	0.14%	67.68
	June 2021	£49.920m	0.14%	55.09
Average Q1		**£44.412m**	**0.13%**	**54.34**
	July 2021	£47.539m	0.15%	59.50
	Aug 2021	£51.555m	0.17%	72.35
	Sept 2021	£52.358m	0.17%	57.20
Average Q2		**£50.464m**	**0.16%**	**63.15**
Average year to date		**£47.454m**	**0.15%**	**59.05**

9.9 **Comparable LIBID Benchmarks**

As highlighted earlier in this report, the levels shown below use the traditional market method for calculating LIBID rates, i.e., LIBOR (-0.125%). Given the ultra-low LIBOR levels this year, this produces negative rates across some periods.

Period	**LIBID Benchmark**
7 day	-0.08%
1 month	-0.07%
3 month	-0.05%
6 month	-0.02%
12 month	**0.07%**

9.10 As illustrated in the tables above the Council's return for the first half of 2021/22 was 0.15% on an average weighted investment duration of 59.05 days; this outperforms the 12-month LIBID benchmark by 0.08% (more than double), despite being of much shorter duration (closer to the two-month negative return). Much has been made earlier in the report of investment rates in the market being low or close to zero for much of the financial year. The Council has achieved this return largely through careful use of various

notice accounts, bank deposits and money market funds. The Council expects to sustain this level of return in the second half of the financial year, however careful planning will be required to maintain a level of investment balances the Council feels is sufficient to counteract any unforeseen liquidity shortages, but not too high as returns earnt may be low or absent. Although Bank Rate may rise at some point, an excess of cash currently in the short end of the market means shorter rates are unlikely to rise significantly, so investments would need to be made for longer maturities to achieve an uplift in return. It is however expected that investments will mature within this financial year or remain liquid as funds will be required towards February and March 2022. Investment balances would of course rise if forward borrowing was undertaken prior to year-end, whether long or short-term.

9.11 For 2021/22 the Council's Medium Term Financial Plan and Annual Investment Strategy budgeted for an expected investment return of 0.10% on new investments placed during 2021/22, assuming an average investment duration of three months; this was predicated on the Link interest rate forecasts in February 2021 and represents the Council's typical investment duration predominantly at the short end of the curve and fairly liquid to cater for cashflow needs. This return will be revised upwards in the second half of the financial year if Bank Rate starts to increase and has a significant effect on market investment rates or if the Council places significant investments for longer periods than 3 months.

9.12 The Deputy Chief Executive (Section 151 Officer), confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2021/22.

10. TREASURY MANAGEMENT STRATEGY STATEMENT (TMSS)

BORROWING STRATEGY

10.1 It is a statutory duty for the Council to determine and keep under review the 'Affordable Borrowing Limits'. Council's approved Prudential Indicators (affordability limits) are outlined in the approved TMSS.

10.2 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement (TMSS) and in compliance with the Council's Treasury Management Practices.

10.3 The Council's original Borrowing Requirement was £84.327m (excluding MRP). The revised estimate of the 2021/22 borrowing required to support prudential borrowing within the capital programme is circa £69.206m due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement, CFR). This includes £15m of PWLB borrowing that has matured and required replacing in 2021/22. There has been some significant re-phasing of capital schemes during the first six months of the year. Despite this, the borrowing that the Council will actually need will also consider the level of investments held and will be greatly influenced by the amount of capital spending during 2021/22.

10.4 The Council's forecast closing capital financing requirement (CFR) for 2021/22 was £866.016m and this has decreased to £848.497m at this mid-year stage.

The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The table in 12.4.3 shows the Council's internally borrowed position. This is a prudent and cost-effective approach in the current economic climate but requires on-going monitoring if upside risk to gilt yields prevails, but more likely, this position becomes unmaintainable due to spent internal resources or limits to short-term market loans.

10.5 The table for PWLB certainty rates below shows for a selection of maturity periods, the range (high and low points) in rates, the average rates, and individual rates over the first six months of the financial year.

	1 Year	**5 Years**	**10 Years**	**25 Years**	**50 Years**
High	0.98%	1.42%	1.81%	2.27%	2.06%
Date	24.09.21	28.09.21	28.09.21	13.05.21	13.05.21
Low	0.78%	1.05%	1.39%	1.75%	1.49%
Date	08.04.21	08.07.21	05.08.21	17.08.21	10.08.21
Average	0.84%	1.16%	1.60%	2.02%	1.81%
Spread	0.20%	0.37%	0.42%	0.52%	0.57%

10.6 The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates having been lower than long-term rates for some time, it has been cost effective for the Council to either use internal resources, or to borrow short-term rather than take long-term borrowing to fully fund its Capital Financing Requirement (CFR). By doing so, the Council has been able to reduce net borrowing costs (and investment income forgone has been negligible due to enduring low short-term rates) and reduce overall treasury risk. This is called maintaining an 'internally borrowed position' and using the Council's cash reserves and balances to fund borrowing as a temporary measure. This strategy has been prudent as investment returns have been low and counterparty risk relatively high.

10.7 The strategy followed in the first half of 2021/22 has been to continue to borrow shorter-term cash from the market (other councils) and to draw back liquid investments to meet cashflow requirements. Years of maintaining an internal borrowing policy has given rise to the need for more significant temporary borrowing. The Council has not undertaken any long-term borrowing during 2021/22.

10.8 The Council continually assesses how much borrowing may be needed in the short to medium term, taking into account cashflows, level of investments or use of short-term borrowing, use of reserves, and spend on the Capital Programme. The availability and type of borrowing likely to be available is also a key consideration.

10.9 The Council has an extensive three-year Capital Programme for the period 2021/22 to 2023/24. The programme is regularly reviewed and at this mid-year stage, there is a total of £349.272m planned expenditure on capital schemes over the next three years and a significant proportion of this, £156.333m, is to be financed by prudential borrowing.

10.10 The Capital Programme is being kept under regular review due to the effects of Coronavirus and shortages of materials and labour. The Council's Borrowing Strategy will, therefore, also be regularly reviewed and then

revised, if necessary, in order to achieve optimum value and risk exposure in the long-term.

10.11 It is not anticipated that long-term borrowing will be undertaken during this financial year, unless long-term rates are particularly advantageous.

10.12 **PWLB maturity certainty rates (gilts plus 80bps) year to date to 30th September 2021**

Gilt yields and PWLB rates were on a falling trend between May and August, however, they rose sharply towards the end of September. 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 and returned to 2.00% at the end of September after the MPC meeting of 23 September.

10.13 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)

10.14 The Council's trigger rates at which to consider long-term borrowing at the present time are in line with the current PWLB forecasts (for the periods indicated above) for the second half of 2021/22. Target new long-term borrowing rates to be considered in 2021/22 from alternative market lenders to the PWLB are at a margin of 40 basis points below the equivalent PWLB rate for the period.

10.15 The Council's borrowing strategy will be reviewed in the coming months to achieve optimum value in the long-term. It is however anticipated that long-term borrowing is less likely to be undertaken during this financial year and the Council will continue to rely on the short-term market and liquid investments.

10.16 This Council has not borrowed in advance of need during the first half of the 2021/22 financial year.

11. DEBT RESCHEDULING

11.1 Debt rescheduling opportunities continue to be limited in the current economic climate and consequent structure of interest rates. No debt rescheduling was undertaken during the first six months of 2021/22.

12. THE COUNCIL'S CAPITAL POSITION (PRUDENTIAL INDICATORS)

12.1 This part of the report aims to update Members on:

- the Council's capital expenditure plans.
- how these plans are being financed.
- the impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- on compliance with the limits in place for borrowing activity.

Appendix 1 gives a full summary of the Prudential and Treasury indicators at the mid-year point.

12.2 **Prudential Indicator for Capital Expenditure**

12.2.1 This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed on 25 February 2021.

Capital Expenditure by Portfolio	**2021/22 Original Estimate £m**	**2021/22 Current Estimate £m**
Adult Care and Health	0.280	0.339
Economy and Regeneration	50.102	67.906
Resources, Commissioning and Governance	50.671	33.693
Sustainable Stockport	59.165	45.176
Total Capital Expenditure	**160.218**	**147.114**
Non HRA	**119.298**	**118.896**
HRA	**40.920**	**28.218**

12.2.2 There has been a net decrease of £13.104m in the 2021/22 Capital Programme since approved in February 2021. This change is made up of several new capital schemes that have been added to the 2021/22 Capital Programme since approved in February 2021, offset by significant re-phasing of schemes to later years. The most significant new schemes added to the 2021/22 Programme include, the Mayoral Development Corporation, £10.647m, Stockport Exchange Phase 4, £3.547m, Public Sector Decarbonisation Scheme, £5.602m and grant funding allocations in Highways (£4.292m) and School Estates (£8.146m). Officers regularly review the spending profiles of their capital schemes and schemes have been re-phased from 2021/22 to later years to reflect the latest information. Most notably, a net total of £30.177m has been re-phased from the 2021/22 School Estates Programme, mostly to 2022/23 and the forecast for the 2021/22 capital expenditure on HRA schemes has reduced by £12.702m since originally approved. Changes in the Capital Programme during the financial year have been reflected in the revised CFR estimates below.

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

12.3.1 The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by the statutory charge to revenue for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	**2021/22 Non HRA Original Estimate £m**	**2021/22 HRA Original Estimate £m**	**2021/22 Total Original Estimate £m**	**2021/22 Non HRA Current Estimate £m**	**2021/22 HRA Current Estimate £m**	**2021/22 Total Current Estimate £m**
Total Capital Expenditure	119.298	40.920	**160.218**	118,896	28,218	**147,114**
Financed By:						

Capital Expenditure	2021/22 Non HRA Original Estimate £m	2021/22 HRA Original Estimate £m	2021/22 Total Original Estimate £m	2021/22 Non HRA Current Estimate £m	2021/22 HRA Current Estimate £m	2021/22 Total Current Estimate £m
Capital Grants	45.079	9.880	**54.959**	52,149	8,386	**60,535**
Capital Receipts	3.611	0.000	**3.611**	308	197	**505**
Capital Contributions	3.241	0.000	**3.241**	3,537	0	**3,537**
Revenue Contribution	2.163	11.917	**14.080**	1,424	11,907	**13,331**
Borrowing Requirement	**65.204**	**19.123**	**84.327**	**61,478**	**7,728**	**69,206**

12.3.2 The Council has set out an ambitious long-term vision for the future of Stockport's Town Centre West area through its Strategic Regeneration Framework, which will be delivered by the Mayoral Development Corporation (MDC).

12.3.3 At its meeting on 1 October 2019, Cabinet approved a recyclable equity and loan facility of £100m to support the MDC delivery strategy. As the MDC develops, investment will be brought into the capital programme as the regeneration works develop and loan facility is required. The loan facility will be funded by prudential borrowing so there will be a subsequent impact on the Council's prudential indicators, in particular the Capital Financing Requirement (CFR) and Minimum Revenue Provision (MRP). The Council's prudential indicators will be reviewed and updated in line with the capital programme to reflect the investment. The 2021/22 Capital Programme has a total of £12.402m prudential borrowing for Mayoral Development Corporation schemes.

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

12.4.1 The following tables show the CFR, which is the underlying external need to incur borrowing for a capital purpose and the expected debt position over the period. This is termed the Operational Boundary.

Prudential Indicator:

Capital Financing Requirement (CFR)	2021/22 Original Indicator £m	2021/22 Current Indicator £m
CFR General Fund (Non HRA)	696.047	690.500
CFR HRA	169.969	157.997
Total CFR	**866.016**	**848.497**

Prudential Indicator:

External Debt: Operational Boundary	2021/22 Original Indicator £m	2021/22 Current Indicator £m
Debt	876.800	876.800
Other Long-term Liabilities	13.700	13.700
Total	**890.500**	**890.500**

12.4.2 It should be noted that the CFR measures the Council's underlying need to borrow, i.e. the extent to which forecast capital expenditure has not been funded from resources such as capital receipts, grants etc. As indicated from

the above, the CFR is much higher than the Council's actual borrowing, as previously reported it has been a treasury policy over recent years to incur capital expenditure in year, but temporarily fund this from the Council's own cash balances, i.e. balances and reserves, rather than external borrowing; often referred to as Internal Borrowing. The Capital Programme is regularly reviewed and during the first half of 2021/22 many schemes have been rephased to later years. As a result, the revised CFR has decreased during the first half of the year to £848.497m and the impact of this reduction can be seen when comparing the mid-year position to the original gross borrowing estimates and limits below. The level of internal borrowing indicates at some point in the financial year the Council may decide to convert some of this internal borrowing and externally borrow for this capital expenditure. However, at the mid-year point in the financial year, spending on the capital programme is 34.6% and, is lower than expectations.

12.4.3 The Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue purposes. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

Gross Borrowing and the CFR	**2021/22 Original Indicator £m**	**2021/22 Actual 30.09.21 £m**
Gross Borrowing	725.827	652.276
Other Long-term Liabilities	13.700	13.700
Total	739.527	**665.976**
CFR	**866.016**	**848.497**

12.4.4 The Deputy Chief Executive (Section 151 Officer), reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

12.4.5 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised Limit and Overall Borrowing	**2021/22 Original Indicator £m**	**2021/22 Current Indicator £m**
Borrowing	896.800	896.800
Other Long-term Liabilities	13.700	13.700
Total	**910.500**	**910.500**

13. ECONOMIC UPDATE

13.1 **UK.** At its meeting ending on 2 November 2021, the Monetary Policy Committee (MPC) judged that the existing stance of monetary policy remained

appropriate. The MPC voted by a majority of 7-2 to maintain Bank Rate at 0.1%. The Committee voted unanimously for the Bank of England to maintain the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, at £20 billion. The Committee voted by a majority of 6-3 for the Bank of England to continue with its existing programme of UK government bond purchases, financed by the issuance of central bank reserves, maintaining the target for the stock of these government bond purchases at £875 billion and so the total target stock of asset purchases at £895 billion.

13.2 Both global and UK GDP increased in 2021 Q3, although at a slower pace than projected in the August Report. Growth is somewhat restrained by disruption in supply chains. Alongside the rapid pace at which global demand for goods has risen, this has led to supply bottlenecks in certain sectors. There have also been some signs of weaker UK consumption demand. While bottlenecks will continue to restrain growth somewhat in the near term, global and UK GDP are nonetheless expected to recover further from the effects of Covid-19. UK GDP is projected to get back to its 2019 Q4 level in 2022 Q1.

13.3 Over the second half of the financial year, (and conditioned on the market-implied path for Bank Rate), UK GDP growth is expected to be relatively subdued. The pace of growth slows as potential supply growth eases back towards pre-Covid rates, and as higher energy prices and the fading of monetary and fiscal policy support temper demand growth. At the Autumn Budget and Spending Review 2021, the Government announced a higher path for government consumption, particularly over the next couple of years. By the end of the forecast period, a margin of spare capacity is expected to emerge.

13.4 The Labour Force Survey unemployment rate fell to 4.5% in the three months to August, while Her Majesty's Revenue and Customs payroll data have continued to rise strongly. Just over a million jobs are likely to have been furloughed immediately before the Coronavirus Job Retention Scheme closed at end-September, significantly more than expected in the August Report. Nonetheless, there have continued to be few signs of increases in redundancies and the stock of vacancies has increased further, as have indicators of recruitment difficulties. Taken together, while there is considerable uncertainty, initial indicators suggest that unemployment will rise slightly in 2021 Q4. The Bank of England's estimate of underlying pay growth has remained above pre-pandemic rates, although pay growth is expected to fall back from its current rate in the November Report central projections.

13.5 Twelve-month CPI inflation fell slightly from 3.2% in August to 3.1% in September. The Bank of England expects inflation to rise to just under 4% in October, accounted for predominantly by the impact on utility bills of past strength in wholesale gas prices. CPI inflation is then expected to rise to 4.5% in November and remain around that level through the winter, accounted for by further increases in core goods and food price inflation. Wholesale gas prices have risen sharply since August. CPI inflation is now expected to peak at around 5% in April 2022, materially higher than expected in the August Report. The upward pressure on CPI inflation is expected to dissipate over time, as supply disruption eases, global demand rebalances, and energy prices stop rising. As a result, CPI inflation is projected to fall back materially from the second half of next year. Conditioned on the market-implied path for Bank Rate and the MPC's current forecasting convention for future energy prices, CPI inflation is projected to be a little above the 2% target in two years'

time and just below the target at the end of the forecast period.

13.6 The MPC's remit is clear that the inflation target applies at all times, reflecting the primacy of price stability in the UK monetary policy framework. The framework also recognises that there will be occasions when inflation will depart from the target as a result of shocks and disturbances. In the recent unprecedented circumstances, the economy has been subject to very large shocks. Given the lag between changes in monetary policy and their effects on inflation, the Committee, in judging the appropriate policy stance, will as always focus on the medium-term prospects for inflation, including medium-term inflation expectations, rather than factors that are likely to be transient. At its recent meetings, the Committee has judged that some modest tightening of monetary policy over the forecast period was likely to be necessary to meet the 2% inflation target sustainably in the medium term. The latest developments, set alongside the Committee's updated projections, reinforce this view. Nevertheless, near-term uncertainties remain, especially around the outlook for the labour market, and the extent to which domestic cost and price pressures persist into the medium term.

13.7 Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% much earlier, but this could be ambitious. The MPC has indicated that looking beyond the coming months, the Committee will continue to focus on the medium-term prospects for inflation. The Committee judges that there are two-sided risks around developments in the economy in the medium term and will reach its assessment on the balance of these risks in light of the relevant data as they emerge. At the MPC's meeting in February 2022 it will only have available the employment figures for November 2021; to get a clearer picture of employment trends, it would need to wait until later next year to have a clearer understanding of the likely peak in inflation.

13.8 The MPC's forward guidance on its intended monetary policy for raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows:

- Placing the focus on raising Bank Rate as 'the active instrument in most circumstances.'
- Raising Bank Rate to 0.50% before starting on reducing its holdings.
- Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
- Once Bank Rate had risen to at least 1%, it would start selling its holdings.

13.9 Covid-19 vaccines were revolutionary in the summer in boosting confidence that life in the UK can largely return to normal 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, or if not, how quickly vaccines can be modified, together with implementation of enhanced testing programmes to contain their spread.

13.10 **USA.** See comments on US treasury yields in 8.14 above.

13.11 **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 increase rates for some time.

13.12 **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. 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.

13.13 **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.

13.14 **World growth.** World growth was in recession in 2020 but recovered during 2021 until losing some 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.

13.15 **Supply shortages**. The pandemic and extreme weather events have been highly disruptive to 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 misdistribution 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 having difficulty 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.

14. SCRUTINY MEMBER TRAINING

14.1 The CIPFA Treasury Management in Public Services Code of Practice places emphasis on the effective management and control of risk as the prime objective of the Council's treasury management activities. The Code also cites the importance of reporting on treasury management strategy and performance and scrutiny of treasury management strategy and policy to a specific named body; the Council has accordingly delegated the role of ensuring effective scrutiny of its Treasury Management Strategy to the Corporate, Resource and Governance Scrutiny Committee.

14.2 In line with the Code, Cabinet and CRMG have received training each year since 2009/10. Further training is being arranged for 23 November 2021 to coincide with the consultation on next year's treasury strategy.

14.3 The session will provide a brief refresher of Members' and Officers' roles and responsibilities within the Treasury Management environment, and how to maintain effective scrutiny of the Treasury Management function. It will update Members on the current global economic position, particularly in the US, Europe and UK and provide up to date interest rate forecasts; possible scenarios for the economy in 2022/23 given current economic indicators and developments in the financial markets. Concentration will particularly be made on new and prevalent issues that will have a major impact on the Council's treasury strategy next year.

15. OTHER CONSIDERATIONS

15.1 FINANCIAL AND RISK ASSESSMENT CONSIDERATIONS

The financial implications are covered in the body of the report.

There are no further financial and risk considerations arising from the report. This report is produced as a finance report and discusses in detail risk mitigation processes which are at the heart of Treasury Management Policy. Treasury Management Risk Management is the practice of planning for unexpected expenditures. It is primarily about mitigating and avoiding the impact of the changing financial environment on the Council's cash flow objectives.

15.2 LEGAL CONSIDERATIONS

There are no Legal and Governance implications to consider as a result of the report and recommendations.

15.3 HUMAN RESOURCES IMPACT

There is no impact to the workforce or the workforce of partner organisations as a result of the report and recommendations.

15.4 EQUALITIES IMPACT

A full Equalities Impact Assessment is undertaken as part of the Council's Treasury Management Strategy Statement, Annual Investment Strategy and

Minimum Revenue Provision Policy report submitted to Council ahead of the forthcoming financial year (in February each year).

This report is a mid-year update on the Treasury Management Strategy Statement for the current financial year.

15.5 ENVIRONMENTAL IMPACT

The Policies and Plans within this Treasury Report do not have an environmental impact.

16. CONCLUSIONS AND RECOMMENDATIONS TO THE CABINET

16.1 Because of the furore around inflation data and the utterances from MPC members, a Bank Rate increase to 0.25% before year end is a distinct possibility. This is, however, perhaps somewhat premature, given current headwinds to the UK economy are significant with energy and metal prices inflated, supply side shortages all across the economy and tax increases in the offing. Any such rise could be seen as an overreaction to the recent surge in inflation with interest rate rises that threaten to curb the economic recovery.

16.2 Short-term interest rates will continue to be lower than long-term rates for a fair while to come.

16.3 Regarding long-term rates, inflation concerns and movements in US Treasury yields continue to underpin a volatile market.

16.4 The Council's investments have outperformed market benchmarks during the first half of the financial year.

16.5 While interest rate expectation changes have primarily shifted longer parts of the money market yield curve higher, the most recent change in sentiment has also impacted on shorter-term maturities. However, the excess of monies in this part of the curve, in addition to other factors, such as bank regulatory requirements, continues to weigh on yields. As such, The Council still needs to continue to manage liquidity requirements carefully to avoid an excess of short-term investments providing a potential drag on performance. The Council will need to continue to find the best way of juggling an adequate but not excessive level of investments to manage cashflow requirements and at the same time also achieve a positive return.

16.6 Borrowing this year has so far been managed through the short-term markets.

16.7 Long-term Interest rate forecasts for PWLB certainty rates (gilts plus 80bps), indicate 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 also likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to a number of factors at play.

16.8 The Council's Treasury Management Strategy remains relevant and effective at the half year point, with no significant changes required other than revisions to interest rate forecasts to reflect the current economic situation.

16.9 Cabinet is asked to recommend the following to the Council meeting:

- Note the report and the treasury activity in the first half of the financial year.
- Note the revised interest rate forecasts for PWLB rates over the short and medium term which will drive the Council's long-term borrowing strategies going forward.

17. RECOMMENDATIONS TO THE SCRUTINY COMMITTEE

17.1 The Scrutiny Committee is recommended to comment on and note the report.

BACKGROUND PAPERS

There are none

Anyone wishing to inspect the above background papers or requiring further information should contact Lorna Soufian on Tel: 0161 474 4026 or by email on lorna.soufian@stockport.gov.uk

APPENDIX 1

Prudential and Treasury Indicators 2021/22

Treasury Indicators

	2021/22 Budget £M	2021/22 Current/ Actual £M
Authorised limit for external debt	910.500	910.500
Operational boundary for external debt	890.500	890.500
Gross external debt	739.527	665.976

Maturity Structure of fixed rate borrowing upper and lower limits

Period	2021/22 Lower	2021/22 Upper
Under 12 months	0%	45%
12 months to 2 years	0%	45%
2 years to 5 years	0%	45%
5 years to 10 years	0%	45%
10 years and above	50%	100%

Interest rate limits

	2021/22 Budget %	2021/22 Actual %
Upper limit of fixed interest rates based on gross debt	100%	100%
Upper limit of variable interest rates based on gross debt	40%	0%

Principal Sums

	2021/22 Budget £M	2021/22 Actual £M
Upper limit for principal sums invested over 365 days	80	0

Capital Indicators

	Budget 2021/22 £000	Current 2021/22 £000
Capital expenditure	160.218	147.114
Capital Financing Requirement (CFR)	866.016	848.497
Annual change in CFR	68.017	50.498
In-year borrowing requirement (excluding MRP)	84.327	69.206
Ratio of financing costs to net revenue stream (non HRA)	8.71%	8.65%
Ratio of financing costs to net revenue stream (HRA)	10.86%	10.90%
Incremental impact of capital investment decisions:		
Increase in council tax (band change) per annum	£22.30	£23.42
Increase in average housing rent per week	£1.59	£0.69