Annex C

TREASURY MANAGEMENT POSITION 2020/21 – QUARTER 3

1.0 LEGISLATIVE REQUIREMENT:

1.1 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (Treasury Management Strategy Statement, Annual and Mid-year reports, as well as quarterly updates). This report therefore ensures this Council is implementing best practice in accordance with the Code.

1.2 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This Quarter 3 report therefore updates Members on the current treasury management position and is presented to Cabinet and also Audit, Governance and Standards Committee.

1.3 The Council's treasury management position is based on its requirement to fund the capital programme and its operational cash flow need. The Council looks to balance the requirement to borrow from external sources with the surplus funds that are available.

1.4 During 2020/21 the Council supported its Capital Expenditure by capital receipts, reserves, revenue contributions, long term borrowing and the use of surplus funds for cash flow purposes. The Council continues to have an underlying need to borrow for capital purposes and has long term external borrowing of £27,700,000 at an average interest rate of 2.21%. These loans were all taken from Public Works Loan Board (PWLB) and are detailed in paragraph 4.1.

1.5 The Capital Financing Requirement in 2020/21, which is the amount of borrowing required to support the capital expenditure programme, is set at £51,994,108. The capital expenditure of the Council is also supported by grants, contributions and reserves. The Capital Financing Requirement refers to the amount of borrowing that could be taken to support the capital expenditure programme.

1.6 The following table shows the treasury management position as at 31 December 2020:-

	31 Dec 20 £000's	**Rate %**
Capital Financing Requirement	51,994	
Borrowing	27,700	2.21
Investments	17,590	0.15

Table 1: Borrowing and Investment position at 30 December 2020

1.7 The table shows that changes in the capital expenditure programme only affects the treasury management position through the surplus funds that are available to the Council to invest, to earn investment income.

2.0 THE ECONOMY, INTEREST RATES AND TREASURY MANAGEMENT STRATEGY:

2.1 The economic background and interest rate forecast, which sets the environment in which the Council's treasury management operates, is attached at Annex D.

3.0 ANNUAL INVESTMENT STRATEGY 2020/21 – QUARTER 3:

3.1 The Treasury Management Strategy Statement (TMSS) for 2020/21 which includes the Annual Investments Strategy, was approved by the Council on 25 February 2020. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity;
- Yield

3.2 The Council's priority is security of its surplus funds when investing with financial institutions. However, the Council will always aim to achieve the optimum return (yield) on investments in line with its risk appetite and which is commensurate with proper levels of liquidity and security. 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. Investments are placed with highly credit rated financial institutions, using the Council's treasury management advisers – Link - suggested creditworthiness approach including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Link.

3.3 Creditworthiness **-** Although the credit rating agencies changed their outlook on many financial institutions from stable to negative during the quarter ended 30 June 2020, the majority of ratings were affirmed due to the continuing strong credit profiles and wider government support provided to financial markets and economies in general. During Quarter 1 and Quarter 2 2020, banks did make provisions for expected credit losses, while the most recent set of quarterly reports saw a number of entities revise down provisions in light of better economic outlooks. As we move into the next quarters ahead, more information will emerge on actual levels of credit losses. (Quarterly performance is normally announced in the second half of the month following the end of the quarter.) This has the potential to cause rating agencies to revisit their initial rating adjustments if they are found to be misaligned. These adjustments could be negative or positive, although it should also be borne in mind that UK banks, among others, went into this pandemic with strong balance sheets.

3.4 At the outset of the COVID-19 pandemic, Link conducted stress testing on the Link credit methodology-based list of counterparties supplied to clients, to test for the results of a 1 notch downgrade to all Long-Term Ratings from all agencies. Under such a scenario, only Commerzbank, Norddeutsche, Landesbank, NatWest Markets Plc (non-ring-fenced entity), Leeds, Skipton and Yorkshire Building Societies moved from Green to No Colour. While there are a further 17 drops in other entities' suggested durations, in these instances, the entities still remain potentially available for use. (Note that this scenario excludes any additional impact from relative movement in CDS pricing.)

3.5 As shown by the interest rate forecasts in Annex D, it is now impossible to earn the level of interest rates commonly seen in previous decades as all short term money market investment rates are barely above zero now that Bank Rate is at 0.10%, while some entities, including more recently the Debt Management Account Deposit Facility (DMADF), are offering negative rates of return in some shorter time periods. Given this environment and the fact that increases in Bank Rate are unlikely to occur before the end of the current forecast horizon of 31 March 2024, investment returns are expected to remain low.

3.6 Negative investment rates - while the Bank of England has said that it is unlikely to introduce a negative Bank Rate, (at least in the next 6 -12 months), some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the COVID crisis; this has caused some local authorities including Hambleton to have sudden large increases in investment balances searching for an investment home, some of which was only very short-term until those sums were able to be passed on. Meanwhile, uncertainty among corporate investors has also heightened their preference for the very short end of the yield curve. This, combined with a glut of monies which was particularly acute in the run up to the calendar year end, lead to some financial entities offering yet deeper negative yields or simply closing their books to new monies until 2021 began.

3.7 As for money market funds (MMFs), yields drifted lower through to the close of the calendar year. In response, managers continued to trim fee levels to ensure that net yields for investors remained in positive territory through the final quarter of the year.

3.8 Inter-local authority lending and borrowing rates have also declined due to elevated cash levels seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur, or when further large receipts will be received from the Government. In addition, the impact of the change in the Public Works Loan Board margin has had a marked impact on rates being offered.

3.9 Investment Counterparty criteria - The current investment counterparty criteria selection approved in the Treasury Management Strategy Statement is meeting the requirement of the treasury management function.

3.10 Credit Default Swap prices - Although Credit Default Swap prices (these are market indicators of credit risk) for banks (including those from the UK) spiked upwards at the end of March / early April as the crisis unfolded, they have returned to near pre-pandemic levels by the close of the year. However, sentiment can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

3.11 Investments held by the Council - The Council held £17,590,000 of investments as at 31 December 2020 and the investment portfolio yield for the first 9 months of the year is 0.15%. A full list of investments held as at 31 December 2020 can be seen in the table below:-

Counterparty	Type of Investment	Interest Rate	Amount
Handelsbanken	Call Account	0.045%	£7,000,000
Federated	Money Market Fund	0.01%	£7,000,000
Blackrock	Money Market Fund	0.00%	£3,590,000
Total			**£17,590,000**

Table 2: Investments held by the Council as at 31 December 2020

3.12 The average level of funds available for investment purposes during Quarter 3 – 31 December 2020 - was £17,793,370. The level of funds available is higher than previous years due to receiving government grants relating to COVID-19, it is also dependant on the timing of precept payments, receipt of other grants and progress on the Capital Programme. The Council is currently not experiencing any cash flow issues as a result of COVID-19, the amount of borrowing continues to support the level of the Capital Programme and the level of the shortfall of increased expenditure and income losses from the pandemic.

3.13

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	-0.07%	0.02%	£23,707

Table 3: Investment performance for Quarter 3 at 31 December 2020

3.14 The table shows that the Council monitors its cash flow investments against the 7 - day rate. The Council outperformed the 7-day benchmark by 0.09%. The current 7-day benchmark return shows a negative amount due to the 7-day benchmark being calculated using the London Inter-Bank Bid (LIBID) rate which is linked to the London Inter-Bank Offer Rate (LIBOR) figure. The Bank of England Base Rate is currently just 0.1%, which means the LIBOR rate will be a similar rate, if not lower given the large amount of liquidity in the very short end of the market. Therefore, this effects the LIBID rates as they are always lower than the LIBOR rate so at the very short end of the curve the LIBID 7-day benchmark is a negative figure.

3.15 The Council's budgeted investment return for 2020/21 was approved at £35,000. Following the Bank of England Base Rates cuts in March 2020 to 0.10%, interest rates available on the Council's investments have reduced during 2020/21, these now range from 0% to 0.045%. The Budget was reduced at Quarter 2 to £24,500 and performance for the year to date is in line with the revised budget.

4.0 BORROWING 2020/21 – QUARTER 3

4.1 Due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement – CFR) there has been no additional borrowing during Quarter 3. It is anticipated that there will be further borrowing in 2020/21 in preparation of the large Capital Programme. The Council currently has seven loans to the value of £27,700,000 of long term borrowing with the Public Works Loan Board (PWLB). These can be seen in the table below:-

Start Date	End Date	No of Years	Rate (%)	Amount
05/09/16	05/09/21	5	1.05	£1,200,000
07/03/19	07/03/69	50	2.45	£9,000,000
25/03/19	25/03/64	45	2.24	£2,500,000
02/09/19	02/09/29	10	1.20	£5,000,000
05/09/19	05/09/34	15	1.43	£5,000,000
16/03/20	16/09/67	47.5	2.23	£2,500,000
16/03/20	16/09/33	13.5	2.19	£2,500,000
Total				**£27,700,000**

Table 4: PWLB Loans

4.2 The margin over gilt yields for certainty Public Works Loan Board rates was cut by 100 basis points from 180 basis points to 80 basis points on 25 November 2020. There has not been a great deal of financial volatility in Public Works Loan Board rates since the start of the financial year, apart from a more significant spike up during the second half of August into early September and in mid November. The 50 year Public Works Loan Board certainty rate for new long term borrowing was unchanged at 2.30% all year to date until the margin change on 25 November 2020 when it fell to 1.30%

4.3 The table below shows the Public Works Loans Board interest rates which were available for loans during Quarter 3 of 2020/21. The Public Works Loans Board is the mechanism by which the Government allows local authorities to borrow at slightly lower interest rates than are available to other institutions. Certainty rates, as detailed in the table, are interest rates available to local authorities if they inform the Government of their borrowing requirements at the beginning of the financial year and are 0.02% (or 20 basis points) below Public Works Loans Board rates. This was introduced by the Government in October 2012.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.65%	0.72%	1.00%	1.53%	1.32%
Date	29/12/2020	11/12/2020	11/12/2020	11/12/2020	11/12/2020
High	1.79%	1.90%	2.28%	2.86%	2.71%
Date	07/10/2020	11/10/2020	11/11/2020	11/11/2020	11/11/2020
Average	1.39%	1.43%	1.75%	2.31%	2.14%

Table 5: Public Works Loan Board (PWLB) certainty rates, Quarter ended 31 December 2020.

4.4 Treasury Borrowing: Due to the overall financial position and the underlying need to borrow for capital purposes, external borrowing of £27,700,000 had been taken up to Quarter 3 2020/21 from the Public Works Loan Board.

4.5 It is anticipated that more borrowing will be required during the financial year 2020/21 to support the overall Capital Programme.

4.6 Rescheduling of Borrowing: No debt rescheduling has been undertaken in 2020/21.

4.7 Repayment of Borrowing: the Council did not have any borrowing to repay during Quarter 3 of 2020/21.

5.0 COMPLIANCE WITH PRUDENTIAL AND TREASURY INDICATORS:

5.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) were approved in the Treasury Management Strategy Statement by Council on 25 February 2020 and are in compliance with the Council's Treasury Management Practices. The Director of Finance and Commercial (S151) reports that no difficulties are envisaged for the current years in complying with these indicators.

5.2 During the financial year to date as 31 December 2020 the Council has operated within the Treasury and Prudential Indicators approved which are attached at Annex E.

5.3 Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 31 December 2020.

ANNEX D

Economic Update

1.1 ECONOMIC BACKGROUND:

United Kingdom

The key quarterly meeting of the Bank of England Monetary Policy Committee kept Bank Rate unchanged on 5 November 2020. However, it revised its economic forecasts to take account of a second national lockdown from 5 November 2020 to 2 December 2020 which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do a further tranche of quantitative easing of £150bn, to start in January when the current programme of £300bn of quantitative easing, announced in March to June, runs out. It did this so that “announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target”. Its forecasts appeared, at that time, to be rather optimistic in terms of three areas:

- The economy would recover to reach its pre-pandemic level in Quarter 1 2022
- The Bank also expected there to be excess demand in the economy by Quarter 4 2022.
- Consumer Price Index inflation was therefore projected to be a bit above its 2% target by the start of 2023 and the “inflation risks were judged to be balanced”.

Significantly, there was no mention of negative interest rates in the minutes or Monetary Policy Report, suggesting that the Monetary Policy Committee remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. However, rather than saying that it “stands ready to adjust monetary policy”, the Monetary Policy Committee this time said that it will take “whatever additional action was necessary to achieve its remit”. The latter seems stronger and wider and may indicate the Bank’s willingness to embrace new tools.

One key addition to the Bank’s forward guidance in August was a new phrase in the policy statement, namely that “it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably”. That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years’ time, do not expect any action from the Monetary Policy Committee to raise Bank Rates – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. The Councils Treasury Advisors Bank Rate forecast currently shows no increase, (or decrease), through to Quarter 1 2024 but there could well be no increase during the next five years as it will take some years to eliminate spare capacity in the economy, and therefore for inflationary pressures to rise to cause the Monetary Policy Committee concern. Inflation is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short lived factor and so not a concern.

COVID-19 vaccines. We had been waiting expectantly for news that various COVID-19 vaccines would be cleared as being safe and effective for administering to the general public. The Pfizer announcement on 9th November was very encouraging as its 90% effectiveness was much higher than the 50-60% rate of effectiveness of flu vaccines which might otherwise have been expected. However, this vaccine has demanding cold storage requirements of minus 70c that impairs the speed of application to the general population. It has therefore been particularly welcome that the Oxford University/AstraZeneca vaccine has now also been approved which is much cheaper and only requires fridge temperatures for storage. The Government has 60m doses on order and is aiming to vaccinate at a rate of 2m people per week starting in January, though this rate is currently restricted by a bottleneck on vaccine production; (a new UK production facility is due to be completed in June).

These announcements, plus expected further announcements that other vaccines could be approved soon, have enormously boosted confidence that **life could largely return to normal during the second half of 2021**, with activity in the still-depressed sectors like restaurants, travel and hotels returning to their pre-pandemic levels; this would help to bring the unemployment rate down. With the household saving rate having been exceptionally high since the first lockdown in March, there is plenty of pent-up demand and purchasing power stored up for these services. A comprehensive roll-out of vaccines might take into late 2021 to fully complete; but if these vaccines prove to be highly effective, then there is a possibility that restrictions could start to be eased, beginning possibly in Quarter 2 2021 once vulnerable people and front-line workers have been vaccinated. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines would radically improve the economic outlook once they have been widely administered; it may allow Gross Domestic Product to rise to its pre-virus level a year earlier than otherwise and mean that the unemployment rate peaks at 7% in 2021 instead of 9%.

Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp after Quarter 1 saw growth at -3.0% followed by -18.8% in Quarter 2 and then an upswing of +16.0% in Quarter 3; this still left the economy 8.6% smaller than in Quarter 4 2019. It is likely that the one month national lockdown that started on 5th November, will have caused a further contraction of 8% m/m in November so the economy may have then been 14% below its pre-crisis level.

December 2020 / January 2021. Since then, there has been rapid back-tracking on easing restrictions due to the spread of a new mutation of the virus, and severe restrictions were imposed across all four nations. These restrictions were changed on 5 January 2021 to national lockdowns of various initial lengths in each of the four nations, as the NHS was under extreme pressure. It is now likely that wide swathes of the UK will remain under these new restrictions for some months; this means that the near-term outlook for the economy is grim. However, the distribution of vaccines and the expected consequent removal of COVID-19 restrictions, should allow Gross Domestic Product to rebound rapidly in the second half of 2021 so that the economy could climb back to its pre-pandemic peak as soon as late in 2022. Provided that both monetary and fiscal policy are kept loose for a few years yet, then it is still possible that in the second half of this decade, the economy may be no smaller than it would have been if COVID-19 never happened. The significant caveat is if another mutation of COVID-19 appears that defeats the current batch of vaccines. However, now that science and technology have caught up with understanding this virus, new vaccines ought to be able to be developed more quickly to counter such a development and vaccine production facilities are being ramped up around the world.

Brexit. The final agreement on 24 December 2020 has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. As the forecasts in this report were based on an assumption of a Brexit agreement being reached, there is no need to amend these forecasts.

Monetary Policy Committee meeting of 17th December. All nine Committee members voted to keep interest rates on hold at +0.10% and the Quantitative Easing (QE) target at £895bn. The Monetary Policy Committee commented that the successful rollout of vaccines had reduced the downsides risks but they were still sufficiently concerned that they voted to extend the availability of the Term Funding Scheme, (cheap borrowing), with additional incentives for small and medium size enterprises for another six months from 30 April 2021 until 31 October 2021. (The Monetary Policy Committee had assumed that a Brexit deal would be agreed.)

US. The Democrats won the presidential election in November, and now that they have won two Senate seats in Georgia in early January, they have effective control of both Congress and the Senate, although power is more limited in the latter. This is likely to enable the Democrats to provide more fiscal stimulus to the economy and so help the speed of economic recovery.

The economy had been recovering quite strongly from its contraction in 2020 of 10.2% due to the pandemic with Gross Domestic Product only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during Quarter 4, to the highest level since mid-August, suggests that the US could be in the early stages of a fourth wave - impacting widely across the US this time. This latest upturn poses a threat that the recovery in the economy could stall. This is the single biggest downside risk to the shorter term outlook – a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, states might feel it necessary to return to more draconian lockdowns.

The restrictions imposed to control the spread of the virus are once again weighing on the economy with employment growth slowing sharply in November and retail sales dropping back. The economy is set for further weakness in December and into the spring. However, a $900bn fiscal stimulus deal passed by Congress in late December will limit the downside. Gross Domestic Product growth is expected to rebound markedly from the second quarter of 2021 onwards as vaccines are rolled out on a widespread basis and restrictions are loosened.

After Chair Jerome Powell unveiled the Fed's adoption of a flexible average inflation target in his Jackson Hole speech in late August 2020, the mid-September meeting of the Fed agreed by a majority to a toned down version of the new inflation target in his speech - that *"it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time."* This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary “trap” like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

The Fed’s meeting on 16 December tweaked the guidance for its monthly asset quantitative easing purchases with the new language implying those purchases could continue for longer than previously believed. Nevertheless, with officials still projecting that inflation will only get back to 2.0% in 2023, the vast majority expect the fed funds rate to be still at near-zero until 2024 or later. Furthermore, officials think the balance of risks surrounding that median inflation forecast are firmly skewed to the downside. The key message is still that policy will remain unusually accommodative – with near-zero rates and asset purchases – continuing for several more years. This is likely to result in keeping Treasury yields low – which will also have an influence on gilt yields in this country.

EU. In early December, the figures for Quarter 3 Gross Domestic Product confirmed that the economy staged a rapid rebound from the first lockdowns. This provides grounds for optimism about growth prospects for next year. In Quarter 2, Gross Domestic Product was 15% below its pre-pandemic level. But in Quarter 3 the economy grew by 12.5% q/q leaving Gross Domestic Product down by “only” 4.4%. That was much better than had been expected earlier in the year. However, growth is likely to stagnate during Quarter 4 and in Quarter 1 of 2021, as a second wave of the virus has affected many countries: it is likely to hit hardest those countries more dependent on tourism.

With inflation expected to be unlikely to get much above 1% over the next two years, the European Central Bank has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the European Central Bank has stated that it retains this as a possible tool to use. The European Central Bank’s December meeting added a further €500bn to the PEPP scheme, (purchase of government and other bonds), and extended the duration of the programme to March 2022 and re-investing maturities for an additional year until December 2023. Three additional tranches of Targeted Longer-Term Refinancing Operations (TLTRO, cheap loans to banks), were approved, indicating that support will last beyond the impact of the pandemic, implying indirect yield curve control for government bonds for some time ahead. The Bank’s forecast for a return to pre-virus activity levels was pushed back to the end of 2021, but stronger growth is projected in 2022. The total PEPP scheme of €1,850bn of Quantitative Easing which started in March 2020 is providing protection to the sovereign bond yields of weaker countries like Italy. There is therefore unlikely to be a euro crisis while the European Central Bank is able to maintain this level of support. However, as in the UK and the US, the advent of highly effective vaccines will be a game changer, although growth will struggle before later in Quarter 2 of 2021.

China. After a concerted effort to get on top of the virus outbreak in Quarter 1, economic recovery was strong in Quarter 2 and then into Quarter 3 and Quarter 4; this has enabled China to recover all of the contraction in Quarter 1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth.

Japan. A third round of fiscal stimulus in early December took total fresh fiscal spending this year in response to the virus close to 12% of pre-virus Gross Domestic Product. That's huge by past standards, and one of the largest national fiscal responses. The budget deficit is now likely to reach 16% of Gross Domestic Product this year. Coupled with Japan's relative success in containing the virus without draconian measures so far, and the likelihood of effective vaccines being available in the coming months, the government's latest fiscal effort should help ensure a strong recovery and to get back to pre-virus levels by Quarter 3 2021 – around the same time as the US and much sooner than the Eurozone.

World growth. World growth will have been in recession in 2020. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

1.2 INTEREST RATE FORECAST:

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Following the conclusion of the HM Treasury review of PWLB margins over gilt yields on 25 November 2020, all forecasts below now include the 1% reduction in the non-HRA Certainty Rate (now gilt yields plus 80bps):

Link Group Interest Rate View 9.11.20													
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20													
	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

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 first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31st March 2024 as economic recovery is expected to be only gradual.

GILT YIELDS / PUBLIC WORKS LOAN BOARD RATES. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession.

Gilt yields had, therefore, already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields initially spiked upwards in March, we have seen yields fall sharply in response to major western central banks taking rapid policy action to deal with excessive stress in financial markets during March 2020, and starting massive quantitative easing driven purchases of government bonds: these actions also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply. At the close on 31st December, all gilt yields from 1 to 8 years were in negative territory, while even 25 year yields were only at 0.84% and the 50 year at 0.64%.

From the local authority borrowing perspective, HM Treasury imposed two changes of margins over gilt yields for Public Works Loan Board rates in 2019-20 without any prior warning. The first took place on 9 October 2019, adding an additional 1% margin over gilts to all Public Works Loan Board period rates. That increase was then, at least partially, reversed for some forms of borrowing on 11 March 2020, but not for mainstream non-HRA capital schemes. A consultation was then held with local authorities and on 25 November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for Public Works Loan Board rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the Public Works Loan Board for any local authority which had purchase of assets for yield in its three year capital programme. The new margins over gilt yields are 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)

As the interest forecast table for Public Works Loan Board certainty rates, (gilts plus 80bps), above shows, there is likely to be little upward movement in Public Works Loan Board rates over the next three years as it will take the UK a prolonged period to eliminate spare capacity in the economy so that inflation might start to become a sufficient concern for both the Monetary Policy Committee to consider raising Bank Rate, and for gilt holders to require a higher yield.