ANNEX C

TREASURY MANAGEMENT STRATEGY STATEMENT - MINIMUM REVENUE PROVISION POLICY STATEMENT and ANNUAL INVESTMENT STRATEGY 2021/22

1.0 INTRODUCTION:

1.1 Background

1.1.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. The first part of the Treasury Management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

1.1.2 The second main 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 that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.1.3 The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

1.1.4 Whilst any service investments, income generating initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure) and are separate from the day to day treasury management activities.

1.1.5 CIPFA defines Treasury Management 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."

1.2 Reporting Requirements

Capital Strategy

1.2.1 The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report which will provide the following:

- a high-level long-term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed; and
- the implications for future financial sustainability.

1.2.2 The aim of the Capital Strategy is to ensure that all elected members on the Full Council fully understand the overall long-term policy objectives and the resulting capital strategy requirements, governance procedures and risk appetite.

1.2.3 The Capital Strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former and in the capital programme. This ensures the separation of the core treasury function under security, liquidity and yield principles and the non-treasury function where the policy for service and commercial investments are usually associated with capital expenditure in relation to an asset. The Capital Strategy 2021/22 will show:

- The corporate governance arrangements for these types of activities;
- Any service objectives relating to the investments;
- The expected income, costs and resulting contribution;
- The debt related to the activity and the associated interest costs;
- The payback period (Minimum Revenue Provision (MRP) policy);
- For non-loan type investments, the cost against the current market value; and
- The risks associated with each activity.

1.2.4 Where a physical asset is being bought, details of market research, advisers used, (and their monitoring), ongoing costs, investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash. It is extremely unlikely that non-treasury investment of a commercial nature will occur in 2021/22 as the Commercial Investment Strategy was suspended by Council in September 2020 due to the change in the market environment. Details are included in the Capital Strategy 2021/22 and in the prudential indicators in this report to illustrate that activity of a commercial nature is zero.

1.2.5 Where the Council has borrowed to fund any non-treasury investment there should also be an explanation of why borrowing was required and why if the Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance and CIPFA Prudential Code 2017 have not been adhered to.

1.2.6 If any non-treasury investments sustain a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital programme and revenue budget.

1.2.7 To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this report. It should be highlighted that non-treasury investments is expenditure being either for commercial activity or for valid service delivery reported through the capital programme.

Treasury Management Reporting

1.2.8 The Council is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals. In addition, quarterly review reports provide a regular update to Cabinet.

Prudential and treasury indicators and treasury strategy

1.2.9 The first, and most important report is forward looking and covers:

- the capital plans (including prudential indicators);
- a Minimum Revenue Provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an Investment Strategy (the parameters on how investments are to be managed).

A Mid Year Treasury Management Report

1.2.10 This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition, this Council will receive quarterly update reports.

An Annual Treasury Report

1.2.11 This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

1.2.12 The above reports are required to be adequately scrutinised by Members before being recommended to the Council. This role is undertaken by Cabinet, in addition to this scrutiny role, Audit, Governance and Standards Committee also scrutinese these reports.

1.3 **Treasury Management Strategy for 2021/22**

1.3.1 The strategy for 2021/22 covers two main areas:

(a) Capital issues

- the capital expenditure plans and the associated prudential indicators; and
- the Minimum Revenue Provision (MRP) policy.

(b) Treasury Management issues

- the current treasury position;
- treasury indicators which will limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt re-scheduling;
- the investment strategy;
- credit worthiness policy;
- policy on use of external service providers; and
- member training.

1.3.2 These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and the Ministry of Housing, Communities and Local Government (MHCLG) Minimum Revenue Provision Guidance (MRP) and Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance.

2.0 The Capital Prudential Indicators 2021/22 to 2023/24:

2.1 The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist Members' overview and confirm their understanding of the Capital Programme.

Capital Expenditure

2.2 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts.

Capital Expenditure	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Services	7,402,914	19,745,917	26,059,362	3,398,892	1,338,458
Commercial activities/ non- financial investments*	-	-	-	-	-
Total	7,402,914	19,745,917	26,059,362	3,398,892	1,338,458

* Commercial activities / non-financial investments relate to areas such as capital expenditure on investment properties, loans to third parties etc.

It should be noted that the Commercial Activity has been reduced to zero due to the decision that was made at Cabinet and Council in September 2020 where the Commercial Investment Strategy was suspended. This report illustrates that commercial activity is estimated to be zero in 2021/22.

2.3 Other long-term liabilities. The above financing need excludes other long-term liabilities, such as Private Finance Initiatives and leasing arrangements which already include borrowing instruments. The Council has no Private Finance Initiatives (PFI).

2.4 The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need. In 2021/22, borrowing may occur to support the Capital Programme.

2.5

Capital Expenditure £	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Existing Capital Programme	7,402,914	19,745,917	26,059,362	3,398,892	1,338,458
New Finance Lease	-	-	-	-	-
Total expenditure	**7,402,914**	**19,745,917**	**26,059,362**	**3,398,892**	**1,338,458**
Financed by:					
Capital receipts	89,568	1,362,853	925,528	21,628	42,040
Capital grants	2,805,079	7,322,022	9,244,334	1,190,602	497,458
Capital reserves	791,716	719,020	437,510	609,060	231,000
Revenue	149,368	84,701	85,036	88,372	67,960
Finance Lease	-	-	-	-	-
Total Financing	3,835,731	9,488,596	10,692,408	1,909,662	838,458
Net financing need for the year	**3,567,183**	**10,257,321**	**15,366,954**	**1,489,230**	**500,000**

The net financing need for commercial activities / non-financial investments included in the above table against expenditure is shown below, this position is zero due to that the Commercial Investment Strategy being suspended at Cabinet and Council in September 2020.

Commercial activities / non-financial investments £m	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Capital Expenditure	-	-	-	-	-
Financing costs	-	-	-	-	-
Net financing need for the year	-	-	-	-	-
Percentage of total net financing need	**0%**	**0%**	**0%**	**0%**	**0%**

2.6 **The Council's Borrowing Need (the Capital Financing Requirement)**

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

2.7 The CFR does not increase indefinitely as the Minimum Revenue Provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets' life, and so charges the economic consumption of capital assets as they are used.

2.8 The Capital Financing Requirement (CFR) is detailed in the table below and for 2021/22 the underlying need for the Council to borrow is £67,361,062. This is a combination of numerous projects the Council is committed to delivering in the 10 Year Capital Programme and significant schemes that contribute to this are the loan to the local housing association, the development of the former prison site Treadmills, the crematorium development and town square. These capital projects and the associated borrowing requirements relate to economic development and regeneration projects (non-treasury investments) as well as service activities (also non-treasury investments); this is detailed in the capital expenditure table above. The CFR provides the Council with the flexibility to use borrowing to support the capital programme if it chooses to do so but still allows the use of surplus funds if available; this is known as internal borrowing. If external borrowing is taken, consideration is given to the Treasury Management environment to ensure that the best option is achieved in relation to interest rates in the short and long term.

2.9 The Capital Financing Requirement includes any other long-term liabilities (e.g. Private Finance Initiative schemes (PFI), finance leases). Whilst these increase the Capital Financing requirement and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has no such Private Finance Initiative schemes or finance leases.

2.10 The Council is asked to approve the Capital Financing Requirement (CFR) projections detailed in the table below:-

	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Capital Financing Requirement B/F	38,169,604	41,736,787	51,994,108	67,361,062	68,634,082
CFR - Services	3,567,183	10,257,321	15,366,954	1,273,020	162,880
CFR – Commercial activities/ non-financial investments	-	-	-	-	-
Total CFR	**41,736,787**	**51,994,108**	**67,361,062**	**68,634,082**	**68,796,962**
Movement in the Capital Financing Requirement	**3,567,183**	**10,257,321**	**15,366,954**	**1,273,020**	**162,880**
Net financing need for the year	3,567,183	10,257,321	15,366,954	1,489,230	500,000
Less Minimum Revenue Provision	-	-	-	(216,210)	(337,120)

	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
and other financing movements					
Movement in the Capital Financing Requirement	**3,567,183**	**10,257,321**	**15,366,954**	**1,273,020**	**162,880**

Minimum Revenue provision (MRP) Policy Statement

2.11 It is a statutory requirement that the Council reports on the Minimum Revenue Position and explains this policy. The Minimum Revenue Provision Policy describes that the Council is required to pay off an element of the accumulated General Fund capital spend each year, the Capital Financing Requirement (CFR) through a revenue charge known as the Minimum Revenue Provision (MRP). The Council is also allowed to undertake additional voluntary payments if required. This is known as the Voluntary Revenue Provision (VRP).

2.12 This Council in 2021/22 will have a Capital Financing Requirement of £67,361,062 to support the total capital programme and this is the potential amount of borrowing that may be required in 2021/22.

2.13 Ministry of Housing, Communities and Local Government (MHCLG) regulations have been issued which require the Full Council to approve a Minimum Revenue Provision (MRP) Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following Minimum Revenue Provision Statement which includes four different approaches for:

1. Capital expenditure on supported and unsupported borrowing
2. Commercial Investment Property portfolio
3. Loan to Third parties
4. Voluntary Revenue Provision

2.14 For capital expenditure incurred before 1 April 2008, or which in the future will be Supported Capital Expenditure, the Minimum Revenue Provision policy will be:

- Based on Capital Financing Requirement (CFR) – Minimum Revenue Provision (MRP) will be based on the Capital Financing Requirement.
  This option provides for an approximate 4% reduction in the borrowing need (Capital Financing Requirement) each year.

2.15 From 1 April 2008 for all unsupported borrowing (including Private Finance Initiative and finance leases) the Minimum Revenue Provision policy will be:

- Asset Life Method – Minimum Revenue Provision will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction). This option provides for a reduction in the borrowing need over approximately the asset's life. There are two main methods that will be considered to achieve this either the Equal Instalment method or the Annuity method. The estimated life of the asset would usually not exceed the useful life of 50 years but consideration will be given to exceed this in the following two scenarios: an appropriately qualified professional advisor’s opinion is that an asset will deliver service functionality for more than 50 years then the use the life suggested by its professional advisor will be used o for a lease or PFI asset, where the length of the lease/PFI contract exceeds 50 years, the length of the lease/PFI contract will be used

2.16 In using the Asset Life Method for the prudent provision for the Minimum Revenue Provision the following can be noted:

- There are two methods of calculation and the Council reserves the right to select the most appropriate method, depending on the type of project: Equal instalment which normally generates a series of equal annual amounts over the estimated life of the asset, where there are equal instalments of interest and principle charged on the annuity method which has the advantage of linking Minimum Revenue Provision to the flow of benefits from an asset where the benefits are expected to increase in later years. It is attractive in connection with projects promoting regeneration or schemes where revenues will increase over time.

- Freehold land cannot properly have a life attributed to it, so it should be treated as equal to a maximum of 50 years. But if there is a structure on the land which the authority considers to have a life longer than 50 years, that same life estimate may be used for the land.

- Timing of the Minimum Revenue Provision - Provision for debt will normally commence in the financial year following the one in which the expenditure is incurred, however in the case of the provision of a new asset, Minimum Revenue Provision would not have to be charged until the asset came into service and would begin in the financial year following the one in which the asset became operational. This “Minimum Revenue Provision holiday” would be perhaps 2 or 3 years in the case of major projects, or possibly longer for some complex infrastructure schemes; this could make projects more affordable

2.17 In addition, where repayments are included in annual Private Finance Initiative schemes or finance leases then this will be applied as the Minimum Revenue Provision (MRP).

2.18 It should be noted that in 2021/22 there is no Minimum Revenue Provision policy for the Commercial Investment Strategy as no non -treasury investments of this type will be made as illustrated in the prudential indicators in this report.

2.19 The Capital Financing Requirement for the loan to the local Housing Association at the beginning of 2021/22 is £34,000,000. The agreement with the local Housing Association states they will make bullet repayments to the Council at years 5, 10, 15, 20 and 25. The bullet repayments made throughout the life of the loan will be set aside by the Council when received to ensure that prudent provision is made for regular repayment. These regular bullet points will be earmarked and used as the Minimum Revenue Provision that the Council needs to make on a regular basis to reduce the Capital Financing Requirement.

2.20 Therefore, it can be noted in 2020/21 £1,000,000 was repaid from the local Housing Association which reduced the level of the Capital Financing Requirement and this will continue when the Council investment is repaid from the local Housing Association at regular intervals thereafter. It should be noted that if no borrowing has been taken to support the capital financing requirement and instead the Council's surplus funds have been used then no Minimum Revenue Provision charge will be made.

2.21 Finally Voluntary Revenue Provision is where the Council believes it is prudent to set aside an increased amount to repay the Capital Financing Requirement during the year. Any charges made over the statutory Minimum Revenue Provision i.e. voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, the cumulative overpayment made each year must be disclosed. Up until the 31 March 2020 the total Voluntary Revenue Provision overpayments were £0m. This Council has never overpaid Minimum Revenue Provision so this does not apply; however it is noted here for future reference if ever needed.

2.22 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances. Working capital balances (Debtors and Creditors) shown in the table are included in 'Other' which is the estimated position at the year-end; these may fluctuate during the year. The Council will run its cash close to zero, therefore reducing its external borrowing costs as interest rates for investments remain at a low level. This is not in the pro forma

Year End Resources	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Fund balances / reserves	13,338,965	11,505,224	8,343,844	7,061,068	5,606,368
Capital receipts	2,107,716	968,863	598,335	586,707	554,667
Provisions	841,532	610,000	610,000	610,000	610,000
Other	11,550,535	8,794,190	8,189,330	8,144,378	7,987,803
Total core funds	**27,838,748**	**21,878,277**	**17,741,509**	**16,402,153**	**14,758,838**
Under/over borrowing	**14,036,787**	**18,294,108**	**12,661,062**	**13,134,082**	**13,296,962**
Expected investments	**13,801,961**	**3,584,169**	**5,080,447**	**3,268,071**	**1,461,876**

Affordability Prudential Indicators

2.23 The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

2.24 **Ratio of financing costs to net revenue stream.** This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs) against the net revenue stream.

%	**2019/20 Actual**	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**
Services	0.18%	4.34%	7.41%	9.15%	10.78%
Commercial activities /non-financial investments	0.00%	0.00%	0.00%	0.00%	0.00%
Total	0.18%	4.34%	7.41%	9.15%	10.78%

2.25 The estimates of financing costs include current commitments and the proposals in this budget report.

2.26 This shows the proportion of finance costs in relation to the Council's total net income position; where the finance costs are the interest on borrowing and the minimum revenue provision set aside to repay that borrowing and where the total net income position is the net funding position of the council – Council tax, business rates, grant funding, income generated – and also income received from the loan to the local housing association.

3.0 BORROWING:

3.1 The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

3.2 Current Portfolio Position

3.2.1 The overall treasury position as at 31 March 2020 and for the position as at 31 December 2020 are shown below for both borrowing and investments.

TREASURY PORTFOLIO				
	Actual 31.03.20	**Actual 31.03.20**	**Current 31.12.20**	**Current 31.12.20**
	£000	**%**	**£000**	**%**
Treasury Investments				
Banks	13,880	100	7,000	40
Money Market Funds	-	-	10,590	60
Total Treasury Investments	**13,880**	**100**	**17,590**	**100**
Treasury External Borrowing				

Local Authorities	-	-	-	-
Public Works Loan Board	27,700	100	27,700	100
Total External Borrowing	**27,700**	**100**	**27,700**	**100**
Net Treasury Investments / (Borrowing)	(13,820)	-	(10,110)	-

3.2.2 The Council's forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need the Capital Financing Requirement (CFR), highlighting any over or under borrowing. The actual position for 2019/20 and the estimated position for future years is reflected in the table below:

£	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
External Debt					
Debt at 1 April	12,700,000	27,700,000	33,700,000	54,700,000	55,500,000
Expected change in Debt	15,000,000	6,000,000	21,000,000	800,000	-
Actual gross debt at 31 March	**27,700,000**	**33,700,000**	**54,700,000**	**55,500,000**	**55,500,000**
The Capital Financing Requirement	**41,736,787**	**51,994,108**	**67,361,062**	**68,634,082**	**68,796,962**
Under / (over) borrowing	**14,036,787**	**18,294,108**	**12,661,062**	**13,134,082**	**13,296,962**

3.2.3 Within the above figures, the level of debt relating to commercial activities / non-financial investment is:

£	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
External Debt for commercial activities / non-financial investments					
Actual debt at 31 March £m	-	-	-	-	-
Percentage of total external debt %	0%	0%	0%	0%	0%

3.2.4 Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt, does not, except in the short term, exceed the total of the Capital Financing Requirement (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, however, ensures that borrowing is not undertaken for revenue or speculative purposes.

3.2.5 The Director of Finance and Commercial (S151 Officer) reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report.

3.3 Treasury Indicators: Limits to Borrowing Activity

3.3.1 **The Operational Boundary.** This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the Capital Financing Requirement (CFR), but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational boundary	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Debt	55,000,000	67,500,000	68,500,000	69,200,000
Other long-term liabilities	600,000	800,000	800,000	800,000
Commercial activities/non-financial investments	-	-	-	-
Total	**55,600,000**	**68,300,000**	**69,300,000**	**70,000,000**

3.3.2 **The Authorised Limit for external debt.** A further key prudential indicator represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following Authorised Limit:

Authorised limit £	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Debt	61,500,000	71,000,000	71,500,000	72,000,000
Other long-term liabilities	1,000,000	1,000,000	1,000,000	1,000,000
Commercial activities/non-financial investments	-	-	-	-
Total	**62,500,000**	**72,000,000**	**72,500,000**	**73,000,000**

3.4 **Prospects for Interest Rates and Economic Background**

3.4.1 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. Link provided the following forecasts on 11 August 2020. However, following the conclusion of the review of PWLB margins over gilt yields on 25 November 2020, all forecasts below have been reduced by 1%. These are forecasts for certainty rates, gilt yields plus 80bps:

Annual Average %	**Bank Rate %**	**PWLB Borrowing Rates % (including certainty rate adjustment)**			
		5 year	**10 year**	**25 year**	**50 year**
Mar 2021	0.10	0.80	1.10	1.50	1.30
Jun 2021	0.10	0.80	1.10	1.60	1.40
Sep 2021	0.10	0.80	1.10	1.60	1.40
Dec 2021	0.10	0.80	1.10	1.60	1.40
Mar 2022	0.10	0.90	1.20	1.60	1.40
Jun 2022	0.10	0.90	1.20	1.70	1.50
Sep 2022	0.10	0.90	1.20	1.70	1.50
Dec 2022	0.10	0.90	1.20	1.70	1.50
Mar 2023	0.10	0.90	1.20	1.70	1.50
Jun 2023	0.10	1.00	1.30	1.80	1.60
Sep 2023	0.10	1.00	1.30	1.80	1.60
Dec 2023	0.10	1.00	1.30	1.80	1.60
Mar 2024	0.10	1.00	1.30	1.80	1.60

3.4.2 Link have made a slight change to the interest rate forecasts table above for forecasts for 3, 6 and 12 months. Traditionally, Link used LIBID forecasts, with the rate calculated using market convention of 1/8th (0.125%) taken off the LIBOR figure. Given that all LIBOR rates up to 6m are currently running below 10bps, using that convention would give negative figures as forecasts for those periods. However, the liquidity premium that is still in evidence at the short end of the curve means that the rates actually being achieved by local authority investors are still modestly in positive territory. While there are differences between counterparty offer rates, Link's analysis would suggest that an average rate of around 10 bps is achievable for 3 months, 10bps for 6 months and 20 bps for 12 months.

3.4.3 During 2021, Link will be continuing to look at market developments in this area and will monitor these with a view to communicating with clients when full financial market agreement is reached on how to replace LIBOR. This is likely to be an iteration of the overnight SONIA rate and the use of compounded rates and Overnight Index Swap (OIS) rates for forecasting purposes.

3.4.4 Link will maintain continuity by providing clients with LIBID investment benchmark rates on the current basis.

3.4.5 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 to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its meeting on 6th August 2020, 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 in the forecast table above as economic recovery is expected to be only gradual and, therefore, prolonged. These forecasts were based on an assumption that a Brexit trade deal would be agreed by 31 December 2020: as this has now occurred, these forecasts do not need to be revised.

3.4.6 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 a heightened expectation 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 last 30 years. 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. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

3.4.7 Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds: this 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. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21.

3.4.8 As the interest forecast table for Public Works Loan Board certainty rates above shows, there is likely to be little upward movement in Public Works Loan Board rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore Public Works Loan Board rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

3.5 Investment and borrowing rates

3.5.1 Investment returns are likely to remain exceptionally low during 2021/22 with little increase in the following two years.

3.5.2 **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt yields up to 6 years were on negative yields during most of the first half of 20/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. The unexpected increase of 100 bps in Public Works Loan Board rates on top of the then current margin over gilt yields of 80 bps in October 2019, required an initial major rethink of local authority treasury management strategy and risk management. However, in March 2020, the Government started a consultation process for amending the margins over gilt rates for Public Works Loan Board borrowing for different types of local authority capital expenditure. It also introduced the following rates for borrowing for different types of capital expenditure: -

- **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
- **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
- **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)

3.5.3 As a consequence of these increases in margins, many local authorities decided to refrain from Public Works Loan Board borrowing unless it was HRA or local infrastructure financing, until such time as the review of margins was concluded.

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 PWLB 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)

3.5.4 **Borrowing for capital expenditure.** As Link's long-term forecast for Bank Rate is 2.00%, and all Public Works Loan Board rates are under 2.00%, there is now value in borrowing from the Public Works Loan Board for all types of capital expenditure for all maturity periods, especially as current rates are at historic lows. However, greater value can be obtained in borrowing for shorter maturity periods so the

Council will assess its risk appetite in conjunction with budgetary pressures to reduce total interest costs. Longer-term borrowing could also be undertaken for the purpose of certainty, where that is desirable, or for flattening the profile of a heavily unbalanced maturity profile.

3.5.5 While this Council will not be able to avoid borrowing to finance new capital expenditure and the rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

3.6 Borrowing Strategy

3.6.1 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

3.6.2 If the Council does undertake borrowing then interest rates will be viewed from 1 year to 50 years, in accordance with the interest rates available from the markets as well as the Public Works Loans Board (PWLB). For 2021/22 interest rates span between 5 years at 0.80% to 0.90%,10 at 1.10% to 1.20%, 25 at 1.60% or 50 years at 1.40%. The interest rates trend is to increase slightly across all years as the 2021/22 year progresses. Therefore, in the current volatile money market, the borrowing target rate for 2021/22 is set at 1.60%. External borrowing will be considered throughout the financial year when interest rates seem most favourable.

3.6.3 Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 treasury operations. The Director of Finance and Commercial (Section 151 Officer) will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp FALL in borrowing rates, then borrowing will be postponed.

- if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected in the next few years.

Any decisions will be reported to Cabinet at the next available opportunity.

3.7 Policy on Borrowing in Advance of Need

3.7.1 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Borrowing in advance will be made within the constraints that:

- The authority would not look to borrow more than 12 months in advance of need.

3.7.2 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the quarterly, mid-year or annual reporting mechanism.

3.8 Debt Rescheduling

3.8.1 Debt rescheduling of current Public Works Loan Board (PWLB) borrowing in our debt portfolio is unlikely to occur as the premature repayment rates provided by the PWLB are much lower than the new borrowing rates provided by the PWLB. The PWLB premature repayment rates are approximately 10-15bps lower than gilt yields. The current low interest rate environment would mean the cost of prematurely repaying any PWLB loans would come with higher premium costs to exit any loans. It is unlikely that any debt rescheduling opportunities will occur in th year ahead however the debt portfolio will continue to be monitored for any opportunities that may prevail.

3.8.2 All rescheduling will be reported to Cabinet, at the earliest meeting following its action.

3.9 New financial institutions as a source of borrowing and / or types of borrowing

3.9.1 Currently the Public Works Loan Board Certainty Rate is set at gilts + 80 basis points for both the Housing Revenue Account (HRA) and non-HRA borrowing, which is what this Council is concerned with as the Council does not have housing. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons:

- Local authorities (primarily shorter dated maturities out to 3 years or so – still cheaper than the Certainty Rate)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a “cost of carry” or to achieve refinancing certainty over the next few years).
- Municipal Bonds Agency

3.9.2 Our advisor Link will keep us informed as to the relative merits of each of these alternative funding sources.

3.10 Approved Sources of Long and Short-term Borrowing

3.10.1 The Council has the following sources and types of funding available to use when necessary:

Approved Sources of Long and Short-term Borrowing		
On Balance Sheet	**Fixed**	**Variable**
PWLB	●	●
Municipal bond agency	●	●
Local authorities	●	●
Banks	●	●
Pension funds	●	●
Insurance companies	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Stock issues	●	●
Local temporary	●	●
Local Bonds	●	●
Local authority bills	●	●
Overdraft	●	●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	●
Medium Term Notes	●	●
Finance leases	●	●

3.11 Maturity structure of borrowing

3.11.1 These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing and are required for upper and lower limits.

The Council is asked to approve the following treasury indicators and limits, the Council currently only has fixed interest rate borrowing:

Maturity structure of fixed interest rate borrowing 2021/22		
	Lower	**Upper**
Under 12 months	0%	100%
12 months to 2 years	0%	100%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years to 20 years	0%	100%
20 years to 30 years	0%	100%
30 years to 40 years	0%	100%

40 years to 50 years	0%	100%
Maturity structure of variable interest rate borrowing 2021/22		
	Lower	Upper
Under 12 months	0%	100%
12 months to 2 years	0%	100%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years to 20 years	0%	100%
20 years to 30 years	0%	100%
30 years to 40 years	0%	100%
40 years to 50 years	0%	100%

4.0 Annual Investment Strategy

4.1 Investment Policy

4.1.1 The Council's investment policy has regard to the following: -

- Ministry of Housing, Communities and Local Government (MHCLG) Guidance on Local Government Investments ("the Guidance")

- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")

- CIPFA Treasury Management Guidance Notes 2018

- The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).

4.1.2 The above guidance from the Ministry of Housing, Communities and Local Government (MHCLG) and CIPFA place a high priority on the management of risk. This Council has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long term ratings.

2. Other information: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

3. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. This authority has defined the list of types of investment instruments that the treasury management team are authorised to use; there are two lists in Annex C1 under the categories of 'specified' and 'non-specified' investments and Counterparty limits will be as set through the Council's treasury management practices – schedules.

- **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity if originally they were originally classified as being non-specified investments solely due to the maturity period exceeding one year.

- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

5. Non-specified and loan investments limit. The Council has determined that it will limit the maximum total exposure to non-specified investments as being 10% of the total investment portfolio.

6. Transaction limits are set for each type of investment in in Annex C1.

7. This authority will set a limit for the amount of its investments which are invested for longer than 365 days, in Annex C1

8. Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, in Annex C1.

9. This authority has engaged external consultants, to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

10. All investments will be denominated in sterling.

11. As a result of the change in accounting standards for 2020/21 under IFRS 9, this Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31 March 2023.

However, this Council will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

4.1.3 With regards to counterparty limts and the amount of surplus funds to be placed with any one counterparty or group of counterparties, specific advice has been taken from the Council's Treasury Management Advisors (Link) due to the difficulty in placing surplus funds in the current economic environment. Therefore, the Counterparty limits are detailed as follows:

Individual Limits – These limits will be set at 35% of total investments or £7m per counterparty whichever is the higher. There are three exceptions to this policy:

(a) with counterparties that are backed by the Government – Royal Bank of Scotland and Natwest – (and therefore are more secure) there will be a 40% limit or £7m per counterparty whichever is the higher.

(b) with the Council's own bank - Lloyds - and associated banks in the Lloyds group – Bank of Scotland – there will be a 40% limit or £7m per counterparty whichever is the higher

(c) with the Debt Management Agency Deposit there will be an unlimited amount with this organisation due to its high level of security.

- **Group Limits** – this policy recognises that individual counterparties (banks/financial institutions etc), whilst being sound in themselves, may be part of a larger group. This brings with it added risks where parent institutions may be in difficulties. Therefore, due to the reduced surplus balances available for investment, the group limit will also be as stated for the individual limits as it is important to diversify the risk to a variety of counterparties.

4.2 Creditworthiness policy

4.2.1 This Council applies the creditworthiness service provided by the Link Group – the Council's Treasury Management Advisors. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings;and
- sovereign ratings to select counterparties from only the most creditworthy countries.

4.2.2 This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of Credit Default Swap (CDS) spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years
- Dark pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
- Light pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.50
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

4.2.3 The Link Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

4.2.4 Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

4.2.5 All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services creditworthiness service.

- if a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately; and
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

4.2.6 Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, as well as information on any external support for banks to help support its decision-making process.

4.2.7 Creditworthiness - Although the credit rating agencies changed their outlook on many UK banks from Stable to Negative during the quarter ended 30 June 2020 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of major financial institutions, including UK banks. However, during Quarter 1 and Quarter 2 2020, banks made provisions for *expected* credit losses and the rating changes reflected these provisions. As we move into future quarters, more information will emerge on *actual* levels of credit losses. (Quarterly earnings reports are 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 earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that banks went into this pandemic with strong balance sheets. This is predominantly a result of regulatory changes imposed on banks following the Great Financial Crisis. Indeed, the Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the UK banking sector to “somewhat less than £80bn”. It stated that in its assessment, “banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the Monetary Policy Committee’s central projection”. The Financial Policy Committee stated that for real stress in the sector, the economic output would need to be twice as bad as the Monetary Policy Committee’s projection, with unemployment rising to above 15%.

4.2.8 All three rating agencies have reviewed banks around the world with similar results in many countries of most banks being placed on Negative Outlook, but with a small number of actual downgrades.

4.2.9 Credit Default Swap (CDS) prices - Although bank CDS prices, (these are market indicators of credit risk), spiked upwards at the end of March / early April 2020 due to the heightened market uncertainty and ensuing liquidity crisis that affected financial markets, they have returned to more average levels since then. Nevertheless, prices are still elevated compared to end-February 2020. Pricing is likely to remain volatile as uncertainty continues. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Council has access to this information via its Link-provided Passport portal.

4.3 Country Limits

4.3.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent), other than the UK where the Council has set no limit. The list of countries that qualify using this AA- credit criteria, as at the date of this report, are shown in Annex C2. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

4.3.2 The UK sovereign rating is currently AA- and following advice from Link Asset Services, the Council's Treasury Management Advisors, and the Council will still operate with UK counterparties.

4.3.3 The Council has determined that, other than the United Kingdom where no limit will apply, a maximum of 30% of total investments or £3m whichever is the lower will be invested in a single institution of a AA- sovereign rated country

4.3.3 In addition, this policy restricts the total of investments in foreign countries to 40% of the total investments.

4.4 Investment Strategy

4.4.1 **In-house funds**

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

4.4.2 **Investment returns expectations**

Bank Rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows (the long-term forecast is for periods over 10 years in the future):

Average earnings in each year	
2020/21	0.10%
2021/22	0.10%
2022/23	0.10%
2023/24	0.10%
2024/25	0.25%
Long term later years	2.00%

The overall balance of risks to economic growth in the UK is probably now skewed to the upside, however, is subject to major uncertainty due to the virus and how quickly successful vaccines may become available and widely administered to the population. It may also be affected by what, if any, deal the UK agrees as part of Brexit.

There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term Public Works Loan Board rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, or a return of investor confidence in equities, could impact gilt yields, (and so Public Works Loan Board rates), in the UK.

4.4.3 Negative investment rates

While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, and in November omitted any mention of negative rates in the minutes of the meeting of the Monetary Policy Committee, 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 to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

As for money market funds (MMFs), yields have continued to drift lower. Some managers have already resorted to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money swilling around at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer nil or negative rates for very short-term maturities. This is not universal, and Money Market Funds are still offering a marginally positive return, as are a number of financial institutions for investments at the very short end of the yield curve.

Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

4.4.7 **Invesment Treasury Indicator and Limit**
Total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

4.4.8 The Council is asked to approve the treasury indicator and limit: -

Maximum principal sums invested > 365 days			
£	**2021/22**	**2022/23**	**2023/24**
Principal sums invested > 365 days	£1,000,000	£1,000,000	£1,000,000

4.4.9 For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

4.5 Investment Risk Benchmarking

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day LIBID. The Council is appreciative that the provision of LIBOR and associated LIBID rates is expected to cease at the end of 2021. It will work with its advisors, Link, in determining suitable replacement investment benchmark ahead of this cessation and will report back to members accordingly.

4.6 End of year investment report

4.6.1 At the end of the 2020/21 financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

5.0 Policy on the Use of External Service Providers and Training

5.1 Policy on the Use of External Service Providers

5.1.1 The Council uses Link Asset Services, Treasury Solutions as its external treasury management advisors. The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

5.1.2 It is also recognised that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

5.1.3 In addition, to appointing external treasury management advisors, it is worth noting that for the undertaking of non-treasury investments, e.g. investment in commercial properties, then a further advisor would be appointed as the Council would require specialist property advice. The scope of investments in the future within the Council’s operations will include both conventional treasury investments, (the placing of residual cash from the Council’s functions), and more commercial type investments, such as investment properties.

5.2 Training

5.2.1 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This applies to Cabinet members and members on Scrutiny committee. During 2021/22, members will be offered training to provide an overview of treasury management and also any specific treasury management are they would choose. This training can be provided by Council officers or by the external service provider – Link. The training needs of treasury management officers in the Council are periodically reviewed and officers have the opportunity to attend seminars and update services from Link.

TREASURY MANAGEMENT PRACTICE – TMP1
CREDIT AND COUNTERPARTY RISK MANAGEMENT
- SPECIFIED AND NON-SPECIFIED INVESTMENTS AND LIMITS

SPECIFIED INVESTMENTS:

1.1 All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' quality criteria where applicable. (Non-specified investments which would be specified investments apart from originally being for a period longer than 12 months, will be classified as being specified once the remaining period to maturity falls to under twelve months).

2.0 NON-SPECIFIED INVESTMENTS:

2.1 These are any investments which do not meet the Specified Investment criteria. A maximum of 100% will be held in aggregate in non-specified investment

3.0 INVESTMENT INSTRUMENTS:

3.1 A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made, it will fall into one of the above categories.

3.2 The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum credit criteria / colour band	**** Max % of total investments/ £ limit per institution**	**Max. maturity period**
DMADF – UK Government	yellow	100%	6 months
UK Government gilts	yellow		5 years
UK Government Treasury bills	yellow		364 days
Bonds issued by multilateral development banks	yellow		5 years
Money Market Funds CNAV	AAA	100%	Liquid
Money Market Funds LVNAV	AAA		Liquid

Money Market Funds VNAV	AAA		Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	AAA	100%	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.5	AAA	100%	Liquid
Local authorities	yellow	100%	5 years
Term deposits with housing associations	Blue Orange Red Green No Colour		12 months 12 months 6 months 100 days Not for use
Term deposits with banks and building societies	Blue Orange Red Green No Colour		12 months 12 months 6 months 100 days Not for use
CDs or corporate bonds with banks and building societies	Blue Orange Red Green No Colour		12 months 12 months 6 months 100 days Not for use
Gilt funds	UK sovereign rating		

A) – SPECIFIED

Institution / Counterparty	***Minimum 'High' Credit Criteria***	***Use***
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house
Term deposits – housing associations	--	In-house
Term deposits – banks and building societies	Coded: Orange on Links Matrix. Fitch's rating: Short-term F1+, Long-term AA- Or equivalent rating from Standard & Poors and Moody's	In-house

UK Part nationalised banks	Coded: Blue on Links Matrix. Fitch's rating: Short-term F1+, Long-term AA- Or equivalent rating from Standard & Poors and Moody's	In-house / Fund Mangers
Banks part nationalised by high credit rated (sovereign rating) countries – non UK	Coded: Blue on Links Matrix. Fitch's rating: Long-term AAA, Or equivalent rating from Standard & Poors and Moody's	In-house and Fund Mangers
Collateralised deposit	UK sovereign rating or Coded: Orange on Links Matrix / UK Sovereign rating	In-house and Fund Mangers
UK Government Gilts	UK Sovereign rating	In-house buy and hold and Fund Managers
Bonds issued by multilateral development banks	Coded: Orange on Links Matrix / Long term AAA	In-house buy and hold and Fund Managers
Bonds issued by a financial institution which is guaranteed by the UK Government	UK Sovereign rating	In-house buy and hold and Fund Managers
Sovereign bond issues (other than the UK Government)	Coded: Orange on Links Matrix / Long term AAA	In-house buy and hold and Fund Managers
Treasury Bills	UK Sovereign rating	Fund Managers
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -		
1a. Money Market Funds (CNAV)	MMF rating	In-house and Fund Managers
1b. Money Market Funds (LVNAV)	MMF rating	In-house and Fund Managers
1c. Money Market Funds (VNAV)	MMF rating	In-house and Fund Managers
2a Ultra-Short Bond Funds with a credit score of 1.25	Bond fund rating	In-house and Fund Managers

2b.Ultra-Short Bond Funds with a credit score of 1.50	Bond fund rating	In-house and Fund Managers
3. Bond Funds	Bond fund rating	In-house and Fund Managers
4. Gilt Funds	UK sovereign rating	In-house and Fund Managers

NON-SPECIFIED INVESTMENTS*:*
A maximum of 100% can be held in aggregate in non-specified investment

1. Maturities of ANY period

Institution / Counterparty	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Term deposits – banks and building societies	Coded: red (6mths) and green (3mths) on Links Matrix. Fitch's rating: Short-term F1, Long-term A-, Or equivalent rating from Standard & Poors and Moody's	In-house	100%	3-6 Months
Fixed term deposits with variable rate and variable maturities: -Structured deposits	Coded: orange (1yr) red (6mths) and green (3mths) on Links Matrix. Fitch's rating: Short-term F1, Long-term A-, Or equivalent rating from Standard & Poors and Moody's	In-house	40%	1 Year
Certificates of deposits issued by banks and building societies.	Coded: orange (1yr) red (6mths) and green (3mths) on Links Matrix. Fitch's rating: Short-term F1, Long-term A-, Or equivalent rating from Standard & Poors and Moody's	In-house buy and hold and Fund Managers	30%	1 Year
Commercial paper other	Coded: orange (1yr) red (6mths) and green (3mths) on Links Matrix. Fitch's rating: Short-term F1, Long-term A-,	In-house	30%	1 Year

	Or equivalent rating from Standard & Poors and Moody's			
Corporate Bonds	Coded: orange (1yr) red (6mths) and green (3mths) on Links Matrix. Fitch's rating: Short-term F1, Long-term A-, Or equivalent rating from Standard & Poors and Moody's	In-house and Fund Managers	30%	1 Year
Floating Rate Notes:	Long-term AAA	Fund Managers	N/A – Capital Expenditure	N/A – Capital Expenditure
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)				
Corporate Bond Fund	-	In house and Fund Managers		

2. Maturities in excess of 1 year

Institution / Counterparty	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Term deposits – local authorities	--	In-house	30%	> 1 year
Term deposits – banks and building societies	Coded: Purple (2yrs)) on Links' Matrix. Fitch's rating: Short-term F1+, Long-term AA- Or equivalent rating from Standard & Poors and Moody's	In-house	30%	> 1 year
Certificates of deposits issued by banks and building societies	Coded: Purple(2yrs) on Links Matrix / Short-term F1+, Long-term AA-	Fund Managers	30%	> 1 year
Collaterised deposit	UK Sovereign rating	In-house and Fund Managers	30%	> 1 year

UK Government Gilts	UK Sovereign rating	In-house and Fund Managers	30%	> 1 year
Bonds issued by multilateral development banks	Long term AAA	In-house and Fund Managers	30%	> 1 year
Sovereign bond issues (i.e. other than the UK Government)	Long term AAA	In-house and Fund Managers	30%	> 1 year
Corporate Bonds	Long term AAA	In-house and Fund Managers	30%	> 1 year
Collective Investment Schemes structure as open Ended Investment Companies (OEICs)				
1. Bond Funds	Long-term AAA	In-house and Fund Managers	30%	> 1 year
2. Gilt Funds	Long-term AAA	In-house and Fund Managers	30%	> 1 year

ANNEX C2

APPROVED COUNTRIES FOR INVESTMENT
Current List as at 20 January 2021

Link Asset Services has advised that Councils should only use approved counterparties from countries with a minimum sovereign credit rating determined by the Council. This Council has determined that it will only use those countries with the sovereign rating of AA- or higher other than the UK where the Council has set no limit. This list will be monitored at least weekly (and for information purposes only, includes other sovereign ratings). This list is as at 20 January 2021.

Based on lowest available rating

AAA

- Australia
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France

AA-

- Belgium
- Hong Kong
- Qatar
- **U.K.**

ANNEX C3

ECONOMIC BACKGROUND

- UK. 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 (QE) 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 Rate – 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 Bank Rate forecast supplied by Link 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 due to base effects from twelve months ago falling out of the calculation, and so is not a concern. Looking further ahead, it is also unlikely to be a problem for some years as it will take a prolonged time for spare capacity in the economy, created by this downturn, to be used up.

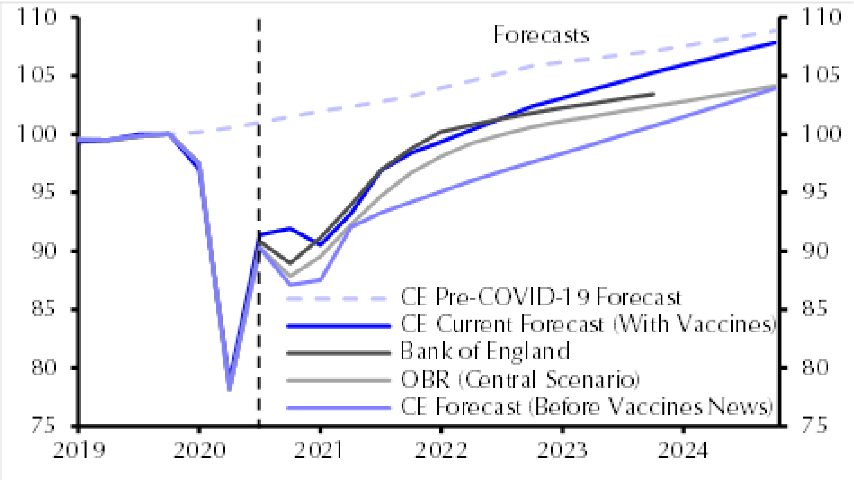
- Public borrowing was forecast in November by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of Gross Domestic Product. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so Public Works Loan Board rates. However, the quantitative easing done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with quantitative easing and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The Office for Budget Responsibility was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of Gross Domestic Product) by 2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery.

- 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. While the one month second national lockdown that started on 5th November caused a further contraction of 5.7% m/m in November, this was much better than had been feared and showed that the economy is adapting to new ways of working. This left the economy 'only' 8.6% below the pre-crisis level.

- Vaccines – the game changer. The Pfizer announcement on 9th November of a successful vaccine has been followed by approval of the Oxford University/AstraZeneca and Moderna vaccines. The Government has a set a target to vaccinate 14 million people in the most at risk sectors of the population by 15th February; as of mid-January, it has made good, and accelerating progress in hitting that target. The aim is to vaccinate all adults by September. This means that the national lockdown starting in early January, could be replaced by regional tiers of lighter restrictions, beginning possibly in Quarter 2. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines have radically improved the economic outlook so that it may now be possible for Gross Domestic Product to recover to its pre-virus level as early as Quarter 1 2022. These vaccines have enormously boosted confidence that life could largely return to normal during the second half of 2021. 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 when life returns to normal.

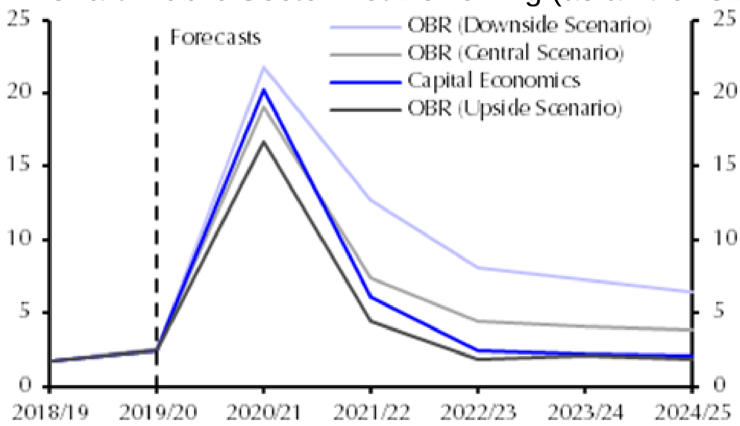
- Provided that both monetary and fiscal policy are kept loose for a few years yet, then it is still possible that in the second half of this decade, the economy may be no smaller than it would have been if COVID-19 never happened. The significant risk is if another mutation of COVID-19 appears that 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.

Chart: Level of real GDP   (Q4 2019 = 100)



This recovery of growth which eliminates the effects of the pandemic by about the middle of the decade, would have major repercussions for public finances as it would be consistent with the government deficit falling to around 2.5% of Gross Domestic Product without any tax increases. This would be in line with the Office for Budget Responsibilities most optimistic forecast in the graph below, rather than their current central scenario which predicts a 4% deficit due to assuming much slower growth. However, Capital Economics forecasts assumed that politicians do not raise taxes or embark on major austerity measures and so, (perversely!), depress economic growth and recovery.

Chart: Public Sector Net Borrowing (as a % of GDP)



- There will still be some painful longer term adjustments as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever, even if vaccines are fully successful in overcoming the current virus. There is also likely to be a reversal of globalisation as this crisis has exposed how vulnerable long-distance supply chains are. On the other hand, digital services are one area that has already seen huge growth.

- Brexit. The final agreement of a trade deal 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 17 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 to the economy that it had highlighted in November 2020. But this was caveated by it saying, "Although all members agreed that this would reduce downside risks, they placed different weights on the degree to which this was also expected to lead to stronger Gross Domestic Product growth in the central case." So, while vaccines are a positive development, in the eyes of the Monetary Policy Committee at least, the economy is far from out of the woods in the shorter term. The Monetary Policy Committee, therefore, voted to extend the availability of the Term Funding Scheme, (cheap borrowing), with additional incentives for small and medium size enterprises for six months from 30 April 2021 until 31 October 2021. (The Monetary Policy Committee had assumed that a Brexit deal would be agreed.)

- Fiscal policy. In the same week as the Monetary Policy Committee meeting, the Chancellor made a series of announcements to provide further support to the economy: -
  - An extension of the COVID-19 loan schemes from the end of January 2021 to the end of March.
  - The furlough scheme was lengthened from the end of March to the end of April.
  - The Budget on 3 March 2021 will lay out the "next phase of the plan to tackle the virus and protect jobs". This does not sound like tax rises are imminent, (which could hold back the speed of economic recovery).

- The Financial Policy Committee (FPC) report on 6 August 2020 revised down their expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its assessment, "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the Monetary Policy Committee's central projection". The Financial Policy Committee stated that for real stress in the sector, the economic output would need to be twice as bad as the Monetary Policy Committee's projection, with unemployment rising to above 15%.

- US. The Democrats gained the presidency and a majority in the House of Representatives in the November elections: after winning two key Senate seats in Georgia in elections in early January, they now also have a very slim majority in the Senate due to the vice president's casting vote. President Biden will consequently have a much easier path to implement his election manifesto. However, he will not have a completely free hand as more radical Democrat plans may not be supported by all Democrat senators. His initial radical plan for a fiscal stimulus of $1.9trn, (9% of GDP), is therefore likely to be toned down in order to get through both houses.

- 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. The 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, individual 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 declining in December, and retail sales dropping back. The economy is set for further weakness into the spring. 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. The Federal Open Market Committee's updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. 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 5 November was unremarkable - but at a politically sensitive time around the elections. At its 16 December meeting the Fed 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 seriously affected many countries. The €750bn fiscal support package eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the countries most affected by the first wave.

- 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 Pandemic Emergency Purchase Programme 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 (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 Pandemic Emergency Purchase Programme 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. At the same time, China's economy has benefited from the shift towards online spending by consumers in developed markets. These factors help to explain its comparative outperformance compared to western economies. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns in the longer term. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

- 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 has been in recession in 2020 and this is likely to continue into the first half of 2021 before recovery in the second half. 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.

- Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world Gross Domestic Product, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation.

Summary

Central banks are, therefore, likely to support growth by maintaining loose monetary policy through keeping rates very low for longer. Governments could also help a quicker recovery by providing more fiscal support for their economies at a time when total debt is affordable due to the very low rates of interest. They will also need to avoid significant increases in taxation or austerity measures that depress demand and the pace of recovery in their economies.

If there is a huge surge in investor confidence as a result of successful vaccines which leads to a major switch out of government bonds into equities, which, in turn, causes government debt yields to rise, then there will be pressure on central banks to actively manage debt yields by further quantitative easing purchases of government debt; this would help to suppress the rise in debt yields and so keep the total interest bill on greatly expanded government debt portfolios within manageable parameters. It is also the main alternative to a programme of austerity.

INTEREST RATE FORECASTS

Brexit. The interest rate forecasts provided by Link in paragraph 3.4 were predicated on an assumption of a reasonable agreement being reached on trade negotiations between the UK and the EU by 31 December 2020. There is therefore no need to revise these forecasts now that a trade deal has been agreed. Brexit may reduce the economy's potential growth rate in the long run. However, much of that drag is now likely to be offset by an acceleration of productivity growth triggered by the digital revolution brought about by the COVID crisis.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but is still subject to some uncertainty due to the virus and the effect of any mutations, and how quick vaccines are in enabling a relaxation of restrictions.
- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term Public Works Loan Board rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to

unexpected domestic developments and those in other major economies, could impact gilt yields, (and so Public Works Loan Board rates), in the UK.

Downside risks to current forecasts for UK gilt yields and Public Works Loan Board rates currently include:

- UK government takes too much action too quickly to raise taxation or introduce austerity measures that depress demand and the pace of recovery of the economy.
- UK - Bank of England takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the Eurozone sovereign debt crisis. The European Central Bank has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for “weaker” countries. In addition, the EU agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next two or three years. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to Gross Domestic Product and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.
- Weak capitalisation of some European banks, which could be undermined further depending on extent of credit losses resultant of the pandemic.
- German minority government & general election in 2021. In the German general election of September 2017, Angela Merkel’s Christian Democratic Union of Germany party was left in a vulnerable minority position dependent on the fractious support of the SPD (Social Democrat Party of Germany) party, as a result of the rise in popularity of the anti-immigration AfD party. Angela Merkel has stepped down from being the Christian Democratic Union of Germany party leader but she will remain as Chancellor until the general election in 2021. This then leaves a major question mark over who will be the major guiding hand and driver of EU unity when she steps down.
- Other minority EU governments. Italy, Spain, Austria, Sweden, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- Austria, the Czech Republic, Poland and Hungary now form a strongly anti-immigration bloc within the EU, and they had threatened to derail the 7 year EU budget until a compromise was thrashed out in late 2020. There has also been a rise in anti-immigration sentiment in Germany and France.
- Geopolitical risks, for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and Public Works Loan Board rates

- UK - a significant rise in inflationary pressures e.g. caused by a stronger than currently expected recovery in the UK economy after effective vaccines are administered quickly to the UK population, leading to a rapid resumption of normal life and return to full economic activity across all sectors of the economy.
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a rapid series of increases in Bank Rate to stifle inflation.