

Report of	Meeting	Date
Deputy Director of Finance/Section 151 Officer	Governance Committee	16 September 2020

TREASURY MANAGEMENT ANNUAL REPORT 2019/20 AND QUARTER ONE MONITORING 2020/21

PURPOSE OF REPORT

- To report on Treasury Management performance and compliance with Prudential Indicators for the financial year ended 31 March 2020.
- To present monitoring figures for the quarter ended 30 June 2020, including updated interest rate forecasts from Link Asset Services.

RECOMMENDATION(S)

- That the report be noted.

EXECUTIVE SUMMARY OF REPORT

- This report advises on compliance with Prudential and Treasury Indicators in 2019/20. The return on investments for the year was 0.64%, which exceeded the benchmark of 0.61%. Details of borrowing and investments as at 31 March 2020 are presented.
- Borrowings and investments as at 30 June 2020 are also presented, and Link Asset Services have provided updated interest rate forecasts for 2019/20 and subsequent financial years.

Confidential report Please bold as appropriate	Yes	No

CORPORATE PRIORITIES

- This report relates to the following Strategic Objectives:

Involving residents in improving their local area and equality of access for all		A strong local economy	
Clean, safe and healthy homes and communities		An ambitious council that does more to meet the needs of residents and the local area	√

BACKGROUND

- The Treasury Strategy for 2019/20 to 2021/22 was approved by Council on 26 February 2019. The strategy included prudential and treasury indicators, the treasury management strategy, annual investment strategy (including the list of approved investment

counterparties), and the annual Minimum Revenue Provision (MRP) Policy. A revised set of indicators was approved by Council on 23 July 2020.

8. A mid-year review of Treasury Management activity was presented to Governance Committee on 20 November 2019. This reported that, during the first half of 2019/20, a major asset purchase had been undertaken and that this had a number of treasury management implications, covering temporarily higher daily cash balances, increased levels of capital and associated borrowing and the approval by Council of a revised set of prudential indicators for the year.
9. On 25 February 2020 Council approved the Treasury Strategy for 2020/21 to 2022/23, which included revised prudential and treasury indicators for 2018/19. Where relevant, comparisons with 2019/20 indicators in this outturn report are to those approved most recently.
10. A glossary of technical terms used in this report is presented as Appendix J.

THE COUNCIL'S OVERALL BORROWING NEED

11. Capital Expenditure and Financing 2019/20

The Council undertakes capital expenditure on long-term activities. These activities may either be:

- financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- if sufficient financing is not available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure for 2019/20.

Table 1 - Capital Expenditure	2019/20 Estimate £000	2019/20 Revised £000	2019/20 Actual £000	2019/20 Variance £000
Customer & Digital	0	882	761	(121)
Early Intervention & Support	1,869	988	1,810	822
Policy & Governance	1,750	100	39	(61)
Business Development & Growth	10,367	44,598	43,440	(1,158)
Capital Expenditure Total	13,986	46,568	46,050	(518)

The large increase in the revised budget and actual levels of expenditure is attributable to the major asset purchase undertaken at the beginning of September 2020, at a cost of £33.7m.

Additional analysis of the schemes included in the 2019/20 Capital Programme was presented to Executive Cabinet on 30 July 2020 in the report 'Provisional Revenue and Capital Outturn 2019/20'.

Financing of the capital expenditure is shown in the following table.

Table 2 - Capital Financing	2019/20 Estimate £000	2019/20 Revised £000	2019/20 Actual £000	2019/20 Variance £000
Capital expenditure from Table 1	13,986	46,568	46,050	(518)
Capital Receipts	(410)	(243)	(233)	10
Grants & Contributions	(4,215)	(3,541)	(4,622)	(1,081)
Revenue and Reserves	(785)	(635)	(746)	(111)
Net financing needed for year	8,576	42,149	40,449	(1,700)

THE COUNCIL'S OVERALL BORROWING NEED

12. Capital Financing Requirement 2019/20

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the unfinanced capital expenditure in 2019/20 plus prior years' unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

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

The CFR is not matched in full by external borrowing, so the Council is said to have under borrowed by using its own cash balances to finance capital expenditure. There is some loss of interest as a result, but had external loans been taken, then the interest payable would have been at a higher rate. Use of the Council's own cash helps to achieve savings in net interest.

The Council's underlying borrowing need is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can be borrowed and repaid, but this does not change the CFR.

The total CFR can also be reduced by:

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

The 2019/20 MRP Policy (as required by MHCLG Guidance) was approved by Council as part of the Treasury Strategy 2019/20 to 2021/22 on 26 February 2019.

The Council's CFR for the year is shown in Table 3 below and represents a key prudential indicator. It includes financing by means of a finance lease for leisure related capital investment, which increases the Council's borrowing need.

Table 3 - Capital Financing Requirement	2019/20 Estimate £000	2019/20 Revised £000	2019/20 Actual £000	2019/20 Variance £000
Opening CFR	51,879	49,284	49,284	0
Net financing need for the year (Table 2)	8,576	42,149	40,449	(1,700)
Less MRP/VRP	(570)	(569)	(569)	0
Closing CFR	59,885	90,864	89,164	(1,700)

See also Note 36 Capital Expenditure and Financing in the Statement of Accounts 2019/20.

13. The CFR and Gross Debt

Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR. In order to ensure that borrowing levels are prudent over the medium term and are only for capital purposes, the Council ensures that its gross external borrowing does not, except in the short term, exceed the total of the CFR in the preceding year (2018/19) plus the estimates of any additional CFR for the current (2019/20) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator would allow the Council some flexibility to borrow in advance of its immediate capital needs, but this facility was not required in 2019/20.

In addition to its borrowing for capital purposes, at 31 March 2020 the Council also had short-term borrowing of £4.5m in respect of its immediate cash flow needs. This figure was higher than would normally be the case (the comparative figure for 2018/19 was £1m) because of the exceptional circumstances arising in March 2020, with the onset of the Covid 19 pandemic and the introduction of measures for the payment of support to local businesses. In order to do this promptly, payments were potentially to be made in advance of the receipt of the associated government funding and, although the gap was only of a few days, the amounts involved were significant and the funds immediately available were not sufficient to cover the potential outward cash flow. The cost of any alternative arrangements (eg an unplanned overdraft) likewise exceeded that for short-term borrowing.

On the basis that it did not relate to capital expenditure and in order to provide clarity in respect of the underlying position, Table 4 excludes reference to the £4.5m of temporary borrowing. The table shows the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

Table 4 - Portfolio Position	2019/20	2019/20	2019/20	2019/20
	Estimate £000	Revised £000	Actual £000	Variance £000
Debt at 1 April	24,879	19,990	19,990	0
Other long-term liabilities (OLTL)	15	15	15	0
Total gross debt 1 April	24,894	20,005	20,005	0
Change in Debt	11,392	44,046	44,036	(10)
Change in OLTL	0	0	0	0
Change in gross debt	11,392	44,046	44,036	(10)
Gross debt 31 March	36,286	64,051	64,041	(10)
Capital Financing Requirement (Table 3)	59,885	90,864	89,164	(1,700)
Under / (over) borrowing	23,599	26,813	25,123	(1,690)

An analysis of external borrowing as at 31 March 2020 is presented in Appendix A. The figures for short-term borrowing include accrued interest payable to lenders, so that the external borrowing matches the total shown in the Balance Sheet in the Statement of Accounts 2019/20.

The authorised limit. This is the “affordable borrowing limit” required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level, except that, under s5 of the Act, the authorised limit may be treated as increased in relation to any payment which:

- (i) is due to the authority which has not yet been received by it, and
- (ii) was not a delayed receipt of a payment which was taken into account when the limit was first arrived at

The revised limit set for 2019/20 by Council on 25 February 2020 was £70.915m and actual gross debt shown in Table 4 was £64.041m. Measured against this figure, which excludes the £4.5m of temporary borrowing, the Council has maintained gross borrowing within its authorised limit and this remains the case if the temporary borrowing is included. The facility provided by s5 of the Act was not, therefore, required.

The operational boundary. This is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached. The revised operational boundary set for 2019/20 was £67.515m and actual gross debt at 31 March 2020, including the £4.5m of short term borrowing, which was entered into on 27 March 2020, was £68.541m. The operational boundary was therefore exceeded by £1.026m for the final few days of the year but, as noted above, the authorised limit was not breached.

Actual financing costs as a proportion of net revenue stream. This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income), against the revenue stream (council tax, business rates, and various Government grants).

Table 5 - Ratio of Financing Costs to Net Revenue Stream	2019/20 Estimate %	2019/20 Actual %	2019/20 Variance %
Ratio	9.21	8.92	(0.29)

The actual ratio was slightly lower than estimated in 2019/20, because the outturn figure for the revenue stream was a little higher than had been forecast.

TREASURY POSITION AS AT 31 MARCH 2020

14. Treasury management debt and investment position

The Council's treasury management debt and investment position is organised to ensure adequate liquidity for revenue and capital activities, security for investments, and to manage risks within all treasury management activities. Gross debt is shown in Table 4, and Investments (including Cash and Cash equivalents but excluding accrued interest) are shown in Table 6.

Table 6 - Year-End Resources 2018/19	2019/20 Estimate £000	2019/20 Revised £000	2019/20 Actual £000	2019/20 Variance £000
Core Funds/Working Balances	(24,599)	(27,813)	(33,884)	(6,071)
Under/(over) borrowing (Table 4)	23,599	26,813	25,123	(1,690)
Investments	(1,000)	(1,000)	(8,761)	(7,761)

The working balances held at 31 March were higher than would normally be the case (the comparative figure for 2018/19 was £2.848m) because of the measures taken to ensure that sufficient funds were available to make the necessary payments of grant support to local businesses, in response to the onset of the Covid 19 pandemic (see under paragraph 13 above). A detailed analysis of Short Term Investments and Cash and Cash Equivalents is presented as Appendix B. Accrued interest is shown so that figures match those in the Balance Sheet and notes in the Statement of Accounts 2019/20. The maximum balance invested with each counterparty complied with the limit approved by the Council. Appendix C presents the approved counterparty limits for 2019/20.

Council approved a maximum of £4m should be invested with UK local authorities for more than 365 days and up to two years. No sums were invested for more than 365 days.

Table 7 - Maximum Principal Sums Invested > 365 Days	2019/20 Estimate £000	2019/20 Revised £000	2019/20 Actual £000	2019/20 Variance £000
UK Government	0	0	0	0
UK Local Authorities **	4,000	4,000	0	(4,000)
UK Banks & Building Societies	0	0	0	0
Non-UK Banks	0	0	0	0
Total	4,000	4,000	0	(4,000)

** Maximum of £2 million per local authority

INVESTMENT PERFORMANCE 2019/20

15. Review of Performance

Investment returns remained low during 2019/20. When the treasury management strategy for the year was approved, the expectation was that Bank Rate would rise from 0.75% to 1.00% in September 2020, but a combination of volatile economic growth figures and continuing uncertainty about the outcome of the Brexit process, together with other factors, meant that this did not occur. By the mid-year point, the expectation was that the increase would now be announced in December 2020, but this again proved not to be the case and the rate remained unchanged at 0.75% until late in March 2020, when it fell sharply, first to 0.25% and then to 0.10%, in response to the economic impacts of the Covid 19 pandemic. This has had a significant impact on investment rates which were already expected to be limited.

Given the relatively low returns available compared to borrowing rates, the Council has continued to achieve budget savings by maintaining a position of under borrowing, which means that it has used its own cash balances to finance capital expenditure rather than taking additional external loans.

Investment Policy. The Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by Council for 2019/20. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as ratings outlooks, credit default swaps, banks share prices etc.). Link Asset Services, the Council's treasury advisors, provide suggested investment durations for the approved counterparties. During 2019/20 cash was not invested in term deposits. To manage the Council's cash flow, balances were held only in highly liquid accounts, specifically in call accounts and MMFs.

Investment performance in 2019/20 is presented in Table 8.

Table 8 - Investment Performance 2019/20	Average Daily Investment £000	Interest 2019/20 £	Average Rate %
Fixed Term Deposits	0	0	n/a
Notice Accounts	0	0	n/a
Call Accounts	2,447	13,961	0.57
Money Market Funds	5,486	37,711	0.69
Debt Management Office DMADF	295	1,479	0.50
Total	8,229	53,151	0.64

The average return of 0.64% in 2019/20 compares to the 0.61% achieved in 2018/19, and reflects underlying interest rates that were of around the same general level for the whole of 2019/20, apart from in the final few days of the year (when they fell suddenly), as they were for two thirds of 2018/19, being marginally higher those in the first third of that year.

The average 7-day LIBID for 2019/20 was 0.53%. The target to exceed for 2019/20 was 7-day LIBID plus 15%, which was 0.61%. This was achieved.

Link Asset Services suggested a budgeted investment earnings rate of 0.75% for 2019/20, based on investment durations of up to three months. This was based on the assumption that the Bank of England's base rate would rise from 0.75% to 1.00% at the beginning of December 2019. As noted above, this change did not occur and the rate remained unchanged until late in March 2020, when it fell sharply in response to the economic impacts of the Covid 19 pandemic. The target was a challenging one, even when based on the original forecasts, because cash was held only in liquid accounts instead of being placed as term deposits, and ultimately it was not possible to achieve it.

MONITORING JUNE QUARTER 2020/21

16. Borrowing and Investments

External borrowing as at 30 June 2020 is presented in Appendix E. The temporary borrowing of £4.5m held at the beginning of the year has been repaid, as has a further temporary loan of £5m entered into in May. No additional longer term borrowing has been entered into, but it is expected that further loans will be entered into during the year. This will be to finance the capital programme and the borrowing has been budgeted for.

Investments as at 30 June 2020 are presented in Appendix F. Cash balances available to invest fluctuate throughout the year, depending on the timing of receipts and payments. Currently the balance is slightly higher than at 31 March 2020, and it is likely to be higher at points during the remainder of the financial year. However, the tendency is for the balance to reduce by 31 March.

Appendix G presents the counterparty limits for 2020/2. It is unlikely that cash will be invested in anything other than liquid accounts with instant access.

17. Prudential and Treasury Indicators and Investment Counterparty Limits

These remain unchanged from those approved by Council on 25 February 2020 and there are no current proposals for any changes.

ADVICE OF LINK ASSET SERVICES

18. Treasury Advisors' review of 2019/20 and forward looking commentaries

Link Asset Services' review of the Economy and Interest Rates in 2019/20 is presented as Appendix D.

A detailed economic commentary on developments during the quarter ended 30 June 2020 is presented as Appendix H.

Appendix I is a detailed commentary on interest rate forecasts. In order to provide continuity with the forecasts contained in the approved Strategy for 2019/20, two updates are included, the first issued at the end of March 2020 at the onset of the Covid 19 pandemic and the second issued in early August 2020. This includes an updated forecast for the rate of return on cash invested for 2020/21 and subsequent years. The suggested target rate for investment earnings in 2020/21 is now just 0.10%. Indications to date are that this is achievable, but this remains subject to substantial uncertainties.

IMPLICATIONS OF REPORT

19. This report has implications in the following areas and the relevant Directors' comments are included:

Finance	√	Customer Services	
Human Resources		Equality and Diversity	
Legal		Integrated Impact Assessment required?	
No significant implications in this area		Policy and Communications	

COMMENTS OF THE STATUTORY FINANCE OFFICER

20. This report meets statutory reporting requirements. Its statistical content is consistent with the Council's financial accounts for the financial year 2019/20.

COMMENTS OF THE MONITORING OFFICER

21. The Monitoring Officer has no comments.

JAMES THOMSON
DEPUTY DIRECTOR OF FINANCE/S151 OFFICER

Background Papers		
Document	Date	File
Treasury Strategy 2019/20 Treasury Strategy 2020/21	26/2/19 25/2/20	***

Report Author	Ext	Date
Tony Furber	5027	9 September 2020

APPENDIX A

External Borrowing 31 March 2020

Type of loan	Loan number	Start date	Maturity date	Interest Rate %	Short-Term Borrowing £000	Long-Term Borrowing £000	Total £000
PWLB loan - Annuity	502694	29/11/2013	26/11/2063	4.34	37	1,593	1,630
PWLB loan - Annuity	502695	29/11/2013	26/11/2043	4.18	68	1,680	1,748
PWLB loan - Annuity	502696	29/11/2013	26/11/2038	4.02	82	1,578	1,660
PWLB loan - Annuity	502697	29/11/2013	26/05/2033	3.69	106	1,400	1,506
PWLB loan - Annuity	502698	29/11/2013	26/05/2028	3.18	144	1,116	1,260
PWLB loan - Annuity	502699	29/11/2013	26/05/2023	2.42	219	556	775
PWLB loan - Maturity	506764	21/12/2017	21/12/2067	2.31	16	2,500	2,516
PWLB loan - EIP	506766	21/12/2017	21/12/2031	1.76	188	1,964	2,152
PWLB loan - EIP	508381	17/01/2019	17/01/2054	2.51	101	2,829	2,930
PWLB loan - EIP	508382	17/01/2019	17/01/2059	2.58	90	2,850	2,940
PWLB loan - EIP	509178	24/04/2019	24/04/2044	2.23	124	2,350	2,474
PWLB loan - Annuity	509641	09/08/2019	09/08/2059	1.87	630	31,170	31,800
PWLB loan - Annuity	509689	16/08/2019	16/08/2059	1.86	39	1,949	1,988
PWLB loan - EIP	509691	16/08/2019	16/08/2039	1.32	155	2,775	2,930
PWLB loan - EIP	165470	28/02/2020	28/02/2060	2.71	164	5,850	6,014
Public Works Loan Board total					2,163	62,160	64,323
Hertfordshire County Council					4,500	0	4,500
Local Authorities total					4,500	0	4,500
External Borrowing total					6,663	62,160	68,823

List of Investments as at 31 March 2020

Counterparty	Type	Sum Invested £000	Accrued Interest £000	Total 31	Rate %	Link	CBC	Date Invested	Maturity Date
				March 2019 £000		Suggested Duration	Approved Duration		
Barclays BPA Deposit Account	Call	2,788	0	2,788	0.10%	6 mths	6 mths	On Call	n/a
Other Cash Balances			22	22					
Call Accounts sub total		2,788	22	2,810					
Federated	MMF	1,700	0	1,700	0.36%	(1)	AAA-rated	On Call	n/a
Aberdeen Standard	MMF	3,000	0	3,000	0.43%	(1)	AAA-rated	On Call	n/a
BlackRock	MMF	2,000	1	2,001	0.37%	(1)	AAA-rated	On Call	n/a
Money Market Funds sub total		6,700	1	6,701					
Other Cash & Cash Equivalents Balance:		(578)		(578)					
Cash and Cash Equivalents		8,910	23	8,933					

Notes

(1) MMF rates are variable. This is the calculated average for the year to March

Investment Counterparties 2019/20

The original list of Investment Counterparties for 2019/20 was approved by Council on 26 February 2019. Amendments to this list, for a temporary period up until the completion of a specified major asset purchase, were approved by Council on 23 July 2019.

Applicable from 1 April 2019 to 23 July 2019 and from 3 September 2019 to 31 March 2020

Category	Institutions	LAS Colour Code	Maximum Period	Limit per Institution
Banks & Building Societies: Call Accounts / Term Deposits / Certificates of Deposit (CDs)				
Government related/guaranteed entities	DMADF (DMO)	Yellow	6 months	Unlimited
	UK Local Authority	Yellow	1 year 2 years	£3m per LA £2m per LA; £4m in total
UK part-nationalised institutions	Royal Bank of Scotland group	Blue	1 year	£4m per group
UK-incorporated Institutions	UK banks and building societies of high credit quality	Orange	1 year	£3m per group (or institution if independent)
		Red	6 months	
		Green	3 months	
Money Market Funds				
Money Market Funds (CNAV and LVNAV)	MMFs of high credit quality - AAA rated		Instant access	£3m per fund

Applicable from 24 July 2019 to 2 September 2019

Category	Institutions	LAS Colour Code	Maximum Period	Limit per Institution
Banks & Building Societies: Call Accounts /Term Deposits / Certificates of				
Government related/guaranteed	DMADF (DMO) UK Local Authority	Yellow Yellow	6 months 1 year 2 years	Unlimited £6m per LA £2m per LA; £4m in total
UK part-nationalised institutions	Royal Bank of Scotland group	Blue	1 year	£6m per group
UK-incorporated Institutions	UK banks and building societies of high credit quality	Orange	1 year	£6m per group (or institution if independent)
		Red	6 months	
		Green	3 months	
Money Market Funds				
Money Market Funds (CNAV and LVNAV)	MMFs of high credit quality - AAA rated		Instant access	£6m per fund

Maximum durations suggested by Link Asset Services (LAS)

Yellow	5 years
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

The Economy and Interest Rates 2019/20

UK. Brexit. The main issue in 2019 was the repeated battles in the House of Commons to agree on one way forward for the UK over the issue of Brexit. This resulted in the resignation of Theresa May as the leader of the Conservative minority Government and the election of Boris Johnson as the new leader, on a platform of taking the UK out of the EU on 31 October 2019. The House of Commons subsequently frustrated that objective and so a general election was held in December. This resulted in a decisive victory for the Conservative Party, as a result of which the UK left the EU on 31 January 2020. However, this still leaves much uncertainty as to whether there will be a reasonable trade deal achieved by the target deadline of the end of 2020.

Economic growth in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 down at -0.2%, quarter 3 bouncing back up to +0.5% and quarter 4 flat at 0.0%, +1.1% y/y. 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election in December. However, the three monthly GDP statistics in January were disappointing, being stuck at 0.0% growth. Since then, the whole world has changed as a result of the **coronavirus outbreak**. It now looks likely that the closedown of whole sections of the economy will result in a fall in GDP of at least 15% in quarter two. What is uncertain, however, is the extent of the damage that will be done to businesses by the end of the lock down period, when the end of the lock down will occur, whether there could be a second wave of the outbreak, how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover.

After the Monetary Policy Committee raised **Bank Rate** from 0.5% to 0.75% in August 2018, Brexit uncertainty caused the MPC to sit on its hands and to do nothing until March 2020; at which point it was abundantly clear that the coronavirus outbreak posed a huge threat to the economy of the UK. Two emergency cuts in Bank Rate from 0.75% occurred in March, first to 0.25% and then to 0.10%. These cuts were accompanied by an increase in quantitative easing (QE), essentially the purchases of gilts (mainly) by the Bank of England of £200bn. The Government and the Bank were also very concerned to stop people losing their jobs during this lock down period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs for three months while the country was locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lock down period when some firms may have little or no income. However, at the time of writing, this leaves open a question as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services. At the time of writing, this is a rapidly evolving situation so there may be further measures to come from the Bank and the Government in April and beyond. The measures to support jobs and businesses already taken by the Government will result in a huge increase in the annual budget deficit in 2020/21 from 2%, to nearly 11%. The ratio of debt to GDP is also likely to increase from 80% to around 105%. In the Budget in March, the Government also announced a large increase in spending on infrastructure; which will also help the economy to recover once the lock down is ended. Provided the coronavirus outbreak is brought under control relatively swiftly, and the lock down is eased, then it is hoped that there will be a sharp recovery, but one that would take a prolonged time to fully recover previous lost momentum.

Inflation has posed little concern for the MPC during the last year, being mainly between 1.5 – 2.0%. It is also not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil, which has fallen sharply in price. Other prices will also be under downward pressure while wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.

Employment had been growing healthily through the last year but it is obviously heading for a big hit in March – April 2020. The good news over the last year is that wage inflation has been significantly higher than CPI inflation which means that consumer real spending power had been increasing and so will have provided support to GDP growth. However, while people cannot leave their homes to do non-food shopping, retail sales will also take a big hit.

USA. Growth in quarter 1 of 2019 was strong at 3.1% but growth fell back to 2.0% in quarter 2 and 2.1% in quarters 3 and 4. The slowdown in economic growth resulted in the Fed cutting rates from 2.25-2.50% by 0.25% in each of July, September and October. Once the coronavirus outbreak started to impact the US in a big way, the Fed took decisive action by cutting rates twice by 0.50%, and then 1.00%, in March, all the way down to 0.00 – 0.25%. Near the end of March, Congress agreed a \$2trn stimulus package (worth about 10% of GDP) and new lending facilities announced by the Fed which could channel up to \$6trn in temporary financing to consumers and firms over the coming months. Nearly half of the first figure is made up of permanent fiscal transfers to households and firms, including cash payments of \$1,200 to individuals.

The loans for small businesses, which convert into grants if firms use them to maintain their payroll, will cost \$367bn and 100% of the cost of lost wages for four months will also be covered. In addition there will be \$500bn of funding from the Treasury's Exchange Stabilization Fund which will provide loans for hard-hit industries, including \$50bn for airlines.

However, all this will not stop the US falling into a sharp recession in quarter 2 of 2020; some estimates are that growth could fall by as much as 40%. The first two weeks in March of initial jobless claims have already hit a total of 10 million and look headed for a total of 15 million by the end of March.

EUROZONE. The annual rate of GDP growth has been steadily falling, from 1.8% in 2018 to only 0.9% y/y in quarter 4 in 2019. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in EZ growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), prompted the ECB to take new measures to stimulate growth. At its March 2019 meeting it announced a third round of TLTROs; this provided banks with cheap two year maturity borrowing every three months from September 2019 until March 2021. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting in September 2019, it cut its deposit rate further into negative territory, from -0.4% to -0.5% and announced a resumption of quantitative easing purchases of debt to start in November at €20bn per month, a relatively small amount, plus more TLTRO measures. Once coronavirus started having a major impact in Europe, the ECB took action in March 2020 to expand its QE operations and other measures to help promote expansion of credit and economic growth.

What is currently missing is a coordinated EU response of fiscal action by all national governments to protect jobs, support businesses directly and promote economic growth by expanding government expenditure on e.g. infrastructure; action is therefore likely to be patchy.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium-term risks have also been increasing. The major feature of 2019 was the trade war with the US. However, this has been eclipsed by being the first country to be hit by the coronavirus outbreak; this resulted in a lock down of the country and a major contraction of economic activity in February-March 2020. While it appears that China had contained the virus by the end of March, these are still early days to be confident and it is clear that the economy is going to take some time to recover its previous rate of growth. Ongoing economic issues remain, in needing to make major progress to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. It also needs to address the level of non-performing loans in the banking and credit systems.

JAPAN has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It appears to have missed much of the domestic impact from the coronavirus in 2019-20 but the virus was then at an early stage there.

WORLD GROWTH. The trade war between the US and China on tariffs was a major concern to financial markets and was depressing worldwide growth during 2019, as any downturn in China would spill over into impacting countries supplying raw materials to China. Concerns were particularly focused on the synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during 2019. In 2020, coronavirus is the big issue which is going to sweep around the world and have a major impact in causing a world recession in growth in 2020.

External Borrowing 30 June 2020

Type of loan	Loan number	Start date	Maturity date	Interest Rate %	Total Borrowing £000
PWLB loan - Annuity	502694	29/11/2013	26/11/2063	4.34	1,599
PWLB loan - Annuity	502695	29/11/2013	26/11/2043	4.18	1,702
PWLB loan - Annuity	502696	29/11/2013	26/11/2038	4.02	1,608
PWLB loan - Annuity	502697	29/11/2013	26/05/2033	3.69	1,443
PWLB loan - Annuity	502698	29/11/2013	26/05/2028	3.18	1,182
PWLB loan - Annuity	502699	29/11/2013	26/05/2023	2.42	663
PWLB loan - Maturity	506764	21/12/2017	21/12/2067	2.31	2,500
PWLB loan - EIP	506766	21/12/2017	21/12/2031	1.76	2,054
PWLB loan - EIP	508381	17/01/2019	17/01/2054	2.51	2,914
PWLB loan - EIP	508382	17/01/2019	17/01/2059	2.58	2,925
PWLB loan - EIP	509178	24/04/2019	24/04/2044	2.23	2,400
PWLB loan - Annuity	509641	09/08/2019	09/08/2059	1.87	31,719
PWLB loan - Annuity	509689	16/08/2019	16/08/2059	1.86	1,983
PWLB loan - EIP	509691	16/08/2019	16/08/2039	1.32	2,925
PWLB loan - EIP	165470	28/02/2020	28/02/2060	2.71	6,000
Public Works Loan Board total					63,617
None					0
Local Authorities total					0
External Borrowing total					63,617

List of Investments as at 30 June 2020

Counterparty	Type	Total 30 June 2019 £000	Rate %	Link Suggested Duration	CBC Approved Duration	Date Invested	Maturity Date
Barclays BPA Deposit Account	Call	1,262	0.60%	6 mths	6 mths	On Call	n/a
Call Accounts sub total		1,262					
Federated	MMF	2,538	0.26%	(1)	AAA-rated	On Call	n/a
Aberdeen Standard	MMF	3,000	0.33%	(1)	AAA-rated	On Call	n/a
Blackrock	MMF	2,112	0.28%	(1)	AAA-rated	On Call	n/a
Money Market Funds sub total		7,651					
Cash Balance		8,912					
		(3,386)					

Notes

(1) MMF rates are variable. This is the calculated average for the year to June

Investment Counterparties 2020/21

Category	Institutions	LAS Colour Code	Maximum Period	Limit per Institution
Banks & Building Societies: Call Accounts /Term Deposits / Certificates of Deposit (CDs)				
Government related/guaranteed entities	DMADF (DMO)	Yellow	6 months	Unlimited
	UK Local Authority	Yellow	1 year 2 years	£3m per LA £2m per LA; £4m in total
UK part-nationalised institutions	Royal Bank of Scotland group	Blue	1 year	£4m per group
UK-incorporated Institutions	UK banks and building societies of high credit quality	Orange	1 year	£3m per group (or institution if independent)
		Red	6 months	
		Green	3 months	
Money Market Funds				
Money Market Funds (CNAV and LVNAV)	MMFs of high credit quality - AAA rated		Instant access	£3m per fund

Maximum durations suggested by Link Asset Services (LAS)

Yellow	5 years
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

Detailed economic commentary on developments during quarter ended 30 June 2020

During the quarter ended 30 June 2020 (*quarter 2 of 2020*):

- GDP fell by 25% at the height of the lockdown in April;
- The epidemic in the UK was brought under control resulting in some relaxation of the lockdown in May and June;
- Consumer spending rebounded strongly in May;
- There was growing evidence that employment had fallen despite the furlough scheme;
- The UK formally notified the EU that it will not extend the Brexit transition period past 31 December.
- Calm has returned to financial markets, with gilt yields falling and equities making a partial recovery.

The initial recovery from the coronavirus appears to have been a bit quicker than we anticipated but with signs that unemployment has already jumped higher, and social distancing likely to be in place for some time, the next leg of the recovery will probably be a slower process. As a result, loose fiscal policy looks like it will be sustained, and we doubt that the latest £100bn expansion of the Bank of England's quantitative easing (QE) program will mark the end of the monetary stimulus package.

The lockdown has been effective in bringing the coronavirus under control in the UK, with the number of deaths falling from over 900 per day in mid-April to around 130 per day at the end of June. And while there have been some local flare ups, there is no sign of a resurgence in cases at the national level. As a result, the government began to ease the lockdown: -

- 13 May - the Government urged those who could not work from home to return to work
- 1 June - outdoor markets and car showrooms were allowed to reopen while some children were able to return to school
- 15 June - most non-essential shops were permitted to open.

At its height, the lockdown led to an unprecedented **25% reduction in economic activity**, making the coronavirus crisis by far the deepest recession on record. GDP fell by 5.8% in March as lockdown measures were introduced in the last week of the month and then by another 20.4% in April. In the worst-affected sector, accommodation and food services, output fell by a staggering 92%. But output was devastated throughout the economy, with GDP down by about 20% in the services and industrial sectors and down by 40% in construction.

As the lockdown started to be eased, activity rebounded strongly. Having fallen by 22.7% from pre-virus levels, retail sales recovered almost half of their peak-to-trough fall in May, driven by continued strong online sales and the reopening of DIY stores. The flash composite IHS Markit Purchasing Managers Index rose from 13.8 in April to 30.0 in May and 47.6 in June. While technically the survey compares activity to the previous month, with a reading of less than 50 signalling contraction, many respondents appear to be giving an indication of how activity compares to normal levels as opposed to the tightly defined question they are asked. As a result, the PMIs support other evidence that suggests that the low point for activity was reached in April, and that activity began to recover in May and took another step up in June.

That said, faster indicators show that **the economy was still operating substantially below pre-virus levels at the end of the quarter**. While on a gradual upward trend, the daily measures of economic activity that we track, such as mobility, are still well below pre-virus levels and suggest that the recovery in the UK is lagging behind that in other countries. What's more, at the end of May, 15% of companies were still closed according to the ONS's Business Impact of Coronavirus Survey and most of those that were opened reported much lower revenue than normal.

The lockdown has prevented the Office for National Statistics from collecting the prices of many items, but it is clear that **inflation has fallen**. CPI inflation dropped to **a four-year low of 0.5% in May**, partly due to the collapse in the Brent Crude oil price from \$60 to \$20 and partly due to weaker core inflation. The oil price has since recovered to \$40. But we suspect that the downward influence on core inflation from the recent plunge in economic activity will persist. As a result, inflation will probably stay close to 0.5% for the next year. And even when the economy recovers, we think that low wage growth will mean inflation doesn't climb much above 1.0%.

Thus far the headline labour market data have not captured the full impact of the crisis. In the three months to April the unemployment rate was unchanged at 3.9%. That is partly because of the huge take-up of the government's furlough scheme. 9.3 million employees have been furloughed and 2.6 million self-employed workers have been given grants, which together accounts for 35% of the workforce. But it's also because the release of official labour lags well behind real time. The timelier (experimental) monthly data show that employment fell by 429,000 m/m in April and data from HMRC suggests another 171,000 people lost their jobs in May. Meanwhile, **the claimant count measure of unemployment shot up from 1.2m to 2.8m between March and May**, pushing the claimant count unemployment rate up from 3.5% to 7.8% - its highest level since 1996. Note, though, that the government has made universal credit more generous during the crisis, so the claimant count figures maybe overestimating unemployment.

While the furlough scheme has mitigated most of the impact of the pandemic, there have clearly already been big consequences for the labour market. While the Government has pushed back the end of the scheme from June to October, it will taper support from August. As a result, we suspect that that will cause firms to lay off more workers. **We expect the unemployment rate to rise to a peak of 6.7% next year**.

Meanwhile, government loan schemes have ensured that, unlike in the Great Financial Crisis, **companies have been able to access credit**. Outstanding lending to businesses increased by £40bn (9.4%) between February and May. While large companies were able to draw down existing credit lines in March, there is no doubt that the government's loan schemes have been effective, particularly in providing small firms with loans.

Even before allowing for some government-guaranteed loans going bad, the fiscal cost of the crisis is eye watering. The government debt-to-GDP ratio exceeded 100% for the first time in over 50 years in May. And we expect the deficit to be £330bn (17% of GDP) in the 2020/21 fiscal year which would **push the debt ratio up to around 105% of GDP**. **But seeing as we expect interest rates to remain at 0.10% for the foreseeable future, we think this higher level of debt will prove sustainable**, and that the government is right to keep fiscal policy loose in order to support the recovery. The bond market has taken the required gilt issuance, including the DMO's announcement at the end of June that it will issue a further £50bn of gilts in August, in its stride, despite the Bank of England reducing the pace of QE in June.

Having successfully resolved market dislocation in March with the cut in interest rates to 0.10% and £200bn of QE among other measures, **the Monetary Policy Committee's (MPC's) focus switched from providing liquidity to supporting demand at its June meeting**. As the pace of the initial rebound in activity has been faster than the MPC anticipated, Andy Haldane, the most optimistic member of the Committee, is hopeful that there will be a quick recovery limiting the fall in employment and the need for more

stimulus. But like us, the majority of the Committee appear worried that it will be difficult for “furloughed workers to be reabsorbed into employment” at the end of the scheme, leading to persistent labour market slack and putting downward pressure on inflation. **As a result, the Committee voted 8-1 in favour of a £100bn increase in QE, taking the total stock of QE gilt purchases to £745bn.**

Crucially, the Bank announced that it will complete the remainder of its announced purchases by the end of the year, implying a reduction in the pace of gilt purchases from around £14bn per week to £4bn. **So rather than buying up the equivalent of all net gilt issuance, as it has done since March, QE purchases will now be equivalent to about a third of net gilt issuance.**

Despite this, the improvement in financial market conditions seen since March has been sustained. The 10-year gilt yield has remained very low at around 0.2%, corporate bond spreads are almost back to their pre-coronavirus levels and the FTSE 100 has recovered almost half of its 33% slump in February and March. Our forecast, based on a continued return of risk appetite as the economy recovers from the coronavirus crisis, is for the FTSE 100 and the pound to rise further this year.

However, the stalling in the recovery in global equities due to the rise in virus cases in the US highlights the downside risks. And the UK government’s formal rejection of an extension to the transition period beyond December 31st 2020 means another risk is looming. We have changed our Brexit assumption from an extension of the transition period to assuming that a slim trade in goods deal is concluded by the end of the year, and that a big step change in the UK-EU relationship will be avoided. But the chance of no deal being agreed is also significant. Even if there is a deal, there may be some disruption at the turn of the year. And if there is a no deal, then Brexit will act as a bigger drag on economic growth. **So, whether a deal is agreed or not, Brexit will have a role to play in the economy’s performance.**

Updated Interest Rate Forecasts 2020/21

11th August 2020

Updating of our forecasts 11.8.20

- There are no changes to our Bank Rate forecasts.
- There is very little change to our forecasts for PWLB rates and only by a few changes of 10 bps.
- We have updated our previous forecasts for LIBID rates as financial markets have moved lower since our previous newsflash. However, as LIBOR rates will cease from the end of 2021, there are no forecasts for 2022 and 2023. We will be continuing to look at market developments in this area and will monitor these with a view to communicating with you when agreement is reached on how to replace LIBOR.
- Please note that we have made a slight change to our interest rate forecasts table below. Traditionally, we have used 3m LIBID forecasts, with the rate calculated using market convention of 1/8th (0.125%) taken off the LIBOR figure. Given that 3m LIBOR is currently running below 10bps, that would give a figure of around 0% to somewhere modestly into negative territory. However, the liquidity premium that is still in evidence at the short end of the curve means that 3m rates actually being achieved by investors is still modestly in positive territory. While there are differences between counterparty offer rates, our analysis would suggest that an average rate of around 10bps should be achievable.

Our PWLB rate forecasts are based on the Certainty Rate (minus 20 bps) which has been accessible to most authorities since 1st November 2012. The table below is for PWLB Certainty Rates for non-HRA borrowing (currently gilts plus 180 basis points). The Treasury consultation on reviewing PWLB margins and lending ended on 31st July. We expect that the Non-HRA Certainty Rate will be subject to revision downwards post the PWLB Consultation Paper conclusion but we don't know the precise timing of that i.e. we would expect it to be somewhere between this August and March next year.

Link Group Interest Rate View 11.8.20											
	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month average earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-
6 Month LIBID	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-
12 Month LIBID	0.20	0.20	0.20	0.20	0.20	0.20	0.20	-	-	-	-
5yr PWLB Rate	1.90	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

In addition, the following rates also apply:

- **PWLB Standard Rate** is gilts plus 200 basis points (G+200bps)
- **PWLB HRA Standard Rate** is gilts plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilts plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

As expected, the Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 6th August. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:

- The fall in **GDP** in the first half of 2020 of 28% was revised upwards to 23%. This is still one of the largest falls in output of any developed nation but is only to be expected as the UK economy is heavily skewed towards consumer facing services – an area which was particularly vulnerable to being damaged by lockdown.

- The peak in the **unemployment rate** was revised down from 9% in Q2 to 7½% by Q4 2020.
- It forecast that there would be excess demand in the economy by Q3 2022 causing **CPI inflation** to rise above the 2% target in Q3 2022, (based on market interest rate expectations for a further loosening in policy). But even if the Bank were to leave policy unchanged, inflation was still projected to be above 2% in 2023.

It also squashed any idea of using **negative interest rates**, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be “less effective as a tool to stimulate the economy” at this time when banks are worried about future loan losses. It also has “other instruments available”, including QE and forward guidance.

The MPC still expects the £300bn of **quantitative easing** purchases announced between the March and June meetings to continue until the “turn of the year”. This implies that the pace of purchases will slow further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.

In conclusion, this would indicate that the Bank can now just sit on its hands as the economy is recovering better than expected. However, the MPC acknowledged that the “medium-term projections were a less informative guide than usual” and the minutes had multiple references to **downside risks**, which were judged to persist both in the short and medium term. One has only to look at the potential for a second wave of the virus to see the dangers. However, rather than a national lockdown, as in March, any spikes in virus infections are now likely to be dealt with by localised measures and this will limit the amount of economic damage caused. In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery. The wind down in the furlough scheme through to the end of October is another development that could cause the Bank to review the need for more support for the economy later in the year. If the Bank felt it did need to provide further support to recovery, then it is likely that the weapon of choice would be more QE. Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. There will also be some painful longer term adjustments as e.g. office space and travel by planes, trains and buses may not recover their previous level of use for several years or possibly ever. There is also likely to be a reversal of globalisation as this crisis has shown up how vulnerable long distance supply chains are. On the other hand, digital services is one area that has already seen huge growth.

One new key addition to **forward guidance** 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 MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistent if it takes no action to raise Bank Rate. In this connection, there has been much discussion by forecasters of the main central banks moving to an average inflation rate target i.e. periods above the target are acceptable.

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

EU. The economy was recovering well towards the end of Q2 after a sharp drop in GDP. However, there are growing fears of a second wave of the virus that could cause a renewed collapse in activity.

US. The incoming sets of data during the first week of August were almost universally stronger than expected. With the number of new daily coronavirus infections beginning to abate, recovery should continue over the coming months and employment growth should pick up again too. The

increase in tension between the US and China is likely to lead to a lack of momentum in developing on the initial positive moves to agree a phase one trade deal.

China. After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2. However, this was boosted 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 poor economic returns and so lead to a further misallocation of resources which will weigh on growth in future years.

Japan. It looks as if a second wave of the virus is gaining momentum and could damage economic growth further.

World growth. Latin America and India are currently hotspots for virus infections. World growth will be in recession this year.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably relatively even but is subject to major uncertainty due to the virus.
- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates while the Bank of England has ruled out the use of negative interest rates and increases in Bank Rate are likely to be some years away. However, it is always possible that safe haven flows, due to unexpected developments in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- **UK / EU trade negotiations** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **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 ECB has taken monetary policy action to support the bonds of weaker EU states, especially Italy. In addition, the EU recently agreed a €750bn support package for weaker states. These actions will shield Italy for the next year or so. However, the cost of the virus crisis has added to Italy's 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.
- Weak capitalisation of some **European banks**, particularly Italian banks.
- **German minority government**. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in recent state elections but the SPD has done particularly badly and this has raised a major question mark over continuing to support the CDU. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until the general election in 2021.
- **Other minority EU governments**. Austria, Sweden, Spain, 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. There has also been rising 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 PWLB rates

- **Post-Brexit** – if agreement was reached all round that removed all threats of economic disruption between the EU and the UK.
- 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 later rapid series of increases in Bank Rate faster than we currently expect.

- **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

LINK GROUP FORECASTS

We do not think that the MPC will increase Bank Rate during the current and next two financial years as we expect the economy to take a prolonged period to recover momentum after the Covid crisis.

Forecasts for average investment earnings beyond the three year time horizon will be heavily dependent on economic and political developments.

Gilt yields and PWLB rates

The general situation is for volatility in bond yields to endure as investor fears and confidence ebb and flow between favouring relatively more “risky” assets i.e. equities, or the “safe haven” of government bonds. The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently, although there are likely to also be periods of sharp volatility from time to time.

Our forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU, (apart from the departure of the UK), within our forecasting time period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

Our target borrowing rates and the current PWLB (certainty) borrowing rates are set out below.

PWLB debt	Current borrowing rate as at 10.8.20	Target borrowing rate now (end of Q3 2020)	Target borrowing rate previous (end of Q3 2020)
5 year	1.74%	1.90%	1.90%
10 year	1.96%	2.10%	2.10%
25 year	2.50%	2.50%	2.50%
50 year	2.30%	2.30%	2.30%

Borrowing advice: since November 2018, PWLB rates have fallen significantly up until 100 bps were added to all PWLB rates in October 2019. As our long-term forecast for Bank Rate is 2.00%, and PWLB certainty rates are close to or above 2.00%, there is little near-term value in borrowing from the PWLB at present, particularly until it is clear what the new non-HRA borrowing rate will look like after HM Treasury concludes its review of the PWLB Consultation Paper responses. Accordingly, clients will need to reassess their risk appetite in terms of either seeking cheaper alternative sources of long-term borrowing or switching to short term borrowing in the money markets until such time as the Government might possibly reconsider the margins charged over gilt yields. Please speak to your CRM to discuss alternative borrowing sources available. Our suggested budgeted investment earnings rates for investments up to about three months duration in each financial year for the next six years are as follows:

Average earnings in each year	Now	Previously
2020/21	0.10%	0.10%
2021/22	0.10%	0.10%
2022/23	0.10%	0.10%
2023/24	0.25%	0.25%
2024/25	0.75%	0.75%
Long term later years	2.00%	2.00%

The long term later years forecast in the table above is an indicator for 10 years+.

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts. The general expectation for an eventual trend of gently rising gilt yields is unchanged. Negative, (or positive), developments could significantly impact safe haven flows of investor money into UK, US and German bonds and produce shorter term movements away from our central forecasts.

Our interest rate forecast for Bank Rate is in steps of 25 bps whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps.

Naturally, we continue to monitor events and will update our forecasts as and when appropriate.

30th March 2020

Updating of our forecasts 30.03.20

Comparison of forecasts for Bank Rate today v. previous forecast								
	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
30.3.20	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
31.1.20	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00
change	-0.65	-0.65	-0.65	-0.65	-0.90	-0.90	-0.90	-0.90

The world has changed considerably since we undertook our last interest rate forecasts and newsflash on 31 January. We are now in a completely different environment where interest rate forecasting is much more problematic and tentative than it is in normal circumstances. The scale of both Government and Central Bank intervention that we have recently seen is historic in its magnitude. What you find in this newsflash, therefore, is a set of forecasts that reflect the latest known situation with regard to coronavirus, and its likely impact on economies around the world given the unprecedented lock-downs now being put in place by many governments.

The new set of forecasts will be subject to change if materially new information/policies come to light. Pragmatically, we are also only going to give forecasts for two years ahead in view of the exceptional levels of uncertainty at the current time.

For now, we are making an assumption that the coronavirus will be “defeated” in the UK over a 6 to 12 months period, either through lock-downs and/or the invention and distribution to the general population of a vaccine. However, no one can be 100% confident that the virus will not return before a vaccine is available and widely used, and so there may be a requirement for further lock-downs despite all our best efforts. In addition,

- We can expect to see on-going market volatility, and therefore the potential for on-going Government and Central Bank intervention as required, for perhaps up to a year but also possibly longer;
- The MPC will aim for very loose monetary policy, primarily through the use of quantitative easing, in order to maintain low yields/funding costs to help support businesses and to also maintain appropriate levels of liquidity;
- We will, therefore, most likely have a very flat yield curve for at least a year before investors are sufficiently confident to push for higher yields in order to hold existing and additional debt incurred in putting measures in place to fight coronavirus.
- Bank Rate will stay at 0.1% for the next two years and any yield steepening will only arise after it is apparent that the end of the coronavirus epidemic is in sight;
- The measures recently introduced by Government to underpin the job security of both PAYE workers and the self-employed will be extended past 12 weeks if necessary;
- Inflation will stay below 2% and wage increases will be tepid in the face of economic uncertainty and a steady rise in unemployment;
- The economy is likely to take a considerable time to recover lost momentum;
- Brexit will still go ahead but the original timeframe may be impacted;
- There will be a recession in world growth in 2020; growth is unlikely to recover quickly.

LINK ASSET SERVICES' FORECASTS

Gilt yields and PWLB rates

The general situation is for volatility in bond yields to endure as investor fears and confidence ebb and flow between favouring relatively more “risky” assets i.e. equities, or the “safe haven” of government bonds. The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently.

Our forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU, (apart from the departure of the UK), within our forecasting time period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China, North Korea and Iran, which have a major impact on international trade and world GDP growth.

Our revised forecasts are based on the Certainty Rate (minus 20 bps) which has been accessible to most authorities since 1st November 2012.

The table below is for PWLB Certainty Rates for non-HRA borrowing (currently gilts plus 180 basis points).

Link Asset Services Interest Rate View								
	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month LIBID	0.45	0.40	0.35	0.30	0.30	0.30	0.30	0.30
6 Month LIBID	0.60	0.55	0.50	0.45	0.40	0.40	0.40	0.40
12 Month LIBID	0.75	0.70	0.65	0.60	0.55	0.55	0.55	0.55
5yr PWLB Rate	1.90	1.90	1.90	2.00	2.00	2.00	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50

In addition, the following rates also apply:

- **PWLB Standard Rate** is gilts plus 200 basis points (G+200bps)
- **PWLB HRA Standard Rate** is gilts plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilts plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

Our target borrowing rates and the current PWLB Certainty Rates are set out below.

PWLB debt	Current borrowing rate as at 30.03.20	Target borrowing rate now (end of Q2 2020)	Target borrowing rate previous (end of Q2 2020)
5 year	1.91%	1.90%	2.30%
10 year	2.08%	2.10%	2.50%
25 year	2.56%	2.50%	3.00%
50 year	2.28%	2.30%	2.90%

Borrowing advice: As our long-term forecast for Bank Rate is now 2.00%, and all PWLB Certainty Rates (gilts plus 180bps), are close to or above 2.00%, there is reduced value in borrowing from the PWLB at present unless it is borrowing which would be eligible for the lower margins over gilts of 100, 80 or 60bps, or unless certainty against budgetary provision is required. (Please note the Government Consultation in respect of the future rates to be offered on General Fund PWLB borrowing closes on 4 June.).

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts. Negative, (or positive), developments could significantly impact safe haven flows of investor money into UK, US and German bonds and produce shorter term movements away from our central forecasts.

Our interest rate forecast for Bank Rate is normally in steps of 25 bps whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps.

Naturally, we continue to monitor events and will update our forecasts as and when appropriate.

Glossary of Terms

Authorised Limit – represents the limit beyond which borrowing is prohibited, and needs to be set and revised by the Council. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need, with some headroom for unexpected movements.

Bank Rate – the rate at which the Bank of England offers loans to the wholesale banks, thereby controlling general interest rates in the economy.

Capital expenditure – material expenditure on capital assets, such as land and buildings, capitalised in accordance with regulations.

Capital Financing Requirement (CFR) – the level of capital expenditure to be financed from borrowing. This requirement will eventually be met by revenue resources through the Minimum Revenue Provision (MRP) mechanism.

CIPFA – Chartered Institute of Public Finance and Accountancy

Counterparty – the other party involved in a borrowing or investment transaction.

Credit Rating – a qualified assessment and formal evaluation of the credit history and capability of repaying obligations of an institution (bank or building society). It measures the probability of the borrower defaulting on its financial obligations, and its ability to repay these fully and on time. Ratings are prepared by Finch, Moody's and Standard & Poor's, and these are monitored by Link Asset Services.

Gilt - is a UK Government liability in sterling, issued by HM Treasury and listed on the London Stock exchange.

Liquidity – the ability of an asset to be converted into cash quickly and without any price discount. The more liquid an organisation is, the better able it is to meet short term financial obligations.

LIBID – London Interbank Bid Rate - the interest rate at which London banks ask to pay for borrowing Eurocurrencies from other banks. Unlike LIBOR, which is the rate at which banks lend money, LIBID is the rate at which banks ask to borrow. It is not set by anybody or organisation, but is calculated as the average of the interest rates at which London banks bid for borrowed Eurocurrency funds from other banks. It is also the interest rate London banks pay for deposits from other banks.

LVNAV MMF (Low Volatility Net Asset Value MMF) - a type of fund categorised as a Short Term MMF. Units in the fund are purchased or redeemed at a constant price, as long as the value of the assets in the fund do not deviate by more than 0.2% from par.

MHCLG – Ministry of Housing, Communities and Local Government (formerly DCLG)

Minimum Revenue Provision (MRP) - is a provision the council has set-aside from revenue to repay loans arising from capital expenditure financed by borrowing. MRP is required even when borrowing is internal rather than external.

Monetary Policy Committee (MPC) – independent body which determines the Bank Rate.

Money Market Fund (MMF) - mutual fund that invests only in highly liquid instruments such as cash, cash equivalent securities, and high credit rating debt-based securities with a short-term, maturity—less than 13 months. As a result, these funds offer high liquidity with a very low level of risk.

Operational Boundary – This indicator is based on the probable external debt during the course of the year; it is not a limit and actual borrowing could vary around this boundary for short times during the year. It should act as an early warning indicator to ensure the Authorised Limit is not breached.

Prudential Code – the Local Government Act 2003 requires the Council to ‘have due regard’ to the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable. The Prudential Code is published by CIPFA.

PWLB – Public Works Loan Board. An institution managed by the Government to provide loans to public bodies at rates which reflect the rates at which the government is able to sell gilts.

Revenue expenditure – day to day items which may not be capitalised without a Government direction, including employees’ pay, transport and premises costs, supplies and services, and benefits.