READING BOROUGH COUNCIL

REPORT BY DIRECTOR OF FINANCE

TO: AUDIT & GOVERNANCE	
DATE: 25th JANUARY 2022	**AGENDA ITEM:**
TITLE	**TREASURY MANAGEMENT STRATEGY MID-YEAR REVIEW 2021/22**
LEAD COUNCILLOR: COUNCILLOR BROCK	**PORTFOLIO: ALL**
SERVICE: FINANCE	**WARDS: BOROUGHWIDE**
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1. PURPOSE OF REPORT AND EXECUTIVE SUMMARY

1.1 The Council adopted a Treasury Management Strategy and an Annual Investment Strategy for 2021/22 at its meeting on 23rd February 2021.

1.2 The purpose of this report is to update Members on the activity of the Treasury Management function during the first half of the year for the period 1st April 2021 to 30th September 2021.

1.3 The Council has not taken out any new external long-term borrowing (loans) during 2021/22 as of 30th September 2021.

1.4 The Council has complied with all elements of its Treasury Management Strategy Statement (TMSS) as agreed by Full Council on 23rd February 2021.

1.5 Changes and proposed changes to the Treasury Management Code, Prudential Code, Public Works Loan Board (PWLB) Lending Terms and regulations to better enforce the duty of local authorities to make prudent Minimum Revenue Provision each year are set out in within section 11 of the main body of this report.

2. RECOMMENDED ACTION

That the Committee note:

2.1 The Treasury Management Mid-Year Report for 2021/22.

APPENDICES

Appendix 1 – Economics Update
Appendix 2 – Investment Criteria & Limits

3. INTRODUCTION

3.1 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An Interest Rates Forecast
- A review of the Treasury Management Strategy Statement (TMSS) and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council's investment portfolio for 2021/22;
- A review of the Council's borrowing strategy for 2021/22;
- A review of any debt rescheduling undertaken during 2021/22;
- A review of compliance with Treasury and Prudential Limits for 2021/22;
- An economic update for the first half of the 2021/22 financial year (Appendix 1).

4 INTEREST RATES FORECAST

4.1 The coronavirus outbreak has had a significant economic impact on both the UK and global economies. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings, although some forecasters had suggested that a cut into negative territory could have happened prior to more recent months when strong recovery started kicking in. However, the minutes of the Monetary Policy Committee in February 2021 made it clear that commercial banks could not implement negative rates within six months; by that time the economy would be expected to be recovering strongly and so there would be no requirement for negative rates.

4.2 The Bank of England raised Bank Rate from 0.10% to 0.25% in December 2021. An updated forecast, provided by the Council's treasury management advisors (Link Group), is set out in Table 1 below.

PWLB Rates

4.3 Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates. As the interest forecast table for PWLB certainty rates below (Table 1) shows, there is forecast to be a steady, but slow, rise in both Bank Rate and gilt yields during the forecast period to December 2023, though there will doubtless be a lot of unpredictable volatility during this forecast period.

4.4 While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in America could have on our gilt yields. As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury yields and UK 10-year gilt yields. This is a significant upward risk exposure to the forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.

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

4.6 Current UK interest rate forecasts (including the 20-basis point certainty rate reduction) are outlined in the following table:

Table 1. Interest Rate Forecasts

	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
	%	%	%	%	%	%	%	%
Bank Rate	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75
5-year PWLB	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80
10-year PWLB	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00
25-year PWLB	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30
50-year PWLB	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10

The Balance of Risks to the UK

4.7 The overall balance of risks to economic growth in the UK is now to the downside, including risks from Covid and its variants - both domestically and their potential effects worldwide. There is a balance of upside risks to forecasts for medium to long-term PWLB rates

4.8 Significant risks to current forecasts include the impact of:

- **Mutations of the virus** render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, or cannot be administered fast enough to prevent further lockdowns. 25% of the population not being vaccinated is also a significant risk to the NHS being overwhelmed and lockdowns being the only remaining option;
- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity;
- **The Monetary Policy Committee** acts 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;
- **The Monetary Policy Committee** tightens monetary policy too late to ward off building inflationary pressures;
- **The Government** acts too quickly to cut expenditure to balance the national budget;
- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues;
- **Longer term US treasury yields** rise strongly and pull gilt yields up higher than forecast;

- **Major stock markets** e.g., in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the “moral hazard” risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy;

- **Geopolitical risks**, for example in Ukraine, Iran, North Korea, but also in Europe and Middle Eastern countries; on-going global power influence struggles between Russia/China/US. These could lead to increasing safe-haven flows.

5 TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY UPDATE

5.1 The Treasury Management Strategy Statement, (TMSS), for 2021/22 was approved by Full Council on 23rd February 2021.

5.2 There are no policy changes required to the TMSS. This report sets out the Council’s position compared to the TMSS in the light of the updated economic position, budgetary changes already approved and revised in-year forecasts of capital expenditure.

6 THE COUNCIL’S CAPITAL POSITION (PRUDENTIAL INDICATORS)

Prudential Indicators for Capital Expenditure

6.1 The Council is required to ensure that all of its Capital Expenditure, investments and borrowing decisions are prudent and sustainable. The prudential indicators for capital expenditure set out whether or not the Council is delivering within its approved budgets.

6.2 Tables 2 and 3 below show the Council’s forecast capital expenditure compared to the Capital Programme agreed in February 2021 (Original Budget) and the Capital Programme as at Quarter 2 (Revised Budget) which includes roll-forwards of budget from 2020/21 which were approved by Policy Committee as part of the Quarter 4 Performance Report (2020/21) in July 2021.

The indicators show that the Council is forecasting to underspend against the approved Capital Programme budget by £30.716m (General Fund) and £9.873m (HRA) as at the of Quarter 2. Further details on significant variances on individual capital schemes are reported to Policy Committee as part of the Quarterly Performance and Monitoring Reports.

Table 2. General Fund Capital Programme

General Fund	2021/22 Original Budget	2021/22 Revised Budget	2021/22 Forecast (30th September 2021)	Variance
	£m	£m	£m	£m
Adult Social Care & Health Services	0.279	1.272	1.272	0.000
Economic Growth & Neighbourhood Services	50.584	76.268	63.073	(13.195)
Economic Growth & Neighbourhood Services - Education Schemes	20.889	24.969	15.280	(9.689)
Resources	4.559	7.409	7.482	0.073
Corporate	11.832	15.006	7.641	(7.365)
Total General Fund	**88.153**	**124.924**	**94.748**	**(30.176)**

Table 3. HRA Capital Programme

Housing Revenue Account	2021/22 Original Budget	2021/22 Revised Budget	2021/22 Forecast (30th September 2021)	Variance
	£m	£m	£m	£m
Housing Revenue Account	39.675	45.494	35.621	(9.873)
Total Housing Revenue Account	**39.675**	**45.494**	**35.621**	**(9.873)**

Changes to the Financing of the Capital Programme

6.3 Tables 4 and 5 below identify the expected financing arrangements of the Council's capital expenditure plans. The Borrowing Requirement increases the underlying indebtedness of the Council by increasing the Capital Financing Requirement (CFR), although this will be reduced in part by revenue contributions for the repayment of debt (the Minimum Revenue Provision).

Table 4. Financing of the General Fund Capital Programme

General Fund	2021/22 Original Budget	2021/22 Revised Budget	2021/22 Forecast (30th September 2021)
	£m	£m	£m
Total Capital Expenditure	**88.153**	**124.924**	**94.748**
Financed by:			
Capital Receipts	2.362	2.532	2.532
Capital Grants and other Contributions	44.850	73.343	56.126
Total Financing (excluding Borrowing)	**47.212**	**75.875**	**58.658**
Net Borrowing Requirement	**40.941**	**49.049**	**36.090**

Table 5. Financing of the HRA Capital Programme

Housing Revenue Account	2021/22 Original Budget	2021/22 Revised Budget	2021/22 Forecast (30th September 2021)
	£m	£m	£m
Total Capital Expenditure	**39.675**	**45.494**	**35.621**
Financed by:			
Capital Receipts	0.000	0.000	0.857
Capital Grants and other Contributions	6.145	5.576	13.783
Capital Reserves	10.710	10.700	8.783
Revenue	0.000	0.355	0.257
Total Financing (excluding Borrowing)	**16.855**	**16.631**	**23.680**
Net Borrowing Requirement	**22.820**	**28.863**	**11.941**

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

6.4 Table 6 shows the Council's CFR, which is its total underlying indebtedness. It also shows the maximum expected debt position (the Operational Boundary) over the period as at 23rd February 2021, which was £680.960m. The revised Operational Boundary is £646.173m which has reduced due to the revised expenditure and financing forecasts.

Table 6. Capital Financing Requirement and Operational Boundary

	2021/22 Original Estimate	2021/22 Forecast (30th September 2021)
	£m	£m
Prudential Indicator - Capital Financing Requirement		
CFR – General Fund	442.444	426.341
CFR - HRA	218.516	199.832
Total CFR	**660.960**	**626.173**
Prudential Indicator - Operational Boundary for External Debt		
Borrowing	660.960	626.173
Headroom	20.000	20.000
Operational Boundary	**680.960**	**646.173**

6.5 The Council's current level of external debt (as at 30th September 2021) is £417.431m, as set out in Table 7 below. The Council is therefore operating significantly within its Operational Boundary.

Limits to Borrowing Activity

6.6 Over the medium term, net borrowing (borrowings less investments) should only be for capital purposes. Gross external borrowing should not, except in the short term, exceed the total of the Council's CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent. However, the Council's Capital Programme has been scaled back as the purchase of commercial property scheme was removed in 2020/21 and other capital schemes have had delivery impacted by Covid-19, so it is unlikely in the current year.

Table 7. Capital Financing Requirement and Actual Borrowing

	2021/22 Original Estimate	2021/22 Forecast (30th September 2021)
	£m	£m
Borrowing	479.149	393.171
Other Long-Term Liabilities	24.261	24.260
Total Debt	**503.410**	**417.431**
CFR (year end position)	**660.960**	**626.173**
Over/(under) Borrowing		**(208.742)**

6.7 The Authorised Borrowing Limit is the expected maximum borrowing need with some headroom for unexpected movements. This is a statutory limit determined under section 3 (1) of the Local Government Act 2003 and sets the limit beyond which borrowing is prohibited without Member approval. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. Table 8 below sets out Authorised Limit. The current level of external debt of £417.431m (as at 30th September 2021) is significantly within the Authorised Limit.

Table 8. Authorised Limit

	2021/22 Original Indicator	2021/22 Forecast (30th September 2021)
	£m	£m
Operational Boundary	680.960	646.173
Headroom	40.000	40.000
Total Authorised Limit	**720.960**	**686.173**

7 BORROWING

7.1 The Council's estimated capital financing requirement (CFR) for 2021/22 as at 30th September 2021 is £626.173m. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing) to fund capital expenditure. The balance of external and internal borrowing is generally driven by market conditions.

7.2 Table 7 above shows that the Council has external borrowing (including prior year borrowing) of £417.431m and has utilised £208.742m of cash flow funds in lieu of borrowing. This is a prudent and cost-effective approach in the current economic climate but will require ongoing monitoring in respect of the Council's cashflow requirements, long-term borrowing requirement and interest rate increases.

7.3 Due to a reduction in capital expenditure and additional grant income due to Covid-19, the Council has not needed to undertake any new long-term PWLB borrowing during 2021/22.

7.4 It is possible that the Council may need to borrow during Quarter 4 of 2021/22 as cash balances are forecast to reduce during this quarter, primarily as £30m of s31 grant re-payments to Central Government in respect of cashflow support given in respect of 2020/21 additional business rate reliefs, as part of the Business Rate Retention Scheme, fall due during this period. However, the current expectation is that this would be met by temporary or short-term borrowing. The Council's Borrowing Strategy will be reviewed and revised as part of the Treasury Management Strategy Statement 2022/23 in order to achieve optimum value and risk exposure in the long-term.

8 DEBT RESCHEDULING

8.1 Debt rescheduling is currently not attractive due to the associated high cost premiums of rescheduling PWLB loans outweighing any potential savings. No debt rescheduling has therefore been undertaken to date in the current financial year.

9 COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

9.1 During the half year ended 30th September 2021, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2021/22.

9.2 All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

10 ANNUAL INVESTMENT STRATEGY

10.1 The Treasury Management Strategy Statement (TMSS) for 2021/22, which includes the Annual Investment Strategy, was approved by the Council on 23rd February 2021. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity;
- Yield.

10.2 The Council aims to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate, it is considered appropriate to keep treasury investments short term to cover cash flow needs, but also to seek out value available in periods up to twelve months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including minimum sovereign credit rating and Credit Default Swap (CDS) overlay information. As shown by the interest rate forecasts in section 4, it is now impossible to achieve the level of returns on investments commonly seen in previous decades as all investment rates have only risen weakly since Bank Rate was cut to 0.10% in March 2020. Given this environment and the fact that Bank Rate may only rise marginally, or not at all, before the second half of 2023, investment returns are expected to remain low.

Creditworthiness

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

Investment Balances

10.4 The average level of funds available for investment purposes during the year to 30th September 2021 was £24.990m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and Capital Programme expenditure.

Table 9. Investment Performance Year to Date as at 30th September 2021

Period	LIBID Benchmark Return	Council Performance	Investment Interest Earned
	%	%	£m
7 Day	(0.08)	0.03	0.01

10.5 The Council also has £15.000m invested in the CCLA Property Fund which is a long-term investment and has received an income of £0.328m over the six-month period to September 2021. The total return on the fund is 4.37%.

10.6 Officers can confirm that the approved limits within the Annual Investment Strategy (attached as Appendix 2) were not breached during the quarter ended 30th September 2021.

11 2021/22 CONSULTATIONS & GUIDANCE CHANGES

Treasury Management and Prudential Codes

11.1 CIPFA published the updated Treasury Management and Prudential Codes on 20th December 2021 following consultation processes. These codes have introduced restrictions to discourage further capital expenditure on commercial investments for yield due to it being a risk to prudent investment. The Council removed its scheme to purchase new commercial properties from its Capital Programme during 2020/21.

11.2 CIPFA has stated that there will be a soft introduction of the codes with local authorities not being expected to have to change their current draft Treasury Management Strategy Statement/Annual Investment Strategy reports for 2022/23 unless they wish to; full implementation is required from 1st April 2023 (2023/24).

11.3 The Council is currently in the process of drafting the 2022/23 Treasury Management Strategy.

Public Works Loan Board (PWLB)

11.4 On 12th August 2021 the DMO issued updated guidance on lending arrangements. The updates largely clarify points raised by some local authorities regarding the previous guidance issued in November 2020. This includes defining activity to allow authorities to distinguish between expenditure on service delivery, housing, regeneration etc vs investment assets bought primarily for yield. There was also an update on the list of responses the government may take if a local authority does not follow PWLB lending policy and examples of different scenarios which would/would not be supported by the PWLB.

11.5 Circular 163 was subsequently released on 8th September 2021 updating the terms and conditions applied to PWLB lending. The changes made are as follows;

- The turnaround time for a PWLB loan increases from two to five working days
- The minimum interest rate for PWLB loans is set a 1bps
- The minimum late repayment fee is set at 10bps.

Minimum Revenue Policy (MRP)

11.6 The Department for Levelling Up, housing and Communities launched a consultation on 30th November 2021 until 8th February 2022, seeking views on proposed changes to regulations to better enforce the duty of local authorities to make prudent Minimum Revenue Provision each year.

11.7 One of these proposals would, if implemented, require Council's to provide MRP on any capital loans given to third parties and wholly owned companies. The Council's current MRP Policy would therefore need to be reviewed and additional budgetary provision made within the Council's revenue budget in order to comply with this change should it materialise.

11.8 The proposal is that the changes will first come into force for the financial year beginning 1st April 2023 therefore there will be no impact on 2022/23; it is not the government's intention that these changes are applied retrospectively.

12 CONTRIBUTION TO STRATEGIC AIMS

12.1 The Council's vision to ensure that Reading realises its potential – and to ensure that everyone who lives and works in Reading can share the benefits of its success. The Council has three inter-connected themes which contribute to delivering this vision. The themes are:

- Healthy environment;
- Thriving communities;
- Inclusive economy.

12.2 Delivery of the Council's revenue and capital budgets is essential to ensuring the Council meets its strategic aims and remains financially sustainable going forward. The treasury management functions are crucial in ensuring that the Council has access to funds when required and in investing surplus funds in secure investments.

13 ENVIRONMENTAL AND CLIMATE IMPLICATIONS

13.1 None have been identified as arising directly from this report.

14 COMMUNITY ENGAGEMENT AND INFORMATION

14.1 Budget-related communications and consultations will continue to be a priority over the next three years as we work to identify savings.

15 EQUALITY IMPACT ASSESSMENT

15.1 None have been identified as arising directly from this report.

16 LEGAL IMPLICATIONS

16.1 The Council is required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals:

- **Prudential and treasury indicators and treasury strategy** - 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** (this report) – 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.

- **An annual treasury report -** 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.

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

17 FINANCIAL IMPLICATIONS

17.1 The financial implications are set out in the body of the report.

18 BACKGROUND PAPERS

- Treasury Management Strategy 2021/22
- Quarter 2 Performance Report 2021/22

Appendix 1 - Economics Update

COVID-19 Vaccines

1. These were the game changer during 2021 which raised high hopes that life in the UK would be able to largely return to normal in the second half of the year. However, the bursting onto the scene of the Omicron mutation at the end of November rendered the initial two doses of all vaccines largely ineffective in preventing infection. This has dashed such hopes and raises the spectre again that a fourth wave of the virus could overwhelm hospitals in early 2022. What we now know is that this mutation is very fast spreading with the potential for total case numbers to double every two to three days, although it possibly may not cause so much severe illness as previous mutations. Rather than go for full lockdowns which heavily damage the economy, the government strategy this time is focusing on getting as many people as possible to have a third (booster) vaccination after three months from the previous last injection, as a booster has been shown to restore a high percentage of immunity to Omicron to those who have had two vaccinations. There is now a race on between how quickly boosters can be given to limit the spread of Omicron, and how quickly will hospitals fill up and potentially be unable to cope. In the meantime, workers have been requested to work from home and restrictions have been placed on large indoor gatherings and hospitality venues. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in sectors like restaurants, travel, tourism and hotels which had been hit hard during 2021, but could now be hit hard again by either, or both, of government restrictions and/or consumer reluctance to leave home. Growth will also be lower due to people being ill and not working, similar to the "pingdemic" in July 2021.

2. The economy, therefore, faces significant headwinds although some sectors have learned how to cope well with Covid. However, the biggest impact on growth would come from another lockdown if that happened. The big question still remains as to whether any further mutations of this virus could develop which render all current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread until tweaked vaccines become widely available.

A Summary Overview of the Future Path of Bank Rate

3. In December, the Bank of England became the first major western central bank to put interest rates up in this upswing in the current business cycle in western economies as recovery progresses from the Covid recession of 2020. The next increase in Bank Rate could be in February or May, dependent on how severe an impact there is from Omicron. If there are lockdowns in January, this could pose a barrier for the MPC to putting Bank Rate up again as early as 3rd February.

4. With inflation expected to peak at around 6% in April, the MPC may want to be seen to be active in taking action to counter inflation on 5th May, the release date for its Quarterly Monetary Policy Report. The December 2021 MPC meeting was more concerned with combating inflation over the medium term than supporting economic growth in the short term. Bank Rate increases beyond May are difficult to forecast as inflation is likely to drop sharply in the second half of 2022.

5. However, the MPC will want to normalise Bank Rate over the next three years so that it has its main monetary policy tool ready to use in time for the next down-turn; all rates

under 2% are providing stimulus to economic growth. We have put year end 0.25% increases into Q1 of each financial year from 2023 to recognise this upward bias in Bank Rate - but the actual timing in each year is difficult to predict.

6. Covid remains a major potential downside threat in all three years as we are likely to get further mutations. How quickly can science come up with a mutation proof vaccine, or other treatment, – and for them to be widely administered around the world? Purchases of gilts under QE ended in December. Note that when Bank Rate reaches 0.50%, the MPC has said it will start running down its stock of QE.

MPC Meeting 16th December 2021

7. The Monetary Policy Committee (MPC) voted 8-1 to raise Bank Rate by 0.15% from 0.10% to 0.25% and unanimously decided to make no changes to its programme of quantitative easing purchases due to finish in December 2021 at a total of £895bn.

8. The MPC disappointed financial markets by not raising Bank Rate at its November meeting. Until Omicron burst on the scene, most forecasters, therefore, viewed a Bank Rate increase as being near certain at this December meeting due to the way that inflationary pressures have been comprehensively building in both producer and consumer prices, and in wage rates. However, at the November meeting, the MPC decided it wanted to have assurance that the labour market would get over the end of the furlough scheme on 30th September without unemployment increasing sharply; their decision was, therefore, to wait until statistics were available to show how the economy had fared at this time.

9. On 10th December we learnt of the disappointing 0.1% m/m rise in GDP in October which suggested that economic growth had already slowed to a crawl even before the Omicron variant was discovered in late November. Early evidence suggests growth in November might have been marginally better. Nonetheless, at such low rates of growth, the government's "Plan B" COVID-19 restrictions could cause the economy to contract in December.

10. On 14th December, the labour market statistics for the three months to October and the single month of October were released. The fallout after the furlough scheme was smaller and shorter than the Bank of England had feared. The single-month data were more informative and showed that LFS employment fell by 240,000, unemployment increased by 75,000 and the unemployment rate rose from 3.9% in September to 4.2%. However, the weekly data suggested this didn't last long as unemployment was falling again by the end of October. What's more, the 49,700 fall in the claimant count and the 257,000 rise in the PAYE measure of company payrolls suggests that the labour market strengthened again in November. The other side of the coin was a further rise in the number of vacancies from 1.182m to a record 1.219m in the three months to November which suggests that the supply of labour is struggling to keep up with demand, although the single-month figure for November fell for the first time since February, from 1.307m to 1.227m.

11. These figures by themselves would probably have been enough to give the MPC the assurance that it could press ahead to raise Bank Rate at this December meeting. However, the advent of Omicron potentially threw a spanner into the works as it poses a major headwind to the economy which, of itself, will help to cool the economy. The financial markets, therefore, swung round to expecting no change in Bank Rate.

12. On 15th December we had the CPI inflation figure for November which spiked up further from 4.2% to 5.1%, confirming again how inflationary pressures have been building sharply.

However, Omicron also caused a sharp fall in world oil and other commodity prices; (gas and electricity inflation has generally accounted on average for about 60% of the increase in inflation in advanced western economies).

13. Other elements of inflation are also transitory e.g., prices of goods being forced up by supply shortages, and shortages of shipping containers due to ports being clogged have caused huge increases in shipping costs. But these issues are likely to clear during 2022, and then prices will subside back to more normal levels. Gas prices and electricity prices will also fall back once winter is passed and demand for these falls away.

14. Although it is possible that the Government could step in with some fiscal support for the economy, the huge cost of such support to date is likely to pose a barrier to incurring further major economy wide expenditure unless it is very limited and targeted on narrow sectors like hospitality, (as announced just before Christmas). The Government may well, therefore, effectively leave it to the MPC, and to monetary policy, to support economic growth – but at a time when the threat posed by rising inflation is near to peaking.

15. This is the adverse set of factors against which the MPC had to decide on Bank Rate. For the second month in a row, the MPC blind-sided financial markets, this time with a surprise increase in Bank Rate from 0.10% to 0.25%. What's more, the hawkish tone of comments indicated that the MPC is now concerned that inflationary pressures are indeed building and need concerted action by the MPC to counter. This indicates that there will be more increases to come with financial markets predicting 1% by the end of 2022. The 8-1 vote to raise the rate shows that there is firm agreement that inflation now poses a threat, especially after the CPI figure hit a 10-year high this week. The MPC commented that "there has been significant upside news" and that "there were some signs of greater persistence in domestic costs and price pressures".

16. On the other hand, it did also comment that "the Omicron variant is likely to weigh on near-term activity". But it stressed that at the November meeting it had said it would raise rates if the economy evolved as it expected and that now "these conditions had been met". It also appeared more worried about the possible boost to inflation form Omicron itself. It said that "the current position of the global and UK economies was materially different compared with prior to the onset of the pandemic, including elevated levels of consumer price inflation". It also noted the possibility that renewed social distancing would boost demand for goods again, (as demand for services would fall), meaning "global price pressures might persist for longer". (Recent news is that the largest port in the world in China has come down with an Omicron outbreak which is not only affecting the port but also factories in the region.)

17. On top of that, there were no references this month to inflation being expected to be below the 2% target in two years' time, which at November's meeting the MPC referenced to suggest the markets had gone too far in expecting interest rates to rise to over 1.00% by the end of the year.

18. These comments indicate that there has been a material reappraisal by the MPC of the inflationary pressures since their last meeting and the Bank also increased its forecast for inflation to peak at 6% next April, rather than at 5% as of a month ago. However, as the Bank retained its guidance that only a "modest tightening" in policy will be required, it cannot be thinking that it will need to increase interest rates that much more. A typical policy tightening cycle has usually involved rates rising by 0.25% four times in a year. "Modest" seems slower than that. As such, the Bank could be thinking about raising interest rates two or three times next year to 0.75% or 1.00%.

19. In as much as a considerable part of the inflationary pressures at the current time are indeed transitory, and will naturally subside, and since economic growth is likely to be weak over the next few months, this would appear to indicate that this tightening cycle is likely to be comparatively short.

20. As for the timing of the next increase in Bank Rate, the MPC dropped the comment from November's statement that Bank Rate would be raised "in the coming months". That may imply another rise is unlikely at the next meeting in February and that May is more likely. However, much could depend on how adversely, or not, the economy is affected by Omicron in the run up to the next meeting on 3rd February. Once 0.50% is reached, the Bank would act to start shrinking its stock of QE, (gilts purchased by the Bank would not be replaced when they mature).

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

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

Appendix 2 - Investment Criteria & Limits

	Credit Rating	Cash Limit	Time Limit
Banks and organisations and securities whose lowest long-term credit rating published by Fitch, Moody's or Standard & Poor is:	AAA	£20m each	5 Years
	AA+		3 Years
	AA		
	AA-		2 Year
	A+		
	A		1 Year
	A-		
The Council's current account, Lloyds Bank Plc should circumstances arise when it does not meet above criteria	N/A	£1m (total)	Next Day
UK Building Societies without credit rating	N/A	£10m each	1 Year
UK Government (irrespective of credit rating)	N/A	Unlimited	50 Years
UK Local Authorities (irrespective of credit rating)	N/A	£20m each	50 Years
UK Registered Providers of Social Housing whose published long-term credit rating is A- or higher	A-	£5m each	2 Years
UK Registered Providers of Social Housing whose published long-term credit rating is lower than A- or without a long-term credit rating	N/A	£2m each	1 Year
	Fund rating	**Cash Limit**	**Time**
Money Market Funds	AAA	£20m each	liquid
Pooled Funds (including pooled property funds)	AAA	£30m total	liquid

Other Limits

a) **Non-specified investment limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments at £30m maximum.

b) **Country limit.** The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of *AA-* from Fitch or equivalent.

c) **Other limits.** In addition:

- no more than £20m will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

Upper limit for principal sums invested for longer than 365 days

	2021/22	2022/23	2023/24
Principal sums invested for longer than 365 days	£30m	£30m	£30m