

Appendix D

Economic Update

The Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures.

There was a major shift in the tone of the MPC's minutes at the September meeting from the previous meeting in August which had indicated that some tightening in monetary policy was now on the horizon, however, they did not want to stifle economic recovery by increasing the Bank Rate too soon. In his press conference after the August MPC meeting, Governor Andrew Bailey said, the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs and that the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment. In other words, it was flagging up a potential danger that labour shortages could push up wage growth by more than it expects and that, as a result, CPI inflation would stay above the 2% target for longer. It also discounted sharp increases in monthly inflation figures which were largely propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, in other words, the MPC had been prepared to look through a temporary spike in inflation.

The MPC's words indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October and due again next April, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected. To emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement; this suggested that it was now willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year. This is a reversal of its priorities in August and a long way from words at earlier MPC meetings which indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. In August, the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021, now its primary concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.

Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in December 2021. At the MPC's meeting in February it will only have available the employment figures for November: to get a clearer picture of employment trends, it would need to wait until the May meeting when it would have data up until February. At its May meeting, it will also have a clearer understanding of the likely peak of inflation.

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

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

COVID-19 vaccines have been the game changer which have enormously boosted confidence that life in the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.

In the US, during the first part of the year, US President Biden's, and the Democratic party's, determination to push through a \$1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic was what unsettled financial markets. However, this was in addition to the \$900bn support package already passed in December 2020. Financial markets were alarmed that all this stimulus was happening at a time when: -

1. A fast vaccination programme has enabled a rapid opening up of the economy.
2. The economy has been growing strongly during 2021.
3. It started from a position of little spare capacity due to less severe lockdown measures than in many other countries.
4. And the Fed was still providing stimulus through monthly QE purchases.

These factors could cause an excess of demand in the economy which could then unleash strong inflationary pressures. This could then force the Federal Reserve Bank (Fed) to take much earlier action to start increasing the Fed rate from near zero, despite their stated policy being to target average inflation. It is notable that in the September Fed meeting, Fed members again moved forward their expectation of when the first increases in the Fed rate will occur. In addition, shortages of workers appear to be stoking underlying wage inflationary pressures which are likely to feed through into CPI inflation. A run of stronger jobs growth figures could be enough to meet the threshold set by the Fed of substantial further progress towards maximum employment for a first increase in the Fed rate.

A further concern in financial markets is when will the Fed end QE purchases of treasuries and how will they gradually wind them down. These purchases are currently acting as a downward pressure on treasury yields. In his late August speech at the Jackson Hole conference, Fed Chair Powell implied that the central bank plans to start tapering its asset purchases before the end of this year. But the plan is conditional on continued improvement in the labour market, which the August employment report suggests is proceeding more slowly than the Fed anticipated. That may mean that any announcement of tapering is pushed back, possibly even into early 2022.

As the US financial markets are, by far, the biggest financial markets in the world, any upward trend in treasury yields will invariably impact and influence financial markets in other countries. Inflationary pressures and erosion of surplus economic capacity look much stronger in the US compared to those in the UK, which would suggest that Fed rate increases are likely to be faster and stronger than Bank Rate increases in the UK. Nonetheless, any upward pressure on treasury yields could put upward pressure on UK gilt yields too.

In the Eurozone, the slow roll out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction in GDP of -0.3% in Q1, Q2 came in with strong growth of 2%, which is likely to continue into Q3, though some countries more dependent on tourism may struggle. Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the ECB is likely to see these as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time.

In China, after a concerted effort to get on top of the virus outbreak in Q1 of 2020, economic recovery was strong in the rest of the year; this enabled China to recover all the contraction. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed

markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021. However, the pace of economic growth has now fallen back after this initial surge of recovery from the pandemic and China is now struggling to contain the spread of the Delta variant through sharp local lockdowns - which will also depress economic growth. There are also questions as to how effective Chinese vaccines are proving. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

Economic Forecast

The Council receives its treasury advice from Link Asset Services. Their latest interest rate forecasts are shown below:

Link Group Interest Rate View												
	Now	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
Bank Rate	0.10%	0.25%	0.25%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%
5yr PWLB Rate	1.45%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.80%	1.90%
10yr PWLB Rate	1.74%	1.80%	1.90%	1.90%	2.00%	2.00%	2.10%	2.10%	2.20%	2.20%	2.20%	2.30%
25yr PWLB Rate	1.96%	2.10%	2.20%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.60%
50yr PWLB Rate	1.67%	1.90%	2.00%	2.10%	2.20%	2.20%	2.20%	2.30%	2.30%	2.40%	2.40%	2.40%

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

As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 4 of 2021/22, a second increase to 0.50% in quarter 2 of 22/23 and a third one to 0.75% in quarter 4 of 22/23.

Significant risks to the forecasts

- COVID vaccines do not work to combat new mutations and/or new vaccines take longer than anticipated to be developed for successful implementation.
- The pandemic causes major long-term scarring of the economy.
- The Government implements an austerity programme that suppresses GDP growth.
- The MPC tightens monetary policy too early – by raising Bank Rate or unwinding QE.
- The MPC tightens monetary policy too late to ward off building inflationary pressures.

- Major stock markets e.g. in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the “moral hazard” risks of having to buy shares and corporate bonds to reduce the impact of major financial market sell-offs on the general economy.
- Geo-political risks are widespread e.g. German general election in September 2021 produces an unstable coalition or minority government and a void in high-profile leadership in the EU when Angela Merkel steps down as Chancellor of Germany; on-going global power influence struggles between Russia/China/US.

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

Borrowing

It is a statutory duty for the Council to determine and keep under review the “Affordable Borrowing Limits”. The Council’s approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy. A list of the approved limits is shown in Appendix B. The Prudential Indicators were not breached during the second quarter of 2021/22 and have not been previously breached. The schedule at Appendix C details the Prudential Borrowing approved and utilised to date.

No new external borrowing has currently been undertaken to date in 2021/22, although discussions are currently being held at the Capital Investment Board where outline business cases are being considered. The schemes being considered are already within the current authorised borrowing limits in place. In the event the authorised borrowing limits need to be amended, this will be reported to Council for approval. The table below illustrates the low and high points across different maturity bands for borrowing rates for the first six months of the financial year

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.78%	1.05%	1.39%	1.75%	1.49%
Date	08/04/2021	08/07/2021	05/08/2021	17/08/2021	10/08/2021
High	0.98%	1.42%	1.81%	2.27%	2.06%
Date	24/09/2021	28/09/2021	28/09/2021	13/05/2021	13/05/2021
Average	0.84%	1.16%	1.60%	2.02%	1.81%
Spread	0.20%	0.37%	0.42%	0.52%	0.57%

Debt Rescheduling

Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. During the first six months of the year no debt rescheduling was undertaken.