Appendix D

Economic Background

After the Bank of England became the first major western central bank to put interest rates up in December, it has quickly followed up its first 0.15% rise by a further three 0.25% rises to 1.00% in May 2022, in what is very likely to be a series of increases during 2022.

The Monetary Policy Committee voted by a majority of 5-4 to increase Bank Rate by 25bps to 0.5% on 4th February, with the minority preferring to increase Bank Rate by 50bps to 0.75%. The Committee also voted unanimously for the following:

1. to reduce the £875bn stock of UK government bond purchases, financed by the issuance of central bank reserves, by ceasing to reinvest maturing assets.

2. to begin to reduce the £20bn stock of sterling non-financial investment-grade corporate bond purchases by ceasing to reinvest maturing assets and by a programme of corporate bond sales to be completed no earlier than towards the end of 2023.

The Bank again sharply increased its forecast for inflation – to now reach a peak of 7.25% in April, well above its 2% target. The Bank estimated that UK GDP rose by 1.1% in quarter 4 of 2021 but, because of the effect of Omicron, GDP would be flat in quarter 1 2022, but with the economy recovering during February and March. Due to the hit to households' real incomes from higher inflation, it revised down its GDP growth forecast for 2022 from 3.75% to 3.25%.

By the time the MPC met in March, the Russian invasion of Ukraine was well established. Serious supply side shocks impacting energy and food prices, as well as impediments to global trade, had persuaded MPC members, by a majority of 8-1, to increase Bank Rate to 0.75% but caution as to the extent of further increases was emphasised. One member of the MPC wanted rates to stay on hold at 0.5%.

The CPI measure of inflation is now expected to exceed 8% in Q1 2022/23, and despite measures announced by the Chancellor in his Spring Fiscal Statement to try to reduce the impact of the cost-of-living squeeze on households by reducing fuel duty by 5p a litre and increasing the threshold for employees paying National Insurance by £3,000 from July, we are still about to see the biggest squeeze on households' living standards for over 50 years.

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

1. Raising Bank Rate as "the active instrument in most circumstances".

2. After Bank Rate hit 0.50% to start reducing its gilt/bonds holdings and to stop reinvesting maturing gilts.

In the US, President Biden, and the Democratic party, have pushed through a huge programme of fiscal stimulus over the past couple of years, whilst the following factors were also in play:-

1. A fast vaccination programme had enabled a rapid opening up of the economy during 2021
2. The economy has been growing swiftly over the second half of 2021/22, whilst unemployment has continued to fall/spare capacity in the labour market has tightened.

It was not much of a surprise that a combination of these factors would eventually cause an excess of demand in the economy which generated strong inflationary pressures. This has eventually been recognised by the Fed and an aggressive response to damp inflation down during 2022 and 2023 is expected.

The flurry of comments from Fed officials following the mid-March meeting – including from Chair Jerome Powell himself – hammering home the hawkish message from the mid-March meeting makes it difficult to see how the Fed will not tighten aggressively through 2022 as a minimum with markets expecting the Fed Funds Rate to hit close to 2% by year end.

In addition, the Fed will soon announce an increasing series of caps on the value of assets they allow to run off the balance sheet each month. That announcement could come as soon as May.

In the Eurozone, the European Central Bank (ECB) joined with the Fed by also announcing on 16 December that it will be reducing its QE purchases - by half from October 2022, i.e., it will still be providing significant stimulus via QE purchases during the first half of 2022. Although headline inflation reached 4.9% in November, over half of that was due to energy but oil and gas prices are expected to fall sharply after the winter. As overall inflation will fall back sharply during 2022, it is likely that the ECB will leave its central rate below zero, currently -0.50%, over the next two years. The main struggle that the ECB has had in recent years is that inflation has been sticking below its target rate of 2% despite all the ECB's major programmes of monetary easing by cutting rates into negative territory and providing QE support.

In China, the pace of economic growth has now fallen back after the initial surge of recovery from the pandemic and China has been struggling to contain the spread of the Delta variant through using sharp local lockdowns - which depress economic growth. However, with Omicron having now spread to China and being much more easily transmissible, this strategy of sharp local lockdowns to stop the virus may not prove so successful in future; this strategy poses a potential renewed threat to world supply chains. The People's Bank of China made a start in December 2021 on cutting its key interest rate to encourage flagging economic growth.

A summary overview of the future path of Bank Rate

- The threat from Omicron was a wild card causing huge national concern at the time of December's MPC meeting; now despite record numbers of infection, the relatively low number of hospitalisations suggests there will be no further lockdowns (at least over spring and summer).
- The MPC has now set out upon a monetary policy tightening spree. In March it voted 8-1 for rates to increase to 0.75%.
- The MPC deliver another 0.25% increase in May to 1%; their position appears to be to go for sharp increases to get the job done and dusted but the cost-of-living squeeze will provide a headwind to tightening too far and too quickly, so for now we only have a further 0.25% increase in place for Q2 2022.
- If, however, the MPC is becomes more heavily focused on combating inflation than on protecting economic growth, interest rate forecasts will be revised accordingly.
- With 54% energy cap cost increases from April, together with 1.25% extra employee national insurance, food inflation around 5% and council tax likely to rise in the region of 5% too - these increases are going to hit lower income families hard despite some limited assistance from the Chancellor to postpone the full impact of rising energy costs.
- Consumers are estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above increases. But most of those holdings are held by more affluent people whereas poorer people already spend nearly all their income before these increases hit and have few financial reserves.
- The most significant issue – will be the current spike in inflation leading to a second-round effect in terms of labour demanding higher wages, and/or lots of people getting higher wages by changing job).
- If the labour market remains very tight during 2022, then wage inflation poses a greater threat to overall inflation being higher for longer, and the MPC may then feel it needs to take more action.

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 fourth quarter of 2021/22 and have not been previously breached. The schedule at Appendix C details the Prudential Borrowing approved and utilised to date.

In November 2020, the Chancellor announced the conclusion to the review of PWLB rates and subsequently all borrowing rates were reduced by 1%; but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three-year capital programme. Link's target rate for new long-term borrowing (50 years) for the fourth quarter of 2021/22 increased to 2.09%. No new external borrowing was undertaken in 2021/22. The low and high points during the quarter can be seen in the table below.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.26%	1.65%	1.85%	2.06%	1.72%
Date	04/01/2022	04/01/2022	04/01/2022	04/01/2022	04/01/2022
High	2.03%	2.37%	2.52%	2.75%	2.49%
Date	15/02/2022	28/03/2022	28/03/2022	23/03/2022	28/03/2022
Average	1.71%	2.01%	2.19%	2.38%	2.09%
Spread	0.77%	0.72%	0.67%	0.69%	0.77%

Long term PWLB rates are expected to rise to 2.3% in June 2022 before increasing to reach 2.4% by December 2022.