

**MEETING: AUDIT AND GOVERNANCE COMMITTEE**

**DATE: 18 NOVEMBER 2021**

**TITLE: TREASURY MANAGEMENT 2021 –2022  
MID YEAR REVIEW**

**PURPOSE: CIPFA’s Code of Practice recommends that a report on the Council’s actual Treasury Management during the current financial year is produced.**

**RECOMMENDATION: RECEIVE THE REPORT FOR INFORMATION**

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## **EXECUTIVE SUMMARY**

**During the six month period between 1 April and 30 September 2021, the Council’s borrowing and investments remained well within the limits originally set. There were no new defaults by banks in which the Council deposited money. Furthermore, it is estimated that the Council’s actual investment income will be higher than the expected income in the 2021/22 budget.**

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## **1. INTRODUCTION**

The Chartered Institute of Public Finance and Accountancy’s Treasury Management Code (CIPFA’s TM Code) requires that Authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end). This report provides a mid-year update.

The Council’s treasury management strategy for 2021/22 was approved by full Council on 4<sup>th</sup> March 2021. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council’s treasury management strategy.

The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council’s Capital Strategy, complying with CIPFA’s requirement, was also approved by full Council also on 4<sup>th</sup> March 2021.

## 2. EXTERNAL CONTEXT

**Economic background:** The economic recovery from coronavirus pandemic continued to dominate the first half of the financial year. By the end of the period over 48 million people in the UK had received their first dose of a COVID-19 vaccine and almost 45 million their second dose.

The Bank of England (BoE) held Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. In its September 2021 policy announcement, the BoE noted it now expected the UK economy to grow at a slower pace than was predicted in August, as the pace of the global recovery had shown signs of slowing and there were concerns inflationary pressures may be more persistent. Within the announcement, Bank expectations for GDP growth for the third (calendar) quarter were revised down to 2.1% (from 2.9%), in part reflecting tighter supply conditions. The path of CPI inflation is now expected to rise slightly above 4% in the last three months of 2021, due to higher energy prices and core goods inflation. While the Monetary Policy Committee meeting ended with policy rates unchanged, the tone was more hawkish.

Government initiatives continued to support the economy over the quarter but came to an end on 30<sup>th</sup> September 2021, with businesses required to either take back the 1.6 million workers on the furlough scheme or make them redundant.

The latest labour market data showed that in the three months to July 2021 the unemployment rate fell to 4.6%. The employment rate increased, and economic activity rates decreased, suggesting an improving labour market picture. Latest data showed growth in average total pay (including bonuses) and regular pay (excluding bonuses) among employees was 8.3% and 6.3% respectively over the period. However, part of the robust growth figures is due to a base effect from a decline in average pay in the spring of last year associated with the furlough scheme.

Annual CPI inflation rose to 3.2% in August, exceeding expectations for 2.9%, with the largest upward contribution coming from restaurants and hotels. The Bank of England now expects inflation to exceed 4% by the end of the calendar year owing largely to developments in energy and goods prices. The Office of National Statistics' (ONS') preferred measure of CPIH which includes owner-occupied housing was 3.0% year/year, marginally higher than expectations for 2.7%.

The easing of restrictions boosted activity in the second quarter of calendar year, helping push GDP up by 5.5% q/q (final estimate vs 4.8% q/q initial estimate). Household consumption was the largest contributor. Within the sector breakdown production contributed 1.0% q/q, construction 3.8% q/q and services 6.5% q/q, taking all of these close to their pre-pandemic levels.

The US economy grew by 6.3% in Q1 2021 (Jan-Mar) and then by an even stronger 6.6% in Q2 as the recovery continued. The Federal Reserve maintained its main interest rate at between 0% and 0.25% over the period but in its most recent meeting made suggestion that monetary policy may start to be tightened soon.

The European Central Bank maintained its base rate at 0%, deposit rate at -0.5%, and asset purchase scheme at €1.85 trillion.

**Financial markets:** Monetary and fiscal stimulus together with rising economic growth and the ongoing vaccine rollout programmes continued to support equity markets over most of the period, albeit with a bumpy ride towards the end. The Dow Jones hit another record high while the UK-focused FTSE 250 index continued making gains over pre-pandemic levels. The more internationally focused FTSE 100 saw more modest gains over the period and remains below its pre-crisis peak.

Inflation worries continued during the period. Declines in bond yields in the first quarter of the financial year suggested bond markets were expecting any general price increases to be less severe, or more transitory, than was previously thought. However, an increase in gas prices in the UK and EU, supply shortages and drivers of HGV and lorry drivers with companies willing to pay more to secure their services, has caused problems for a range of industries and, in some instances, led to higher prices.

The 5-year UK benchmark gilt yield began the financial year at 0.36% before declining to 0.33% by the end of June 2021 and then climbing to 0.64% on 30<sup>th</sup> September. Over the same period the 10-year gilt yield fell from 0.80% to 0.71% before rising to 1.03% and the 20-year yield declined from 1.31% to 1.21% and then increased to 1.37%.

The Sterling Overnight Rate (SONIA) averaged 0.05% over the quarter.

**Credit review:** Credit default swap spreads were flat over most of the period and are broadly in line with their pre-pandemic levels. In late September spreads rose by a few basis points due to concerns around Chinese property developer Evergrande defaulting but are now falling back. The gap in spreads between UK ringfenced and non-ringfenced entities continued to narrow, but Santander UK remained an outlier compared to the other ringfenced/retail banks. At the end of the period Santander UK was trading the highest at 53bps and Lloyds Bank plc the lowest at 32bps. The other ringfenced banks were trading between 37-39bps and Nationwide Building Society was 39bps.

Over the period Fitch and Moody's upwardly revised to stable the outlook on a number of UK banks and building societies on our counterparty list, recognising their improved capital positions compared to last year and better economic growth prospects in the UK.

Fitch also revised the outlooks for Nordea, Svenska Handelsbanken and Handelsbanken plc to stable from negative. The rating agency considered the improved economic prospects in the Nordic region to have reduced the baseline downside risks it previously assigned to the lenders.

The successful vaccine rollout programme is credit positive for the financial services sector in general and the improved economic outlook has meant some institutions have been able to reduce provisions for bad loans. While there is still uncertainty around the full extent of the losses banks and building societies will suffer due to the pandemic-related economic slowdown, the sector is in a generally better position now compared to earlier this year and 2020.

At the end of the period Arlingclose had completed its full review of its credit advice on unsecured deposits. The outcome of this review included the addition of NatWest Markets plc to the counterparty list together with the removal of the suspension of Handelsbanken plc. In addition, the maximum duration for all recommended counterparties was extended to 100 days.

As ever, the institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review.

### 3. LOCAL CONTEXT

On 31<sup>st</sup> March 2021, the Council had net investments of £27.4m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment.

These factors are summarised in the table below.

#### Balance Sheet Summary –

	<b>31.3.21 Actual £m</b>
CFR	174
Less: Other debt liabilities	(2)
<b>Borrowing CFR</b>	<b>172</b>
Less: Usable reserves	(108)
Less: Working capital	(16)
<b>Net borrowing</b>	<b>48</b>

\* finance leases, PFI liabilities

Lower official interest rates have lowered the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position at 30<sup>th</sup> September 2021 and the change during the period is shown in the table below.

#### Treasury Management Summary

	<b>31.3.21 Balance £m</b>	<b>6 month Movement £m</b>	<b>30.9.21 Balance £m</b>	<b>30.9.21 Rate %</b>
Long-term borrowing	(104.7)	0.1	(104.6)	5.5
Short-term borrowing	(5.0)	5.0	0.0	n/a
PFI	(1.5)	0.0	(1.5)	n/a
<b>Total borrowing</b>	<b>(111.2)</b>	<b>5.1</b>	<b>(106.1)</b>	
Short-term investments	34.9	43.3	78.2	0.6
Cash and cash equivalents	28.6	(5.7)	22.9	0.0
<b>Total investments</b>	<b>63.5</b>	<b>37.6</b>	<b>101.1</b>	
<b>Net borrowing</b>	<b>(47.7)</b>	<b>42.7</b>	<b>(5.0)</b>	

#### 4. BORROWING UPDATE

Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing.

Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

The Authority is not planning to purchase any investment assets primarily for yield within the next three years and so is able fully access the PWLB

##### Revised PWLB Guidance

HM Treasury published further guidance on PWLB borrowing in August 2021 providing additional detail and clarifications predominantly around the definition of an 'investment asset primarily for yield'. The principal aspects of the new guidance are:

- Capital expenditure incurred or committed to before 26<sup>th</sup> November 2020 is allowable even for an 'investment asset primarily for yield'.
- Capital plans should be submitted by local authorities via a DELTA return. These open for the new financial year on 1<sup>st</sup> March and remain open all year. Returns must be updated if there is a change of more than 10%.
- An asset held primarily to generate yield that serves no direct policy purpose should not be categorised as service delivery.
- Further detail on how local authorities purchasing investment assets primarily for yield can access the PWLB for the purposes of refinancing existing loans or externalising internal borrowing.
- Additional detail on the sanctions which can be imposed for inappropriate use of the PWLB loan. These can include a request to cancel projects, restrictions to accessing the PLWB and requests for information on further plans.

##### Changes to PWLB Terms and Conditions from 8<sup>th</sup> September 2021

The settlement time for a PWLB loan has been extended from two working days (T+2) to five working days (T+5). In a move to protect the PWLB against negative interest rates, the minimum interest rate for PWLB loans has also been set at 0.01% and the interest charged on late repayments will be the higher of Bank of England Base Rate or 0.1%.

Municipal Bonds Agency (MBA): The MBA is working to deliver a new short-term loan solution, available in the first instance to principal local authorities in England, allowing them access to short-dated, low rate, flexible debt. The minimum loan size is expected to be £25 million. Importantly, local authorities will borrow in their own name and will not cross guarantee any other authorities.

If the Authority intends future borrowing through the MBA, it will first ensure that it has thoroughly scrutinised the legal terms and conditions of the arrangement and is satisfied with them.

UK Infrastructure Bank: £4bn has been earmarked for of lending to local authorities by the UK Infrastructure Bank which is wholly owned and backed by HM Treasury. The availability of this lending to local authorities, for which there will be a bidding process, is yet to commence. Loans will be available for qualifying projects at gilt yields plus 0.6%, which is 0.2% lower than the PWLB certainty rate.

## 5. BORROWING STRATEGY

At 30<sup>th</sup> September 2021 the Council held £103.1m of loans as part of its strategy for funding previous years' capital programmes, and £1.5m for specific projects. Outstanding loans on 30<sup>th</sup> September are summarised in the table below.

### Borrowing Position

	<b>31.3.21</b>	<b>6 month</b>	<b>30.9.21</b>	<b>30.9.21</b>
	<b>Balance</b>	<b>Movement</b>	<b>Balance</b>	<b>Rate</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>%</b>
Public Works Loan Board	86.9	0.0	86.9	5.75
Bank (long term)	16.2	0.0	16.2	4.22
Local Authority	5.0	(5.0)	0.0	n/a
Specific Projects	1.6	(0.1)	1.5	n/a
<b>Total borrowing</b>	<b>109.7</b>	<b>(5.1)</b>	<b>104.6</b>	

The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

With short term interest rates remaining much lower than long term rates, the Council considered it to be more cost effective in the near term to use internal resources and borrow short term loans instead. This strategy enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

## 6. TREASURY INVESTMENT ACTIVITY

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the 6 months, the Council's investment balance ranged between £62.9 and £147.9 million due to timing differences between income and expenditure. The investment position during the period is shown in the table below.

### Treasury Investment Position

	<b>31.3.21</b>	<b>6 month</b>	<b>30.9.21</b>	<b>30.9.21</b>
	<b>Balance</b>	<b>Movement</b>	<b>Balance</b>	<b>Income</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>Returns</b>
				<b>%</b>
Banks & building societies (unsecured)	8.6	15.8	24.4	0.10
Local authorities	20.0	5.0	25.0	0.07
Debt Management Office	0.0	24.0	24.0	0.01
Money Market Funds	26.0	(7.5)	18.5	0.01
Pooled Funds	8.9	0.3	9.2	4.10
<b>Total investments</b>	<b>63.5</b>	<b>37.6</b>	<b>101.1</b>	

Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before

seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Ultra low short-dated cash rates which have been a feature since March 2020 when Bank Rate was cut to 0.1% have resulted in the return on sterling low volatility net asset value money market funds (LVNAV MMFs) being close to zero even after some managers have temporarily waived or lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee cuts or waivers should result in MMF net yields having a floor of zero, but the possibility cannot be ruled out.

Deposit rates with the Debt Management Account Deposit Facility (DMADF) are also largely around zero.

£10m of the Authority's investments are held in externally managed strategic pooled property and equity funds where short-term security and liquidity are lesser consideration, and the objectives instead are regular revenue income and long-term price stability. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued stability in meeting the Authority's investment objective are regularly reviewed.

The performance of our pooled property and equity funds at 30 September 2021 can be seen below:

STRATEGIC POOLED FUND PORTFOLIO			GWYNEDD				From:	22/02/2019	To:	30/09/2021
FUND NAME	ASSET CLASS	No of Units Held in Period	Current Value £	Capital Growth £	Dividends Earned £	Holding Period (yrs)	Capital Return	Income Return	Total Return	Volatility
AEGON (KAMES) DIVERSIFIED MONTHLY INCOME FUND	MULTI ASSET	1,158,480	1,254,947	-4,947	157,264	2.6	0.40%	12.58%	12.98%	15.6%
CCLA - LAMIT PROPERTY FUND	PROPERTY	1,524,344	4,713,881	-286,119	493,097	2.6	-5.72%	9.86%	4.14%	5.7%
NINETY ONE (INVESTEC) DIVERSIFIED INCOME FUND	MULTI ASSET	1,209,599	1,207,116	-42,884	136,604	2.6	-3.43%	10.93%	7.50%	7.8%
SCHRODER INCOME MAXIMISER FUND	EQUITY - UK	5,173,994	2,067,528	-447,780	428,897	2.5	-17.80%	17.05%	-0.75%	17.7%
<b>GRAND TOTAL</b>			<b>9,243,472</b>	<b>-771,837</b>	<b>1,215,861</b>	<b>2.6</b>	<b>-7.71%</b>	<b>12.14%</b>	<b>4.43%</b>	<b>8.0%</b>
			Unrealised capital loss since purchase:		<b>-756,529</b>	Annualised income return:		<b>4.53%</b>		

It is evident that the combined capital value of £9.243m is less than the initial investment of £10m. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters, and even years; but with the confidence that over a three to five year period total returns will exceed cash interest rates. Investment in these funds will be maintained in the medium term.

## Investment Benchmarking

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in the table below.

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
30.06.2021	4.66	A+	51%	35	1.43
30.09.2021	4.52	A+	41%	34	1.74
<b>Similar LAs</b>	<b>4.73</b>	<b>A+</b>	<b>58%</b>	<b>48</b>	<b>0.48</b>
<b>All LAs</b>	<b>4.69</b>	<b>A+</b>	<b>69%</b>	<b>10</b>	<b>2.35</b>

## Treasury Management Performance

The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates.

The Council's budgeted investment income for the year is £0.4m, however the actual expected investment income for the year 2021/22 is slightly higher, estimated at £0.44m.

## 7. COMPLIANCE

I can confirm that the treasury management activities undertaken during the period complied fully with CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

The Council's borrowing and investments remained well within the limits originally set.

### Debt Limits

	Maximum during period	30.9.21 Actual	2021/22 Operational Boundary	2021/22 Authorised Limit	Complied
Borrowing	£109.7m	£104.6m	£184m	£194m	✓
PFI & finance leases	£1.5m	£1.5m	£6m	£6m	✓
<b>Total debt</b>	<b>£111.2m</b>	<b>£106.1m</b>	<b>£190m</b>	<b>£200m</b>	✓

### Investment Limits

	Counterparty Maximum during period	Counterparty 30.9.21 Actual	Counterparty 2021/22 Limit	Complied
The UK Government	£50m	£24m	Unlimited	✓
Local authorities & other government entities	£5m	£5m	£10m	✓
Secured investments	£0	£0m	£10m	✓
Banks (unsecured)	£5m	£5m	£5m	✓
Building societies (unsecured)	£0	£0	£5m	✓
Registered providers (unsecured)	£0m	£0m	£5m	✓
Money market funds	£7m	£7m	£10m	✓
Strategic pooled funds	£5m	£5m	£10m	✓
Real Estate Investment Trusts	£0	£0	£10m	✓
Other investments	£0m	£0m	£5m	✓



## Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators.

**Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating or credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target	Actual	Complied
Portfolio average credit score	6.0	4.52	✓

**Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments.

	30.9.21 Actual	2021/22 Target	Complied
Total cash available within 3 months	£76.9m	£10m	✓

**Interest Rate Exposures:** This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one year revenue impact of a 1% rise or fall in interest was:

Interest rate risk indicator	30.9.21 Actual	2021/22 Limit	Complied
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£573,968	£635,000	✓
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£0	£24,000	✓

**Maturity Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Actual	Upper	Lower	Complied?
Under 12 months	1.46%	25%	0%	✓
12 months and within 24 months	1.50%	25%	0%	✓
24 months and within 5 years	11.37%	50%	0%	✓
5 years and within 10 years	6.74%	75%	0%	✓
10 years and above	78.92%	100%	0%	✓

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

**Principal Sums Invested for Periods Longer than 364 days:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2021/22	2022/23	2023/24
Actual principal invested beyond year end	£0m	£0m	£0m
Limit on principal invested beyond year end	£20m	£20m	£20m
<b>Complied</b>	✓	✓	✓

## 8. INVESTMENT TRAINING

During the period, officers have attended investment training with Arlingclose and CIPFA relevant to their roles.

## 9. REVISION TO CIPFA CODES

In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These followed the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. In June, CIPFA provided feedback from this consultation.

In September CIPFA issued the revised Codes and Guidance Notes in draft form and opened the latest consultation process on their proposed changes. The changes include:

- Clarification that (a) local authorities must not borrow to invest primarily for financial return (b) it is not prudent for authorities to make any investment or spending decision that will increase the Capital Financing Requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority.
- Categorising investments as those (a) for treasury management purposes, (b) for service purposes and (c) for commercial purposes.
- Defining acceptable reasons to borrow money: (i) financing capital expenditure primarily related to delivering a local authority's functions, (ii) temporary management of cash flow within the context of a balanced budget, (iii) securing affordability by removing exposure to future interest rate rises and (iv) refinancing current borrowing, including replacing internal borrowing.
- For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services).
- Prudential Indicators
  - New indicator for net income from commercial and service investments to the budgeted net revenue stream.
  - Inclusion of the liability benchmark as a mandatory treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the authority's full debt maturity profile.
  - Excluding investment income from the definition of financing costs.
- Incorporating ESG issues as a consideration within TMP 1 Risk Management.
- Additional focus on the knowledge and skills of officers and elected members involved in decision making

## 10. OUTLOOK FOR THE REMAINDER OF 2021/22

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
<b>Official Bank Rate</b>													
Upside risk	0.00	0.15	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
<b>Arlingclose Central Case</b>	<b>0.10</b>	<b>0.10</b>	<b>0.25</b>	<b>0.25</b>	<b>0.25</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>
Downside risk	0.00	0.00	0.15	0.15	0.15	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

Arlingclose expects Bank Rate to rise in Q2 2022. We believe this is driven as much by the Bank of England's desire to move from emergency levels as by fears of inflationary pressure.

Investors have priced in multiple rises in Bank Rate to 1% by 2024. While Arlingclose believes Bank Rate will rise, it is by a lesser extent than expected by markets.

The global economy continues to recover from the pandemic but has entered a more challenging phase. The resurgence of demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. This is particularly apparent in the UK due to the impact of Brexit.

While Q2 UK GDP expanded more quickly than initially thought, the 'pingdemic' and more latterly supply disruption will leave Q3 GDP broadly stagnant. The outlook also appears weaker. Household spending, the driver of the recovery to date, is under pressure from a combination of retail energy price rises, the end of government support programmes and soon, tax rises. Government spending, the other driver of recovery, will slow considerably as the economy is taken off life support.

Inflation rose to 3.2% in August. A combination of factors will drive this to over 4% in the near term. While the transitory factors affecting inflation, including the low base effect of 2020, are expected to unwind over time, the MPC has recently communicated fears that these transitory factors will feed longer-term inflation expectations that require tighter monetary policy to control. This has driven interest rate expectations substantially higher.

The supply imbalances are apparent in the labour market. While wage growth is currently elevated due to compositional and base factors, stories abound of higher wages for certain sectors, driving inflation expectations. It is uncertain whether a broad-based increase in wages is possible given the pressures on businesses.

Government bond yields increased sharply following the September FOMC and MPC minutes, in which both central banks communicated a lower tolerance for higher inflation than previously thought. The MPC in particular has doubled down on these signals in spite of softer economic data. Bond investors expect higher near-term interest rates but are also clearly uncertain about central bank policy.

The MPC appears to be playing both sides, but has made clear its intentions to tighten policy, possibly driven by a desire to move away from emergency levels. While the economic outlook will be challenging, the signals from policymakers suggest Bank Rate will rise unless data indicates a more severe slowdown.