

## North Norfolk District Council Treasury Management Mid-Year Update 2021-22

### Introduction

The Authority has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports. This quarterly report provides an additional update.

The Authority's treasury management strategy for 2021/22 was approved at a meeting on 24<sup>th</sup> February 2021. The Authority 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 remains central to the Authority'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 Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 24<sup>th</sup> February 2021.

### 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.

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.

**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, that was previously thought. However, an increase in gas prices in the UK and EU, supply shortages and a dearth 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 instance, lead to higher prices.

**Credit review:** 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.

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.

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

### **Local Context**

On 31<sup>st</sup> March 2021, the Authority had net investments of £41.810m 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.

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 Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk.

The treasury management position on 30<sup>th</sup> September 2021 and the change over the six months is shown in Table 1 below.

**Table 1: Treasury Management Summary**

	<b>31.3.21 Balance £m</b>	<b>Movement £m</b>	<b>30.9.21 Balance £m</b>	<b>30.9.21 Rate %</b>
Long-term borrowing	0.000	0.000	0.000	N/A
Short-term borrowing	7.000	(4.000)	3.000	
<b>Total borrowing</b>	<b>7.000</b>	<b>(4.000)</b>	<b>3.000</b>	
Long-term investments	32.000	0.000	32.000	
Short-term investments	0.000	0.000	0.000	
Cash and cash equivalents	9.810	(8.715)	1.095	
<b>Total investments</b>	<b>41.810</b>	<b>(8.715)</b>	<b>33.095</b>	
<b>Net investments</b>	<b>34.810</b>	<b>(4.715)</b>	<b>30.095</b>	

### **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.

Competitive market alternatives may be available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders. Further changes to the CIPFA Prudential Code expected in December 2021 are likely to prohibit borrowing for the primary purpose of commercial return even where the source of borrowing is not the PWLB.

The Authority is currently reviewing its capital programme in light of PWLB lending arrangement changes and may consider the cancellation of planned purchases of assets primarily for yield so as to retain access to 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.

## Borrowing Strategy during the period

At 30<sup>th</sup> September 2021 the Authority held £3m of loans, (a decrease of £4m to 31<sup>st</sup> March 2021), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30<sup>th</sup> September are summarised in Table 2 below.

Table 2: Borrowing Position

	<b>31.3.21 Balance £m</b>	<b>Net Movement £m</b>	<b>30.9.21 Balance £m</b>	<b>30.9.21 Weighted Average Rate %</b>	<b>30.9.21 Weighted Average Maturity (years)</b>
Local authorities (short-term)	7.000	(4.000)	3.000		<1
<b>Total borrowing</b>	<b>7.000</b>	<b>(4.000)</b>	<b>3.000</b>		

The Authority'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 Authority's long-term plans change being a secondary objective.

With short-term interest rates remaining much lower than long-term rates and with surplus of liquidity continuing to feature in the LA to LA market, the Authority considered it to be more cost effective in the near term to use internal resources or borrowed rolling temporary / short-term loans instead. The net movement in temporary / short-term loans is shown in table 3 above.

The Authority's borrowing decisions are not predicated on any one outcome for interest rates.

PWLB funding margins have lurched quite substantially and there remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields plus 0.80%. The Authority will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.

### **Treasury Investment Activity**

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £33.095 and £71.747 million due to timing differences between income and expenditure. The investment position is shown in table 3 below.

Table 3: Treasury Investment Position

	<b>31.3.21 Balance £m</b>	<b>Net Movement £m</b>	<b>30.9.21 Balance £m</b>	<b>30.9.21 Income Return %</b>
Banks & building societies (unsecured)	0.000	0.000	0.000	N/A
Money Market Funds	9.810	(8.715)	1.095	0.01
Other Pooled Funds				
- <i>Cash plus funds</i>	3.000	0.000	3.000	0.45
- <i>Short-dated bond funds</i>	3.000	0.000	3.000	0.41
- <i>Strategic bond funds</i>	5.000	0.000	5.000	1.59
- <i>Equity income funds</i>	8.000	0.000	8.000	3.03
- <i>Property funds</i>	5.000	0.000	5.000	5.19
- <i>Multi asset income funds</i>	8.000	0.000	8.000	3.83
<b>Total investments</b>	<b>41.810</b>	<b>(8.715)</b>	<b>33.095</b>	<b>2.36</b>

Both the CIPFA Code and government guidance require the Authority 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 Authority'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.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 4 below.

Table 4: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2021	4.92	A+	100%	1	0.15%
30.09.2021	4.75	A+	100%	1	0.01%
<b>Similar LAs</b>	<b>4.66</b>	<b>A+</b>	<b>69%</b>	<b>32</b>	<b>0.08%</b>

\*Weighted average maturity

**Externally Managed Pooled Funds:** £32m of the Authority’s investments are held in externally managed strategic pooled bond, equity, multi-asset and property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generated an average total return of £1.349m, comprising a £0.458m income return which is used to support services in year, and £0.891m of capital growth.

The Authority is invested in bond, equity, multi-asset and property funds. The improved market sentiment in the past 6 months is reflected in equity, property and multi-asset fund valuations and, in turn, in the capital values of the Authority’s equity and multi-asset income funds in the Authority’s portfolio. The prospect of higher inflation and rising bond yields resulted in muted bond fund performance. The change in capital values and income earned is shown in Table 4.

Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority’s medium- to long-term investment objectives are regularly reviewed. 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 has been maintained during the half year.

The Authority has budgeted £1,172,889 income from these investments in 2021/22. Income received to date was £458,000.

### **Non-Treasury Investments**

The definition of investments in CIPFA’s revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in the Investment Guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The Authority also held £2.947m of such investments in

- directly owned property £0.390m
- loans to housing associations and community housing £2.558m

These investments generated £0.066m of investment income for the Authority after taking account of direct costs, representing a rate of return of 4.48%. This compares favourably against Treasury investment rates, particularly against shorter term deposits. These investments represent a different risk to the Authority, as property investments do not carry the same interest rate or credit risk, but there is the risk of loss of income through voids and other market factors. They also require more staff time to manage than externalised pooled investments.

The Authority does not currently rely on these funds from Non-Treasury investments to balance the budget, but in a climate of reduced Government funding, is likely to do so more in the future. To guard against the risk of reducing levels of income from these investments, they are proactively managed by experienced and qualified individuals within the Authority, with external advice as required.

### **Treasury Performance**

The Authority 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, as shown in table 5 below.

**Table 5: Performance**

	<b>Actual £m</b>	<b>Budget £m</b>	<b>Over/ under</b>	<b>Actual %</b>	<b>Benchmark %</b>	<b>Over/ under</b>
Money Market Funds	0.000	0.000	N/A	0.01%	N/A	Over
Pooled Funds	0.458	0.586	Under	2.85%	3.45%	Under
<b>Total treasury investments</b>	<b>0.458</b>	<b>0.586</b>	<b>Under</b>	<b>2.36</b>	<b>3.45%</b>	<b>Under</b>

### **Compliance**

The Chief Finance Officer reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 6 below.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 6 below.

**Table 6: Debt Limits**

	<b>H1 Maximum</b>	<b>30.9.21 Actual</b>	<b>2021/22 Operational Boundary</b>	<b>2021/22 Authorised Limit</b>	<b>Complied? Yes/No</b>
Borrowing	10.000m	3.000m	23.530m	28.400m	Yes
<b>Total debt</b>	<b>10.000m</b>	<b>3.000m</b>	<b>23.530m</b>	<b>28.400m</b>	Yes



Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

**Table 7: Investment Limits**

	<b>H1 Maximum</b>	<b>30.9.21 Actual</b>	<b>2021/22 Limit</b>	<b>Complied? Yes/No</b>
Local authorities & other government entities	nil	nil	Unlimited	Yes
Secured investments	nil	nil	Unlimited	Yes
Banks (unsecured)	nil	nil	£5m	Yes
Building societies (unsecured)	nil	nil	£5m	Yes
Registered providers (unsecured)	nil	nil	£10m	Yes
Money market funds	£14.080	£1.095m	£20m	Yes
Strategic pooled funds	£32m	£32m	Unlimited	Yes
Real estate investment trusts	nil	nil	£10m	Yes
The UK Government	£26m	nil	Unlimited	Yes
Other investments	nil	nil	£5m	Yes
Any group of pooled funds under the same management	£7m	£7m	£15m	Yes
Negotiable instruments held in a broker's nominee account	nil	nil	£10m	Yes
Foreign countries	nil	nil	£6m	Yes

**Treasury Management Indicators**

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

**Security:** The Authority 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. Unrated investments are assigned a score based on their perceived risk.

	<b>30.9.21 Actual</b>	<b>2021/22 Target</b>	<b>Complied?</b>
Portfolio average credit score	4.75	6.0	Yes

**Liquidity:** The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	<b>30.9.21 Actual</b>	<b>2021/22 Target</b>	<b>Complied?</b>

Total sum borrowed in past 3 months without prior notice	£0m	£10m	Yes
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**Interest Rate Exposures:** This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests 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	£335,281	£600,000	Yes
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£335,281	£600,000	Yes

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

**Maturity Structure of Borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	30.9.21 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	100%	100%	0%	Yes
12 months and within 24 months	0%	100%	0%	Yes
24 months and within 5 years	0%	100%	0%	Yes
5 years and within 10 years	0%	100%	0%	Yes
10 years and above	0%	100%	0%	Yes

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 a year:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2021/22	2022/23	2023/24
Actual principal invested beyond year end	£32m	£32m	£32m
Limit on principal invested beyond year end	£50m	£50m	£50m
Complied?	Yes	Yes	Yes

### Revisions 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

**MHCLG Improvements to the Capital Finance Framework:** MHCLG published a brief policy paper in July outlining the ways it feels that the current framework is failing and potential changes that could be made. The paper found that “while many authorities are compliant with the framework, there remain some authorities that continue to engage in practices that push the bounds of compliance and expose themselves to excessive risk”.

The actions announced include greater scrutiny of local authorities and particularly those engaged in commercial practices; an assessment of governance and training; a consideration of statutory caps on borrowing; further regulations around Minimum Revenue Provision (MRP) and ensuring that MHCLG regulations enforce guidance from CIPFA and the new PWLB lending arrangements.

A further consultation on these matters is expected soon.

Arlingclose’s Economic Outlook for the remainder of 2021/22 (based on the October 2021 interest rate forecast)

	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
Official Bank Rate													
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
Arlingclose Central Case	0.10	0.10	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
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 increased 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.