Treasury Management Mid-year Report for 2020/21

SUMMARY

This Report advises members of the Treasury Management Service performance for 2020/21 as at 30th September 2020 and illustrates the compliance to-date with the Treasury Management Indicators for 2020/21.

PORTFOLIO	Finance
WARDS AFFECTED	All

RECOMMENDATION

The Performance and Finance Scrutiny committee are advised to NOTE and COMMENT on the report.

1. EXECUTIVE SUMMARY

1.1 This report sets out the performance of the Council's investments and borrowing for the first six months of the year. It is also intended to demonstrate that the Council is complying with the Treasury Management Indicators set by Full Council as part of the Treasury Management Strategy.

1.2 The Council is complying with all the Treasury Management Indicators set for 2020/21 as at the 30th September 2020.

2. RESOURCE IMPLICATIONS

2.1 None directly as a result of this paper, but the investment income and borrowing costs do impact the revenue budget.

3. KEY ISSUES

Background

3.1 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).

3.2 The Council's Treasury Management Strategy for 2020/21 was approved by Executive on 26th February 2020.

3.3 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 approved by Full Council on 26th February 2020.

3.4 Through investment, the Council is potentially exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The Council is also exposed to increases in revenue costs on its borrowing due to changes in interest rates. The Council seeks to moderate this impact by following the advice of its treasury advisers. This report covers treasury and borrowing activity and the associated monitoring and control of risk.

Local Context

3.5 At 31 March 2020, the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £196m. The Council must not borrow in excess of its CFR requirement and indeed at the 30th September total borrowing was £170m.

4. TREASURY PERFORMANCE

Borrowing Activity to 30th September 2020

4.1 At 30 September 2020 the Council held £170m of borrowing, (an increase of £10m on 31/3/2020) as part of its strategy for funding previous and current year's capital programmes. The increase was due to short term borrowing for the construction of a new Leisure Centre.

The borrowing position is shown in the table below:

Borrowing Position - 30.09.2020

	31.03.20 Balance £m	**Movement £m**	**30.09.20 Balance £m**	**30.09.20 Weighted average rate %**
Public Works Loan Board	55.89	(2.54)	53.35	2.54%
Local authorities (long-term)	0.27	(0.27)	0.00	0.00%
Local authorities (short-term)	104.00	13.10	117.10	0.72%
Total Borrowing	**160.16**	**10.29**	**170.45**	**1.09%**

4.2 At 30th September 2020, the Council had an upper operational limit of borrowing of £230m.

4.3 The Council's chief objective when borrowing continues to be striking 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 rates remaining much lower than long term rates, on the advice of its treasury advisers, the Council considered it to be more cost effective in the near term to borrow short term loans instead.

4.4 In order to reduce risk the Council entered into £50million of forward starting loans during 2017/18 with forward starting dates. Hence in 2020/21 a loan of £25million with a fixed interest rate of 2.853% will be advanced to the Council and then a further £25m in 2021/22

with a fixed interest rate of 2.908% will be advanced. Both loans will be repayable over 40 years.

4.5 On 9th October 2019 the PWLB raised the cost of certainty rate borrowing to 1.8% above UK gilt yields making it relatively expensive. Market alternatives are available, however the financial strength of individual authorities will be scrutinised by investors and commercial lenders.

4.6 The Chancellor's March 2020 Budget statement included significant changes to Public Works Loan Board (PWLB) policy and launched a wide-ranging consultation on the PWLB's future direction. Announcements included a reduction in the margin on new Housing Revenue Account (HRA) loans to 0.80% above equivalent gilt yields. £1.15bn of additional "infrastructure rate" funding at gilt yields plus 0.60% has been made available to support specific local authority infrastructure projects for England, Scotland and Wales for which there is a bidding process.

4.7 The consultation titled "Future Lending Terms" allows stakeholders to contribute to developing a system whereby PWLB loans can be made available at improved margins to support qualifying projects. It contains proposals to allow authorities that are not involved in "debt for yield" activity to borrow at lower rates as well as stopping local authorities using PWLB loans to buy commercial assets primarily for yield. The consultation also broaches the possibility of slowing, or stopping, individual authorities from borrowing large sums in specific circumstances.

4.8 The consultation closed on 31st July 2020 with the announcement and implementation of the revised lending terms expected in the latter part of this calendar year or early next year.

4.9 Municipal Bonds Agency (MBA): The MBA revised its standard loan terms and framework agreement. Guarantees for the debt of other borrowers are now proportional and limited and a requirement to make contribution loans in the event of a default by a borrower has been introduced. The agency has issued 5-year floating rate and 40-year fixed rate bonds in 2020, in both instances Lancashire County Council is the sole borrower and guarantor.

4.10 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.

Investment Activity to 30th September 2020

4.11 On 1st April 2020 and 15th June 2020, the Authority received central government funding to support small and medium businesses during the coronavirus pandemic through grant schemes. £23m was received and temporarily invested with the Debt Management Office and other Local Authorities. £15m was disbursed by the end of September 2020.

4.12 The Council held invested funds, representing income received in advance of expenditure plus balances and reserves held. During the half year, the Council's average investment balance was £20 million.

4.13 The Council's investment position at the half year is shown in the table below.

Investment Activity Summary at 30 September 2020

Investment Counterparty	Balance on 01/04/20	Investments Made	Maturities/ Investments Sold	Balance on 30/09/20	Average Income Rate to 30th September
	£000s	£000s	£000s	£000s	%
Government					
- UK Central Government Short Term	2,000	242,031	(237,461)	6,570	0.02%
- Other Local Authorities Short Term	0	13,500	(10,000)	3,500	0.32%
Banks, Building Societies & Other Organisations					
- Short Term	736	20,375	(19,065)	2,046	0.02%
AAA-rated Money Market Funds					
- Short Term Cash Equivalents	9,000	20,650	(19,950)	9,700	0.20%
- Long Term	2,106	0	(56)	2,051	4.26%
Total Investments	**13,842**	**296,556**	**(286,531)**	**23,867**	**0.42%**

4.14 Continued downward pressure on short-dated cash rate brought net returns on sterling low volatility net asset value money market funds (LVNAV MMFs) close to zero even after some managers have temporarily lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee waivers should maintain positive net yields, but the possibility cannot be ruled out.

4.15 On 25th September the overnight, 1- and 2-week deposit rates on Debt Management Account Deposit Facility (DMADF) deposits dropped below zero percent to -0.03%, the rate was 0% for 3-week deposits and 0.01% for longer maturities.

4.16 The return on Money Market Funds net of fees also fell over the six months and for many funds net returns range between 0% and 0.1%. In many instances, the fund management companies have temporarily lowered or waived fees to maintain a positive net return.

4.17 In the light of the pandemic crisis and the likelihood of unexpected calls on cash flow, the Authority kept more cash available at very short notice than is normal. Liquid cash was diversified over several counterparties and/or Money Market Funds to manage both credit and liquidity risks.

4.18 Due to the amounts of government grants that we are now receiving, we would like the Performance and Finance Scrutiny committee to allow a change in the Council's treasury management strategy by increasing the limit of the amount of money we can invest in Money Market Funds from £10m to £15m as a way of reducing our liability to negative interest rates for a temporary period of 6 months.

4.19 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.

4.20 The Council maintained its investment of £2m in the CCLA Property Fund whilst the remainder of investments were invested in money market funds. This £2m longer term investment generated an average total negative return of £7k (4.26% dividend yield), comprising £49k income return which is used to support services in year, and £56k of capital loss.

4.21 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 Council's 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. In light of their performance the Council's, investment in these funds has been maintained.

4.22 In a relatively short period since the onset of the COVID-19 pandemic in March and the ensuing enforced lockdown in many jurisdictions, the global economic fallout has been sharp and large. Market reaction was extreme with large falls in equities, corporate bond markets and, to some extent, real estate echoing lockdown-induced paralysis and the uncharted challenges for governments, business and individuals.

4.23 Similar to many other property funds, dealing (i.e. buying or selling units) in the CCLA Local Authorities Property Fund was suspended by the fund in March 2020. The relative infrequency of property transactions in March as the pandemic intensified meant that it was not possible for valuers to be confident that their valuations correctly reflected prevailing conditions. To avoid material risk of disadvantage to buyers, sellers and holders of units in the property fund, the management company was obliged to suspend transactions until the required level of certainty is re-established. The dealing suspension was lifted in September 2020. There has also been a change to redemption terms for the CCLA Local Authorities Property Fund; from September 2020 investors are required to give at least 90 calendar days' notice for redemptions.

4.24 In 2020/21 the Authority expects to receive significantly lower income from its cash and short-dated money market investments and from its externally managed funds than it did in 2019/20 and earlier years. Dividends and income paid will ultimately depend on many factors including but not limited to the duration of COVID-19 and the extent of its economic impact, the fund's sectoral asset allocation, securities held/bought/sold and, in the case of equities, the enforced or voluntary dividend cuts or deferral.

4.25 Annex A lists the Council's investments as at the 30th September 2020.

Credit Risk

4.26 The table below shows counterparty credit quality as measured by credit ratings.

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating
31/03/2020	4.07	AA-	3.57	AA-
31/09/2020	3.95	AA-	3.47	AA

The value weighted average and time weighted average credit ratings increased to 3.95 at 30.09.2020 compared to 4.07 at 31.03.2020. This AA- rating at 30.09.20 is still above the Council's target of A.

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
-B- = lowest credit quality = 16
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

Budgeted Income and Outturn

4.27 The average cash balance was £18m during the half year. The Council's best performing investment was its £2m of externally managed pooled (property fund) which generated income of £49k to 30/09/20.

4.28 The balance of the Council's investments were kept in short-term money markets.

4.29 The Council's investment income for the first six months was £63k compared to an annual budgeted figure of £140k. The Estimated return at year end is £112k which will show a shortfall of £28k due to low interest rates as per annex D of this report.

Readiness for Brexit

4.30 The scheduled leave date for the UK to leave the EU is now 31st December 2020 and as 31st December 2020 approaches, the Council will ensure there are enough accounts open at UK domiciled banks and Money Market Funds to hold sufficient liquidity required in the near term and that its account with the Debt Management Account Deposit Facility (DMADF) remains available for use in an emergency.

Counterparty Update provided in association with Arlingclose Treasury Advisers

4.31 Credit review: Credit default swap spreads eased over most of the period but then started to tick up again through September. In the UK, the spreads between ringfenced and non-ringfenced entities remains, except for retail bank Santander UK whose CDS spread

remained elevated and the highest of those we monitor at 85bps while Standard Chartered was the lowest at 41bps. The ringfenced banks are currently trading between 45 and 50bps.

4.32 After a busy second quarter of the calendar year, the subsequent period has been relatively quiet for credit changes for the names on our counterparty list. Fitch assigned a AA- deposit rating to Netherlands lender Rabobank with a negative outlook and prior to that, while not related to our counterparty list but quite significant, revised the outlook on the US economy to Negative from Stable while also affirming its AAA rating.

4.33 There continues to remain much uncertainty around the extent of the losses banks and building societies will suffer due to the impact from the coronavirus pandemic and for the UK institutions on our list there is the added complication of the end of the Brexit transition period on 31st December and what a trade deal may or may not look like. The institutions on Arlingclose's counterparty list and recommended duration remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.

Compliance with Treasury Management Indicators

4.34 The Council confirms compliance with its Treasury Management Indicators in the period to 30th September 2020. These were set in February 2020. Details of these indicators are shown in Annexes B and C.

Economic Review and Outlook for the remainder of the year

4.35 The Council's advisers Arlingclose have provided an Economic Review of the year so far and an outlook for Quarters 3 and 4. This is included in Annex D.

5 PROPOSALS

5.1 It is proposed that the Performance and Finance Scrutiny Committee NOTE and COMMENT on the report.

6 CORPORATE OBJECTIVES AND KEY PRIORITIES

6.1 The Treasury Management processes support the Council's objective of 'Delivering services efficiently, effectively and economically'.

7 POLICY FRAMEWORK

7.1 The Council fully complies with the requirements of the CIPFA Code of Practice on Treasury Management. The current relevant criteria and constraints incorporated into the Treasury Management Policy Statement are:

- New borrowing is to be contained within the limits approved by the Council, in accordance with the CIPFA Prudential Code for Capital Finance in Local Authorities, and the Council's prudential indicators.

- Investments to be made in accordance with the MHCLG guidance on Local Council Investments, on the basis of credit ratings agencies and as detailed in the Treasury Management Policy statement and approved schedules and practices.

- Sufficient funds to be available to meet the Council's estimated outgoings for any day.

- Investment objectives are to maximise the return to the Council balanced against the risks to protect reserves.

8 LEGAL ISSUES

8.1 The report demonstrates that the Council is complying with the Prudential Framework.

9 RISK MANAGEMENT

9.1 Weak returns on investments could lead to a reduction in income generated to support the revenue budget.

9.2 The limits in this report in respect to counterparties and investments are the overall limits for agreement by Council. However from time to time these may be tightened temporarily by the Executive Head of Finance in consultation with the Portfolio Holder for Finance to reflect increased uncertainty and increase in perceived risk in financial institutions and the economy. This will usually be at the cost of lower returns.

9.3 The Council has taken and acted on advice from its advisers in relation to increasing returns albeit at increased risk and its borrowing strategy. There are risks that interest rates can change and that any investment is not guaranteed.

9.4 The investments ratings provided by credit ratings agencies are only a guide and do not give 100% security. There is always a risk that an institution may be unable to repay its loans whatever the credit rating. However this can be mitigated by spreading investments amongst a number of institutions.

10 OFFICER COMMENTS

10.1 None other than within the report.

ANNEXES	**Annex A – Investments as at 30th September 2020** **Annex B – Treasury Management Performance Indicators**
BACKGROUND PAPERS	**CIPFA code on Treasury Management**
AUTHOR/CONTACT DETAILS	Nahidah Cuthbert Nahidah.cuthbert@surreyheath.gov.uk Thais Dean Thais.dean@surreyheath.gov.uk
HEAD OF SERVICE	Martin Hone - 01276 707257 Martin.Hone@surreyheath.gov.uk Executive Head of Finance

Annex A

INVESTMENTS as at 30th September 2020

	£
Debt Management Office	6,570,000
Other Local Authorities Short Term	3,500,000
Total Government	**10,070,000**
Money Market Fund - Aberdeen Standard	3,000,000
Money Market Fund – CCLA	700,000
Money Market Fund – Federated	3,000,000
Money Market Fund - Legal and General	3,000,000
Total Money Market Funds	**9,700,000**
CCLA Property Fund	2,050,571
Total Longer Term Investments	**2,050,571**
NatWest Bank Accounts	2,045,965
Total Invested	**23,866,536**

Annex B

Treasury Management Indicators as at the 30th September 2020

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

Debt Limits: 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.

	30.09.20 Actual £m	**2020/21 Operational Boundary £m**	**2020/21 Authorised Limit £m**	**Complied? Yes/No**
Borrowing	170	230	235	Yes

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:

	Upper	**Lower**	**Actual**	**30.09.20 £000s**
Not over 1 year	100%	0%	69%	117.64
Over 1 but not over 2 years	100%	0%	1%	1.09
Over 2 but not over 5 years	100%	0%	2%	3.30
Over 5 but not over 10 years	100%	0%	3%	5.60
Over 10 but not over 15 years	100%	0%	4%	7.25
Over 15 but not over 20 years	100%	0%	3%	5.23
Over 20 but not over 30 years	100%	0%	3%	5.43
Over 25 but not over 30 years	100%	0%	2%	3.18
Over 30 but not over 40 years	100%	0%	6%	10.80
Over 40 years	100%	0%	6%	10.94
Total			**100%**	**170.45**

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 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:

	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£2m	£2m	£2m
Actual	£2m		

	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£2.5m	£2.5m	£2.5m
Actual	£2.0m		

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 30/09/2020
Portfolio average credit rating	A	AA-

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 within a rolling three month period, without additional borrowing.

	Target	Actual 30/09/2020
Total cash available within 3 months	£5m	£9m

Interest Rate Exposures:

This indicator is set to control the Council's exposure to interest rate risk. The Council has set the limit on one-year revenue impact of a 1% rise in interest rates at £1m. The Council complied with this indicator as the interest payable for the half year was £860k. The Council has sufficient reserves in an Interest Equalisation Reserve to mitigate the impact of an interest rate rise for 2020/21.

Annex C

Additional Compliance Information

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

Investment Limits

	2020/21 Limit	**30.09.20 Actual**	**Complied**
Any single organisation, except the UK Government	£3m each	0	Yes
UK Central Government	Unlimited	£6.6m	Yes
UK Local Authorities	£3m each	£3.5m	Yes
Any group of organisations under the same ownership	£3m per group	£2.0m	Yes
Any group of pooled funds under the same management	£5m per manager	£2.0m	Yes
Negotiable instruments held in a broker's nominee account	£10m per broker	0	Yes
Limit per non-UK country	£2m per country	0	Yes
Registered providers	£5m in total	0	Yes
Unsecured investments with building societies	£5m in total	0	Yes
Loans to unrated corporates	£2m in total	0	Yes
Money Market Funds	£10m in total	£9.7m	Yes

Annex D

Economic Review provided by the Council's Treasury Advisors, Arlingclose

Economic background: The spread of the coronavirus pandemic dominated during the period as countries around the world tried to manage the delicate balancing act of containing transmission of the virus while easing lockdown measures and getting their populations and economies working again. After a relatively quiet few months of Brexit news it was back in the headlines towards the end of the period as agreement between the UK and EU on a trade deal was looking difficult and the government came under fire, both at home and abroad, as it tried to pass the Internal Market Bill which could override the agreed Brexit deal, potentially breaking international law.

The Bank of England (BoE) maintained Bank Rate at 0.1% and its Quantitative Easing programme at £745 billion. The potential use of negative interest rates was not ruled in or out by BoE policymakers, but then a comment in the September Monetary Policy Committee meeting minutes that the central bank was having a harder look at its potential impact than was previously suggested took financial markets by surprise.

Government initiatives continued to support the economy, with the furlough (Coronavirus Job Retention) scheme keeping almost 10 million workers in jobs, grants and loans to businesses and 100 million discounted meals being claimed during the 'Eat Out to Help Out' (EOHO) offer.

GDP growth contracted by a massive 19.8% (revised from first estimate -20.4%) in Q2 2020 (Apr-Jun) according to the Office for National Statistics, pushing the annual growth rate down to -21.5% (first estimate -21.7%). Construction output fell by 35% over the quarter, services output by almost 20% and production by 16%. Recent monthly estimates of GDP have shown growth recovering, with the latest rise of almost 7% in July, but even with the two previous monthly gains this still only makes up half of the lost output.

The headline rate of UK Consumer Price Inflation (CPI) fell to 0.2% year/year in August, further below the Bank of England's 2% target, with the largest downward contribution coming from restaurants and hotels influenced by the EOHO scheme. The Office for National Statistics' preferred measure of CPIH which includes owner-occupied housing was 0.5% y/y.

In the three months to July, labour market data showed the unemployment rate increased from 3.9% to 4.1% while wages fell 1% for total pay in nominal terms (0.2% regular pay) and was down 1.8% in real terms (-0.7% regular pay). Despite only a modest rise in unemployment over the period, the rate is expected to pick up sharply in the coming months as the furlough scheme ends in October. On the back of this, the BoE has forecast unemployment could hit a peak of between 8% and 9%.

The US economy contracted at an annualised rate of 31.7% in Q2 2020 (Apr-Jun). The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% but announced a change to its inflation targeting regime. The move is to a more flexible form of average targeting which will allow the central bank to maintain interest rates at low levels for an extended period to support the economy even when inflation is 'moderately' above the 2% average target, particularly given it has been below target for most of the last decade.

The European Central Bank maintained its base rate at 0% and deposit rate at -0.5%.

Financial markets: Equity markets continued their recovery, with the Dow Jones climbing to not far off its pre-crisis peak, albeit that performance being driven by a handful of technology stocks including Apple and Microsoft, with the former up 75% in 2020. The FTSE 100 and 250 have made up around half of their losses at the height of the pandemic in March. Central bank and government stimulus packages continue to support asset prices, but volatility remains.

Ultra-low interest rates and the flight to quality continued, keeping gilts yields low but volatile over the period with the yield on some short-dated UK government bonds remaining negative. The 5-year UK benchmark gilt yield started and ended the June–September period at -0.06% (with much

volatility in between). The 10-year gilt yield also bounced around, starting at 0.21% and ending at 0.23% over the same period, while the 20-year rose from 0.56% to 0.74%. 1-month, 3-month and 12-month bid rates averaged 0.02%, 0.06% and 0.23% respectively over the period.

At the end of September, the yield on 2-year US treasuries was around 0.13% while that on 10-year treasuries was 0.69%. German bund yields remain negative across most maturities.

Outlook for the remainder of 2020/21

The medium-term global economic outlook is weak. While the strict initial lockdown restrictions have eased, coronavirus has not been supressed and second waves have prompted more restrictive measures on a regional and national basis. This ebb and flow of restrictions on normal activity will continue for the foreseeable future, at least until an effective vaccine is produced and importantly, distributed.

The global central bank and government responses have been significant and are in many cases on-going, maintaining more stable financial, economic and social conditions than otherwise. This has supported a sizeable economic recovery in Q3.

However, the scale of the economic shock to demand, on-going social distancing measures, regional lock downs and reduced fiscal support will mean that the subsequent pace of recovery is limited. Early signs of this are already evident in UK monthly GDP and PMI data, even before the latest restrictions.

This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Bank Rate is therefore likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero. Money markets have priced in a chance of negative Bank Rate.

Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or if the UK leaves the EU without a deal.

Arlingclose expects Bank Rate to remain at the current 0.10% level and additional monetary loosening in the future most likely through further financial asset purchases (QE). While Arlingclose's central case for Bank Rate is no change from the current level of 0.1%, further cuts to Bank Rate to zero or even into negative territory cannot be completely ruled out.

Gilt yields are expected to remain very low in the medium term. Shorter-term gilt yields are currently negative and will remain around zero or below until either the Bank of England expressly rules out negative Bank Rate or growth/inflation prospects improve.

Downside risks remain in the near term, as the government dials down its fiscal support measures, reacts to the risk of a further escalation in infection rates and the Brexit transition period comes to an end.

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50