Greater Manchester Combined Authority

Date: 29th July 2022

Subject: Annual Treasury Outturn 2021/22

Report of: Councillor David Molyneux, Portfolio Lead - Resources

Steve Wilson, Treasurer to GMCA

Purpose of Report

This Authority is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2021/22. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

During 2021/22 the minimum reporting requirements were that the full Authority should receive the following reports:

- an annual treasury strategy in advance of the year
- a mid-year, (minimum), treasury update report
- an annual review following the end of the year describing the activity compared to the strategy, (this report)

The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Authority's policies previously approved by Members.

This Authority confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit Committee before they were reported to the full Authority.

Recommendations:

The GMCA is requested to:

Note the contents of the report.

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Equalities Impact, Carbon and Sustainability Assessment:

N/A

Risk Management

There are considerable risks to the security of the GMCA's resources if appropriate Treasury Management strategies and policies are not adopted and followed. The GMCA has established good practice in relation to Treasury Management

Legal Considerations

The Authority has adopted the clauses within the CIPFA Treasury Management Code of Practice, the second of which is that the organisation will receive reports on its treasury and investment management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close. This annual outturn report therefore meets this requirement.

Financial Consequences – Revenue

Financial consequences are contained in the body of the report.

Financial Consequences – Capital

Financial Consequences are contained in the body of the report.

Number of attachments to the report: n/a

Comments/recommendations from Overview & Scrutiny Committee

N/A

Background Papers

GMCA, 12 February 2021, Treasury Management Strategy Statement and Annual Investment Strategy 2021/22

Tracking/ Process

Does this report relate to a major strategic decision, as set out in the GMCA Constitution?

No

Exemption from call in

Are there any aspects in this report which means it should be considered to be exempt from call in by the relevant Scrutiny Committee on the grounds of urgency?

N/A

GM Transport Committee

N/A

Overview and Scrutiny Committee

N/A

1. Introduction and Background

1.1 This report summarises the following:

a) Capital activity during the year;
b) Impact of this activity on the Authority's underlying indebtedness, (the Capital Financing Requirement);
c) The actual prudential and treasury indicators;
d) Overall treasury position identifying how the Authority has borrowed in relation to this indebtedness, and the impact on investment balances;
e) Summary of interest rate movements in the year;
f) Detailed debt activity; and
g) Detailed investment activity.

2. The Authority's Capital Expenditure and Financing

2.1 The Authority undertakes capital expenditure on long-term assets. These activities may either be:

a) Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Authority's borrowing need; or
b) If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

2.2 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£m	**31 March 2021 Actual**	**2021/22 Budget**	**31 March 2022 Actual**
Capital expenditure	416.381	457.069	526.153
Financed in year	(361.337)	(329.039)	(429.011)
Unfinanced capital expenditure	55.044	128.030	97.142

3. The Authority's Overall Borrowing Need

3.1 The Authority's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Authority's indebtedness. The CFR results from the capital activity of the Authority and resources used to pay for the capital spend. It represents the 2021/22 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

3.2 Part of the Authority's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Authority's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, (such as the Government, through the Public Works Loan Board (PWLB), or the money markets), or utilising temporary cash resources within the Authority.

3.3 Reducing the CFR – the Authority's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Authority is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

3.4 The total CFR can also be reduced by:

a) the application of additional capital financing resources, (such as unapplied capital receipts); or

b) charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

3.5 The Authority's 2021/22 MRP Policy, (as required by Department for Levelling Up, Housing and Communities (DLUHC) Guidance), was approved as part of the Treasury Management Strategy Report for 2021/22 on 12 February 2021 and subsequently revised on 11 February 2022.

3.6 The Authority's CFR for the year is shown below and represents a key prudential indicator. It includes Private Finance Initiative (PFI) and leasing schemes on the balance sheet, which increase the Authority's borrowing need. No borrowing is required against these schemes as a borrowing facility is included in the contract.

CFR (£m)	**31 March 2021 Actual**	**2021/22 Budget**	**31 March 2022 Actual**
Opening balance	2,382.404	2,396.554	2,345.059
Add unfinanced capital expenditure (as above)	55.044	128.030	97.142
Less MRP/VRP	(89.127)	(87.641)	(81.224)
Less PFI & finance lease repayments	(3.262)	(3.659)	(1.090)
Closing balance	2,345.059	2,436.943	2,359.887

3.7 Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

3.8 Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Authority should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2021/22) plus the estimates of any additional capital financing requirement for the current (2022/23) and next two financial years. This essentially means that the Authority is not borrowing to support revenue expenditure. This indicator allowed the Authority some flexibility to borrow in advance of its immediate capital needs in 2021/22. The table below highlights the Authority's gross borrowing position against the CFR. The Authority has complied with this prudential indicator.

£m	**31 March 2021**	**2021/22**	**31 March 2022**

	Actual	Budget	Actual
Gross borrowing position	1,541.244	1,521.603	1,466.670
CFR	2,345.059	2,436.943	2,359.887
Under / (over) funding of CFR	803.815	915.340	893.220

3.9 The authorised limit - the authorised limit is the ‘affordable borrowing limit’ required by s3 of the Local Government Act 2003. Once this has been set, the Authority does not have the power to borrow above this level. The table below demonstrates that during 2021/22 the Authority has maintained gross borrowing within its authorised limit.

3.10 The operational boundary – the operational boundary is the expected borrowing position of the Authority during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

3.11 Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

	2021/22
Authorised limit	£2,685.069m
Maximum gross borrowing position during the year	£1,496.620m
Operational boundary	£2,563.021m
Average gross borrowing position	£1,461.393m
Financing costs as a proportion of net revenue stream	9.9%

4. Treasury Position as at 31 March 2022

4.1 The Authority's treasury management debt and investment position is organised by the treasury management service to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the Authority's Treasury Management Practices. At the end of 2021/22 the Authority's treasury, (excluding borrowing by PFI and finance leases), position was as follows:

DEBT PORTFOLIO	**31 March 2021 Principal**	**Rate/ Return**	**Average Life yrs**	**31 March 2022 Principal**	**Rate/ Return**	**Average Life yrs**
PWLB	£567.494m	4.57%	16	£546.199m	4.64%	16
Market	£929.332m	2.71%	20	£879.710m	2.81%	20
Total debt excl PFI liabilities	**£1,496.826m**	**3.41%**	**19**	**£1,425.909m**	**3.51%**	**18**
CFR	£2,345.058m			£2,359.887m		
Over / (under) borrowing	£803.815m			£893.220m		
Total investments	£138.810m	0.0549%	0	£244.934m	0.2816%	0
Net debt	**£665.005m**			**£648.286m**		

DEBT PORTFOLIO	**31 March 2021 actual**	**31 March 2022 actual**
Under 12 months	£130.280m	£87.175m
12 months and within 24 months	£30.679m	£38.696m

24 months and within 5 years	£129.288m	£143.177m
5 years and within 10 years	£396.139m	£378.592m
10 years and within 20 years	£423.601m	£457.099m
20 years and within 30 years	£223.663m	£161.993m
30 years and within 40 years	£73.176m	£69.176m
40 years and within 50 years	£90.000m	£90.000m

INVESTMENT PORTFOLIO	**31 March 2021 Actual £m**	**31 March 2021 Actual %**	**31 March 2022 Actual £m**	**31 March 2022 Actual %**
Treasury investments				
Banks	89.376	64.1%	13.358	5.4%
Local authorities	50.000	35.9%	171.000	69.6%
DMADF (HM Treasury)	-	0.0%	61.300	25.0%
TOTAL TREASURY INVESTMENTS	**139.376**	**100.0%**	**245.658**	**100.0%**
Non-Treasury investments				
Third party loans	244.815	97.0%	217.387	84.2%
Equity	7.501	3.0%	40.766	15.8%
TOTAL NON-TREASURY INVESTMENTS	**252.316**	**100%**	**258.153**	**100%**

Treasury investments	139.376	35.6%	245.658	48.8%
Non-Treasury investments	252.316	64.4%	258.153	51.2%
TOTAL OF ALL INVESTMENTS	**391.692**	**100%**	**503.811**	**100%**

	31 March 2021 Actual £m	**31 March 2022 Actual £m**
Investments		
Longer than 1 year	75.347	130.407
Up to 1 year	316.345	373.404
Total	**391.692**	**503.811**

5. The Strategy for 2021/22

5.1 Investment strategy and control of interest rate risk

5.1.1 Investment returns remained close to zero for much of 2021/22. Most local authority lending managed to avoid negative rates and one feature of the year was the continued growth of inter local authority lending. The expectation for interest rates within the treasury management strategy for 2021/22 was that Bank Rate would remain at 0.1% until it was clear to the Bank of England that the emergency level of rates introduced at the start of the Covid-19 pandemic were no longer necessitated.

5.1.2 The Bank of England and the Government also maintained various monetary and fiscal measures, supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the various lockdowns/negative impact on their cashflow. The Government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates remained low until towards the turn of the year when inflation concerns indicated central banks, not just the Bank of England, would need to lift interest rates to combat the second-round effects of growing levels of inflation (Consumer Price Inflation (CPI) was 6.2% in February 2022).

5.1.3 While the Authority has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

5.1.4 Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as illustrated in the charts shown above and below. Such an approach has also provided benefits in terms of reducing counterparty risk exposure, by having fewer investments placed in the financial markets.

5.2 Borrowing strategy and control of interest rate risk

5.2.1 During 2021/22, the Authority maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Authority's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were very low and minimising counterparty risk on placing investments also needed to be considered.

5.2.2 A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

5.2.3 The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

5.2.4 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Treasurer therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks:

a) if it had been felt that there was a significant risk of a sharp FALL in long- and short-term rates, (for example, due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

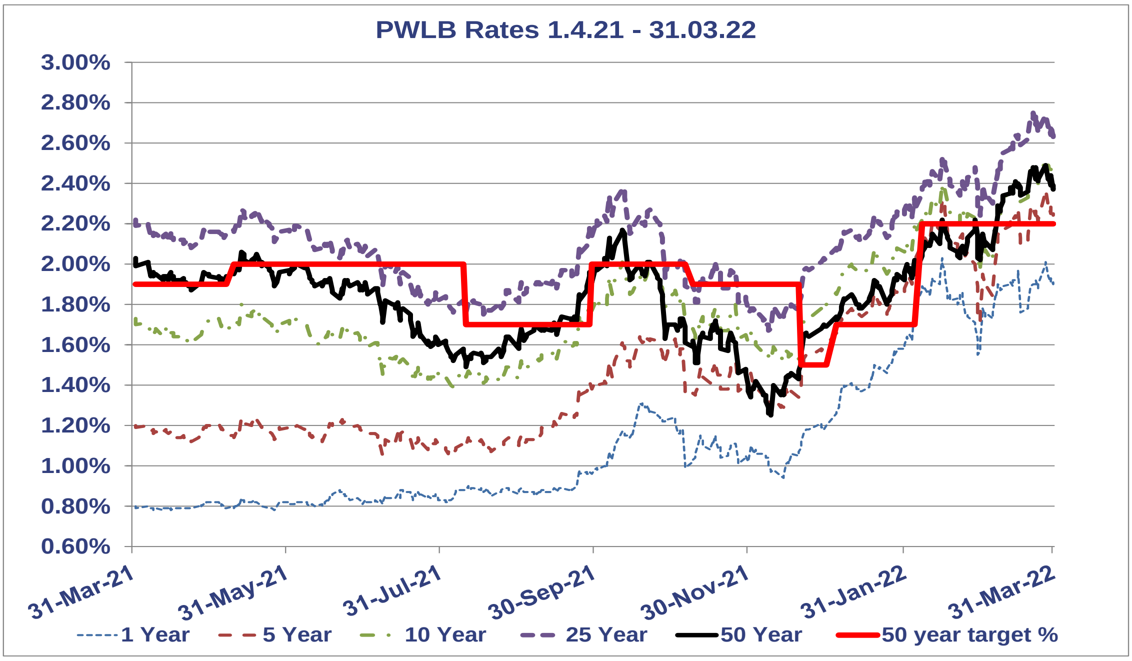
b) if it had been felt that there was a significant risk of a much sharper RISE in long- and short-term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

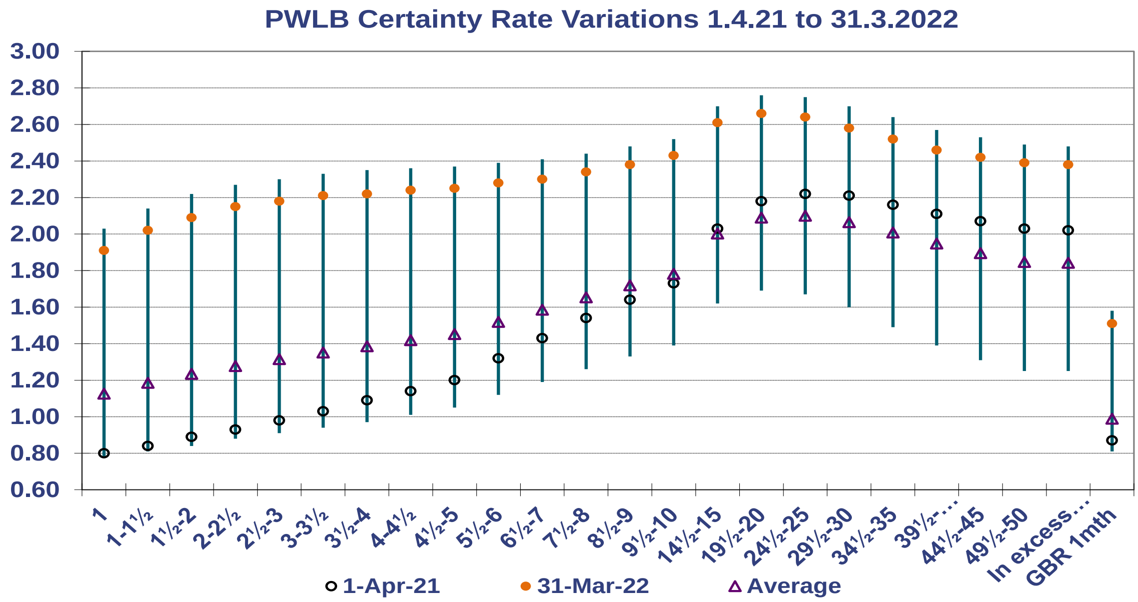
5.2.5 Interest rate forecasts expected only gradual rises in medium and longer-term fixed borrowing rates during 2021/22 and the two subsequent financial years until the turn of the year, when inflation concerns increased significantly. Internal, variable, or short-term rates, were expected to be the cheaper form of borrowing until well in to the second half of 2021/22.

5.2.6 Forecasts at the time of approval of the treasury management strategy report for 2021/22 were as follows:

Link Group Interest Rate View	8.2.21												
	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	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
3 month ave earnings	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
6 month ave earnings	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
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.90	0.90	0.90	0.90	1.00	1.00	1.10	1.10	1.10	1.20	1.20	1.20	1.20
10 yr PWLB	1.30	1.30	1.30	1.30	1.40	1.40	1.50	1.50	1.50	1.60	1.60	1.60	1.60
25 yr PWLB	1.90	1.90	1.90	1.90	2.00	2.00	2.10	2.10	2.10	2.20	2.20	2.20	2.20
50 yr PWLB	1.70	1.70	1.70	1.70	1.80	1.80	1.90	1.90	1.90	2.00	2.00	2.00	2.00

5.2.7 PWLB rates 2021/22

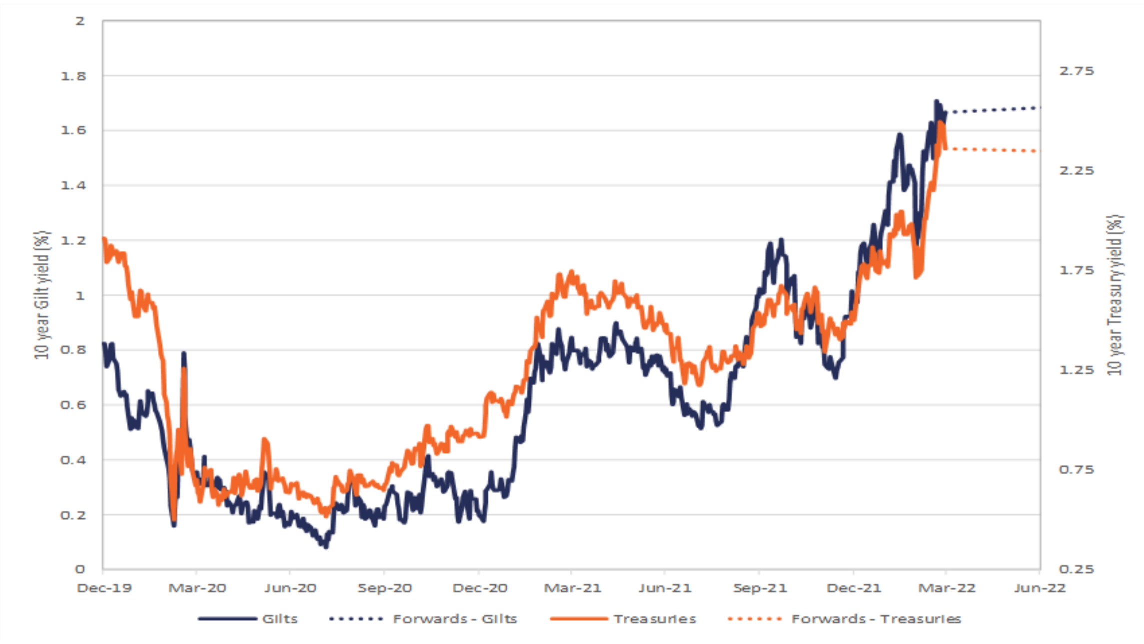




High/low/average PWLB rates for 2021/22

	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2021	0.80%	1.20%	1.73%	2.22%	2.03%
31/03/2022	1.91%	2.25%	2.43%	2.64%	2.39%
Low	0.78%	1.05%	1.39%	1.67%	1.25%
Low date	08/04/2021	08/07/2021	05/08/2021	08/12/2021	09/12/2021
High	2.03%	2.37%	2.52%	2.75%	2.49%
High date	15/02/2022	28/03/2022	28/03/2022	23/03/2022	28/03/2022
Average	1.13%	1.45%	1.78%	2.10%	1.85%
Spread	1.25%	1.32%	1.13%	1.08%	1.24%

5.2.8 PWLB rates are based on gilt (United Kingdom (UK) Government bonds) yields through HM Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in United States (US) treasury yields. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have seen, over the last two years, many bond yields up to 10 years in the Eurozone turn negative on expectations that the European Union (EU) would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession. Recently, yields have risen since the turn of the year on the back of global inflation concerns.



5.2.9 Gilt yields fell sharply from the spring of 2021 through to September 2021 and then spiked back up before falling again through December 2021. However, by January 2022 sentiment had well and truly changed, as markets became focussed on the embedded nature of inflation, spurred on by a broader opening of economies post the pandemic, and rising commodity and food prices resulting from the Russian invasion of Ukraine.

5.2.10 At the close of the day on 31 March 2022, all gilt yields from 1 to 5 years were between 1.11% – 1.45% while the 10-year and 25-year yields were at 1.63% and 1.84%.

5.2.11 Regarding PWLB borrowing rates, the various margins attributed to their pricing are as follows:

- PWLB Standard Rate is gilt plus 100 basis points (G+100bps)
- PWLB Certainty Rate is gilt plus 80 basis points (G+80bps)
- PWLB HRA Standard Rate is gilt plus 100 basis points (G+100bps)
- PWLB HRA Certainty Rate is gilt plus 80bps (G+80bps)
- Local Infrastructure Rate is gilt plus 60bps (G+60bps)

5.2.12 There is likely to be a further rise in short dated gilt yields and PWLB rates over the next three years as Bank Rate is forecast to rise from 0.75% in March 2022 to 1.25% later this year, with upside risk likely if the economy proves resilient in the light of the cost-of-living squeeze. Medium to long dated yields are driven primarily by inflation concerns but the Bank of England is also embarking on a process of Quantitative Tightening when Bank Rate hits 1%, whereby the Bank's £895bn stock of gilt and corporate bonds will be sold back into the market over several years. The impact this policy will have on the market pricing of gilts, while issuance is markedly increasing, is an unknown at the time of writing.

6. Borrowing Outturn

6.1 Borrowing - Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

6.2 Borrowing in advance of need - the Authority has not borrowed more than, or in advance of its needs, purely to profit from the investment of the extra sums borrowed.

6.3 Rescheduling - No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

7. Investment Outturn

7.1 Investment Policy – the Authority's investment policy is governed by DLUHC investment guidance, which has been implemented in the annual investment strategy approved by the Authority on 12 February 2021. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

7.2 The investment activity during the year conformed to the approved strategy, and the Authority had no liquidity difficulties.

7.3 Resources – the Authority's cash balances comprise revenue and capital resources and cash flow monies. The Authority's core cash resources comprised as follows:

Balance Sheet Resources (£m)	**31 March 2021**	**31 March 2022**
Balances	44.951	45.115
Earmarked reserves	422.560	497.677
Provisions	16.044	19.159
Usable capital receipts	54.265	68.572
Total	**537.820**	**630.522**

7.4 Investments held by the Authority

a) The Authority maintained an average balance of £504.089m of internally managed funds.

b) The internally managed funds earned an average rate of return of 0.0506%.

c) Total investment income was £0.251m

7.5 Investments held by the Authority as at 31 March 2022

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest LT / Fund Rating	Historic Risk of Default
Barclays Bank Plc (NRFB)	8,348,673	0.00%		Call	A	0.000%
Bank of Scotland Plc (RFB)	5,009,607	0.01%		Call	A+	0.000%
Cornwall Council	20,000,000	0.35%	16/02/2022	01/04/2022	AA-	0.000%
DMO	61,300,000	0.50%	31/03/2022	01/04/2022	AA-	0.000%
Telford & Wrekin Council	5,000,000	0.07%	24/11/2021	06/04/2022	AA-	0.000%
Westminster City Council	5,000,000	0.40%	07/03/2022	07/04/2022	AA-	0.000%
Suffolk County Council	5,000,000	0.07%	09/12/2021	11/04/2022	AA-	0.001%
East Dunbartonshire Council	5,000,000	0.04%	19/10/2021	19/04/2022	AA-	0.001%
Suffolk County Council	10,000,000	0.04%	07/12/2021	19/04/2022	AA-	0.001%
South Somerset District Council	7,000,000	0.04%	20/12/2021	20/04/2022	AA-	0.001%
Telford & Wrekin Council	5,000,000	0.04%	21/10/2021	21/04/2022	AA-	0.001%
Cheshire East Council	5,000,000	0.17%	24/01/2022	22/04/2022	AA-	0.001%
South Somerset District Council	3,000,000	0.04%	23/12/2021	25/04/2022	AA-	0.002%
Conwy County Borough Council	3,000,000	0.06%	26/10/2021	26/04/2022	AA-	0.002%
Middlesborough Council	5,000,000	0.18%	27/01/2022	27/04/2022	AA-	0.002%
South Somerset District Council	3,000,000	0.10%	27/01/2022	27/04/2022	AA-	0.002%
Telford & Wrekin Council	5,000,000	0.06%	27/10/2021	27/04/2022	AA-	0.002%
Lancashire County Council	10,000,000	0.17%	28/01/2022	28/04/2022	AA-	0.002%
Surrey County Council	20,000,000	0.11%	24/01/2022	29/04/2022	AA-	0.002%
Suffolk County Council	5,000,000	0.05%	05/01/2022	05/05/2022	AA-	0.002%
Aberdeen City Council	5,000,000	0.26%	07/02/2022	09/05/2022	AA-	0.002%
Somerset West and Taunton Council	10,000,000	0.45%	17/02/2022	17/05/2022	AA-	0.003%
Kirklees Borough Council	5,000,000	0.45%	18/02/2022	18/05/2022	AA-	0.003%
Cheltenham Borough Council	5,000,000	0.45%	21/02/2022	23/05/2022	AA-	0.003%
Medway Council	10,000,000	0.48%	25/02/2022	25/05/2022	AA-	0.004%
PCC for Merseyside	15,000,000	0.40%	21/02/2022	11/07/2022	AA-	0.007%
Total Investments	**£245,658,279**	**0.28%**				**0.001%**

8. The Economy and Interest Rates

8.1 **UK Economy**. Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16 December 2021, 0.50% at its meeting of 4 February 2022 and then to 0.75% in March 2022.

8.2 The UK economy has endured several false dawns through 2021/22, but with most of the economy now opened up and nearly back to business-as-usual, the Gross Domestic Product (GDP) numbers have been robust (9% y/y Q1 2022) and sufficient for the Monetary Policy Committee (MPC) to focus on tackling the second-round effects of inflation, now that the CPI measure has already risen to 6.2% and is likely to exceed 8% in April 2022.

8.3 Gilt yields fell towards the back end of 2021, but despite the war in Ukraine gilt yields have shot higher in early 2022. At 1.38%, 2-year yields remain close to their recent 11-year high and 10-year yields of 1.65% are close to their recent six-year high. These rises have been part of a global trend as central banks have suggested they will continue to raise interest rates to contain inflation.

8.4 Historically, a further rise in US Treasury yields will probably drag UK gilt yields higher. There is a strong correlation between the two factors. However, the squeeze on real household disposable incomes arising from the 54% leap in April 2022 utilities prices as well as rises in council tax, water prices and many phone contract prices, are strong headwinds for any economy to deal with. In addition, from 1 April 2022, employees also pay 1.25% more in National Insurance tax. Consequently, inflation will be a bigger drag on real incomes in 2022 than in any year since records began in 1955.

8.5 **Average inflation targeting**. This was the major change in 2020/21 adopted by the Bank of England in terms of implementing its inflation target of 2%. The key addition to the Bank's forward guidance in August 2020 was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That mantra now seems very dated. Inflation is the 'genie' that has escaped the bottle, and a perfect storm of supply side shortages, labour shortages, commodity price inflation, the impact of Russia's invasion of Ukraine and subsequent Western sanctions all point to inflation being at elevated levels until well into 2023.

8.6 **USA**. The flurry of comments from Fed officials following the mid-March 2022 Federal Open Market Committee (FOMC) meeting – including from Chair Jerome Powell himself – hammering home the hawkish message from the mid-March 2022 meeting, has had markets pricing in a further 225bps of interest rate increases in 2022 on top of the initial move to an interest rate range of 0.25% - 0.5%.

8.7 In addition, the Fed is expected to start to run down its balance sheet. Powell noted that the rundown could come as soon as the next meeting in May 2022.

8.8 The upward pressure on inflation from higher oil prices and potential knock-on impacts on supply chains all argue for tighter policy (CPI is estimated at 7.8% across Q1), but the hit to real disposable incomes and the additional uncertainty points in the opposite direction.

8.9 More recently, the inversion of the 10y-2y Treasury yield spread at the end of March 2022 led to predictable speculation that the Fed's interest rate hikes would quickly push the US economy into recession. Q1 GDP growth is likely to be only between 1.0% and 1.5% annualised (down from 7% in Q4 2021). But, on a positive note, the economy created more than 550,000 jobs per month in Q1, a number unchanged from the post-pandemic 2021 average. Unemployment is only 3.8%.

8.10 **EU**. With euro-zone inflation having jumped to 7.5% in March 2022 it seems increasingly likely that the European Central Bank (ECB) will accelerate its plans to tighten monetary policy. It is likely to end net asset purchases in June 2022 – earlier than the Q3 date which the ECB targeted in March 2022. And the market is now anticipating possibly three 25bp rate hikes later this year followed by more in 2023. Policymakers have also hinted strongly that they would re-start asset purchases if required. In a recent speech, Christine Lagarde said "we can design and deploy new instruments to secure monetary policy transmission as we move along the path of policy normalisation."

8.11 While inflation has hit the headlines recently, the risk of recession has also been rising. Among the bigger countries, Germany is most likely to experience a 'technical' recession because its GDP contracted in Q4 2021, and its performance has been subdued in Q1 2022. However, overall, Q1 2022 growth for the Eurozone is expected to be 0.3% q/q with the y/y figure posting a healthy 5.2% gain. Finishing on a bright note, unemployment fell to only 6.8% in February 2022.

8.12 **China**. After a concerted effort to get on top of the virus outbreak in Q1 of 2020, economic recovery was strong in the rest of the year; however, 2021 has seen the economy negatively impacted by political policies that have focussed on constraining digital services, restricting individual freedoms, and re-establishing the power of the One-Party state. With the recent outbreak of Covid-19 in large cities, such as Shanghai, near-term economic performance is likely to be subdued. Official GDP numbers suggest growth of c4% y/y, but other data measures suggest this may be an overstatement.

8.13 **Japan**. The Japanese economic performance through 2021/22 is best described as tepid. With a succession of local lockdowns throughout the course of the year, GDP is expected to have risen only 0.5% y/y with Q4 seeing a minor contraction. The policy rate has remained at -0.1%, unemployment is currently only 2.7% and inflation is sub 1%, although cost pressures are mounting.

8.14 **World growth**. World growth is estimated to have expanded 8.9% in 2021/22 following a contraction of 6.6% in 2020/21.

8.15 **Deglobalisation**. Until recent years, world growth has been boosted by increasing globalisation, specifically, countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last 30 years, which now accounts for 18% of total world GDP (the US accounts for 24%), and Russia's recent invasion of Ukraine, has unbalanced the world economy. In addition, after the pandemic exposed how frail extended supply lines were around the world, both factors are now likely to lead to a sharp retrenchment of economies into two blocs of western democracies v. autocracies. It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China (and to a much lesser extent Russia) to supply products and vice versa. This is likely to reduce world growth rates.

8.16 **Central banks' monetary policy**. During the pandemic, the governments of western countries have provided massive fiscal support to their economies which has resulted in a big increase in total government debt in each country. It is therefore very important that bond yields stay low while debt to GDP ratios slowly subside under the impact of economic growth. This provides governments with a good reason to amend the mandates given to central banks to allow higher average levels of inflation than we have generally seen over the last couple of decades. Both the Fed and Bank of England have already changed their policy towards implementing their existing mandates on inflation, (and full employment), to hitting an average level of inflation. Greater emphasis could also be placed on hitting subsidiary targets for example, full employment before raising rates. Higher average rates of inflation would also help to erode the real value of government debt more quickly.

9. Non-Treasury Management Investments

9.1 The Authority's non-treasury management investments are managed by the Core Investment team.

9.2 The Housing Investment Fund is to be invested into housing schemes to create new homes. The £300m Fund, of which £180m is currently drawn, was created by a loan from central government of which 80% is underwritten by the Authority. It is on track to achieve its target of delivering 10,000 new homes across GM and has been recycled twice. The Fund will close to new commitments in 2025 with a runoff to 2028.

9.3 £70m of Core Funds which was originally sourced from regional Regional Growth Fund and Growing Places Fund monies in 2011/12 and 2012/13. The Fund is invested across business and commercial property as debt or equity and can be recycled and retained for a similar purpose. The fund has to date created and supported 9,345 jobs.

9.4 There are three European Regional Development Fund (ERDF) investments. Evergreen 1 was established under the 2007-13 ERDF Operational Programme and consists of £60m commercial property debt focussed on office buildings, infrastructure and industrial developments. Evergreen 2 was established under the 2014-20 ERDF Operational Programme and consists of £45m of commercial property debt focussed on research and innovation office/laboratory space and energy efficiency in buildings. The Low Carbon Fund was established under the 2014-20 ERDF Operational Programme and is aimed at renewable energy generation and distribution of assets. These funds are managed by an external fund manager.

9.5 There are two Life Sciences Funds managed by external fund managers. Fund 1 is an investment of £10m in a total fund of £31m and is now closed to new investments. Fund 2 is an investment of £10m in a total fund of up to £25m.

10. IFRS16

10.1 Following its emergency consultation on exploratory proposals for changing the Code of Practice on Local Authority Accounting in the United Kingdom, CIPFA Local Authority (Scotland) Accounts Advisory Committee (LASAAC) issued its preliminary decision and feedback statement. This preliminary decision was subsequently considered by the government’s Financial Reporting Advisory Board (FRAB). FRAB advised CIPFA LASAAC that it agreed with the deferral of IFRS 16 Leases until 1 April 2024. FRAB also advised CIPFA LASAAC that the Code had to allow and should encourage local authorities to adopt the standard before this date should they wish to.

10.2 Conrad Hall, Chair, CIPFA LASAAC said:

"CIPFA LASAAC is of the view that IFRS 16 remains the best form of reporting local authority leases and shares FRAB's objective of promoting excellence in financial reporting. The decision to defer IFRS 16 is a pragmatic response due to the severe delays in the publication of audited local authority financial statements in England. The decision should not be viewed as a commentary on the usefulness of the information derived from the implementation of the standard."

CIPFA LASAAC has therefore followed its preliminary decision with its formal decision: to defer the implementation of IFRS 16 until 1 April 2024 (and therefore in the 2024/25 Code). However, both the 2022/23 and the 2023/24 Codes will allow for adoption as of 1 April 2022 or 2023.

10.3 Rob Whiteman, CIPFA CEO said:

"CIPFA is supportive of the decision to delay the implementation of IFRS 16 Leases until 2024. This decision is a necessary one and has been made in the interests of the sector. The deferral should reduce resource pressures in the local audit framework while there are ongoing audit timeliness issues."

11. Recommendations

11.1 Recommendations are set out at the front of the report.