Harrow COUNCIL LONDON

REPORT FOR:	**CABINET**
Date of Meeting:	8 December 2016
Subject:	Treasury Management Strategy Statement and Annual Investment Strategy: Mid-year Review 2016-17
Key Decision:	No
Responsible Officer:	Dawn Calvert, Director of Finance
Portfolio Holder:	Councillor Adam Swersky, Portfolio Holder for Finance and Commercialisation
Exempt:	No
Decision subject to Call-in:	No
Wards affected:	All
Enclosure:	Appendix A – Economic and Interest Rates Update

Section 1 – Summary and Recommendations

Summary

This report sets out the mid-year review of treasury management activities for 2016-17 and discusses the possibility of seeking increased returns via a peer-to-peer lending platform.

Recommendation

Cabinet is asked:
(1) to note the Treasury Management Mid-Year review for 2016-17
(2) to consider whether officers should investigate further "peer-to-peer" investment opportunities discussed in paragraphs 37-43.

Reasons

(a) To promote effective financial management and comply with the Local Authorities (Capital Finance and Accounting) Regulations 2003, other relevant guidance and the Council's Financial Regulations.
(b) To keep Members informed of Treasury Management activities and performance.

Section 2 – Report

Introduction

1. This report deals with treasury management activity which plays a significant part in supporting the delivery of all the Council's corporate priorities.

Options considered

2. The consideration of this report is a requirement of the CIPFA "Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (2011 Edition)" [The Treasury Management Code].

Background

3. The Chartered Institute of Public Finance and Accountancy (CIPFA) defines Treasury Management as:

   "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

   The Council has adopted this definition.

4. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure.

5. The first main function of the Treasury Management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. In line with the Treasury Management Strategy Statement surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

6. The second main function of the Treasury Management service is the funding of the Council's capital programme. This programme provides a guide to the borrowing need of the Council, essentially the longer term cashflow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion, any debt previously drawn may be restructured to meet Council risk or cost objectives.

7. The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' "The Prudential Code for Capital Finance in Local Authorities (2011 Edition)" [The Prudential Code] and the Treasury Management Code to set Treasury and Prudential Indicators for the next three years to ensure that the Council's capital investment programme is affordable, prudent and sustainable.

8. The CIPFA Treasury Management Code has been adopted by the Council.

9. The primary requirements of the Treasury Management Code are as follows:

   - Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
   - Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

- Receipt by the full Council or Cabinet of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of Treasury Management strategy and policies to a specific named body. For this Council the delegated body is Governance, Audit, Risk Management and Standards Committee.

10. The purpose of this report is specifically to meet one of the above requirements, namely the mid-year report of Treasury Management activities for financial year 2016/17. The report details progress during the year against the Strategy approved by Council on 25 February 2016. The report covers the following:

- Treasury position as at 30 September 2016 including investment portfolio and borrowing portfolio (paragraphs 11-23);
- Economic and interest rates update (paragraph 24 and Appendix A);
- Compliance with Prudential Indicators (paragraphs 25-34);
- Local HRA indicators (paragraphs 35-36)
- Additional investment opportunities (paragraphs 37-43)

Treasury Position as at 30 September 2016

11. The Council's borrowings and investment (cash balances) position as at 30 September 2016 is detailed below:

Table 1: Outstanding Investments and Borrowings

	As at 30 September 2016			As at 31 March 2016		
	Principal £m	Average Rate %	Average Life	Principal £m	Average Rate %	Average Life
Total Investments	**77.9**	**0.73**	**37 days**	**76.2**	**0.87**	**74 days**
Total Borrowing						
Public Works Loan Board	218.5	4.09	34.7 yrs	218.5	4.09	35.2 yrs
Market Loans	115.8	4.53	35.5 yrs	115.8	4.53	36.0 yrs
Total	**334.3**	**4.24**	**35.0 yrs**	**334.3**	**4.24**	**35.5 yrs**

The above analysis assumes loans structured as Lender Option, Borrower Option loans (LOBOs) mature at the end of the contractual period. If the first date at which the lender can reset interest rates is used as the maturity date, the average life for market loans would be 7.7 years and, for the whole debt portfolio, 25.3 years. LOBOs are discussed further in paragraph 20.

Review of Investment Portfolio

12. The Council remains a cautious investor placing security and liquidity considerations ahead of income generation. With Bank Rate having started the year at 0.5% and being cut to 0.25% on 4 August it is impossible, at comparable risk levels, to invest at interest rates commonly seen in previous decades. During the first half of the year the rate on offer for instant access investments has been 0.25% (RBS), for investments of three months with Lloyds plc in the range of 0.50% to 0.65% and for investments of over one year periods just over 1%. With balances reducing and the demands of the capital programme it has not been appropriate to commit investments to periods beyond three months with a consequent effect on rates realised. Additionally, the maturity of some relatively high-earning investments has had the effect of reducing both the average interest rate being received and the average life of the investments.

13. The Council held £77.9m of investments as at 30 September 2016 compared with £76.2m at 31 March 2016. However they have fallen by over £20m since the end of May when they were at their high point in the year and are now at their lowest mid-year level for at least five years. The investment portfolio yield for the first six months of the year is 0.73% against the three months LIBOR of 0.38%. The reduction in investments is due primarily to the investments in the capital programme. The Council's investment income budget is £1.8m and the forecast outturn is an unfavourable balance of £0.4m due to the reduction in the cash balances.

14. The only counterparties actively in use during the period have been Lloyds, Royal Bank of Scotland Group and Svenska Handelsbanken.

15. The performance of the investment portfolio is benchmarked on a quarterly basis by the Treasury Management Adviser both against their risk adjusted model and the returns from other local authorities. As at 30 September 2016, the average yield on the portfolio of 0.73% was in line with the model return and was in the top third of all local authorities.

16. In addition to the investment of cash balances, the Council, at its meeting in July 2013, approved a loan of £15m to West London Waste Authority to help finance the cost of a new energy from waste plant. The term of the loan is 25 years at an interest rate of 7.604% on a reducing balance. The drawdown as at September 2016 is £13.7m and the remaining facility of £1.3m is predicted to be drawn by December 2016. For the financial year 2016/17, the outturn forecast on the interest accrued is £1.1m which is included as part of the investment income budget of £1.8m.

17. The table below sets out the counterparty position as at 30 September 2016.

Table 2: Investment Balances

	2015/16				2016/17	
	Sep-15		Mar-16		Sep-16	
	£m	%	£m	%	£m	%
Specified Investments						
Banks & Building Societies	14.3	13.1	19.7	25.9	14.8	19.0
Money Market Funds	1.6	1.5	1.6	2.1	1.6	2.0
Non –Specified Investments						
Banks & Building Societies	93.1	85.3	54.8	71.9	61.3	78.8
Enhanced Money Market Funds	0.1	0.1	0.1	0.1	0.2	0.2
Total	**109.1**	**100.0**	**76.2**	**100.0**	**77.9**	**100.0**

18. At its meeting in November 2014 the Council approved HB Public Law Ltd. which is wholly owned by the Council to be added to the counterparty list. The Council has approved a start-up loan of £100,000 for three years. To date there has been a drawdown of £40,000 in April 2015. The Council has approved a start-up loan of £274,000 for three years to Concilium Business Services limited which is wholly owned by the Council. To date there have been drawdowns totalling £120,000.

Review of Borrowing Portfolio

19. At 30 September 2016 the Council held £334.3m of external borrowing which was unchanged from the position at 31 March 2016. It is currently expected that borrowing of £30m will be required before the end of the financial year.

20. Within this total is a sum of £83.8m borrowed during the period December 2007 to May 2010 under LOBO structures with maturities between 2050 and 2078. In exchange for an interest rate that was below that offered on long term debt by the PWLB, the lender has the option at the end of five years (and yearly or half yearly thereafter) to reset the interest rate. If the rate of interest changes, the Council is permitted to repay the loan at no additional cost. One of the loans arranged was with Barclays Bank plc in the sum of £13m at an interest rate of 3.99% with a maturity date of 2078. On 22 June 2016 Barclays advised that they intended to forgo their option to change the interest rate for the remainder of the loan period. In future analysis of outstanding debt, including table 1 above and 3 below, this borrowing will be analysed as a fixed term loan at a fixed rate.

21. The table below analyses the maturity profile of borrowing.

Table 3: Borrowing Maturity Profile

Maturity structure of borrowing	upper limit	lower limit	LOBO final maturity		LOBO interest reset date	
	%	%	£m	%	£m	%
under 12 months	30	0	10.0	3.0	80.8	24.2
12 months and within 24 mths	20	0	0.0	0.0	0.0	0.0
24 months and within 5 years	30	0	22.0	6.6	22.0	6.6
5 years and within 10 years	40	0	5.0	1.5	5.0	1.5
10 years and above	90	30	297.3	88.9	226.5	67.7
Total			**334.3**	**100.0**	**334.3**	**100.0**

22. The average borrowing rate is 4.24% and the forecast outturn on borrowing cost is £0.1m above the budget of £7.8m.

23. Debt rescheduling opportunities have been very limited in the current economic climate given the structure of interest rates and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. A detailed review of the possibilities for rescheduling was discussed with the Treasury Management Adviser in January 2016y who advised that in a period of such low interest rates there are no financial advantages available which could be recommended for acceptance. Hence, no debt rescheduling was undertaken during the first six months of the year.

Economic and Interest Rates Updates

24. An economic update for the first part of the 2016/17 financial year along with the interest rate forecast and commentary provided by Capita as at 30th September 2016 is included as Appendix A.

Compliance with Prudential Indicators

Capital Expenditure and Funding

25. The Council's capital expenditure programme is the key driver of Treasury Management activity. The output of the capital expenditure programme is reflected in the statutory prudential indicators, which are designed to assist Members' overview and confirm the capital expenditure programme. The table below summarises the capital expenditure and funding for the current financial year and gives an indication of future levels of investment.

Table 4: Capital Expenditure

	2015/16	2016/17	2016/17	2017/18	2018/19	2019/20
	Actual	Estimate	Forecast	Forecast	Forecast	Forecast
	£'000	£'000	£'000	£'000	£'000	£'000
Expenditure						
Non - HRA	79,623	82,425	84,423	19,200	25,107	12,783
HRA	13,554	25,550	17,399	25,486	11,013	8,639
Regeneration	0	25,480	10,871	83,770	114,450	110,220
TOTAL	**93,177**	**133,455**	**112,693**	**128,456**	**150,570**	**131,642**
Funding:-						
Grants	22,967	25,759	25,379	530	530	530
Capital receipts	30,472	10,398	0	12,651	1,960	36,301
Revenue financing	9,679	9,987	12,089	11,354	8,753	6,842
Section 106 / Section 20	1458	1,565	448	1,481	250	70
TOTAL	**64,576**	**47,709**	**37,916**	**26,016**	**11,493**	**43,743**
Net financing need for the year	**28,601**	**85,746**	**74,777**	**102,440**	**139,077**	**87,899**

26. The increase in the expenditure on the capital programme is due primarily to the carry forward of slippage from 2015/16. This has an impact on the annual change in capital financing requirement and net borrowing requirement as detailed in tables below.

Capital Financing Requirement (CFR)

27. The CFR is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any new capital expenditure, which has not immediately been paid for, will increase the CFR.

Table 5: Capital Financing Requirement

	2015/16	2016/17	2016/17	2017/18	2018/19	2019/20
	Actual	Estimate	Forecast	Forecast	Forecast	Forecast
	£'000	£'000	£'000	£'000	£'000	£'000
CFR as at 31 March						
Non – HRA	268,264	356,142	323,761	412,201	537,278	611,177
HRA	149,477	154,783	154,783	154,783	154,783	154,783
TOTAL	**417,741**	**510,925**	**478,544**	**566,984**	**692,061**	**765,960**
Annual change in CFR						
Non – HRA	13,393	87,878	55,497	88,440	125,077	73,899
HRA	- 30	5,306	5,306	-	-	-
TOTAL	**13,363**	**93,184**	**60,803**	**88,440**	**125,077**	**73,899**

28. Debt outstanding, including that arising from PFI and leasing schemes, should not normally exceed the CFR. As the Council has funded a substantial amount of capital expenditure from revenue resources, as shown in Table 6 below, current forecast gross debt of £364m is well below the CFR of £479m.

Table 6: Changes to Gross Debt

	2015/16	2016/17	2016/17
	Actual	Estimate	Forecast Outturn
	£'000	£'000	£'000
External Debt			
Debt at 1 April	334,434	359,466	334,434
Expected change in Debt	-	85,715	30,000
Other long-term liabilities (OLTL) 1st April	18,075	17,733	17,032
Expected change in OLTL	- 1,043	- 826	- 800
Actual gross debt at 31 march	351,466	462,088	380,666
Capital financing requirement	417,741	510,925	478,544
Under / (Over) borrowing	**66,275**	**48,837**	**97,878**

29. The table below shows the net borrowing after investment balances are taken into account.

Table 7: Net Borrowing

Net Borrowing			
	2015/16	2016/17	2016/17
	Actual	Estimate	Forecast Outturn
	£'000	£'000	£'000
Brought forward 1 April	215,356	258,201	258,201
Carried forward 31 March	258,201	385,181	334,434
Change in net borrowing	**42,845**	**126,980**	**76,233**

The estimated net borrowing at 31 March 2017 of £334.4m is made up of outstanding borrowing of £364.4m (including an additional £30m likely to be borrowed during the financial year) partly offset by estimated investment balances of £30.0m.

Operational Boundary and Authorised Limit

30. Operational Boundary – This limit is based on the Council's programme for capital expenditure, capital financing requirement and cash flow requirements for the year.

31. Authorised Limit – This represents a limit beyond which external debt is prohibited. The Council's policy is to set this rate at the Capital Financing Requirement. The Government retains an option to control either the total of all councils' programmes, or those of a specific council, although this power has not yet been exercised.

Table 8: Boundaries

	2015/16	2016/17	2016/17
		Original	Revised
	£m	£m	£m
Authorised Limit for external debt			
Borrowing and finance leases	416	511	479
Operational Boundary for external debt			
Borrowing	340	445	364
Other long term liabilities	19	17	16
Total	359	462	381
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing	340	445	364
Upper limit for variable rate exposure			
Net principal re variable rate borrowing	-	-	-
Upper limit for principal sums invested over 364 days*	41	60	60

Affordability Indicators

32. Ratio of Financing Costs to Net Revenue Streams – This indicator identifies the trend in the cost of capital (borrowing, depreciation, impairment and other long term obligation costs net of investment income) against the net revenue stream. Tables 9 and 10 below show the current position for the General Fund and HRA respectively.

Table 9: Ratio of Financing Costs to Net Revenue Stream – General Fund

	2015/16 Actual	2016/17 Estimate	2016/17 Forecast Outturn
Net revenue stream (£'000)	167,491	165,754	173,392
Interest costs (£'000)	7,866	8,378	7,910
Interest costs - finance leases (£'000)	1,766	2,100	2,100
Interest and investment income (£'000)	-1,817	-1,509	-1,332
MRP (£'000)	15,326	13,000	14,000
Total financing costs (£'000)	23,141	21,969	22,678
Ratio of total financing costs against net revenue stream (%)	13.8	13.3	13.1

The ratio shows a small reduction between 2015-16 and 2016-17 which suggests that the capital programme remains affordable.

Table 10: Ratio of Financing Costs to Gross Revenue Stream - HRA

	2015/16 Actual	2016/17 Estimate	2016/17 Forecast Outturn
Gross revenue stream (£'000)	32,111	32,170	32,164
Interest costs of self-funding borrowing (£'000)	3,078	3,078	3,078
Interest costs of other borrowing (£'000)	3,265	3,411	3,373
Interest and investment income (£'000)	-156	-147	-147
Depreciation (£'000)	7,789	6,573	6,573
Impairment (£'000)	177	0	0
Total financing costs (£'000)	14,153	12,915	12,877
Ratio of total financing costs against net revenue stream (%)	44.1	40.1	40.0
Ratio of total financing costs (excluding depreciation and impairment) against net revenue stream (%)	19.3	19.7	19.6

33. Incremental impact of Capital Investment Decisions on Council Tax and Housing Rents – This indicator identifies the revenue costs associated with proposed changes to the capital programme and the impact on Council Tax and Housing Rents.

34. The tables below identify the revenue costs associated with the proposed capital programme and the impact on Council Tax and housing rents.

Table 11: Incremental Impact of Capital Investment Decisions – Council Tax

	2015/16 Actual	2016/17 Estimate	2016/17 Forecast Outturn
Net financing need (£'000)	28,601	85,746	74,776
Borrowing at 25-50 years PWLB rate (£'000)	930	1,886	1,645
MRP (2%) (£'000)	572	1,715	1,496
Total increased costs (£'000)	1,502	3,601	3,141
CTax base £'000)	79,795	82,000	82,000
% increase	1.9	4.4	3.8
Band D Council Tax	1,529	1,560	1,560
Overall increase £ pa	**28.77**	**68.51**	**59.75**

Table 12: Incremental Impact of Capital Investment Decisions – Housing Rents

	2015/16 Actual	2016/17 Estimate	2016/17 Forecast Outturn
Net Financing need (£'000)	-	3,570	5,306
Borrowing @ 2% (25-50years PWLB rate) (£'000)	-	71	106
Depreciation @ 2% (£'000)	-	71	106
Total increased costs	-	143	212
Number of dwellings	4,867	4,816	4,839
Increase in average housing rent per week £	**-**	**0.57**	**0.84**

Local HRA indicators

35. The ratio of gross revenue stream to debt shows a consistent pattern which is affordable by the HRA. As the number of dwellings reduces over the two years, the debt outstanding per dwelling is estimated to increase. However, the annual increases are only marginal and the ratio compared to the average value of each dwelling is low enough for the measure to raise no concern.

Table 13: Local HRA Indicators

	2015/16 Actual	2016/17 Estimate	2016/17 Forecast Outturn
Debt (CFR) (£m)	149.48	154.78	154.78
Gross Revenue Stream (£m)	32.11	32.17	32.16
Ratio of Gross Revenue Stream to Debt (%)	**21**	**21**	**21**
Average Number of Dwellings	4,867	4,816	4,839
Debt outstanding per dwelling (£)	**30,712**	**32,139**	**31,987**

36. HRA Debt Limit is shown in the table below

Table 14: HRA Debt

	2015/16 Actual	2016/17 Estimate	2016/17 Forecast Outturn
	£m	£m	£m
HRA Debt Limit	151.34	154.94	154.94
HRA CFR	149.48	154.78	154.78
Headroom	**1.86**	**0.15**	**0.15**

Additional investment opportunities

37. As discussed in paragraph 12 above interest rates available from institutions on the Council's counterparty list and beyond are at historically very low levels and the Council is earning, overall, well under 1% on its cash balances. Advice available to the Council suggests that returns are likely to remain low.

38. Notwithstanding this both officers and Members have expressed concern over the poor rates available and officers keep the counterparty list under review and opportunities to potentially realise better returns are investigated.

39. Regular meetings are held with the Treasury Management Adviser and they are always asked to update officers on investment opportunities which might be available. Vehicles discussed include gilts, European Investment Bank, money market funds, enhanced cash plus funds property funds and covered bonds. The Council has recently agreed to make direct investments of up to £20m in property but the other vehicles do not generally offer returns substantially in excess of those currently achieved.

40. Recently officers have been investigating “peer-to-peer” lending platforms and, in particular Funding Circle, one of the UK’s largest such platform. Investment through Funding Circle involves lending to small and medium sized businesses in the UK, US, Germany, Spain and the Netherlands. Its publicity states that, since its founding in 2010, it has lent over £2.5bn to over 20,000 businesses and has received investments from over 54,000 lenders. It is regulated by the Financial Conduct Authority but is not covered by the Financial Services Compensation Scheme.

41. The biggest single investor is the British Business Bank, a development bank wholly owned by the UK Government. Other investors include UK Government Business Finance Partnership, European Investment Bank, several county councils, several London boroughs and several district councils.

42. Funding Circle have advised that after fees and bad debts the average return achieved by investors is 7.1% and opportunities are available to structure investments in accordance with risk appetite.

43. Cabinet is asked to consider whether officers should investigate “peer-to-peer” investment opportunities further which would be reported as part of the Treasury Management Strategy Statement report to be considered in January/February 2017.

Implications of the Recommendation

44. The recommendation is asking the Cabinet to note the position on treasury management activities and to consider whether “peer-to-peer” investment opportunities should be investigated further.. It does not affect the Council’s staffing / workforce and has no equalities or community safety impact.

Legal Implications

45. The purpose of this report is to comply with the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 and other relevant guidance referred to in the report.

Financial Implications

46. In addition to supporting the Council’s revenue and Capital programmes the Treasury Management net budget of £6.0m (Interest payable £7.8m; Interest receivable £1.8m) discussed in paragraphs 16 and 22 is an important part of the General Fund budget. Any savings achieved, or overspends incurred have a direct impact on the delivery of the budget.

Performance Issues

47. The Council meets the requirements of the CIPFA Treasury Management Code and therefore is able to demonstrate best practices for the Treasury Management function.

48. As part of the Prudential Code the Council must agree a series of prudential indicators and measure its performance against them. These indicators and performance are detailed in the report.

Environmental Impact

49. There is no direct environmental impact.

Risk Management Implications

50. The identification, monitoring and control of risk are central to the achievement of the Treasury Management objectives. Potential risks are included in the directorate risk register and are identified, mitigated and monitored in accordance with Treasury Management Practice notes approved by the Treasury Management Group.

Equalities Implications / Public Sector Equality Duty

51. There are no equalities implications arising from this report.

Corporate Priorities

52. This report deals with the Treasury Management activity which plays a significant part in supporting the delivery of all the Council's corporate priorities.

Section 3 - Statutory Officer Clearance

Name:	Dawn Calvert	x	Chief Financial Officer
Date:	15 November 2016		
Name:	Caroline Eccles	x	on behalf of the Monitoring Officer
Date:	25 November 2016		

Ward Councillors notified:	**NO as report impacts on all Wards** .
EqIA carried out: **EqIA cleared by:**	**NO** There are no equalities implications arising from this “information” report.

Section 4 - Contact Details and Background Papers

Contact: Ian Talbot (Treasury and Pension Fund Manager)
Tel: 020-8424-1450 / Email: ian.talbot@harrow.gov.uk

Background Papers: None.

Call-In Waived by the Chair of Overview and Scrutiny Committee	**NOT APPLICABLE** *[Call-in applies]*

Appendix A

Provided by Capita Asset Services at 30 September 2016

Economics and interest rates

Economics update

UK. GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were strong but 2015 was disappointing at 1.8%, though it still remained one of the leading rates among the G7 countries. Growth improved in quarter 4 of 2015 from +0.4% to 0.7% but fell back to +0.4% (2.0% y/y) in quarter 1 of 2016 before bouncing back again to +0.7% (2.1% y/y) in quarter 2. During most of 2015, the economy had faced headwinds for exporters from the appreciation during the year of sterling against the Euro, and weak growth in the EU, China and emerging markets, plus the dampening effect of the Government's continuing austerity programme. The referendum vote for Brexit in June this year delivered an immediate shock fall in confidence indicators and business surveys, pointing to an impending sharp slowdown in the economy. However, subsequent surveys have shown a sharp recovery in confidence and business surveys, though it is generally expected that although the economy will now avoid flat lining, growth will be weak through the second half of 2016 and in 2017.

The Bank of England meeting on August 4th addressed this expected slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to 0.25%. The Inflation Report included an unchanged forecast for growth for 2016 of 2.0% but cut the forecast for 2017 from 2.3% to just 0.8%. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting and suggested that the Government will need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation). The new Chancellor Phillip Hammond announced after the referendum result, that the target of achieving a budget surplus in 2020 will be eased in the Autumn Statement on November 23.

The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. CPI has started rising during 2016 as the falls in the price of oil and food twelve months ago fall out of the calculation during the year and, in addition, the post referendum 10% fall in the value of sterling on a trade weighted basis is likely to result in a 3% increase in CPI over a time period of 3-4 years. However, the MPC is expected to look thorough a one off upward blip from this devaluation of sterling in order to support economic growth, especially if pay increases continue to remain subdued and therefore pose little danger of stoking core inflationary price pressures within the UK economy.

USA. The American economy had a patchy 2015 with sharp swings in the growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 disappointed at +0.8% on an annualised basis while quarter 2 improved, but only to a lacklustre +1.4%. However, forward indicators are pointing towards a pickup in growth in the rest of 2016. The Fed. embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene and then the Brexit vote, have caused a delay in the timing of the second increase which is now strongly expected in December this year.

EZ. In the Eurozone, the ECB commenced in March 2015 its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month; this was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise from around zero towards the target of 2%. GDP growth rose by 0.6% in quarter 1 2016 (1.7% y/y) but slowed to +0.3% (+1.6% y/y) in quarter 2. This has added to comments from many forecasters that central banks around the world are running out of ammunition to stimulate economic growth and to boost inflation. They stress that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand in the their economies and economic growth.

Japan is still bogged down in anaemic growth and making little progress on fundamental reform of the economy while Chinese economic growth has been weakening and medium term risks have been increasing.

Interest rate forecasts

The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Bank rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.25%	0.25%	0.25%	0.25%	0.50%
5yr PWLB rate	1.00%	1.00%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.20%	1.30%
10yr PWLB rate	1.50%	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.70%	1.80%
25yr PWLB rate	2.30%	2.30%	2.40%	2.40%	2.40%	2.40%	2.50%	2.50%	2.50%	2.50%	2.60%
50yr PWLB rate	2.10%	2.10%	2.20%	2.20%	2.20%	2.20%	2.30%	2.30%	2.30%	2.30%	2.40%

Capita Asset Services undertook a quarterly review of its interest rate forecasts after the MPC meeting of 4th August cut Bank Rate to 0.25% and gave forward guidance that it expected to cut Bank Rate again to near zero before the year end. The above forecast therefore includes a further cut to 0.10% in November this year and a first increase in May 2018, to 0.25%, but no further increase to 0.50% until a year later. Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual after they do start. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when the growth in average disposable income is still weak and could well turn negative when inflation rises during the next two years to exceed average pay increases.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities. However, we have been experiencing exceptional levels of volatility in financial markets which have caused significant swings in PWLB rates. Our PWLB rate forecasts are based on the Certainty Rate (minus 20 bps) which has been accessible to most authorities since 1st November 2012.

The overall balance of risks to economic recovery in the UK remains to the downside. Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Monetary policy action reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some major developed economies, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Weak capitalisation of some European banks.
- A resurgence of the Eurozone sovereign debt crisis.
- Geopolitical risks in Europe, the Middle East and Asia, increasing safe haven flows.
- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or Fed. rate increases, causing a further flight to safe havens (bonds).
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.