REPORT FOR: **CABINET**

Date of Meeting:	6 December 2018
Subject:	Treasury Management Strategy Statement and Annual Investment Strategy: Mid-year Review 2018/19
Key Decision:	No – information report only
Responsible Officer:	Dawn Calvert, Director of Finance
Portfolio Holder:	Councillor Adam Swersky, Portfolio Holder for Finance and Resources
Exempt:	No
Decision subject to Call-in:	No – information report only
Wards affected:	All
Enclosures:	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 2018/19.

Recommendation

Cabinet is requested to note the Treasury Management Mid-Year review for 2018/19.

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 (2017 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 borrowing, 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."

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 (2017 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 to provide the mid-year update report of Treasury Management activities for financial year 2018/19. The report details progress during the year against the Strategy approved by Council on 22 February 2018. The report covers the following:

- Treasury position as at 30 September 2018 including investment portfolio and borrowing portfolio (paragraphs 12-22);
- Economic and interest rates update (paragraph 23 and Appendix A);
- Compliance with Prudential Indicators (paragraphs 24-33);
- Local Housing Revenue Account (HRA) indicators (paragraphs 34-35)
- Additional investment opportunities (paragraphs 36-38)

Capital Strategy

11. In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities will be required to prepare a Capital Strategy which is intended to provide the following: -

- a high-level overview of how capital expenditure, capital financing and Treasury Management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

The Prudential Code has also expressed concern that local authorities should ensure that an authority's approach to commercial activities should be proportional to its overall resources.

A report setting out the Capital Strategy will be brought to Cabinet in February 2019**.**

Treasury Position as at 30 September 2018

12 The Council's borrowings and investment (cash balances) position as at 30 September 2018 is detailed below:

Table 1: Outstanding Investments and Borrowings

	As at 30 September 2018			As at 31 March 2018		
	Principal £m	**Rate** %	**Life**	**Principal** £m	**Rate** %	**Life**
Total Investments	**36.62**	**0.27**	**2 Days**	**16.84**	**0.22**	**2 days**
Total Borrowing						
Public Works Loan Board	218.5	4.09	32.7 Years	218.5	4.09	33.2 Years
Market Loans	105.8	4.23	36.8 Years	105.8	4.29	37.3 Years
Total	**324.3**	**4.13**	**34.0 Years**	**324.3**	**4.15**	**34.5 Years**

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 14.2 years and, for the whole debt portfolio, 26.9 years.

Review of Investment Portfolio

13. The Council is a prudent investor placing security and liquidity considerations ahead of income generation. With the Bank Rate having risen to 0.75%, by September 30th the rate on offer for instant access investments has risen to 0.60% (RBS). The Council has reduced cash balances and a cash management strategy focused on minimising the net cost of borrowing. Therefore it has not been appropriate to commit investments to periods beyond one month with a consequent effect on investment return.

14. The Council held £36.6m of investments as at 30 September 2018 compared with £16.8m at 31 March 2018. The investment portfolio yield for the first six months of the year is 0.35% against the average three months LIBOR of 0.71%. The Council's investment income budget is £1.4m and the forecast outturn is £1.3m, the variance of £0.1m is due to the combination of the reduction in the cash balances and low yields on short-term cash investments.

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

16. The performance of the investment portfolio is measured on a quarterly basis by the Treasury Management Adviser against their risk adjusted model. As at 30 September 2018, the average yield on the portfolio was 0.35%.This reflects lower priced investment rates available before the base rate increase in August 2018.

17. 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 loan balance at the end of March 2018 is £16.3m which includes interest accrued to date. As the Waste Plant went live in December 2016 WLWA are now repaying the loan with Interest as agreed. For the financial year 2018/19, the outturn forecast on the interest accrued is £1.25m which is included as part of the investment income budget.

18. The table below sets out the counterparty position as at 30 September 2018.

Table 2: Investment Balances

	2017/18				2018/19	
	Sep-17		Mar-18		Sep-18	
	£m	%	£m	%	£m	%
Specified Investments						
Banks & Building Societies	11.3	21.1	0.0	0.0	0.0	0.0
Money Market Funds	1.6	3.0	1.6	9.5	1.6	4.4
Non –Specified Investments						
Banks & Building Societies	40.4	75.7	15.1	89.9	34.9	95.4
Enhanced Money Market Funds	0.1	0.2	0.1	0.6	0.1	0.3
Total	**53.4**	**100.0**	**16.8**	**100.0**	**36.6**	**100.0**

Review of Borrowing Portfolio

19. At 30 September 2018 the Council held £324.3m of long terms external borrowing. It is currently expected that temporary borrowing of up to £85m may be required before the end of the current financial year. This will be replaced by PWLB long-term borrowing in 2019/20, or in the final quarter of the current financial year, should forecast borrowing rates increase before 31 March 2019.

20. 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	3.1	80.8	24.9
12 months and within 24 mths	20	0	12.0	3.7	12.0	3.7
24 months and within 5 years	30	0	5.0	1.5	5.0	1.5
5 years and within 10 years	40	0	5.0	1.5	5.0	1.5
10 years and above	90	30	292.3	90.1	221.5	68.3
Total			**324.3**	**100.0**	**324.3**	**100.0**

21. The average borrowing rate as at 30 September 2018 was 4.1% and the forecast outturn on borrowing cost was £7.4m, a favourable variance of £0.7m on the budget of £8.1m.

22. 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. No debt rescheduling was undertaken during the first six months of the year. In October 2018 the Council negotiated a premature loan redemption after Royal Bank of Scotland advised of their intention to assign the loans held by the Council to a third party. The assignment was for £30 million fixed loans with an average interest rate of 3.9% and 40.5 year average maturity. A loan was borrowed from the Public Works Loan Board for £30 million at 2.75% for 40.5 years. These restructuring results in reduced long-term borrowing costs for the Council.

Economic and Interest Rates Updates

23. An economic update for the first part of the 2018/19 financial year along with the interest rate forecast and commentary provided by Link Treasury Services as at 30th September 2018 is included as Appendix A.

Compliance with Prudential Indicators

Capital Expenditure and Funding

24. 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

	2017/18	2018/19	2018/19
	Actual	Estimate	Forecast
	£'000	£'000	£'000
Expenditure			
Non - HRA	67,180	53,430	78,025
HRA	11,877	2,739	10,380
Regeneration	15,074	71,900	7,062
TOTAL	**94,131**	**128,069**	**95,467**
Funding:-			
Grants	13,309	9,674	15,663
Capital receipts	8,137	11,044	3,044
Revenue financing	8,753	7,418	18,492
Section 106 / Section 20	5,456	4,618	559
TOTAL	**35,655**	**32,754**	**37,758**
Net financing need for the year	**58,476**	**95,315**	**57,709**

25. The capital estimate is in accordance with the budget set. This has an impact on the annual change in capital financing requirement and net borrowing requirement as detailed in tables below. The revised forecast is due to slippage and underspending in year on the capital programme.

Capital Financing Requirement (CFR)

26 The CFR as set out in Table 5, 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

	2017/18	2018/19	2018/19
	Actual	Estimate	Forecast
	£'000	£'000	£'000
CFR as at 31 March			
Non – HRA	343,209	452,419	400,901
HRA	151,014	150,683	150,683
TOTAL	**494,223**	**603,102**	**551,584**
Annual change in CFR			
Non – HRA	39,557	109,210	- 51,518
HRA	1,477	- 331	-
TOTAL	**41,034**	**108,879**	**- 51,518**

27. 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 £340m is below the forecast CFR of £552m.

Table 6: Changes to Gross Debt

	2017/18	2018/19	2018/19
	Actual	Estimate	Forecast Outturn
	£'000	£'000	£'000
External Debt			
Debt at 1 April	324,261	324,261	324,261
Expected change in Debt	**58,476**	**95,315**	**58,833**
Other long-term liabilities (OLTL) 1st April	16,000	16,000	16,000
Expected change in OLTL			-
Actual gross debt at 31 March	340,261	340,261	340,261
Capital financing requirement	**494,223**	**603,102**	**552,708**
Under / (Over) borrowing	**153,962**	**262,841**	**212,447**

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

Table 7: Net Borrowing

Net Borrowing			
	2017/18	2018/19	2018/19
	Actual	Estimate	Forecast Outturn
	£'000	£'000	£'000
Brought forward 1 April	258,201	307,421	389,576
Carried forward 31 March	307,421	389,576	352,806
Change in net borrowing	**49,220**	**82,155**	**-36,770**

£5 million temporary borrowing has been taken in the financial year to date. Any further temporary borrowing taken in the current year to minimise borrowing costs .will be replaced by long- term PWLB borrowing in the next financial year.

Operational Boundary and Authorised Limit

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

30. 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

	2017/18	2018/19	2018/19
	Actual	Original	Revised
	£m	£m	£m
Authorised Limit for external debt			
Borrowing and finance leases	568	607	607
Operational Boundary for external debt			
Borrowing	448	435	435
Other long term liabilities	16	16	16
Total	464	451	451
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing	448	435	435
Upper limit for variable rate exposure			
Net principal re variable rate borrowing	-	-	-
Upper limit for principal sums invested over 364 days*	60	60	60

Affordability Indicators

31. 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 show the current position for the General Fund and HRA respectively.

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

	2017/18 Actual	2018/19 Estimate	2018/19 Forecast Outturn
Net revenue stream (£'000)	164,804	167,913	167,913
Interest costs (£'000)	7,316	8,174	7,400
Interest costs - finance leases (£'000)	1,682	1,700	1,700
Interest and investment income (£'000)	-1,360	-1,300	-1,300
MRP (£'000)	16,584	18,925	16,600
Total financing costs (£'000)	**24,222**	**23,478**	**24,400**
Ratio of total financing costs against net revenue stream (%)	**14.7**	**14.2**	**14.5**

The ratio shows a small reduction between 2017/18 and 2018/19 which indicates that the capital programme remains affordable.

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

	2017/18 Actual	2018/19 Estimate	2018/19 Forecast Outturn
Gross revenue stream (£'000)	32,245	32,114	31,761
Interest costs of self-funding borrowing (£'000)	-3,751	-3,751	-3,751
Interest costs of other borrowing (£'000)	-2,491	-2,614	-2,486
Interest and investment income (£'000)	26	0	0
Depreciation (£'000)	-7,679	-7,636	-8,026
Impairment (£'000)	-230	0	0
Total financing costs (£'000)	-14,125	-14,001	-14,263
Ratio of total financing costs against net revenue stream (%)	-43.8	-43.6	-44.9
Ratio of total financing costs (excluding depreciation and impairment) against net revenue stream (%)	-19.3	-19.8	-19.6

32. 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.

33. 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

	2017/18 Actual	2018/19 Estimate	2018/19 Forecast Outturn
Net financing need (£'000)	41,952	46,131	50,447
Borrowing at 25-50 years PWLB rate (£'000)	1,133	1,401	1,513
MRP (2%) (£'000)	839	923	1,009
Total increased costs (£'000)	**1,972**	**2,324**	2,522
CTax base £'000)	82,000	84,466	84,466
% increase	2.4	2.8	2.8
Band D Council Tax	1,560	1,689	1,689
Overall increase £ pa	**37.51**	**46.47**	**47.29**

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

	2017/18 Actual	2018/19 Estimate	2018/19 Forecast Outturn
Net Financing need (£'000)	5,306.0	2,160	5,242
Borrowing @ 2% (25-50years PWLB rate) (£'000)	106.1	43.2	104.8
Depreciation @ 2% (£'000)	106	43	105
Total increased costs	212	86	210
Number of dwellings	4,825	4,781	4,812
Increase in average housing rent per week £	**0.84**	**0.34**	**0.84**

Local HRA indicators

34. 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

	2017/18 Actual	2018/19 Estimate	2018/19 Forecast Outturn
Debt (CFR) (£m)	151,015	150,683	150,683
Gross Revenue Stream (£m)	32,245	32,114	31,761
Ratio of Gross Revenue Stream to Debt (%)	**21%**	**21%**	**21%**
Average Number of Dwellings	4,825	4,781	4,812
Debt outstanding per dwelling (£)	**31,302**	**31,517**	**31,317**

35. HRA Debt Limit is shown in the table below

Table 14: HRA Debt

	2017/18 Actual	2018/19 Estimate	2018/19 Forecast Outturn
	£m	£m	£m
HRA Debt Limit	150,683	150,683	150,683
HRA CFR	151,015	150,683	150,683
Headroom	- 332	-	-

Additional investment opportunities

36. As discussed in paragraph 12 above interest rates available from institutions on the Council's counterparty list and remain at low levels and the Council is earning, overall, under 0.30% on its cash balances. Advice available to the Council suggests that returns are likely to remain low.

37. 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.

38. 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.

Legal Implications

39. 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

40. In addition to supporting the Council's revenue and Capital programmes the Treasury Management net budget of £6.1m (Interest payable £7.4m; Interest receivable £1.3m) 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.

Risk Management Implications

41. 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

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

Corporate Priorities

43. 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 Date: 31 October 2018	X	Chief Financial Officer
Name: Caroline Eccles Date: 23 November 2018	X	on behalf of the Monitoring Officer

Procurement Clearance

Name: Nimesh Mehta Date: 27/11/2018	x	Head of Procurement

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: Iain Millar (Treasury and Pensions Manager)
Tel: 020-8424-1432 / Email: iain.millar@harrow.gov.uk

Background Papers: None

Appendix A

Provided by Link Asset Services at 30 September 2018

Economics update

UK. The first half of 2018/19 has seen UK **economic growth** post a modest performance, but sufficiently robust for the Monetary Policy Committee, (MPC), to unanimously (9-0) vote to increase **Bank Rate** on 2nd August from 0.5% to 0.75%. Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

Some MPC members have expressed concerns about a build-up of **inflationary pressures**, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components, but is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate. The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

As for the **labour market,** unemployment has continued at a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 2.9%, (3 month average regular pay, excluding bonuses) and to a one month figure in July of 3.1%. This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 0.4%, near to the joint high of 0.5% since 2009. (The previous high point was in July 2015.) Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC were right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy. However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit.

In the **political arena**, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

USA. President Trump's massive easing of fiscal policy is fuelling a (temporary) boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2, but also an upturn in inflationary pressures. With inflation moving towards 3%, the Fed increased rates another 0.25% in September to between 2.00% and 2.25%, this being four increases in 2018, and indicated they expected to increase rates four more times by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US, (China in particular), could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019.

EUROZONE. Growth was unchanged at 0.4% in quarter 2, but has undershot early forecasts for a stronger economic performance in 2018. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of 2% for 2018, the horizon is less clear than it seemed just a short while ago.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

JAPAN - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

Interest rate forecasts

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

Link Asset Services Interest Rate View	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

The flow of generally positive economic statistics after the end of the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, to 0.75%. However, the MPC emphasised again, that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a medium term forecast. We do not think that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. We also feel that the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Bank of England monetary policy takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of

anti-austerity noise. This is likely to lead to friction with the EU when setting the target for the fiscal deficit in the national budget. Unsurprisingly, investors have taken a dim view of this and so Italian bond yields have been rising.

- Austria, the Czech Republic and Hungary now form a strongly anti-immigration bloc within the EU while Italy, this year, has also elected a strongly anti-immigration government. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position as a result of the rise of the anti-immigration AfD party. To compound this, the result of the Swedish general election in September 2018 has left an anti-immigration party potentially holding the balance of power in forming a coalition government. The challenges from these political developments could put considerable pressure on the cohesion of the EU and could spill over into impacting the euro, EU financial policy and financial markets.
- The imposition of trade tariffs by President Trump could negatively impact world growth. President Trump's specific actions against Turkey pose a particular risk to its economy which could, in turn, negatively impact Spanish and French banks which have significant exposures to loans to Turkey.
- Weak capitalisation of some European banks.
- Rising interest rates in the US could negatively impact emerging countries which have borrowed heavily in dollar denominated debt, so causing an investor flight to safe havens e.g. UK gilts.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- President Trump's fiscal plans to stimulate economic expansion causing a significant increase in inflation in the US and causing further sell offs of government bonds in major western countries.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.