Essential Reference Paper B

East Herts District Council

Treasury Management Mid-Year Review

2016/17

Contents

1 Background

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined 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."

2 Introduction

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) is adopted by this Council.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full council 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.
4. 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.
5. 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 Audit and Governance Committee:

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2016/17 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure (prudential indicators);
- A review of the Council's investment portfolio for 2016/17;
- A review of the Council's borrowing strategy for 2016/17;
- A review of any debt rescheduling undertaken during 2016/17;
- A review of compliance with Treasury and Prudential Limits for 2016/17.

Key Changes to the Treasury and Capital Strategies

There have been no key changes to the Treasury and Capital Strategies.

3 Economics and interest rates

3.1 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 Monetary Policy Committee (MPC) 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.

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 Federal Reserve 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.

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 stuck in anaemic growth and making little progress on fundamental reform of their economy while Chinese economic growth has been weakening and medium term risks have been increasing.

3.2 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 Public Works Loan Board (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. The Capita Asset Services 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 US Federal reserve 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 US Federal reserve 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.

4 Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2016/17 was approved by this Council on 17 February 2016.

- There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

5 The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

5.1 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure by Service	**2016/17 Original Estimate £'000**	**2016/17 Position as at 30/09/16 £'000**	**2016/17 Revised Estimate £'000**
Total capital expenditure	4,608	712	5,078

The main material increases being the cost of the demolition of 1 The Causeway (£600k), Improvements to The Wash, Maidenhead Street & Bull Plain, Hertford (£500k) and the Section 106 grant funding paid to Network Homes to help fund affordable housing units (£288k). These have been partially offset by the Castle Weir Micro Hydro Scheme forecast as unlikely to commence in 2016/17 (-£201k) and the funding for Future Social Housing Schemes forecast not to be spent in 2016/17 (£821k).

5.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure

Capital Expenditure	**2016/17 Original Estimate £'000**	**2016/17 Revised Estimate £'000**
Total capital expenditure	**4,608**	**5,078**
Financed by:		
Capital receipts	1,640	2,171
Capital grants	293	570
Capital reserves	14	1,491
Revenue	25	34
Total financing	**2,636**	**812**
Borrowing requirement	**0**	**0**

Movement in capital receipts represents sale of land at Aubries, Walkern (£1.4m), increased council house sales (£719k) partially offset by a reduction in expected sales of land, awaiting decision on housing company.

Movement in Capital grants is mainly due to an increased disabled facilities grant.

Movement in the use of Capital reserves are due to the demolition of 1 The Causeway (£600k), use of S106 to fund affordable housing schemes (£288k) and new tennis courts at Watton-On-Stone (£38k),

5.3 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement

The council is currently in a negative CFR position. We are almost on target to achieve the original forecast Capital Financing Requirement but the change in the use of reserves originally forecast has resulted in a reduction in the net movement.

Prudential Indicator – the Operational Boundary for external debt

	2016/17 Original Estimate £m	**2016/17 Revised Estimate £m**
Prudential Indicator – Capital Financing Requirement		
Total CFR	(21,008)	(21,101)
Net movement in CFR	**4**	**1**
Prudential Indicator – the Operational Boundary for external debt		
Borrowing	7.5	7.5
Other long term liabilities*	0.3	0.3
Total debt (year end position)	**7.8**	**7.8**

** On balance sheet finance leases etc.*

5.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose*. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2016/17 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

** The management of transferred debt should be excluded from net borrowing.*

	2016/17 Original Estimate £m	**2016/17 Revised Estimate £m**
Borrowing	7.5	7.5
Other long term liabilities*	0.3	0.3
Total debt	**7.8**	**7.8**
CFR* (year end position)	**(21,008)**	**(21,101)**

** Includes on balance sheet finance leases etc.*

The Head of Strategic Finance and Property reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	**2016/17 Original Indicator £m**	**2016/17 Revised Indicator £m**
Borrowing	12	12
Other long term liabilities*	1	1
Total	**13**	**13**

** Includes on balance sheet finance leases etc.*

6 Investment Portfolio

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 3, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.25% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis together with other risks which could impact on the creditworthiness of banks, prompts a low risk strategy. Given this risk environment, investment returns are likely to remain low.

The Council held £41.5m in short investments as at 30th September 2016 (£34.5m at 31 March 2016) and the investment portfolio yield for the first 6 months of the year is 0.71% against a benchmark 6months Libid uncompounded *of 0.52 %.*

The Council also holds £20m, as long term investments, in two property funds which have produced an average net yield of 3.6%

The Head of Strategic Finance and Property confirms that the approved limits within the Annual Investment Strategy were not breached during the first 6 months of 2016/17.

The Council's budgeted investment return for 2016/17 is £902k, and performance for the year to date is estimated at £18k above budget, however an assumption that recent economic events could result in a reduction in the property fund income has been built into this estimate.

Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

7 Borrowing

The Council's capital financing requirement (CFR) for 2016/17 is (£21,012m). The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. Table 5.4 shows the Council has borrowings of £7.8m.

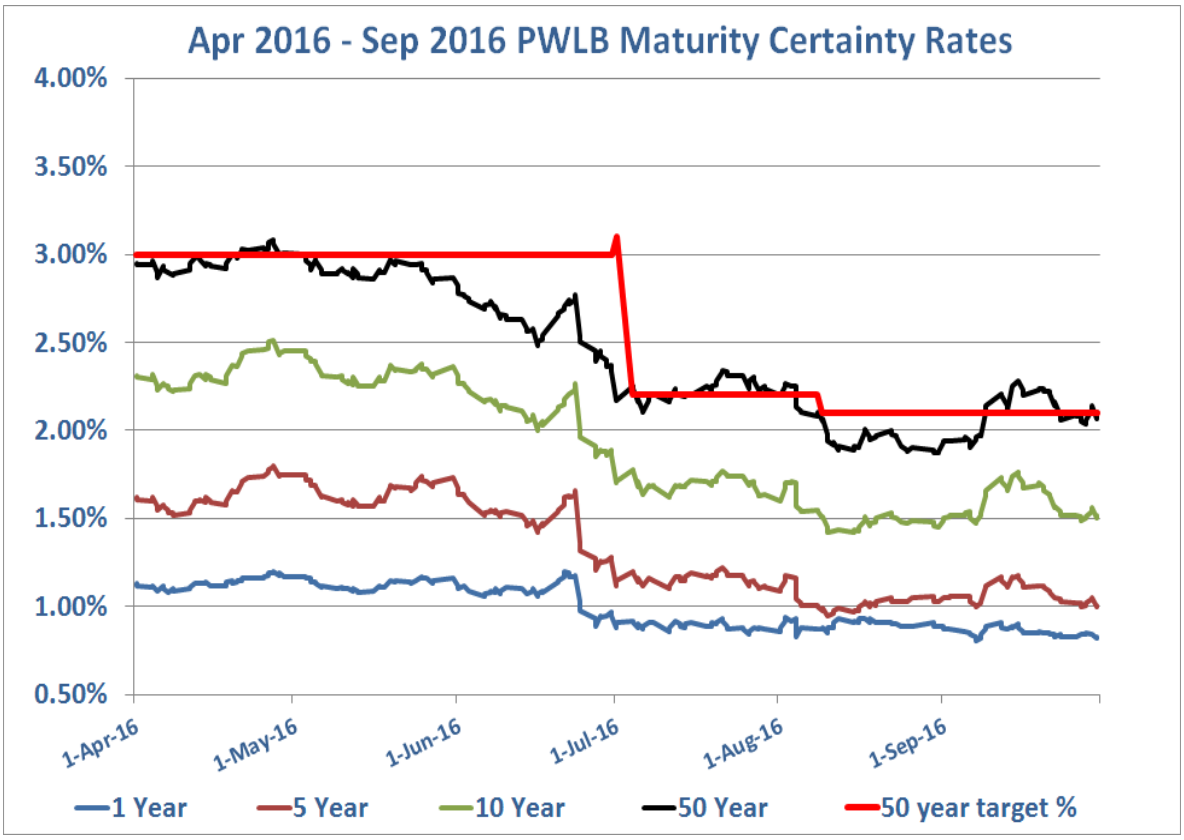
As shown in the graph below, the general trend to date has been a sharp fall in interest rates in the current financial year.

The Council is in a negative CFR position and it is anticipated that further borrowing will not be undertaken during this financial year.

The graph and table below show the movement in PWLB certainty rates for the first six months of the year to date:

PWLB certainty rates 1 April 2016 to 30TH September 2016

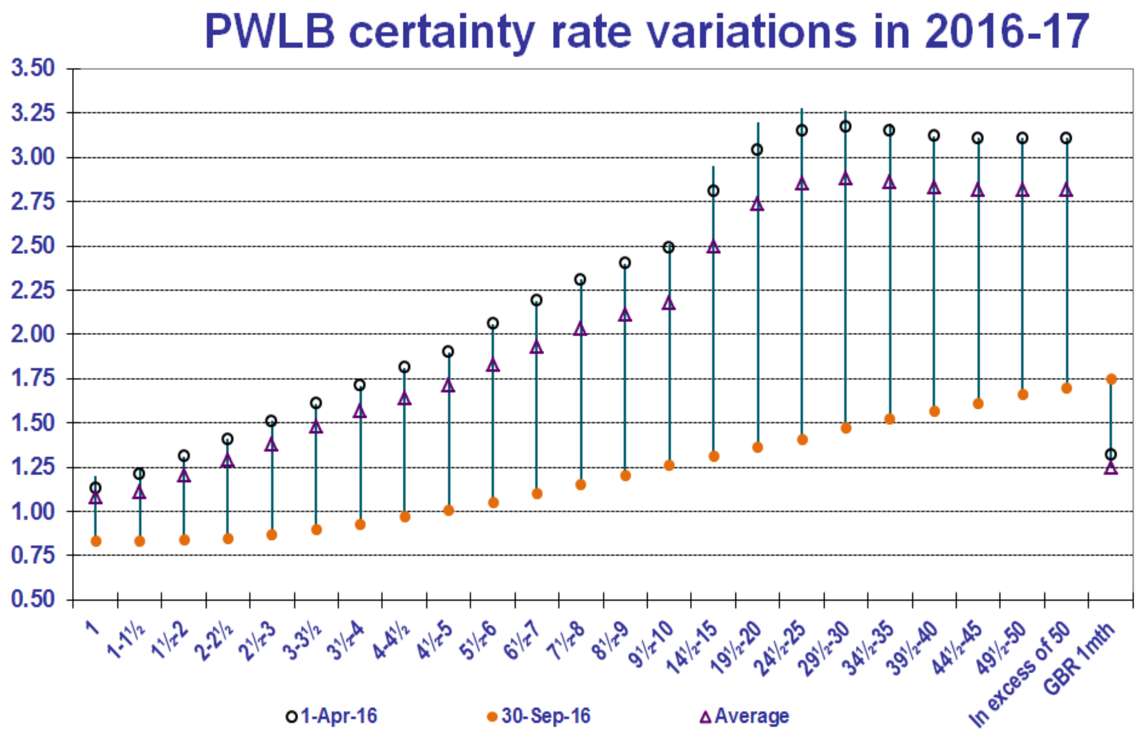
	1 Year	5 Year	10 Year	25 Year	50 Year
1/4/16	1.13%	1.62%	2.31%	3.14%	2.95%
30/9/16	0.83%	1.01%	1.52%	2.27%	2.10%
Low	0.81%	0.95%	1.42%	2.08%	1.87%
Date	07/09/2016	10/08/2016	10/08/2016	12/08/2016	30/08/2016
High	1.20%	1.80%	2.51%	3.28%	3.08%
Date	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016
Average	0.99%	1.33%	1.92%	2.69%	2.46%



8 Debt Rescheduling

Debt rescheduling opportunities have been very limited in the current economic climate given the consequent 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 has therefore been undertaken to date in the current financial year.

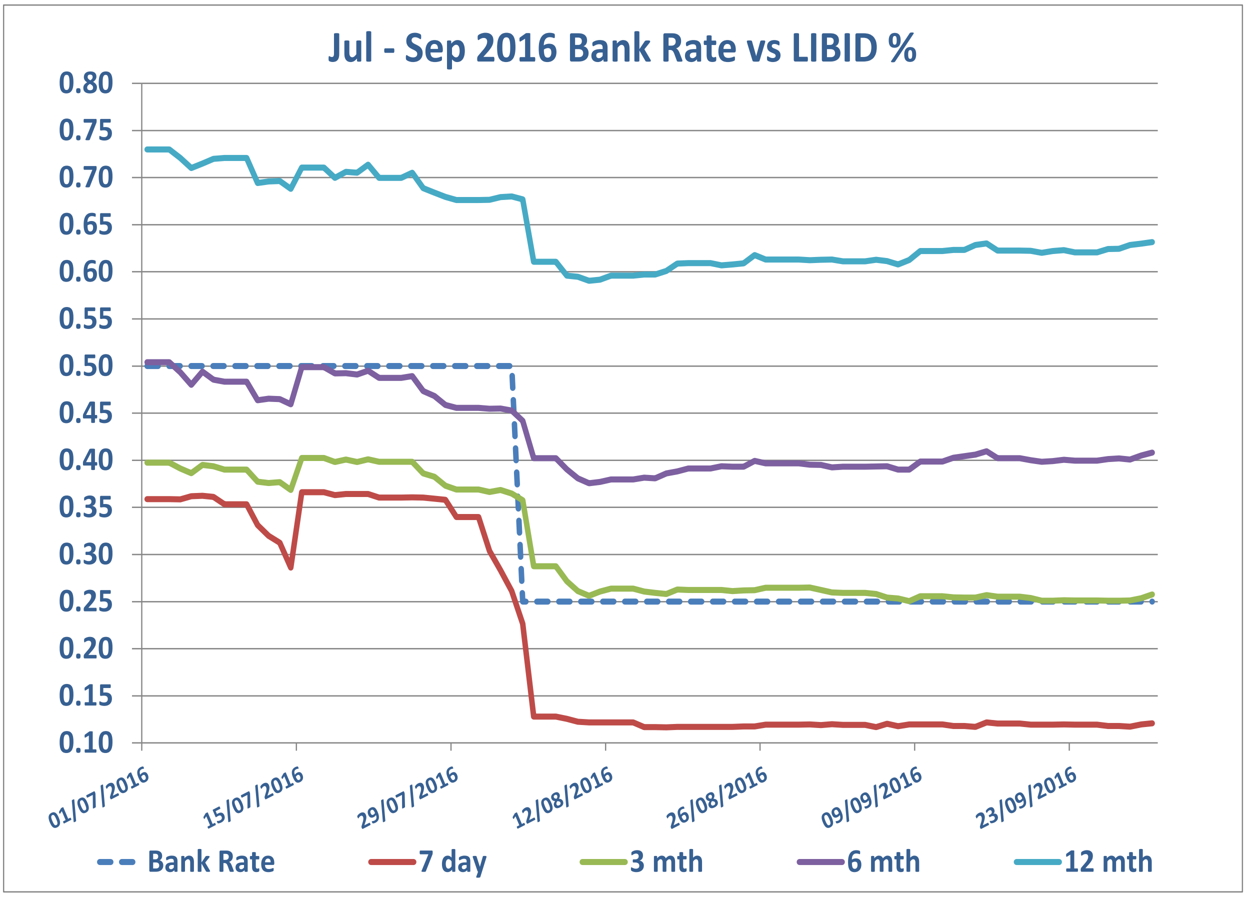
APPENDIX 1: Borrowing



APPENDIX 2: Investments

Investment performance year to 30 September 2016

Benchmark	Benchmark Return (LIBID Uncompounded)	Council Performance
7 day	0.28%	0.28%
1 month	0.30%	0.40%
3 month	0.38%	0.55%
6 month	0.52%	0.65%
12 month	0.76%	0.84%



APPENDIX 3: Detailed commentary on interest rate forecasts

Our treasury management advisers, Capita Asset Services have provided us with the following update to their interest rate forecasts.

August quarterly inflation report review

- *4.8.16 MPC decisions: -*
    - *Bank Rate cut from 0.50% to 0.25%*
    - *new gilt purchases of £60bn*
    - *high quality corporate bond purchases of £10bn*
    - *Term Funding Scheme to provide £100bn of cheap funding to banks*
    - *last three measures to be financed by creation of new central bank reserves boosting the Bank's Asset Purchase Facility from £375bn to £545bn*
- *Forward guidance that a further cut to near zero (0.10%?), is likely – probably November quarterly inflation report meeting, if data comes in as forecast, but Carney has dismissed the ideas of negative rates and helicopter money*
- *Considerable variety of views as to whether these latest measures will have much direct impact on the economy; but they are likely to have an indirect effect by impacting on perceptions and boosting confidence that the Bank is taking action and doing as much as possible - so this WILL help sentiment.*
- *Limited benefit of a quarter per cent cut in Bank Rate on the cost of mortgages - but also because 36% of households rent, 33% own their property outright, so only 30% own their homes by mortgages and only half of those are on variable rate mortgages.*
- *The Chancellor has said he will do 'whatever is needed' i.e. to promote growth; two options – fiscal policy e.g. cut taxes, increase investment allowances for businesses etc and / or increase government expenditure on infrastructure, housing etc. This will mean that the deficit elimination timetable will need to slip further into the future as promoting growth (and ultimately boosting tax revenues in the longer term), will be a more urgent priority.*
- *Our tentative forecast is for increases in Bank Rate in May 2018 to 0.25% and to 0.50% May 2019; but these will very much depend on how strongly, and how soon, the UK economy makes a gradual recovery, and so start a process of very gradual increases in Bank Rate over a prolonged period*
- *GDP forecasts – Bank of England 2016 +2.0% unchanged; 2017 +0.8%, 2018 +1.8% sharply down. Note – this is not indicating a return to recession.*
- *GDP forecasts - Capital Economics 2016 +1.7%, 2017 +1.5%, 2018 +2.5%. They feel that pessimism has been overdone and Brexit will not have as big an effect as feared*
- *Consumer confidence fell very sharply on the GfK consumer confidence index immediately after the Brexit vote but fully recovered by the end of September.*
- *The July UK PMIs, (published early August), fell very sharply but a month later, rebounded equally sharply showing that initial pessimism was an alarmist over reaction. In addition, the Visa UK monthly index published 8 August showed consumer spending rising by 1.6% in July (i.e. fully after the referendum), showing that actual consumer behaviour and rate of expenditure has been little impacted by the Brexit result.*
- *The Bank of England quarterly Inflation Report shows Inflation rising up above the MPC's 2% target in 2018 to about 2.4% in 2018 and 2019 due to the recent fall in the value of sterling etc., but the MPC is likely to look through that and take a longer term view in order to give time for economic growth to recover.*
- *Rising EU and geopolitical risks e.g.*
    - *Current - under capitalisation of Italian and some German banks poses a major risk with state aid firmly ruled out by the EU as a potential way out*
    - *Italian constitutional referendum on 4 December 2016 on reforming the Senate and reducing its powers, has also become a confidence vote on Prime Minister Renzi who has said he will resign if there is a 'no' vote; this could destabilise Italy and stop progress to fundamental political and economic reform which is urgently needed to deal with Italy's core problems, especially low growth*
    - *Nov 2016 US presidential election*
    - *2017: French Presidential election April – May and German Federal general election between August and October could be affected by significant shifts in voter intentions as a result of terrorist attacks and a rise in anti EU sentiment*

  - *Core EU principle of free movement of people within the EU is a growing issue leading to major stress and tension between EU states*
- *US - next rate rise now likely to be postponed until December 2016; rate rises will cause Treasury yields to also rise and so cause a growing gap between Treasury and gilt yields over time*
- *Lacklustre economic growth in the EU, (our biggest trading partner), but could be negatively impacted by any adverse political developments*
- *Japan bogged down in anaemic growth and making little progress on fundamental reform of the economy*
- *Chinese economic growth weakening; medium term risks increasing*
- *Most of the major developed economies of the world, apart from the US, appear to be becoming bogged down in lacklustre growth with central banks running out of ammunition to provide further support to economic growth. National governments will need to support economic growth by undertaking structural reforms, fiscal policy and direct investment expenditure.*

CAPITA ASSET SERVICES' FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

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.

We have pointed out consistently that the Fed. rate is likely to go up more quickly and more strongly than Bank Rate in the UK and recent events have not changed that view, just that the timing of such increases may well have been deferred somewhat. While there is normally a high degree of correlation between the two yields, we would expect to see a growing decoupling of yields between the two i.e. we would expect US yields to go up faster than UK yields. We will need to monitor this area closely and the resulting effect on PWLB rates.

The overall balance of risks to economic recovery in the UK remains to the downside.

We would, as always, remind clients of the view that we have expressed in our previous interest rate revision newsflashes of just how unpredictable PWLB rates and bond yields are at present. We are experiencing exceptional levels of volatility which are highly correlated to emerging market, geo-political and sovereign debt crisis developments. Our revised forecasts are based on the Certainty Rate (minus 20 bps) which has been accessible to most authorities since 1st November 2012.

Apart from the uncertainties already explained above, 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.

	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
3 month LIBID	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.30	0.40	0.50	0.60
6 month LIBID	0.30	0.30	0.30	0.40	0.40	0.50	0.50	0.50	0.60	0.60	0.70
12 month LIBID	0.50	0.50	0.60	0.60	0.70	0.70	0.70	0.80	0.80	0.80	0.90
5 yr PWLB	1.00	1.00	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.30
10 yr PWLB	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80
25 yr PWLB	2.30	2.30	2.40	2.40	2.40	2.40	2.50	2.50	2.50	2.50	2.60
50 yr PWLB	2.10	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.30	2.30	2.40

BANK RATE	now	previously
Q3 2016	0.25%	0.25%
Q1 2017	0.10%	0.25%
Q1 2018	0.10%	0.25%
Q1 2019	0.25%	0.50%

Our suggested budgeted investment earnings rates for investments up to about three months duration in each financial year for the next seven years are as follows: -

Average earnings in each year	Now	Previously
2016/17	0.25%	0.25%
2017/18	0.10%	0.25%
2018/19	0.25%	0.50%
2019/20	0.50%	0.50%
2020/21	0.75%	0.75%

2021/22	1.00%	1.25%
2022/23	1.25%	1.50%
2023/24	1.50%	2.00%
Later years	2.50%	2.75%

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts. The general expectation for an eventual trend of gently rising gilt yields and PWLB rates is expected to remain unchanged. Negative, (or positive), developments could significantly impact safe-haven flows of investor money into UK, US and German bonds and produce shorter term movements away from our central forecasts.

Our interest rate forecast for Bank Rate is in steps of 25 bps whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps.

Naturally, we continue to monitor events and will update our forecasts as and when appropriate.

APPENDIX 4: Approved countries for investments

Based on lowest available rating

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- Hong Kong
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Qatar
- U.K.