| REPORT TO: | **AUDIT COMMITTEE** | | |
|---|---|---|---|
| DATE: | 28 October 2019 | | |
| TITLE: | **MID YEAR REVIEW TREASURY REPORT 2019/2020** | | |
| TYPE OF REPORT: | Review | | |
| PORTFOLIO(S): | Cllr Angie Dickinson | | |
| REPORT AUTHOR: | Tina Stankley | | |
| OPEN/EXEMPT | Open | WILL BE SUBJECT TO A FUTURE CABINET REPORT: | *No* |

**<u>REPORT SUMMARY/COVER PAGE</u>**

PURPOSE OF REPORT/SUMMARY:


Summary

The Council has formally adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (2011) and remains fully compliant with its requirements.

One of the primary requirements of the Code is receipt by Council of a Mid-Year Review Report.

The Mid-Year Review Report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- A review of the Treasury Management Strategy;
- The Council's capital expenditure (prudential indicators);


RECOMMENDATIONS:

Audit Committee is asked to review and note the report and the treasury activity and recommend that Cabinet note the report.

REASONS FOR RECOMMENDATIONS:

The Council has formally adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (2011) and remains fully compliant with its requirements.

One of the primary requirements of the Code is:

Receipt by Audit Committee of a Mid-Year Review Report.

## 1. The 2019/2020 Mid-Year Review

1.1 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

1.2 The primary requirements of the Code are as follows:

1.2.1 Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

1.2.2 Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

1.2.3 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.

1.2.4 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.

1.2.5 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 the Audit Committee:

1.3 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 2019/20 financial year (see section 2 and Appendix 1);
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy (see section 3);
- The Council's capital expenditure and prudential indicators (see section 4);
- A review of the Council's investment portfolio for 2019/20 (see section 5);
- A review of the Council's borrowing strategy for 2019/20 (see section 6);
- A review of any debt rescheduling undertaken during 2019/20 (see section 7);

## 2. Economic Update and Interest Rates Forecast.

2.1 An economic update provided by Link Asset Services (the Council's Treasury Advisor) can be found in Appendix 1. Brexit uncertainty has been the dominating factor in 2019 and has had a dampening effect on the UK's economic growth in the year so far. This is unlikely to change until there Is some clarity on what is going to happen over Brexit.

2.2 The following interest rate forecast has been provided by Link Asset Services.

| Link Asset Services Interest Rate View | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank Rate View | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 |
| 3 Month LIBID | 0.70 | 0.70 | 0.70 | 0.70 | 0.80 | 0.90 | 1.00 | 1.00 | 1.00 | 1.10 | 1.20 |
| 6 Month LIBID | 0.80 | 0.80 | 0.80 | 0.80 | 0.90 | 1.00 | 1.10 | 1.10 | 1.20 | 1.30 | 1.40 |
| 12 Month LIBID | 1.00 | 1.00 | 1.00 | 1.00 | 1.10 | 1.20 | 1.30 | 1.30 | 1.40 | 1.50 | 1.60 |
| 5yr PWLB Rate | 1.20 | 1.30 | 1.50 | 1.60 | 1.70 | 1.70 | 1.80 | 1.90 | 2.00 | 2.00 | 2.10 |
| 10yr PWLB Rate | 1.50 | 1.60 | 1.80 | 1.90 | 2.00 | 2.00 | 2.10 | 2.20 | 2.30 | 2.30 | 2.40 |
| 25yr PWLB Rate | 2.10 | 2.30 | 2.40 | 2.50 | 2.60 | 2.70 | 2.70 | 2.80 | 2.90 | 3.00 | 3.00 |
| 50yr PWLB Rate | 2.00 | 2.20 | 2.30 | 2.40 | 2.50 | 2.60 | 2.60 | 2.70 | 2.80 | 2.90 | 2.90 |

2.3 With the continued uncertainty over Brexit and with concerns about the outlook for both the global and domestic economies the Monetary Policy Committee (MPC) has left the Bank Rate unchanged at 0.75% so far in 2019. The MPC in looking ahead have assumed on the one hand that if there is an agreed deal on Brexit rates would need to rise at a “gradual pace and to a limited extent”. However this is now also conditional on “some recovery in global growth”. Then on the other hand it is assumed that If there were a no deal Brexit, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth.

2.4 The interest rate forecasts in the table above have been based on an assumption that there is an agreed deal on Brexit. However given the level of uncertainty this is a huge assumption and so forecasts may need to be materially reassessed in the light of events over the next few weeks or months

## 3. Treasury Management Strategy Statement and Annual Investment Strategy Update

3.1 The Treasury Management Strategy Statement, (TMSS), for 2019/20 was approved by this Council on 11 April 2019.

3.2 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.

## 4. The Council’s Capital Position (Prudential Indicators)

4.1 This section of the report provides an update on:

- 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.

4.2 **Prudential Indicators for Capital Expenditure**

4.2.1 The table below shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at full Council on 21 February 2019.

| Capital Expenditure | 2019/20 Original Estimate | 2019/20 Actual as at 30 Sept 19 | 2019/20 Revised Estimate |
|---|---|---|---|
| | £'000 | £'000 | £'000 |
| Major Projects | 43,887 | 8,310 | 51,079 |
| Operational Schemes: | | | |
| Central and Community Services | 2,528 | 1,244 | 3,343 |
| Commercial Services | 2,897 | 680 | 3,530 |
| Environment and Planning | 0 | 0 | 8 |
| Finance Services | 50 | 23 | 101 |
| Exempt Schemes | 14,037 | 3,759 | 17,093 |
| **Total Capital Expenditure** | **63,399** | **14,016** | **78,511** |

4.3 **Changes to the Financing of the Capital Programme**

4.3.1 The table below shows how the capital expenditure is expected to be financed in the year. The borrowing requirement shown at the bottom of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by needing to replace maturing debt and other treasury requirements.

| Financing Capital Expenditure | 2019/20 Original Estimate | 2019/20 Actual as at 30 Sept 19 | 2019/20 Revised Estimate |
|---|---|---|---|
| | £'000 | £'000 | £'000 |
| Total Capital Expenditure | 63,399 | 14,016 | 78,511 |
| Capital Receipts | (51,950) | (9,001) | (44,293) |
| Capital Grants | (4,281) | (1,150) | (5,081) |
| Capital Reserves | (3,559) | (3,705) | (10,451) |
| Revenue | (1,665) | (160) | (2,312) |
| **Total financing** | **(61,455)** | **(14,016)** | **(62,137)** |
| | | | |
| **Borrowing requirement** | **(1,944)** | **0** | **(16,373)** |

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

4.5 The first table below shows the CFR, which is the underlying need to borrow for a capital purpose (i.e. capital expenditure which has not been financed immediately through the use of capital receipts, capital grants or revenue contributions and is still to be financed). The second table shows the level of external debt that the Council has that relates to commercial activities.

| Capital Financing Requirement (CFR) | 2019/20 Original Estimate | 2019/20 Actual as at 30 Sept 19 | 2019/20 Revised Estimate |
|---|---|---|---|
| | £'000 | £'000 | £'000 |
| **Prudential Indicator – Capital Financing Requirement** | | | |
| CFR | 49,422 | 44,251 | 44,251 |
| | | | |
| **Net Movement in CFR** | **1,352** | **4,916** | **4,916** |
| | | | |
| **Prudential Indicator – the Operational Boundary for External Debt** | | | |
| Borrowing | 31,223 | 16,000 | 16,000 |
| Other Long Term Liabilities * | 0 | 0 | 0 |
| **Total Debt (Year End Position)** | **31,223** | **28,251** | **28,251** |

* On balance sheet PFI and finance leases etc.

| External Debt for commercial activities | 2019/20 Original Estimate | 2019/20 Actual as at 30 Sept 19 | 2019/20 Revised Estimate |
|---|---|---|---|
| | £'000 | £'000 | £'000 |
| Actual debt at 31 March £m | 2,818 | 2,818 | 2,818 |
| Percentage of total external debt % | 15% | 18% | 18% |

4.6 The Council is currently under-borrowed against the CFR, as, whilst the Council has adequate cash balances, it is more advantageous to continue to employ internal resources until cash flow forecasts indicates the need for additional borrowing. PWLB borrowing rates are currently forecast to rise over the next year, but as investment rates are still very low, there is a cost of carry for external borrowing. Borrowing will need to be taken at some point in the future to replace the internal funds (cash) which have been used and there also be a need to take further additional borrowing, which would be dependent upon any additional capital programme requirements not anticipated at this point.

4.7 The council is on target to remain below the original forecast CFR. The table above also shows the expected debt position over the period, which is termed the Operational Boundary.

4.8 **Limits to Borrowing Activity**

4.9 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 2019/20 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.

| | 2019/20 Original Estimate | 2019/20 Actual as at 30 Sept 19 | 2019/20 Revised Estimate |
|---|---|---|---|
| | £'000 | £'000 | £'000 |
| Borrowing | 39,000 | 28,251 | 28,251 |
| Other Long Term Liabilities * | 1,000 | 1,000 | 1,000 |
| Commercial Activities | 10,000 | 10,000 | 10,000 |
| **Total Debt (Year End Position)** | **50,000** | **39,251** | **39,251** |
| **CFR * (Year End Position)** | **49,422** | **45,603** | **45,603** |

* Includes on balance sheet PFI and finance leases etc.

4.10 The Chief Finance Officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator

4.11 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** | **2019/20 Original Estimate** | **2019/20 Actual as at 30 Sept 19** | **2019/20 Revised Estimate** |
|---|---|---|---|
| | **£'000** | **£'000** | **£'000** |
| Borrowing | 44,000 | 44,000 | 44,000 |
| Other Long Term Liabilities * | 1,000 | 1,000 | 1,000 |
| Commercial Activities | 10,000 | 10,000 | 10,000 |
| **Total** | **55,000** | **55,000** | **55,000** |

* Includes on balance sheet PFI and finance leases etc.

## 5. Investment Portfolio 2019/20

5.1 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and then to obtain an appropriate level of return which is consistent with the Council's risk appetite. As shown by forecasts in section 2.2, 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 0.75% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

5.2 The Council held £19m of investments as at 30 September 2019 (£12.555m at 31 March 2019) and the investment portfolio yield for the first 6 months of the year is 0.75% against a benchmark 7 day LIBID rate of 0.57%.

5.3 A full list of investments held as at 30 September 2019 is in Appendix 2:

5.4 The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first 6 months of 2019/20.

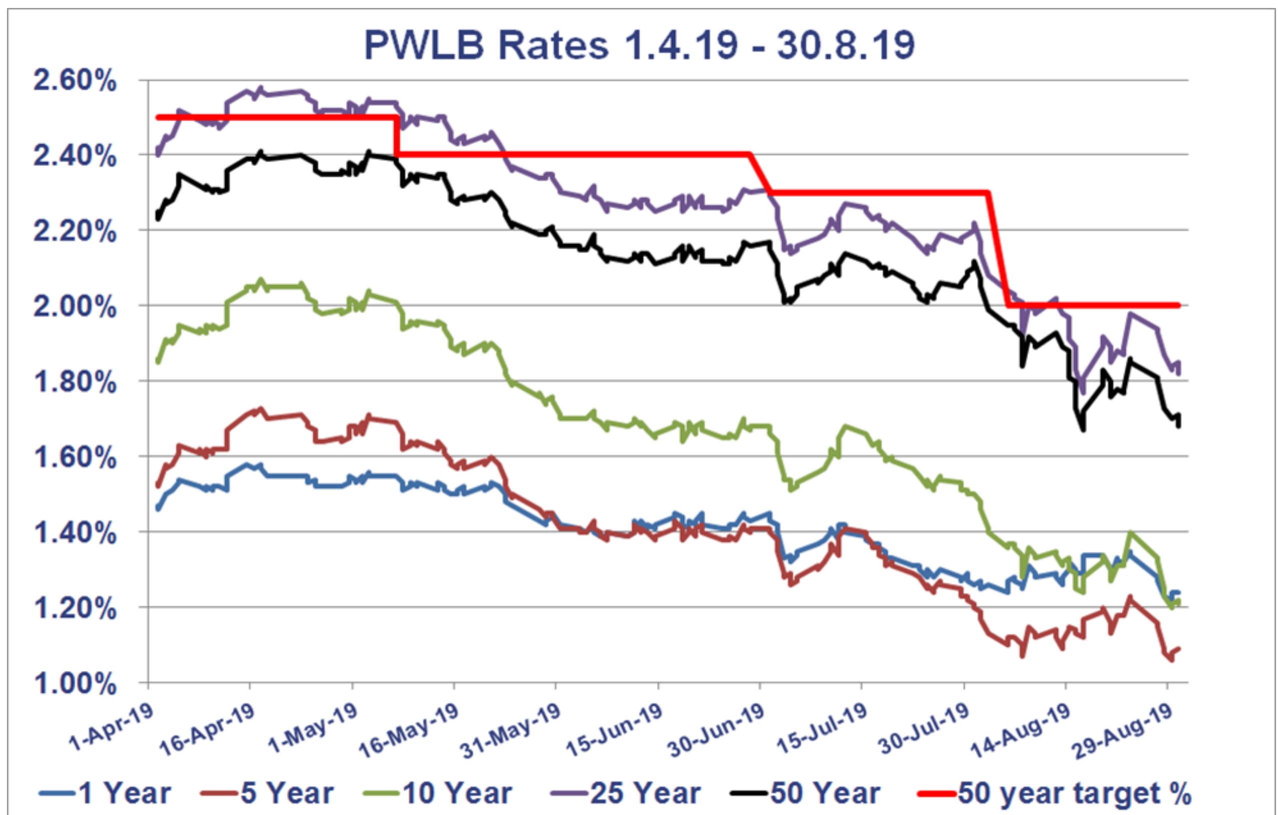
5.5 The Council's budgeted investment return for 2019/20 is £354,910 and performance for the year to date is £107,270 below budget. This budget will be reviewed as part of the estimates process.

## 6. Borrowing

6.1 The Council's capital financing requirement (CFR) for 2019/20 is £44,251m. 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. The Council has borrowings of £16m and has utilised £28.251m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

6.2 It is anticipated that further borrowing will not be undertaken during this financial year.

6.3 The graph and table below show the movement in PWLB certainty rates for the first six months of the year to date. As can be seen from both the graph and table the general trend for the rates has been downwards over the period from the beginning of April to the end of August.




| | 1 Year | 5 Year | 10 Year | 25 Year | 50 Year |
|---|---|---|---|---|---|
| Low | 1.22% | 1.06% | 1.20% | 1.77% | 1.67% |
| Date | 29/08/2019 | 29/08/2019 | 29/08/2019 | 16/08/2019 | 16/08/2019 |
| High | 1.58% | 1.73% | 2.07% | 2.58% | 2.41% |
| Date | 15/04/2019 | 17/04/2019 | 17/04/2019 | 17/04/2019 | 17/04/2019 |
| Average | 1.41% | 1.41% | 1.68% | 2.27% | 2.13% |

7. **Debt Rescheduling**

7.1 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.

**8. Financial ImplicationsThe financial implications of the borrowing and investment strategy are reflected in the financing adjustment figure included in the Financial Plan 2017/2022 approved at Council on 22 February 2018 and updated as reported in the Budget Monitoring reports.**

**9. Risk Management Implications**

9.1 There are elements of risk in dealing with the treasury management function although the production and monitoring of such controls as prudential indicators and the treasury management strategy help to reduce the exposure of the Council to the market. The costs and returns on borrowing and investment are in themselves a reflection of risk as seen by the market forces.

**10. Policy Implications**

10.1 There are no changes in the Treasury Management policy at present.

**11. Statutory Considerations**

11.1 The Council must set prudential indicators and adopt a Treasury Management Strategy and Annual Investment Strategy.

**12. Access to Information**

The Budget 2018/2023 – The Financial Plan
Capital Programme 2018/2023
Treasury Management Strategy and Annual Investment Strategy 2019/2020
Budget Monitoring reports 2019/2020

## APPENDIX 1

**Economics update**

**UK.** This first half year has been a time of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on or 31 October, with or without a deal. However, so far, there has been no majority of MPs for any one option to move forward on enabling Brexit to be implemented. At the time of writing, (first week in September), the whole political situation in the UK over **Brexit** is highly fluid and could change radically by the day. The vote in the Commons on 3 September looks likely to lead to a delay in the date for Brexit to 31 January 2020, but there is also likelihood that there will be an imminent general election. In such circumstances, any interest rate forecasts are subject to material change as the situation evolves. At present, if the UK does soon achieve an agreed deal on Brexit, including some additional clarification wording on the Irish border backstop, then it is possible that growth could recover quickly. The MPC could then need to address the issue of whether to raise Bank Rate when there is very little slack left in the labour market; this could cause wage inflation to accelerate which would then feed through into general inflation. On the other hand, if there was a no deal Brexit and there was a significant level of disruption to the economy, then growth could falter and the MPC would be likely to cut Bank Rate in order to support growth. However, with Bank Rate still only at 0.75%, it has relatively little room to make a big impact and the MPC would probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by way of tax cuts and / or expenditure on infrastructure projects, to boost the economy. However, infrastructure projects generally take a long time to plan and to start up, and so to feed through into impacting the economy; tax cuts would be much quicker in impacting the level of consumption in the economy.

The first half of 2019/20 has seen UK **economic growth** fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. This mirrored investor confidence around the world which is now expecting a significant downturn or possibly even a recession in some developed economies. It was therefore no surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, (July 2.1%), and is likely to shift only a little upwards over the rest of 2019/20. It does not therefore pose any immediate concern to the MPC at the current time.

With regard to the **labour market,** despite the contraction in quarterly GDP growth of -0.2%q/q, (+1.2% y/y), in quarter 2, employment rose by 115,000 in the same quarter: this suggests that firms are preparing to expand output and suggests there could be a return to positive growth in quarter 3. Unemployment has continued near to a 44 year low, edging up from 3.8% to 3.9% on the Independent Labour Organisation measure in June; however, that was caused by a rise in the participation rate to an all-time high. Job vacancies fell for a sixth consecutive month, hitting record levels, and indicating that employers are having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to a high point of 3.9%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 1.8%. As 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 could mean that the MPC will need to take action to raise Bank Rate if there is an agreed Brexit deal as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the **political arena**, if there is a general election soon, 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 although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.

**USA.** President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of strong growth to 2.9% y/y. Growth in 2019 has been falling back after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2. Quarter 3 is expected to fall further. The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not to be seen as the start of a series of cuts to ward off a downturn in growth. Financial markets are, however, expecting another cut in September. Investor confidence has been

badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This trade war is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.

**BOND YIELDS.** It is this souring of investor confidence that has largely contributed to the sharp fall in bond yields on government debt in mid-2019 in the major western economies as investors have switched out of risky assets - equities, fearing an impending recession, and buying into bonds, so pushing their prices up and correspondingly, pushing yields down. Investors have little confidence that the US China trade war will have a satisfactory outcome in the near future and both sides look as if they are digging in to entrenched positions. However, most domestic US economic indicators are not currently pointing to a recession in the US, only to a slowing of growth. Provided the major world economies do avoid recession, then it is likely that there will be some reversal of this flow from equities into bonds and, therefore, that bond yields will recover to a limited extent from recent truly exceptional lows. However, the near-term reality is that we have seen 10 year bond yields fall below 2 year yields in the US; this has historically been a prime indicator of impending recession in the US, though this correlation has been much weaker in the UK. All German bond yields between 2 and 30 years are actually negative while many other EZ countries have bond yields which are also negative, at least in some maturity years.

**EUROZONE.** Growth has been slowing from +1.9% during 2018 to +0.4% q/q (+1.2% y/y) in quarter 1 and then to +0.2% q/q (+1.0% y/y) in quarter 2; there appears to be little upside potential to the growth rate in the rest of 2019. German GDP growth fell to -0.1% in quarter 2; industrial production was down 5.2% y/y in June with car production especially being hit. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars. The ECB meeting in July expressed concern as to the weak outlook for growth and how low inflation was despite all the monetary stimulus the bank still has in place. The ECB is therefore expected to take action to cut its main rate of -0.4% further, but only marginally, and to look at the potential for more quantitative easing and/or other instruments of monetary policy to provide further stimulus to economic growth. On the political front, Spain and Italy are in the throes of trying to form coalition governments while the very recent results of two German state elections will put further pressure on the frail German CDU/SDP coalition government.

**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. The trade war with the US does not appear to have had a significant effect on GDP growth as yet as some of the impact of tariffs has been offset by falls in the exchange rate and by transhipping exports through other countries, rather than directly to the US.

**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-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 |
| Bank Rate View | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 |
| 3 Month LIBID | 0.70 | 0.70 | 0.70 | 0.70 | 0.80 | 0.90 | 1.00 | 1.00 | 1.00 | 1.10 | 1.20 |
| 6 Month LIBID | 0.80 | 0.80 | 0.80 | 0.80 | 0.90 | 1.00 | 1.10 | 1.10 | 1.20 | 1.30 | 1.40 |
| 12 Month LIBID | 1.00 | 1.00 | 1.00 | 1.00 | 1.10 | 1.20 | 1.30 | 1.30 | 1.40 | 1.50 | 1.60 |
| 5yr PWLB Rate | 1.20 | 1.30 | 1.50 | 1.60 | 1.70 | 1.70 | 1.80 | 1.90 | 2.00 | 2.00 | 2.10 |
| 10yr PWLB Rate | 1.50 | 1.60 | 1.80 | 1.90 | 2.00 | 2.00 | 2.10 | 2.20 | 2.30 | 2.30 | 2.40 |
| 25yr PWLB Rate | 2.10 | 2.30 | 2.40 | 2.50 | 2.60 | 2.70 | 2.70 | 2.80 | 2.90 | 3.00 | 3.00 |
| 50yr PWLB Rate | 2.00 | 2.20 | 2.30 | 2.40 | 2.50 | 2.60 | 2.60 | 2.70 | 2.80 | 2.90 | 2.90 |

It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit. In its last meeting on 1 August, the MPC became more dovish as it was more concerned about the outlook for both the global and domestic economies. That's shown in the policy statement, based on an assumption that there is an agreed deal on Brexit, where the suggestion that rates would need to rise at a "gradual pace and to a limited extent" is now also conditional on "some recovery in global growth". Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. If there were a no deal Brexit, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth.
The above forecasts have been based on an assumption that there is some sort of muddle through to an agreed deal on Brexit. Given the current level of uncertainties, this is a huge assumption and so forecasts may need to be materially reassessed in the light of events over the next few weeks or months.

**The balance of risks to the UK**

- The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are currently a little below those to the downside.

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England** takes action too quickly, or too far, 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 2018 of a government which has made a lot of anti-austerity noise. The EU has had sharp disagreements in successive years with Italy over setting a budget within the limits of EU rules. (Early September – a new coalition government may be formed which would be less anti-EU.) The rating agencies have already downgraded Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold Italian debt. Unsurprisingly, investors are becoming increasingly concerned by the actions of the Italian government and consequently, Italian bond yields have risen – at a time when the government faces having to refinance over €200bn of debt maturing in 2019. However, the biggest concern is the major holdings of Italian government debt held by Italian banks and insurers. Any downgrading of such debt would cause Italian bond prices to fall, causing losses on their portfolios, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc. This is the so called **'doom loop'**. Due to the Italian government's already high level of debt, it would not be able to afford to bail out the banking system. **Portugal** faces the same problem as its debt is also only one notch above junk level.
- Weak capitalisation of some **European banks**, particularly Italian banks.
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD had a major internal debate as to whether it could continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. However, this makes little practical difference as she has continued as Chancellor, though more recently concerns have arisen over her health. Early September 2019 – the results of the Saxony and Brandenburg regional elections were again very disappointing for the CDU and SPD; this will rejuvenate the tensions of October 2018 between these two parties that form the current coalition government.
- **Other minority EU governments.** Sweden, Spain, Portugal, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Italy, Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.

- The increases in interest rates in the US during 2018, combined with a trade war between the USA and China, sparked major volatility in equity markets during the final quarter of 2018 and into 2019. In mid-2019, investor fears of a looming recession have again sparked moves by investors out of riskier assets i.e. equities, into safe havens of government bonds of major western countries. Some **emerging market countries** which have borrowed heavily in dollar denominated debt could be particularly exposed to investor flight from equities to safe havens, typically US treasuries, German bunds and UK gilts.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks,** for example in 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**

- **Brexit** – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary 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

## Investment Portfolio as at 30 September 2019 APPENDIX 2

| Institution | Principal £ | Rate % |
|---|---|---|
| BNP (Banque Nationale de Paris) – MMF* | 4,000,000 | 0.70 |
| HSBC Sterling – MMF* | 4,000,000 | 0.69 |
| LGIM (Northern Trust) – MMF* | 4,000,000 | 0.69 |
| Northamptonshire CC | 3,000,000 | 1.25 |
| Cheshire West and Chester | 2,000,000 | 1.00 |
| Barnsley MBC | 2,000,000 | 0.92 |
| Dudley Metro Borough Council | 3,000,000 | 1.08 |
| **Total Investments** | **22,000,000** | |

*MMF – denotes Money Market Fund used for daily cash flow purposes, an average daily % rate is shown.

## Borrowing Portfolio as at 30 September 2019

## APPENDIX 3

| Institution | Principal £ | Rate % |
|---|---|---|
| Gloucestershire CC | 3,000,000 | 0.97% |
| Vale of Glamorgan | 3,000,000 | 0.75% |
| **Total Short Term** | **6,000,000** | |
| Barclays | 5,000,000 | 3.81% |
| Barclays | 5,000,000 | 3.81% |
| **Total Long Term** | **10,000,000** | |

**Prudential Indicators:** **APPENDIX 4**

| Net borrowing and the CFR | | |
|---|---|---|
| | **31 March 2019 Actual £million** | **30 September 2019 Actual £million** |
| Borrowing | 13.10 | 16.00 |
| Investments | (13.70) | (22.00) |
| **Net Position** | **(0.60)** | **(6.00)** |
| | | |
| **Capital Financing Requirement** | **44.25** | **49.42** (estimate for 2019/2020 year end) |

In order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2019/2020. This essentially means that the Council is not borrowing to support revenue expenditure. The Council has complied with this prudential indicator.

**The Council's Capital Position and Associated Prudential Indicators**

The capital programme 2019/2020 was updated for rephasing and amendments as part of the closedown of the accounts 2018/2019. The updated estimates were approved by Council on 18 June 2019 and are shown in the table below. The capital programme 2018/2019 has been revised as reported in the Monthly Monitoring reports.

| **Capital Expenditure** | **Capital Programme 2019/2020 (Cabinet 18 June 2019) £'000** | **2019/20 Actual as at 30 Sept 19** |
|---|---|---|
| | **£'000** | **£'000** |
| Major Projects | 43,704 | 8,310 |
| Operational Schemes: | | |
| Central and Community Services | 2,868 | 1,244 |
| Commercial Services | 2,971 | 680 |
| Environment and Planning | 0 | 0 |
| Finance Services | 101 | 23 |
| Exempt Schemes | 20,450 | 3,759 |
| **Total Capital Expenditure** | **75,093** | **14,016** |

| Budget Related Prudential Indicators – Revised | | | | |
|---|---|---|---|---|
| | **2019/2020 revised estimate £000** | **2020/21 Estimate £000** | **2021/22 Estimate £000** | **2022/23 Estimate £000** |
| **Capital Expenditure** Approved at Cabinet 18 June 2019 | 75,093 | 52,592 | 21,167 | 17,903 |
| **Ratio of financing costs to net revenue stream** (Equals net treasury cost ie cost of borrowing less the income from investments divided by the total of Government grant and total council tax). | 3.81% | 3.67% | 3.60% | 3.40% |
| **Capital Financing Requirement (CFR) as at 31 March** this reflects the Council's underlying need to borrow for capital purposes | 49,422 | 53,016 | 50,850 | 52,213 |

| Authorised / Operational Limit for external debt | | | | |
|---|---|---|---|---|
| | 2019/20<br><br>£'000 | 2020/21 estimate £'000 | 2021/22 estimate £'000 | 2022/23 estimate £'000 |
| **Authorised Limit for external debt** | 44,000 | 48,000 | 46,000 | 47,000 |
| **Operational Boundary for external debt** | 50,000 | 54,000 | 52,000 | 53,000 |

- The Authorised Limit represents the maximum limit beyond which borrowing is prohibited, and needs to be set and revised by Members.

- The Operational Boundary for External Debt is a working practice limit that is set lower than the Authorised Limit. In effect the authorised limit includes a degree of contingency in case of circumstances arising that take the limit above the operational limit.

| Interest Rate Exposures (Limit on fixed and variable rate borrowing) | | | | |
|---|---|---|---|---|
| | 2018/2019 Upper % | 2019/2020 Upper % | 2020/2021 Upper % | 2021/2022 Upper % |
| **Limits on fixed interest rates based on net debt** | 100% | 100% | 100% | 100% |
| **Limits on variable interest rates based on net debt** | 40% | 40% | 40% | 40% |

| Maturity Structure of fixed interest rate borrowing | | | |
|---|---|---|---|
| | Lower | Upper | Portfolio Position as at 30 September 2019 |
| **Under 12 months** | 0% | 100% | 37.50% |
| **12 months to 2 years** | 0% | 100% | 0% |
| **2 years to 5 years** | 0% | 100% | 0% |
| **5 years to 10 years** | 0% | 100% | 0% |
| **10 years and above** | 0% | 100% | 62.50% |