Appendix 2

Brighton & Hove City Council
Economic Overview and Interest Rate prospect 2017/18

A forecast of interest rates over the medium term is set out in Table A below.

Economic Background

The Monetary Policy Committee (MPC) cut the Bank Base Rate from 0.50% to 0.25% on 4 August 2016 in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut the Bank Base Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half of 2016 than originally forecast; also, inflation forecasts have risen substantially as a result of a continuation of the fall in the value of sterling since early August. Consequently, the Bank Base Rate has not been cut in any subsequent MPC meetings, and on current trends, it now appears unlikely that there will be another cut.

During the two-year period 2017-2019, when the UK is negotiating the terms of withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects (i.e. by raising the Bank Base Rate) which is likely to be adversely impacted by the uncertainty of what form the negotiations will eventually take, Accordingly, a first increase to 0.50% is forecast in Quarter 2, 2019, after those negotiations are expected to be concluded.

GDP Growth rates in 2013, 2015 and 2015 (2.2%, 2.9% and 1.8% respectively) were some of the strongest rates among the G7 countries. Data released recently shows that the economy grew faster in Q4 2016 than was previously estimated as a result of a revision of manufacturing data, revising the quarter's growth from 0.6% to 0.7%. The annual result however was revised downwards as a result of a downward revision of data in the first half of the year. GDP for 2016 is now estimated at 2.0% (previous estimate: 2.2%). UK GDP has now seen growth in 13 consecutive quarters.

Borrowing & Investment Rates

The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications

- The possibility of a resurgence of Eurozone sovereign debt difficulties, particularly Greece and Italy and stress arising from disagreement between EU countries on free movement of people, immigration policy and how to deal with terrorist threat may cause safe haven flow (reducing gilt yields and therefore PWLB rates) or volatility of interest rates;
- Geo-political risks in Europe, the Middle East and Asia may also cause an increase in safe haven flows which would reduce gilt rates and therefore PWLB interest rates;

- A revision of US economic, monetary and foreign policy with the change of administration may impact upon global growth expectations, inflation and is likely to cause investors to re-assess risk which will impact on the price and therefore the yield of treasury instruments such as gilts;
- Other external influences such as the pace of global growth, inflation levels, and the impact of monetary policy on sustainable growth across the globe will cause re-assessment by investors which will impact gilt rates, and therefore PWLB rates.

Investment returns are likely to remain very low during 2017/18 and beyond; Capita Asset Services have provided an expected investment return for new investments invested for a period of less than 3 months (Table A). The Financing Budget for 2017/18 reflects a higher expected investment income on the basis that the weighted average maturity of the council's debt portfolio is expected to be longer than 100 days.

The overall long term expected trend (as seen in table A) is for gilt yields and PWLB rates to rise. However, PWLB rates and gilt yields have been experiencing an exceptional level of volatility that has been highly correlated to geo political issues, sovereign debt crisis and emerging market developments. It is likely that these rates will see high levels of volatility for the foreseeable future.

Officers have already taken advantage of the low points of this rate volatility during 2015/16 and 2016/17 by undertaking £20m of general fund new borrowing to reduce the council's under-borrowing position. There remains a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns. Achieving an appropriate balance between long term benefits compared to the short term cost of carry will be a fundamental consideration for any borrowing decisions undertaken in the next three years.

Table A – Interest Rate forecasts April 2017 to March 2020 (annual averages)

	Bank Rate	Returns on liquid Investments*	Long-term borrowing rates		
			5 year	25 year	50 year
2017/18	0.25%	0.25%	1.63%	2.95%	2.75%
2018/19	0.25%	0.25%	1.75%	3.10%	2.90%
2019/20	0.63%	0.50%	1.95%	3.30%	3.10%

(Source – Capital Asset Services: Interest Rate Forecast, February 2017)

** Liquid investments are defined as those invested for less than 3 months. The council has budgeted for an average investment return of 0.50% in 2017/18 to account for up to 60% of the investment portfolio being held for up to one year.*