City of Westminster

HOUSING, FINANCE AND CORPORATE SERVICES POLICY AND SCRUTINY

Date:	9 January 2017
Status:	For General Release
Title:	Draft Treasury Management Strategy Statement for 2017/18 to 2021/22
Wards Affected:	All
Policy Context:	To manage the Council's finances prudently and efficiently.
Financial Summary:	The Annual Treasury Management Strategy Statement sets out the Council's strategy for ensuring that: 1. Its capital investment plans are prudent, affordable and sustainable; 2. The financing the Council's capital programme and ensuring that cash flow is properly planned 3. Cash balances are appropriately invested to generate optimum returns having regard to security and liquidity of capital.
Report of:	Steven Mair, City Treasurer

1. EXECUTIVE SUMMARY

1.1 The Local Government Act 2003 requires the Council to ‘have regard to’ the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable. These are contained within this report.

1.2 The Act also requires the Council to set out a statement of its treasury management strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the Council’s policies for managing its investments and for giving priority to the security and liquidity of those investments. The Treasury Management Strategy Statement and Annual Investment Strategy must both have regard to guidance issued by CLG and must be agreed by the full Council.

1.3 This report sets out the Council’s proposed Treasury Management Strategy Statement (TMSS) for the period 2017/18 to 2021/22, and Annual Investment Strategy (AIS) for the year ended 31 March 2018, together with supporting information.

1.4 The TMSS and AIS form part of the Council’s overall budget setting and financial framework, and will be finalised and updated as work on the Council’s 2017/18 budget is progressed in January and February 2017.

2. RECOMMENDATIONS

2.1 The Committee is asked to review in advance of further work as noted above and approval by Cabinet and then Full Council:

(i) The Treasury Management Strategy Statement set out in sections 5 to 7;
(ii) The prudential Indicators set out in section 8;
(iii) The overall borrowing strategy and borrowing limits for 2017/18 to 2021/22 as detailed in section 6;
(iv) Investment strategy and approved investments set out in Appendix 1;
(v) The Minimum Revenue Provision Policy set out in Appendix 2.

3. REASONS FOR DECISIONS

3.1 To comply with the Local Government Act 2003, other regulations and guidance and to ensure that the Council’s borrowing and investment plans are prudent, affordable and sustainable and comply with statutory requirements.

If you have any queries about this Report or wish to inspect any of the Background Papers, please contact:

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BACKGROUND PAPERS

Treasury Management Strategy Statement 2016/17 (Approved by Council March 2016) and Amendment to Investment Strategy 2016/17 (Approved by Council November 2016)

1. Section 3 Local Government Act 2003
2. Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended
3. DCLG Guidance on Minimum Revenue Provision 2012
4. DCLG Guidance on Local Government Investments – March 2010
5. CIPFA Prudential Code for Capital Finance in Local Authorities, 2011
6. CIPFA Treasury Management Code of Practice, 2011

4. BACKGROUND INFORMATION

4.1 The Council is required to operate a balanced budget, which broadly means that monies received during the year will cover expenditure. The function of treasury management is to ensure that:

(i) The Council's capital programme and corporate investment plans are adequately funded;

(ii) Cash is available when it is needed on a day to day basis, to discharge the Council's legal obligations and deliver Council services;

(iii) Surplus monies are invested wisely.

4.2 The Council has formally adopted CIPFA's Code of Practice on Treasury Management, and follows the key requirements of the Code as set out in Appendix 3.

4.3 The TMSS covers three main areas summarised below:

4.3.1 Capital spending

- Capital spending plans and other investment opportunities
- CFR projections and affordability
- The Minimum Revenue Provision (MRP) policy (Appendix 2)

4.3.2 Borrowing

- Overall borrowing strategy
- Expected borrowing rates
- Limits on external borrowing
- Maturity structure of borrowing;
- Policy on borrowing in advance of need;
- Debt rescheduling.

4.3.3 Managing cash balances

- The current and forecast cash position
- Council policy on investing and risk
- Expected return on investments
- Short and long term investments.

4.4 The Annual Investment Strategy (AIS) at Appendix 1 provides more detail on how the Council's surplus cash investments are to be managed in 2017/18. Approved schedules of specified and non-specified investments will be updated following consideration by Members and Schedules of approved and finalisation of 2017/18 budget plans.

TREASURY MANAGEMENT STRATEGY STATEMENT

5. SECTION 1 - CAPITAL SPENDING

Capital spending plans

5.1 Table 1 summarises the Council's capital expenditure plans, both in terms of those agreed previously, and those forming part of the current budget cycle. The table sets out the Council's current expectations about whether these plans are to be financed by capital or revenue resources.

5.2 Compared with the forecast in the 2016/17 TMSS General Fund capital spend has slipped back by around £100m in 2016/17 to 2017/18 and future years, and the HRA capital programme reflects an increase of £100m per annum over the period 2017/18 to 2020/21. The risks are that:

(i) continued slippage in new starts will push borrowing requirements to later years when interest rates are forecast to be higher than currently;

(ii) slippage in the programme of capital receipts may increase the need to borrow in the medium-term.

Table 1 Capital spending and funding plans

2015/16 Actual £m		2016/17 Forecast £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	Total £m
	Expenditure							
69	General Fund	187	323	282	215	158	166	**1,331**
55	HRA	71	138	189	142	137	93	**770**
124	**TOTAL**	**258**	**461**	**471**	**357**	**295**	**259**	**2,101**
	Funding							
	General Fund							
30	Grants & Contributions	93	116	103	31	44	5	**392**
12	Capital receipts applied	20	93	32	26	104	52	**327**
	HRA							
2	Grants & Contributions	3	18	5	9	13	13	**61**
10	Capital receipts applied - RTB	6	46	127	90	68	49	**386**
23	Major Repairs Reserve (MRR)	24	24	24	24	24	24	**144**
17	Revenue financing	8	44	18	15	9	6	**100**
94	**TOTAL**	**154**	**341**	**309**	**195**	**262**	**149**	**1,410**
30	**Net financing need for the year**	**104**	**120**	**162**	**162**	**33**	**110**	**691**

Other investment opportunities

5.3 As well as investing in assets owned by the Council and used in the delivery of services, the Council also invests, where appropriate, in:

(i) Infrastructure projects, such as green energy;

(ii) Loans to third parties;

(iii) Shareholdings in limited companies and joint ventures.

5.4 Such investments are treated as expenditure for treasury management and prudential borrowing purposes even though they do not create physical assets in the Council's accounts. Appropriate budgets in respect of these activities will be agreed as part of the Council's budget setting and ongoing monitoring processes and considered as part of the Investment Strategy.

5.5 In addition the Council has a substantial commercial property portfolio which forms part of the investment strategy. In previous years, the Council has invested in traditional asset classes of offices, retail and industrial/logistics, which meet the Council requirements for the income to be secure and reliable and the investments low risk.

5.6 Following a Cabinet decision in late 2015, the Council allocated funds to invest in commercial property commencing 2016/17 The aim is to diversify the property portfolio into sectors that have historically been considered alternatives but are increasingly being viewed as mainstream. The strategy focuses on increasing the income generated by the Council from its property holdings while also improving the quality of the Council's current portfolio. This will be further progressed in 2017/18 within the overall context of the Council's annual investment strategy.

Capital Financing Requirement (CFR)

5.7 The CFR measures the extent to which capital expenditure has not yet been financed from either revenue or capital resources. Essentially it measures the Council's underlying borrowing need. Each year, the CFR will increase by the amounts of new capital expenditure not immediately financed.

5.8 Table 2 below shows that the CFR will increase over the medium term. Consequently, the capital financing charge to revenue will increase, reflecting the capital spending plans.

Table 2 Capital Financing Requirement forecast

2015/16 Actual £m		2016/17 Forecast £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
	CFR as at 31 March						
215	General Fund	286	398	539	688	688	782
256	HRA	286	292	307	311	334	335
471	**TOTAL**	**572**	**690**	**846**	**999**	**1,022**	**1,117**
	Annual change in						
12	General Fund	71	111	142	149	(1)	94
2	HRA	30	6	15	4	23	1
14	**TOTAL**	**101**	**117**	**157**	**153**	**22**	**95**
	Reasons for Change						
30	Net financing	104	119	162	162	33	110
(4)	Less MRP	(3)	(2)	(5)	(9)	(11)	(15)
(12)	Less Capital Receipts	0	0	0	0	0	0
14	**TOTAL**	**101**	**117**	**157**	**153**	**22**	**95**

5.9 Table 3 below confirms that the Council's gross debt does not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for current year and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

Table 3 Borrowing compared to the Capital Financing Requirement

2015/16 Actual £m		2016/17 Forecast £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
251	Gross Projected Debt	251	251	331	559	585	764
471	Capital Financing Requirement	572	689	846	999	1,022	1,117
220	**Under / (over) borrowing**	**321**	**438**	**515**	**440**	**437**	**353**

Affordability

5.10 The objective of the affordability indicators is to ensure that the level of investment in capital assets proposed remains within sustainable limits, and in particular, the impact on the Council's "bottom line" as reflected in the impact on council tax and rent levels. Table 4 below sets out the expected ratio of capital financing costs to income for both General Fund and HRA activities:

Table 4 Ratio of capital financing costs to income

2015/16 Actual %		2016/17 Forecast %	2017/18 Estimate %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %	2021/22 Estimate %
1.37	General Fund	0.32	(0.55)	2.03	7.07	7.78	12.11
35.86	HRA	31.25	32.21	31.57	32.02	32.42	32.30

5.11 For 2016/17 and 2017/18, gross capital financing charges (loan interest, MRP and finance and PFI payments) for the General Fund capital programme are largely outweighed by income from investments and the commercial property portfolio. However in future years the Council will begin to incur increasing capital financing charges in line with the forecast increase in the General Fund CFR in Table 2.

5.12 The capital financing charges arising from the HRA capital programme increase in line with the forecast increase income, hence capital charges as a proportion of the HRA net revenue stream remain in the range 31% to 32%.

5.13 Table 5 below sets out the Incremental impact of the capital programme on council tax and housing rents.

Table 5 Impact of capital investment decisions on council tax and housing rents

2015/16 Actual £		2016/17 Forecast £	2017/18 Estimate £	2018/19 Estimate £	2019/20 Estimate £	2020/21 Estimate £	2021/22 Estimate £
(11.56)	Increase/(decrease) in Council Tax (band D) per annum	(13.63)	(2.84)	41.26	60.56	15.18	45.97
6.68	Increase/(decrease) in average housing rent per week	(1.19)	0.76	(0.22)	0.86	1.93	1.71

5.14 For the General Fund capital programme, although the ratio of capital financing costs to income is relatively low as shown in Table 4 above, there is a much greater impact on council tax as shown in Table 5, because the Council has a very low council taxbase. The decrease in 2017/18 of £2.84 per Band D council tax reflects the reduction in capital financing costs in 2017/18 compared to 2016/17, and the subsequent increase reflects the increase in capital charges as the capital programme progresses.

5.15 The capital charges from the HRA capital programme increase is gradual and therefore there is relatively little impact on housing rents between years as shown in Table 5.

6. SECTION 2 - BORROWING

Overall borrowing strategy

6.1 The Council's main objective when borrowing money is to strike an appropriate balance between securing low interest costs and achieving cost certainty over the period for which funds are required. Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. The key factors influencing the 2017/18 strategy are:

(i) forecast borrowing requirements,

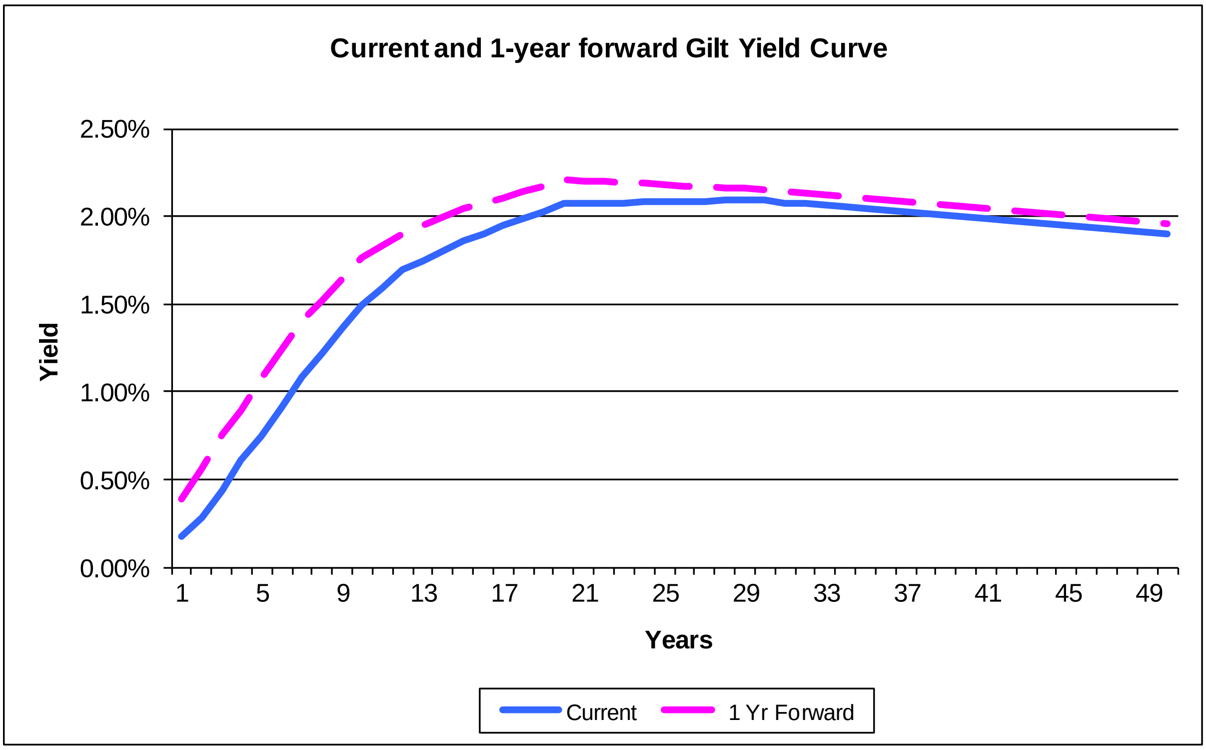
(ii) the current economic and market environment, and

(iii) interest rate forecasts.

6.2 The Council is currently maintaining an under-borrowed position. This means that capital expenditure has not been fully funded from loan debt as other funding streams (such as government grants and 3rd party contributions, use of Council reserves and cash balances and capital receipts) have been employed where available. This policy has served the Council well over the last few years while investment returns have been low and counterparty risk has been relatively high.

Prospects for Interest Rates

6. 3 However, the borrowing position needs to be kept under review to avoid incurring higher borrowing costs in future years when the Council may not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt. Market commentators are forecasting an increase in interest rates across all maturities (see graph below) – though a limited increase rather than a material change. More detail on their interest rate forecasts is at Appendix 4.



Source: Bloomberg

6.4 Against this background and the risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Treasury Management team will continue to monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances (within their approved remit).

6.5 If it were considered that there was a significant risk of a sharp fall in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

6.6 In the event that interest rates rose beyond the forecast used in the capital programme the revenue interest cost to the Council would increase. A rise of an extra 1% would cost £6m a year at peak external borrowing requirements of the capital programme for the period 2016/17 to 2021/22.

Borrowing limits

6.7 The Prudential Code requires the Council to set two limits on its total external debt, as set out in Table 6 below. The limits have been reduced by 10-20% per annum compared with the 2016/17 TMSS to reflect slippage in the capital programme. The limits are:

(i) **Authorised Limit for External Debt (Prudential Indicator 7a)** – This is the limit prescribed by section 3(1) of the Local Government Act 2003 representing the maximum level of borrowing which the Council may incur. It reflects the level of external debt which, while not desired, could be afforded in the short term, but may not be sustainable in the longer term.

(ii) **Operational Boundary (Prudential Indicator 7b)** – This is the limit which external debt is not normally expected to exceed. The boundary is based on current debt plus anticipated net financing need for future years.

Table 6 Overall borrowing limits

2015/16 Actual £m		2016/17 Forecast £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
	Authorised Limit for external						
471	Borrowing and other long term liabilities	572	689	846	999	1,022	1,117
	Operational Boundary for						
251	Borrowing	251	251	331	559	585	764
15	Other long term liabilities	12	11	11	11	10	10
266	**Total**	**263**	**262**	**342**	**570**	**595**	**774**

6.8 In addition, borrowing for the HRA has to remain within the HRA Debt Limit (prescribed in the HRA Self-Financing Determinations 2012) as detailed in the table below. Borrowing for the HRA is measured by the HRA CFR.

Table 7 HRA borrowing

2015/16 Actual £m		2016/17 Forecast £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
333	HRA Debt Limit	334	334	334	334	334	334
256	HRA CFR	286	292	307	311	334	334
77	**Headroom**	**48**	**42**	**27**	**23**	**0**	**0**

6.9 The City Treasurer reports that the Council complied with these indicators in the current year and does not envisage difficulties for the future.

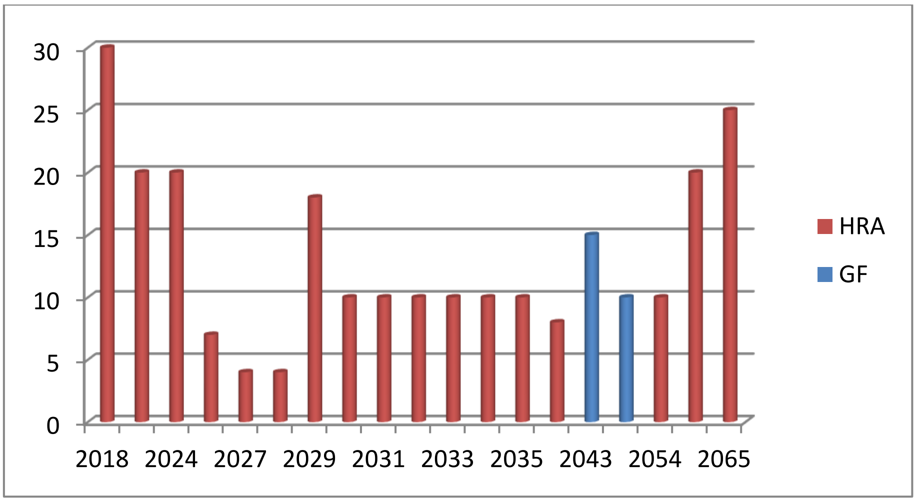
Maturity structure of borrowing (Prudential Indicator 10)

6.10 Managing the profile of when debt matures is essential for ensuring that the Council is not exposed to large fixed rate sums falling due for re-financing within a short period, and thus potentially exposing the Council to additional cost. Table 8 below sets out current upper and lower limits for debt maturity which are unchanged from 2016/17. The chart below shows the principal repayment profile for current council borrowing remains within these limits.

Table 8 Debt maturity profile limits

Actual maturity at 30 Sept 2016 %		upper limit %	lower limit %
0	under 12 months	40	0
12	12 months and within 24 months	35	0
8	24 months and within 5 years	35	0
11	5 years and within 10 years	50	0
69	10 years and above	100	35

Maturity profile of long-term borrowing



6.11 The Council has £70 million of LOBO (Lender Option Borrower Option) debt, none of which matures in the near future. Were the lender to exercise their option, officers will consider accepting the new rate of interest or repaying (with no penalty). Repayment of the LOBO may need to be considered for re-financing.

6.12 In the event that there is a much sharper rise in long and short term rates than currently forecast, then the balance of the loan portfolio will be re-visited with a view to taking on longer term fixed rate borrowing in anticipation of future rate rises.

Policy on Borrowing in Advance of Need

6.13 The Council has the power to borrow in advance of need in line with its future borrowing requirements under the Local Authorities (Capital Finance and Accounting)(England) Regulations 2003, as amended. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

6.14 Risks associated with any borrowing in advance of activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Debt Rescheduling

6.15 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the cost of debt repayment (premiums incurred).

6.16 The reasons for any rescheduling to take place will include:

(i) generating cash savings and / or discounted cash flow savings;
(ii) helping to fulfil the treasury strategy; and
(iii) enhancing the balance of the portfolio by amending the maturity profile and/or the balance of volatility.

6.17 Consideration will also be given to identifying the potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

6.18 Any rescheduling will be reported to Housing, Finance & Customer Services Policy and Scrutiny Committee, in accordance with the usual monitoring cycle.

7. SECTION 3 - MANAGING CASH BALANCES

Current cash position and cash flow forecast

7.1 Table 9 below shows that cash balances have increased by £282m in the past six months which is mainly due to income such as council tax, business rates and grants received in advance.

Table 9 Cash position at 30 September 2016

As at 31 March 2016			As at 30 September 2016	
Principal £m	Average Rate %		Principal £m	Average Rate %
		Investments		
585		Specified	886	
44		Non - specified	25	
629	**0.59**	**Total Investments**	**911**	**0.66**
		Borrowing		
181	4.75	Public Works Loan Board	181	4.75
70	5.08	Market Loans	70	5.08
251	**4.84**	**Total Borrowing**	**251**	**4.84**

7.2 The medium-term cash flow forecast (see below) shows that the Council has a substantial positive cashflow position with an average cash position of more than £600m for the medium-term. The reason for the high cash balance is largely due to business rates and the amount held pending rating appeals.

Table 10 Medium-term cashflow forecast

	2017/18	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m	£m
Balance at 1 April	**820**	**700**	**587**	**652**	**630**
Movement in Cash					
Capital Receipt	139	159	116	172	101
Grants & Contributions	134	108	40	57	18
Revenue Financing/ MRR	68	42	39	33	30
Cash In	**341**	**309**	**195**	**262**	**149**
Capital Programme	(461)	(472)	(357)	(295)	(259)
Cash Out	**(461)**	**(472)**	**(357)**	**(295)**	**(259)**
Borrowing	0	80	227	26	180
Repayment of debt		(30)		(15)	(5)
Balance 31 March	**700**	**587**	**652**	**630**	**693**
Average Balance	**760**	**644**	**620**	**641**	**661**

7.3 Approved Council policy is to set aside £150m to provide working capital and cover day to day contingencies. Therefore an average of £450m is available to be invested over the longer-term without impacting on the Council's need for liquidity.

Prospects for Investment Returns

7.4 Investment returns on cash-based deposits are likely to remain low during 2017/18 and beyond. Borrowing interest rates have been on a generally downward trend during most of 2016; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of August when a new package of quantitative easing purchasing of gilts was announced.

7.5 Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. The Council is therefore committed to investigating and pursuing alternatives to cash-based investments where it is considered prudent to do so.

Council policy on investing and managing risk

7.6 The aim is to manage risk and reduce the impact of any adverse movement in interest rates on the one hand but at the same time not setting the limits to be so restrictive that they impair opportunities to reduce costs or improve performance.

Balancing short and longer term investments

7.7 During the first half of 2016/17 investment of surplus funds for more than 364 days totalled £24.9m which was well within the upper limit for such investments of £200m.

Table 11 Investment limits

2015/16 Actual £m		2016/17 Forecast £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
	Upper limit for fixed interest rate exposure						
251	Net principal re fixed rate borrowing	251	251	331	559	585	764
	Upper limit for variable rate exposure						
0	Net principal re variable rate borrowing	0	0	0	0	0	0
25	Upper limit for principal sums invested for more than 364 days	200	450	450	450	450	450

7.8 In view of the limited investment returns currently being experienced on short term cash-based investments and the substantial positive cashflow position over the medium-term (see paragraph 7.2 above), it is suggested that for 2017/18 and future years the Council consider increasing its limit on longer term investments (i.e. non-specified investments) to £450m for the next 5 years.

8. SUMMARY OF PRUDENTIAL INDICATORS (PIs)

8.1 The purpose of prudential indicators (PIs) is to provide a reference point or "dashboard" so that senior officers and Members can:

(i) easily identify whether approved treasury management policies are being applied correctly in practice and

(ii) take corrective action as required.

8.2 As the Council's s151 officer, the City Treasurer has a responsibility to ensure that appropriate PIs are set and monitored and that any breaches are reported to Members.

8.3 The City Treasurer has confirmed that the PIs set out below are all expected to be complied with in 2016/17 and he does not envisage at this stage that there will be any difficulty in achieving compliance with the suggested indicators for 2017/18.

PI ref	Para ref		2015/16 actual	2016/17 forecast	2017/18 proposed
1	5.2	Capital expenditure	£30m	£104m	£120m
2	5.8	Capital Financing Requirement (CFR)	£471m	£572m	£690m
3	5.9	Net debt vs CFR	£220m underborrowing	£321m underborrowing	£438m underborrowing
4	5.10	Ratio of financing costs to revenue stream	GF 1.37% HRA 35.86%	GF 0.32% HRA 31.25%	GF (0.55%) HRA 32.21%
5	5.12	Incremental impact of new capital investment decisions on council tax	£11.56 decrease in Band D council tax charge per annum	£13.63 decrease in Band D council tax charge per annum	£2.84 decrease in Band D council tax charge per annum
6	5.12	Impact of new capital investment decisions on housing rents	£6.68 increase in average rent per week	£1.19 decrease in average rent per week	£0.76 increase in average rent per week
7a	6.7	Authorised limit for external debt	£471m	£572m	£689m
7b	6.7	Operational debt boundary	£266m	£263m	£262m
7c	6.8	HRA debt limit	£333m	£334m	£334m
8	7.3	Working capital balance	£150m	£150m	£150m
9	7.7	Limit on surplus funds invested for more than 364 days (i.e. non-specified investments)	£25m	£200m	£450m
10	6.10	Maturity structure of borrowing	Upper limit under 12 months - 40% Lower limit 10 years and above - 35%	Upper limit under 12 months - 40% Lower limit 10 years and above - 35%	Upper limit under 12 months - 40% Lower limit 10 years and above - 35%

Appendix 1

ANNUAL INVESTMENT STRATEGY

1. The Council holds significant invested funds, representing income received in advance of expenditure, balances and reserves. During the first half of the current year, the Council's average investment balance has been around £882m and the cash flow projections shows this pattern is expected to continue in the forthcoming year. Investments are made with reference to the core balance, future cash flow requirements and the outlook for interest rates.

2. The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Investment Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

3. In accordance with the above guidance and to minimise the risk to investments, the Council applies minimum acceptable credit criteria to generate a list of highly creditworthy counterparties which will provide security of investments, enable diversification and minimise risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Investment returns expectations

4. Bank Rate was cut in August 2016 from 0.50% to 0.25%. It is forecast there will be a further cut during 2017 bringing the base rate down to 0.10% and it is not expected to rise back to 0.25% until quarter 2 2019. Bank Rate forecasts for financial year ends (March) are:

2016/17	0.25%
2017/18	0.25%
2018/19	0.25%
2019/20	0.75%

5. The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows

2017/18	0.40%
2018/19	0.60%
2019/20	1.25%
2020/21	1.50%
2021/22	1.50%

Investment time limits

6. This limit is set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment. For the year 2017/18, the proposed limit of investments for over 364 days is £450m as set out in table 11 of the TMSS.

Investment Policy

7. The Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to assess continually and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

8. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector to establish the most robust scrutiny process on the suitability of potential investment counterparties.

Creditworthiness Policy

9. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

   (i) It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security and monitoring their security; and

   (ii) It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

10. The City Treasurer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those which determine which types of investment instrument are either specified or non-specified as they provide an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

11. The Council takes into account the following relevant matters when proposing counterparties:

   (i) the financial position and jurisdiction of the institution;
   (ii) the market pricing of credit default swaps[1] for the institution;
   (iii) any implicit or explicit Government support for the institution;
   (iv) Standard & Poor's, Moody's and Fitch's short and long term credit ratings;
   (v) Sovereign ratings to select counterparties from only the most creditworthy countries; and
   (vi) Core Tier 1 capital ratios[2].

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[1] Credit Default Swaps (CDS) are tradable instruments where the buyer receives a pay-out from the seller if the party to whom the CDS refers (often a financial institution) has a "credit event" (e.g. default, bankruptcy, etc.). The price of the CDS gives an indication to the market's view of likelihood – the higher the price the more likely the credit event.

[2] The Tier 1 capital ratio is the ratio of a bank's core equity capital to its total risk-weighted assets (RWA). Risk-weighted assets are the total of all assets held by the bank weighted by credit risk according to a formula

12. Changes to the credit rating will be monitored and in the event that a counter party is downgraded and does not meet the minimum criteria specified in Appendix 1, the following action will be taken immediately:

(i) no new investments will be made;

(ii) existing investments will be recalled if there are no penalties; and

(iii) full consideration will be given to recall or sale existing investments which would be liable to penalty clause.

Specified and Non-specified investments

13. The DCLG Guidance on Local Government Investments made under section 15(1) of the Local Government Act 2003, places restrictions on Local authorities around the use of specified and non-specified investments. A specified investment is defined as an investment which satisfies all of the conditions below:

(i) The investment and any associated cash flows are denominated in sterling;
(ii) The investment has a maximum maturity of one year;
(iii) The investment is not defined as capital expenditure; and
(iv) The investment is made with a body or in an investment scheme of high credit quality; or with the UK Government, a UK Local Authority or parish/community council.

14. A non-specified investment is any investment that does not meet all the conditions above. In addition to the long-term investments listed in the table at the end of Appendix 1, the following non-specified investments that the Council may make include:

(i) **Green Energy Bonds** - Investments in solar farms are a form of Green Energy Bonds that provide a secure enhanced yield. The investments are structured as unrated bonds and secured on the assets and contracts of solar and wind farms. Before proceeding with any such investment, internal and external due diligence will be undertaken in advance of investments covering the financial, planning and legal aspects.

(ii) **Loans** - The Council will allow loans (as a form of investment) to be made to organisations delivering services for the Council where this will lead to the enhancement of services to Westminster Stakeholders. The Council will undertake due diligence checks to confirm the borrower's creditworthiness before any sums are advanced and will obtain appropriate levels of security or third party guarantees for loans advanced. The Council would expect a return commensurate with the type and duration of the loan. A limit of £50 million for this type of investment is proposed with a duration of over the life of the asset and Council's cash flow requirements. The operator of Westminster's leisure centres is seeking to borrow £1.25 million to finance a refurbishment of the leisure centres and this would be the first call on this type of investment opportunity. All loans would need to be in line with the Council's Scheme of Delegation and Key Decision thresholds levels

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determined by the Regulator (usually the country's central bank). Most central banks follow the Basel Committee on Banking Supervision (BCBS) guidelines in setting formulae for asset risk weights.
The Core Tier 1 ratios for the four UK banks that WCC uses are: Barclays: 10.2%, HSBC: 11.2%, Lloyds: 12.0% and RBS: 10.8%.

(iii) **Shareholdings in limited companies and joint ventures** – The Council invests in three forms of company:

- Small scale businesses funded through the Civic Enterprise Fund aimed at promoting economic growth in the area. Individual investments are no more than £0.5m and the aim is for the Fund to be self-financing over the medium-term

- Trading vehicles which the Council has set up to undertake particular functions. These are not held primarily as investments but to fulfil Council service objectives. For example, CityWest Homes is a company limited by guarantee to run the housing arms-length management organisation. Any new proposals will be subject to due diligence as part of the initial business case. As these are not to be held primarily as investment vehicles, then there is an expectation that they will break-even.

- Trading vehicles held for a commercial purpose where the Council is obliged to undertake transactions via a company vehicle. These will be wholly owned subsidiaries of the Council with the aim of diversifying the investment portfolio risk.

15. For any such investments, specific proposals will be considered by the Director of Treasury and Pensions, and approved by the s151 Officer after taking into account:

(i) cash flow requirements

(ii) investment period

(iii) expected return

(iv) the general outlook for short to medium term interest rates

(v) creditworthiness of the proposed investment counterparty

(vi) other investment risks.

16. The value of non-specified investments will not exceed their Investment allocation. The Council must now formulate a strategy that allocates it's cash in the most effective manner to short, medium and long term non-specified investments.

Country of Domicile

17. The current TMSS allows deposits / investments with financial entities domiciled in the following countries: Australia, Canada, Denmark, Finland, France, Germany, Japan, Luxembourg, Netherlands, Norway, Singapore, Spain, Sweden, Switzerland, UK and USA. This list will kept under review and any proposed changes to the policy reported to the next meeting

Schedule of investments

18. The criteria for providing a pool of high quality short, medium and long-term, cash-based investment counterparties along with the time and monetary limits for institutions on the Council's counterparty list are in the table overleaf:

All investments listed below must be sterling denominated

Investments	Minimum Credit Rating Required (S&P/Moody's/Fitch)	Maximum Individual Counterparty Investment Limit (£m)	Maximum tenor
DMO Deposits	Government Backed	Unlimited	6 months
UK Government (Gilts/T-Bills/Repos)	Government Backed	Unlimited	Unlimited
Supra-national Banks, European Agencies	LT: AA+/Aa1/AA+	£200m	5 years
Covered Bonds	LT: AA+/Aa1/AA+	£300m	10 years
Network Rail	Government guarantee	Unlimited	Oct 2052
TfL	LT: AA-/Aa3/AA-	£100m	5 years
GLA UK Local Authorities (LA) Local Government Association (LGA)	N/A	GLA : £100M	5 years
		LA : £50m per LA £100m in aggregate	3 years
		LGA : £20m	12 years
Commercial Paper issued by UK and European Corporates	ST: A-1/P-1/F-1	£40m per name, £200m in aggregate	6 months
Money Market Funds (MMF)	LT: AAA/Aaa/AAA By at least two of the main credit agencies	£70m per Fund Manager £300m in aggregate	3 day notice
Enhanced Money Funds (EMF)	LT: AAA/Aaa/AAA By at least one of the main credit agencies	£25m per fund manager, £75m in aggregate	Up to 7 day notice
Collateralised Deposits	Collateralised against loan	£60m	50 years
UK Bank (Deposit or Certificates of Deposit)	LT: AA-/Aa3/AA- ST: F1+	£75m	5 years
UK Bank (Deposit or Certificates of Deposit)	LT: A-/A3/A ST: F1	£50m	3 years
Non-UK Bank (Deposit or Certificates of Deposit)	LT: AA-/Aa2/AA- ST: F1+	£50m	5 years
	LT: A/A2/A ST: F1	£35m	3 years
Green Energy Bonds	Internal and External due diligence	Less than 25% of the total project investment or maximum of £20m per bond. £50m in aggregate	10 years
Rated UK Building Societies	LT: A-/A3/A ST: F1	£10m per Building Society, £50m in aggregate	1 year
Loans to organisations delivering services for the Council	Due diligence	£50m in aggregate	Over the life of the asset

Sovereign approved list:
Australia, Canada, Denmark, Finland, France, Germany, Japan, Luxembourg, Netherlands, Norway, Singapore, Spain, Sweden, Switzerland, UK and USA

Appendix 2

Minimum Revenue Provision (MRP) Policy

1. Capital expenditure is generally defined as expenditure on assets that have a life expectancy of more than one year. The accounting approach is to spread the cost over the estimated useful life of the asset. The mechanism for spreading these costs is through an annual MRP. The MRP is the means by which capital expenditure, which is financed by borrowing or credit arrangements, is funded by Council Tax.

2. Regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended (Statutory Instrument (SI) 3146/2003) requires full Council to approve a Minimum Revenue Provision (MRP) Statement setting out the policy for making MRP and the amount of MRP to be calculated which the Council considers to be prudent. In setting a level which the Council considers to be prudent, the Guidance states that the broad aim is to ensure that debt is repaid over a period reasonably commensurate with that over which the capital expenditure provides benefits to the Council.

3. The Council is recommended to approve the following MRP Statement:

   (i) For capital expenditure incurred before 1 April 2007, MRP will be calculated using Option 1 (the 'Regulatory Method') of the CLG Guidance on MRP. Under this option MRP will be 4% of the closing non-HRA CFR for the preceding financial year.

   (ii) For all capital expenditure incurred after 1 April 2007 financed from unsupported (prudential) borrowing (including PFI and finance leases), MRP will be based upon the asset life method under Option 3 of the DCLG Guidance.

   (iii) In some cases where a scheme is financed by prudential borrowing it may be appropriate to vary the profile of the MRP charge to reflect the future income streams associated with the asset, whilst retaining the principle that the full amount of borrowing will be charged as MRP over the asset's estimated useful life.

   (iv) A voluntary MRP may be made from either revenue or voluntarily set aside capital receipts.

   (v) Estimated life periods and amortisation methodologies will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

   (vi) As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

(vii) Charges included in annual PFI or finance leases to write down the balance sheet liability shall be applied as MRP.

(viii) Where borrowing is undertaken for the construction of new assets, MRP will only become chargeable once such assets are completed and operational.

(ix) If property investments are short-term (i.e. no more than 4 years) and for capital appreciation, the Council will not charge MRP as these will be funded by the capital receipt on disposal.

4. There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made. For the Council this is componentised based on the life of component and the gross replacement cost within the overall existing use value – social housing of the HRA stock.

Appendix 3

CIPFA requirements

The Council has formally adopted CIPFA's Code of Practice on Treasury Management (updated November 2011) and complies with the requirements of the Code as detailed below:

- Maintaining a Treasury Management Policy Statement setting out the policies and objectives of the Council's treasury management activities

- Maintaining a statement of Treasury Management Practices that sets out the manner in which the Council will seek to achieve these policies and objectives

- Presenting the Full Council with an annual TMSS statement, including an annual investment strategy and Minimum Revenue Provision policy for the year ahead (this report) a half year review report and an annual report (stewardship report) covering compliance during the previous year

- A statement of delegation for treasury management functions and for the execution and administration of statement treasury management decisions. (see below).

- Delegation of the role of scrutiny of treasury management activities and reports to a specific named body. At Westminster City Council this role is undertaken by the Housing, Finance and Corporate Services Policy and Scrutiny Committee.

Treasury Management Delegations and Responsibilities

The respective roles of the Council, Cabinet, Housing, Finance and Corporate Services Policy and Scrutiny committee and Section 151 officer are summarised below. Further details are set out in the Treasury Management Practices.

Council

Council will approve the annual treasury strategy, including borrowing and investment strategies. In doing so Council will establish and communicate their appetite for risk within treasury management having regard to the Prudential Code

Cabinet

Cabinet will recommend to Council the annual treasury strategy, including borrowing and investment strategies and receive a half-year report and annual out-turn report on treasury activities.

Cabinet also approves revenue budgets, including those for treasury activities.

Housing, Finance and Corporate Services Policy and Scrutiny Committee

This committee is responsible for ensuring effective scrutiny of the Treasury strategy and policies.

Section 151 Officer

Council has delegated responsibility for the implementation and monitoring of treasury management decisions to the Section 151 Officer to act in accordance with approved policy and practices. The s151 Officer has full delegated powers from the Council and is responsible for the following activities:

(i) Investment management arrangements and strategy;
(ii) Borrowing and debt strategy;
(iii) Monitoring investment activity and performance;
(iv) Overseeing administrative activities;
(v) Ensuring compliance with relevant laws and regulations;
(vi) Provision of guidance to officers and members in exercising delegated powers.

Director of Treasury and Pension Fund

Has responsibility for the execution and administration of treasury management decisions, acting in accordance with the Council's Treasury Policy Statement and CIPFA's 'Standard of Professional Practice on Treasury Management'.

Treasury Team

Undertakes day to day treasury investment and borrowing activity in accordance with strategy, policy, practices and procedures.

Training

The CIPFA code requires the s151 officer to ensure that Members with responsibility for making treasury management decisions and for scrutinising treasury functions to receive adequate training. The training needs of all officers are reviewed periodically as part of the Learning and Development programme. Officers attend various seminars, training sessions and conferences during the year and appropriate Member training is offered as and when needs, and suitable opportunities, are identified.

Appendix 4

Prospects for Interest Rates

1. The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives our central view.

Capita Asset Services Interest Rate View													
	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Dec-19	Mar-20
Bank Rate View	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.75%	0.75%
3 Month LIBID	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.40%	0.50%	0.60%	0.80%	0.90%
6 Month LIBID	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.50%	0.60%	0.70%	0.90%	1.00%
12 Month LIBID	0.70%	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.80%	0.90%	1.00%	1.10%	1.30%	1.40%
5yr PWLB Rate	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	2.00%	2.00%
10yr PWLB Rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.70%
25yr PWLB Rate	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%
50yr PWLB Rate	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%
Bank Rate													
Capita Asset Services	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.75%	0.75%
Capital Economics	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.75%
5yr PWLB Rate													
Capita Asset Services	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	2.00%	2.00%
Capital Economics	1.60%	1.70%	1.80%	1.90%	1.95%	2.05%	2.20%	2.30%	2.40%	2.60%	2.80%	3.20%	3.30%
10yr PWLB Rate													
Capita Asset Services	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.70%
Capital Economics	2.30%	2.35%	2.45%	2.50%	2.55%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.60%	3.70%
25yr PWLB Rate													
Capita Asset Services	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%
Capital Economics	2.90%	3.00%	3.05%	3.10%	3.15%	3.25%	3.30%	3.35%	3.45%	3.55%	3.75%	4.15%	4.35%
50yr PWLB Rate													
Capita Asset Services	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%
Capital Economics	2.80%	2.85%	2.95%	3.00%	3.05%	3.10%	3.15%	3.20%	3.30%	3.50%	3.70%	4.10%	4.20%

2. The above forecasts indicate the impact that the Brexit vote on 23rd June has had in as much as Bank Rate was consequently cut on 4th August from 0.50% to 0.25% as the Monetary Policy Committee (MPC) took action to stimulate economic growth when business surveys, at that time, were strongly indicating a sharp economic downturn. The MPC also said that it was very likely that they would cut Bank Rate again before the year-end so the above forecast therefore includes a further cut to 0.10% in November 2016. However, economic statistics since August have indicated stronger growth than the MPC expected in August; also, inflation forecasts have risen substantially as a result of the sharp fall in the value of sterling since early August. This increases the possibility that Bank Rate may not be cut again in November, though another cut cannot be ruled out. During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects already adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases

within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

3. Economic forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and 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 investment 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.

4. 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.

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

6. PWLB rates and gilt yields have been experiencing exceptional levels of volatility that are highly correlated to geo-political, sovereign debt crisis and emerging market developments.

7. Apart from the above uncertainties, downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

   (i) Monetary policy action by central banks 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.

   (ii) Major national polls:

   - US presidential election 8.11.16;
   - Italian constitutional referendum 4.12.16;
   - Spain has held two inconclusive general elections and is still unable to form a workable government with a coalition holding a majority of seats; if this impasse continues beyond 31 October, a third general election will have to be held – currently tentatively scheduled for 25.12.16

   (iii) Dutch general election 15.3.17;

   (iv) French presidential election April/May 2017;

   (v) French National Assembly election June 2017;

(vi) German Federal election August – October 2017.

(vii) A resurgence of the Eurozone sovereign debt crisis.

(viii) Weak capitalisation of some European banks.

(ix) Geopolitical risks in Europe, the Middle East and Asia, increasing safe haven flows.

(x) UK economic growth and increases in inflation are weaker than we currently anticipate.

(xi) Weak growth or recession in the UK's main trading partners - the EU and US.

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

(i) UK inflation rising to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium in gilt yields.

(ii) A rise in US Treasury yields as a result of Fed. funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.

(iii) 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.

(iv) A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

Economic Background

UK

9. GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were strong but 2015 was disappointing at 1.8%, though it 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.

10. The referendum vote for Brexit in June 2016 delivered an immediate shock fall in confidence indicators and business surveys at the beginning of August, which were interpreted as pointing to an impending sharp slowdown in the economy. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys so that it is generally expected that the economy will

post positive growth numbers through the second half of 2016 and in 2017, albeit at a slower pace than in the first half of 2016.

11. The Monetary Policy Committee (MPC) meeting on 4th August was dominated by consideration of the initial shock fall in business surveys and the expected sharp slowdown in growth. The result was a package of measures that included a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing for banks to use to lend to businesses and individuals. The Bank of England quarterly 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% and the forecast for 2018 to 1.8%. However, some forecasters think that the Bank has been too pessimistic with its forecasts; since then, later statistics and the sharp recovery in business surveys have provided support for this view. 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 to boost economic growth 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 23rd November.

12. The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. CPI had already 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 18% fall in the value of sterling on a trade weighted basis, (as at late October), is likely to result in additional upward pressure on CPI. However, this further increase in inflationary pressures will take 2-3 years to gradually work its way through the economy so is unlikely to cause major concern to the MPC unless the increases are stronger than anticipated. The MPC is, therefore, on balance, expected to look thorough this one off upward blip in inflation from the 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 arising from within the UK economy. The Bank of England will most probably have to revise its inflation forecasts significantly higher in its 3rd November quarterly Inflation Report: this rise in inflation expectations has caused investors in gilts to

demand a sharp rise in longer term gilt yields, which have already risen by around fifty basis points since mid-August. It should be noted that 27% of gilts are held by overseas investors who will have seen the value of their gilt investments fall by 18% as a result of the devaluation of sterling, (if their investments had not been currency hedged). In addition, the price of gilts has fallen further due to a reversal of the blip up in gilt prices in early August after further quantitative easing was announced - which initially drove yields down, (i.e. prices up). Another factor that is likely to dampen gilt investor sentiment will be a likely increase in the supply of gilts if the Chancellor slows down the pace of austerity and the pace of reduction in the budget deficit in the Autumn Statement - as he has already promised. However, if there was a more serious escalation of upward pressure on gilt yields, this could prompt the MPC to respond by embarking on even more quantitative easing, (purchases of gilts), to drive gilt yields back down.

USA

13. The American economy had a patchy 2015 with sharp swings in the quarterly growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 disappointed at +0.8% on an annualised basis while quarter 2 improved, but only to a lacklustre +1.4%. However, forward indicators are pointing towards a pickup in growth in the rest of 2016. The Fed embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene and then the Brexit vote, have caused a delay in the timing of the second increase which is now strongly expected in December 2016. Overall, despite some data setbacks, the US is still probably the best positioned of the major world economies to make solid progress towards a balanced combination of strong growth, full employment and rising inflation: this is going to require the central bank to take action to raise rates so as to make progress towards normalisation of monetary policy, albeit at lower central rates than prevailed before the 2008 crisis.

Eurozone

14. 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 2016 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 significantly 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. Forward indications are that economic growth in the EU is likely to continue at moderate levels with Germany continuing to outperform other major European economies. 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 and economic growth in their economies.

15. There are also significant political risks within the EZ in as much as Spain has held two general elections since December 2015 and still been unable to form a functioning government holding a majority of seats, while the Netherlands, France and Germany face general elections in 2017. A further cause of major political tension and political conflict, is one of the four core principals of the EU – the free movement of people within the EU, (note – not in just the Eurozone common currency area). In addition, Greece has been a cause of major concern in terms of its slowness in delivering on implementing fundamental reforms required by the EU to reduce its budget deficit in exchange for the allocation of further bailout money.

16. Another area of major concern is that many Italian banks are exposed to substantial amounts of underperforming loans and are undercapitalised. Some German banks are also undercapitalised, especially Deutsche Bank, which is under threat of major financial penalties from regulatory authorities that will further weaken its capitalisation. What is clear is that national governments are forbidden by EU rules from providing state aid to bail out those banks that are at risk, while, at the same time, those banks are unable realistically to borrow additional capital in financial markets due to their vulnerable financial state. However, they are also 'too big, and too important to their national economies, to be allowed to fail'.

Asia

17. Economic growth in China has been slowing down and this, in turn, has been denting economic growth in emerging market countries dependent on exporting raw materials to China. Medium term risks have been increasing in China e.g. a dangerous build up in the level of credit

compared to the size of GDP, plus there is a need to address a major over supply of housing and surplus industrial capacity, which both need to be eliminated. This needs to be combined with a rebalancing of the economy from investment expenditure to consumer spending. However, the central bank has a track record of supporting growth through various monetary policy measures which further stimulate the growth of credit risks and so increase the existing major imbalances within the economy.

18. Economic growth in Japan is still anaemic, and skirting with deflation, despite successive rounds of huge monetary stimulus and massive fiscal action to promote consumer spending. The government is also making little progress on fundamental reforms of the economy.

Emerging countries

19. There are also concerns around the vulnerability of some emerging countries which are particularly exposed to the downturn in demand for commodities from China or to competition from the increase in supply of American shale oil and gas reaching world markets. Financial markets could also be vulnerable to risks from major sovereign wealth funds of those countries that are highly exposed to the falls in commodity prices from the levels prevailing before 2015, especially oil, and which, therefore, may have to liquidate substantial amounts of investments in order to cover national budget deficits over the next few years if the price of oil does not return to pre-2015 levels.