REPORT TO	DATE OF MEETING
Governance Committee	21 September 2016

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SOUTH RIBBLE BOROUGH COUNCIL forward with South Ribble

SUBJECT	PORTFOLIO	AUTHOR	ITEM
Treasury Management Activity Mid-year Review 2016/17	Finance & Resources	M L Jackson	7

1. SUMMARY AND LINK TO CORPORATE PRIORITIES

To review the Treasury and Investment Strategies approved by the Council on 2 March 2016, and to report on performance in the first five months of the year, and compliance with prudential and treasury indicators.

2. RECOMMENDATIONS

Governance Committee is asked to note and comment on the report.

Governance Committee is asked to recommend that Council approves changes to Prudential Indicators and Treasury Indicators as presented in Appendix B.

3. DETAILS AND REASONING

The Code of Practice for Treasury Management specifies that Councils should review their Treasury Strategy and activity half yearly. This report meets that requirement.

4. INTEREST RATE FORECAST

The interest rate forecast of the Council's Treasury Advisor, Capita Asset Services – Treasury Solutions is presented in Appendix C. The appendix also includes a review of the Bank of England's August quarterly inflation report, and commentary on issues relevant to treasury management activity. In particular, Capita consider the impact of the cut in the BoE base rate to 0.25% following the EU referendum result on potential investment earning rates for 2016/17 and the following seven years.

Comparison with the forecast in February 2016, when the Treasury Strategy was first presented to Cabinet, shows that now Capita are considering the possibility of a further reduction in base rate to 0.10% by the end of 2016/17; whereas an increase to 0.75% was indicated. Rather than increasing to 1.75% by the end of 2018/19, it is estimated that the base rate will return to 0.50% only in early 2019/20.

Capita's suggested rate of return on cash invested is now much lower than previously indicated. The average earnings for three-month investments had been forecast to increase to 1.75% by 2018/19, and 3.00% by 2023/24. Taking account of the base rate cut and the likelihood that it will not increase above 0.50% for many years, the estimated rate achievable for 2018/19 is now only 0.25%, and for 2023/24 only 1.50%.

Public Works Loan Board (PWLB) interest rates had been expected to increase each quarter to the end of 2018/19. Though rates are still expected to increase slowly, they may reach a peak of only 2.6% for 25-year loans rather than the 3.8% reported in February. As indicated below, the Council presently has no plans to incur external borrowing in the current financial year and the next two, so

the increase in borrowing rates should have no immediate impact on the revenue budget. This plan will be re-assessed as part of the 2017/18 budget setting process.

5. REVIEW OF THE TREASURY STRATEGY

The Treasury Management and Investment Strategies for 2016/17 were approved by Council on 2 March 2016. They defined the Council's investment priorities as the security of capital sums invested, and the maintenance of liquidity. Consistent with these priorities, the optimum return (yield) on investments would be sought.

Cash available for investment in 2016/17 was expected to peak as high as £42m, in particular before Council Tax and NNDR are due to be paid by the Council to the Government and other local authorities. This estimated peak has been not been exceeded so far this year, the maximum to date being around £37m. However, it is estimated that total cash could exceed the approved maximum in late December, because cash for precepts will not be paid over until 2017. It is recommended that Council should increase this Treasury Indicator to £45m, which is a technical adjustment without any impact on the Council's finances.

6. TREASURY ACTIVITY

Investment activity in the half year is summarised in the following table:

	Average Daily Investment £'000	Earnings to 31/8/2016 £	Average Rate %
Debt Management Office	0	0	0.00
Other fixed term deposits	20,209	59,488	0.70
Notice Accounts	4,000	19,282	1.15
Call accounts	2,151	2,908	0.32
Money Market Funds	5,032	9,405	0.45
Total	**31,392**	**91,083**	**0.69**

A full list of investments currently held is shown at Appendix A. The current total invested is £33.999m, including term deposits, notice accounts, call accounts, and money market funds. The equivalent average daily investment for this period in 2015/16 was £28.099m, and the total invested at 31 August was £32.409m.

The list of investment counterparties and associated investment limits approved for 2016/17 are also presented in the same appendix.

The interest earning benchmark is the average LIBID 7 day rate. This was 0.31% for the period reported, compared to the rate achieved of 0.69%. A key performance indicator for Shared Financial Services is that the rate achieved should exceed the 7 day LIBID plus 15%, which was 0.356%. Therefore the target was achieved.

At this stage in 2015/16, the average rate achieved was 0.47%. The main reason for the improvement in the average rate of return achieved is the approval by Council in September 2015 of a revised list of investment counterparties and limits. This presented the option of using new counterparties offering higher rates of interest, and investing larger sums with them.

The new counterparties used from October 2015 onwards have included Goldman Sachs, Santander, Coventry Building Society, and German bank Helaba. Though not a new counterparty, the Council has also used its BlackRock MMF account for the first time in several years. Use of these counterparties has meant that use of the DMO and other low interest rate accounts could be minimised.

The following table compares the budgets for interest receivable against the latest projection. Though interest rates are now lower than expected in the Treasury Strategy, cash balances available to invest are currently higher than last year. In addition, £21m term investments and £4m in the Santander 180-day notice account were invested before the recent cut in BoE base rate. Much of the total will mature during the remainder of the financial year, and will be reinvested at lower rates of interest than being paid at present. However, at present it does not appear necessary to forecast a change from the budget, but this will be reviewed as each sum is reinvested.

	Budget for year £'000	**Actual to 31/8/2016 £'000**	**Forecast for year £'000**
Interest earned	165	91	165
Heritable repayment	0	0	0
Total	**165**	**91**	**165**

Investment Options

Banks and building societies currently approved for use as investment counterparties, together with Capita's recommended investment durations, are as follows:

Suggested Investment Durations as at 7 September 2016			
Country	Counterparty	Suggested Duration	Limit per institution
United Kingdom	Royal Bank of Scotland Plc National Westminster Bank Plc	12 mths 12 mths	£5m per group
	Bank of Scotland Plc Lloyds Bank Plc	6 mths 6 mths	£4m per group
	Barclays Bank Plc	6 mths	£4m
	Coventry Building Society	6 mths	£4m
	Goldman Sachs International Bank	6 mths	£4m
	HSBC Plc	12 mths	£4m
	Leeds Building Society	6 mths	£4m
	Nationwide Building Society	6 mths	£4m
	Santander UK Plc	6 mths	£4m
Germany	Landesbank Hessen-Thuringen Girozentrale (Helaba)	12 mths	£3m

In practice, several of these institutions cannot be used by this council. Some of the banks do not require investments from local authorities; some only accept minimum deposits greater than our strategy allows; and some accept deposits for minimum periods greater than we can invest for, such as two or three years. Finally interest rates offered by some banks are so low that there is little or no advantage in using them instead of the DMO. The banks and building societies that have accepted investments from the council are as listed in Appendix A.

To avoid having to invest in the DMO or other low interest accounts, it is suggested that the incoming Chief Executive and Chief Finance Officer should consider which of the following options should be recommended to members:

- Addition of more UK banks and buildings societies with minimum suggested investment duration of six months to the list of those approved for use.
- Increase in the limit per UK group or institution from £4m to £5m, for those with minimum suggested investment duration of six months.
- Addition of more non-UK banks (EU banks with UK offices, accepting sterling deposits) with minimum suggested investment duration of six months to the list of those approved for use.
- Increase in the limit per non-UK group or bank from £3m to £4m, and the limit for this category in total from £6m to £8m. Only applicable to banks with minimum suggested investment duration of six months.

It is by no means clear to what extent these changes would help to offset the reduction in interest rates offered to the council in recent weeks. With regard to timescales it is a statutory requirement for the Council to have a Chief Financial (s151) Officer in place. The appointment will need to go to Council on 5th October for approval and therefore it anticipated that this review will be completed by the end of November 2016 as part of the 2017/18 Budget Setting process.

Icelandic Investment Claim

So far in 2016/17 there have been no repayments in respect of the Heritable investment claim. The balance of the claim remaining to be recovered is still £40,000. In total, £1.974m of the original £2m investment has been recovered. Recovery to date is around 98% of the claim value, which has exceeded expectations.

7. BORROWING

The Treasury Strategy indicated that no borrowing was necessary in the current financial year and the next two years. This remains the case and no borrowing is planned at present.

Use of the Council's own cash balances instead of external borrowing is a form of temporary internal borrowing at a variable rate. The cost of such internal borrowing is in effect the rate of interest that could have been earned had the cash been invested rather than being used to finance capital expenditure. However, if the Council had more cash to invest (as a result of taking loans from the PWLB to finance capital expenditure), the average rate achieved would have fallen below the 0.69% earned to date because the likelihood is that a greater balance would have been placed in the DMO. Depending on the period of the loans, the cost of PWLB borrowing to generate the additional cash would be between 1.5% and 2.3% at present. This budgetary plan will be re-assessed as part of the 2017/18 Budget Setting process.

8. PRUDENTIAL INDICATORS AND TREASURY INDICATORS

Council of 2 March 2016 approved Prudential Indicators and Treasury Indicators for 2016/17. While it is not meaningful to review all indicators at a mid-year stage, Appendix B presents proposed changes to the relevant indicators. It is recommended that Council should approve a number of changes, in particular to reflect changes to the Capital Programme and therefore the Capital Financing Requirement; and the higher than expected peak of cash available for investment.
Prudential Indicator 1 in Table 1 shows an increase in the Council's capital expenditure in 2016/17 from £5.421m to £6.712m. This is as a result of one capital project (purchase of commercial units at Momentum Business Park) funded from earmarked revenue resources at a cost of £0.610m; and rephasing of £0.681m expenditure from 2015/16, of which £0.214m is unfinanced capital expenditure (i.e. financed by prudential borrowing).

Prudential Indicator 2 in Table 2 shows a net reduction in the Capital Financing Requirement as at 31 March 2017, arising from the effect of rephasing capital expenditure by borrowing to 2016/17, and reduced expenditure on the leisure lease in 2015/16.

Treasury Indicator 4 is the approved total for principal sums invested for greater than 364 days. It was not planned to make any investments for periods over 364 days during 2016/17. However, three investments have been made for 365 or 366 days, though this is not considered to have had an impact on security or liquidity of the investments. In one case the extra day was because 2016 is a leap year, and the other two were as a result of the terms offered by the financial institutions.

9. TREASURY CONSULTANTS' ADVICE

Appendix C presents the advice of Capita Asset Services in respect of economic matters in the first five months of 2016/17. In addition, a detailed commentary on interest rate forecasts is included.

10. WIDER IMPLICATIONS

In the preparation of this report, consideration has been given to the impact of its proposals in all the areas listed below, and the table shows any implications in respect of each of these. The risk assessment which has been carried out forms part of the background papers to the report.

FINANCIAL	The financial implications are outlined within the report.

LEGAL	Compliance with various Regulations and statutory Codes of Practice

RISK	The Council's treasury management strategy and policies are designed to ensure the effective control and management of the risks associated with such activities.

THE IMPACT ON EQUALITY	

OTHER (see below)	

Asset Management	*Corporate Plans and Policies*	*Crime and Disorder*	*Efficiency Savings/Value for Money*
Equality, Diversity and Community Cohesion	*Freedom of Information/ Data Protection*	*Health and Safety*	*Health Inequalities*
Human Rights Act 1998	*Implementing Electronic Government*	*Staffing, Training and Development*	*Sustainability*

BACKGROUND DOCUMENTS

Treasury Management in the Public Services: Code of Practice
CIPFA Prudential Code for Capital Finance in Local Authorities
DCLG Guidance on Local Government Investments

Appendix A

Investments as at 31 August 2016

Counterparty	Type	Amount £'000	Rate %	Date of investment	Date of Maturity
Goldman Sachs	Term	3,000	0.54	14/06/2016	14/09/2016
Nationwide Building Society	Term	2,000	0.71	29/03/2016	29/09/2016
Bank of Scotland	Term	2,000	0.80	01/04/2016	30/09/2016
Nationwide Building Society	Term	1,000	0.71	01/04/2016	03/10/2016
Coventry Building Society	Term	1,000	0.60	04/04/2016	04/10/2016
Bank of Scotland	Term	1,000	0.65	13/07/2016	13/10/2016
Coventry Building Society	Term	1,000	0.60	15/04/2016	17/10/2016
Coventry Building Society	Term	1,000	0.60	16/05/2016	16/11/2016
Bank of Scotland	Term	1,000	0.80	14/06/2016	14/12/2016
Helaba	Term	2,000	0.95	14/12/2015	14/12/2016
Nationwide Building Society	Term	1,000	0.65	23/06/2016	16/12/2016
Lancashire County Council	Term	3,000	0.63	24/05/2016	24/05/2017
Helaba	Term	1,000	0.85	16/06/2016	16/06/2017
Lancashire County Council	Term	1,000	0.62	29/06/2016	28/06/2017
Fixed Term Deposits sub total		**21,000**		**Listed in order of maturity**	
Santander UK - 95 Day	Notice	0			
Santander UK - 180 Day	Notice	4,000	1.15		
Notice Accounts sub total		**4,000**			
Bank of Scotland	Call	0	0.15		
Barclays (deposit account)	Call	2,282	0.20 (1)		
Barclays (current account)	Call	2			
Call Accounts sub total		**2,284**			
Federated MMF	MMF	2,075	0.39 (2)		
Ignis Liquidity MMF	MMF	1,640	0.40 (2)		
BlackRock MMF	MMF	3,000	0.39		
Money Market Funds sub total		**6,715**			
Total		**33,999**			

Notes:

(1) Includes 0.20% annual bonus.

(2) MMF rates are variable. This is the calculated average for the year to August.

Investment Counterparties 2016/17

Category	Institutions	CAS Colour Code	Maximum Period	Limit per Institution
Banks & Building Societies: Call Accounts /Term Deposits / Certificates of Deposit (CDs)				
Government related/guaranteed	DMADF (DMO) UK Local Authority	Yellow Yellow	6 months 1 year	Unlimited £4m per LA
UK part-nationalised institutions	Royal Bank of Scotland group	Blue	1 year	£5m per group
UK-incorporated Institutions	UK banks and building societies of high credit quality	Orange Red Green	1 year 6 months 3 months	£4m per group (or independent institution)
Non-UK Banks	Non-UK banks of high credit quality	Orange Red Green	1 year 6 months 3 months	£3m per group (or independent institution); £6m in total for this category
Money Market Funds				
Money Market Funds (CNAV)	MMFs of high credit quality - AAA rated		Instant access	£4m per fund
Enhanced Money Market Funds (VNAV)	EMMFs of high credit quality - AAA rated		T+2 or T+3	£3m per fund; £6m in total for this category
Property Funds				
Property Funds	Specific Funds to be selected based on CAS guidance & undertaking due diligence checks			£2m in total for this category

Appendix B

Prudential Indicators & Treasury Indicators 2016/17

Council Approved the Prudential Indicators and Treasury Indicators for 2015/16 on 2 March 2016. The following tables present proposed revisions to relevant indicators. These changes to indicators would require Council approval.

Prudential Indicator 1 – Capital Investment

Table 1 – Capital Expenditure	2016/17 Estimate £'000	From 2015/16 £'000	Other Changes £'000	2016/17 Revised £'000
Capital expenditure under Leisure Contract – treated as a finance lease (affects the CFR see Prudential Indicator 2 below)	18	0	0	18
Capital expenditure incurred directly by the Council	5,421	681	610	6,712
Less Capital resources				
Capital receipts	(1,400)	(56)	0	(1,456)
Grants & contributions	(2,472)	(270)	0	(2,742)
Revenue and reserves	(1,391)	(141)	(610)	(2,142)
Unfinanced amount (affects the CFR see Prudential Indicator 2 below)	158	214	0	372

The table shows that capital expenditure incurred by the Council is expected to increase to £6.712m, of which £0.681m is rephrased from 2015/16, and £0.610m is a new project funded from earmarked revenue resources. The unfinanced amount (i.e. borrowing) increases by £0.214m as a result of rephrasing from 2015/16. This affects the Capital Financing Requirement, presented in the table below.

Prudential Indicator 2 – Capital Financing Requirement (CFR)

Table 2 – Capital Financing Requirement (CFR)	31/3/17 Estimate £'000	From 2015/16 £'000	Other Changes £'000	31/3/17 Revised £'000
Estimated CFR	**5,386**	**(100)**	**0**	**5,286**
Reasons for the annual change in the CFR				
Additional finance lease liability	18	0	0	18
Unfinanced capital expenditure (as above)	158	214	0	372
Repayment of finance lease	(246)	0	0	(246)
Annual revenue charge (MRP)	(787)	27	0	(760)

Though unfinanced capital expenditure rephased from 2015/16 is £0.214m, the estimated CFR as at 31 March 2017 is shown to be 0.100m less than expected when the CFR was approved by Council in March 2016. The reduction is as a result of finance lease capital expenditure being £0.127m less than expected in 2015/16, offset by a reduction in the 2016/17 Minimum Revenue Provision by £0.027m. The MRP reduction is as a result of the rephasing of unfinanced capital expenditure from 2015/16 to 2016/17.

Treasury Indicator 1 – Upper limit on Variable rate exposure

The Council is exposed to interest rate movements on its invested cash. The amount varies considerably throughout the year. When this indicator was proposed for 2016/17 it was estimated that balances available to invest would peak at £42m. Though this figure has not been exceeded to date, it is possible that it could be exceeded around the end of the calendar year. It is recommended that Council should approve a revised Treasury Indicator 1 of £45m, for each year from 2016/17 to 2018/19.

Appendix C

Capita Asset Services' Updated Interest Rate Forecast

August quarterly inflation report review

- We have updated our forecasts of 4 July in the immediate aftermath of the referendum result, to take account of the MPC meeting of 4 August which cut Bank Rate from 0.50% to 0.25%. We would refer clients back to the commentary in our newsflash of 4 July as many of our comments then are little changed, although there has been a rapid stabilisation of the fluid political situation in the UK at that time with the appointment of a new Prime Minister. We have therefore provided a summary of recent developments as follows.

- 4 August 2016 MPC decisions: -
    - Bank Rate cut from 0.50% to 0.25%
    - new gilt purchases of £60bn
    - high quality corporate bond purchases of £10bn
    - Term Funding Scheme to provide £100bn of cheap funding to banks
    - last three measures to be financed by creation of new central bank reserves boosting the Bank's Asset Purchase Facility from £375bn to £545bn

- Forward guidance that a further cut to near zero (0.10%?), is likely – probably November quarterly inflation report meeting, if data comes in as forecast, but Carney has dismissed the ideas of negative rates and helicopter money

- Considerable variety of views as to whether these latest measures will have much direct impact on the economy; but they are likely to have an indirect effect by impacting on perceptions and boosting confidence that the Bank is taking action and doing as much as possible - so this WILL help sentiment.

- Limited benefit of a quarter per cent cut in Bank Rate on the cost of mortgages - but also because 36% of households rent, 33% own their property outright, so only 30% own their homes by mortgages and only half of those are on variable rate mortgages.

- The Chancellor has said he will do 'whatever is needed' i.e. to promote growth; two options – fiscal policy e.g. cut taxes, increase investment allowances for businesses etc. and / or increase government expenditure on infrastructure, housing etc. This will mean that the deficit elimination timetable will need to slip further into the future as promoting growth (and ultimately boosting tax revenues in the longer term), will be a more urgent priority.

- Our tentative forecast is for increases in Bank Rate in May 2018 to 0.25% and to 0.50% May 2019; but these will very much depend on how strongly, and how soon, the UK economy makes a gradual recovery, and so start a process of very gradual increases in Bank Rate over a prolonged period

- GDP forecasts – Bank of England: 2016 +2.0% unchanged; 2017 +0.8%, 2018 +1.8% sharply down. Note – this is not indicating a return to recession.

- GDP forecasts - Capital Economics: 2016 +1.7%, 2017 +1.5%, 2018 +2.5%. They feel that pessimism has been overdone and Brexit will not have as big an effect as feared

- Consumer confidence has dipped very sharply on the latest GfK consumer confidence index; a small increase in unemployment is likely in the immediate future; if house prices were to dip significantly, this could also compound negativism and dampen consumer expenditure

- We will need to see if the July UK PMIs (published early August), have over egged pessimism in the immediate aftermath of the shock from the referendum result. The Visa UK monthly index published 8 August showed consumer spending rising by 1.6% in July (i.e. after the referendum), so one initial set of statistics is showing that actual consumer behaviour appears to be little impacted by the Brexit result.

- The Bank of England quarterly inflation report shows Inflation rising up above the MPC's 2% target in 2018 to about 2.3% due to the recent fall in the value of sterling etc., but the MPC is likely to look through that and take a longer term view in order to give time for economic growth to recover

- Rising EU and geopolitical risks, e.g.
    - Current - under capitalisation of Italian banks poses a major risk with state aid firmly ruled out by the EU as a potential way out
    - October 2016 Italian constitutional referendum on reforming the Senate and reducing its powers has also become a confidence vote on Prime Minister Renzi who has said he will resign if there is a 'no' vote; this could destabilise Italy and stop progress to fundamental political and economic reform which is urgently needed to deal with Italy's core problems, especially low growth
    - Nov 2016 US presidential election
    - 2017: French Presidential election April – May and German Federal general election between August and October could be affected by significant shifts in voter intentions as a result of terrorist attacks and a rise in anti EU sentiment
    - Core EU principle of free movement of people within the EU is a growing issue leading to major stress and tension between EU states

- US economy growing strongly; next rate rise now likely to be postponed until December 2016; then sharper increases will cause Treasury yields to also rise; this should give rise to a growing gap between Treasury and gilt yields over time

- Lack lustre economic growth in the EU (our biggest trading partner), which could be negatively impacted by political developments

- Japan bogged down in anaemic growth and making little progress on fundamental reform of the economy

- Chinese economic growth weakening; medium term risks increasing

CAPITA ASSET SERVICES' FORWARD VIEW

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

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities.

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

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

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

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

- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or Fed. rate increases, causing a further flight to safe havens (bonds).
- Geopolitical risks in Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.
- A resurgence of the Eurozone sovereign debt crisis.
- Weak capitalisation of some European banks.
- Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation in western economies, especially the Eurozone and Japan.

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

- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.

- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

Borrowing advice: with yields now at historic lows borrowing should be considered if appropriate to your strategy. We see particular value in the 40yr to 50yr range at present but other periods should be considered if more appropriate locally. As the outlook continues to be uncertain we would suggest borrowing is taken in tranches so as to benefit from the current rates but also to provide some flexibility if rates fall further.

	Bank Rate %		PWLB Borrowing Rates % (including certainty rate adjustment)							
			5 year		10 year		25 year		50 year	
	Aug 16	Feb 16	Aug 16	Feb 16	Aug 16	Feb 16	Aug 16	Feb 16	Aug 16	Feb 16
Sep-16	0.25	0.50	1.00	2.00	1.50	2.50	2.30	3.30	2.10	3.10
Dec-16	0.10	0.50	1.00	2.10	1.50	2.60	2.30	3.30	2.10	3.10
Mar-17	0.10	0.75	1.00	2.20	1.50	2.70	2.30	3.50	2.10	3.30
Jun-17	0.10	0.75	1.10	2.30	1.60	2.80	2.40	3.50	2.20	3.30
Sep-17	0.10	1.00	1.10	2.40	1.60	2.90	2.40	3.60	2.20	3.40
Dec-17	0.10	1.00	1.10	2.60	1.60	3.00	2.40	3.60	2.20	3.40
Mar-18	0.10	1.25	1.10	2.70	1.60	3.10	2.40	3.70	2.20	3.50
Jun-18	0.25	1.25	1.20	2.80	1.70	3.30	2.50	3.70	2.30	3.60
Sep-18	0.25	1.50	1.20	2.90	1.70	3.40	2.50	3.70	2.30	3.60
Dec-18	0.25	1.50	1.20	3.00	1.70	3.50	2.50	3.80	2.30	3.70
Mar-19	0.25	1.75	1.20	3.10	1.70	3.60	2.50	3.80	2.30	3.70
Jun-19	0.50		1.30		1.80		2.60		2.40	

Investment returns
Capita's suggested budgeted investment earning rates for investments up to about three months duration in each financial year for the next seven years are as follows:

Average Earnings in each financial year		
	Revised August 2016	Original February 2016
2016/17	0.25%	0.60%
2017/18	0.10%	1.25%
2018/19	0.25%	1.75%
2019/20	0.50%	2.25%
2020/21	0.75%	2.50%
2021/22	1.00%	2.75%
2022/23	1.25%	2.75%
2023/24	1.50%	3.00%
Later years	2.50%	3.00%

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

Our interest rate forecast for Bank Rate is in steps of 25 bps whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps.
Naturally, we continue to monitor events and will update our forecasts as and when appropriate.

CAPITA - Additional Commentary and Observations

Overall, the first half of the year has been solid, but nothing more. This leaves open the option for further stimulus measures in the coming months. However, as with the UK, Japan and China, central banks are at pains to restate that monetary policy cannot solve all ills, and that fiscal support is also needed. The issue is whether this remains palatable, especially in Europe, where a number of countries have general elections to contend with in the coming year.

Brexit has trumped all other considerations for the time being. UK and European markets have been most affected, with analysts increasingly pricing in expectations of another near term rate cut in the UK. Further support measures, in addition to the recent boost to Quantitative Easing, could also be put in place, as highlighted by the Governor of the Bank of England, in efforts to stabilise market sentiment. Note that when enacting its fresh policy support in August, the Bank suggested that July's activity data was likely too pessimistic and that growth for the quarter should be around 0.1%. Even if this was to materialise, then it could still see the need for a further rate cut in the coming months.

On the economic front, central bank activity continues to dominate underlying sentiment and will remain at the forefront in driving market confidence for some time to come. The current bout of market volatility reminds investors that sentiment remains subject to abrupt changes. It is likely that further bouts will occur in the coming months as investors react to events, such as prospects of future Fed policy moves later this year, and whether the most recent ECB support package will be enough to turn around the fortunes of the currency bloc. However, Brexit considerations have now added a further layer of uncertainty into the thinking for the Eurozone and the US.

Further afield, market participants will look to see whether the recent extreme moves in market sentiment (emanating from China) are actually reflective of a weakening global economy, or are a repeat of the volatility that beset markets, but had little lingering impact, in Autumn 2015. The Bank of Japan did surprise markets with its policy rate cut in January, but will this provide enough of a boost to get inflation heading back to the rates desired by the authorities?

In the UK, the Bank of England (BoE) cut the bank rate for the first time since 2009 to 0.25%, as the Monetary Policy Committee (MPC) voted unanimously in favour of a cut. It also expanded its Quantitative Easing (QE) programme by £60bn to £435bn, however three policymakers voted against the expansion. In addition, the BoE unveiled two new schemes: one to buy £10bn of high grade corporate bonds and the "Term Funding Scheme". This could be worth up to £100bn and is aimed at ensuring banks keep lending into the real economy even after rates have been cut.

The August Inflation Report showed the BoE left its growth forecasts unchanged at 2% for 2016 but lowered its forecast for 2017 significantly to 0.8% from the previous estimate of 2.3%. The inflation forecast was revised up sharply due to the fall in sterling and is now forecasted to hit its 2% target in 2017 and rise further to 2.4% in 2018 and 2019.

The Brexit vote, alongside negligible inflation and the fact that the recovery was already going through something of a wobble, suggests that the next move in rates is more likely down again. Markets are now increasingly pricing in expectations of another rate cut, potentially before the year is out, with no expectation of a hike for the foreseeable future.

At its July meeting, the Federal Reserve held interest rates steady as expected, commenting that "near-term risks to the economic outlook have diminished", with Brexit not being the main factor in their decision to leave rates unchanged, but low energy prices i.e. inflation. The meeting minutes for July showed that officials were divided over the urgency to raise the rate again. As ever, the decision on whether to act or not will be based primarily on domestic data releases. The second element will remain the international backdrop. If another raft of uncertainty hits market sentiment then this could stay the hand of the central bank for some while yet. At present, forecasters are pencilling in the potential for a September hike, but market pricing is not looking for anything until

the turn of the year at the earliest. However, both of these views may converge towards the latter stages of this year, in light of the recent comments by Fed Chair, Janet Yellen, at the Jackson Hole central bankers' symposium.

At the July ECB meeting, the central bank offered no new levels of support, leaving the main interest rate at -0.4%. This was no surprise to markets, given the larger than expected policy support provided in March may still be feeding into the bloc's economies. In the accompanying press conference, Draghi hinted that the ECB was in no hurry to provide further economic stimulus, given that financial markets so far had been "resilient" in the wake of last month's Brexit vote. He also said that, should it become more clear going forward that more support is required to lift inflation towards the target, the bank was ready to "act by using all the instruments available within its mandate... Our assessment is that euro area financial markets have weathered the spike in uncertainty and volatility with encouraging resilience...What is clear is that financial markets, and also the banking sector, have reacted in a fairly resilient fashion to the event." He also stated that the ECB "did not yet have [the necessary] information to take decisions" at its July meeting. "When we have new information, we will be in a better position to reassess the underlying macroeconomic conditions."

The actions/words, or inactions, of central bankers are likely to continue to be the key themes dominating market sentiment in the coming months, but in light of the change in UK political/economic outlook there will be an increased level of political influence on the markets for some time, as the process of extracting the UK from the EU commences, and, in all probability, drags on. Central banks have undertaken enormous support programmes in recent years, in an effort to stabilise the world economy. However, can they be unwound without causing material market turbulence in the future – such as that seen in emerging markets in early 2014? While the US has already commenced minimising the levels of increased support, the full unwinding of policy support for major economies will take many years to accomplish. Equally, how easily can the UK reverse forty years of EU membership without any detrimental effect to itself or its former partners, and will this prove a test case / template that other EU members might watch with a view to similar action, with the risk of a break-up of the EU.