

West of England Combined Authority
Treasury Management Strategy Statement 2019/20

1. Introduction

- 1.1 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has substantial sums of money invested and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management.
- 1.2 Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

2. External Context

- 2.1 **Economic background:** The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2019/20.
- 2.2 UK Consumer Price Inflation (CPI) for October was up 2.4% year/year, slightly below the consensus forecast and broadly in line with the Bank of England's November Inflation Report. The most recent labour market data for October 2018 showed the unemployment rate edged up slightly to 4.1% while the

employment rate of 75.7% was the joint highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.3% as wages continue to rise steadily and provide some pull on general inflation. Adjusted for inflation, real wages grew by 1.0%, a level still likely to have little effect on consumer spending.

- 2.3 The rise in quarterly GDP growth to 0.6% in Q3 from 0.4% in the previous quarter was due to weather-related factors boosting overall household consumption and construction activity over the summer following the weather-related weakness in Q1. At 1.5%, annual GDP growth continues to remain below trend. Looking ahead, the BoE, in its November Inflation Report, expects GDP growth to average around 1.75% over the forecast horizon, providing the UK's exit from the EU is relatively smooth.
- 2.4 Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy has been made since. However, the Bank expects that should the economy continue to evolve in line with its November forecast, further increases in Bank Rate will be required to return inflation to the 2% target. The Monetary Policy Committee continues to reiterate that any further increases will be at a gradual pace and limited in extent.
- 2.5 While US growth has slowed over 2018, the economy continues to perform robustly. The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the current 2%-2.25% in September. Markets continue to expect one more rate rise in December, but expectations are fading that the further hikes previously expected in 2019 will materialise as concerns over trade wars drag on economic activity.
- 2.6 **Credit outlook:** The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ringfenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts.
- 2.7 The Bank of England released its latest report on bank stress testing, illustrating that all entities included in the analysis were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in. The BoE did not require any bank to raise additional capital.

- 2.8 European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.
- 2.9 **Interest rate forecast:** Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% increases during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.
- 2.10 The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. While assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity (*at the time of writing*). As such, the risks to the interest rate forecast are considered firmly to the downside.
- 2.11 Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.7% and 2.2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.
- 2.12 A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.
- 2.13 For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 1.3% for WECA balances, and 0.9% for LGF and RIF balances.

3. Local Context

- 3.1 On 31st December 2018, the Authority held £188m of investments and no borrowing. This is set out in further detail at **Appendix B**.
- 3.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment.
- 3.3 The Authority is currently debt free and its capital expenditure plans do not currently imply any need to borrow over the forecast period. Investments are forecast to fall to £133m by the end of 2019/20 as capital grants are used to finance capital expenditure and reserves are used to finance the revenue budget.

4. Investment Strategy

- 4.1 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Since 1 April 2018, the Authority's investment balance has ranged between £123m and £210m, and similarly for 2019/20 the balances are expected to range between £120m and £198m (slightly lower due to capital grants and reserves being used to finance spend).
- 4.2 As well as holding investments in its own right, the Authority also acts as Accountable Body for the West of England Revolving Investment Fund (RIF) and Local Growth Fund (LGF), holding Government Grants until they are ready to be distributed to Local Authorities and other organisations for infrastructure works over the coming years.
- 4.3 The funds are invested in line with the WECA strategy primarily to protect the capital and in order to achieve this high level of capital security, investments are made predominantly with Central Government, Local Authorities and Banks.
- 4.4 Interest earned on RIF investments is re-invested into the Fund. LGF investment returns are earmarked to fund the corporate support and governance costs that come with performing the Accountable Body function for the Local Enterprise Partnership (LEP).
- 4.5 **Objectives:** The CIPFA Code requires the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total

return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. Given the current level of CPI at 2.2% this will be difficult to achieve with fixed term deposits alone. However, the intention is to consider further longer term investments such as pooled funds, which will achieve a higher rate of return. Any temporary liquidity issues that may arise can then be dealt with by short term borrowing.

- 4.6 **Negative interest rates:** If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.
- 4.7 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to further diversify into more secure and/or higher yielding asset classes during 2019/20. This is especially the case for the estimated £20m that is available for longer-term investment. A dwindling proportion of the Authority's surplus cash remains invested in short-term unsecured bank deposits and money market funds. This diversification will represent a continuation of the strategy adopted in 2018/19. The strategy of this policy is to set outer limits for treasury management operations. In the case of exceptional market uncertainty, WECA officers will operate in a more restrictive manner than the policy allows.
- 4.8 **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.
- 4.9 **Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types in table 1 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 1: Approved investment counterparties and limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£10m 5 years	£15m 20 years	£10m 50 years	£10m 20 years	£5m 20 years
AA+	£10m 5 years	£15m 10 years	£15m 25 years	£5m 10 years	£5m 10 years
AA	£10m 4 years	£15m 5 years	£15m 15 years	£5m 5 years	£5m 10 years
AA-	£10m 3 years	£15m 4 years	£10m 10 years	£5m 4 years	£5m 10 years
A+	£10m 2 years	£15m 3 years	£10m 5 years	£5m 3 years	£5m 5 years
A	£10m 13 months	£10m 2 years	£10m 5 years	£5m 2 years	£5m 5 years
A-	£10m 6 months	£10m 13 months	£10m 5 years	£5m 13 months	£5m 5 years
None	£1m 6 months	n/a	£10m 25 years	£50,000 5 years	£3m 5 years
Pooled funds and real estate investment trusts		£10m per fund or trust			

This table must be read in conjunction with the notes below

- a) **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.
- b) **Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.
- c) **Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses

in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

- d) **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.
- e) **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £50,000 per company as part of a diversified pool in order to spread the risk widely.
- f) **Registered providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.
- g) **Pooled funds:** Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

The Authority may consider further investment in Pooled Funds during 2019/20 with a view to providing further diversification and the potential for earning a higher investment yield on long-term investment balances. Cash that is not required to meet any short or medium-term liquidity need can be invested for the longer term with a greater emphasis on achieving returns that will support spending on local WECA services.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify

into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

- h) **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.
- i) **Operational bank accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £100,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.
- j) **Risk assessment and credit ratings:** Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
- no new investments will be made,
 - any existing investments that can be recalled or sold at no cost will be, and
 - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

- k) **Other information on the security of investments:** The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests,

including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Authority's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

- l) **Investment limits:** The Authority's revenue reserves available to cover investment losses are forecast to be £0.5 million on 31st March 2019. This low level of reserves means that in the event of a single default loss, WECA will have limited resources to cover such a loss. The revenue budget report elsewhere on this agenda recommends a small increase in general reserves. With this in mind, the maximum that will be lent to any one organisation (other than the UK Government) will be £10 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£10m per group
Any group of pooled funds under the same management	£10m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£15m per country (AAA sovereign rating) £10m per country (AA+ sovereign rating)
Registered providers and registered social landlords	£50m in total
Unsecured investments with building societies	£20m in total
Loans to unrated corporates	£20m in total
Money market funds	£100m in total
Real estate investment trusts	£50m in total

m) **Liquidity management:** The Authority uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium-term financial plan and cash flow forecast. The intention is to invest a limited amount of funds on a longer term basis to secure higher returns, and based on cashflow forecasts. This may result in a temporary liquidity issue, which will be dealt with via short term borrowing – as a proactive treasury tool.

5. **Borrowing Strategy**

5.1 The Authority currently holds no borrowing. The balance sheet forecast shows that the Authority does not expect to need to borrow in 2019/20.

5.2 **Objectives:** The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

5.3 **Strategy:** The Authority does not currently have any underlying need to borrow long-term to fund capital expenditure. WECA holds no long-term loans and no long-term borrowing is anticipated during 2019/20. Therefore, a debt-free strategy will be maintained until such time as the Authority determines that its capital strategy and prioritised programme of investment requires consideration of any borrowing decision.

5.4 As part of its approach to liquidity management, the Authority may borrow short-term loans to cover any unplanned cash flow shortages as they arise. Rather than always keeping cash on instant access for unplanned cash flows (where security and liquidity will mean yields will be low) the Authority will retain the option of short-term borrowing at current low rates to enable it to explore increasing investments in longer-term and more diversified assets. The Authority will test access to borrowing occasionally even where this is not required to ensure liquidity is available.

5.5 **Sources of borrowing:** The approved sources of short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except Avon Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

5.6 **Other sources of debt finance:** In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

5.7 **Short-term and variable rate loans:** These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

6. Treasury Management Indicators

6.1 The Authority measures and manages its exposures to treasury management risks using the following indicators.

6.2 **Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

Credit risk indicator	Target
Minimum portfolio average credit rating	A-

6.3 **Liquidity:** The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each quarter without giving prior notice.

Liquidity risk indicator	Target
Total sum borrowed in past 3 months without prior notice	£30m

6.4 **Interest rate exposures:** This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£570k

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

6.5 **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£100m	£75m	£50m

7. Related Matters

The CIPFA Code requires the Authority to include the following in its treasury management strategy.

- 7.1 **Financial Derivatives:** In the absence of any explicit legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.
- 7.2 **Markets in Financial Instruments Directive (MiFID II):** As a result of the directive, Local Authorities will be treated as retail clients, but can opt up to professional client status, providing that they meet certain criteria which includes having an investment balance of at least £10m and the persons authorised to make investment decisions on behalf of WECA having at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies must assess that these persons have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

8. Financial Implications

- 8.1 The budget for WECA investment income in 2019/20 is £0.82 million, based on an average investment portfolio of £71 million at an interest rate of 1.3% and making an allowance for impairment as required. In addition, the budget for the LEP investment income in 2019/20 is £0.5 million, based on an average investment of £60 million at an interest rate of 0.9% and making an allowance for impairment. The differing levels of interest expected to be achieved reflect the ability to invest the funds for longer terms and hence achieve a higher return. Longer term investment of LEP funds is limited as LGF grant will all be spent within the next 2 years. If actual levels of investments, or actual

interest rates, differ from those forecast, performance against budget will be correspondingly different.

9. Other Options Considered

- 9.1 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted the West of England Mayor and Chief Executive, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller

Appendix A – Arlingclose Economic & Interest Rate Forecast December 2018

Underlying assumptions:

- Our central interest rate forecasts are predicated on there being a transitional period following the UK's official exit from the EU.
- The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. We believe that MPC members consider that: 1) tight labour markets will prompt inflationary pressure in the future, 2) ultra-low interest rates result in other economic problems, and 3) higher Bank Rate will be a more effective policy weapon if downside risks to growth crystallise.
- Both our projected outlook and the increase in the magnitude of political and economic risks facing the UK economy means we maintain the significant downside risks to our forecasts, despite the potential for slightly stronger growth next year as business investment rebounds should the EU Withdrawal Agreement be approved. The potential for severe economic outcomes has increased following the poor reception of the Withdrawal Agreement by MPs. We expect the Bank of England to hold at or reduce interest rates from current levels if Brexit risks materialise.
- The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in the middle quarters of 2018, but more recent data suggests the economy slowed markedly in Q4. Our view is that the UK economy still faces a challenging outlook as the country exits the European Union and Eurozone economic growth softens.
- Cost pressures are easing but inflation is forecast to remain above the Bank's 2% target through most of the forecast period. Lower oil prices have reduced inflationary pressure, but the tight labour market and decline in the value of sterling means inflation may remain above target for longer than expected.
- Global economic growth is slowing. Despite slower growth, the European Central Bank is conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. More recent US data has placed pressure on the Federal Reserve to reduce the pace of monetary tightening – previous hikes and heightened expectations will, however, slow economic growth.
- Central bank actions and geopolitical risks have and will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon, but recent events around Brexit have dampened interest rate expectations. Our central case is for Bank Rate to rise twice in 2019, after the UK exits the EU. The risks are weighted to the downside.

- Gilt yields have remained at low levels. We expect some upward movement from current levels based on our central case that the UK will enter a transitional period following its EU exit in March 2019. However, our projected weak economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities.

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.17
Arlingclose Central Case	0.75	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.13
Downside risk	0.00	-0.50	-0.75	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-0.85
3-mth money market rate														
Upside risk	0.10	0.10	0.10	0.10	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.17
Arlingclose Central Case	0.90	0.95	1.10	1.30	1.40	1.40	1.40	1.35	1.35	1.35	1.35	1.35	1.35	1.27
Downside risk	-0.20	-0.45	-0.60	-0.80	-0.90	-0.90	-0.90	-0.85	-0.85	-0.85	-0.85	-0.85	-0.85	-0.76
1-yr money market rate														
Upside risk	0.20	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.33
Arlingclose Central Case	1.15	1.25	1.35	1.50	1.70	1.60	1.50	1.40	1.35	1.35	1.35	1.35	1.35	1.40
Downside risk	-0.35	-0.50	-0.60	-0.80	-0.90	-0.90	-0.90	-0.85	-0.85	-0.85	-0.85	-0.85	-0.85	-0.77
5-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.37
Arlingclose Central Case	1.15	1.25	1.35	1.50	1.50	1.40	1.35	1.35	1.30	1.30	1.30	1.30	1.30	1.33
Downside risk	-0.50	-0.60	-0.65	-0.80	-0.80	-0.70	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.66
10-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.37
Arlingclose Central Case	1.50	1.65	1.70	1.80	1.80	1.75	1.75	1.70	1.70	1.70	1.70	1.70	1.70	1.70
Downside risk	-0.55	-0.70	-0.70	-0.80	-0.80	-0.75	-0.75	-0.70	-0.70	-0.70	-0.70	-0.70	-0.70	-0.71
20-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.37
Arlingclose Central Case	2.00	2.10	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.18
Downside risk	-0.60	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.73
50-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.37
Arlingclose Central Case	1.90	1.95	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	1.99
Downside risk	-0.60	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.73

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%

PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Appendix B - Existing Investment & Debt Portfolio Position

	31 Dec 2018 Actual Portfolio £m	31 Dec 2018 Average Rate %
External borrowing:	0	0
Other long-term liabilities:	0	0
Total gross external debt	0	0
Treasury investments:		
Banks & building societies (unsecured)	30	0.85
Covered bonds & repo (secured)	0	0
Government (incl. local authorities)	124	0.93
Corporate bonds and loans	0	0
Money Market Funds	24	0.74
Other pooled funds (CCLA Property Fund)	10	4.05
Real estate investment trusts	0	0
Total treasury investments	188	0.90
Net debt	0	0