Appendix 2

Brighton & Hove City Council
Economic Overview and Interest Rate prospect 2016/17

ECONOMIC OVERVIEW (Source – Capita Asset Services, February 2016)

There has been some market unease coming into 2016 fuelled by weaker economic performance in China, a continuation of price pressures on commodities (particularly oil), and a re-pricing of credit risk in respect of major financial institutions. As a result, a number of major economies have implemented or mooted further economic stimulus, including Japan's surprise implementation of negative interest rates. Additionally, Janet Yellen, governor on the board of the US Federal Reserve, has indicated in her February speech that US official rate rises may be slower than originally anticipated in December.

Bank of England Governor Mark Carney has also given indications that a rise in UK interest rates are likely to be pushed back, citing weak growth, pressure on wages, and low inflation as main factors. Current economic forecasts show interest rate rises pushed back to the last quarter of 2016.

The economic environment in general has been volatile and as such, economic forecasting remains difficult with so many external influences weighing on the UK. Confidence remains a significant factor in the economic outlook: ongoing volatility in financial markets could dampen investment decision making as corporates take a more cautious view of prospects in the coming years due to international risks. This could also impact via a slowdown in increases in employment. However, consumers will be enjoying the increase in disposable incomes as a result of falling prices of fuel, food and other imports from emerging countries which could well feed through into an increase in consumer expenditure and demand in the UK economy.

INTEREST RATE PROSPECTS

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

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

- Eurozone sovereign debt difficulties have not gone away, and are arguably merely postponed. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods. Additionally, investor fear may cause further safe haven investments which will affect gilt rates (and therefore PWLB rates);
- Uncertainty around the risk of a UK exit from the EU is likely to cause volatility in UK markets as investors re-assess UK risk.
- Other external influences such as the pace of global growth, inflation levels, and the impact of monetary policy on sustainable growth across the globe will cause re-assessment by investors which will impact gilt rates, and therefore PWLB rates.

- Investment returns are likely to remain relatively low during 2016/17 and beyond; Capita Asset Services have provided average investment return (Table A), which have been reflected in the 2016/17 budget and the Medium Term Financial Strategy.
- Borrowing interest rates have been volatile during 2015 as alternating bouts of good and bad news have promoted optimism and then pessimism in financial markets. Borrowing rates have reached historical lows at the end of 2015 and early 2016 as a result of the continuation of falling commodity prices, the flight to safe havens arising from geo-political tensions and emerging country economy weakness, and credit risk re-pricing of financial institutions and mining companies.
- Officers have already taken advantage of these very low rates with £15.000m of new borrowing undertaken during 2015/16 to reduce the council's under borrowing position.
- There remains a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns. Achieving an appropriate balance between long term benefits compared to the short term cost of carry will be a fundamental consideration for any borrowing decisions undertaken in the next three years.

Table A – Interest Rate forecasts April 2016 to March 2019 (annual averages)

	Bank Rate	Returns on Investments	Long-term borrowing rates		
			5 year	25 year	50 year
2016/17	0.52%	0.60%	1.96%	3.28%	3.13%
2017/18	0.92%	1.25%	2.41%	3.57%	3.37%
2018/19	1.42%	1.75%	2.88%	4.53%	3.62%

(Source – Capital Asset Services: Interest Rate Forecast, February 2016)