Appendix 2

Brighton & Hove City Council
Economic Overview and Interest Rate prospect 2015/16

ECONOMIC OVERVIEW (Source – Capita Asset Services, February 2015)

UK GDP growth surged during 2013 and the first half of 2014, but growth slowed towards the end of 2014. There are good grounds for optimism that growth will pick back up again in 2015 as the positive effects from the fall in the price of oil feeds through to consumers and other parts of the economy. The Monetary Policy Committee maintained it's GDP forecast for 2015 at 2.9% in it's February meeting, but revised it's forecasts for 2016 and 2017 to 2.7% and 2.7% respectively. The main source of the upward revision came from higher consumption growth.

CPI inflation has fallen to a record low of 0.30% in January 2015. There is a real possibility that CPI inflation could turn negative for a short period around midyear 2015. This is expected to be a temporary blip until the fall of the price of oil drops out of the calculation; this will help improve consumer disposable income and so underpin economic growth during 2015. However, this may make it difficult for the MPC to raise the Bank Rate as early as previous expectations, and as such, our treasury advisors have pushed back their forecast of an increase in bank rate to Q1, 2016. Other issues, such as a successful resolution for Greece and the Eurozone, will impact on the actual timing of an official rate rise.

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:

- Greece: The newly elected anti austerity party, Syriza is making a strong push to renegotiate the austerity programme and debt repayments with its creditors. Whilst the Eurozone has put sufficient firewalls in place in the event of a Greek departure from Europe, there is a concern that there may be a strengthened support for anti austerity political parties in the EU, particularly Portugal and Spain, who have general elections coming up in late 2015.
- As for the Eurozone in general, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation, Middle East and Ebola, have led to a resurgence of those concerns as risks increase that it could be heading into deflation and prolonged very weak growth. 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;

- Investment returns are likely to remain relatively low during 2015/16 and beyond; Capita Asset Services have provided average investment return (Table A), which have been reflected in the 2015/16 budget and the Medium Term Financial Strategy.
- Borrowing interest rates have been volatile during 2014 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 2014 and early 2015 as a result of the dramatic fall in inflation, plummeting oil prices, and the flight to safe havens arising from tensions in the Middle East and the Ukraine. Borrowing rates are expected to remain volatile in 2015, which will be impacted by how long it takes to decide what will happen in Greece and other factors that will impinge on market and investor sentiment. There are also potential risks around UK EU membership which could also affect investor sentiment towards the UK and towards gilts as an investment which could lead to a jump in gilt yields, and therefore PWLB borrowing rates.
- The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years, but officers are now actively seeking appropriate borrowing opportunities in order to take advantage of the historically low rates at a time where rises in borrowing rates are expected.
- There will remain 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. Minimising cost of carry remains a prime focus for officers, and the current Borrowing Strategy (Appendix 3) recommends using forward rate borrowing to address this.

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Table A – Interest Rate forecasts April 2015 to March 2018 (annual averages)

	Bank Rate	Returns on Investments	Long-term borrowing rates		
			5 year	25 year	50 year
2015/16	0.56%	0.60%	2.28%	3.53%	3.53%
2016/17	1.00%	1.10%	2.78%	4.10%	4.10%
2017/18	1.56%	1.75%	3.25%	4.53%	4.53%

(Source – Capital Asset Services: Interest Rate Forecast, February 2015)