Appendix A – Economic Summary and Regulatory Changes

1. Economic Summary

1.1. **Growth and Inflation:** The UK economy as measured by its Gross Domestic Product (GDP) expanded by 1.2% for the year to March 2018, down from 2.0% a year earlier.

1.2. UK inflation as measured by the Office for National Statistics' new main measure of inflation, the Consumer Price Index including owner occupiers' housing costs (CPIH), was 2.3% for the year to March 2018, down from 2.5% in February 2018. Since reaching a recent high of 2.8% towards the end of 2017, the rate has fallen back to its lowest level since March 2017.

1.3. The labour market continued to improve through 2017 and in Q1 2018, the latest figures showing the employment rate at 75.7% (the highest rate since comparable records began in 1971) and the unemployment rate at 4.2%, a 47-year low, down from 4.5% a year earlier. Wage growth increased by 2.5% including bonuses, which meant that real earnings increased by 0.2% (i.e., after inflation), increasing consumers' spending power.

1.4. **UK Monetary Policy**: In a 7-2 vote, the Bank of England's Monetary Policy Committee (MPC) increased the Bank Rate by 0.25% in November 2017 to 0.5% in line with market expectations. It was significant in that it was the first rate hike in ten years, although in essence the MPC reversed its August 2016 cut following the Referendum result. The MPC was keen to return inflation to the 2.0% target over a more conventional (18-24 month) horizon with 'gradual' and 'limited' policy tightening.

1.5. The programme of purchasing UK Government bonds of £435BN (Quantitative Easing) and £10BN of corporate bond purchases to maintain the supply of credit to the economy has remained unchanged in 2017/18.

1.6. At its meeting ending 1 August 2018, the MPC voted by 9-0 to increase the Bank Rate by 0.25%, to 0.75%. An ongoing tightening of monetary policy over the next few years is considered appropriate to return inflation sustainably to its 2.0% target.

1.7. Inflation has been increasing by more than the MPC's 2.0% target on average over the past year, primarily due to the big fall in sterling following the Brexit vote. If the economy continues to perform as expected, the MPC is of the view that it will need to raise interest rates a bit more over the next few years.

1.8. It expects any rises in interest rates to happen at a gradual pace and to a limited extent. Interest rates are likely to remain substantially lower than a decade ago.

1.9. **Financial markets**: The FTSE All Share index had a strong finish to the calendar year 2017, reaching a record high before a global equity correction and sell-off ended the financial year down 3% from a year earlier (3,885 as at 31 March 2018 compared to 4,011 as at 31 March 2017).

1.10. **PWLB rates**: The movement in fixed interest rates at which local authorities can borrow from the Public Works Loan Board (PWLB) is set out in the table below.

Period	31 March 2017	31 March 2018
1 year	0.8%	1.5%
3 year	1.0%	1.7%
5 year	1.3%	1.9%
10 year	2.0%	2.3%
25 year	2.6%	2.6%
50 year	2.3%	2.3%

1.11. The rates above reflect the PWLB's 'Certainty Rate'. The Government after 1 November 2012, reduced by 0.2% the interest rates on loans from the PWLB to local authorities who provide information to Government on their plans for long-term borrowing and associated capital spending. The Council has provided the required information and can therefore access this Certainty Rate.

1.12. PWLB interest rates have fluctuated during the year. Overall at the year end the rates were higher than those at the start of the 2017/18 financial year.

1.13. However, it should be noted that the longer term borrowing rates are the most relevant here given the nature of the Council's long term borrowing requirement and these were unchanged at the year end when compared to the start of the 2017/18 financial year.

1.14. This gave support to the Council's strategy of sourcing its borrowing from other local authorities on a short term rolling basis at an average rate of 0.4% (inclusive of brokerage fees) in 2017/18 to achieve significant revenue cost savings over the more traditional route of borrowing long term from the PWLB.

2. Local Authority Regulatory Changes

2.1. **Revised CIPFA Codes:** CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017. The required changes from the 2011 Code are being incorporated into the Council's Treasury Management Strategies and monitoring reports.

2.2. The 2017 Prudential Code introduces the requirement for a Capital Strategy which provides a high-level overview of the long-term context of capital expenditure and investment decisions and their associated risks and rewards along with an overview of how risk is managed for future financial sustainability. The Code also expands on the process and governance issues of capital expenditure and investment decisions. The Council will be preparing a Capital Strategy for the 2019/20 financial year.

2.3. In the 2017 Treasury Management Code, the definition of 'investments' has been widened to include non-treasury investments such as commercial investments in properties in the definition of "investments". Loans supporting service outcomes and investments in subsidiaries must be discussed in the Capital Strategy or Investment Strategy. Additional risks of such investments are to be set out clearly and the impact on financial sustainability is to be identified and reported.

2.4. Another change is the inclusion of financial guarantees as instruments requiring risk management and addressed within the Treasury Management Strategy. Approval of the technical detail of the Treasury Management Strategy may be delegated to a committee rather than needing the approval of full Council.

2.5. **MiFID II:** As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3 January 2018 local authorities were automatically treated as retail clients but could "opt up" to professional client status, providing certain criteria was met which includes having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the authority having at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies have had to assess that that person(s) have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

2.6. The Council has met the conditions to opt up to professional status and has done so in order to maintain its MiFID II status prior to January 2018. The Council will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.