# Treasury Management Strategy – Interest Rates

## *Current Medium Term Financial Plan*

1. The strategy for 2014/15 approved by Council in February 2014 set out forecast interest rates over the medium term. The forecast was for an average bank rate of:

- 2014/15 0.50%
- 2015/16 0.50%
- 2016/17 0.75%
- 2017/18 1.00%

2. The rates achieved on deposits were forecast to be 0.3% higher than the average bank rate for 2014/15 and 2015/16, reducing to 0.05% above base rate in 2016/17 and at base rate in 2017/18. The target return rates included in the current MTFP are:

- 2014/15 0.80%
- 2015/16 0.80%
- 2016/17 0.80%
- 2017/18 1.00%

## *Economic Outlook*

3. UK economic recovery has continued during 2014 and appears more sustainable. GDP growth has continued and financial markets have remained relatively resilient despite a number of significant geopolitical and economic events, tensions in Russia and Ukraine, and in the Middle East, and public support for a large Portuguese bank.

4. The Bank of England alerted markets to the risk that interest rates may rise sooner than expected if economic data releases continued to show stronger results than anticipated. Financial market prices suggest expectations of a 0.25% increase in the Bank Rate in the first quarter of 2015.

5. At its meeting in August, the Bank of England Monetary Policy Committee voted to keep the bank's base rate at 0.5%. Whilst employment and output growth had remained firm, wages growth remained weak and for the majority of MPC members there was insufficient evidence of inflationary pressures to justify an increase in the Bank Rate. Inflation had eased again to 1.6% in July, dropping further than expected after the spike to 1.9% in June.

6. There were concerns that an increase in Base Rate ahead of wage growth risked increasing vulnerability of highly indebted households. However, two members of the committee voted for a 0.25% rise in the Bank Rate, noting that the continuing fall in unemployment alongside evidence of tightening in the labour market created a prospect that wage growth would pick up. The Bank Rate is likely to

remain materially below its pre-crisis average for some time and anticipated increases over the next 3 years are expected to be gradual.

### *Updated Forecast*

7. The Council uses the services of Arlingclose Limited to provide investment advice to the Council, as part of this service they help the Council formulate a view on interest rates. Arlingclose's current view on interest rates is that the average Bank Rate will remain at 0.5% until the 3rd quarter of 2015. Inflationary pressure is currently low and likely to remain so in the short-term. Arlingclose believes that spare capacity in the labour market and the lack of wage and inflationary pressures will continue to cause debate in the MPC and expect the first rise in official rates to be slightly later than market sentiment indicates.

8. Arlingclose also provide upside and downside risks to their forecast. The upside risk given for base rates ranges from 0.25% in Q3 2014 to 1% in Q2 2017. Downside risks range from 0.25% in Q3 2015 to 1% in Q1 2017.

9. The Council's Treasury Management Strategy Team, taking into account the advice from Arlingclose, and the current economic outlook, has determined the average bank rate forecasts over the medium term:

   - 2015/16 0.9%
   - 2016/17 1.5%
   - 2017/18 1.9%

10. Based on past performance on rates achieved on deposits, the current portfolio and market rates, the Treasury Management Strategy Team proposes the target rate of return should be 0.1% higher than the average bank rate for 2015/16 and 0% for 2016/17 and 2017/18. The reduction in the target outperformance reflects the rising interest rate environment. The strategic measures budget estimates will be based on the following:

    - 2015/16 1.0%
    - 2016/17 1.5%
    - 2017/18 1.9%

11. The budget for 2014/15 assumed an average cash balance of £300m. This figure has now been revised to £360m as a result of higher than forecast balances at the start of the previous financial year, and an increase in the estimate of the impact of early grant receipts.