Kent Police and Crime Commissioner

Treasury Management Strategy Statement 2019/20

Introduction

The Police and Crime Commissioner (PCC) adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code-updated in 2017) which requires the PCC to approve a treasury management strategy before the start of each financial year.

In addition, the former Department for Communities and Local Government (DCLG, now known as the Ministry of Housing, Communities and Local Government) issued revised *Guidance on Local Authority Investments* in March 2010 (revised in 2018) that requires the PCC to approve an investment strategy before the start of each financial year. .

This report fulfils the PCC's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the MHCLG Guidance.

In addition the Treasury Management Strategy Statement now forms part of the PCC's overall Capital Strategy.

Background

Treasury management can be defined as the management of the PCC's investments and cash flows, banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

The PCC is required to operate a balanced budget, which means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is an effective cash flow forecasting model to ensure that cash is available when it is needed. Any surplus money will be invested in low risk counterparties or instruments commensurate with a low risk appetitive providing security of capital and sufficient liquidity initially before investment return.

A vital function of treasury management is the funding of the PCC's capital programme. This provides a guide to when substantial funding is required to support the programme and will identify any requirement for the PCC to borrow money to fund particular projects.

The PCC invests substantial sums of money 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 risk are therefore central to the PCC's treasury management strategy and is a crucial part of the PCC's governance framework.

In accordance with the MHCLG Guidance, the PCC will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates; changes in the PCC's capital programme or in the level of its investment balance.

Treasury Management Advisors

Arlingclose were reappointed as the PCC's Treasury Management advisors during 2017/18 for a two year period with options to extend for future years. Arlingclose provide a number of treasury services for the PCC and advise on investment and borrowing strategies. They also provide a number of management templates, of which this is one, and opinions and views on the financial environment. Arlingclose's view on the external context within which this treasury management strategy operates is included as Appendix A.

Local Context

During 2018/19 the PCC held £0m of borrowing (excluding PFI and short term cash flow borrowing) and investments ranged from £39m to £90m. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.18 Actual £m	**31.3.19 Forecast £m**	**31.3.20 Forecast £m**	**31.3.21 Forecast £m**	**31.3.22 Forecast £m**	**31.3.23 Forecast £m**
General Fund CFR	41.9	40.6	38.1	37.4	40.2	43.0
Less: Other debt liabilities *	42.0	40.7	39.6	39.0	37.0	35.1
Borrowing CFR	**-0.1**	**-0.1**	**-1.5**	**-1.6**	**3.1**	**7.9**
Less: External borrowing **	0	0	0	0	0	0
Internal (over) borrowing	**-0.1**	**-0.1**	**-1.5**	**-1.6**	**3.1**	**7.9**
Less: Usable reserves	51.1	51.0	29.1	19.4	20.9	16.6
Less: Working capital	12.5	12.5	12.5	12.5	12.5	12.5
Investments (new borrowing)	**63.7**	**63.6**	**43.1**	**33.5**	**30.3**	**21.2**

Table may not sum due to rounding
* finance leases, PFI liabilities and transferred debt that form part of the PCC's total debt
** shows only loans to which the PCC is committed and excludes optional refinancing

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. The PCC's strategy is, where possible, to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

Excluding the PFI contracts, the PCC is currently debt free and the current capital expenditure plans do not imply any need to borrow over the forecast period. Investments are forecast to fall as capital receipts are used to finance capital expenditure and reserves are used to support the revenue budget.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the PCC's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the PCC expects to comply with this recommendation.

Borrowing Strategy

As stated previously, the PCC is currently debt free, excluding the PFI contracts. The investment programme forecast in table 1 shows that the PCC does not expect to need to borrow in 2019/20 or over the medium term. The PCC's 2019/20 budget approved in February stated that the investment programme is increasingly reliant on in-year asset disposals to fund the expenditure. Depending on the project, business case and life expectancy of the asset the PCC may borrow to fund the longer life assets. Any decision to borrow will be made, like all decisions, with value for money for the tax payer in mind and only be done when it is the most cost effective way of delivering a project.

The PCC's borrowing strategy addresses the key issue of affordability without compromising the longer-term stability of the organisation. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the PCC is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the PCC with this 'cost of carry' and breakeven analysis.

Alternatively, the PCC may arrange forward starting loans during 2019/20, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the PCC may borrow short-term loans to cover unplanned cash flow shortages.

Sources of borrowing: The approved sources of long-term and 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 Kent Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
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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

The PCC continues to investigate other sources of finance, such as local authority loans and bank loans, which may be available at more favourable rates.

Municipal Bonds Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities including PCCs. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to the PCC.

Short-term and variable rate loans: These loans leave the PCC 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.

Investment Strategy

The PCC holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the PCC's investment balance has ranged between £40m and £90m million, and while it is not expected that these levels will be maintained in the forthcoming year due to planned use of reserves there will still be significant sums to invest.

Objectives: Both the CIPFA Code and the MHCLG Guidance require the PCC 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 PCC'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 PCC 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.

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.

Strategy: Given the increasing risk and very low returns from short-term unsecured bank investments, the PCC diversified into more secure and/or higher yielding asset classes during 2017/18 and this continued in 2018/19.and 2018/19??? There are no plans to change this strategy 2019/20. There are no significant changes between the 2018/19 strategy and the 2019/20 strategy.

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.

Approved counterparties: Based on advice from Arlingclose and the estimated average investment portfolio, the PCC may invest its surplus funds with any of the counterparty types in table 2 overleaf, subject to the cash limits (per counterparty) and the time limits shown.

Table 2: 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	£5m 5 years	£5m 20 years	£5m 50 years	£5m 20 years	£5m 20 years
AA+	£5m 5 years	£5m 10 years	£5m 25 years	£5m 10 years	£5m 10 years
AA	£5m 4 years	£5m 5 years	£5m 15 years	£5m 5 years	£5m 10 years
AA-	£5m 3 years	£5m 4 years	£5m 10 years	£5m 4 years	£5m 10 years
A+	£5m 2 years	£5m 3 years	£5m 5 years	£5m 3 years	£5m 5 years
A	£5m 13 months	£5m 2 years	£5m 5 years	£5m 2 years	£5m 5 years

A-	£5m 6 months	£5m 13 months	£5m 5 years	£5m 13 months	£5m 5 years
None	£1m 6 months	n/a	£5m 25 years	£1m 5 years	£5m 5 years
Pooled funds	£5m per fund				

This table must be read in conjunction with the notes below

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.

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.

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.

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 without risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

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 £500,000 per company as part of a diversified pool in order to spread the risk widely.

Registered providers: Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered 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 of Communities (in Northern Ireland). As providers of public services; they retain the likelihood of receiving government support if needed.

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.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the PCC 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 PCC's investment objectives will be monitored regularly.

Operational bank accounts: The PCC may incur operational exposures, for example though 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 PCC maintaining operational continuity.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the PCC'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.

Other information on the security of investments: The PCC 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 and reports in the quality financial press and analysis and advice from the PCC'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 PCC 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 PCC'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.

Investment limits: The PCC's revenue reserves available to cover investment losses are forecast to be £29 million on 31st March 2019. In order that no more than 20%(10% in 2018/19) of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £5 million. The percentage of reserves 'at risk' is greater than in 2018/19 (10%) due to the reduction in the overall level of reserves. This is still a manageable risk, however, it will remain under review should reserve levels fall lower than expected. 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	£5m each
UK Government	Unlimited
Any group of organisations under the same ownership	£5m per group
Any group of pooled funds under the same management	£20m per manager
Negotiable instruments held in a broker's nominee account	£20m per broker
Foreign countries	£5m per country
Registered providers and registered social landlords	£15m in total
Unsecured investments with building societies	£5m in total
Loans to unrated corporates	£5m in total
Money Market Funds	£40m in total

Liquidity management: The PCC 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 PCC being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the PCC's medium term financial plan and cash flow forecast.

Management and Execution

This Treasury Management Strategy will be managed by the Chief Finance Officer (CFO) to the PCC. The CFO has engaged the treasury management team of Kent County Council (KCC) on a day-to-day basis to execute the actual dealing for both investing and borrowing, in line with the strategy. This engagement is subject to a Service Level Agreement which is reviewed on an annual basis. KCC provide reports on a weekly, monthly and quarterly basis alongside other treasury management information.

Execution will also be informed by daily/weekly updates from Arlingclose on counter-party risk changes and profiles. In addition, the CFO will monitor the wider trade press in respect of treasury management risks and trends. The CFO will decide on duration periods within the term limits set above depending on current circumstances, and will notify the KCC dealing team accordingly, with the current instruction being that duration limits should not exceed the lower of the advice offered by Arlingclose and the maximum limits set out above.

No new investments will be placed with institutions suspended or placed on negative ratings watch by Arlingclose. The CFO will meet with Arlingclose to review their advice and views at least twice a year.

The CFO will recommend any changes in the above strategy to the PCC as circumstances change but in moments of urgency the CFO will have the authority to reduce portfolio risk by reducing term periods, deposit limits or allowable categories in the face of changing market conditions and his professional view that such changed conditions makes the strategy too high risk. Where possible and practical such changes will be agreed and documented with the PCC in advance but if not possible due to leave or absence a report will be made by the CFO to the PCC within 5 working days of any changes being implemented.

The CFO to the PCC has treasury management experience and will assess his training needs regularly. The CFO will receive support from the Finance Support Officer of the OPCC and will ensure a relevant training programme is in place. Both the CFO and the Finance Support Officer will review training opportunities, courses, seminars and conferences provided by Arlingclose and CIPFA and other appropriate organisations.

Joint Audit Committee

The CIPFA code states clearly that effective scrutiny of the treasury management activities of the PCC should be delegated to an independent body. The PCC has decided that the Joint Audit Committee (JAC) would be the most appropriate body for this role.

The Treasury Management strategy and implementation and compliance with best practice and the Cipfa Code will be part of the annual core Internal Audit programme of work. The Joint Audit Committee will review the final internal audit report and any recommendations and make appropriate comments.

The JAC will receive three reports on treasury management during the year; the strategy; and two performance reports; a mid-year update and an end of year report. The performance reports will include an update on:

- Current investments in counterparties
- Effectiveness of the cash flow forecasting model
- Actual return on investment against estimated return on investment both as a monetary value and as a percentage
- Any non-compliance with the treasury management strategy
- Training undertaken

Treasury Management Indicators

The PCC measures and manages its exposures to treasury management risks using the following indicators. These have not changed from 2018/19.

Security: The PCC 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. Unrated investments are assigned a score based on their perceived risk.

	Target
Portfolio average credit rating or score-AS 2018/19	*AA-*

Liquidity: The PCC has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling 3 month period, without additional borrowing.

	Target
Total cash available within 3 months	£35m

Interest rate exposures: This indicator is set to control the PCC's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures will be:

	2018/19	**2019/20**	**2020/21**	**2021/22**
Upper limit on fixed interest rate exposure	£35m	£35m	£35m	£35m
Upper limit on variable interest rate exposure	£10m	£10m	£10m	£10m

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

Principal sums invested for periods longer than 364 days: 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:

	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£10m	£8m	£8m

Maturity Structure of Borrowing

The code states that we should include our maturity structure of borrowing within our Treasury Management Strategy. Currently the PCC has zero borrowing (except for PFI) and although the likelihood of borrowing has increased at the moment it is difficult to ascertain the amount or length of borrowing required. Any borrowing that is undertaken for cashflow purposes is short term borrowing of a duration no longer than 4 months.

Other Items

There are a number of additional items that the PCC is obliged by CIPFA to include in its Treasury Management Strategy.

Policy on the use of financial derivatives: In the absence of any explicit legal power to do so, the PCC 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.

Investment of money borrowed in advance of need: The PCC may, from time to time, borrow in advance of need, where this is expected to provide the best long-term value for money. Since amounts borrowed will be invested until spent, the PCC is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the PCC's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £50 million. The maximum period between borrowing and expenditure is expected to be two years, although the PCC is not required to link particular loans with particular items of expenditure.

MiFID II Client Classification

From 3 January 2018, as a result of the second Markets in Financial Instruments Directive (MiFID II), PCC's were treated as retail clients who can "opt up" to be professional clients, providing that they meet certain criteria. Regulated financial services firms include banks, brokers, advisers, fund managers and custodians, but only where they are selling, arranging, advising or managing designated investments. In order to opt up to professional client status, the PCC must have an investment balance of at least £10 million and the person authorised to make investment decisions on behalf of the authority must have at least one year's relevant professional experience. In addition, the PCC must assess that that person has the expertise, experience and knowledge to make investment decisions and understand the risks involved. The OPCC for Kent meets these criteria.

The main additional protection for retail clients is a duty on the firm to ensure that the investment is "suitable" for the client. However, PCC's are not protected by the Financial Services Compensation Scheme nor are they eligible to complain to the Financial Ombudsman Service whether they are retail or professional clients.

The PCC meets the conditions to opt up to professional status and has done so in order to maintain the current MiFID status.

Financial Implications-

The budget for investment income in 2019/20 is £0.425 million, based on an average investment portfolio of £54 million at an interest rate of 0.8%. This includes the income generated from Pooled Fund investments which generate a much higher return (4.6%) than for other investments (0.4%). In the interest of transparency we will identify the returns on each type of investment. The budget for debt interest paid in 2019/20 is £0 million, based on an average debt portfolio of £0 million at an average interest rate of 0%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

Other Options Considered

The CIPFA Code do not prescribe any particular treasury management strategy for PCC's to adopt. The CFO, having consulted the PCC, 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 overleaf.

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
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Appendix A – Arlingclose Economic & Interest Rate Forecast December 2018

Underlying assumptions:

- Our central interest rate forecasts are predicated on there being a transitionary 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 transitionary 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.