Treasury Management Mid-year Report 2017/18

Summary

Report to advise members of the Treasury Management Service performance for 2017/18 as at 30th September 2017 and to illustrate the compliance to-date with the Prudential Indicators for 2017/18.

Portfolio – Finance (Councillor Richard Brooks)
Date signed off: 14th November 2017
Wards Affected - All

Recommendation

The Executive is advised to NOTE and COMMENT on the report;

1. Executive Summary

1.1 This report sets out the performance of the Council's investments and borrowing for the first six months of the year. It is also intended to demonstrate that the Council is complying with the Prudential Indicators set by Full Council as part of the Treasury Strategy.

1.2 The Council is complying with all the Prudential Indicators set for 2017/18 as at the 30th September 2017.

2. Resource Implications

2.1 None directly as a result of this paper, but the investment income and borrowing costs do impact the revenue budget.

3. Key Issues

Background

3.1 The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end).

3.2 The Authority's Treasury Management Strategy for 2017/18 was approved by Executive on 7th February 2017.

3.3 Through investment the Authority is potentially exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The Council seeks to moderate this impact by following the

advice of its treasury advisors. This report covers treasury activity and the associated monitoring and control of risk.

Local Context

3.4 At 31/3/2017 the Authority's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £140.2m.

3.5 The Authority is predicted to have an increasing CFR over the next 3 years due to the capital programme as currently known. Any further capital investment for example investment in property would increase the CFR further still.

4. Treasury Performance

Borrowing Activity to 30th September 2017

4.1 At 30/9/2017 the Authority held £111.4m of borrowing, (a decrease of £7.6m on 31/3/2017), which was used to fund the previous years' capital programmes – principally property investment.

4.2 At 30th September 2017 the Council had an upper authorised operational limit of borrowing £185m.

4.3 The Authority's chief objective when borrowing continues to be striking an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. On the advice of its treasury advisors the council has continued to borrow on a short term basis in order to take advantage of low interest rates and hence borrowing costs.

Overall borrowing has decreased for 2 reasons. Firstly loan repayments were made on the period on the longer fixed term loans and secondly the Council has used its cashflow movements to manage borrowing.

Borrowing Position 2017/18

	31.3.17 Balance £m	**Movement £m**	**30.9.17 Balance £m**	**30.9.17 Weighted average rate %**	**30.9.17 Weighted average maturity years**
Public Works Loan Board	16.22	(0.06)	16.16	2.90%	35.0
Local authorities (long-term)	1.00	(0.27)	0.74	0.00%	5.0
Local authorities (short-term)	101.50	(7.00)	94.50	0.32%	0.3
Total Borrowing	**118.73**	**(7.33)**	**111.40**	**1.07%**	**1.2**

Investment Activity to 30th September 2017

4.4 The Authority held invested funds, representing income received in advance of expenditure plus balances and reserves held. During the first half of 2017/18 the Authority's investment balance ranged between £6m and £11 million due to timing differences between income and expenditure. The investment position during the half year is shown in the table below.

Investment Activity Summary at 30 September 2017

Investment Counterparty	Balance on 01/04/17	Investments Made	Maturities/ Investments Sold	Balance on 30/09/17	Average Rate at 30th September
	£000s	£000s	£000s	£000s	%
UK Central Govenrment					
- Short Term	**0**	6,500	-6,500	**0**	0.10
UK Local Authorities					
- Short Term	**2,000**	0	-2,000	**0**	0.35%
- Long Term	**2,000**	0	0	**2,000**	1.30%
Banks, Building Societies & Other Organisations					
- Short Term	**5,434**	43,575	-48,323	**686**	0.13%
AAA-rated Money Market Funds					
- Short Term Cash Equivalents	**0**	33,901	-27,701	**6,199**	0.07%
- Long Term	**2,054**	0	0	**2,054**	3.52%
Total Investments	**11,488**	**83,976**	**-84,525**	**10,940**	

4.5 The Guidance on Local Government Investments in England gives priority to security and liquidity and the Authority's aim is to achieve a yield commensurate with these principles.

4.6 Given the increasing risk and continued low returns from short-term unsecured bank investments, the Authority has maintained its investment in a more secure and/or higher yielding asset class. £2m has been placed in a longer-term investment with the remainder in invested in short-term unsecured deposits and money market funds.

4.7 The Authority's £2m of externally managed pooled property funds generated an average total return of £120k (3.52%), comprising £75k income return which is used to support services in year, and £45k of capital growth. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued stability in meeting the Authority's investment objectives are regularly reviewed. In light of their performance and the Authority's latest cash flow forecasts, investment in these funds has been maintained.

4.8 Security of capital has remained the Authority's main investment objective. This has been maintained by following the Authority's counterparty policy as set out in its Treasury Management Strategy Statement for 2017/18.

4.9 Counterparty credit quality was assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating for institutions defined as having "high credit quality" is A- across rating agencies Fitch, S&P and Moody's); credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

Credit Risk

4.10 The table below shows counterparty credit quality as measured by credit ratings and the percentage of the in-house investment portfolio exposed to bail-in risk.

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating	Investments exposed to bail-in risk
31/03/2017	4.32	AA-	4.00	AA-	61%
30/06/2017	4.33	AA-	3.98	AA-	66%
30/09/2017	4.44	AA-	4.31	AA-	64%

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

Counterparty Update provided in association with Arlingclose Treasury Advisors

4.11 UK bank credit default swaps continued their downward trend, reaching three-year lows by the end of June. Bank shares have not moved in any particular pattern.

4.12 There were a few credit ratings changes during the quarter. The significant change was the downgrade by Moody's to the UK sovereign rating in September from Aa1 to Aa2 which resulted in subsequent downgrades to sub-sovereign entities including local authorities. Moody's downgraded Standard Chartered Bank's long-term rating to A1 from Aa3 on the expectation that the bank's profitability will be lower following management's

efforts to de-risk their balance sheet. The agency also affirmed Royal Bank of Scotland's and NatWest's long-term ratings at Baa1, placed Lloyds Bank's A1 rating on review for upgrade, revised the outlook of Santander UK plc, and Nationwide and Coventry building societies from negative to stable but downgraded the long-term rating of Leeds BS from A2 to A3. The agency downgraded long-term ratings of the major Canadian banks on the expectation of a more challenging operating environment and the ratings of the large Australian banks on its view of the rising risks from their exposure to the Australian housing market and the elevated proportion of lending to residential property investors.

4.13 S&P also revised Nordea Bank's outlook to stable from negative, whilst affirming their long-term rating at AA-. The agency also upgraded the long-term rating of ING Bank from A to A+. Ring-fencing, which requires the larger UK banks to separate their core retail banking activity from the rest of their business, is expected to be implemented within the next year. In May, following Arlingclose's advice, the Authority reduced the maximum duration of unsecured investments with Bank of Scotland, HSBC Bank and Lloyds Bank from 13 months to 6 months as until banks' new structures are finally determined and published, the different credit risks of the 'retail' and 'investment' banks cannot be known for certain.

4.14 Ring-fencing, which requires the larger UK banks to separate their core retail banking activity from the rest of their business, is expected to be implemented within the next year. In May, following Arlingclose's advice, the Authority reduced the maximum duration of unsecured investments with Bank of Scotland, HSBC Bank and Lloyds Bank from 13 months to 6 months as until banks' new structures are finally determined and published, the different credit risks of the 'retail' and 'investment' banks cannot be known for certain.

4.15 The new EU regulations for Money Market Funds were finally approved and published in July and existing funds will have to be compliant by no later than 21st January 2019. The key features include Low Volatility NAV (LVNAV) Money Market Funds which will be permitted to maintain a constant dealing NAV, providing they meet strict new criteria and minimum liquidity requirements. MMFs will not be prohibited from having an external fund rating (as had been suggested in draft regulations). Arlingclose expects most of the short-term MMFs it recommends to convert to the LVNAV structure and awaits confirmation from each fund.

Regulatory Updates

MiFID II:

4.16 Local authorities are currently treated by regulated financial services firms as professional clients who can "opt down" to be treated as retail clients instead. But from 3rd January 2018, as a result of the second Markets in Financial Instruments Directive (MiFID II), local authorities will be 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, the authority 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 firm must assess that that person has the expertise, experience and knowledge to make investment decisions and understand the risks involved.

4.17 The main additional protection for retail clients is a duty on the firm to ensure that the investment is "suitable" for the client. However, local authorities 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. It is also likely that retail clients will face an increased cost and potentially restricted access to certain products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice. The Authority has declined to opt down to retail client status in the past as the costs were thought to outweigh the benefits.

4.18 The Authority meets the conditions to opt up to professional status and intends to do so in order to maintain their current MiFID status.

CIPFA Consultation on Prudential and Treasury Management Codes

4.19 In February 2017 CIPFA canvassed views on the relevance, adoption and practical application of the Treasury Management and Prudential Codes and after reviewing responses launched a further consultation on changes to the codes in August with a deadline for responses of 30th September 2017.

4.20 The proposed changes to the Prudential Code include the production of a new high-level Capital Strategy report to full council which will cover the basics of the capital programme and treasury management. The prudential indicators for capital expenditure and the authorised borrowing limit would be included in this report but other indicators may be delegated to another committee. There are plans to drop certain prudential indicators, however local indicators are recommended for ring fenced funds (including the HRA) and for group accounts. Other proposed changes include applying the principles of the Code to subsidiaries.

4.21 Proposed changes to the Treasury Management Code include the potential for non-treasury investments such as commercial investments in properties in the definition of "investments" as well as loans made or shares brought for service purposes. Another proposed 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 approval of full Council. There are also plans to drop or alter some of the current treasury management indicators.

4.22 CIPFA intends to publish the two revised Codes towards the end of 2017 for implementation in 2018/19, although CIPFA plans to put transitional arrangements in place for reports that are required to be approved before the start of the 2018/19 financial year. In addition it is likely that Department of Communities and Local Government (DCLG) will be revising its Investment Guidance (and its MRP guidance) for local authorities in England; however there have been no announcements on this as yet.

Budgeted Income and Outturn

4.23 The average cash balances were £8m during the half year. The Authority's best performing investment was its £2m of externally managed pooled (property fund) which generated an average return of 3.52%.

4.24 The majority of the Authority's investments were kept in short-term money market rates and have remained at relatively low levels.

4.25 Although the Authority's investment income for the first six months has only been £45k which is below the targeted budget of £150k, this reduction in income has been offset by savings in the interest paid on borrowing short term from other Public Bodies rather than from the Public Works Loan Board.

Compliance with Prudential Indicators

4.26 The Authority confirms compliance with its Prudential Indicators for 2017/18, which were set in February 2017 and revised in June 2017 as part of the Authority's Treasury Management Strategy Statement as at the 30th September 2017. Details of treasury-related Prudential Indicators can be found in Appendix 1.

Economic Review and Outlook for the remainder of the year

4.27 The Council's advisors Arlingclose have provided an Economic Review of the year so far and an outlook for Qtrs 3 and 4. This is included in Annex D

5. Options

5.1 The Executive is asked to note on comment on the report as appropriate.

6. Proposals

6.1 It is proposed that the Executive NOTE and COMMENT on the report;

7. Corporate Objectives and Key Priorities

7.1 The Treasury Management processes support the Council's objective of 'Delivering services efficiently, effectively and economically'.

8. Policy Framework

8.1 The Council fully complies with the requirements of the CIPFA Code of Practice on Treasury Management. The current relevant criteria and constraints incorporated into the Treasury Management Policy Statement are:

- New borrowing is to be contained within the limits approved by the Council, in accordance with the CIPFA Prudential Code for Capital Finance in Local Authorities, and the Council's prudential indicators.

- Investments to be made in accordance with the CLG guidance on Local Authority Investments, on the basis of Fitch, Moody's and Standard & Poors credit ratings and as detailed in the Treasury Management Policy statement and approved schedules and practices.

- Sufficient funds to be available to meet the Council's estimated outgoings for any day.

- Investment objectives are to maximise the return to the Council balanced against the risks to protect reserves.

9. Legal Issues

9.1 The report demonstrates that the Council is complying with the Prudential Framework.

10. Risk Management

10.1 Weak returns on investments could lead to a reduction in income generated to support the revenue budget.

10.2 The limits in this report in respect to counterparties and investments are the overall limits for agreement by Council. However from time to time these may be tightened temporarily by the Executive Head of Finance in consultation with the portfolio holder for Finance to reflect increased uncertainty and increase in perceived risk in financial institutions and the economy. This will usually be at the cost of lower returns.

10.3 The Council has taken and acted on advice from its advisors in relation to increasing returns albeit at increased risk and its borrowing strategy. There are risks that interest rates can change and that any investment is not guaranteed

10.4 The investments ratings provided by credit ratings agencies are only a guide and do not give 100% security. There is always a risk that an institution may

be unable to repay its loans whatever the credit rating. However this can be mitigated by spreading investments amongst a number of institutions.

11. Officer Comments

11.1 None other than within the report.

Annexes	**Annex A – Investments as at 30th September 2017** **Annex B – Treasury Management Performance Indicators** **Annex C - Prudential Indicators as at 30th September 2017**
Background papers	**CIPFA code on Treasury Management**
Author/contact details	**Nahidah Cuthbert – Accountant** **Nahidah.cuthbert@surreyheath.gov.uk**
Head of Service	**Kelvin Menon - Executive Head of Finance**

Annex A

INVESTMENTS as at 30th September 2017

	£	Maturity Date
Glasgow City Council	2,000,000	30-Oct-18
Total Local Authorities	**2,000,000**	
AAA Rated MM Fund - Blackrock	2,200,434	N/A
AAA Rated MM Fund - CCLA	1,000,000	N/A
AAA Rated MM Fund - Standard Life (Ignis)	3,000,000	N/A
Total Money Market Funds	**6,200,434**	
CCLA Property Fund	2,131,384	N/A
Total Longer Term Investments	**2,131,384**	
NatWest SIBA	677,194	Instant Access
Total Invested (including NatWest SIBA)	**11,009,012**	

The Council's advisors Arlingclose have provided an Economic Review of the year so far and an outlook for Qtrs 3 and 4. This is included in Annex D

Annex B

Treasury Management Indicators as at the 30th September 2017

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as an amount of net principal borrowed will be:

	2017/18	**2018/19**	**2019/20**
Upper limit on fixed interest rate exposure	£190m	£190m	£190m
Actual	£0.5m		
Upper limit on variable interest rate exposure	£190m	£190m	£190m
Actual	£0.1m		

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	**Lower**	**Actual**
Not over 1 year	100%	0%	86%
Over 1 but not over 2 years	100%	0%	0%
Over 2 but not over 5 years	100%	0%	2%
Over 5 but not over 10 years	100%	0%	1%
Over 10 but not over 15 years	100%	0%	1%
Over 15 but not over 20 years	100%	0%	1%
Over 20 but not over 30 years	100%	0%	1%
Over 25 but not over 30	100%	0%	1%
Over 30 but not over 40 years	100%	0%	3%
Over 40 years	100%	0%	4%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

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 total principal sum invested to final maturities beyond the period end will be:

	2017/18	**2018/19**	**2019/20**
Limit on principal invested beyond year end	£15m	£15m	£15m
Actual	£2m		

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average [credit rating] or [credit score] 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.

	Target	**Actual 30/09/2017**
Portfolio average credit rating	A	AA

Liquidity: The Authority 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 three month period, without additional borrowing.

	Target	**Actual 30/09/2017**
Total cash available within 3 months	£5m	£6m

<u>Outlook for the remainder of 2017/18</u>

The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. Both consumer and business confidence remain subdued. Household consumption growth, the driver of UK GDP growth, has softened following a contraction in real wages. Savings rates are at an all-time low and real earnings growth (i.e. after inflation) struggles in the face of higher inflation.

The Bank of England's Monetary Policy Committee has changed its rhetoric, implying a rise in Bank Rate in "the coming months". Arlingclose is not convinced the UK's economic outlook justifies such a move at this stage, but the Bank's

interpretation of the data seems to have shifted.

This decision is still very data dependant and Arlingclose is, for now, maintaining its central case for Bank Rate at 0.25% whilst introducing near-term upside risks to the forecast as shown below. Arlingclose's central case is for gilt yields to remain broadly stable in the across the medium term, but there may be near term volatility due to shifts in interest rate expectations.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Official Bank Rate													
Upside risk	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Downside risk	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25

Appendix 1

Prudential Indicators as at the 30th September 2017

The Local Government Act 2003 requires the Authority to have regard to CIPFA's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure: The Authority's planned capital expenditure and financing may be summarised as follows. Further detail is provided in the capital programme outturn.

Capital Expenditure and Financing	**2015/16 Actual £m**	**2016/17 Estimate £m**	**2017/18 Estimate £m**	**2018/19 Estimate £m**
Capital Programme	18	**107**	4	7.5
Total Expenditure	**18**	**107**	**4**	**7.5**
Capital Receipts	1	0	0	0
Government Grants	0	1	0	3.1
Borrowing	17	106	4	4.4
Total Financing	**18**	**107**	**4**	**7.5**

Estimates of Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose.

Capital Financing Requirement	**31.03.17 Actual £m**	**31.03.18 Estimate £m**	**31.03.19 Estimate £m**	**31.03.20 Estimate £m**
Total CFR	**140**	**148**	**153**	**156**

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a

key indicator of prudence.

Debt	31.03.17 Actual £m	31.03.18 Estimate £m	31.03.19 Estimate £m	31.03.20 Estimate £m
Borrowing	119	179	153	156
Total Debt	**119**	**179**	**153**	**156**

The figures above could increase significantly if the council decides to invest in more property.

The actual debt levels are monitored against the Operational Boundary and Authorised Limit for External Debt, below.

Operational Boundary for External Debt: The Operational Boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.

Operational Boundary	2017/18 £m	2018/19 £m	2019/20 £m
Borrowing	185	185	185
Total Debt	**185**	**185**	**185**

The Authority confirms that during the first six months the Operational Boundary was not breached. In June 2017, the Council increased the Operational Boundary to £185m and the Authorised Limit to £190m.

Authorised Limit for External Debt: The Authorised Limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2017/18 £m	2018/19 £m	2019/20 £m
Borrowing	190	190	190
Total Debt	190	190	190

Total debt at 30/09/2017 was £111.4m. The Authority confirms that during 2017/18 the Authorised Limit was not breached at any time.

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	**2017/18 Estimate %**	**2018/19 Estimate %**	**2019/20 Estimate %**
General Fund	-45	-58	-63

Incremental Impact of Capital Investment Decisions: This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed earlier in this report.

Incremental Impact of Capital Investment Decisions	**2017/18 Estimate £**	**2018/19 Estimate £**	**2019/20 Estimate £**
General Fund - increase in annual Band D Council Tax	-28.24	12.50	3.50

Adoption of the CIPFA Treasury Management Code: The Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services at its meeting on 26th February 2014.*

Annex C

Economic Review provide by the Council's Treasury advisors Arlingclose

1) Commodity prices fluctuated over the period with oil falling below $45 a barrel before inching back up to $58 a barrel. UK Consumer Price Inflation (CPI) index rose with the data print for August showing CPI at 2.9%, its highest since June 2013 as the fall in the value of sterling following the June 2016 referendum result continued to feed through into higher import prices. The new inflation measure CPIH, which includes owner occupiers' housing costs, was at 2.7%.
2) The unemployment rate fell to 4.3%, its lowest since May 1975, but the squeeze on consumers intensified as average earnings grew at 2.5%, below the rate of inflation. Economic activity expanded at a much slower pace as evidenced by Q1 and Q2 GDP growth of 0.2% and 0.3% respectively. With the dominant services sector accounting for 79% of GDP, the strength of consumer spending remains vital to growth, but with household savings falling and real wage growth negative, there are concerns that these will be a constraint on economic activity in the second half of calendar 2017.
3) The Bank of England made no change to monetary policy at its meetings in the first half of the financial year. The vote to keep Bank Rate at 0.25% narrowed to 5-3 in June highlighting that some MPC members were more concerned about rising inflation than the risks to growth. Although at September's meeting the Committee voted 7-2 in favour of keeping Bank Rate unchanged, the MPC changed their rhetoric, implying a rise in Bank Rate in "the coming months". The Council's treasury advisor Arlingclose is not convinced the UK's economic outlook justifies such a move at this stage, but the Bank's interpretation of the data seems to have shifted.
4) In contrast, near-term global growth prospects improved. The US Federal Reserve increased its target range of official interest rates in June for the second time in 2017 by 25bps (basis points) to between 1% and 1.25% and, despite US inflation hitting a soft patch with core CPI at 1.7%, a further similar increase is expected in its December 2017 meeting. The Fed also announced confirmed that it would be starting a reversal of its vast Quantitative Easing programme and reduce the $4.2 trillion of bonds it acquired by initially cutting the amount it reinvests by $10bn a month.
5) Geopolitical tensions escalated in August as the US and North Korea exchanged escalating verbal threats over reports about enhancements in North Korea's missile programme. The provocation from both sides helped wipe off nearly $1 trillion from global equity markets but benefited safe-haven assets such as gold, the US dollar and the Japanese yen. Tensions remained high, with North Korea's threat to fire missiles towards the US naval base in Guam, its recent missile tests over Japan and a further testing of its latent nuclear capabilities.

6) Prime Minister Theresa May called an unscheduled General Election in June, to resolve uncertainty but the surprise result has led to a minority Conservative government in coalition with the Democratic Unionist Party. This clearly results in an enhanced level of political uncertainty. Although the potential for a so-called hard Brexit is diminished, lack of clarity over future trading partnerships, in particular future customs agreements with the rest of the EU block, is denting business sentiment and investment. The reaction from the markets on the UK election's outcome was fairly muted, business confidence now hinges on the progress (or not) on Brexit negotiations, the ultimate 'divorce bill' for the exit and whether new trade treaties and customs arrangements are successfully concluded to the UK's benefit.
7) In the face of a struggling economy and Brexit-related uncertainty, Arlingclose expects the Bank of England to take only a very measured approach to any monetary policy tightening; any increase will be gradual and limited as the interest rate backdrop will have to provide substantial support to the UK economy through the Brexit transition.
8) **Financial markets:**
   Gilt yields displayed significant volatility over the six-month period with the appearing change in sentiment in the Bank of England's outlook for interest rates, the push-pull from expectations of tapering of Quantitative Easing (QE) in the US and Europe and from geopolitical tensions, which also had an impact. The yield on the 5-year gilts fell to 0.35% in mid-June, but then rose to 0.80% by the end of September. The 10-year gilts similarly rose from their lows of 0.93% to 1.38% at the end of the quarter, and those on 20-year gilts from 1.62% to 1.94%.
9) The FTSE 100 nevertheless powered away reaching a record high of 7548 in May but dropped back to 7377 at the end of September. Money markets rates have remained low: 1-month, 3-month and 12-month LIBID rates have averaged 0.25%, 0.30% and 0.65% over the period from January to 21st September.