Appendix 11

Warwick District Council Financial Strategy 2020/21-2024/25

1 INTRODUCTION

"Money" is one of 3 keys strands of the Council's Fit for the Future Programme. The others are People and Services. This document supports the delivery of the Council's services and the projects within the Programme, as well as supporting all Council Strategies to deliver its aims and objectives.

It considers the major funding issues facing the Council in the Medium Term (the next 5 years). Extending the Strategy beyond this period would rely on broad estimates and many uncertainties. It would not be prudent to base the Strategy on a shorter period as risks and significant issues arising in the medium term could occur before the Council has developed the means of managing these. Forecast future levels of Funding are projected alongside other known constraints and opportunities.
The Council has a Code of Financial Practice and Code of Procurement Practice which underpin the Strategy.

Monthly Budget Review Reports are considered by the Senior Management Team, with Members of the Executive being updated on a quarterly basis. Alongside this, regular updated 5 year Financial Projections are included. Full Council receive the latest 5 Year Forecast alongside this Strategy within the Budget and Council Tax Reports presented in February of each year.

2. BACKGROUND

2.1 The Economic Background, as provided by Treasury Advisors, Link Asset Services – their Report is reproduced as Annex 1.

2.2 Recent years have seen many changes to the nature of Funding Local Authorities receive from Central Government. The new Business Rate Retention Scheme was introduced from 1st April 2013. Whilst setting the NNDR Baseline, Government then allowed Council to retain a share of any growth above this Baseline. There is a safety net whereby the Authority would receive a top up payment should actual Business Rates collected fall more than 7.5% below their Baseline.

Alongside this, the proportion of Business Rates to Revenue Support Grant has increased since this scheme was introduced. The 4 year settlement announced in December 2015 and January 2016 saw Revenue Support Grant become zero in 2019/20, having reduced significantly over the 3 year period. The Council's other main income source is its local Council Tax payers.

2.3 In December 2017, the government announced the intention to increase the level of business rates retained by local government from the current 50% to the equivalent of 75% from April 2020. During 2019/20 selected authorities piloted this scheme. This Council will closely monitor further developments as the scheme evolves. The proposals surrounding the 75% Business Rate Retention show that Revenue Support Grant will cease.

2.4 The Financial Strategy and projections have been updated in line with the 2020/21 Government Settlement Figures announced in December 2019. The Council's Financial Strategy is based upon the absence of Revenue Support Grant announced by the Government and its own Business Rates forecasts using the NNDR1 and NNDR3 returns and local intelligence, including support from "Analyse Local", independent Business Rates Consultants.

2.5 As referred to above, from 2013/14, the District Council retains 20% of any growth in business rates above the pre-determined Baseline. The Council's Baseline for 2019/20 is £3.392m. This is the amount the Council retains. If the actual amount collected varies to the Baseline, the Council will retain more or less income, working out at the Council retaining 20% of any increased revenues. Conversely, if there is any reduction in the new business rate receipts, the Council will bear 20% of this cost. There is a Safety Net whereby the Council will not be able to receive less than £3.137 million, this being within 7.5% of the Baseline retained income figure. However, this Authority has entered into Pooling arrangements. This means the Safety Net payment would be paid to the Pool rather than the actual authority falling into the Safety Net.

The Baseline has been inflated annually since the scheme commenced in 2013 until 2021, when there is due to be a "reset" of the system. The proposed changes to the Business Rate Scheme are discussed in more detail in Section 3.5 of the Budget Report.

The Council entered into a "pooling" arrangement with the other Warwickshire councils. Under this arrangement the amounts due to be paid to Central Government under the Levy should greatly reduce, meaning more income will be retained locally. Whilst there are risks attached to pooling, especially if income should substantially decline, however, based on the latest projections, the Council should benefit from remaining in the pool in 2020/21.

2.6 The Council also receives Government Support by way of New Homes Bonus (NHB) for 2020/21 this is £3.726 million. A proportion of this is allocated to the Waterloo Housing Association as part of the WC Housing Joint Venture. Initially, NHB was funded on a 6 year rolling time limited basis. After consultation the Government phased a reduction for this from 6 (2016/17) to 4 years from 2018/19. It is paid on a rolling basis. To date the Council has not had to use New Homes Bonus to support recurring expenditure on core service provision. This prudence has proved wise so far, whilst allowing the

Council to support new schemes and replenish Reserve balances.

2.7 The Council are permitted to increase their share of Council Tax by either 2% or £5 (per band D equivalent) without triggering a Referendum. However, it is proposed to hold a Referendum, and to increase this by an additional £1 per week (£52 per year per band D equivalent) to £223.86 per year. The additional monies generated will be used to fund items within the Climate Emergency Agenda (Appendix 12).

2.8 In March 2012 the Housing Revenue Account (HRA) borrowed £136.2m to make a one off 'buy out' payment when the Housing Subsidy system was replaced by 'Self Financing'. This debt is serviced from HRA rental income, in place of the payments previously made to the National Housing Rent Pool under the Housing Subsidy system. A 50 year Business Plan is maintained to demonstrate the viability of the HRA and the capacity to invest in the service and provide new homes.

2.9 A 'Prudential Framework' for borrowing was introduced from 2004/05. Local authorities no longer have to obtain Government approval before borrowing. Control is by prudential limits based on the authority's revenue resources. The Council can borrow if it can afford the revenue consequences.

2.10 The Council reviews its budgets on a monthly basis, amending these as changes are identified, rather than reporting upon variations and updating its current year's budgets once at part of the following year's budget setting process. The process will be constantly reviewed to identify further efficiencies so that data can be produced in the most timely and accurate manner.

2.11 The Council made great strides with publishing the 2018/19 Statement of Accounts, on time and signed by external audit, following the failure to publish its 2017/18 Accounts within statutory deadline. Processes were thoroughly reviewed and scrutinised with an Action plan drawn up, with regular updates provided to members. Internally formal procedures were created, and training was provided to all people involved within the final accounts process.

3. CORPORATE STRATEGY AND FIT FOR THE FUTURE PROGRAMME

3.1 The Council's Organisational Purpose being:

"**Warwick District: a great place to live, work and visit**".

3.2 During 2010, the Council adopted its Fit For the Future programme as its Corporate Strategy to provide an organisation framework to progress these objectives. As well as focusing on delivering quality services that its customers' need, the programme and subsequent updates have set challenging savings targets to be delivered. Achieving these will assist the Council in delivering its services in the future in light of uncertainty surrounding the economic climate, and future reductions in Central Government Support.

This programme needs to stay up to date and relevant in providing the strategic framework for the Council to meet the challenges it faces. Projects within the programme will be adjusted to reflect opportunities and challenges arising from Government initiatives and legislation as well as the Council's own Local Priorities.

These include-

The impact of Brexit on the economy and changes in legislation as Britain leaves the European Union is still uncertain.

In his Autumn Statement 2019, the Chancellor announced that the National Living Wage rise from £8.21 to £8.72 in April 2020.

3.3 As well as these initiatives, other major issues that will affect the Council's finances over this period are:

(i) Monitoring the medium term financial forecast will identify this Council's progress in meeting its various savings initiatives and the profile of the savings still to be identified.
(ii) The impact of pressures to improve environmental sustainability, and meet the climate change agenda.
(iii) Energy costs which are extremely volatile.
(iv) Major developments that may occur, such as, Kenilworth School Relocation, Europa Way and other potential strategic opportunities.
(vi) Major investment in multi storey car parks that will require structural renewal.
(vii) The Council completed condition surveys on its Corporate Assets. The Council continues to strive to ensure its Corporate Asset properties are maintained at a reasonable standard. So far it has been able to resource these costs. Ongoing Funding for future liabilities will need to be found.
(viii) The potential to work with partners and realising savings by pooling resources.
(ix) Capital receipts have reduced considerably and any for the future are extremely uncertain.
(x) The volatility of many of the Council's income budgets.
(xi) The rate of economic recovery and investment interest returns.
(xii) Trees throughout the district need replacing for which funding will need to be sought.
(xiii) Ongoing reviews on how the Council manages and delivers its services.
(xiv) Development of the Fit for the Future Programme and the Council's ability to adapt to change.

(xv) Efficient procurement to deliver quality services at minimum cost.
(xvi) Superannuation Fund and pensions changes further to the changes to the Local Government Pension Scheme introduced in April 2014.The pensions fund, in common with most others, continues to carry a projected deficit, although plans are in place to seek to ensure the fund is in surplus.
(xvii) In June 2016, the country voted to leave the European Union. The initial impact saw a reduction in interest rates and a drop in the pound against other currencies. As there is a still a lot of be agreed in terms of the arrangement for UK withdrawal from the EU, this situation will need to be kept under review, with the impact on the Council's finances routinely assessed. The Council will amend its medium term financial forecasts as necessary to reflect any impact and related issues e.g. changes in legislation such as VAT.
(xviii) Renewal of the Council's major contracts in 2021/22.

3.4 The Council will plan replacements and renewals of equipment (including ICT Resources), and repair and maintenance in a careful manner concentrating on the sustainability of services as a first priority. In addition, the Council needs to continually review its reserves in the light of a very ambitious programme of change, and constant uncertain external pressures on the planning regime.

3.5 The Council continues to promote agile working and the electronic storage of records. These link to the asset management plan strategy of reducing office space needs.

3.6 During 2017/18, the major refurbishment of 2 of the Council's Leisure Centres, Newbold Comyn and St Nicholas Park Leisure Centres was completed. The Council now moves to Phase 2 of its plan to develop all of its Leisure Centres and redevelop the 2 Kenilworth ones, consulting with Stakeholders prior to undertaking the development. Following the consultation, the Council has selected suitable options for each leisure centre and is progressing to RIBA stage 3 on each. From June 2017, the Council outsourced the management of its Leisure Centres. A private contractor will be able to operate in a more cost efficient way, benefitting from Mandatory Rate Relief and achieving economies of scale from operating many Leisure Centres across the country. From 2019, this Council will receive an annual concession from the Operator. There is potential to receive more income from a "Profit Share" arrangement. In the interests of prudence, none of this 'profit share' has been factored into the Financial Forecasts.

3.7 Several Major Projects are currently being worked on, with further reports due to members.

- Demolition of the old Covent Garden Car Park to enable the development of the new Multi Storey Car Park, housing and Council HQ, enhancing the parking offering to residents and visitors and delivering savings on the current HQ running costs.

- Working with partners to develop the land at Europa Way and deliver housing and a new stadium.
- Preparation for the Commonwealth Games Bowls in 2022 at Victoria Park which offers a significant opportunity to promote the Town and its attractions and support the local economy.
- Delivery of the St Marys Lands Masterplan to enhance and promote the landscape character creating a natural open green space and promote St. Mary's Lands as a visitor destination supporting the many organisations within it.
- Phase 2 of the Leisure Centres refurbishment project
- A number of significant housing projects, delivering both private and social housing.

4. FINANCIAL PRINCIPLES

4.1 The following are the principles (for both the General Fund and the Housing Revenue Account) that underpin the Financial Strategy:

(i) Savings and developments will be based upon corporate priorities as set out in the Council's Fit for the Future programme.

(ii) In order to achieve further savings the Council continues to explore all avenues including

- Shared services and joint working
- Outsourcing where other providers can deliver a minimum of the same standard of service more efficiently
- Efficient Procurement
- Benchmarking costs and income and understanding differences
- Increasing fees and paying customers where there is spare capacity and looking for opportunities to maximize income
- Accessing grants to assist with corporate priorities
- Controlling costs
- Workforce planning
- More efficient and greater use of technology

(iii) The Council has ambitions to effectively manage its resources. In setting both its Council Tax and Housing Rents, the Council takes account of its budget requirement, the support it receives from Central Government, inflation and the affordability of its local tax and rent payers.

(iv) The Council's base policy for Council house rent increases is currently to follow Central Government guidance. Any diversion from this policy will be requested in the annual Rent Setting report to Council, and reflected in the HRA Business Plan.

(v) Whilst the Council will aim for Fees and Charges to be increased so that income is at least maintained in real terms, it will be mindful of the reality of the current economic conditions and its competitors. The Council is committed to making good use of the ability to raise funds through charges and put them to good use for the community.

(vi) The Council still needs to develop its ability to benchmark all services across the Council.

(vii) This Council takes a positive approach to partnership working, realising the following benefits: -

a) Levering in additional external funding.
b) Ensuring improved use of sites, whether or not in the ownership of the Council.
c) Ensuring the future sustainability of projects.
d) Sharing/Reducing costs
e) Strengthening the resilience of the service
f) Enhancing quality of services

(viii) The Financial Strategy takes account of all revenue effects of the capital programme to ensure that the decisions taken are sustainable into the future.

(ix) The Council will hold reserves for specific purposes, as to be agreed by Executive.

(x) The Capital Investment Reserve shall be maintained with a minimum uncommitted balance of £1m and a General Fund Balance of £1.5m.

(xi) Any unplanned windfalls of income, whether service specific or more general, will be reported to the Executive who will prioritise how such income is used as part of setting future balanced budgets and meeting the Council's priorities.

5. PROCESS & MONITORING

Preparing budgets

5.1 The budget setting process is consistent with the service area planning process and the Fit for the Future Programme with recent years focusing on reductions in budgets and efficiencies.

5.2 When the Capital Programme is approved by Council the capital schemes will still be subject to individual approval on the basis of an evaluation and Business Case in accordance with the Council's Capital Strategy.

Monitoring and managing budgets

5.3 Under the monthly “Budget Review” Process, Budgets are amended as soon as changes are identified. The Financial Code of Practice is regularly updated to incorporate any changes in practice. The Financial Code of Practice was reviewed and updated in 2015 to reflect changes in this process and procurement practices.

5.4 Accountants work with Service Areas to identify budget variances and changes; these are reported to the Senior Management Team on a monthly basis. Regular reports are submitted for consideration by the Executive and Scrutiny Committees. The Council continues to review and refine its current processes, putting tighter controls in place to improve the quality and accuracy of the review process.

Consultation

5.5 The Council has a track record of consulting both partner organisations and the public this is an important contribution to assist identifying options and in learning lessons.

5.6 There is extensive consultation with partners on Fit For the Future, and the Sustainable Community Strategy.

5.7 The Council takes a strategic 5 year approach to determine how budgets are set and service prioritised.

5.8 The Council has a record of consulting where appropriate on the development of individual schemes.

6 ASSUMPTIONS

6.1 The following assumptions will be used in bringing forward proposals on the budget

(i) Forecasts for Business Rates income are based upon the Council’s local forecasts and out-turns. The Council uses a company called Analyse Local to forecast its provision for appeals.

(ii) Interest projections will continue to be based on the rates projected by Link Asset Services Treasury Solutions, the treasury management advisers.

(iii) It is assumed general inflation will increase by 2% per annum. Where the Council is contractually bound to increase costs and the Business Rates multiplier are increased by the relevant percentages.

7. HOUSING REVENUE ACCOUNT (HRA)

7.1 Housing Self Financing was implemented on 1st April 2012. A 50 year HRA Business Plan has been developed to ensure sufficient funds will be available to service the £136.2m debt taken out with the PWLB in order to 'buy' the Council out of the existing Housing Subsidy system, provide the necessary funding to maintain the stock and enable the building of new homes over the life of the Business Plan.

7.2 There is a requirement to follow Central Government National Housing Rent Policy when determining rents on HRA dwellings. With effect from April 2016, the rent charged by local authorities has had to be reduced by 1% per year for 4 years. When a new tenancy begins the Council can re-let at Target Social Rent, in time bringing all social housing rents in line with 2002 Convergence policy. From April 2020 social rents policy will change, allowing the rent charged to be increased by CPI + 1% each year. The council does have discretion over the setting of garage rents, Warwick Response charges and rents for HRA owned shops and commercial properties.

8. REVENUE FORECASTS

8.1 Revenue forecasts will be drawn up in line with this strategy, and the strategy itself will be reviewed every year when the budget is set. The current forecasts are set out in the February 2020 Budget Report, which reported savings required as follows:

	2021/22 £'000	2022/23 £'000	2023/24 £'000	2024/25 £'000
Deficit-Savings Required(+)/Surplus(-) future years	0	522	1,868	1,762
Change on previous year	0	522	1,346	-106

These are indicative based on current assumptions, and assumes that savings are achieved and maintained.

8.2 The forecasts are reviewed throughout the year, with the Executive being informed of the latest projections as part of the Budget Process.

9. ASSET RESOURCE BACKGROUND

9.1 Set out below is a summary of the Council's assets and its existing plans to use its resources to invest for the future.

9.2 The Council's assets as shown in the balance sheet as at 31st March 2019 are summarised below: -

	No	Value £'000
Operational Assets		
HRA		
Operational Land and Buildings	7,524	395,186
Surplus Assets/Work in Progress	-	0
Vehicles, Plant, Furniture and Equipment	-	501
General Fund		
Operational Land and Buildings	119	74,391
Surplus Assets/Work In Progress	3	745
Vehicles, Plant, Furniture and Equipment		2,234
Community Assets	-	7,638
Infrastructure	-	2,001
Heritage Assets	-	8,315
Total	**7,646**	**491,011**
Investment Properties	**88**	**10,966**

9.3 A summary of the proposed capital programme for the period to March 2024 is given below. This programme gives an indication of the level of the Council's available capital resources that are to be devoted to capital expenditure during this period.

	Latest Budget 19/20 £'000's	Proposed Expend. 20/21 £'000's	Proposed Expend. 21/22 £'000's	Proposed Expend. 22/23 £'000's	Proposed Expend. 23/24 £'000's	TOTAL 2019/20 to 2023/24 £'000's
Strategic Leadership & CWLEP	237.4	264.5	277.0	277.0	257.0	1,312.9
Health & Community Protection	1,119.5	1,623.7	23.7	15.7		2,782.6
Culture Portfolio	879.3	673.9	23.7	15.8		1,592.7
Finance Portfolio	150.0	750.0	150.0	150.0	150.0	1,350.0
Neighbourhood Portfolio	998.1	883.0	2,160.7	80.0	80.0	4,201.8
Development Portfolio	10,077.9	6,358.4	286.4	76.0		16,798.7
Housing Investment	40,250.0	14,837.6	5,797.5	5,803.4	5,809.3	72,497.8
Total Capital Programme	**53,712.2**	**25,391.1**	**8,719.0**	**6,417.9**	**6,296.3**	**100,536.5**

10. CAPITAL PRIORITIES

10.1 The main focus of the programme is:

- Realising local aspirations as expressed within the Corporate Strategy (which incorporates the Community Plan and the Council’s Resource Strategies) and it’s Fit for the Future Programme;

- Maintaining, and where possible enhancing, the condition of the Council’s existing assets so as to reduce future maintenance liabilities and to encourage their effective use. Where appropriate this will include working in partnership with others such as the Friends of the Pump Room Gardens, Jockey Club and Golf Centre on St Marys Lands. Supporting capital schemes that provide revenue savings to the Council, in particular supporting investment in Information and Communication Technology so as to modernise activities and release resources for other purposes.

- Achieving regeneration and economic vitality in main population centres.

10.2 Key particular projects that link to the corporate strategy are: -

- Enabling developments across the district that improve the environment such as Europa Way, and the improvement of Leamington Old Town.

- To continue to maintain the Government's "decent homes" standard.

- To increase the number of affordable houses in the district.

- Enhanced Leisure Facilities

11. FINANCING THE CAPITAL STRATEGY

11.1 The Capital Strategy needs to have regard to the financial resources available to fund it. The main sources of funding are detailed below: -

- Capital Receipts – primarily resulting from the sale of the Council's assets as other receipts have fallen in recent years. This income is lumpy and limited, although there are still schemes being considered that could realise further capital receipts.

  - The Council is required to sell homes to eligible tenants at a significant discount under the right-to buy (RTB). A proportion of such receipts are taken by the Treasury; with the balance retained by the Council, some having to be to provide for new dwellings and the remainder the Council having flexibility over its use.

  - Capital Contributions – including contributions from developers (often under Section 106 Planning Agreements and now from the Community Infrastructure Levy as well) and grants towards specific schemes.

  - Use of Council's own resources – either by revenue contributions to capital, or use of earmarked reserves.

  - Borrowing – the Council has freedom to borrow under the Prudential System provided it can demonstrate that it has the resource to service the debt.

  - Leasing – the Council now requires that, where appropriate, an options appraisal is undertaken in order to identify the most efficient source of financing capital purchases. In certain cases this may take the form of either a lease.

12. REVIEW

12.1 This strategy will be subject to annual review to ensure that changes are included and that development issues have been implemented. It has been reviewed in the light of the Fit for the Future programme.

13. RISKS

13.1 Previous years have demonstrated that the Council needs to consider the risk in setting and managing its budgets.

13.2 The key risks that could arise and ways in which they should be managed are set out in the main February Budget report and associated appendix.

13.3 The Council maintains a Significant Business Risk Register which is reviewed bi-annually by the Executive and quarterly by the Senior Management Team. Each Service Area has its own Service Risk Register. These are presented for the consideration of the Finance and Audit Scrutiny Committee on a quarterly rotating basis.

13.4 All major projects the Council undertakes have their own separate Risk Register.

13.5 There is a separate section on Risk in all Committee Reports to Members.

ANNEX 1

Link Asset Services Economic Background

UK

- **General election** December 2019 returned a large Conservative majority on a platform of getting Brexit done. UK left the EU on 31 January 2020.
- There is still considerable uncertainty about whether the UK and EU will be able to agree the details of a **trade deal** by the deadline set by the prime minister of December 2020. This leaves open the potential risks of a no deal or a hard Brexit.
- **GDP growth** has been weak in 2019 and is likely to be around only 1% in 2020.
- **November MPC meeting and Bank of England quarterly Monetary Policy Report** (formerly called the Inflation Report). MPC voted 7-2 to keep rates on hold. Increase in concerns among MPC members around weak UK growth caused by weak global economic growth and the potential for Brexit uncertainties to become entrenched and so delay UK economic recovery.
- **MPC meeting on 30 January 2020** again voted 7-2 to keep rates on hold. Their key view was that there was currently 'no evidence about the extent to which policy uncertainties among companies and households had declined' i.e. they were going to sit on their hands and see how the economy goes in the next few months.
- If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with **Bank Rate** still only at 0.75%. It would, therefore, probably suggest that it would be up to the Chancellor to provide help to support growth by way of a **fiscal boost** e.g. tax cuts, infrastructure spending etc.
- **CPI inflation** has been hovering around the Bank of England's target of 2% during 2019, but fell again in both October and November to a three-year low of 1.5%. It is likely to remain close to, or under 2% over the next two years and so it does not pose any immediate concern to the MPC. However, if there was a hard or no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.
- **Labour market.** Employment growth has been quite resilient through 2019 until the three months to September where it fell by 58,000. However, there was an encouraging pick up again in the three months to October to growth of 24,000, which showed that the labour market was not about to head into a major downturn. The unemployment rate held steady at a 44-year low of 3.8%. Wage inflation has been steadily falling from a high point of 3.9% in July to 3.5% in October (3-month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.0%. As the UK economy is very much services sector driven,

an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The other message from the fall in wage growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

USA

- **Growth** in 2019 has been falling after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2 and then 2.1% in quarter 3. The economy looks likely to have maintained a growth rate similar to quarter 3 into quarter 4; fears of a recession in 2020 have largely dissipated.
- The strong growth in **employment numbers** during 2018 has weakened during 2019, indicating that the economy had been cooling, while inflationary pressures were also weakening.
- **CPI inflation** rose from 1.8% to 2.1% in November, a one year high, but this was singularly caused by a rise in gasoline prices.
- **The Fed** finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not intended to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc.). It then cut rates by 0.25% again in September and by another 0.25% in its October meeting to 1.50 – 1.75%.
- At its September meeting it also said it was going to **start buying Treasuries again**, although this was not to be seen as a resumption of quantitative easing but rather an exercise to relieve liquidity pressures in the repo market. In the first month, it will buy $60bn, whereas it had been reducing its balance sheet by $50bn per month during 2019.
- The Fed left rates unchanged in **December.** However, the accompanying statement was more optimistic about the future course of the economy so this would indicate that further cuts are unlikely.
- **Trade war with China.** The trade war is depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China. However, progress has been made in December on agreeing a phase one deal between the US and China to roll back some of the tariffs; this gives some hope of resolving this dispute.

EUROZONE

- **Growth** has been slowing from +1.8 % in 2018 to around half of that at the end of 2019; there appears to be little upside potential in the near future.
- **The European Central Bank (ECB)** ended its programme of quantitative easing purchases of debt in December 2018, which then meant that the central

banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by quantitative easing purchases of debt.

- However, the downturn in EZ growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it announced a **third round of TLTROs**; this provides banks with cheap borrowing.
- However, since then, the downturn in EZ and world growth has gathered momentum; at its meeting on 12 September it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a **resumption of quantitative easing purchases of debt for an unlimited period.**
- At its October meeting it said these purchases would start in November at €20bn per month - a relatively small amount compared to the previous buying programme. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this very limited loosening of monetary policy will have much impact on growth and, unsurprisingly, the ECB stated that governments would need to help stimulate growth by 'growth friendly' fiscal policy.
- There were no policy changes in the December meeting, which was chaired for the first time by the new President of the ECB, Christine Lagarde. However, the outlook continued to be down beat about the economy; this makes it likely there will be further monetary policy stimulus to come in 2020. She also announced a thorough review during 2020 of how the ECB conducts monetary policy, including the price stability target.
- Several EU countries have **coalition governments.** More recently, Austria, Spain and Italy have been in the throes of trying to form coalition governments with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The latest results of German state elections has put further pressure on the frail German CDU/SDP coalition government and on the current leadership of the CDU.

CHINA

- Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and shadow banking systems. In addition, there still needs to be a greater switch from investment in industrial capacity, property construction and infrastructure to consumer goods production.

JAPAN

- It has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

WORLD GROWTH – reversal of globalisation

- Until recent years, world growth has been boosted by **increasing globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation.
- **Central banks are, therefore, likely to come under more pressure to support growth by looser monetary policy measures and this will militate against central banks increasing interest rates in 2020 and beyond**.
- The trade war between the US and China has been during 2019, and still is, a major concern to **financial markets** due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, (though such fears have largely dissipated towards the end of 2019).
- These concerns resulted in **Government bond yields falling in 2019** in the developed world. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been predicting a downturn in growth; this confirms investor sentiment that the outlook for growth during the year ahead is weak.