

## ECONOMIC AND INTEREST OUTLOOK

The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, for December 2018 is detailed below. The Council will reappraise its strategy from time to time and, if needs be, realign it with evolving market conditions and expectations for future interest rates.

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
<b>Official Bank Rate</b>													
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Ca	0.75	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Downside risk	0.00	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
<b>3-mth money market rate</b>													
Upside risk	0.10	0.10	0.10	0.10	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Arlingclose Central Ca	0.90	0.95	1.10	1.30	1.40	1.40	1.40	1.35	1.35	1.35	1.35	1.35	1.35
Downside risk	0.20	0.45	0.60	0.80	0.90	0.90	0.90	0.85	0.85	0.85	0.85	0.85	0.85
<b>1-yr money market rate</b>													
Upside risk	0.20	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35
Arlingclose Central Ca	1.15	1.25	1.35	1.50	1.70	1.60	1.50	1.40	1.35	1.35	1.35	1.35	1.35
Downside risk	0.35	0.50	0.60	0.80	0.90	0.90	0.90	0.85	0.85	0.85	0.85	0.85	0.85
<b>5-yr gilt yield</b>													
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Ca	1.15	1.25	1.35	1.50	1.50	1.40	1.35	1.35	1.30	1.30	1.30	1.30	1.30
Downside risk	0.50	0.60	0.65	0.80	0.80	0.70	0.65	0.65	0.65	0.65	0.65	0.65	0.65
<b>10-yr gilt yield</b>													
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Ca	1.50	1.65	1.70	1.80	1.80	1.75	1.75	1.70	1.70	1.70	1.70	1.70	1.70
Downside risk	0.55	0.70	0.70	0.80	0.80	0.75	0.75	0.70	0.70	0.70	0.70	0.70	0.70
<b>20-yr gilt yield</b>													
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Ca	2.00	2.10	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20
Downside risk	0.60	0.70	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
<b>50-yr gilt yield</b>													
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Ca	1.90	1.95	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Downside risk	0.60	0.70	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%

PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

### Underlying Assumptions:

- The MPC left Bank Rate unchanged at the September meeting, after voting unanimously to increase Bank Rate to 0.75% in August.
- Our central interest rate forecasts are predicated on there being a transitional period following the UK's official exit from the EU.
- Both the 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

- Cost pressures were projected to ease but have risen more recently and are forecast to remain above the Bank's 2% target through most of the forecast period. The rising price of oil and tight labour market means inflation may remain above target for longer than expected. This means that strong real income growth is unlikely in the near future.
- 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 both that: 1) ultra-low interest rates result in other economic problems, and 2) higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise and cuts are required.
- The global economy appears to be slowing, particularly the Eurozone and China, where the effects of the trade war has been keenly felt. Despite slower growth, the European Central Bank is adopting a more strident tone in conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. Meanwhile, European political issues, mostly lately with Italy, continue.
- The US economy is expanding more rapidly. The Federal Reserve has tightened monetary policy by raising interest rates to the current 2%-2.25% range; further rate hikes are likely, which will start to 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. Our central case is for Bank Rate is to rise twice in 2019. 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 transitional 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.