

## ECONOMIC AND INTEREST OUTLOOK

The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, for December 2013 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.

	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
<b>Official Bank Rate</b>													
Upside risk		0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	1.00
<b>Arlingclose Central Case</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>
Downside risk													
<b>3-month LIBID rate</b>													
Upside risk	0.20	0.25	0.30	0.35	0.40	0.50	0.55	0.60	0.65	0.70	0.75	0.90	0.95
<b>Arlingclose Central Case</b>	<b>0.45</b>	<b>0.45</b>	<b>0.50</b>	<b>0.55</b>	<b>0.65</b>	<b>0.75</b>	<b>0.75</b>	<b>0.75</b>	<b>0.75</b>	<b>0.75</b>	<b>0.80</b>	<b>0.80</b>	<b>0.80</b>
Downside risk			0.05	0.10	0.20	0.30	0.30	0.30	0.30	0.30	-0.35	-0.35	-0.35
<b>1-yr LIBID rate</b>													
Upside risk	0.35	0.30	0.35	0.40	0.45	0.50	0.60	0.70	0.75	0.75	0.75	0.80	0.80
<b>Arlingclose Central Case</b>	<b>0.90</b>	<b>0.95</b>	<b>0.95</b>	<b>0.95</b>	<b>1.00</b>	<b>1.05</b>	<b>1.10</b>	<b>1.15</b>	<b>1.20</b>	<b>1.25</b>	<b>1.30</b>	<b>1.40</b>	<b>1.40</b>
Downside risk	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
<b>5-yr gilt yield</b>													
Upside risk	0.50	0.75	0.75	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
<b>Arlingclose Central Case</b>	<b>1.45</b>	<b>1.50</b>	<b>1.55</b>	<b>1.60</b>	<b>1.65</b>	<b>1.70</b>	<b>1.75</b>	<b>1.85</b>	<b>1.95</b>	<b>2.10</b>	<b>2.30</b>	<b>2.50</b>	<b>2.50</b>
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.75	-0.80	-0.80	-0.80
<b>10-yr gilt yield</b>													
Upside risk	0.50	0.50	0.50	0.65	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00
<b>Arlingclose Central Case</b>	<b>2.55</b>	<b>2.60</b>	<b>2.65</b>	<b>2.70</b>	<b>2.75</b>	<b>2.80</b>	<b>2.85</b>	<b>2.90</b>	<b>3.00</b>	<b>3.10</b>	<b>3.30</b>	<b>3.50</b>	<b>3.50</b>
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.75	-0.80	-0.80	-0.80
<b>20-yr gilt yield</b>													
Upside risk	0.50	0.75	0.75	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
<b>Arlingclose Central Case</b>	<b>3.25</b>	<b>3.30</b>	<b>3.35</b>	<b>3.40</b>	<b>3.45</b>	<b>3.50</b>	<b>3.55</b>	<b>3.65</b>	<b>3.75</b>	<b>3.85</b>	<b>4.05</b>	<b>4.15</b>	<b>4.15</b>
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.70	-0.75	-0.80	-0.80
<b>50-yr gilt yield</b>													
Upside risk	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00
<b>Arlingclose Central Case</b>	<b>3.45</b>	<b>3.50</b>	<b>3.55</b>	<b>3.60</b>	<b>3.65</b>	<b>3.70</b>	<b>3.75</b>	<b>3.80</b>	<b>3.85</b>	<b>3.95</b>	<b>4.05</b>	<b>4.15</b>	<b>4.15</b>
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.70	-0.75	-0.80	-0.80

### Underlying Assumptions:

- Growth continues to strengthen with the second estimate for Q3 growth coming in at an unrevised 0.8%. The service sector remains the main driver of growth, boosted by a contribution from construction.
- The unemployment rate has fallen to 7.6%. The pace of decline in this measure will be dependent on a slower expansion of the workforce than the acceleration in the economy, alongside the extent of productivity.
- The CPI for November has fallen to 2.1%, a much more comfortable position for the MPC. Utility price increases are expected to keep CPI above the 2% target in 2014, before falling back again.
- The principal measure in the MPC's Forward Guidance on interest rates is the Labour Force Survey (LFS) unemployment rate. The MPC intends not to raise the

Bank Rate from its current level of 0.5% at least until this rate has fallen to a threshold of 7%.

- The reduction in uncertainty and easing of credit conditions have begun to unlock demand, much of which has fed through to the housing market. In response to concerns over a house price bubble, the Bank of England announced a curtailment of the Funding for Lending Scheme, which will henceforth concentrate on business lending only.
- The MPC will not hesitate to use macro prudential and regulatory tools to deal with emerging risks (such as curtailing the FLS). Absent risks to either price stability or financial stability, the MPC will only tighten policy when it is convinced about the sustained durability of economic growth.
- Federal Reserve monetary policy expectations - the slowing in the pace of asset purchases ('tapering') and the end of further asset purchases - will remain predominant drivers of the financial markets. Tapering of asset purchases will begin in Quarter 1 2014. The US political deadlock over the debt ceiling will need resolving in Quarter 1 2014.
- The European backstop mechanisms have lowered the risks of catastrophic meltdown. The slightly more stable economic environment at the aggregate Eurozone level could be undone by political risks and uncertainty in Italy, Spain and Portugal (doubts over longevity of their coalitions). The ECB has discussed a third LTRO, as credit conditions remain challenging for European banks.
- China data has seen an improvement, easing markets fears. Chinese leaders have signalled possible monetary policy tightening.
- On-going regulatory reform and a focus on bail-in debt restructuring of is likely to prolong banking sector deleveraging and maintain the corporate credit bottleneck.

### **Forecast:**

- The projected path for short term interest rates remains flat. Markets are still pricing in an earlier rise in rates than warranted under Forward Guidance and the broader economic backdrop. The MPC will not raise rates until there is a sustained period of strong growth. However, upside risks weight more heavily at the end of our forecast horizon.
- Gilt yields are projected to continue on an upward path through the medium term. The recent climb in yields was overdone given the soft fundamental global outlook and risks surrounding the Eurozone, China and US.