

## APPENDIX 3

### INTEREST RATE FORECASTS & ECONOMIC BACKGROUND

The data below shows a variety of forecasts published by a number of institutions. The first three are individual forecasts including those of UBS and Capital Economics (an independent forecasting consultancy). The final one represents summarised figures drawn from the population of all major City banks and academic institutions.

The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

#### 1. INDIVIDUAL FORECASTS

##### Sector View interest rate forecast – 15<sup>th</sup> January 2007

	Q/E1 2007	Q/E2 2007	Q/E3 2007	Q/E4 2007	Q/E1 2008	Q/E2 2008	Q/E3 2008	Q/E4 2008	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	Q/E1 2010	Q/E2 2010	Q/E3 2010
Bank rate	5.50%	5.50%	5.50%	5.25%	5.00%	4.75%	4.75%	4.75%	4.75%	4.75%	5.00%	5.00%	5.00%	5.00%	5.00%
5yr PWLB rate	5.25%	5.25%	5.00%	4.75%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
10yr PWLB rate	5.00%	5.00%	4.75%	4.75%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
25yr PWLB rate	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
50yr PWLB rate	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%

##### Capital Economics interest rate forecast – 15<sup>th</sup> January 2007

	Q/E1 2007	Q/E2 2007	Q/E3 2007	Q/E4 2007	Q/E1 2008	Q/E2 2008	Q/E3 2008	Q/E4 2008
Bank rate	5.25%	5.50%	5.50%	5.25%	4.75%	4.50%	4.50%	4.50%
5yr PWLB rate	5.35%	5.05%	4.85%	4.65%	4.45%	4.55%	4.65%	4.75%
10yr PWLB rate	4.95%	4.75%	4.45%	4.45%	4.55%	4.65%	4.75%	4.85%
25yr PWLB rate	4.45%	4.35%	4.25%	4.25%	4.25%	4.35%	4.45%	4.55%
30yr PWLB rate	4.25%	4.15%	3.95%	4.05%	4.05%	4.15%	4.25%	4.35%
50yr PWLB rate	4.05%	3.95%	3.95%	4.05%	4.05%	4.15%	4.15%	4.25%

**UBS interest rate forecast (for quarter ends) – 15<sup>th</sup> January 2007**

	Q/E1 2007	Q/E2 2007	Q/E3 2007	Q/E4 2007	Q/E1 2008	Q/E2 2008	Q/E3 2008	Q/E4 2008
<b>Bank rate</b>	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%
<b>10yr PWLB rate</b>	4.85%	4.80%	4.80%	4.80%	4.80%	4.80%	4.80%	4.90%
<b>25yr PWLB rate</b>	4.25%	4.25%	4.25%	4.30%	4.35%	4.40%	4.45%	4.55%
<b>50yr PWLB rate</b>	4.15%	4.15%	4.25%	4.35%	4.40%	4.45%	4.55%	4.65%

**2. SURVEY OF ECONOMIC FORECASTS**

**HM Treasury** – January 2007 (pre **Bank Rate increase 15.1.07**) summary of forecasts of 26 City and 14 academic analysts for Q4 2006 and 2007. (2008 – 2010 are as at November 2006 but are based on 18 forecasts)

	bank rate actual	Quarter ended		annual average bank rate		
		Q4 2006	Q4 2007	ave. 2008	ave. 2009	ave. 2010
<b>Indep. forecasters BoE Bank Rate</b>	5.00%	4.96%	4.89%	4.86%	4.88%	4.85%
<b>Highest bank rate</b>	5.00%	5.00%	6.00%	5.90%	5.60%	6.10%
<b>Lowest bank rate</b>	5.00%	4.50%	4.00%	3.75%	4.00%	4.00%

**ECONOMIC BACKGROUND – Sector - January 2007**

**International**

- The US, UK and EU economies have all been on the upswing of the economic cycle in 2005 and 2006 and so have been raising interest rates in order to cool their economies and to counter inflationary pressures stimulated by high oil, gas and electricity prices which could feed through into increases in wage inflation, producer prices etc.
- The US is ahead of the UK and EU in the business cycle and it looks as if the Fed. rate has probably already peaked at 5.25% whereas there is still an expectation in the financial markets of further increases in the EU and UK.
- The major feature of the US economy is a still steepening downturn in the housing market which is likely to drag consumer spending, and so the wider economy, down with it (e.g. house building, employment etc.). Falling house prices will also undermine household wealth and so lead to an increase in savings (which fell while house prices were rising healthily) and so conversely will lead to a fall in consumer expenditure.

- The Fed. may be reluctant and tardy to respond to the aforementioned downturn in the economy if inflationary pressures remain stubbornly high. This could exacerbate the downturn both in the US and the world economies.
- EU growth picked up strongly in the first half of 2006 and remained healthy in the second half. Growth to slow moderately in 2007 due to weaker US and global demand.
- Despite sharply increased energy prices, disinflationary pressures from falls in prices of manufactured goods from China and India have helped to keep headline inflation in the advanced economies to an average of around 3% and will fall as the energy effects go into reverse.

## UK

- GDP: the UK is on the upswing of the economic cycle from a low point reached in June 2005. Robust growth is expected to continue for a little longer but a modest cooling is expected in 2007 (2006 2.7%, 2007 2.2%) and to continue at below the trend rate of 2.5% thereafter.
- Recovery in consumer spending and retail sales has underpinned this upswing in GDP.
- The housing market has proved more robust than expected; house price inflation over 8% p.a.
- Higher than expected immigration from Eastern Europe has strengthened growth and dampened wage inflation.
- The MPC's decision to raise Bank Rate in November 2006 and January 2007 were needed to bring CPI inflation down to the 2% target level two years ahead. The MPC has been concerned that short term price increases (CPI has been significantly above target since June 2006) could feed through into wage settlements in the current pay round and anchor inflation expectations at a higher level.
- Household income growth to recover in 2007 as inflation falls and pay rises. But extra income likely to go into a recovery of the savings rate, pension saving and servicing debt costs (as rates rise) rather than consumer expenditure.
- Public sector real increase in expenditure per annum to weaken to 2.5% over the next few years from 3% average over 2000-2005.
- The three increases in Bank Rate in August and November 2006 and then January 2007, are expected to dampen the housing market and increases in unsecured borrowing although one more increase in Bank Rate is forecast.
- World slowdown in growth in 2007 will dampen UK exports.
- OUTLOOK: Once inflation is back under control, Bank Rate will switch to a falling trend in late 2007 to counter above negative effects on the economy and growth.