

Appendix 4 –

Arlingclose Economic & Interest Rate Forecast

Underlying assumptions:

- In a 7-2 vote, the MPC increased Bank Rate in line with market expectations to 0.5%. Dovish accompanying rhetoric prompted investors to lower the expected future path for interest rates. The minutes re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.
- Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have downwardly assessed the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.
- The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2.
- Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.
- Some data has held up better than expected, with unemployment continuing to decline and house prices remaining relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis. Weaker long term growth may prompt deterioration in the UK's fiscal position.
- The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger Eurozone economic expansion.
- Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.
- Geo-political risks remains elevated and helps to anchor safe-haven flows into the UK government bond (gilt) market.

Forecast:

- The MPC has increased Bank Rate, largely to meet expectations they themselves created. Future expectations for higher short term interest rates are

subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.

- Our central case for Bank Rate is 0.5% over the medium term. The risks to the forecast are broadly balanced on both sides.
- The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

| | 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 | Average |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| Official Bank Rate | | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.00 | 0.00 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.19 |
| Arlingclose Central Case | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| 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 | -0.15 |
| 3-month LIBID rate | | | | | | | | | | | | | | |
| Upside risk | 0.10 | 0.10 | 0.10 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.22 |
| Arlingclose Central Case | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Downside risk | -0.10 | -0.10 | -0.15 | -0.15 | -0.15 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.20 |
| 1-yr LIBID rate | | | | | | | | | | | | | | |
| Upside risk | 0.15 | 0.15 | 0.20 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.27 |
| Arlingclose Central Case | 0.70 | 0.70 | 0.70 | 0.70 | 0.80 | 0.80 | 0.80 | 0.80 | 0.80 | 0.80 | 0.80 | 0.80 | 0.80 | 0.77 |
| Downside risk | -0.15 | -0.20 | -0.30 | -0.30 | -0.30 | -0.30 | -0.30 | -0.30 | -0.30 | -0.30 | -0.30 | -0.15 | -0.15 | -0.26 |
| 5-yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.20 | 0.25 | 0.25 | 0.25 | 0.30 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.40 | 0.32 |
| Arlingclose Central Case | 0.75 | 0.75 | 0.80 | 0.80 | 0.80 | 0.85 | 0.90 | 0.90 | 0.95 | 0.95 | 1.00 | 1.05 | 1.10 | 0.89 |
| Downside risk | -0.20 | -0.20 | -0.25 | -0.25 | -0.25 | -0.35 | -0.40 | -0.40 | -0.40 | -0.40 | -0.40 | -0.40 | -0.40 | -0.33 |
| 10-yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.20 | 0.25 | 0.25 | 0.25 | 0.30 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.40 | 0.32 |
| Arlingclose Central Case | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 | 1.30 | 1.30 | 1.35 | 1.40 | 1.45 | 1.50 | 1.55 | 1.55 | 1.36 |
| Downside risk | -0.20 | -0.25 | -0.25 | -0.25 | -0.25 | -0.30 | -0.35 | -0.40 | -0.40 | -0.40 | -0.40 | -0.40 | -0.40 | -0.33 |
| 20-yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.20 | 0.25 | 0.25 | 0.25 | 0.30 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.40 | 0.32 |
| Arlingclose Central Case | 1.85 | 1.85 | 1.85 | 1.85 | 1.85 | 1.90 | 1.90 | 1.95 | 1.95 | 2.00 | 2.05 | 2.05 | 2.05 | 1.93 |
| Downside risk | -0.20 | -0.30 | -0.25 | -0.25 | -0.30 | -0.35 | -0.40 | -0.45 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.38 |
| 50-yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.20 | 0.25 | 0.25 | 0.25 | 0.30 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.40 | 0.32 |
| Arlingclose Central Case | 1.70 | 1.70 | 1.70 | 1.70 | 1.70 | 1.75 | 1.80 | 1.85 | 1.90 | 1.95 | 1.95 | 1.95 | 1.95 | 1.82 |
| Downside risk | -0.30 | -0.30 | -0.25 | -0.25 | -0.30 | -0.35 | -0.40 | -0.45 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.39 |