

## Prospects for interest rates

The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view.

| Link Asset Services Interest Rate View |        |        |        |        |        |        |        |        |        |        |        |        |        |        |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
|  | 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 | Mar-22 |
| Bank Rate View                         | 0.75%  | 0.75%  | 1.00%  | 1.00%  | 1.00%  | 1.00%  | 1.25%  | 1.25%  | 1.50%  | 1.50%  | 1.50%  | 1.75%  | 1.75%  | 2.00%  |
| 3 Month LIBID                          | 0.80%  | 0.80%  | 0.90%  | 1.10%  | 1.10%  | 1.20%  | 1.40%  | 1.50%  | 1.60%  | 1.60%  | 1.70%  | 1.80%  | 1.90%  | 2.00%  |
| 6 Month LIBID                          | 0.90%  | 0.90%  | 1.00%  | 1.20%  | 1.20%  | 1.30%  | 1.50%  | 1.60%  | 1.70%  | 1.70%  | 1.80%  | 1.90%  | 2.00%  | 2.10%  |
| 12 Month LIBID                         | 1.00%  | 1.00%  | 1.10%  | 1.30%  | 1.30%  | 1.40%  | 1.60%  | 1.70%  | 1.80%  | 1.80%  | 1.90%  | 2.00%  | 2.10%  | 2.20%  |
| 5yr PWLB Rate                          | 2.00%  | 2.10%  | 2.20%  | 2.20%  | 2.30%  | 2.30%  | 2.40%  | 2.50%  | 2.50%  | 2.60%  | 2.60%  | 2.70%  | 2.70%  | 2.80%  |
| 10yr PWLB Rate                         | 2.50%  | 2.50%  | 2.60%  | 2.70%  | 2.70%  | 2.80%  | 2.90%  | 2.90%  | 3.00%  | 3.10%  | 3.10%  | 3.20%  | 3.20%  | 3.20%  |
| 25yr PWLB Rate                         | 2.90%  | 3.00%  | 3.00%  | 3.10%  | 3.20%  | 3.20%  | 3.30%  | 3.40%  | 3.50%  | 3.50%  | 3.60%  | 3.60%  | 3.60%  | 3.70%  |
| 50yr PWLB Rate                         | 2.70%  | 2.80%  | 2.80%  | 2.90%  | 3.00%  | 3.00%  | 3.10%  | 3.20%  | 3.30%  | 3.30%  | 3.40%  | 3.40%  | 3.40%  | 3.50%  |

Link Asset Services economic view is summarised below:

The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth has been healthy since that meeting, but is expected to weaken somewhat during the last quarter of 2018. At their November meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. The next increase in Bank Rate is therefore forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors

searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.00 – 2.25% in September 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We have, therefore, seen US 10 year bond Treasury yields rise above 3.2% during October 2018 and also seen investors causing a sharp fall in equity prices as they sold out of holding riskier assets.

Rising bond yields in the US have also caused some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure has been dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.