



Arlingclose Ltd:
Independent treasury management services

Economic and Interest Rate Forecast

June 2018

Economic and Interest Rate Forecast June/July 2018

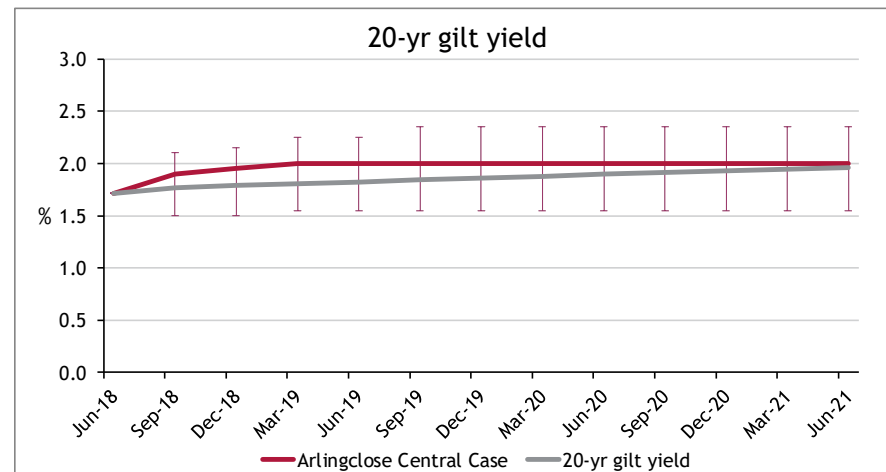
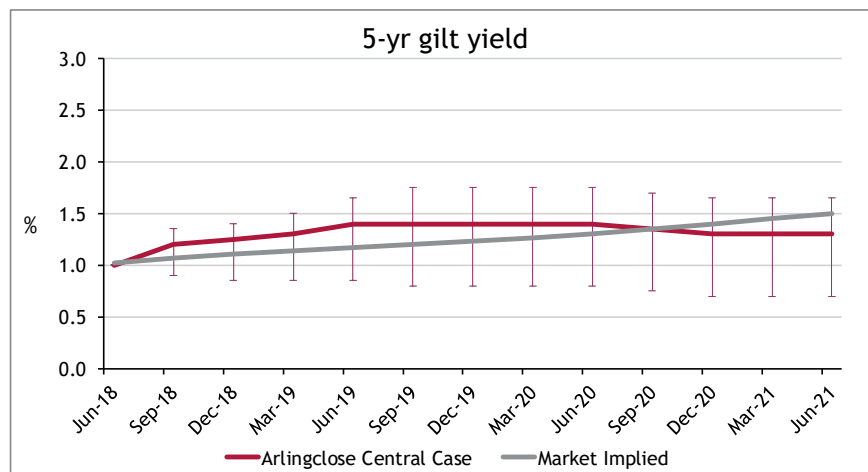
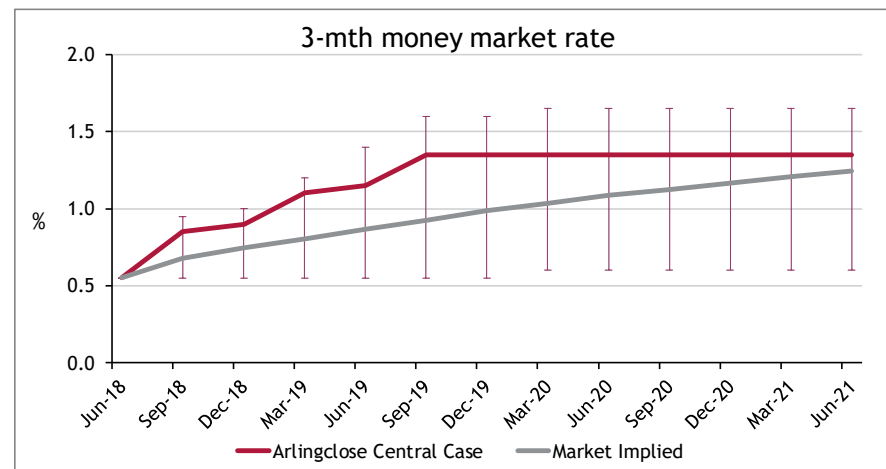
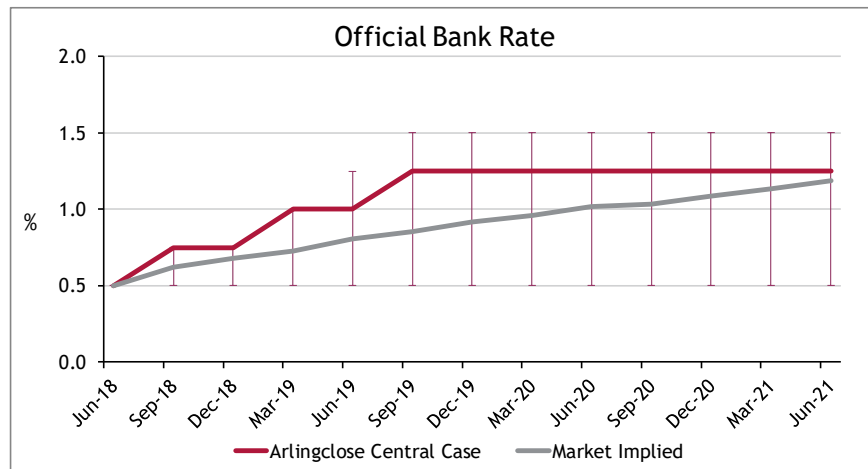
- The MPC minutes supported our view that MPC will seek to raise Bank Rate in the short term. While the majority of the Committee voted to maintain Bank Rate at 0.5% as expected, the unexpected vote for a rate hike by the Bank's chief economist Andy Haldane increased the probability of a near term rate rise.
- Our projected outlook for the UK economy, however, means that we believe monetary tightening in the current environment to be a potential policy error and so maintain the significant downside risks to our interest rate forecast.
- The MPC has a definite bias towards tighter monetary policy. While policymakers are wary of domestic inflationary pressures over the next two years, we believe that MPC members consider both that: 1) ultra-low interest rates result in other economic problems, and that 2) higher Bank Rate will be a more effective weapon should downside Brexit risks crystallise.
- The current soft UK economic environment prompted the MPC not to tighten policy in May. The economic data since then has been mixed, but suggests that GDP growth will recover somewhat in Q2 2018 after the weak expansion in Q1. The MPC appears to be focused on data sets that support monetary tightening, at the expense of others that show a less healthy economic environment.
- As noted previously, the Bank has moved the goalposts around both the forecast horizon and supply capacity of the UK economy in order to justify monetary tightening even in a below-trend economic environment.
- Our view is that the UK economy still faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. Central bank actions and geopolitical risks, such as prospective trade wars, have and will continue to produce significant volatility in financial markets, including bond markets.

	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
Official Bank Rate													
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 Case	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Downside risk	0.00	-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75
3-mth money market rate													
Upside risk	0.00	0.10	0.10	0.10	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.55	0.85	0.90	1.10	1.15	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35
Downside risk	0.00	-0.30	-0.35	-0.55	-0.60	-0.80	-0.80	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75
1-yr money market rate													
Upside risk	0.10	0.20	0.20	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35
Arlingclose Central Case	0.84	1.00	1.05	1.15	1.25	1.45	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Downside risk	-0.20	-0.35	-0.40	-0.50	-0.60	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75
5-yr gilt yield													
Upside risk	0.00	0.15	0.15	0.20	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35
Arlingclose Central Case	1.00	1.20	1.25	1.30	1.40	1.40	1.40	1.40	1.40	1.35	1.30	1.30	1.30
Downside risk	0.00	-0.30	-0.40	-0.45	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60
10-yr gilt yield													
Upside risk	0.00	0.20	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35
Arlingclose Central Case	1.27	1.55	1.65	1.70	1.75	1.75	1.75	1.75	1.75	1.70	1.70	1.70	1.70
Downside risk	0.00	-0.35	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
20-yr gilt yield													
Upside risk	0.00	0.20	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35
Arlingclose Central Case	1.72	1.90	1.95	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Downside risk	0.00	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45
50-yr gilt yield													
Upside risk	0.00	0.20	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35
Arlingclose Central Case	1.63	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.85	1.85
Downside risk	0.00	-0.35	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45

- The MPC has maintained expectations of a rise in interest rates this year.
- Our central case is for Bank Rate is to rise once in 2018 and twice more in 2019. The risks are weighted to the downside.
- Gilt yields have been volatile, but remain historically low. We expect some upward movement from current levels based on our interest rate projections and the strength of the US economy, but volatility arising from both economic and political events will continue to offer borrowing opportunities.

Arlingclose and Market Projections June/July 2018

Charts show the Arlingclose central case along with upside and downside risks:
Arlingclose judges that there is currently a higher risk of outcomes to the downside



Cost of Carry Analysis

If our interest rate forecasts are correct, it will be cheaper overall to borrow long-term now and suffer the cost of carry in the meantime if PWLB rates fall below those shown in the left-hand table

(Based on PWLB maturity loans borrowed at the certainty rate)

PWLB CR Breakeven Levels

29 Jun 18

		Total term	5	10	20	50
		PWLB rate	1.77	2.18	2.55	2.35
Forward period (mo)	Investment rates					
3	0.66	1.82	2.25	2.61	2.46	
6	0.79	1.87	2.32	2.68	2.57	
9	0.83	1.86	2.31	2.67	2.56	
12	0.87	1.85	2.29	2.66	2.54	
15	0.91	1.77	2.24	2.63	2.53	
18	0.94	1.71	2.19	2.61	2.52	
21	0.98	1.65	2.14	2.58	2.51	
24	1.01	1.60	2.10	2.55	2.49	
27	1.04	1.52	2.03	2.52	2.48	
30	1.07	1.45	1.97	2.50	2.47	
33	1.10	1.42	1.93	2.47	2.49	
36	1.12	1.39	1.89	2.44	2.50	

Forecast PWLB rates (adjusted for shorter term)

		Total term	5	10	20	50
Forward period (mo)						
3		1.89	2.30	2.65	2.48	
6		2.00	2.41	2.74	2.60	
9		2.05	2.44	2.76	2.60	
12		2.10	2.47	2.78	2.60	
15		2.08	2.46	2.78	2.60	
18		2.05	2.44	2.78	2.60	
21		2.03	2.42	2.78	2.60	
24		2.01	2.40	2.77	2.60	
27		1.94	2.36	2.77	2.60	
30		1.86	2.31	2.76	2.60	
33		1.84	2.29	2.75	2.63	
36		1.82	2.26	2.74	2.65	

Current rates within 10bp of breakeven
Current rates below breakeven

From Arlingclose's May 2018 forecast

Bank of England Inflation Report - May 2018

Overview

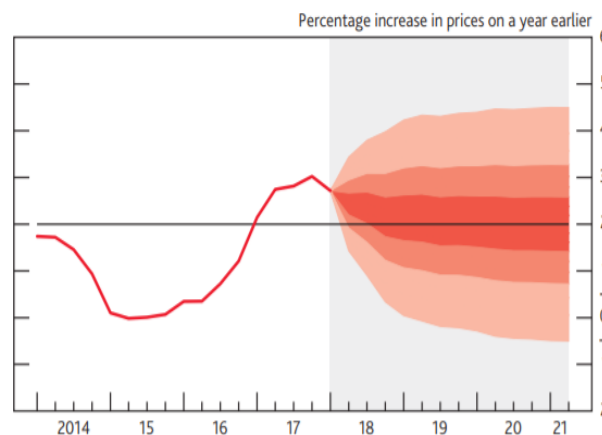
The initial estimate of GDP growth in Q1 was 0.1%, although other indicators suggested growth was stronger than this. The estimate was 0.3 percentage points lower than predicted in February and the Bank of England believes the adverse weather conditions prevalent in February and March resulted in the weaker than expected GDP growth. The MPC expect GDP to grow by around 1.75% per year on average over the forecast period.

CPI inflation fell to 2.5% in March, lower than had been expected at the time of the February report. The MPC envisages that the depreciation of the sterling on the price of imports is likely to diminish faster than initially expected. CPI inflation is anticipated to fall back to target a quicker than expected in February; reaching the target in two years.

Wage growth and domestic cost pressures are rising gradually as was expected. The rate at which productivity levels are expected to grow is projected to remain well below pre-crisis rates and the UK economy has very limited degree of slack. In the MPC's central projection, therefore, a small margin of excess demand will emerge by early 2020, feeding through into higher rates of pay growth and thus domestic cost pressures.

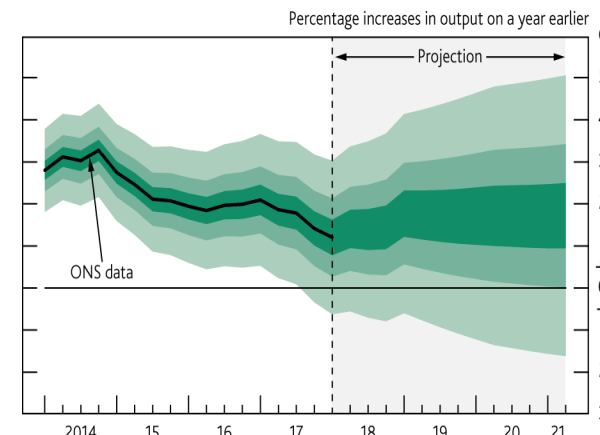
Projection for CPI Inflation

Based on market interest rate expectations and other policy actions as announced



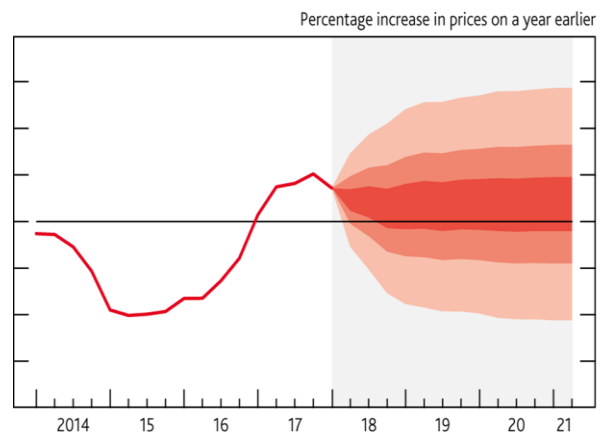
Projection for GDP Growth

Based on market interest rate expectations and other policy actions as announced



Projection for CPI Inflation

Based on constant 0.5% Bank Rate and other policy actions as announced



Projection for LFS Unemployment Rate

Based on market interest rate expectations and other policy actions as announced

