

Updated Interest Rate Forecast

31 March 2020

LINK ASSET SERVICES UPDATED INTEREST RATE FORECAST

Updating of our forecasts 30.03.20

Comparison of forecasts for Bank Rate today v. previous forecast								
	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
30.3.20	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
31.1.20	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00
change	-0.65	-0.65	-0.65	-0.65	-0.90	-0.90	-0.90	-0.90

The world has changed considerably since we undertook our last interest rate forecasts and newsflash on 31 January. We are now in a completely different environment where interest rate forecasting is much more problematic and tentative than it is in normal circumstances. The scale of both Government and Central Bank intervention that we have recently seen is historic in its magnitude. What you find in this newsflash, therefore, is a set of forecasts that reflect the latest known situation with regard to coronavirus, and its likely impact on economies around the world given the unprecedented lock-downs now being put in place by many governments.

The new set of forecasts will be subject to change if materially new information/policies come to light. Pragmatically, we are also only going to give forecasts for two years ahead in view of the exceptional levels of uncertainty at the current time.

For now, we are making an assumption that the coronavirus will be “defeated” in the UK over a 6 to 12 months period, either through lock-downs and/or the invention and distribution to the general population of a vaccine. However, no one can be 100% confident that the virus will not return before a vaccine is available and widely used, and so there may be a requirement for further lock-downs despite all our best efforts. In addition,

- We can expect to see on-going market volatility, and therefore the potential for on-going Government and Central Bank intervention as required, for perhaps up to a year but also possibly longer;
- The MPC will aim for very loose monetary policy, primarily through the use of quantitative easing, in order to maintain low yields/funding costs to help support businesses and to also maintain appropriate levels of liquidity;
- We will, therefore, most likely have a very flat yield curve for at least a year before investors are sufficiently confident to push for higher yields in order to hold existing and additional debt incurred in putting measures in place to fight coronavirus.
- Bank Rate will stay at 0.1% for the next two years and any yield steepening will only arise after it is apparent that the end of the coronavirus epidemic is in sight;
- The measures recently introduced by Government to underpin the job security of both PAYE workers and the self-employed will be extended past 12 weeks if necessary;
- Inflation will stay below 2% and wage increases will be tepid in the face of economic uncertainty and a steady rise in unemployment;
- The economy is likely to take a considerable time to recover lost momentum;

- Brexit will still go ahead but the original timeframe may be impacted;
- There will be a recession in world growth in 2020; growth is unlikely to recover quickly.

LINK ASSET SERVICES' FORECASTS

Gilt yields and PWLB rates

The general situation is for volatility in bond yields to endure as investor fears and confidence ebb and flow between favouring relatively more “risky” assets i.e. equities, or the “safe haven” of government bonds. The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently.

Our forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU, (apart from the departure of the UK), within our forecasting time period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China, North Korea and Iran, which have a major impact on international trade and world GDP growth.

Our revised forecasts are based on the Certainty Rate (minus 20 bps) which has been accessible to most authorities since 1st November 2012.

The table below is for PWLB Certainty Rates for non-HRA borrowing (currently gilts plus 180 basis points).

Link Asset Services Interest Rate View								
	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month LIBID	0.45	0.40	0.35	0.30	0.30	0.30	0.30	0.30
6 Month LIBID	0.60	0.55	0.50	0.45	0.40	0.40	0.40	0.40
12 Month LIBID	0.75	0.70	0.65	0.60	0.55	0.55	0.55	0.55
5yr PWLB Rate	1.90	1.90	1.90	2.00	2.00	2.00	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50

In addition, the following rates also apply:

- **PWLB Standard Rate** is gilts plus 200 basis points (G+200bps)
- **PWLB HRA Standard Rate** is gilts plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilts plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

Our target borrowing rates and the current PWLB Certainty Rates are set out below.

PWLB debt	Current borrowing rate as at 30.03.20	Target borrowing rate now (end of Q2 2020)	Target borrowing rate previous (end of Q2 2020)
5 year	1.91%	1.90%	2.30%
10 year	2.08%	2.10%	2.50%
25 year	2.56%	2.50%	3.00%
50 year	2.28%	2.30%	2.90%

Borrowing advice: As our long-term forecast for Bank Rate is now 2.00%, and all PWLB Certainty Rates (gilts plus 180bps), are close to or above 2.00%, there is reduced value in borrowing from the PWLB at present unless it is borrowing which would be eligible for the lower margins over gilts of 100, 80 or 60bps, or unless certainty against budgetary provision is required. (Please note the Government Consultation in respect of the future rates to be offered on General Fund PWLB borrowing closes on 4 June.).

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts. Negative, (or positive), developments could significantly impact safe haven flows of investor money into UK, US and German bonds and produce shorter term movements away from our central forecasts.

Our interest rate forecast for Bank Rate is normally in steps of 25 bps whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps.

Naturally, we continue to monitor events and will update our forecasts as and when appropriate.

Interest Rate Strategy Group

www.linkassetsservices.com

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