

TREASURY MANAGEMENT STRATEGY STATEMENT AND
ANNUAL INVESTMENT STRATEGY 2012/13

Interest Rate and Economic Outlook Forecasts

(Sector – 7.12.11)

	Mar 2012 (%)	Jun 2012 (%)	Sep 2012 (%)	Dec 2012 (%)	Mar 2013 (%)	Jun 2013 (%)	Sep 2013 (%)	Dec 2013 (%)	Mar 2014 (%)	Jun 2014 (%)	Sep 2014 (%)	Dec 2014 (%)	Mar 2015 (%)
Bank Rate	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.50	2.00	2.25	2.50
5yr PWLB*	2.30	2.30	2.30	2.40	2.50	2.60	2.70	2.80	2.90	3.10	3.30	3.50	3.70
10yr PWLB	3.30	3.30	3.40	3.40	3.50	3.60	3.70	3.80	4.00	4.20	4.40	4.60	4.80
25yr PWLB	4.20	4.20	4.30	4.30	4.40	4.50	4.60	4.70	4.80	4.90	5.00	5.10	5.20
50yr PWLB	4.30	4.30	4.40	4.40	4.50	4.60	4.70	4.80	4.90	5.00	5.10	5.20	5.30

*Public Works Loan Board

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Economic Background

Global economy – The outlook for the global economy remains uncertain with the UK economy struggling to generate sustained recovery that offers optimism for the outlook 2012, or possibly even into 2013. Consumer and business confidence levels are low and with little to boost sentiment. Significant increases in the growth rate in the short term are not expected.

At the centre of much of the uncertainty is the ongoing Eurozone sovereign debt crisis which has intensified throughout 2011. A major concern has been Greece. Even with an Eurozone, International Monetary Fund (IMF) and European Central bank (ECB) bailout package and the imposition of austerity measures aimed at deficit reduction, the lack of progress and the ongoing deficiency in addressing the underlying lack of competitiveness of the Greek economy, has seen an escalation of their problems. A default of some kind is expected but it currently remains unresolved if this will be either “orderly” or “disorderly”, and/or also include exit from the Euro bloc.

There is growing concern about the situation in Italy and the risk that contagion has not been contained. Italy is the third biggest debtor country in the world but its prospects are limited given the poor rate of economic growth over the last decade.

UK economy

The Government’s austerity measures, aimed at addressing the public sector deficit over the next four years, have yet to fully impact on the economy. The EU is the UK’s major trading partner so the wider Eurozone position is impacting on the ability to have an export-led recovery. The housing market, a gauge of consumer confidence, remains weak and the outlook is for house prices to be little changed for a prolonged period.

Economic Growth – Growth forecasts have been revised downwards with modest growth expected in 2012. There are concerns about a technical recession (two quarters of negative growth).

Unemployment – The low growth forecasts will limit the short term prospects for improvement in unemployment figures.

Inflation and Bank Rate - For the last two years, the Monetary Policy Committee (MPC) contention has been that high inflation was the outcome of temporary external factors and other one off events e.g. changes in VAT; that view remains in place with Consumer Price Index (CPI) inflation standing at 4.2%. They remain of the view that the rate will fall back to, or below, the 2% target level within the two year horizon.

AAA rating – The ratings agencies have recently reaffirmed the UK’s AAA sovereign rating and have expressed satisfaction with Governments policy at deficit reduction. They have, though, warned that this could be reviewed if the

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policy were to change, or was seen to be failing to achieve its desired outcome. This credit position has ensured that the UK government is able to fund itself at historically low levels and with the “safe haven” status from Eurozone debt also drawing in external investment the pressure on rates has been down, and looks set to remain so far some time.

Sector’s forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains weak and whilst there is still a broad range of views as to the potential performance, they have all been downgraded throughout 2011. Key areas of uncertainty include:

- A worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself;
- The impact of the Eurozone crisis on financial markets and the banking sector;
- The impact of the Government’s austerity plan on confidence and growth and the need to rebalance the economy from services to exporting manufactured goods;
- A continuation of high levels of inflation;
- The economic performance of the UK’s trading partners, in particular the European Union and United States, with some analysts suggesting the recession could return to both; and,
- Stimulus packages failing to stimulate growth as expected.

The overall balance of risks remains weighted to the downside. Lack of economic growth, both domestically and overseas, will impact on confidence putting upward pressure on unemployment. It will also further knock levels of demand which will bring the threat of recession back into focus.

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to high volumes of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

Given the weak outlook for economic growth, Sector forecast that the prospects for any interest rate changes before mid-2013 are very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth does not materialise.