LINK Group

Updated Interest Rate Forecast 29 May 2024

LINK GROUP UPDATED INTEREST RATE FORECAST

Updating of our forecasts 28 May 2024

Comparison of forecasts for Bank Rate today v. previous forecast

Bank Rate	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
28.05.24	5.25	5.00	4.50	4.00	3.50	3.25	3.25	3.25	3.25	3.00	3.00	3.00
05.02.24	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Change	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.00	0.00	0.00

- On 9 May, the Bank of England's Monetary Policy Committee (MPC) kept rates on hold for the sixth time in a row but is now firmly in the camp of preparing the market for near-term interest rate cuts. The vote in favour of keeping rates on hold was 7-2. There were seven members that voted for rates to stay on hold but, importantly, Bank of England insider, David Ramsden, joined Dr. Swati Dhingra in voting for a 25bps cut.

- Subsequently, the UK April inflation data disappointed to the upside, with annual CPI falling from 3.2% to 2.3%, but this was above the Bank of England and consensus view of 2.1%, with services and core inflation (excluding energy, food, alcohol and tobacco) remaining sticky at 5.9% and 3.9% respectively.

- However, despite these upside surprises, the CPI measure of inflation is likely to fall close to or below 2% when next reported on 19 June, and based on Capital Economics' latest forecasts is likely to fall close to 1% within the next year. Indeed, Capital Economics also forecast RPI to fall close to zero over the same timeline.

- Nonetheless, there remain several key factors that could act as a headwind to near-term rate cuts. The first of these is the stickiness of wage inflation. With average pay increasing at close to 6% y/y, the Bank of England will be keeping a close eye on upcoming wage and employment data. In particular, it will be looking for a loosening in the labour market arising from a reduction in the prevailing near 1 million job vacancies, an increase in unemployment (currently 4.3%), and government policies that do not significantly impact the current elevated level of migration (c700k per annum).

- Moreover, whatever the shape of domestic data, recent gilt market movements have been heavily influenced by the sentiment pertaining to US monetary policy. Again, inflation and labour data has proven sticky and the market's expectation for rate cuts has gradually reduced throughout the course of the year, so that possibly rates may not start to be cut until November at the earliest. In any event, even if the Bank of England starts to cut rates first, it may mean that the medium and longer parts of the curve take longer to fully reflect any such action until the US yield curve shifts lower too. Given the potential inflationary upside risk to US treasuries if Trump wins the presidential election in November (increased tariffs on imports from China for example), therein lies a further risk to yields remaining elevated for longer.

- Closer to home, the General Election is not expected to have a significant impact on UK monetary policy. Both leading parties are aware of the public finance backdrop, and there is minimal leeway for further tax cuts or added spending without negatively impacting market sentiment. It may even be the case that the Bank of England will steer clear of an August rate cut – should that be supported by the inflation data – in favour of weighing up fiscal policy implications and market sentiment in the aftermath of the election.

- Accordingly, our central case is still for a rate cut before the end of September, but we are not committed to whether it will be in August or September. Thereafter, the path and speed of rate cuts is similar to that which we previously forecast, with Bank Rate eventually falling to a low of 3% by H2 2026.

- However, given the increased uncertainty surrounding our central gilt market forecasts, and the significant issuance that will be on-going from several of the major central banks, we have marginally increased our PWLB forecasts by c20 to 30 basis points across the whole curve.

- In summary, regarding PWLB rates, movement in the short-end of the curve is expected to reflect our Bank Rate expectations to a large degree, whilst medium to longer-dated PWLB rates will remain influenced not only by the outlook for inflation, but by the market's appetite for significant gilt issuance

(£200bn+ for each of the next few years). As noted at the March Strategic Issues webinars, there is upside risk to that part of our forecast despite the Debt Management Office skewing its issuance to the shorter part of the curve.

Our current and previous PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1 November 2012. Please note, the lower Housing Revenue Account (HRA) PWLB rate started on 15 June 2023 for those authorities with an HRA (standard rate minus 60 bps).

Link Group Interest Rate View	28.05.24											
	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.00	4.50	4.00	3.50	3.25	3.25	3.25	3.25	3.00	3.00	3.00
3 month ave earnings	5.30	5.00	4.50	4.00	3.50	3.30	3.30	3.30	3.30	3.00	3.00	3.00
6 month ave earnings	5.30	4.90	4.40	3.90	3.50	3.30	3.30	3.30	3.30	3.10	3.10	3.20
12 month ave earnings	5.10	4.80	4.30	3.80	3.50	3.40	3.40	3.40	3.40	3.20	3.30	3.40
5 yr PWLB	4.90	4.70	4.50	4.30	4.10	4.00	3.90	3.90	3.90	3.90	3.90	3.80
10 yr PWLB	5.00	4.80	4.60	4.40	4.30	4.10	4.10	4.10	4.00	4.00	4.00	3.90
25 yr PWLB	5.30	5.20	5.00	4.80	4.70	4.50	4.50	4.40	4.40	4.40	4.30	4.30
50 yr PWLB	5.10	5.00	4.80	4.60	4.50	4.30	4.30	4.20	4.20	4.20	4.10	4.10

Gilt yields and PWLB rates

The overall longer-run trend is for gilt yields and PWLB rates to fall back over the timeline of our forecasts, as inflation continues to fall through 2024 and 2025. Our target borrowing rates are set **two years forward** (as we expect rates to fall back) and the current PWLB (certainty) borrowing rates are set out below: -

PWLB debt	Current borrowing rate as at 28.05.24 p.m.	Target borrowing rate now (end of Q1 2026)	Target borrowing rate previous (end of Q4 2025)
5 years	5.01%	3.90%	3.70%
10 years	5.03%	4.10%	3.90%
25 years	5.46%	4.40%	4.20%
50 years	5.24%	4.20%	4.00%

Borrowing advice: Our long-term (beyond 10 years) forecast for Bank Rate remains at 3%. As all PWLB certainty rates are currently significantly above this level, borrowing strategies will need to be reviewed in that context. Overall, better value can be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should also be considered. Temporary borrowing rates will, generally, fall in line with Bank Rate cuts.

Our suggested budgeted earnings rates for investments up to about three months' duration in each financial year are set out below.

Average earnings in each year	Now	Previously
2024/25	4.70%	4.55%
2025/26	3.35%	3.10%
2026/27	3.10%	3.00%
2027/28	3.25%	3.25%
2028/29	3.25%	3.25%
Years 6 to 10	3.25%	3.25%
Years 10+	3.50%	3.25%

We will continue to monitor economic and market developments as they unfold. Typically, we formally review our forecasts following the quarterly release of the Bank of England's Monetary Policy Report but will consider our position on an ad hoc basis as required.

Our interest rate forecast for Bank Rate is 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