

Annex 2

Arlingclose's Economic Outlook for the remainder of 2022/23 (based on 26th September 2022 interest rate forecast)

	Current	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	2.25	4.25	5.00	5.00	5.00	5.00	5.00	5.00	5.00	4.75	4.25	3.75	3.25
Downside risk	0.00	-1.00	-1.00	-0.75	-0.50	-0.50	-0.50	-0.75	-1.25	-1.50	-1.75	-1.75	-1.75

Arlingclose expects Bank Rate to rise further during 2022/23 to reach 5% by the end of the year.

The MPC is particularly concerned about the demand implications of fiscal loosening, the tight labour market, sterling weakness and the willingness of firms to raise prices and wages.

The MPC may therefore raise Bank Rate more quickly and to a higher level to dampen aggregate demand and reduce the risk of sustained higher inflation. Arlingclose now expects Bank Rate to peak at 5.0%, with 200bps of increases this calendar year.

This action by the MPC will slow the economy, necessitating cuts in Bank Rate later in 2024.

Gilt yields will face further upward pressure in the short term due to lower confidence in UK fiscal policy, higher inflation expectations and asset sales by the BoE. Given the recent sharp rises in gilt yields, the risks are now broadly balanced to either side. Over the longer term, gilt yields are forecast to fall slightly over the forecast period.

Background:

Monetary policymakers are behind the curve having only raising rates by 50bps in September. This was before the "Mini-Budget", poorly received by the markets, triggered a rout in gilts with a huge spike in yields and a further fall in sterling. In a shift from recent trends, the focus now is perceived to be on supporting sterling whilst also focusing on subduing high inflation.

There is now an increased possibility of a special Bank of England MPC meeting to raise rates to support the currency. Followed by a more forceful stance over concerns on the looser fiscal outlook. The MPC is therefore likely to raise Bank Rate higher than would otherwise have been necessary given already declining demand. A prolonged economic downturn could ensue.

Uncertainty on the path of interest rates has increased dramatically due to the possible risk from unknowns which could include for instance further tax changes including implementing windfall taxes.

The government's blank cheque approach to energy price caps, combined with international energy markets priced in dollars, presents a fiscal mismatch that has contributed to significant decline in sterling and sharp rises in gilt yields which will feed through to consumers' loans and mortgages and business funding costs.

UK government policy has mitigated some of the expected rise in energy inflation for households and businesses flattening the peak for CPI, whilst extending the duration of elevated CPI. Continued currency weakness could add inflationary pressure.

The UK economy already appears to be in recession, with business activity and household spending falling. The short- to medium-term outlook for the UK economy is relatively bleak.

Global bond yields have jumped as investors focus on higher and stickier US policy rates. The rise in UK government bond yields has been sharper, due to both an apparent decline in investor confidence and a rise in interest rate expectations, following the UK government's shift to borrow to loosen fiscal policy. Gilt yields will remain higher unless the government's plans are perceived to be fiscally responsible.

The housing market impact of increases in the Base Rate could act as a "circuit breaker" which stops rates rising much beyond 5.0%, but this remains an uncertainty.