

Market Overview – April to September 2010
(courtesy of Butlers)

Interest Rate Movements and Expectations

UK short-term interest rates fluctuated in a very narrow range in the first half of the financial year. The official interest rate (i.e. the Bank of England Base Rate) was held at its record low of ½% in spite of above target inflation and evidence of a recovery in activity in most industrialised economies. Quantitative easing (i.e. the re-purchase of government and other stock by the Bank) remained at unchanged at £200 billion. The tenuous nature of the economic upturn, confidence that price pressures will abate and the still fragile state of the financial sector supported the case for the maintenance of an accommodative monetary policy.

Long-term interest rates peaked in the early stages of the financial year. The rise was reversed in May. Confidence that the change of government will prompt a more aggressive approach to deficit reduction encouraged new investment in gilt-edged securities. More important, however, was the financial crisis in the euro-zone, triggered by the threat of a sovereign debt default by Greece. This, together with evidence of decelerating growth in the United States of America, ensured continued demand for high quality government debt. Gilt yields and Public Works Loan Board rates subsided towards their 2009 lows as a result.

Looking forward, short-term rates are expected to remain on hold for a considerable time. The recovery in the economy is likely to remain insipid. The danger of a double-dip recession is fading but the crisis in the euro-zone, the prospects of tight economic policies at home and tenuous consumer confidence means the threat has not evaporated completely.

Long-term interest rates will continue to benefit from these considerations and might be pressured lower in the event of a fresh programme of Quantitative Easing. Nevertheless, without this additional support, yields are probably close to their low point. Disappointment with the UK's inflation performance and the absence of QE would return yields to a gradually rising trend before the year is out.

Interest rate projections

	Base Rate	Short-term rates		Long-term rates		
		3 mths	1 year	5 yrs	20 yrs	50 yrs
2010/11	0.5	0.7	1.5	2.4	4.2	4.3
2011/12	1.1	1.3	2.2	3.1	4.8	4.9
2012/13	2.3	2.5	3.3	4.0	5.0	5.1

