Board	**POLICY AND ORGANISATION BOARD**
Date of meeting:	**30th NOVEMBER 2022**
Title:	**TREASURY MANAGEMENT ANNUAL REVIEW 2021/22, PROGRESS REPORT 2022/23, & PRUDENTIAL INDICATORS**
Author:	**BOROUGH TREASURER**
Status:	**FOR NOTING**

Purpose

The annual treasury report is a requirement of the Council's reporting procedures and covers the treasury activity for 2021/22 together with an in year review 2022/23. The report also includes the Prudential Indicators for 2021/22 in accordance with the requirements of the Prudential Code.

Recommendations

The Board notes

- The Treasury Management outturn report 2021/22 as identified in 2.2
- The Treasury Management position for 2022/23 at the end of September 2022 as identified in 2.3
- The Prudential Indicators outturn report 2021/22 as identified in 2.4

1 Background

1.1 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.2 The Council's treasury management strategy for 2021/22 was approved at a meeting of Council on 24th March 2021. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

1.3 The objectives of the Prudential Code are to ensure, within a clear framework, that the capital expenditure plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice and in full understanding of the risks involved and how these risks will be managed to levels that are acceptable to the Council.

1.4 This report also meets the requirement of the 2017 CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) by reporting the 2021/22 outturn indicators against those approved by Full Council on the 3rd February 2021 as part of the Medium Term Financial Strategy & Budget report 2022/23.

1.5 Actual figures have been taken from or prepared on a basis consistent with the Council's draft statement of accounts.

2.0 Report

2.1 EXTERNAL CONTEXT

2.1.1 A general background description to the Public Sector Treasury Management Environment in 2021/22 as provided by Arlingclose Ltd, the Council's Treasury Management advisers is set out in Appendix A.

The narrative covers the following broad areas

- Economic Commentary
- Financial Markets
- Credit review

2.2 TREASURY MANAGEMENT OUTTURN REPORT 2021/22

2.2.1 On 31st March 2022, the Council had net borrowing (borrowings less investments) of £44.2m arising from its revenue and capital income and expenditure, a decrease of £9.7m on the previous year. This reduction is only temporary as the cashflows of the Council have been impacted by the receipts of various forms of government financial support in response to Covid 19 and the energy crisis which will unwind in 2022/23.

Lower official interest rates have lowered the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing.

The Council pursued its strategy of keeping borrowing and investments below underlying levels as measured by the Capital Financing Requirement, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

Details behind the borrowing and investing activity are set out below.

2.2.2 **Borrowing Activity**

At 31st March 2022, the Council held £57.8m in loans a decrease of £7.1m on the previous year, as part of its strategy for funding previous and current years' capital programmes. The year end position is summarised below with 2020/21 figures for comparison. As mentioned in 2.2.1 above this reduction in borrowing is temporary and arises due to positive cashflows of the Council during 2021/22.

(Following Housing Finance reform, two separate pools are being operated for Council debt and these are also shown below).

2021/22	General Fund			HRA			Total		
	31-Mar £'000	Rate %	Avge Life (Yrs)	31-Mar £'000	Rate %	Avge Life (Yrs)	31-Mar £'000	Rate %	Avge Life (Yrs)
Fixed rate borrowing:									
PWLB	**5,938**	3.10%	23.83	**46,812**	3.25%	25.44	**52,750**	3.12%	25.26
Variable rate borrowing:									
Local Authority	**5,000**	0.56%	0.67	-	-	-	**5,000**	0.56%	0.67
Gross borrowing	**10,938**			**46,812**			**57,750**		

2020/21	General Fund			HRA			Total		
	31-Mar £'000	Rate %	Avge Life (Yrs)	31-Mar £'000	Rate %	Avge Life (Yrs)	31-Mar £'000	Rate %	Avge Life (Yrs)
Fixed rate borrowing:									
PWLB	**6,038**	3.07%	24.72	**49,812**	3.20%	24.90	**55,850**	3.19%	24.88
Variable rate borrowing:									
Local Authority	**9,000**	0.15%	0.39	-	-	-	**9,000**	0.15%	0.39
Gross borrowing	**15,038**			**49,812**			**64,850**		

(Fixed rate borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other borrowing are classed as variable rate)

The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required.

In keeping with the objectives no new long term borrowing was undertaken, while existing long term loans of £3.10m were allowed to mature without replacement.

With short term interest rates remaining much lower than long-term rates, the Council considered it more cost effective in the near term to use internal resources and short term borrowing instead.

Short Term borrowing ranged between £3m and £9m averaging £5.9m during 2021/22 compared to an average of £6m during 2020/21.

This strategy enabled the Council to reduce net borrowing costs (despite foregoing investment income) and reduce overall treasury risk.

Interest Payable on all borrowings was £1,784,030 compared to a revised budget of £1,795,300 (£1,929,773 in 2020/21).

2.2.3 Treasury Investment Activity

CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2021. These define treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held.

The Council's investment balances during 2021/22 are summarised in the table below and vary due to timing differences between income and expenditure. The Council has opted for professional client status under the Markets in Financial Instruments Directive II; one of the requirements to keep this status is to maintain investment balances of at least £10m.

All Investments were classified as variable rate investments i.e. interest rate was not fixed for a period greater than 1 year.

The average return on investments during the year was 0.08% compared with 0.17% the previous year.

Ultra low short-dated cash rates, which were a feature since March 2020 when Bank rate was cut to 0.1% prevailed for much of 2021/22.

Interest receivable on Treasury Management Investments was £14,400 compared to a revised budget of £4,600 (£18,800 in 2020/21).

Investment Position at	Money Market Funds £000's	Rate %	Banks & Building Societies (unsecured) £000's	Rate %	Central Government (DMADF)	Rate %	Local Authorities £000's	Rate %	Total Investments £000's	Average Rate %
31/03/2021	7,500	0.02%	1,500	0.01%	-	-	2,000	0.08%	11,000	0.03%
Qtr 1 (end)	9000	0.02%	350	0.01%	-	-	2,000	0.08%	11,350	0.03%
Qtr 2 (end)	12,000	0.01%	3,000	0.01%	-	-	2,000	0.08%	17,000	0.02%
Qtr 3 (end)	8,000	0.08%	4,090	0.10%	-	-	2,000	0.11%	14,090	0.09%
31/03/2022	11,550	0.50%	-	-	-	-	2,000	0.75%	13,550	0.54%

All investments undertaken during 2021/22 were in line with the Council's investment strategy.

Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

In furtherance of these objectives the Council maintains a spread of short term investments across unsecured bank & building society deposits and more secure investments i.e. other Local Authority Deposits and Money Market Funds.

2.2.4 Treasury Management Indicators

Maturity Structure of Borrowing (duration remaining of loans): This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

The Maturity Structure of Borrowing	31-Mar-21 Actual %	2021/22 Lower %	2021/22 Upper %	Complied
Under 12 months	14%	0%	30%	✔
12 months and within 24 months	5%	0%	25%	✔
24 months and within 5 years	20%	0%	25%	✔
5 years and within 10 years	6%	0%	20%	✔
10 years and above	61%	0%	70%	✔

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one year revenue impact of a 1% rise or fall in rates was measured at 31st March 2022

Interest rate exposures	2021/22 Revised £000's	2021/22 Actual £000's	Complied
Limits on one-year revenue impact of a 1% rise in interest rates	12	(111)	✔
Limits on one-year revenue impact of a 1% fall in interest rates	(29)	(50)	✔

The impact of a change in interest rate is calculated on the assumption that maturing loans and investments will be replaced at current rates.

2.3 THE TREASURY POSITION IN 2022/23 (at the end of September 2022)

2.3.1 EXTERNAL CONTEXT

A general background description to the Public Sector Treasury Management Environment in 2022/23 to the end of September is set out below

Economic Summary: The ongoing conflict in Ukraine has continued to put pressure on global inflation and the economic outlook for UK and world growth remains weak. The UK political situation towards the end of the period following the 'fiscal event' increased uncertainty further.

The economic backdrop during the April to September period continued to be characterised by high oil, gas and commodity prices, ongoing high inflation and its impact on consumers' cost of living, no imminent end in sight to the Russia-Ukraine hostilities and its associated impact on the supply chain, and China's zero-Covid policy.

The Bank of England, Federal Reserve and the European Central Bank all pushed up interest rates over the period and committed to fighting inflation, even when the consequences were in all likelihood recessions in those regions.

UK inflation remains extremely high with the latest CPI inflation figure for October 2022 at 11.1%.

The Bank of England increased the official Bank Rate to 3.00% over the period. From 0.75% in March, the Monetary Policy Committee (MPC) pushed through rises of 0.25% in each of the following two MPC meetings, before hiking by 0.50% in August and again in September and 0.75% in November. The September vote was 5-4, with five votes for a 0.5% increase, three for an 0.75% increase and one for an 0.25% increase. The October vote was 7-2 with seven votes for an increase of 0.75%, one vote for 0.5% and one vote for a 0.25% increase. The majority of the Committee agreed that while further increases in Bank Rate may be necessary (should the economy follow the latest forecasts), they are likely to be at a lower peak than the levels priced in by financial markets. Considerable uncertainty remains surrounding the outlook and the Committee noted its commitment to acting decisively to bring down inflation should it prove to be more persistent than forecast.

Financial markets: Uncertainty remained in control of financial market sentiment and bond yields remained volatile, continuing their general upward trend as concern over higher inflation and higher interest rates continued to dominate.

2.3.2 At 30th September the Council had net borrowing of £41.1m a decrease of £3.1m from the 31st March 2022, this is only a temporary position reflecting the Council's in year cashflow at this point in time, this is reflected in an increase in its short term investments and reduction in short term borrowing

Details behind the borrowing and investing activity are set out below.

2.3.2 **Borrowing Activity**

Over the April-September period short term PWLB rates rose dramatically, particular in late September after the Chancellor's 'mini-budget', included unfunded tax cuts and additional borrowing to fund consumer energy price subsidies. Exceptional volatility threatened financial stability, requiring Bank of England intervention in the gilt market. Over a twenty-four-hour period some PWLB rates increased to 6%, before the intervention had the desired effect, bringing rates back down by over 1% for certain maturities. A truly wild and unprecedented period in fixed income markets, with a direct impact on PWLB rates.

Interest rates rose by over 2% during the period in both the long and short term. As an indication the 5-year maturity certainty rate rose from 2.30% on 1st April to 5.09% on 30th September; over the same period the 30-year maturity certainty rate rose from 2.63% to 4.68%

At the 30th September, the Council held £55.7m of loans, little change since the beginning of the financial year. The outstanding loans are summarised in the table below.

30th September 2022	**General Fund**			**HRA**			**Total**		
	£000's	**Rate %**	**Avge Life (Yrs)**	**£000's**	**Rate %**	**Avge Life (Yrs)**	**£000's**	**Rate %**	**Avge Life (Yrs)**
Fixed rate borrowing:									
PWLB	**5,888**	3.09%	23.33	**46,812**	3.25%	24.94	**52,700**	3.19%	24.76
Variable rate borrowing:									
Local Authorities	**3,000**	0.28%	0.50	-	-	-	**3,000**	0.28%	0.50
Gross borrowing	**8,888**			**46,812**			**55,700**		

The Council's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing is being maintained.

2.3.3 **Investments Activity**

The Council continues to maintain a spread of short term investments across a number of asset classes with more use being made of the Governments debt management account deposit facility (DMADF) a flexible and secure addition to the Council's existing range of investment options.

The following table summarises the investments of short term surplus funds during 2022/23 up to 30th September 2022.

All investments are in line with the Council's investment strategy.
(Balances within the Council's operational bank accounts are excluded from the figures below)

Investment Position at	Money Market Funds £000's	Rate %	Banks & Building Societies (unsecured) £000's	Rate %	Central Government (DMADF)	Rate %	Local Authorities £000's	Rate %	Total Investments £000's	Average Rate %
31/03/2022	11,550	0.50%	-	-	-	-	2,000	0.75%	13,550	0.54%
Qtr 1 (end)	9,000	0.66%	-	-	2,650	1.03%	2,000	0.75%	13,650	0.75%
Qtr 2 (end)	6,960	1.32%	50	0.10%	3,200	2.07%	-	-	10,210	1.55%

2.3.4 **PWLB Interest Rates**

In August 2021 HM Treasury significantly revised guidance for the PWLB lending facility with more detail and 12 examples of permitted and prohibited use of PWLB loans. Council's that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

CIPFA published its revised Prudential Code for Capital Finance and Treasury Management Code on 20th December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments.

To comply with the Prudential Code, the Council must not borrow to invest primarily for financial return. This Code also states that it is not prudent for local authorities to make investment or spending decision that will increase the CFR unless directly and primarily related to the functions of the authority.

Borrowing is permitted for cashflow management, interest rate risk management, to refinance current borrowing and to adjust levels of internal borrowing. Borrowing to refinance capital expenditure primarily related to the delivery of a local authority's function but where a financial return is also expected is allowed, provided that financial return is not the primary reason for the expenditure. The changes align the CIPFA Prudential Code with the PWLB lending rules.

The Council can borrow from the PWLB provided it can confirm it is not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. Councils that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing.

The Council is not planning to purchase any investment assets primarily for yield within the next three years and so is able to fully access the PWLB.

2.4 THE PRUDENTIAL INDICATORS OUTTURN REPORT 2021/22

2.4.1 The Local Government Act 2003 requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

This report compares the approved indicators with the outturn position for 2021/22.

2.4.2 THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING 2021/22

The table below shows the actual capital expenditure which was financed and unfinanced during the year.

Capital Expenditure	**2021/22 Revised £'000**	**2021/22 Actual £'000**	**Difference £'000**
General Fund (GF)			
Capital expenditure	**5,221**	**2,084**	**(3,137)**
Financed in year	(3,390)	(1,875)	1,515
Unfinanced capital expenditure	**1,831**	**209**	**(1,622)**
Housing Revenue Account (HRA)			
Capital expenditure	**3,630**	**3,315**	**(315)**
Financed in year	(3,630)	(3,315)	**315**
Unfinanced capital expenditure	**0**	**0**	**0**

2.4.3 **Capital Financing Requirement:** The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

	2021/22 Revised £'000	**2021/22 Actual £'000**	**Difference £'000**
General Fund	21,953	20,450	**(1,503)**
HRA	61,565	61,446	**(119)**
Total CFR	**83,518**	**81,896**	**(1,622)**

The CFR was £1.621m less than estimated; this was mainly due to slippage with the 2021/22 capital programme which resulted in a lower level of unfinanced capital expenditure.

2.4.4 **Gross Debt and the Capital Financing Requirement:** In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This is a key indicator of prudence.

Debt and CFR	2021/22 Revised £'000	2021/22 Actual £'000	Difference £'000
Total Debt	70,850	57,750	**(13,100)**
Capital Financing requirement	83,518	81,896	**(1,622)**
Under / (Over) Borrowing	**12,668**	**24,146**	**(11,478)**
Split between			
General Fund	(915)	(9,392)	**(8,477)**
HRA	(11,753)	(14,754)	**(3,001)**

The debt remained below the CFR during 2021/22.

2.4.5 **THE AUTHORISED LIMIT AND OPERATIONAL BOUNDARY FOR EXTERNAL DEBT**

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Operational Boundary for External Debt: The operational boundary is based on the Council's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring.

Authorised Limit, Operational Boundary and Total Debt	2021/22 Limits £000's	Maximum Debt 2021/22	Complied
Operational boundary	76,900	64,850	✔
Authorised Limit	85,000	67,850	✔

2.4.6 **Actual financing costs as a proportion of net revenue stream** - this prudential indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Ratio of Financing Costs to Net Revenue Stream	2021/22 Revised %	2021/22 Actual %	Difference %
General Fund	2.9%	3.0%	0.1%
HRA	33.7%	34.4%	0.7%

3 Risk Assessment

3.1 The Council has complied with the relevant statutory and regulatory requirements, which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

3.2 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Arlingclose Ltd, the Council's advisers, has proactively managed the debt and investments over the year.

4 Conclusion

4.1 This report summaries the treasury activities and prudential indicators for 2021/22 and reviews the treasury activities up to 30th September 2022. It is a key governance report for the Treasury Management function.

<table>
<tr><td>Financial Services comments:</td><td>As contained in the report.</td></tr>
<tr><td>Legal Services comments:</td><td>This report fulfils the Council’s legal obligation under the Local Government Act 2003 to have regard to the CIPFA Treasury Management Code of Practice.</td></tr>
<tr><td>Equality and Diversity:</td><td>N/A</td></tr>
<tr><td>Climate Change Implications</td><td>N/A</td></tr>
<tr><td>Crime and Disorder:</td><td>N/A</td></tr>
<tr><td>Service Improvement Plan implications:</td><td rowspan="2">This report is required in order that to fulfil statutory requirements associated with the achievement of both service improvement plan and corporate plan targets.</td></tr>
<tr><td>Corporate Plan</td></tr>
<tr><td>Risk Assessment</td><td>As contained in the report</td></tr>
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<tr><td>Appendices/Enclosures:</td><td>A. General Background Description To The Public Sector Treasury Management Environment In 2021/22</td></tr>
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Appendix A

General Background Description To The Public Sector Treasury Management Environment In 2021/22

The following narrative was provided by Arlingclose Ltd

***Economic background**: The continuing economic recovery from coronavirus pandemic, together with the war in Ukraine, higher inflation, and higher interest rates were major issues over the period.*

Bank Rate was 0.1% at the beginning of the reporting period. April and May saw the economy gathering momentum as the shackles of the pandemic restrictions were eased. Despite the improving outlook, market expectations were that the Bank of England would delay rate rises until 2022. Rising, persistent inflation changed that.

UK CPI was 0.7% in March 2021 but thereafter began to steadily increase. Initially driven by energy price effects and by inflation in sectors such as retail and hospitality which were re-opening after the pandemic lockdowns, inflation then was believed to be temporary. Thereafter price rises slowly became more widespread, as a combination of rising global costs and strong demand was exacerbated by supply shortages and transport dislocations. The surge in wholesale gas and electricity prices led to elevated inflation expectations. CPI for February 2022 registered 6.2% year on year, up from 5.5% in the previous month and the highest reading in the National Statistic series. Core inflation, which excludes the more volatile components, rose to 5.2% y/y from 4.4%.

The government's jobs furlough scheme insulated the labour market from the worst effects of the pandemic. The labour market began to tighten and demand for workers grew strongly as employers found it increasingly difficult to find workers to fill vacant jobs. Having peaked at 5.2% in December 2020, unemployment continued to fall and the most recent labour market data for the three months to January 2022 showed the unemployment rate at 3.9% while the employment rate rose to 75.6%. Headline 3-month average annual growth rate for wages were 4.8% for total pay and 3.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 0.1% while regular pay fell by 1.0%.

With the fading of lockdown – and, briefly, the 'pingdemic' – restraints, activity in consumer-facing sectors improved substantially as did sectors such as oil and mining with the reopening of oil rigs but materials shortages and the reduction in the real spending power of households and businesses dampened some of the growth momentum. Gross domestic product (GDP) grew by an upwardly revised 1.3% in the fourth calendar quarter of 2021 according to the final estimate (initial estimate 1.0%) and took UK GDP to just 0.1% below where it was before the

pandemic. The annual growth rate was revised down slightly to 7.4% (from 7.5%) following a revised 9.3% fall in 2020.

Having increased Bank Rate from 0.10% to 0.25% in December, the Bank of England hiked it further to 0.50% in February and 0.75% in March. At the meeting in February, the Monetary Policy Committee (MPC) voted unanimously to start reducing the stock of its asset purchase scheme by ceasing to reinvest the proceeds from maturing bonds as well as starting a programme of selling its corporate bonds.

In its March interest rate announcement, the MPC noted that the invasion of Ukraine had caused further large increases in energy and other commodity prices, with the expectation that the conflict will worsen supply chain disruptions around the world and push CPI inflation to around 8% later in 2022, even higher than forecast only a month before in the February Monetary Policy Report. The Committee also noted that although GDP in January was stronger than expected with business confidence holding up and the labour market remaining robust, consumer confidence had fallen due to the squeeze in real household incomes.

GDP growth in the euro zone increased by 0.3% in calendar Q4 2021 following a gain of 2.3% in the third quarter and 2.2% in the second. Headline inflation remains high, with CPI registering a record 7.5% year-on-year in March, the ninth successive month of rising inflation. Core CPI inflation was 3.0% y/y in March, was well above the European Central Bank's target of 'below, but close to 2%', putting further pressure on its long-term stance of holding its main interest rate of 0%.

The US economy expanded at a downwardly revised annualised rate of 6.9% in Q4 2021, a sharp in increase from a gain of 2.3% in the previous quarter. In its March 2022 interest rate announcement, the Federal Reserve raised the Fed Funds rate to between 0.25% and 0.50% and outlined further increases should be expected in the coming months. The Fed also repeated it plan to reduce its asset purchase programme which could start by May 2022.

<u>Financial markets</u>: The conflict in Ukraine added further volatility to the already uncertain inflation and interest rate outlook over the period. The Dow Jones started to decline in January but remained above its pre-pandemic level by the end of the period while the FTSE 250 and FTSE 100 also fell and ended the quarter below their pre-March 2020 levels.

Bond yields were similarly volatile as the tension between higher inflation and flight to quality from the war pushed and pulled yields, but with a general upward trend from higher interest rates dominating as yields generally climbed.

The 5-year UK benchmark gilt yield began the quarter at 0.82% before rising to 1.41%. Over the same period the 10-year gilt yield rose from 0.97% to 1.61% and the 20-year yield from 1.20% to 1.82%.

The Sterling Overnight Rate (SONIA) averaged 0.39% over the quarter.

Credit review: In the first half of FY 2021-22 credit default swap (CDS) spreads were flat over most of period and are broadly in line with their pre-pandemic levels. In September spreads rose by a few basis points due to concerns around Chinese property developer Evergrande defaulting but then fell back. Fitch and Moody's revised upward the outlook on a number of UK banks and building societies on the Authority's counterparty to 'stable', recognising their improved capital positions compared to 2020 and better economic growth prospects in the UK.

Fitch also revised the outlook for Nordea, Svenska Handelsbanken and Handelsbanken plc to stable. The agency considered the improved economic prospects in the Nordic region to have reduced the baseline downside risks it previously assigned to the lenders.

The successful vaccine rollout programme was credit positive for the financial services sector in general and the improved economic outlook meant some institutions were able to reduce provisions for bad loans. However, in 2022, the uncertainty engendered by Russia's invasion of Ukraine pushed CDS prices modestly higher over the first calendar quarter, but only to levels slightly above their 2021 averages, illustrating the general resilience of the banking sector.

Having completed its full review of its credit advice on unsecured deposits, in September Arlingclose extended the maximum duration limit for UK bank entities on its recommended lending list from 35 days to 100 days; a similar extension was advised in December for the non-UK banks on this list. As ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.