Appendix 1

External Factors Impacting on Treasury during 2021/22

A summary of the external factors in 2021-22 is provided by the council's treasury advisor, Arlingclose Ltd, and is detailed below.

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.

Financial markets: 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.

Forecast interest Rates (June 2022)

The following forecast interest forecast are set against a background of:

Arlingclose now expects Bank Rate to rise to 2.25% by December, in 25bp steps at each of the next four meetings. We now also expect a reduction in Bank Rate during the forecast period.

High inflation is dampening global economic growth, raising the chances of regional recessions even as policymakers accelerate monetary tightening to reduce the risk of persistently higher long-term inflation expectations.

- The MPC will raise Bank Rate further to dampen aggregate demand and reduce the risk of sustained higher inflation.

- Risks remain weighted to the upside in the short term following the MPC's more hawkish stance.

- Gilt yields will remain under upward pressure in the short term on inflation and central bank policy expectations, and investor uncertainty. Yields will decline over the medium time as weak growth places pressure on central banks to ease policy.

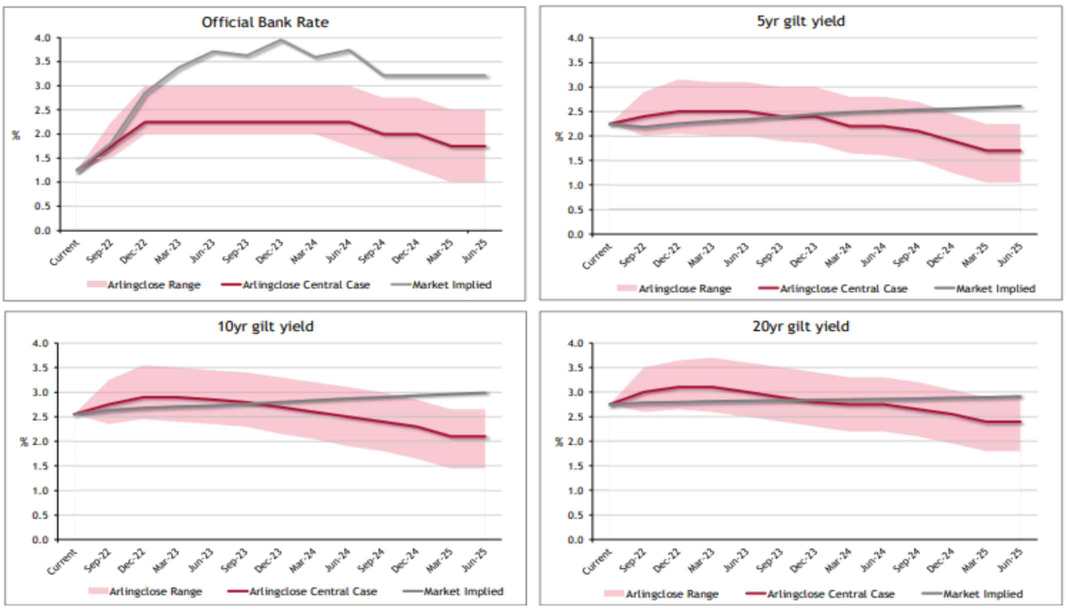
- The risks around the gilt yield forecasts remain tilted to the upside over the short term, primarily due to US policy uncertainty. Over the medium term, the balance of risks shifts to the downside as growth softens.

	Current	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Arlingclose Central Case	1.25	1.75	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.00	2.00	1.75	1.75
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-0.75
3-month money market ra													
Upside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Arlingclose Central Case	1.65	2.00	2.50	2.40	2.30	2.20	2.20	2.20	2.10	2.00	1.90	1.85	1.85
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-0.75
5yr gilt yield													
Upside risk	0.00	0.50	0.65	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.55	0.55	0.55
Arlingclose Central Case	2.25	2.40	2.50	2.50	2.50	2.40	2.40	2.20	2.20	2.10	1.90	1.70	1.70
Downside risk	0.00	-0.40	-0.45	-0.50	-0.50	-0.50	-0.55	-0.55	-0.60	-0.60	-0.65	-0.65	-0.65
10yr gilt yield													
Upside risk	0.00	0.50	0.65	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.55	0.55	0.55
Arlingclose Central Case	2.55	2.75	2.90	2.90	2.85	2.80	2.70	2.60	2.50	2.40	2.30	2.10	2.10
Downside risk	0.00	-0.40	-0.45	-0.50	-0.50	-0.50	-0.55	-0.55	-0.60	-0.60	-0.65	-0.65	-0.65
20yr gilt yield													
Upside risk	0.00	0.50	0.55	0.60	0.60	0.60	0.60	0.55	0.55	0.55	0.50	0.50	0.50
Arlingclose Central Case	2.75	3.00	3.10	3.10	3.00	2.90	2.80	2.75	2.75	2.65	2.55	2.40	2.40
Downside risk	0.00	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.55	-0.55	-0.55	-0.60	-0.60	-0.60
50yr gilt yield													
Upside risk	0.00	0.50	0.55	0.60	0.60	0.60	0.60	0.55	0.55	0.55	0.50	0.50	0.50
Arlingclose Central Case	2.55	2.80	2.90	2.90	2.80	2.70	2.60	2.60	2.60	2.50	2.40	2.30	2.30
Downside risk	0.00	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.55	-0.55	-0.55	-0.60	-0.60	-0.60

Arlingclose and Market Projections June 2022

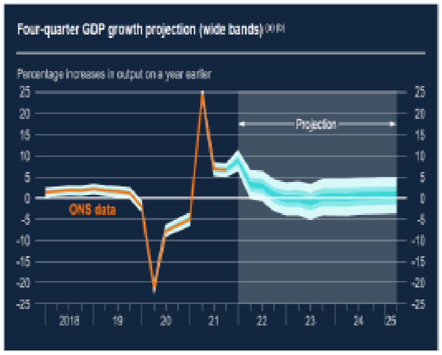
Charts show the Arlingclose central case along with upside and downside risks:
Arlingclose judges that the risks around its forecasts are initially to the upside before becoming more balanced over time.

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80
UKIB Rate (Maturity Loans) = Gilt yield + 0.60%

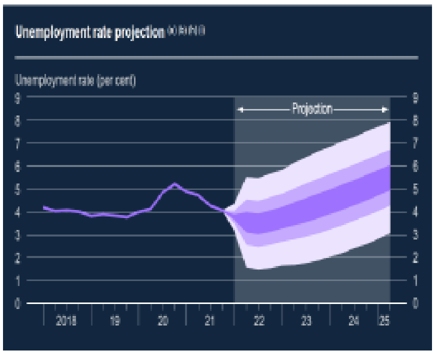


Bank of England Monetary Policy Report - May 2022

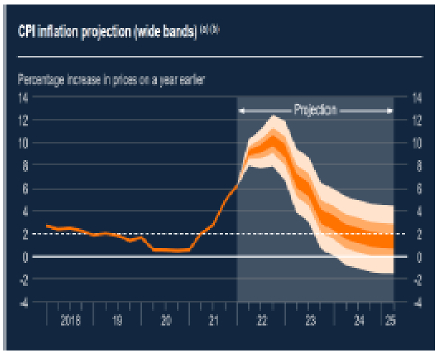
Outlook for UK GDP



Outlook for UK Unemployment



Outlook for UK CPI inflation



- Persistently higher global commodity prices and tradable goods prices from supply chain constraints, both accentuated by the invasion of Ukraine, lead to a sharp slowdown in world activity and push global consumer price inflation up further before their effects eventually dissipate.
- Demand growth in the UK slows sharply over the first half of the projection, predominantly reflecting the adverse impact of higher global commodity and tradable goods prices.
- The labour market tightens further in the near term before the slowdown in demand leads to a rise in unemployment and excess supply over the rest of the projection.
- The vast majority of the increase and subsequent fall in CPI inflation reflects the impact of external factors. Domestic price pressures rise further this year, as wage growth strengthens, and companies rebuild their margins. The increase in excess supply moderates these forces such that inflation is close to the 2% target in two years' time and well below it in three years.