OVERVIEW & SCRUTINY

DATE OF MEETING: **18th JULY 2023**

TITLE OF REPORT: **TREASURY MANAGEMENT OUTTURN 2022/23**

Report of: **Executive Director of Corporate Services & Section 151 Officer**

Cabinet Member: **Councillor James Radley, The Deputy Leader and Portfolio Holder for Finance and Corporate Services**

1 PURPOSE OF REPORT

1.1 To report the Council's Treasury Management activities during the year ended 31 March 2023 for scrutiny and comments in advance of consideration by Cabinet.

2 OFFICER RECOMMENDATION

2.1 To consider the report and forward comments to Cabinet.

3 BACKGROUND

3.1 This Council is required by regulations issued under the Local Government Act 2003 to produce a separate annual treasury management review of activities and the actual prudential and treasury indicators for 2022/23. This is also a requirement of Hart's Treasury Strategy approved by Council. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

3.2 During 2022/23 the minimum reporting requirements were that the Council should receive the following reports:

- an annual treasury strategy in advance of the year (24.02.2022)
- a mid-year (minimum) treasury update report (26.01.23)
- an annual review following the end of the year describing the activity compared to the strategy (this report).

3.3 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

3.4 This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all the above treasury management reports by the Scrutiny Committee before they were reported to the full Council. Appendix A details economic commentary from Hart's treasury advisors Link.

4 THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING

4.1 The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or

- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

	2021-22 Actual £'000	2022-23 Budget £'000	2022-23 Actual £'000
Capital Expenditure	21,688	5,076	2,400
Financed in year	(3,127)	(5,076)	(2,400)
Unfinanced capital expenditure	**18,561**	**0**	**0**

5 THE COUNCIL'S OVERALL BORROWING NEED

5.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's notional indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend each year. It represents the cumulative unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

5.2 Part of the Council's treasury activity is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, (such as the Government, through the Public Works Loan Board [PWLB], or the money markets, or utilising temporary cash resources within the Council (internal borrowing).

5.3 Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

5.4 The total CFR can also be reduced by:

- the application of additional capital financing resources, (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

5.5 The Council's 2022/23 MRP Policy, (as required by DLUHC Guidance), was approved as part of the Treasury Management Strategy Report for 2022/23 on 24.02.2022.

5.6 The Council's CFR for the year is shown below and represents a key prudential indicator.

CFR	2021-22 Actual £'000	2022-23 Actual £'000
Opening Balance	22,889	41,450
Unfinanced capital expenditure	18,561	(588)
Closing Balance	**41,450**	**40,862**

5.7 Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

5.8 Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2022/23) plus the estimates of any additional capital financing requirement for the current (2023/24) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2022/23. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	2021-22 Actual £'000	2022-23 Budget £'000	2022-23 Actual £'000
CFR	41,450	40,509	40,862
Gross Borrowing Position	18,088	25,173	15,769
(Under) / over funding of CFR	**(23,362)**	**(15,336)**	**(25,093)**

5.9 The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2022/23 the Council has maintained gross borrowing within its authorised limit.

5.10 The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

5.11 Actual financing costs as a proportion of net revenue stream - this 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.

	2022-23 £'000
Authorised limit	30,000
Maximum gross borrowing position during the year	15,769
Operational boundary	25,000
Average gross borrowing position	16,928
Financing costs as a proportion of net revenue stream	0.39%

6 TREASURY POSITION AS AT 31st MARCH 2023

6.1 The Council’s treasury management debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council’s Treasury Management Practices. At the end of 2022/23 the Council‘s treasury position was as follows:

Treasury	31/03/2022 Principal £'000	Rate/ Return	Average Life Years	31/03/2023 Principal £'000	Rate/ Return	Average Life Years
Fixed rate funding:						
PWLB 1	8,337	2.19%	20 years	7,992	2.19%	19 years
PWLB 2	6,800	1.91%	50 years	6,800	1.91%	49 years
Hampshire County Council	2,950	0.00%	2 years	977	0.00%	1 year
Variable rate funding:						
PWLB	0			0		
Market	0			0		
Total debt	**18,087**			**15,769**		
CFR	**41,450**			**40,862**		
Over / (under) borrowing	**(23,363)**			**(25,093)**		
Total investments	29,647			25,873		
Net debt	(53,009)			(50,966)		

6.2 The maturity structure of the debt portfolio was as follows:

	2021-22 £'000	2022-23 £'000
Less than one year	2,439	1,434
Between one and two years	1,314	345
Between two and five years	1,085	1,123
Between five and ten years	1,998	2,042
Between ten and fifteen years	2,228	2,277
Between fifteen and twenty years	2,224	1,748
More than twenty years	6,800	6,800

6.3 Investment portfolio:

Treasury investments	**31/03/2022** **Actual** **£'000**	**31/03/2022** **Actual** **%**	**31/03/2023** **Actual** **£'000**	**31/03/2023** **Actual** **%**
Banks	15,747	53%	21,873	85%
Money market funds	13,900	47%	4,000	15%
Total	**29,647**	**100%**	**25,873**	**100%**

6.4 The maturity structure of the investment portfolio was as follows:

Investment portfolio	**31/03/2022** **Actual** **£'000**	**31/03/2023** **Actual** **£'000**
Up to 1 year	29,647	25,873
Longer than 1 year	0	0
Total	**29,647**	**25,873**

7 BORROWING OUTTURN

7.1 Treasury Borrowing – breakdown of borrowing at 31st March 2023:

Lender	Principal £'000	Type	Interest Rate	Maturity	Average for 2022/23
PWLB 1	7,992	Fixed Rate	2.19%	25 years	8,165
PWLB 2	6,800	Fixed Rate	1.91%	50 years	6,800
Hampshire County Council	977	Fixed Rate	0.00%	7 years	1,963

7.2 Due to investment concerns, both counterparty risk and comparatively low investment returns, no borrowing was undertaken during the year.

7.3 The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

7.4 No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

8 INVESTMENT OUTTURN

8.1 Investment Policy – the Council's investment policy is governed by DLUHC investment guidance, which has been implemented in the annual investment strategy approved by the Council on 24th February 2022. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

8.2 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

8.3 Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources	2021/22 £'000	2022/23 £'000
Earmarked Reserves	(26,092)	(23,435)
Provisions	(687)	(548)
Usable Capital Receipts	(386)	(482)
Total	**(27,165)**	**(24,465)**

8.4 Investments held by the Council

- The Council maintained an average balance of £36.1m of internally managed funds.
- The internally managed funds earned an average rate of return of 2.02%.
- The comparable performance indicator is the average 90 day SONIA rate, which was 1.84%.
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This compares with a budget assumption of £35m average investment balances earning an average rate of 0.66%.

9 EQUALITIES

9.1 There are no impacts to equality from the recommendations of this paper

10 CLIMATE CHANGE IMPLICATIONS

10.1 There are no direct carbon/environmental impacts arising from the recommendations of this paper.

11 CONCLUSION

11.1 This report provides Members with information on the level of investment and interest earned during the last financial year and demonstrates the council's compliance with the Treasury Management Strategy.

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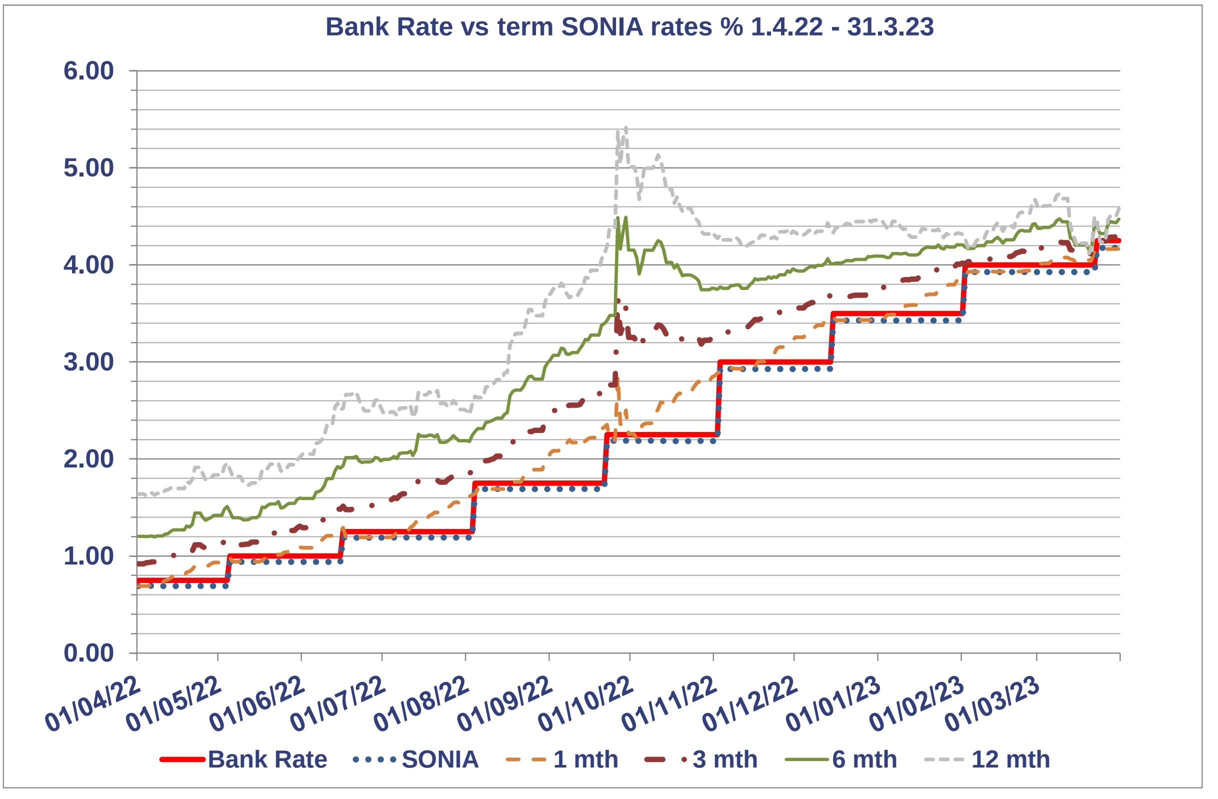
BACKGROUND PAPERS:
Treasury Management Strategy Statement (24th February 2022)

APPENDIX A – BACKGROUND ECONOMIC INFORMATION FROM TREASURY ADVISORS LINK

THE STRATEGY FOR 2022/2023

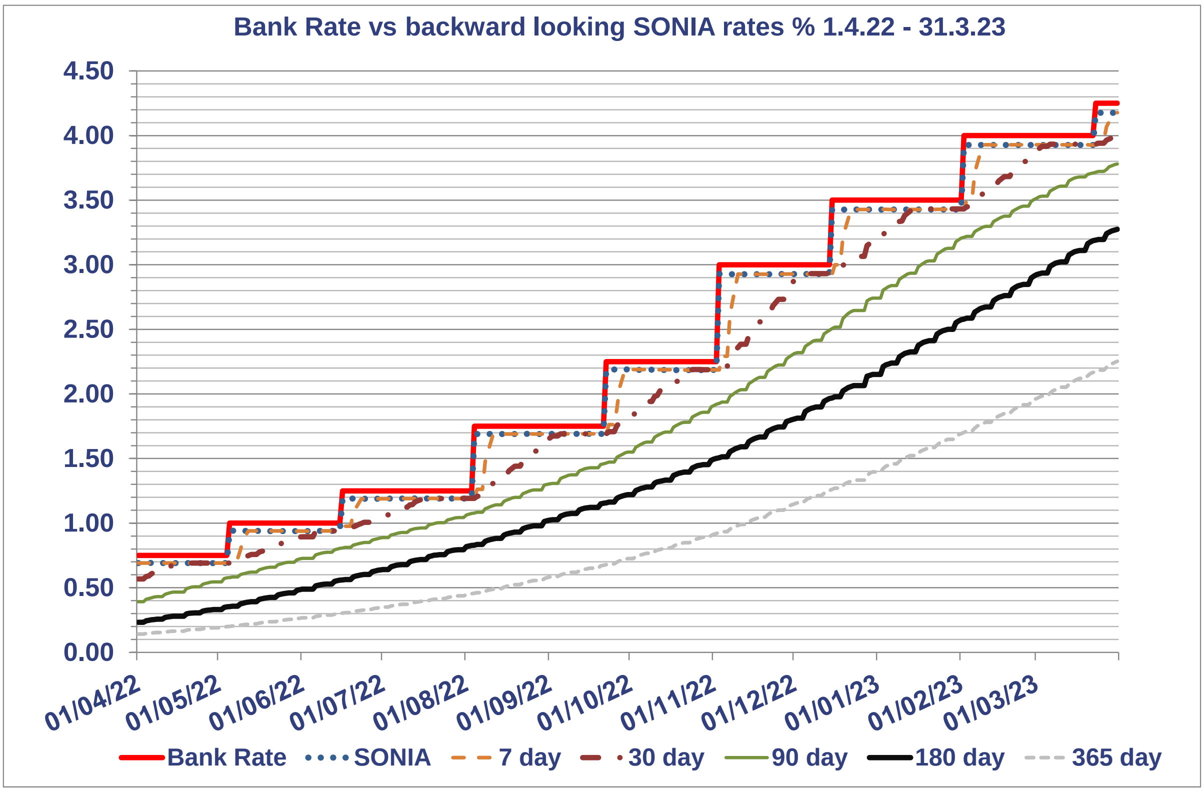
i. Investment strategy and control of interest rate risk



FINANCIAL YEAR TO QUARTER ENDED 31/3/2023

	Bank Rate	SONIA	1 mth	3 mth	6 mth	12 mth
High	4.25	4.18	4.17	4.30	4.49	5.41
High Date	23/03/2023	31/03/2023	31/03/2023	31/03/2023	29/09/2022	29/09/2022
Low	0.75	0.69	0.69	0.92	1.20	1.62
Low Date	01/04/2022	28/04/2022	01/04/2022	01/04/2022	07/04/2022	04/04/2022
Average	2.30	2.24	2.41	2.72	3.11	3.53
Spread	3.50	3.49	3.48	3.38	3.29	3.79

ii. Investment Benchmarking Data – Sterling Overnight Index Averages (Backward-looking) 2022/23



FINANCIAL YEAR TO QUARTER ENDED 31/03/2023							
	Bank Rate	SONIA	7 day	30 day	90 day	180 day	365 day
High	4.25	4.18	4.18	4.00	3.78	3.27	2.25
High Date	23/03/2023	31/03/2023	31/03/2023	31/03/2023	31/03/2023	31/03/2023	31/03/2023
Low	0.75	0.69	0.69	0.57	0.39	0.23	0.14
Low Date	01/04/2022	28/04/2022	29/04/2022	01/04/2022	01/04/2022	01/04/2022	01/04/2022
Average	2.30	2.24	2.20	2.09	1.81	1.42	0.90
Spread	3.50	3.49	3.49	3.43	3.39	3.04	2.11

iii. Investment returns picked up throughout the course of 2022/23 as central banks, including the Bank of England, realised that inflationary pressures were not transitory, and that tighter monetary policy was called for.

iv. Starting April at 0.75%, Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 4.25% by the end of the financial year, with the potential for a further one or two increases in 2023/24

v. The sea-change in investment rates meant local authorities were faced with the challenge of pro-active investment of surplus cash for the first time in over a decade, and this emphasised the need for a detailed working knowledge of cashflow projections so that the appropriate balance between maintaining cash for liquidity purposes, and "laddering" deposits on a rolling basis to lock in the increase in investment rates as duration was extended, became an on-going feature of the investment landscape.

vi. With bond markets selling off, equity valuations struggling to make progress and, latterly, property funds enduring a wretched Q4 2022, the more traditional investment options, such as specified investments (simple to understand, and less than a year in duration) became more actively used.

vii. Meantime, through the autumn, and then in March 2023, the Bank of England maintained various monetary policy easing measures as required to ensure specific markets, the banking system and the economy had appropriate levels of liquidity at times of stress.

BORROWING STRATEGY AND CONTROL OF INTEREST RATE RISK

i. During 2022/23, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were initially low and minimising counterparty risk on placing investments also needed to be considered.

ii. A cost of carry generally remained in place during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns. As the cost of carry dissipated, the Council sought to avoid taking on long-term borrowing at elevated levels (>4%) and has focused on a policy of internal and temporary borrowing, supplemented by short-dated borrowing (<3 years) as appropriate.

iii. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this has been kept under review to avoid incurring higher borrowing costs in the future when this Authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

iv. Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Treasury Management Team therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks:

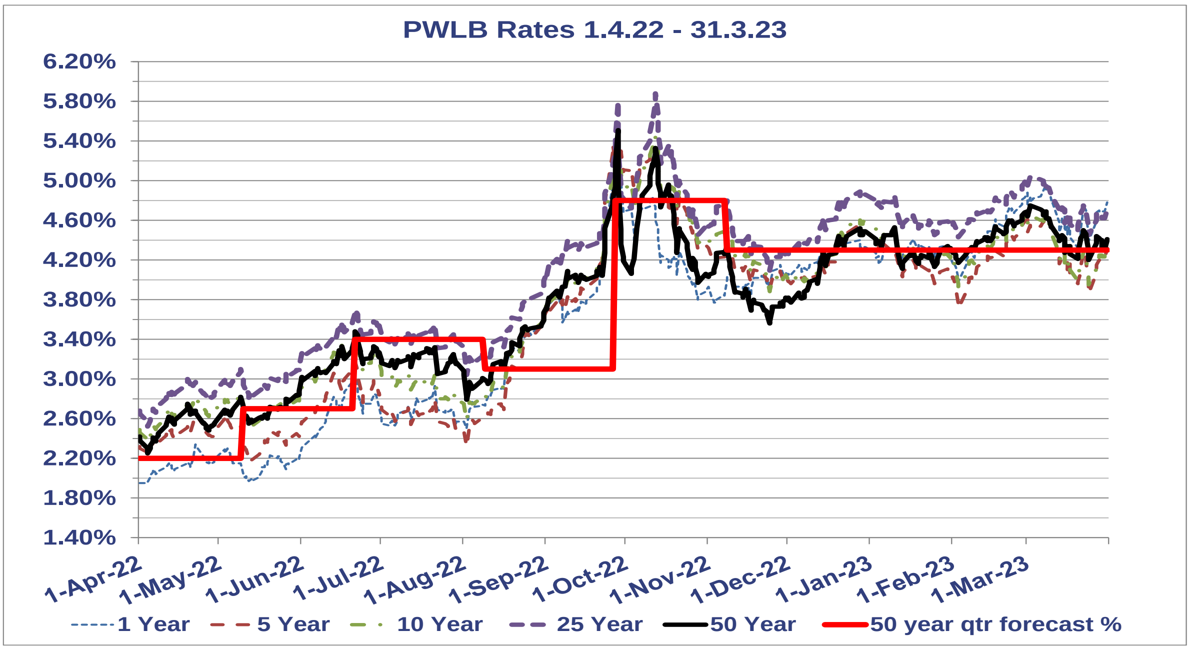
* if it had been felt that there was a significant risk of a sharp FALL in long and short-term rates, (e.g., due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

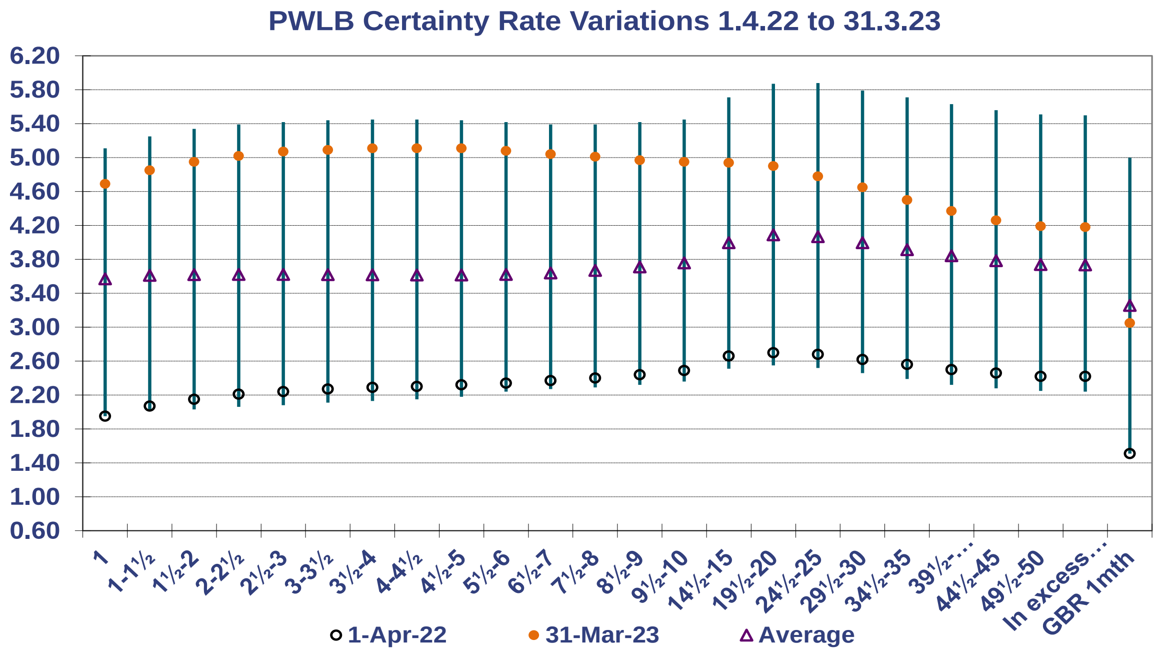
* if it had been felt that there was a significant risk of a much sharper RISE in long and short-term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

v. Interest rate forecasts were initially suggesting only gradual rises in short, medium and longer-term fixed borrowing rates during 2022/23 but by August it had become clear that inflation was moving up towards 40-year highs, and the Bank of England engaged in monetary policy tightening at every Monetary Policy Committee meeting during 2022, and into 2023, either by increasing Bank Rate by 0.25% or 0.5% each time. Currently the CPI measure of inflation is still above 10% in the UK but is expected to fall back towards 4% by year end. Nonetheless, there remain significant risks to that central forecast.

Link Group Interest Rate View	27.03.23											
	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26
BANK RATE	4.50	4.50	4.25	4.00	3.50	3.25	3.00	2.75	2.75	2.50	2.50	2.50
3 month ave earnings	4.50	4.50	4.30	4.00	3.50	3.30	3.00	2.80	2.80	2.50	2.50	2.50
6 month ave earnings	4.50	4.40	4.20	3.90	3.40	3.20	2.90	2.80	2.80	2.60	2.60	2.60
12 month ave earnings	4.50	4.40	4.20	3.80	3.30	3.10	2.70	2.70	2.70	2.70	2.70	2.70
5 yr PWLB	4.10	4.10	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20	3.20	3.10
10 yr PWLB	4.20	4.20	4.00	3.90	3.80	3.70	3.50	3.50	3.40	3.30	3.30	3.20
25 yr PWLB	4.60	4.50	4.40	4.20	4.10	4.00	3.80	3.70	3.60	3.50	3.50	3.40
50 yr PWLB	4.30	4.20	4.10	3.90	3.80	3.70	3.50	3.50	3.30	3.20	3.20	3.10

vi. PWLB Rates 01/04/22 – 31/03/23





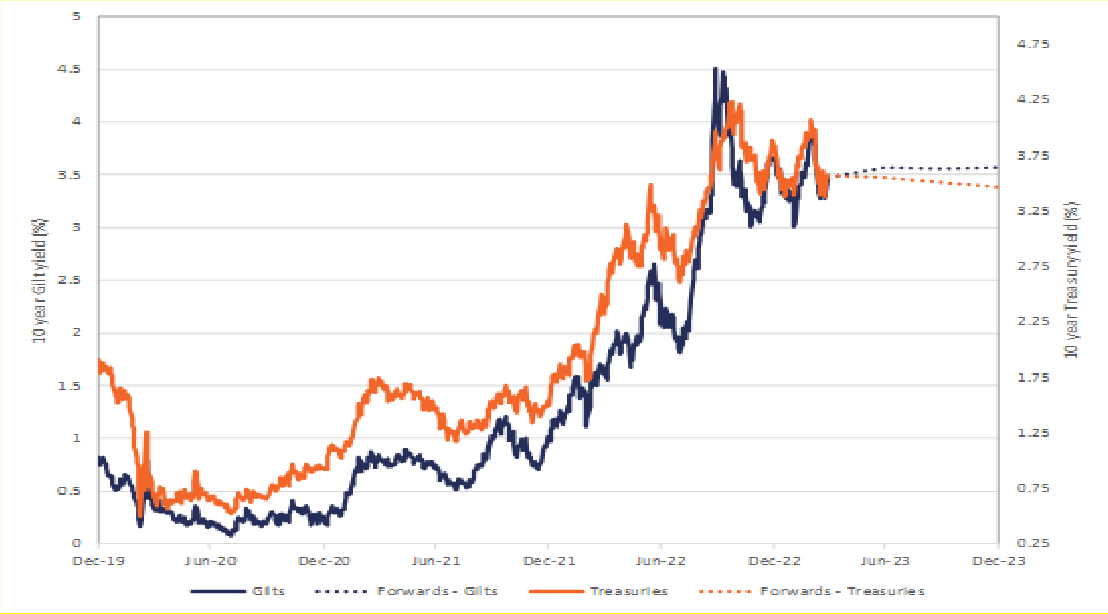
vii. HIGH/LOW/AVERAGE PWLB RATES FOR 2022/23

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.45%	5.88%	5.51%
Date	28/09/2022	28/09/2022	12/10/2022	12/10/2022	28/09/2022
Average	3.57%	3.62%	3.76%	4.07%	3.74%
Spread	3.16%	3.26%	3.09%	3.36%	3.26%

viii. PWLB rates are based on gilt (UK Government bonds) yields through HM Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. Indeed, in recent years many bond yields up to 10 years in the Eurozone turned negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession.

ix. However, since early 2022, yields have risen dramatically in all the major developed economies, first as economies opened post-Covid; then because of the inflationary impact of the war in Ukraine in respect of the supply side of many goods. In particular, rising cost pressures emanating from shortages of energy and some food categories have been central to inflation rising rapidly. Furthermore, at present the FOMC, ECB and Bank of England are all being challenged by persistent inflation that is exacerbated by very tight labour markets and high wage increases relative to what central banks believe to be sustainable.

x. Graph of UK gilt yields v. US treasury yields



xi. There is likely to be a fall in gilt yields and PWLB rates across the whole curve over the next one to two years as Bank Rate first rises to dampen inflationary pressures and a tight labour market, and is then cut as the economy slows, unemployment rises, and inflation (on the Consumer Price Index measure) moves closer to the Bank of England's 2% target.

xii. As a general rule, short-dated gilt yields will reflect expected movements in Bank Rate, whilst medium to long-dated yields are driven primarily by the inflation outlook.

xiii. The Bank of England is also embarking on a process of Quantitative Tightening, but the scale and pace of this has already been affected by the Truss/Kwarteng "fiscal experiment" in the autumn of 2022 and more recently by the financial market unease with some US (e.g., Silicon Valley Bank) and European banks (e.g., Credit Suisse). The gradual reduction of the Bank's original £895bn stock of gilt and corporate bonds will be sold back into the market over several years. The impact this policy will have on the market pricing of gilts, while issuance is markedly increasing, is an unknown at the time of writing.

C THE ECONOMY AND INTEREST RATES

UK. Economy.

i. Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022/23.

ii. Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps in 2022. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	Eurozone	US
Bank Rate	4.25%	3%	4.75%-5%
GDP	0.1%q/q Q4 (4.1%y/y)	+0.1%q/q Q4 (1.9%y/y)	2.6% Q4 Annualised
Inflation	10.4%y/y (Feb)	6.9%y/y (Mar)	6.0%y/y (Feb)
Unemployment Rate	3.7% (Jan)	6.6% (Feb)	3.6% (Feb)

iii. Q2 of 2022 saw UK GDP deliver growth of +0.1% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Q4 GDP was positive at 0.1% q/q. Most recently, January saw a 0.3% m/m increase in GDP as the number of strikes reduced compared to December. In addition, the resilience in activity at the end of 2022 was, in part, due to a 1.3% q/q rise in real household disposable incomes. A big part of that reflected the £5.7bn payments received by households from the government under the Energy Bills Support Scheme.

iv. Nevertheless, CPI inflation picked up to what should be a peak reading of 11.1% in October, although hopes for significant falls from this level will very much rest on the movements in the gas and electricity markets, as well as the supply-side factors impacting food prices. On balance, most commentators expect the CPI measure of inflation to drop back towards 4% by the end of 2023. As of February 2023, CPI was 10.4%.

v. The UK unemployment rate fell through 2022 to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact remains, however, that with many economic participants registered as long-term sick, the UK labour force shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food (up 18.3% y/y in February 2023) and energy that have endured since Russia's invasion of Ukraine on 22 February 2022.

vi. Bank Rate increased steadily throughout 2022/23, starting at 0.75% and finishing at 4.25%.

vii. In the interim, following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and October. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of the 17th of November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have reversed the increases seen under the previous tenants of No10/11 Downing Street, although they remain elevated in line with developed economies generally.

viii. As noted above, GDP has been tepid throughout 2022/23, although the most recent composite Purchasing Manager Indices for the UK, US, EZ and China have all surprised to the upside, registering survey scores just above 50 (below suggests economies are contracting, and above suggests expansion). Whether that means a shallow recession, or worse, will be avoided is still unclear. Ultimately, the MPC will want to see material evidence of a reduction in inflationary pressures and a loosening in labour markets. Realistically, that is an unlikely outcome without unemployment rising and wage settlements falling from their current levels. At present, the bigger rise in employment kept the ILO unemployment rate unchanged at 3.7% in January. Also, while the number of job vacancies fell for the ninth consecutive month in February, they remained around 40% above pre-pandemic levels.

ix. Our economic analysts, Capital Economics, expect real GDP to contract by around 0.2% q/q in Q1 and forecast a recession this year involving a 1.0% peak-to-trough fall in real GDP.

x. The £ has remained resilient of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.23. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 4.5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

xi. As for equity markets, the FTSE 100 started 2023 strongly, rising to a record high of 8,014 on 20th February, as resilient data and falling inflation boosted earnings. But global equities fell sharply after concerns over the health of the global banking system emerged early in March. The fall in the FTSE 100 was bigger than the drop in the US S&P 500. Indeed, at around 7,600 now, the FTSE is 5.2% below its record high on 20th February, while the S&P 500 is only 1.9% lower over the same period. That's despite UK banks having been less exposed and equity prices in the UK's financial sector not falling as far. It may be due to the smaller decline in UK interest rate expectations and bond yields, which raise the discounted value of future earnings, compared to the US.

xii. **USA.** The flurry of comments from Fed officials over recent months suggest there is still an underlying hawkish theme to their outlook for interest rates.

Markets are pricing in a further interest rate increases of 25-50bps, on top of the current interest rate range of 4.75% - 5%.

xiii. In addition, the Fed is expected to continue to run down its balance sheet once the on-going concerns about some elements of niche banking provision are in the rear-view mirror.

xiv. As for inflation, it is currently at c6% but with the economy expected to weaken during 2023, and wage data already falling back, there is the prospect that should the economy slide into a recession of any kind there will be scope for rates to be cut at the backend of 2023 or shortly after.

xv. **EU.** Although the Euro-zone inflation rate has fallen below 7%, the ECB will still be mindful that it has further work to do to dampen inflation expectations and it seems destined to raise rates to 4% in order to do so. Like the UK, growth has remained more robust than anticipated but a recession in 2023 is still seen as likely by most commentators.