South Cambridgeshire District Council

REPORT TO: Audit & Governance 28 September 2021

LEAD CABINET MEMBER: Councillor John Williams, Lead Cabinet Member for Finance

LEAD OFFICER: Peter Maddock, Head of Finance

Treasury Management – Annual Report 2020/2021

Executive Summary

1. This report outlines the Treasury Management activities in the financial year 2020/2021 and invites the Audit and Governance Committee to note the Treasury Management performance and approve the report.

Key Decision

2. This is not a key decision as there are no resource implications directly arising from the report at this stage.

Recommendations

3. **That Audit and Governance Committee is requested to consider the report, to seek any clarification and, if satisfied, approve the Treasury Management Annual Report.**

Reasons for Recommendations

4. To consider a report on Treasury Management activities during the financial year 2020/2021.

Details

Treasury Portfolio 2020/2021: Summary Position

5. The summary position as at 31 March 2021 (with comparable data for 31 March 2020) is shown below:

	31 March 2020		31 March 2021	
Borrowing	**£000**	**Rate %**	**£000**	**Rate %**
PWLB	205,123	3.51	205,123	3.51
LOBO - Market	Nil		Nil	
Local Authority	10,000	0.82	44,000	0.50
Other Long-Term Liabilities	Nil		Nil	
Total Debt	**215,123**		**249,123**	
Investments	**(111,719)**		**(111,658)**	
Net Borrowing/(Investment)	**103,404**		**137,465**	

Investments

6. Investments are categorised into long and short term (i.e. less than 365 days). The sum of £25.27 million had less than one year to maturity as at 31 March 2021 and is, therefore, classified as short term. The remaining balance held of £86.39 million is classified as a long-term investment. The increase in Long Term Investments reflects the increased allocation to South Cambs Limited and loan to Cambridge Leisure and Ice Centre during the year. A summary of the investments held is shown below:

	Balance 01/04/2020	New Investments	Maturities/ Sales	Interest Accrued	Balance 31/03/2021
	£000	£000	£000	£000	£000
Investment Counterparty					
Short Term:					
Clearing Banks	5,000	27,000	(32,000)	(11)	14,000
Other Banks	Nil	25,000	(25,000)		Nil
Building Societies	Nil	76,500	(76,500)		Nil
Housing Associations	5,000	5,000	(5,000)	(48)	5,000
Local Authorities	9,500	30,130	(39,630		Nil
Money Market Funds	9,860	108,315	(118,175)		Nil
Call Account	Nil	118,375	(112,110)		6,265
Long Term:					
CLIC (Ice Rink Loan)	2,400			(103)	2,400
South Cambs Ltd	71,644	12,349		(579)	83,993
Total Investments	**103,404**				**111,658**
Increase/(Decrease) in Investments					**8,254**

7. Investment returns remained low during 2020/2021. The UK Bank Rate remained at its record low of 0.1% during 2020/2021 and this provided a degree of stability for the Council's liquid holdings and in the short-term Local Authority Market. Short-term money market rates are still, however, at very low levels with average 3-month London Interbank Bid Rate (LIBID) in 2020/2021 being 0.03%, 6 month LIBID 0.01% and 1 year LIBID 0.03%. These rates correlate to the anticipated return to be achieved on investments over the durations quoted. The Council's actual return of 2.95% shows the effect of the portfolio's long-term duration set out above.

8. Recurring themes throughout 2020/2021 in the UK were the uncertainty following the UK withdrawal from the European Union (EU) on 31 January 2020, and the full effects of the Coronavirus pandemic, each acting as a dampener on growth and inflation expectations. In the UK an initial coronavirus lockdown was implemented in late March 2020 with the closure, at that time, of schools and all non-essential retail outlets. Restrictions were eased from 1 June 2021 with the phased reopening of schools but any prospect of an increase in growth potential in the UK were, however, dashed with further essential lockdowns taking effect from 5 November 2020 and 6 January 2021. A tiered system of restrictions was introduced after the second lockdown from 2 December 2020 with a roadmap eventually announced for lifting the lockdown fully; this eventually occurred on 19 July 2021.

9. In response to the prevailing economic conditions interest rates were cut globally with banks seeking to provide liquidity through the purchase of financial assets. In the UK itself, the Bank of England cut the Base Rate initially on 11 March 2020 to 0.25% (from 0.75%) and subsequently it was reduced further on 19 March 2020 to a record low level of 0.1%. It was maintained at this level throughout 2020/2021.

10. The Government also introduced a number of financial measures that sought to help businesses survive the crisis caused by the Coronavirus pandemic, including loan guarantees for bank lending, payment of business grants and the expansion of retail relief reducing the business rates liability for many businesses. These measures continued during the financial year 2020/2021. Given the uncertainty throughout 2020/2021 a cautious approach has been evident whereby investments continued to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to prevailing borrowing rates.

11. HM Treasury commenced, in March 2020, a consultation on potential changes to the rules around local authorities borrowing from the PWLB. The aim of the consultation was to develop a proportionate and equitable way to prevent local authorities from using PWLB loans to buy commercial assets primarily for yield, without impeding their ability to pursue service delivery, housing, and regeneration under the prudential regime. Following the consultation, the Government announced (on 25 November 2020) revised lending terms for PWLB borrowing and initial guidance to support Local Authorities to determine if a proposed project is an appropriate use of PWLB loans. These new terms applied to all loans arranged from 9.00am on 26 November 2020.

12. The unexpected increase in PWLB interest rates, by one percentage point from 8 October 2019, was reversed on 26 November 2020 to coincide with the introduction of new borrowing restrictions. This was in line with the Government announcement at the start of the consultation process to cut the interest rate on new PWLB loans, subject to market conditions, once a workable system could be designed and implemented to ensure that support would not be diverted into debt for-yield activity.

13. In respect of investments generally, the overall structure of interest rates has for some time meant that short term rates have remained lower than long term rates. In this scenario, the strategy has continued to be to reduce investments and borrow for short periods and possibly at variable rates when required. However, this needs careful review to avoid incurring higher borrowing costs in the future when the authority may not be able to avoid new borrowing to finance capital expenditure and/or refinance maturing debt.

14. The Council’s primary objective in relation to its investments is to ensure that long term capital is not put at risk but that, within acceptable risk parameters, the portfolio is managed to ensure that interest is maximised. Liquidity is managed through the use of money market funds with additional access to the liquid PWLB and Local Authority borrowing market. This objective is reinforced in the Treasury Management Strategy approved by Council on 23 February 2021. The Council has also appointed a Treasury Management Advisor, Link Asset Services, to enable independent specialist advice to be obtained on all aspects of the treasury management function, including advice on investments.

15. Short term borrowing of £44 million was obtained from Local Authorities to fund further loans to South Cambs Ltd, investment strategy acquisitions such as 296 Cambridge Science Park and the Vitrum Building and regeneration sites like Northstowe.

16. The table below lists the £5 million held in fixed term investments as at 31 March 2021. These investments are deposits with registered housing provider Places for People Ltd:

	Amount	Interest	Total	Term	Rate	Maturity Date
	£000	£000	£000	Days	%	
Counterparty						
Places for People	1,000	12.699	1,013	364	1.50	26/05/2021
Places for People	2,500	35.000	2,535	364	1.40	30/06/2021
Places for People	1,500	14.959	1,515	364	1.50	05/07/2021
Total	5,000					

17. The remaining £20.27 million of short-term investment balances were held in Notice accounts and the Council's Call account for liquidity purposes.

18. Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy, as set out in its Treasury Management Strategy Statement for 2020/2021, which defined "high credit quality" organisations as those having a long-term credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher.

19. All new investments are undertaken in accordance with advice from the Council's Treasury Management Adviser. A list of investment counterparties used during 2020/2021 is listed in **Appendix A**.

Borrowing

20. At 31 March 2021 the Council had external borrowing of £249.123 million:

	Balance 01/04/2020	Maturing Debt	Reclassified Debt	New Debt	Balance 31/03/2021
	£000	£000	£000	£000	£000
Borrowing					
Short Term Borrowing	10,000	(10,000)		44,000	44,000
Long Term Borrowing	205,123				205,123
Total Borrowing	**215,123**				**249,123**
Other Long Term Liabilities					
Total External Debt	**215,123**				**249,123**

21. £205,123 million of the total relates to borrowing from the PWLB. The PWLB loans were obtained for Housing Revenue Account (HRA) purposes as part of the HRA Self-Financing in 2012. These loans are fixed interest maturity loans having an average term to maturity of approximately 25 years and bearing interest at an average rate of 3.51%.

Cash Management

22. In keeping with the MHCLG's Guidance on Investments, the Council maintained a sufficient level of liquidity averaging £5.8 million through the use of Money Market Funds, Notice accounts and Call accounts.

23. Internal Treasury Management includes the management of the Council's bank account balances. The aim is for all cleared funds to be deposited in interest bearing accounts or time deposits.

Outturn Budget Monitoring

24. Council, at its meeting on 20 February 2020, approved a net budget in 2020/2021 for interest payable of £2.128 million and investment income of £4.537 million. A lower than forecast borrowing requirement and using short term borrowing rather than longer term in the year contributed to a decrease in interest payable. Lower than forecast capital expenditure in 2020/2021 resulted in lower Minimum Revenue Provision (MRP) cost. MRP is not applied to lending to South Cambs Ltd.

25. The budget is compared to the final outturn position in the table below:

	Budget 2020/2021	Outturn 2020/2021	Variance
	£000	**£000**	**£000**
Expenditure Description			
Interest Payable - PWLB & Short-Term Loans	9,321	7,253	(2,068)
Contribution to/(from) Reserves/Provision	(1,382)	1,795	3,177
Minimum Revenue Provision	2,075	870	(1,205)
Interest Receivable	(4,537)	(4,148)	389
Net Expenditure	**5,477**	**5,770**	**293**

26. The significant variances against budget were the Contribution to Reserves, MRP and Interest Payable. The Reserves increased by £1,795 million rather than the reduction forecast. The additional contribution related to unused Covid-19 Grant monies carried forward including unspent money from the £1.9 million Local Authority Support Grant. The other significant contribution was to the Renewables Reserve from the additional gain on the Business Rates Pool. Interest Payable was lower than budgeted due to changes to the Capital Programme following the introduction of new PWLB lending rules and the use of short term borrowing from Local Authorities that offer rather lower rates than that of the PWLB. MRP was also lower due to changes to the Capital Programme.

Benchmarking

27. Benchmarking data is also provided by the Council's Treasury Management Adviser. Investment return rates for the year to 31 March 2021 (excluding lending to South Cambs Ltd) are reported on a quarterly basis and were better than the client average and can be compared as follows:

	Investment Returns	
Quarter Ending	SCDC	Client Average
30 June 2020	0.70%	0.50%
30 September 2020	0.50%	0.36%
31 December 2020	0.35%	0.24%
31 March 2021	0.41%	0.24%

28. Benchmarking data on average weighted credit scores of the Council's counterparties (based in information held by the Council's Treasury Management Adviser) is set out in the table below and illustrates the Council's credit risk position in relation to other Councils:

	Weighted Average Credit Risk	
Quarter Ending	SCDC	Comparators
31 March 2020	2.53	2.88
30 June 2020	3.48	2.60
30 September 2020	3.45	2.87
31 December 2020	5.30	3.01
31 March 2021	5.20	3.12

29. The benchmarking shows that the Council's portfolio began the year with a slightly lower average credit risk than its Comparators group and finished the year with slightly higher exposure than the group. The Council has maintained investment returns above the client average.

Treasury Management Strategy for 2020/2021

(a) Interest Rates and Investments

30. The Treasury Management Strategy for 2020/2021 was prepared in the context of a record low interest rate policy with Bank of England Base Rate responding to economic conditions by initially reducing the rate from 0.75% to 0.25% on 11 March 2020 and then reducing it further on 19 March 2020 to the record low level of 0.1%. It was maintained at this level throughout 2020/2021. This intervention in the financial markets has continued to affect the Council's holdings.

31. The Council continued its policy of minimising risk by investing in Fixed Deposits only with highly rated Banks and Building Societies, Local Authority Counterparties and Registered Providers and using Money Market Funds and Bank Call Accounts to manage liquidity. This policy coupled with using pooled fund investments (suitably diversified) to maximise interest return on an element of the Council's portfolio has enabled the Council to reduce the cost of Capital Financing.

(b) Borrowing

32. The 2020/2021 borrowing strategy was based upon obtaining new PWLB loans of £113 million to fund the capital programme. Capital expenditure saw significant change related to the Investment Strategy and was significantly lower than planned due to changes in PWLB lending rules. Theis change and careful management of cash flows and short-term borrowing enabled the Council to fund the capital

programme without entering into long term borrowing. The Council did, however, borrow £44 million of short term Local Authority loans during the year, and £44 million of this was outstanding as at 31 March 2021.

33. During 2020/2021 there was a requirement for short term external borrowing of £44 million and this was used to finance capital expenditure. This is inclusive of additional loans to the value of £12.3 million made to South Cambs Limited. These loans are recognised as capital expenditure in the year increasing the Council's underlying need to borrow (the Capital Financing Requirement).

	Actual 2019/2020 £'000	**Original Budget 2020/2021 £'000**	**Actual 2020/2021 £'000**
Capital Financing Requirement (CFR) as at 1st April			
- General Fund	64,645	153,748	98,910
- HRA	204,429	204,429	204,429
Total	**269,074**	**358,177**	**303,339**
Change in the CFR	39,536	89,103	34,265
Minimum Revenue Provision	(581)	(870)	(870)
Capital Financing Requirement (CFR) as at 31 March	**308,029**	**446,410**	**336,734**

Economy

34. The Council's Treasury Management Advisers have provided a summary of the economy during 2020/2021, and related performance, and this is included at **Appendix B**.

Compliance with Performance Indicators

35. During the financial year the Council operated within the treasury limits and prudential indicators approved by Full Council on 20 February 2020.

36. Performance against prudential indicators in 2020/2021 was as follows:

(1) Acceptance of the CIPFA Treasury Management Code of Practice (National Indicator)

This indicator demonstrates that the Council adopted the principles of best practice. The Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* in January 2012. The Council adopted the CIPFA Treasury Management Code & Guidance Notes as part of its Treasury Management Policy and Strategy which was considered and approved at its meeting on 20 February 2020.

(2) Fixed Interest Rate Exposure and Variable Interest Rate Exposure

This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable interest rate exposures is expressed as the proportion of net principal borrowed.

Maturity structure of borrowing	Under 12 months	More than 12 months	Under 12 months - Actual	More than 12 months - Actual
Upper limit for fixed interest rate exposure	100%	100%	100%	100%
Upper limit for variable rate exposure	100%	0%	0%	0%

(3) Maturity Structure of Fixed Rate Borrowing

37. This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Fixed Rate Borrowing		
Lender	Repayable within	Amount £,000
Local Authorities	<12 Months	19,000
Local Authorities	1-5 years	25,000
PWLB	15 – 20 years	45,000
PWLB	20 – 25 years	50,000
PWLB	25 – 30 years	50,000
PWLB	30 – 35 years	50,000
PWLB	35 – 40 years	10,123

The 2011 revision to the CIPFA Treasury Management Code now requires the prudential indicator relating to Maturity of Fixed Rate Borrowing to reference the maturity of LOBO loans to the earliest date on which the lender can require payment.

(4) Upper Limit for Total Principal Sums Invested Over 364 Days

The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

The only loans exceeding 364 days are loans made to South Cambs Ltd, a wholly owned subsidiary of the Council, and Cambridge Ice and Leisure Centre (CLIC). Lending to CLIC formed 2% of the investment portfolio at 31 March 2021.

The limit relates to the maximum amount that can be invested in year. With regard to liquidity, no more than 50% of the total average portfolio held will be invested in instruments over 364 days, excluding South Cambs Ltd.

(5) Credit Risk

The Council considers security, liquidity and yield, in that order, when making investment decisions. Credit ratings remain an important element of assessing credit risk but they are not a sole feature in the assessment of counterparty credit risk.

The Council also considers alternative assessments of credit strength and information on corporate developments and market sentiment towards counterparties. The following key tools are used, either by ourselves or the appointed Treasury Advisers to assess credit risk:

- Published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns);
- Sovereign support mechanisms;
- Credit default swaps (where quoted);
- Share prices (where available);
- Economic fundamentals (such as a country's net debt as a percentage of its GDP);
- Corporate developments, news, articles, markets sentiment and momentum.

The only indicators with prescriptive values are credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

(6) Liquidity Risk

The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

Implications

38. In the writing of this report, taking into account the financial, legal, staffing, risk management, equality and diversity, climate change, community safety and any other key issues, the following implications have been considered:

Legal

39. The Council is required to have regard to the CIPFA Code of Practice for Treasury Management in the Public Services. The Code recommends that an annual post year report on Treasury Management activities is prepared for consideration after each year end.

Policy

40. Full Council, at its meeting on 20 February 2020, approved the Council's Treasury Management Policy and Strategy Statements for 2020/2021 and the Strategy was reaffirmed by Audit and Governance Committee, at its meeting on 24 November 2020, following a mid-year review.

Finance

41. In 2020/2021 the Council managed a turnover in investments of £403 million (£387 million in 2019/2020) in-house within the Finance Team in the Finance Directorate. As at 31 March 2021, the Council had funds to the market value of £111.7 million (£103.4 million at 31 March 2020), all managed in-house. These funds include capital balances, reserves and provisions, collection fund monies and monies held on behalf of third parties. The increase was due primarily to Covid-19 Grant income and retained business rates.

42. At 31 March 2021 the Council had external borrowing of £249.1 million plus £Nil million of leasing liabilities (£215.1 million with no refuse vehicle leasing liabilities at 31 March 2020)

Risks

43. There are clearly inherent risks in placing investments both in terms of the security of the capital invested and the level of return from the investment. The approved Treasury Management Strategy 2020/2021 identified the Councils investment priorities as:

(i) The security of the capital;
(ii) The liquidity of its investments.

44. The Treasury Management Strategy states that the Authority'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 low investment income.

45. The Council engages an external Treasury Management Adviser to provide appropriate and timely advice on the Council's treasury portfolio (and, in particular, to provide advice on counter-party creditworthiness and investment limits). This appointment is regarded as critical given the investment risks.

Environmental

46. There are no direct environmental implications arising from the report.

Equality and Diversity

47. In preparing this report, due consideration has been given to the District Council's statutory Equality Duty to eliminate unlawful discrimination, advance equality of opportunity and foster good relations, as set out in Section 149(1) of the Equality Act 2010. A relevance test for equality has determined that the activity has no relevance to South Cambridgeshire District Council's statutory equality duty to eliminate unlawful discrimination, advance equality of opportunity and foster good relation. An equality impact assessment is not needed.

Effect on Council Priority Areas

48. Timely and robust consideration of the Council's treasury management activities is vital to ensure that financial performance is in line with expectations.

Background Papers

Where the Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012 require documents to be open to inspection by members of the public, they must be available for inspection:

(a) at all reasonable hours at the offices of South Cambridgeshire District Council;
(b) on the Council's website; and
(c) in the case of documents to be available for inspection pursuant to regulation 15, on payment of a reasonable fee required by the Council by the person seeking to inspect the documents at the offices of South Cambridgeshire District Council.

The following documents are relevant to this report:

- Budget Setting Report – Report to Council: 20 February 2020

- Capital Strategy – Report to Council: 20 February 2020
- Treasury Management Strategy – Report to Council: 20 February 2020
- Mid-Year 2020/2021 Treasury Management Report – Report to Audit & Corporate Governance Committee: 24 November 2020

Appendices

A Investment Counterparties 2020/2021

B Treasury Management Adviser – Economic Review 2020/2021

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Appendix A

Investment Counterparties 2020/2021

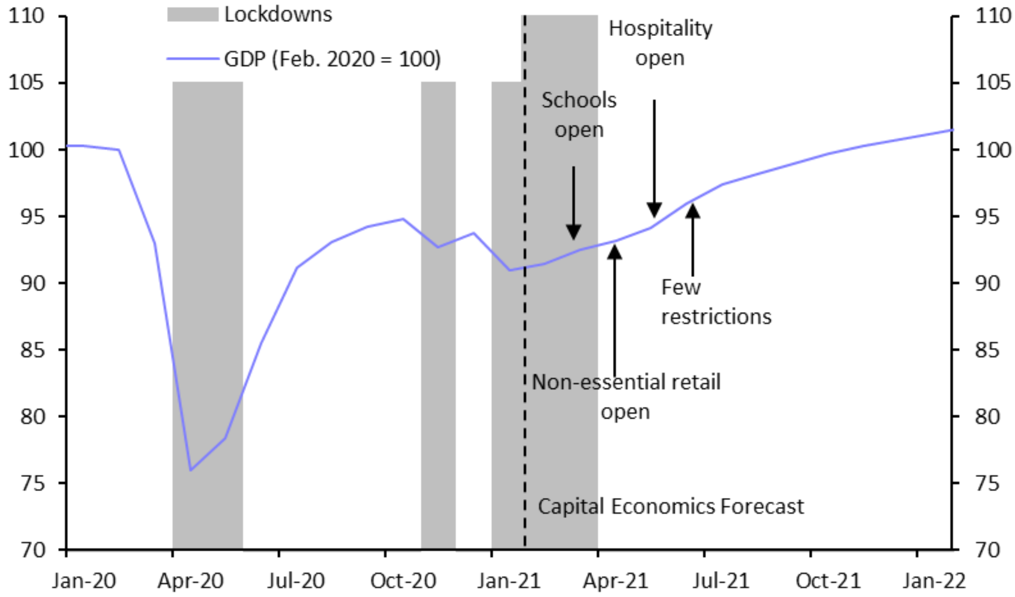
The Council’s investment counterparties used during 2020/2021 are listed below:

Category	Counterparty
Building Society	Coventry BS
Clearing Bank	Barclays Bank
Clearing Bank	Lloyds Bank
Clearing Bank	Santander UK
Other Bank	Close Brothers
Other Bank	Standard Chartered
Housing Association	Places for People
Local Authority	Peterborough City Council
Local Authority	Uttlesford DC
Local Authority	Conwy CBC
Local Authority	Derbyshire CC
Local Authority	North of Tyne CA
Local Authority	Surrey CC
Local Authority	Lichfield Council
Local Authority	Cheltenham BC
Local Authority	Eastleigh BC
Local Authority	Calderdale MBC
Money Market Fund	Aberdeen Standard Life
Money Market Fund	Deutsche Bank
Money Market Fund	Aviva
Call account	Barclays Bank plc
South Cambs Ltd	Ermine Street Housing
Other investments	Cambridge Leisure and Ice Centre

Appendix B

Treasury Management Adviser – Economic Review 2020/2021

UK. Coronavirus. The financial year 2020/21 will go down in history as being the year of the pandemic. The first national lockdown in late March 2020 did huge damage to an economy that was unprepared for such an eventuality. This caused an economic downturn that exceeded the one caused by the financial crisis of 2008/09. A short second lockdown in November did relatively little damage but by the time of the third lockdown in January 2021, businesses and individuals had become more resilient in adapting to working in new ways during a three month lockdown so much less damage than was caused than in the first one. The advent of vaccines starting in November 2020, were a game changer. The way in which the UK and US have led the world in implementing a fast programme of vaccination which promises to lead to a return to something approaching normal life during the second half of 2021, has been instrumental in speeding economic recovery and the reopening of the economy. In addition, the household saving rate has been exceptionally high since the first lockdown in March 2020 and so there is plenty of pent-up demand and purchasing power stored up for services in the still-depressed sectors like restaurants, travel and hotels as soon as they reopen. It is therefore expected that the UK economy could recover its pre-pandemic level of economic activity during quarter 1 of 2022.



Both the Government and the Bank of England took rapid action in March 2020 at the height of the crisis to provide support to financial markets to ensure their proper functioning, and to support the economy and to protect jobs.

The **Monetary Policy Committee** cut Bank Rate from 0.75% to 0.25% and then to 0.10% in March 2020 and embarked on a £200bn programme of quantitative easing QE (purchase of gilts so as to reduce borrowing costs throughout the economy by lowering gilt yields). The MPC increased then QE by £100bn in June and by £150bn in November to a total of £895bn. While Bank Rate remained unchanged for the rest of the year, financial markets were concerned that the MPC could cut Bank Rate to a negative rate; this was firmly discounted at the February 2021 MPC meeting when it was established that commercial banks would be unable to implement negative rates for at least six months – by which time the economy was expected to be making a strong recovery and negative rates would no longer be needed.

Average inflation targeting. This was the major change adopted by the Bank of England in terms of implementing its inflation target of 2%. The key addition to the Bank's forward guidance in August was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and ***achieving the 2% target sustainably***". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. This sets a high bar for raising Bank Rate and no increase is expected by March 2024, and possibly for as long as five years. Inflation has been well under 2% during 2020/21; it is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short lived factor and so not a concern to the MPC.

Government support. The Chancellor has implemented repeated rounds of support to businesses by way of cheap loans and other measures, and has protected jobs by paying for workers to be placed on furlough. This support has come at a huge cost in terms of the Government's budget deficit ballooning in 20/21 and 21/22 so that the Debt to GDP ratio reaches around 100%. The Budget on 3rd March 2021 increased fiscal support to the economy and employment during 2021 and 2022 followed by substantial tax rises in the following three years to help to pay the cost for the pandemic. This will help further to strengthen the economic recovery from the pandemic and to return the government's finances to a balanced budget on a current expenditure and income basis in 2025/26. This will stop the Debt to GDP ratio rising further from 100%. An area of concern, though, is that the government's debt is now twice as sensitive to interest rate rises as before the pandemic due to QE operations substituting fixed long-term debt for floating rate debt; there is, therefore, much incentive for the Government to promote Bank Rate staying low e.g. by using fiscal policy in conjunction with the monetary policy action by the Bank of England to keep inflation from rising too high, and / or by amending the Bank's policy mandate to allow for a higher target for inflation.

BREXIT. The final agreement on 24th December 2020 eliminated a significant downside risk for the UK economy. The initial agreement only covered trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. There was much disruption to trade in January as form filling has proved to be a formidable barrier to trade. This appears to have eased somewhat since then but is an area that needs further work to ease difficulties, which are still acute in some areas.

USA. The US economy did not suffer as much damage as the UK economy due to the pandemic. The Democrats won the presidential election in November 2020 and have control of both Congress and the Senate, although power is more limited in the latter. This enabled the Democrats to pass a $1.9trn (8.8% of GDP) stimulus package in March on top of the $900bn fiscal stimulus deal passed by Congress in late December. These, together with the vaccine rollout proceeding swiftly to hit the target of giving a first jab to over half of the population within the President's first 100 days, will promote a rapid easing of restrictions and strong economic recovery during 2021. The Democrats are also planning to pass a $2trn fiscal stimulus package aimed at renewing infrastructure over the next decade. Although this package is longer-term, if passed, it would also help economic recovery in the near-term.

After Chair Jerome Powell spoke on the **Fed's adoption of a flexible average inflation target** in his Jackson Hole speech in late August 2020, the mid-September meeting of the Fed agreed a new inflation target - that *"it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time."* This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. There is now some expectation that where the Fed has led in changing its policy towards implementing its inflation and full employment mandate, other major central banks will follow, as indeed the Bank of England has done so already. The Fed expects strong economic growth during 2021 to have only a transitory impact on inflation, which explains why the majority of Fed officials project US interest rates to remain near-zero through to the end of 2023. The key message is still that policy will remain unusually accommodative – with near-zero rates and asset purchases – continuing for several more years. This is likely to result in keeping treasury yields at historically low levels. However, financial markets in 2021 have been concerned that the sheer amount of fiscal stimulus, on top of highly accommodative monetary policy, could be over-kill leading to a rapid elimination of spare capacity in the economy and generating higher inflation much quicker than the Fed expects. They have also been concerned as to how and when the Fed will eventually wind down its programme of monthly QE purchases of treasuries. These concerns have pushed treasury yields sharply up in the US in 2021 and is likely to have also exerted some upward pressure on gilt yields in the UK.

EU. Both the roll out and take up of vaccines has been disappointingly slow in the EU in 2021, at a time when many countries are experiencing a sharp rise in cases which are threatening to overwhelm hospitals in some major countries; this has led to renewed severe restrictions or lockdowns during March. This will inevitably put back economic recovery after the economy had staged a rapid rebound from the first lockdowns in Q3 of 2020 but contracted slightly in Q4 to end 2020 only 4.9% below its pre-pandemic level. Recovery will now be delayed until Q3 of 2021 and a return to pre-pandemic levels is expected in the second half of 2022.

Inflation was well under 2% during 2020/21. **The ECB** did not cut its main rate of -0.5% further into negative territory during 2020/21. It embarked on a major expansion of its QE operations (PEPP) in March 2020 and added further to that in its December 2020 meeting when it also greatly expanded its programme of providing cheap loans to banks. The total PEPP scheme of €1,850bn is providing protection to the sovereign bond yields of weaker countries like Italy. There is, therefore, **unlikely to be a euro crisis** while the ECB is able to maintain this level of support.

China. After a concerted effort to get on top of the virus outbreak in Q1 of 2020, economic recovery was strong in the rest of the year; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth.

Japan. Three rounds of government fiscal support in 2020 together with Japan's relative success in containing the virus without draconian measures so far, and the roll out of vaccines gathering momentum in 2021, should help to ensure a strong recovery in 2021 and to get back to pre-virus levels by Q3.

World growth. World growth was in recession in 2020. Inflation is unlikely to be a problem in most countries for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

Deglobalisation. Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last 30 years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. In March 2021, western democracies implemented limited sanctions against a few officials in charge of government policy on the Uighurs in Xinjiang; this led to a much bigger retaliation by China and is likely to mean that the China / EU investment deal then being negotiated, will be torn up. After the pandemic exposed how frail extended supply lines were around the world, both factors are now likely to lead to a sharp retrenchment of economies into two blocs of western democracies v. autocracies. It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products and vice versa. This is likely to reduce world growth rates.

Central banks' monetary policy. During the pandemic, the governments of western countries have provided massive fiscal support to their economies which has resulted in a big increase in total government debt in each country. It is therefore very important that bond yields stay low while debt to GDP ratios slowly subside under the impact of economic growth. This provides governments with a good reason to amend the mandates given to central banks to allow higher average levels of inflation than we have generally seen over the last couple of decades. Both the Fed and Bank of England have already changed their policy towards implementing their existing mandates on inflation, (and full employment), to hitting an average level of inflation. Greater emphasis could also be placed on hitting subsidiary targets e.g. full employment before raising rates. Higher average rates of inflation would also help to erode the real value of government debt more quickly.