South Cambridgeshire District Council

REPORT TO:	Audit & Governance	29 September 2022
LEAD CABINET MEMBER:	Councillor John Williams, Lead Cabinet Member for Finance	
LEAD OFFICER:	Peter Maddock, Head of Finance	

Treasury Management – Annual Report 2021/2022

Executive Summary

1. This report outlines the Treasury Management activities in the financial year 2021/2022 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 2021/2022.

Details

Treasury Portfolio 2021/2022: Summary Position

5. The summary position as at 31 March 2022 (with comparable data for 31 March 2021) is shown below:

	31 March 2021		31 March 2022	
Borrowing	**£000**	**Rate %**	**£000**	**Rate %**
PWLB	205,123	3.51	205,123	3.51
LOBO - Market	Nil		Nil	
Local Authority	44,000	0.50	50,000	0.35
Other Long-Term Liabilities	Nil		Nil	
Total Debt	**249,123**		**255,123**	
Investments	**(111,658)**		**(117,560)**	
Net Borrowing/(Investment)	**137,465**		**137,563**	

Investments

6. Investments are categorised into long and short term (i.e. less than 365 days). The sum of £16 million had less than one year to maturity as at 31 March 2022 and is, therefore, classified as short term. The remaining balance held of £101.56 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 Cambourne Town Council during the year. A summary of the investments held is shown below:

	Balance 01/04/2021	New Investments	Maturities/ Sales	Interest Accrued	Balance 31/03/2022
	£000	£000	£000	£000	£000
Investment Counterparty					
Short Term:					
Clearing Banks	14,000	0	(14,000)	Nil	Nil
Other Banks	Nil	29,000	(21,000)	2.3	8,000
Building Societies	Nil	153,960	(151,960)	0.9	2,000
Housing Associations	5,000	2,500	(4,000)	38.0	3,500
Local Authorities	Nil	23,500	(21,000)	0.3	2,500
Money Market Funds	Nil	59,660	(57,505)	0.6	2,155
Call Account	6,265	138,950	(143,330)	0.2	1,885
Long Term:					
CLIC (Ice Rink Loan)	2,400	0	0	103.4	2,400
South Cambs Ltd	83,993	10,627	0	457.6	94,620
Cambourne Town Council	Nil	500	0	1.7	500
Total Investments	**111,658**				**117,560**
Increase/(Decrease) in Investments					**5,902**

7. Investment returns remained low during 2021/2022. The UK Bank Rate remained at its record low of 0.1% until 16 December 2021 and this provided a degree of stability for the Council's liquid holdings and in the short-term Local Authority Market. The increase in December 2021 to 0.25% was followed by further increases, in response to market conditions, to 0.5% on 3 February 2022 and to 0.75% from 17 March 2022. Short-term money market rates remained at relatively low levels with average 3-month London Interbank Bid Rate (LIBID) in 2021/2022 being -0.02%, 6-month LIBID 0.06% and 1-year LIBID 0.22%. These rates correlate to the anticipated return to be achieved on investments over the durations quoted. The Council's actual return of 3.20% shows the effect of the portfolio's long-term duration set out above.

8. Recurring themes throughout 2021/2022 in the UK were the process of recovery from the full effects of the Coronavirus pandemic, in line with the roadmap for lifting the lockdown fully effective from 19 July 2021 and, of significance, high inflation levels. The UK inflation rate in March 2022, as measured by the Consumer Price Index (CPI), was 7.0%. CPI measures the overall change in consumer prices based on a representative basket of goods and services over time. The alternative measure, CPIH, extends CPI to include owner occupiers' housing costs, along with council tax. The inflation measures for the year to March 2022 were as follows: CPIH inflation was 6.2% in March 2022, up from 5.5% in the year to February. CPI inflation was 7.0% in March 2022, up from 6.2% in the year to February.

9. The world appears to be moving towards a stage of acceleration in inflation not seen in the last forty years. This worldwide increase in inflation began in early 2021, and it has been attributed primarily to supply shortages caused by the COVID-19 pandemic and the Russian invasion of Ukraine, coupled with stronger consumer demand. As a result, many countries have seen their highest inflation in decades and banking institutions have responded by aggressively increasing interest rates.

10. For local authorities, increased energy prices, spiralling inflation, and national living wage pressures have added unforeseen extra cost pressures on council budgets. The cost-of-living crisis has created a perfect storm of increasing public demand for services and rising fuel and other bills for local authorities. Without funding to offset this crisis, Councils could have to scale back construction projects or make in-year reductions to services. This has prompted Councils to make recalculations and to look at further cuts as they battle budgetary pressures, exacerbated by rising costs.

11. In respect of investments generally, the overall structure of interest rates has for some time meant that short term rates have generally 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.

12. 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 22 February 2022. 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.

13. The Council holds £50 million of Short-term borrowing from other Local Authorities. This has funded further loans to South Cambs Ltd, the acquisition of Cambourne Business Park Limited plus Plot 4010 and the development of South Cambridgeshire Investment Partnership (SCIP).

14. The table below lists the £16 million held in fixed term investments as at 31 March 2022. These investments are deposits with Standard Chartered Sustainable Fund (an Environmental, Social and Governance (ESG) fund that the Council has used significantly during 2021/22), a registered housing provider, a local Authority and a Building Society to maintain diversification:

	Amount £000	Interest £000	Total £000	Term Days	Rate %	Maturity Date
Counterparty						
Wirral Borough Council	2,500	1.2	2,501	32	0.53	25/04/2022
Standard Chartered	7,000	10.7	7,011	59	0.95	19/05/2022
Yorkshire	2,000	2.4	2,002	76	0.57	19/05/2022
Places for People	1,000	7.0	1,007	365	0.70	26/05/2022
Places for People	2,500	42.5	2,543	365	1.70	30/06/2022
Standard Chartered	1,000	6.0	1,006	161	1.36	01/09/2022

Total	16,000					

15. The remaining £4.04 million of short-term investment balances were held in Money Market Funds and the Council's Call account for liquidity purposes.

16. 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 2021/2022, 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.

17. All new investments are undertaken in accordance with advice from the Council's Treasury Management Adviser. A list of investment counterparties used during 2021/2022 is listed in **Appendix A**.

Borrowing

18. At 31 March 2022 the Council had external borrowing of £255.123 million:

	Balance 01/04/2021	Maturing Debt	Reclassified Debt	New Debt	Balance 31/03/2022
	£000	£000	£000	£000	£000
Borrowing					
Short Term Borrowing	44,000	(19,000)		25,000	50,000
Long Term Borrowing	205,123				205,123
Total Borrowing	**249,123**				**255,123**
Other Long-Term Liabilities	-				-
Total External Debt	**249,123**				**255,123**

19. £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

20. In keeping with the MHCLG's Guidance on Investments, the Council maintained a sufficient level of liquidity averaging £7.7 million through the use of Money Market Funds, Notice accounts and Call accounts.

21. 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

22. Council, at its meeting on 23 February 2021, approved a net budget in 2021/2022 for interest payable of £1.205 million and investment income of £5.641 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 2021/2022 resulted in lower Minimum Revenue Provision (MRP) cost. MRP is not applied to lending to South Cambs Ltd.

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

	Budget 2021/2022	Outturn 2021/2022	Variance
	£000	£000	£000
Expenditure Description			
Interest Payable - PWLB & Short-Term Loans	575	186	(389)
Contribution to/(from) Reserves/Provision (*Est)	(1,059)	644	1,703
Minimum Revenue Provision	1,363	1,113	(250)
Interest Receivable	(3,281)	(3,384)	(103)
Net Expenditure	**(2,402)**	**(1,441)**	**961**

24. The significant variances against budget were the Contribution to Reserves and Interest Payable. The Reserves are estimated to increase by £0.644 million rather than the reduction forecast. This change to contribution is related to the slippage on the Greening of South Cambs Hall project and associated reduction in contribution from Renewable Reserve. MRP was lower due to changes to the Capital Programme. These changes also led to lower amounts of interest being payable as borrowing balances were smaller.

Benchmarking

25. Benchmarking data is also provided by the Council's Treasury Management Adviser. Investment return rates for the year to 31 March 2022 (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 2021	0.52%	0.18%
30 September 2021	0.30%	0.15%
31 December 2021	0.31%	0.16%
31 March 2022	0.85%	0.45%

26. 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 credit risk position in relation to other Councils:

	Weighted Average Credit Risk	
Quarter Ending	**SCDC**	**Comparators**
31 March 2021	5.20	3.12
30 June 2021	4.82	3.07
30 September 2021	4.62	3.11
31 December 2021	4.93	3.17

31 March 2022	4.35	2.95

27. The benchmarking shows that the Credit Risk on the Council's portfolio has reduced during the year although it has a higher than average Credit Risk compared to other District Authorities. The Council has maintained investment returns significantly above the client average.

Treasury Management Strategy for 2021/2022

(a) Interest Rates and Investments

28. The Treasury Management Strategy for 2021/2022 was prepared in the context of low, but increasing interest rates, with the Bank of England Base Rate responding to economic conditions by initially increasing the rate from its record low 0.1% to 0.25% on 16 December 2021, and then increasing it further to 0.5% on 3 February 2022 and then to 0.75% from 17 March 2022. This intervention in the financial markets has continued to affect investment returns from the Council's holdings.

29. 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

30. The 2021/2022 borrowing strategy was based upon obtaining new PWLB loans of £60 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. This 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 a further £6 million of short-term Local Authority loans during the year, and £50 million was outstanding as at 31 March 2022.

31. During 2021/2022 there was a requirement for short term external borrowing of £50 million and this was used to finance capital expenditure. This is inclusive of additional loans to the value of £10.6 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 2020/2021 £'000	**Budget 2021/2022 £'000**	**Actual 2021/2022 £'000**
Capital Financing Requirement (CFR) as at 1st April			
- General Fund	98,910	127,960	127,130
- HRA	204,429	204,429	204,429
Total	**303,339**	**332,389**	**331,559**
Change in the CFR	34,265	29,050	28,220
Minimum Revenue Provision	(870)	(1,363)	(1,113)
Capital Financing Requirement (CFR) as at 31 March	**336,734**	**360,056**	**358,666**

Economy

32. The Council's Treasury Management Advisers have provided a summary of the economy during 2021/2022, and related performance, and this is included at **Appendix B**.

Compliance with Performance Indicators

33. During the financial year the Council operated within the treasury limits and prudential indicators approved by Full Council on 23 February 2021.

34. Performance against prudential indicators in 2021/2022 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 23 February 2021.

(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

35. 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	50,000
PWLB	10 – 15 years	5,000
PWLB	15 – 20 years	50,000
PWLB	20 – 25 years	50,000
PWLB	25 – 30 years	50,000
PWLB	30 – 35 years	50,123

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 as at 31 March 2022.

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

36. 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

37. 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

38. Full Council, at its meeting on 23 February 2021, approved the Council's Treasury Management Policy and Strategy Statements for 2021/2022 and the Strategy was reaffirmed by Audit and Governance Committee, at its meeting on 1 December 2021, following a mid-year review.

Finance

39. In 2021/2022 the Council managed a turnover in investments of £419 million (£403 million in 2020/2021) in-house within the Finance Team in the Finance Directorate. As at 31 March 2022, the Council had funds to the market value of £117.6 million (£111.7 million at 31 March 2021), 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 retained business rates.

40. At 31 March 2022 the Council had external borrowing of £255.123 million plus £Nil million of leasing liabilities (£249.1 million with no refuse vehicle leasing liabilities at 31 March 2020)

Risks

41. 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 2021/2022 identified the Councils investment priorities as:

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

42. 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.

43. 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

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

Equality and Diversity

45. 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

46. 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: 23 February 2021
- Capital Strategy – Report to Council: 23 February 2021
- Treasury Management Strategy – Report to Council: 23 February 2021
- Mid-Year 2021/2022 Treasury Management Report – Report to Audit & Corporate Governance Committee: 1 December 2021

Appendices

A Investment Counterparties 2021/2022

B Treasury Management Adviser – Economic Review 2021/2022

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Appendix A

Investment Counterparties 2021/2022

The Council’s investment counterparties used during 2021/2022 are listed below:

Category	Counterparty
Building Society	Coventry BS
Building Society	Yorkshire 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	Cornwall Council
Local Authority	Guildford BC
Local Authority	PCC for Hampshire
Local Authority	Slough BC
Local Authority	Uttlesford DC
Local Authority	Wirral BC
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/Loans	Cambourne Town Council

Appendix B

Treasury Management Adviser – Economic Review 2021/2022

The Economy and Interest Rates

UK. Economy. Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021, 0.50% at its meeting of 4th February 2022 and then to 0.75% in March 2022.

The UK economy has endured several false dawns through 2021/22, but with most of the economy now opened up and nearly back to business-as-usual, the GDP numbers have been robust (9% y/y Q1 2022) and sufficient for the MPC to focus on tackling the second-round effects of inflation, now that the CPI measure has already risen to 6.2% and is likely to exceed 8% in April.

Gilt yields fell towards the back end of 2021, but despite the war in Ukraine gilt yields have shot higher in early 2022. At 1.38%, 2-year yields remain close to their recent 11-year high and 10-year yields of 1.65% are close to their recent six-year high. These rises have been part of a global trend as central banks have suggested they will continue to raise interest rates to contain inflation.

Historically, a further rise in US Treasury yields will probably drag UK gilt yields higher. There is a strong correlation between the two factors. However, the squeeze on real household disposable incomes arising from the 54% leap in April utilities prices as well as rises in council tax, water prices and many phone contract prices, are strong headwinds for any economy to deal with. In addition, from 1st April 2022, employees also pay 1.25% more in National Insurance tax. Consequently, inflation will be a bigger drag on real incomes in 2022 than in any year since records began in 1955.

Average inflation targeting. This was the major change in 2020/21 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 2020 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 mantra now seems very dated. Inflation is the "genie" that has escaped the bottle, and a perfect storm of supply side shortages, labour shortages, commodity price inflation, the impact of Russia's invasion of Ukraine and subsequent Western sanctions all point to inflation being at elevated levels until well into 2023.

USA. The flurry of comments from Fed officials following the mid-March FOMC meeting – including from Chair Jerome Powell himself – hammering home the hawkish message from the mid-March meeting, has had markets pricing in a further 225bps of interest rate increases in 2022 on top of the initial move to an interest rate range of 0.25% - 0.5%.

In addition, the Fed is expected to start to run down its balance sheet. Powell noted that the rundown could come as soon as the next meeting in May.

The upward pressure on inflation from higher oil prices and potential knock-on impacts on supply chains all argue for tighter policy (CPI is estimated at 7.8% across Q1), but the hit to real disposable incomes and the additional uncertainty points in the opposite direction.

More recently, the inversion of the 10y-2y Treasury yield spread at the end of March led to predictable speculation that the Fed's interest rate hikes would quickly push the US economy into recession. Q1 GDP growth is likely to be only between 1.0% and 1.5% annualised (down from 7% in

Q4 2021). But, on a positive note, the economy created more than 550,000 jobs per month in Q1, a number unchanged from the post-pandemic 2021 average. Unemployment is only 3.8%.

EU. With euro-zone inflation having jumped to 7.5% in March it seems increasingly likely that the ECB will accelerate its plans to tighten monetary policy. It is likely to end net asset purchases in June – i.e., earlier than the Q3 date which the ECB targeted in March. And the market is now anticipating possibly three 25bp rate hikes later this year followed by more in 2023. Policymakers have also hinted strongly that they would re-start asset purchases if required. In a recent speech, Christine Lagarde said "we can design and deploy new instruments to secure monetary policy transmission as we move along the path of policy normalisation."

While inflation has hit the headlines recently, the risk of recession has also been rising. Among the bigger countries, Germany is most likely to experience a "technical" recession because its GDP contracted in Q4 2021, and its performance has been subdued in Q1 2022. However, overall, Q1 2022 growth for the Eurozone is expected to be 0.3% q/q with the y/y figure posting a healthy 5.2% gain. Finishing on a bright note, unemployment fell to only 6.8% in February.

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; however, 2021 has seen the economy negatively impacted by political policies that have focussed on constraining digital services, restricting individual freedoms, and re-establishing the power of the One-Party state. With the recent outbreak of Covid-19 in large cities, such as Shanghai, near-term economic performance is likely to be subdued. Official GDP numbers suggest growth of c4% y/y, but other data measures suggest this may be an overstatement.

Japan. The Japanese economic performance through 2021/22 is best described as tepid. With a succession of local lockdowns throughout the course of the year, GDP is expected to have risen only 0.5% y/y with Q4 seeing a minor contraction. The policy rate has remained at -0.1%, unemployment is currently only 2.7% and inflation is sub 1%, although cost pressures are mounting.

World growth. World growth is estimated to have expanded 8.9% in 2021/22 following a contraction of 6.6% in 2020/21.

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 18% of total world GDP (the USA accounts for 24%), and Russia's recent invasion of Ukraine, has unbalanced the world economy. In addition, 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 (and to a much lesser extent Russia) 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.