AUDIT COMMITTEE

23 SEPTEMBER 2021

TREASURY MANAGEMENT STRATEGY MID-YEAR REVIEW REPORT 2021/22

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Summary

This report gives and overview of treasury management activity since 1 April 2021 and presents a review of the Treasury Strategy approved by Council on 18 February 2021.

The key indicators are set out in the table below:

Indicator	2021/22 £000	2022/23 £000	2023/24 £000	2024/25 onwards £000
Capital Expenditure	137,003	124,791	137,328	51,727
Capital Financing Requirement (CFR) at year end	431,386	502,892	475,424	496,353
External Borrowing	383,642	458,591	437,901	468,906
Underborrowing	47,744	44,301	37,523	27,447

The movement in the capital financing requirement is shown below:

Capital Financing Requirement	2021/22 £000	2021/23 £000	2023/24 £000	2024/25 onwards £000
Opening Balance	331,606	431,386	502,892	475,424
In Year Borrowing Requirement	101,392	74,949	19,133	51,512
Less MRP & VRP*	-358	-2,239	-5,622	-8,966
Less Repaid from Receipts	0	0	-39,823	-20,507
Less KCC Debt Repayment	-1,254	-1,204	-1,156	-1,110
Closing CFR	431,386	502,892	475,424	496,353

* Minimum Revenue Provision (MRP) relating to general fund and Voluntary Revenue Provision (VRP) relating to Housing Revenue Account are net of the repayment holiday identified by Link.

1. Budget and Policy Framework

1.1 Audit Committee is responsible for the scrutiny of the Council's Treasury Management, Investment Strategy and Minimum Revenue Provision Policy Statement along with Treasury Management Practices and associated Schedules.

1.2 There needs to be, as a minimum, a mid-year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved.

1.3 This report is also scheduled for consideration by Cabinet on 28 September 2021 and full Council on 7 October 2021.

2. Background

2.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensures this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, providing adequate liquidity initially, before looking to maximise investment return.

2.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing requirements of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending liabilities. This management of longer-term cash may involve arranging long or short-term loans, or using long-term cash flow surpluses, and on occasion, debt previously incurred may be restructured to meet Council risk or cost objectives.

2.3 As a consequence treasury management is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2.4 The principal requirements of the Code are as follows:

(i) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities;

(ii) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives;

(iii) Receipt by full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review

Report and an Annual Report (stewardship report) covering activities undertaken during the previous year;

(iv) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific committee. For this Council the delegated body is the Audit Committee.

2.5 This mid year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- A review of the Treasury Management Strategy Statement and Annual Investment Strategy (Section 3);
- A review of the Council's borrowing strategy for 2021/22 (Section 4);
- A review of the Council's investment portfolio for 2021/22(Section 5);
- A review of any debt rescheduling undertaken during 2021/22 (Section 6);
- A review of compliance with Treasury and Prudential Limits for 2021/22. (Section 7);
- An economic update for the first part of 2021/22 (Appendix).

3. Treasury Management Strategy Statement and Annual Investment Strategy Update

3.1 Full Council approved the 2021/22 Treasury Management Annual Investment Strategy on the 18 February 2021.

3.2 The Strategy stated that officers would aim to smooth out the maturity profile and reduce reliance on short term debt. However the availability of short funding from other local authorities at much lower rates than available for longer duration from PWLB has meant a continued use of short term borrowing Furthermore, borrowing for projects expected to generate capital receipts in a short timescale, such as those undertaken by Medway Development Company, and also capital schemes funded by grants which are paid after expenditure has been defrayed, will require shorter periods than loans taken for other projects. The current position is shown in the graph at 4.9.

4. Borrowing & Borrowing Limits

4.1 The purpose of the Capital Financing Requirement (CFR) is to demonstrate that Council borrowing is undertaken to fund capital expenditure only. The CFR represents the long term assets of the Council that have not been funded from sources other than borrowing, such as grants and external contributions, capital receipts or revenue funding. External borrowing should not exceed the CFR over the medium term. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

4.2 An updated estimate of the CFR and borrowing position compared with the estimate included in the Treasury Strategy is shown in the table below:

CFR & Borrowing	Per Strategy £000	Revised Estimate £000
CFR 31 March 2022	464,897	431,386
External Debt*	437,110	383,642
Under-borrowing	27,787	47,744
Estimated In Year Borrowing Required**	104,683	94,774

The lower estimates arise from the evolution of the capital programme including changes to profiling and funding since the Strategy was formulated in late 2020.

4.3 The Chief Finance Officer reports that no difficulties are envisaged for the current or future years in ensuring that borrowing does not exceed CFR.

4.4 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit, which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in a longer-term scenario. It is a forecast of maximum borrowing requirement with some capacity for unexpected movements. This is the statutory limit determined under section 3(1) of the Local Government Act 2003. The Council's authorised borrowing limit for 2021/22 is £236.587 million and it will not exceed this limit.

4.5 Recent strategy has been to reduce interest rate risk and smooth the borrowing repayment profile by taking out new borrowing for longer repayment terms. Progress towards this aim has been limited by the factors noted in 3.2 above.

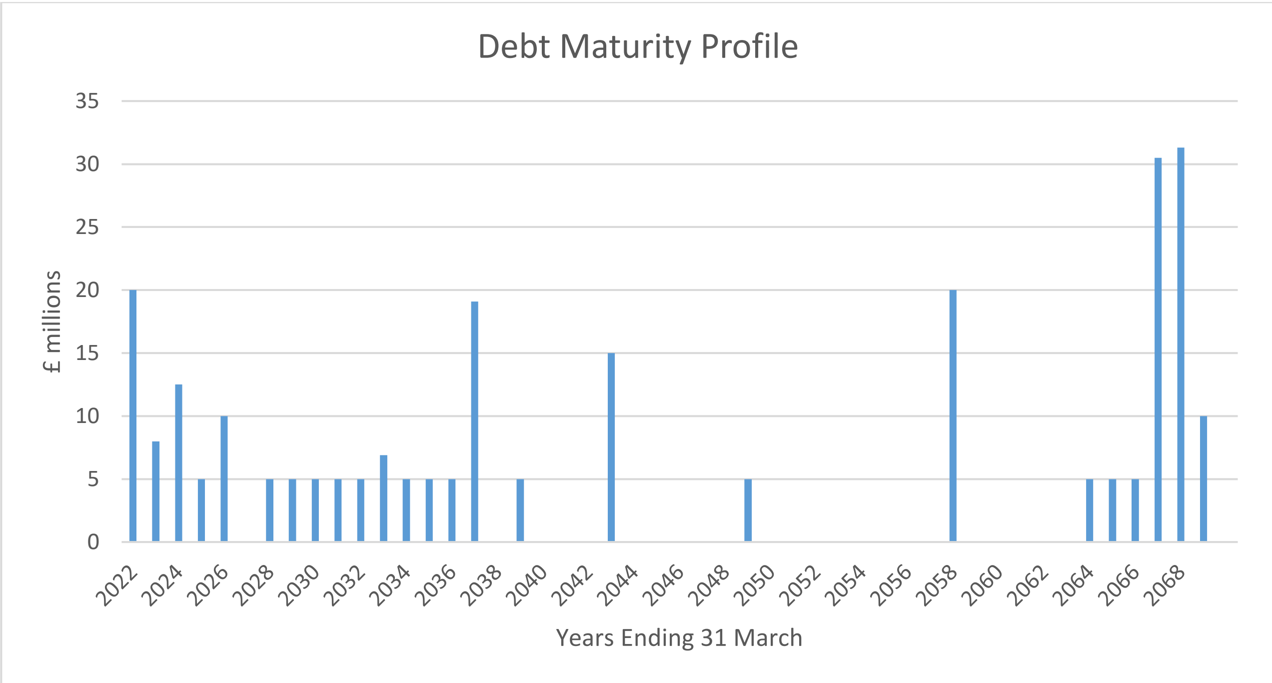
4.6 Link's current forecast of interest rates are as follows:

	Sept 21	Dec 21	March 22	June 22	Sept 22	Dec 22	Mar 23	Jun 23
Bank rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.25%
5 yr PWLB	1.20%	1.20%	1.20%	1.30%	1.30%	1.30%	1.40%	1.40%
10 yr PWLB	1.60%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%
25 yr PWLB	1.90%	2.00%	2.10%	2.20%	2.30%	2.30%	2.30%	2.40%
50 Yr PWLB	1.70%	1.80%	1.90%	2.00%	2.10%	2.10%	2.10%	2.20%

4.7 One of the risks inherent within Treasury management is "Interest rate risk". This risk is high where a large proportion of an organisation's borrowing portfolio reach termination point at the same time. The organisation has then to re-finance a large proportion of their portfolio at a set point in time with the risk that interest rates may not be favourable.

4.8 In order to protect against this risk it is prudent to spread repayment dates over a number of years thereby reducing the risk of a large proportion of the portfolio being affected by adverse interest rates.

4.9 The graph in below shows the debt portfolio repayment profile as at 23 August 2021. All debts are being shown as repayable at term, although the LOBO's (Lender Option Borrower Option) have a variety of "call" periods of between 6 months and every 5 years. The risk of a call occurring is currently low and therefore these have been shown as running to full term.



5. Investment Portfolio 2021/22

5.1 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 3, it is a very difficult investment market. Rates are very low and in line with the current 0.1% Bank Rate (as at 23 August 2021). Given the risk environment, investment returns are likely to remain low.

5.2 The investment portfolio yield on cash investments at 23 August 2021 rages from 0.0% to about 0.02%.

5.3 A full list of in house investments held as at 23 August 2021 is shown below:

Investments: Core Investments (Local Authorities)	**Principal 23 August 2021 £**	**Interest %**
CCLA Property Fund (July 2021 market value)	12,650,204	n/a
Patriza Hannover Property UT (June 2021 market value)	4,904,670	n/a
Lothbury Property Trust (June 2020 market value)	4,771,150	n/a
Total Core Investments	**22,326,024**	n/a
Investments: Liquid Investments	**Principal 23 August 2021 £**	**Interest %**
Svenska Handelsbanken	1,152	0.00%
Lloyds	10,886	0.01%
Barclays	4,287	0.00%
NatWest	3,300,000	0.01%
CCLA Public Sector Deposit Fund	9,386,532	Approx. 0.02%
Total Liquid Investment	**12,702,857**	n/a

Investments	**Principal 23 August 2021 £**	**Interest %**
Total In house Investments	**35,028,881**	n/a

5.4 Members may like to note the overall performance of the investment in property funds since purchase as shown below.

Detail	**£**	**£**
Invested 2015/16	3,000,000	
Invested 2017/18	19,999,365	
Total Cost of Investment		22,999,365
Current Valuation (as above)		22,326,024
Capital (Loss) to Date		-673,341
Dividends Received 2016/16 to 2020/21	3,550,191	
Dividends 2021/22 to Date	212,928	
Total Dividends to Date		3,763,119
Total Return to Date		3,089,778

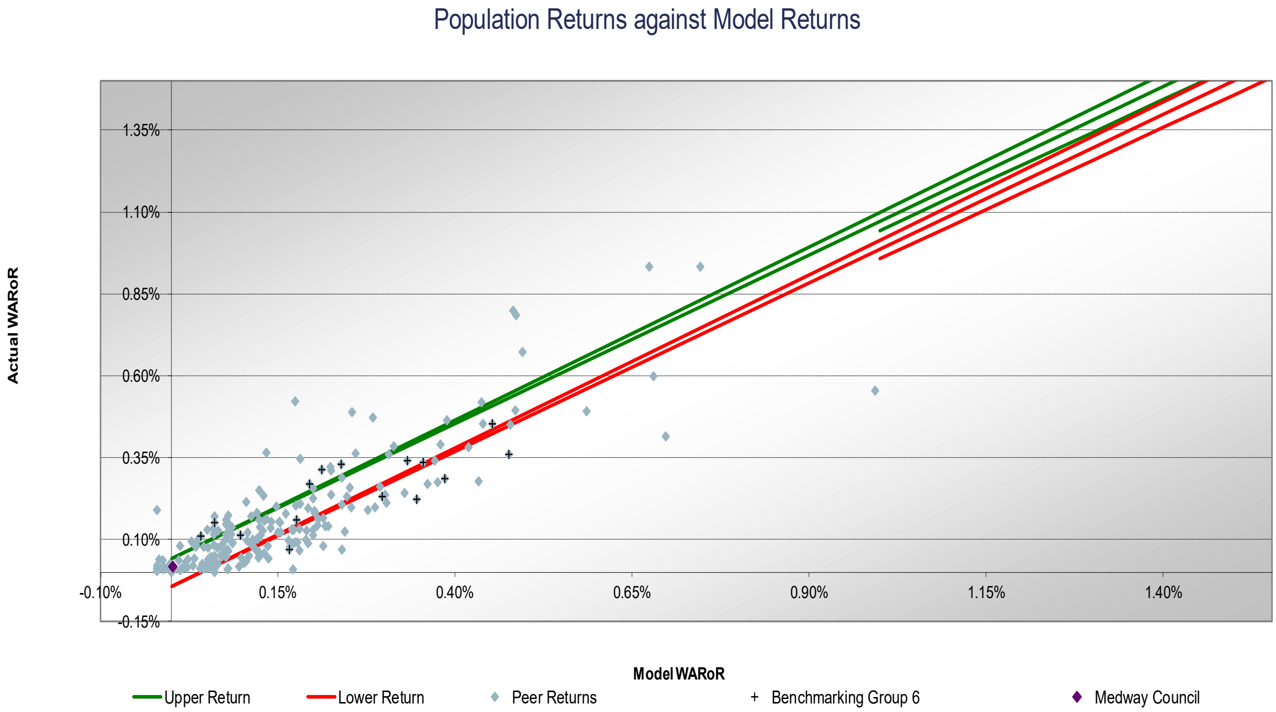
5.5 The Council’s finance and interest net expenditure for 2021/22 is expected to match the budget.

5.6 Investment Counterparty Criteria

5.6.1 The current investment counterparty criteria selection approved in the Treasury Strategy is meeting the requirement of the treasury management function.

5.7 Benchmarking

5.7.1 The in-house Treasury team, contribute to the Link Asset Services benchmarking club which produces quarterly reports. Shown below is a graph showing Medway's performance to June.



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Medway Council	0.02%	0.00%	0.01%	-0.04%	0.05%	Inline

5.7.2 The "x" axis of the graph shows the "Model Weighted Average Rate of Return", this is easiest interpreted as the level of return we should expect for the level of risk that we are taking with our investment portfolio. This is then plotted against the "Actual Weighted Average Rate of Return" on the "y" scale, running diagonally upwards across the graph are two parallel lines, if a Council performance falls between these lines then they are deemed to be receiving a return as would be expected for their level of risk, below these two lines and performance is considered below that expected and above then the return being received is above that expected. As can be seen Medway's return fell in line with expectations for our level of risk. However, the data includes only at cash deposits and excludes property funds.

5.7.3 In assessing the risk inherent in an Investment Portfolio for the benchmarking, three factors are taken into account,

(i) The number of days to maturity of an investment. With a larger the number of days left to maturity the greater the risk that an adverse event could occur
(ii) The total number of days that the investment was originally invested for, again the longer an authority is comfortable to invest for the greater the risk it is willing to take.
(iii) The creditworthiness of the counterparties in which the authority invests.

5.7.4 The table below shows some detail from the June 2021 benchmarking data comparing Medway in-house performance against all participants of the benchmarking group; unitaries and other local councils.

Comparison of risk and returns table below:

Authority/Group	Model Weighted Average Rate of Return	Risk: Weighted Average Maturity (Days)	Risk: Weighted Average Total Time (Days)	Risk: Weighted Average Credit Risk	Weighted Average Rate of Return
Medway	**0.00%**	**0**	**0**	**2.10**	**0.02%**
Average English Unitaries (21)	0.19%	73	152	2.46	0.16%
Average Total Population (212)	n/a	69	127	2.97	0.17%
Average Local Benchmarking Group (15)	0.24%	103	188	2.98	0.23%
Brighton & Hove CC	0.33%	171	279	1.91	0.33%
East Sussex CC	0.24%	113	172	2.62	0.33%
Sevenoaks DC	0.10%	33	68	2.65	0.11%
Tonbridge and Malling BC	0.18%	77	130	3.06	0.16%

6. Debt Rescheduling

6.1 Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. During the first six months of the year, no debt rescheduling was undertaken, and it is not envisaged that any will occur before the end of the financial year. However, officers and the council's financial advisers, Link Asset Services, will continue to monitor the situation and opportunities will be carefully considered.

7. Compliance with Treasury and Prudential Limits

7.1 It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". Council's approved Treasury and Prudential Indicators (affordability limits) are outlined in the approved Treasury Management Strategy Statement.

7.2 During the financial year to date the Council has operated within the treasury limits set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

8. Risk management

8.1 Risk and the management thereof is a feature throughout the Strategy and in detail within the Treasury Management Practices 1 published alongside the Treasury Management Strategy at the start of 2021.

9. Financial and legal implications

9.1 The finance and legal implications are highlighted throughout this report. The Council has delegated responsibility for the execution and administration of treasury management decisions to the Chief Finance Officer, who will act in accordance with the Council's policy statement and Treasury Management Practices.

10. Recommendations

10.1 The Committee is requested to consider this report, note its contents and note that the report will also be referred to Cabinet and Full Council.

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Appendices

Appendix 1 – View of economic conditions

Background Papers

None

APPENDIX 1 - VIEW OF ECONOMIC CONDITIONS

This section has been prepared by the Authority's Treasury Advisors, Link.

ECONOMICS UPDATE (Quarter to June 2021)

UK. The 24 June Monetary Policy Committee meeting voted unanimously to keep Bank Rate unchanged at 0.10%. They voted by a majority of 8-1 to continue unchanged the existing programme of UK government bond purchases of £875bn which is due to end by the end of this year. In the press release, it was noted that:-

> *"Since May, developments in global GDP growth have been somewhat stronger than anticipated, particularly in advanced economies. Global price pressures have picked up further, reflecting strong demand for goods, rising commodity prices, supply-side constraints and transportation bottlenecks, and these have started to become apparent in consumer price inflation in some advanced economies. Financial market measures of inflation expectations suggest that the near-term strength in inflation is expected to be transitory".*

The MPC noted the developing upside risks in the UK to both activity and inflation. It said that the news on activity "had predominately been to the upside" and that Bank staff had "revised up their expectations for 2021 Q2 GDP growth to 5½% from 4¼%". For the first time, the policy statement noted that "there are increasing signs of recruitment difficulties for some businesses" and the minutes said, "it was possible that the near-term upward pressure on prices could prove somewhat larger than expected". Indeed, by saying that inflation "is likely to exceed 3% for a temporary period" the MPC admitted the Governor will have to write to the Chancellor later this year explaining why inflation is more than 1% above the 2% target.

But the key point is that the MPC still appears willing to ride out the **inevitable spike in inflation** over the next six months as it thinks it will be short-lived and caused by one-off reopening price rises and supply shortages relative to demand - boosted by consumers having built up huge savings of around £145bn during lockdown. These spikes will drop out of the CPI calculation over the next twelve months. The forward guidance in the policy statement designed to demonstrate the MPC's patience was left intact, and the emphasis remained on "the medium-term prospects for inflation" rather than factors that are "likely to be transient". The minutes said the MPC should "ensure that the recovery was not undermined by a premature tightening in monetary conditions". It also repeated that it will not raise Bank Rate until the 2% inflation target has been attained sustainably i.e. the mere fact that it is forecasting inflation to be over 2% during 2021 and 2022 is not in itself sufficient to justify an increase in Bank Rate in the near future. The MPC indicated in the minutes that some members would prefer to wait for a clearer picture of the underlying pace of the recovery once the furlough scheme expires at the end of September, before making any judgement on medium-term inflationary pressures. This implies that the MPC may be unlikely to be in a position to consider a change in policy until early in 2022 at the earliest.

In addition, the Bank is undertaking a review of its stated current policy to raise Bank Rate first before **unwinding quantitative easing** (QE) purchases of gilts. Indeed, it now appears to be likely that the Bank could unwind QE first before raising Bank Rate as it sees QE as a very useful quick acting weapon to use to combat any sudden dysfunction in financial markets, as happened in March 2020. However, it is currently nearly maxed out on the total level of QE. Unwinding QE first would cause short term gilt yields to remain anchored at low levels and medium and long term gilt yields to steepen. Money markets are currently expecting Bank Rate to start rising in mid-2022 but they are probably being too heavily influenced by looking across the Atlantic where inflationary pressures are much stronger than in the UK and building up further under a major boost from huge Federal government stimulus packages. Overall, there could be only a minimal increase in **Bank Rate** in 2023 or possibly no increases before 2024.

GDP. The Bank revised up its expectations for the level of UK GDP in 2021 Q2 by around 1½% since the May Report due to the easing of restrictions on economic activity; this now leaves total GDP in June only around 2½% below its pre-Covid 2019 Q4 level. UK GDP grew by 1.5% in the three months to April 2021: this was the first expansion since the three months to December 2020. Forward looking monthly business surveys are running at exceptionally high levels indicating that we are heading into a strong economic recovery. Capital Economics do not think that the UK economy will suffer major scarring from the lockdowns. The one month delay to the final easing of restrictions in July is unlikely to have much effect on the progress of recovery with GDP getting back to pre-Covid levels during August.

CPI. The annual inflation rate in the United Kingdom rose to 2.1% y/y in May from 1.5% y/y in April: this is the first time that the measure has been above the Bank of England's 2% target since July 2019.

COVID-19 vaccines. These have been the game changer which have enormously boosted confidence that **life in the UK could largely return to normal during the second half of 2021** after a third wave of the virus threatened to overwhelm hospitals in Q1 this year. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The UK has made fast progress, giving both jabs to nearly half of the total population and one jab to two thirds, (84% of all adults). This programme should be completed in the second half of the year. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.

US. Since the Democrats won the elections in late 2020 and gained control of both Congress and the Senate, (although power is more limited in the latter), they have passed a $1.9trn (8.8% of GDP) stimulus package in March 2021 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 now negotiating to pass a $1trn 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 unveiled 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 by a majority to a toned down version of the new inflation target in his speech - 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 had actually been under-shooting the 2% target significantly for most of the last decade, so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after that 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 by allowing inflation to run higher for longer, even if they do not call it a policy of average inflation targeting as such.

In the **Fed's June meeting**, it stuck to its line that it expects strong economic growth this year to have only a transitory impact on inflation which is being temporarily boosted by base effects, spikes in reopening inflation and supply shortages. The big surprise was the extent of the upward shift in the "dot plot" of interest rate projections: having previously expected no hikes until 2024 at the earliest, most officials now anticipate two in 2023, with 7 out of 18 expecting to raise rates next year. This was a first indication that there was rising concern about the risks around inflationary pressures building up on a more ongoing basis and is somewhat hard to reconcile to the words around inflation pressures being only transitory.

Treasury yields in the US ought to rise much more strongly than gilt yields in the UK due to the divergence in the levels of inflationary pressures and the levels of surplus capacity currently in both economies, (the US is much nearer full capacity than the UK). Bond investor sentiment could lean in the direction that even if central banks refrain from raising central rates in the short term, all they are doing is setting up sharper increases further down the line. This is likely to cause increases in longer-term bond yields without any actual increases in central rates. There will then be a question as to how strong an influence rising treasury yields will have on gilt yields. Due to the divergence between the US and UK economies, it is expected that the Fed rate will need to increase first before Bank Rate and that there could be a significant delay before the Bank of England follows suit.

EU. Both the roll out and take up of vaccines was disappointingly slow in the EU in the first few months of 2021 but has since been rapidly catching up. This delay 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. After contracting by another 0.3% in Q1 of 2021, recovery will now be delayed until Q3 of 2021. At its June meeting, the ECB forecast strong economic recovery with growth of 4.6% and 4.7% in 2021 and 2022 respectively.

Inflation is likely to rise sharply to around 2.5% during 2021 for a short period, but as this will be transitory, due to one-off factors, it will cause the ECB little concern. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. The ECB's December 2020 meeting added a further €500bn to the PEPP scheme, (purchase of government and other bonds), and extended the duration of the programme to

March 2022 and re-investing maturities for an additional year until December 2023. Three additional tranches of TLTRO, (cheap loans to banks), were approved, indicating that support will last beyond the impact of the pandemic, implying indirect yield curve control for government bonds for some time ahead. The total PEPP scheme of €1,850bn of QE, which started in March 2020, 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 maintains this level of support. The March ECB meeting also took action to suppress the rise in long bond yields by stepping up its monthly PEPP purchases. Meetings in April and June confirmed these policies so monetary policy will remain highly accommodative with no sign yet of tapering of asset purchases.

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 2020; this enabled China to recover all the contraction in Q1 2021. 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. After making a rapid recovery in 2020/21, growth is likely to be tepid in 2021/22.

Japan. A third round of fiscal stimulus in December 2020 took total fresh fiscal spending in 2020 in response to the virus close to 12% of pre-virus GDP. That is huge by past standards, and one of the largest national fiscal responses. The resurgence of Covid in Q1 2021, coupled with a slow roll out of vaccines, has pushed back economic recovery. However, quickening of vaccinations in the second half of 2021 will lead to a strong economic recovery to get back to pre-virus levels by the end of 2021 – around the same time as the US and sooner than the Eurozone.

World growth. World growth was in recession in 2020 but should recover during 2021. Inflation is unlikely to be a significant problem in most countries for some years due to the creation of excess production capacity and depressed demand during the coronavirus crisis.

Impact on gilt yields and PWLB rates in 2021. Since the start of 2021 gilt yields and PWLB rates have risen sharply. What has unsettled financial markets has been a $1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic, in addition to the $900bn support package passed in December. Financial markets have been concerned that the two packages, on top of the Fed already stimulating the economy by cutting the Fed rate to near zero and unleashing massive QE, could cause an excess of demand in the economy which **unleashes strong inflationary pressures**; these could then force the FOMC to take much earlier action to start increasing the Fed rate from near zero, despite their stated policy being to target average inflation and saying that increases were unlikely in the next few years.

A further concern in financial markets is **when will the Fed end quantitative easing (QE) purchases of treasuries** and how they will gradually wind it down. These ongoing monthly purchases are currently acting as downward pressure on treasury yields. Nonetheless, during late February and in March, yields rose sharply. As the US financial markets are, by far, the biggest financial markets in the world, any trend upwards there will invariably impact and influence financial markets in other countries. It is noticeable that gilt yields moved higher after the MPC meeting in early February as a result of both developments in the US, and financial markets also expecting a **similarly rapid recovery of the UK economy as in the US**; both countries were expected to make similarly rapid progress with vaccinating their citizens and easing Covid restrictions. They are, therefore, expecting inflation to also increase more quickly in the UK and cause the MPC to respond by raising Bank Rate more quickly than had previously been expected.

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 which caused considerable consternation in western countries. 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 from rates in prior decades.

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. The Fed has changed its policy on inflation to targeting an average level of inflation. Greater emphasis will 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.