Lincolnshire COUNTY COUNCIL
Working for a better future

Open Report on behalf of Andrew Crookham, Executive Director - Resources

Report to:	**Pensions Committee**
Date:	**17 March 2022**
Subject:	**Independent Advisor's Report**

Summary:

This report provides a market commentary by the Committee's Independent Advisor on the current state of global investment markets.

Recommendation(s):

That the Committee note the report.

Background

Investment Commentary – March 2022

Ukraine – and the Dilemma facing all the World's Central Bankers

Inflation is rising higher and more quickly than anyone expected, almost everywhere around the world. It presents Central Bankers with a dilemma. Do they raise interest rates quickly (and withdraw other financial support measures) in order to bring inflation rapidly under control - at the risk of sending the current robust global economy into a tail spin? Or do they proceed at their current measured pace, and risk higher inflation becoming embedded into economic expectations - thus risking a wage inflation spiral?

Ukraine crisis

Apart from inflation, the global markets' other anxiety is obviously the frightening situation in the Ukraine, bringing with it the possibility of a significant and lasting conflict with Russia, regarded now as a "pariah" state. Regional conflicts rarely have any lasting effects on the level of stock markets or interest rates – but this one clearly does. It not only involves Russia, the USA and most of Europe, but also China on the fringes. What makes the disagreement between the super powers into a crisis is the energy dimension. Much of Eastern Europe and, of course, Germany have become very reliant on imports of gas and oil from Russia. At the time of writing, the war between Russia and Ukraine remains a local one – but for how long? Meanwhile, the world prices of energy have soared, with oil reaching over $100 per barrel (an annual increase of over 70%), as alternative sources of supply are strictly limited.

In a wider context, following the ignominious US withdrawal from Afghanistan, both Russia and China are keen to test US resolve as a continuing global super power. We already have a first indication in that President Biden has indicated that US troops will not be stationed inside Ukraine to defend that country against outside aggression - only within neighbouring NATO allied countries that border on Ukraine.

Inflation and living standards

Inflation levels around the world are too high. They range, pretty much, between 5% and 7% with the UK at the higher end, and Europe the lower. Most Central Banks have inflation targets and 2% is a typical figure. For most of last year, many economists regarded rising inflation as a temporary phenomenon, provoked by the well understood supply chain problems. Some still hold that view. But inflation rates have not yet peaked, because they do not yet incorporate the inevitable higher energy prices. So far, wage increases have not, perhaps surprisingly, matched price increases. So real living standards are falling and will fall further this year. The risk of a sharp slowdown in expenditure by consumers - i.e. you and me – is thus very real. Increases in energy prices are best regarded as equivalent to tax increases; they are unavoidable for most people. And certainly in the UK, there are wide ranging actual HMRC tax increases due in April. So, the fall in living standards is now certain, in my view. And, with it, the risk of economic contraction. Hence, the dilemma of Central Bankers.

Most of the world's Central Bankers have now publicly expressed their anxiety that price increases are getting too high, if not actually out of control. That said, only the Bank of England has actually raised interest rates; none have yet commenced to withdraw the huge financial support provided to their respective economies as Covid took hold in 2020. The worsening situation in Ukraine probably makes drastic Central Bank action less likely, and maybe subject to delay, for fear of exacerbating pressure on economies from falling living standards.

Share price prospects

So far, most companies remain optimistic about their prospects. The global economy is currently growing robustly – but this could change quickly, with a heightened if small risk of recession. Interest rates will rise as 2022 unfolds – the only uncertainty is how quickly. Rising interest rates have a direct negative effect on some shares, e.g. high tech – but not for the majority of the market. But the combination of serous military conflict in Ukraine with sharply higher energy prices injects a greater than usual amount of uncertainty into market prospects. Could markets fall say 20% from current levels? Yes, in a worst case. Will they – perhaps only President Putin knows the answer?

Conclusion

Peter Jones
1 March 2022

Consultation

a) Risks and Impact Analysis

The Pension Fund has a risk register which can be obtained by contacting the Head of Pensions.

Background Papers

No background papers within Section 100D of the Local Government Act 1972 were used in the preparation of this report.

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