Treasury Management Report – Mid-year update 2020/21

1. BACKGROUND

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management recommends that Members be updated on treasury management activities regularly (annual, mid-year or quarterly reports). This half year report updates Members in compliance with the Code.

2. ECONOMIC CLIMATE

2.1 The Covid-19 pandemic has continued to have a major impact upon the UK and worldwide economy through the period of the first half year to 30 September 2020 and is expected to continue in the foreseeable future.

2.2 A detailed commentary by the Council's Treasury Advisers Link Asset Services (LAS) covering first half year to 30 September is provided at Appendix A to this report, which sets out the outcome of the Bank of England's Monetary Policy Committee (MPC) meeting on 6th August 2020. In summary the key issues include:

- The Bank rates unchanged at 0.10% since it was March 2020.
- The level of quantitative easing unchanged at £745bn.
- A revision of the forecast falls in GDP in the first half of 2020 from 28% to 23% (subsequently revised to -21.8%).
- A revised down forecast peak in the unemployment rate from 9% in Q2 to 7½% by Q4 2020.
- A forecast that there would be excess demand in the economy by Q3 2022 causing CPI inflation to rise above the 2% target in Q3 2022, (based on market interest rate expectations for a further loosening in policy). Nevertheless, even if the Bank were to leave policy unchanged, inflation was still projected to be above 2% in 2023.

2.3 Given that the economy was recovering better than expected, the MPC indicated that negative interest rates are unlikely to be used as stimulus for the economy in the next 6 months or more.

2.4 It is anticipated that the amount of economic damage caused by spikes in the virus infection would be limited by localised measures rather than a national lockdown, as in March.

2.5 The wind down of the initial furlough scheme through to the end of October, could cause the Bank to review the need for more support for the economy later in the year.

2.6 The Chancellor announced in late September, a second six-month package from 1st November of government support for jobs whereby it will pay up to 22% of the costs of retaining an employee working a minimum of one third of their normal hours. There was further help for the self-employed, freelancers and the hospitality industry. However, this is a much less generous scheme than the furlough package and will inevitably mean there will be further job losses from the 11% of the workforce still on furlough in mid-September.

2.7 Brexit uncertainties ahead of the year-end deadline will potentially impact recovery.

- Bank of England held Bank Rate at 0.75%; noting the deterioration in global activity and sentiment, they confirmed that monetary policy decisions related to Brexit could be in either direction depending on whether or not a deal is ultimately reached by 31st October;
- The UK economy contracted by 0.2%; following the 0.5% gain in Q1 which was distorted by stockpiling ahead of Brexit;
- Brexit negotiations remained at an impasse; UK equities continued to underperform given the uncertainty, generally meaning investors are holding safe-haven government bonds/gilts instead.

3. INTEREST RATE FORECAST

3.4 The latest forecast for UK Bank Rate along with PWLB borrowing rates (certainty rate) from the Council’s treasury advisors is set out in Table 1 below.

4. PWLB Rates

4.4 PWLB rates varied within a relatively narrow range between April and July but the longer end of the curve rose during August. This increase came in two periods following speculation that the US might fall into recession;

- The first in the second week of the month was on the back of hopes for fresh US stimulus. This saw investors switch monies out of government bonds and into equities.
- The second shift higher at the longer end of the curve came in the latter stages of the month as investors reacted to the announcement of the tweak to the Fed’s inflation target.

4.5 The 50-year PWLB target rate for new long-term borrowing was unchanged at 2.30%.

4.6 The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut the Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its meeting on 6th August (and the subsequent September meeting), although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary.

4.7 The PWLB rates shown in Table 1 below, are inclusive of the new increased margins and certainty rate discount (more detailed commentary on interest rates forecast in appendix B of the report).

Table 1. Interest and PWLB rates (%)

Link Group Interest Rate View 11.8.20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month average earnings	0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 month average earnings	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 month average earnings	0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

5. INVESTMENTS

5.4 At 31st March 2020 investment balances totalled £40.48m, held in Money Market Funds, Call/Notice accounts, Certificates of Deposits, Local Authority loans and the CCLA Property Fund. This figure excludes third party loans and share capital.

5.5 Due to the nature of various government funding streams and timing of capital expenditure, the average level of funds available for investment purposes during Q1 was £64.98m and for Q2 was £58.02m.

5.6 Table 2 below summarises the maturity profile of the Council's investment portfolio at the end of Q2 2020/21 £43.43m (excluding third party loans):

Table 2 – Investment maturity profile at end of Q2 2020/21

		Maturity Period					
		0d	**0-3m**	**3-6m**	**5yrs ***	**Total**	
Product	**Access Type**	**£m**	**£m**	**£m**	**£m**	**£m**	**%**
Money Market Funds	Same-Day	35.48				**35.48**	***81.7***
Bank Call Account	Instant Access	1.00				**1.00**	***2.3***
Local Authority Loans	Fixed Term						
Pooled Property Fund	Redemption Period Applies				6.95	**6.95**	***16.0***
	Total	**36.48**			**6.95**	**43.43**	***100.0***
	%	***84.0***			***16.00***	***100.0***	

5.4 Set out below are details of the amounts outstanding on loans and share equity investments classed as capital expenditure advanced to third party organisations at the end of Q2:

Table 3 – Third Party Loans

Loan Summary	**Amount (£m)**
University of Northampton (UoN) – **HM Treasury backed**	24.88
Northampton Town Rugby Football Club (NTRFC)	4.18
Total	**29.06**

5.5 Financial markets trade on confidence and certainty, and for some time now, both have been in short supply. Investment rates have increased from historical lows following bank base rate rises, but remain relatively low in short to medium-term durations, with limited pickup in value for longer durations.

5.6 Investment balances are forecast to reduce by the financial year end as internal resources from temporary positive cashflow surpluses are applied to fund expenditure demands in lieu of fully funding the borrowing requirement (internal borrowing) on a net basis. This process effectively reduces the cost of carrying additional borrowing at a higher cost than the income that could be generated through short term investment of those balances, as well as reducing investment counterparty credit risk.

5.7 The Council's investments at the mid-year point outperformed the most comparable weighted duration benchmark by 84 basis points, largely due to an average dividend return of c.4.2% on the Council's investment held in the CCLA Property Fund.

Table 4: Benchmark Performance – Q2 2020/20

Benchmark	Benchmark Return	Council Performance
3m LIBID	0.10%	0.94%
6m LIBID	0.10%	0.51%

5.8 Leaving market conditions aside, the Council's return on investments is influenced by a number of factors, the largest contributors being the duration of investments and the credit quality of the institution or instrument:

- Credit risk is the consideration of the likelihood of default and is controlled through the creditworthiness policy approved by Council.
- The duration of an investment introduces liquidity risk; the risk that funds can't be accessed when required.
- Interest rate risk; the risk that arises from fluctuating market interest rates.

5.9 These factors and associated risks are actively managed by the Northamptonshire County Council (NCC) Finance Treasury team on behalf of Northampton Borough Council.

6 BORROWING

6.1 The Council can raise cash through borrowing in order to fund expenditure on its capital programme for the benefit of Northampton. The amount of new borrowing needed each year is determined by capital expenditure plans and projections of the Capital Financing Requirement, underlying borrowing requirement, forecast cash-backed reserves and both current and forecast economic condition

6.2 Overall borrowing outstanding has decreased during the first half of this year by £0.39m in line with scheduled debt repayments on annuity loans.

6.3 Table 5 below sets out the maturity profile of the Council's borrowing portfolio at the end of Q2. £245.0m is held with the PWLB, £16.11m from Market sources (Market loans/ Growing Places funding/ Homes & Communities Agency).

Table 5: Borrowing Maturity Profile – Q2 2020/21

Term Remaining	**Borrowing**	
	£m	**%**
Under 12 months	14.41	5.52
1-2 years	1.01	0.39
2-5 years	20.42	7.83
5-10 years	34.77	13.33
10-20 years	6.97	2.67
20-30 years	5.47	2.10
30-40 years	3.76	1.44
40 years and above	174.00	66.72
TOTAL	**260.81**	**100.0**

6.4 The Council does not hold any Lender Option, Borrower Option (LOBO) loans.

6.5 The Council is in an internally borrowed cash position and balances as at the end of quarter 2, however the latest forecast for the rest of year indicates that this will change and the Council will need to borrow by the end of the year. The size of the borrowing is largely dependent on operational expenditure and the delivery of HRA retained element of the capital programme this year. This is being closely monitored and the recent announcement on the 26th of November by PWLB to reduced borrowing rate by 100 basis points is encouraging.

Whilst we have mentioned the operational demand above as a reason for borrowing, we have also noted and forecast a 20% reduction on cash income collections when compared to previous year's performance. We believe this is largely due to the impact of pandemic despite the Central govt. grants received in the 1st half of the year to assist local governments during this unprecedented period. We are closely monitoring the situation, whilst trying to understand the underlying trend currently developing.

6.6 In addition to the issue of operational demands on cash mentioned above, the University of Northampton recently contacted the council during the first half of the year to explore options to extend a loan facility on £8.5m that is due for repayment to the PWLB in March 2021. Funding options are being considered; with the aim to get funding at the optimal rates based on Market activity. The end result is that council would need to borrowing for another year at no cost to the council. The financial report being presented will include this decision for Cabinet approval.

6.7 Finally, back in August at the special cabinet meeting held on 19th August 2020, the cabinet approved the decision to proceed with increasing the HRA budget and support it with additional borrowing of £50m. Plans are in place to proceed with obtaining additional borrowing estimated at £20m initially before the end of the year.

BORROWING RESTRUCTURING

6.1 No borrowing rescheduling has been undertaken this year. Rescheduling opportunities are limited in the current economic climate. For PWLB loans, due to the spread between the carrying rate of existing borrowing and early redemption rates, substantial exit (premium) costs would be incurred. For market borrowing, the lender uses the certainty of the loans cashflow profile to hedge against forecast interest rate movements and so would pass the cost of unwinding these instruments onto the Council as an exit (premium) cost. Officers continue to monitor the position regularly.

7. TREASURY AND PRUDENTIAL INDICATORS

7.1 The Council's Treasury and Prudential Indicators (affordability limits) were approved alongside the TMSS. It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the financial year to date the Council has operated within the Treasury and Prudential Indicators set out in the Council's TMSS:

Table 6: Treasury and Prudential Indicators

Prudential Indicator	**2020/21 Indicator**	**2020/21 Q2**
Authorised limit for external debt (Inc' Third Party Loans)	----- £418.000m -----	
Operational boundary for external debt (Inc' Third Party Loans)	----- £398.000m -----	
Capital Financing Requirement (CFR) (Inc' Third Party Loans and Finance Lease Liabilities)	£354.000m	£313m
Ratio of financing costs to net revenue streams: GF	8.49%	7.25%
Ratio of financing costs to net revenue streams: HRA	31.42%	23.2%
Principal sums invested > 365 days (Exc' third party loans)	£14.000m	£6.95m
Maturity structure of borrowing limits:-		
Under 12 months	Max. 50% Min. 0%	5.5%
12 months to 2 years	Max. 50% Min. 0%	0.57%
2 years to 5 years	Max. 50% Min. 0%	7.34%
5 years to 10 years	Max. 50% Min. 0%	12.29%
10 years to 20 years	Max. 50% Min. 0%	1.51%
20 years to 30 years	Max. 60% Min. 0%	0.07%
30 years to 40 years	Max. 80% Min. 0%	6.20%
40 years and above	Max. 100% Min. 0%	66.41%

Appendix A Economic Commentary; Extract from Treasury Advisors (Link Asset Services)

UK

- As expected, the Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 6th August. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:

    - The fall in GDP in the first half of 2020 was revised from 28% to 23% (subsequently revised to -21.8%). This is still one of the largest falls in output of any developed nation. However, it is only to be expected as the UK economy is heavily skewed towards consumer-facing services – an area which was particularly vulnerable to being damaged by lockdown.
    - The peak in the unemployment rate was revised down from 9% in Q2 to 7½% by Q4 2020.
    - It forecast that there would be excess demand in the economy by Q3 2022 causing CPI inflation to rise above the 2% target in Q3 2022, (based on market interest rate expectations for a further loosening in policy). Nevertheless, even if the Bank were to leave policy unchanged, inflation was still projected to be above 2% in 2023.

- It also squashed any idea of using negative interest rates, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be "less effective as a tool to stimulate the economy" at this time when banks are worried about future loan losses. It also has "other instruments available", including QE and the use of forward guidance.
- The MPC expected the £300bn of quantitative easing purchases announced between its March and June meetings to continue until the "turn of the year". This implies that the pace of purchases will slow further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.
- In conclusion, this would indicate that the Bank could now just sit on its hands as the economy was recovering better than expected. However, the MPC acknowledged that the "medium-term projections were a less informative guide than usual" and the minutes had multiple references to downside risks, which were judged to persist both in the short and medium term. One has only to look at the way in which second waves of the virus are now impacting many countries including Britain, to see the dangers. However, rather than a national lockdown, as in March, any spikes in virus infections are now likely to be dealt with by localised measures and this should limit the amount of economic damage caused. In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery. The wind down of the initial generous furlough scheme through to the end of October is another development that could cause the Bank to review the need for more support for the economy later in the year. Admittedly, the Chancellor announced in late September a second six month package from 1st November of government support for jobs whereby it will pay up to 22% of the

costs of retaining an employee working a minimum of one third of their normal hours. There was further help for the self-employed, freelancers and the hospitality industry. However, this is a much less generous scheme than the furlough package and will inevitably mean there will be further job losses from the 11% of the workforce still on furlough in mid-September.

- Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one after a sharp recovery in June through to August which left the economy 11.7% smaller than in February. The last three months of 2020 are now likely to show no growth as consumers will probably remain cautious in spending and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind. If the Bank felt it did need to provide further support to recovery, then it is likely that the tool of choice would be more QE.
- There will be some painful longer term adjustments as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever. There is also likely to be a reversal of globalisation as this crisis has shown up how vulnerable long-distance supply chains are. On the other hand, digital services is one area that has already seen huge growth.
- One key addition to the Bank's forward guidance 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
- The Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its assessment "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.
- US. The incoming sets of data during the first week of August were almost universally stronger than expected. With the number of new daily coronavirus infections beginning to abate, recovery from its contraction this year of 10.2% should continue over the coming months and employment growth should also pick up again. However, growth will be dampened by continuing outbreaks of the virus in some states leading to fresh localised restrictions. At its end of August meeting, the Fed tweaked its inflation target from 2% to maintaining an average of 2% over an unspecified time period i.e.following periods when inflation has been running persistently below 2%, appropriate monetary policy will likely aim to achieve inflation moderately above 2% for some time. This change is 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 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. The

Fed also called on Congress to end its political disagreement over providing more support for the unemployed as there is a limit to what monetary policy can do compared to more directed central government fiscal policy. The FOMC's updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

- EU. The economy was recovering well towards the end of Q2 after a sharp drop in GDP, (e.g. France 18.9%, Italy 17.6%). However, the second wave of the virus affecting some countries could cause a significant slowdown in the pace of recovery, especially in countries more dependent on tourism. The fiscal support package, eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support and quickly enough to make an appreciable difference in weaker countries. The ECB has been struggling to get inflation up to its 2% target and it is therefore expected that it will have to provide more monetary policy support through more quantitative easing purchases of bonds in the absence of sufficient fiscal support.
- China. After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and has enabled it to recover all of the contraction in Q1. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.
- Japan. There are some concerns that a second wave of the virus is gaining momentum and could dampen economic recovery from its contraction of 8.5% in GDP. It has been struggling to get out of a deflation trap for many years and to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. The resignation of Prime Minister Abe is not expected to result in any significant change in economic policy.
- World growth. Latin America and India are currently hotspots for virus infections. World growth will be in recession this year. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

Appendix B Interest Rate Forecast Commentary; Extract from Treasury Advisors (Link Asset Services)

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its meeting on 6th August (and the subsequent September meeting), although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31st March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

GILT YIELDS / PWLB RATES. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March. After gilt yields spiked up during the initial phases of the health crisis in March, we have seen these yields fall sharply to unprecedented lows as major western central banks took rapid action to deal with excessive stress in financial markets, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply. At the close of the day on 30th September, all gilt yields from 1 to

6 years were in negative territory, while even 25-year yields were at only 0.76% and 50 year at 0.60%.

From the local authority borrowing perspective, HM Treasury imposed two changes of margins over gilt yields for PWLB rates in 2019-20 without any prior warning. The first took place on 9th October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was then at least partially reversed for some forms of borrowing on 11th March 2020, but not for mainstream General Fund capital schemes, at the same time as the Government announced in the Budget a programme of increased infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins; this was to end on 4th June, but that date was subsequently put back to 31st July. It is clear HM Treasury will no longer allow local authorities to borrow money from the PWLB to purchase commercial property if the aim is solely to generate an income stream (assets for yield).

Following the changes on 11th March 2020 in margins over gilt yields, the current situation is as follows: -

- PWLB Standard Rate is gilt plus 200 basis points (G+200bps)
- PWLB Certainty Rate is gilt plus 180 basis points (G+180bps)
- PWLB HRA Standard Rate is gilt plus 100 basis points (G+100bps)
- PWLB HRA Certainty Rate is gilt plus 80bps (G+80bps)
- Local Infrastructure Rate is gilt plus 60bps (G+60bps)

It is possible that the non-HRA Certainty Rate will be subject to revision downwards after the conclusion of the PWLB consultation; however, the timing of such a change is currently an unknown, although it would be likely to be within the current financial year.

As the interest forecast table for PWLB certainty rates, (gilts plus 180bps), above shows, there is likely to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020/21.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably relatively even, but is subject to major uncertainty due to the virus.
- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- UK - second nationwide wave of virus infections requiring a national lockdown
- UK / EU trade negotiations – if it were to cause significant economic disruption and a fresh major downturn in the rate of growth.
- UK - Bank of England takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the Eurozone sovereign debt crisis. The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for "weaker" countries. In addition, the EU recently agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next year or so. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.
- Weak capitalisation of some European banks, which could be undermined further depending on extent of credit losses resultant of the pandemic.
- German minority government & general election in 2021. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in subsequent state elections but the SPD has done particularly badly. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until the general election in 2021. This then leaves a major question mark over who will be the major guiding hand and driver of EU unity when she steps down.
- Other minority EU governments. Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.

- Austria, the Czech Republic, Poland and Hungary now form a strongly anti-immigration bloc within the EU. There has also been a rise in anti-immigration sentiment in Germany and France.
- Geopolitical risks, for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.
- US – the Presidential election in 2020: this could have repercussions for the US economy and SINO-US trade relations.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- UK - stronger than currently expected recovery in UK economy.
- Post-Brexit – if an agreement was reached that removed the majority of threats of economic disruption between the EU and the UK.

The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.