

19 January 2021

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Title	Treasury Management Strategy - Mid Year Review Report 2020/21		
Wards affected	Not applicable		

1 Executive Summary

- 1.1 The 2020/21 Treasury Management Strategy Statement (TMSS) was approved by Council on 13 February 2020. This report is a mid-year review of the Council's treasury management.
- 1.2 Complying with CIPFA's Code of Practice on Treasury Management the update includes:
 - an economic update
 - whether key elements of the TMSS and annual investment strategy require changes
 - performance against prudential indicators
 - a review of borrowing strategy
 - highlights areas to be taken into consideration in preparing the 2021/22 TMSS
- 1.3 In addition, this report covers recent changes in the structure of Public Works Loan Board lending rates to local authorities.

2 Recommended Decision

- 2.1 To approve the mid-year review.

3 Reason for Recommended Decision

- 3.1 Treasury Management governance arrangements require Governance and Audit to approve a mid-year Treasury Management report.

4 Alternative Options

- 4.1 Alternative options regarding treasury management activities are considered on an ongoing basis, in consultation with the Council's Treasury Advisors, Link Asset Services.

5 Introduction

- 5.1 The Council operates a balanced budget in line with statutory requirements. This broadly means that in year income meets the Council's spending requirements.
- 5.2 Treasury Management operations ensure:

- that cashflow is adequately planned, with surplus monies being invested in line with the Council's Treasury Management Policies and Practices and the Council's risk appetite for investments and borrowing
- that the Council's capital plans are fully funded, treasury management practices supporting the requirement for long term cashflow planning and supporting the Council's need to borrow.
- Local Authorities are required under statute to self-regulate on the affordability, prudence and sustainability of its capital investment plans and borrowing through a process of setting estimates, indicators and the Council's overall risk appetite; and reporting on these on a regular basis.

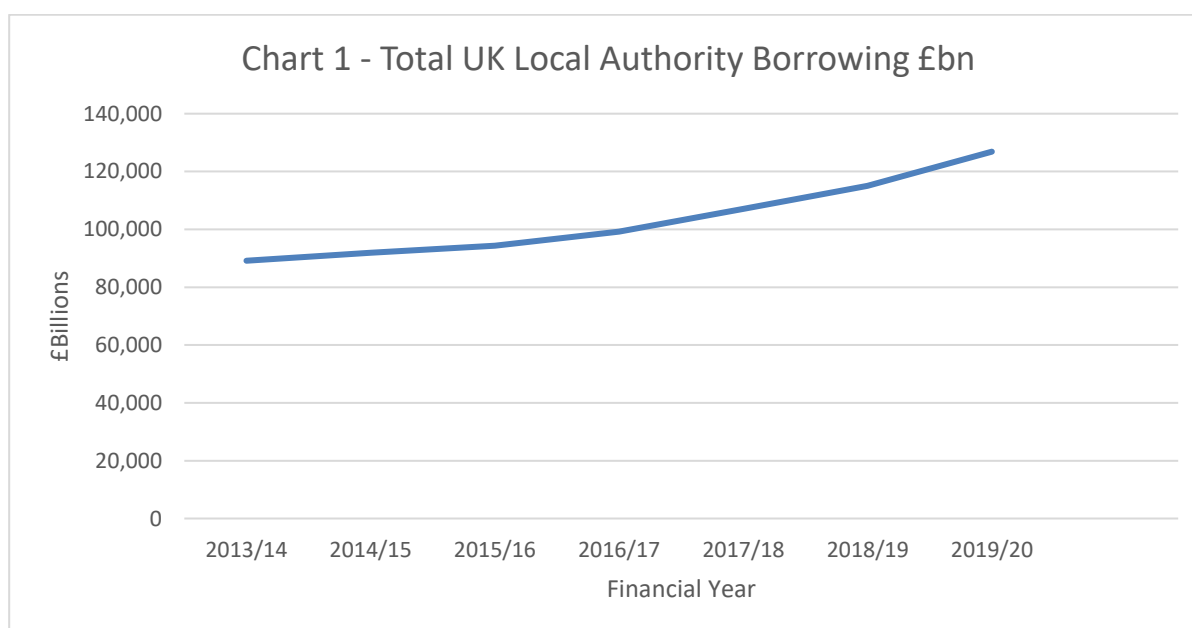
5.3 Treasury Management is defined as 'the management of the Council's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of risks associated with these activities; and the pursuit of optimum performance consistent with those risks.'

5.4 The management of the Council's treasury management processes is supported by Treasury Management Practices and the Council employs Link Asset Services to provide specialist consultancy in respect of treasury management, especially with regards to investments and debt, as well as capital accounting arrangements and asset finance.

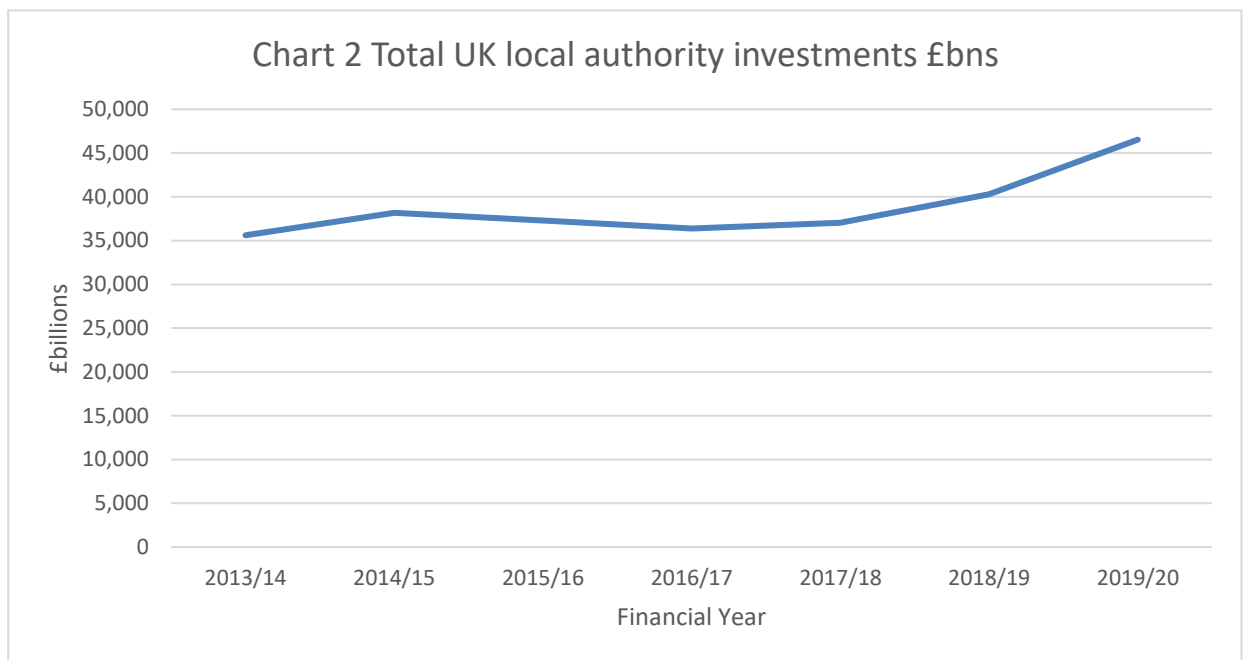
5.6 In line with statutory requirements the Council has adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017). This mid-year position report complies with the Code.

6 Economic Update

6.1 Local authority borrowing has gradually increased over the last few financial years. This reflects the funding of local authority capital programmes.



6.2 Over the same period there has been more variability in total investments.



- 6.3 There has been a considerable rise in the use of money market funds and other managed funds reflecting the low rates on offer from banks directly to local authorities. The table shows Colchester's comparative position at September 2020.

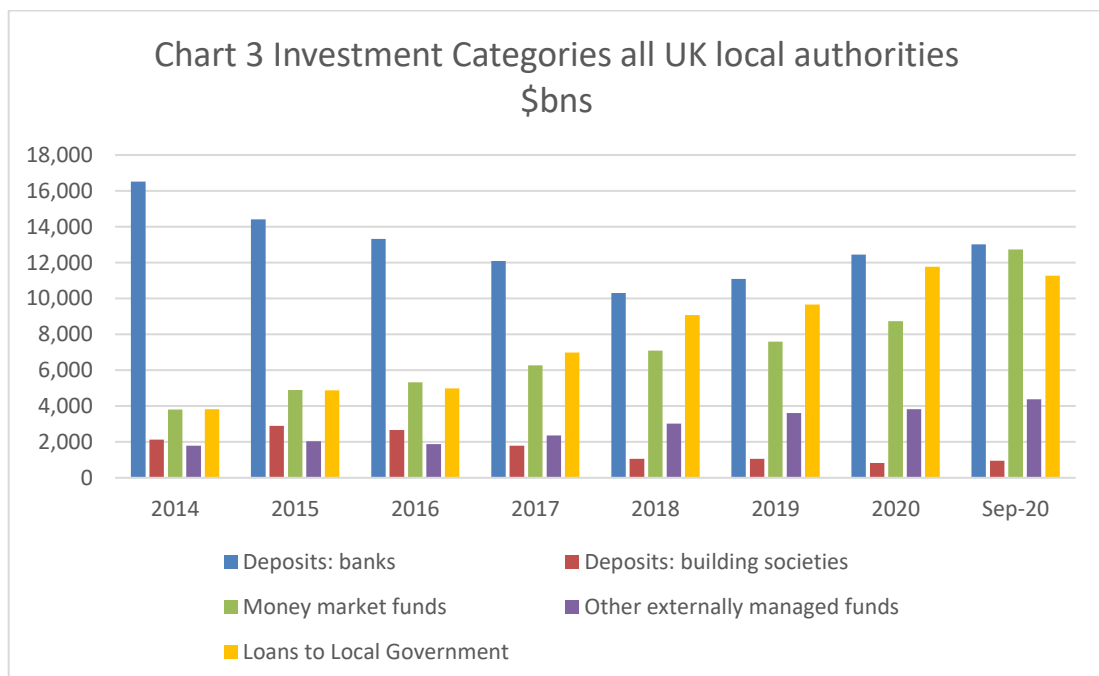


Table 1 – Investment distribution 30 September 2020		UK local authorities	Colchester
1	Bank	25%	33%
2	Building society	2%	Nil
3	Money market funds	25%	52%
4	Externally managed funds	9%	Nil
5	Local government	18%	15%
6	Other	22%	Nil
7	Total	100%	100%

6.4 The economic forecast remains difficult given the impact of the global pandemic. A recent update provided by the Council's Treasury advisors concludes the following over the next few years based on a level risk analysis:

- 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.

6.5 Full details of the Council's Treasury Advisors economic analysis are included at Appendix A to this report.

7 Treasury Management Strategy 2020/21

7.1 The TMSS includes the following key elements:

- The Council continues to maintain an under-borrowed position. It will borrow internally, reducing the cost of carry as current investment rates are substantially below long term borrowing rates. This also reduces the Council's exposure to credit risk by reducing the level of investment balances.
- The Council's investment policy reflects a low appetite for risk; emphasising the priorities of security and liquidity over yield.
- The budgeted return on investments placed for periods up to 100 days is 0.5%. This was set prior to the impact of the global pandemic.
- That the Council complies with the CIPFA Prudential and Treasury Management Codes (Revised 2017); in relation to setting of capital plans, setting and reporting on prudential indicators, evaluation of the General Fund MRP and other related governance guidance.

7.2 No immediate mid-year changes are proposed to the TMSS.

8 The Council's Capital Position and Prudential Indicators

8.1 This part of the report updates:

- The Council's capital expenditure plans and their financing
- The impact of changes to the Council's capital plans on prudential Indicators and the underlying need to borrow
- Compliance with the limits on borrowing activity.

Capital Expenditure

8.2 The table below identifies the revised 2020/21 capital programme forecast since the original capital budget was approved by Council in February 2020. A review of the capital programme was reported to Cabinet in November 2020.

Table 3 Capital Expenditure 2020/21 £k	Original Estimate	Revised Estimate
General Fund capital expenditure	72,249	25,070
HRA capital expenditure	30,163	29,332
Total capital expenditure	102,412	54,402

8.3 The main variances are as follows:

- On-lending to Colchester Commercial Holdings Limited £26.6m
- New Strategic Priorities £10m.

Changes to the financing of the capital programme

8.4 Funding of the capital programme is updated for the lower expected level of expenditure. The Medium Term Financial Forecast provides minimum revenue provision and interest for new debt.

	Table 4 - New Borrowing Requirement 2020/21 All £k	Original Estimate	Revised Estimate
1	General Fund capital expenditure	72,249	25,070
2	HRA capital expenditure	30,163	29,332
3	Total capital expenditure	102,412	54,402
	Resourced by:		
4	Capital receipts	23,625	8,336
5	Capital grants	11,578	10,318
6	Capital reserves	3,176	9,901
7	Finance leases	0	0
8	Revenue	8,716	2,826
9	New borrowing requirement	55,317	23,021

Capital Financing Requirement (CFR)

8.5 The following table shows the CFR, the Council's total need to borrow for capital purposes including both past and current financial years.

Table 5 - CFR 2020/21 All £k	Original Estimate	Revised Estimate
Opening balance	183,566	177,610
Unfinanced capital expenditure	55,317	24,924
Less MRP	1,996	1,903
Closing balance	236,887	200,631

Limits to borrowing activity

- 8.6 Councils' have a responsibility to ensure that over the medium-term net borrowing is only be for capital purposes. Gross external debt should not - except in the short term - exceed the CFR in the preceding year plus any additional CFR for the current and the next two financial years. This allows 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.

Table 6 - Limits to Borrowing activity 2020/21 All £k	Original Estimate	Revised Estimate
Gross Debt 1 April 2020	165,324	162,444
Borrowing 2020/21	55,317	7,500
Other Long Term Liabilities	0	0
Gross Debt 31 March	220,641	159,944
CFR	236,887	200,631
Under/(Over) Borrowed Position	16,246	30,687

- 8.7 The Council is expected to be in an under borrowed position compared to its CFR at the end of 2020/21. This is in line with the Treasury Management Strategy. The Council can demonstrate that its borrowing is for capital investment purposes.
- 8.8 The Operational Boundary is the limit against which external debt is not normally expected to exceed.

Table 7 – Operational Boundary All £k	Original Estimate	Revised Estimate
Operational Boundary	247,617	247,617

9 Investment Portfolio 2020/21

- 9.1 In accordance with the Prudential Code, the Council is required to ensure that the security and liquidity of its investments take priority over the level of return. As detailed at paragraph 5, it is a very difficult investment market in terms of returns
- 9.2 The Council had £58m of investments as at 30th September 2020 (£62.4m as at 31 September 2019).
- 9.3 A full list of investments is listed at Appendix B (confidential section of the Agenda).
- 9.4 The Head of Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of the year.

10 Borrowing

- 10.1 The Council is forecast to have borrowings of £169,944m at the end of the financial year, with the expectation of utilising £30,687 of cash flow funds in lieu of borrowing to fund the capital programme. This is prudent and cost effective approach in the current economic climate and interest rate structure.
- 10.2 As detailed above further borrowing of £7.5m is planned during this financial year. This level of borrowing is dependent on the timing of capital projects. It remains possible that the Council may borrow less than this in this financial year.

11 PWLB interest rate structure

- 11.1 On 26th November 2020, HM Treasury announced a cut in the rates, taking them back to the level they were at before the Treasury increased them by one percentage point in October 2019.
- 11.2 Under the new rules, councils seeking to borrow from PWLB will now have to provide a three year capital plan, confirming it does not intend to borrow primarily for yield at point over the period or from any source.

12. Standard References

- 11.1 There are no particular references to the Strategic Plan; consultation; or publicity consideration; community safety; health and safety implications.

13. Financial implications

- 12.1 As set out in the body of this report.

13. Risk Management Implications

- 13.1 The Council's Treasury Management Strategy supported by the Treasury Management Practices, reflects the council's low risk appetite for treasury management investments; in line with the current economic outlook. The mid-year review provides the opportunity to report and review on the practices for the first six months of the financial year against the Council's strategy and take remedial action as required.

Appendices

- Appendix A – Economic Update from Link Asset Services
- Appendix B – Confidential paper

Economics and interest rates

3.1 Economics update

- 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.

3.2 Interest rate forecasts

The Council's treasury advisor, Link Group, provided the following forecasts on 26th November 2020 (PWLB rates are certainty rates, gilt yields plus 180bps):

Link Group Interest Rate View		9.11.20		(The Capital Economics forecasts were done 11.11.20)											
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20															
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	
5 yr PWLB	0.80	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00	
10 yr PWLB	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30	
25 yr PWLB	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80	
50 yr PWLB	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60	
Bank Rate															
Link	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	
Capital Economics	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-	
5yr PWLB Rate															
Link	0.80	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00	
Capital Economics	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	-	-	-	-	-	
10yr PWLB Rate															
Link	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30	
Capital Economics	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	-	-	-	-	-	
25yr PWLB Rate															
Link	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80	
Capital Economics	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	-	-	-	-	-	
50yr PWLB Rate															
Link	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60	
Capital Economics	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	-	-	-	-	-	

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%.

Following the changes on 26th November 2020 in margins over gilt yields, the current situation is as follows: -

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **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)

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** – another 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.

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

- **UK** - stronger than currently expected recovery in UK economy.
- **Post-Brexit deal.**
- 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.