Appendix D

Economic Background and Borrowing Update

Economic Background

The first quarter of 2024/25 saw:

- GDP growth flatlining in April following positive Q4 2023/24 growth figures of 0.7% q/q.
- A stalling in the downward trend in wage growth, with the headline 3myy rate staying at 5.9% in April.
- CPI inflation falling from 2.3% in April to 2.0% in May.
- Core CPI inflation decreasing from 3.9% in April to 3.5% in May.
- The Bank of England holding rates at 5.25% in May and June.
- 10-year gilt yields climbing to 4.35% in April, before closing out at 4.32% in May.

The news that the economy grew by 0.7% q/q in Q4 2023/24 confirmed that it moved out of its very mild technical recession that prevailed at the back end of 2023. However, data released for April and May so far shows a slight stalling in the recovery, with GDP data for April coming out at 0.0% m/m, as inclement weather weighed on activity.

On a more positive note, the 2.9% m/m increase in retail sales volumes in May more than reversed the 1.8% m/m drop in April as rainfall returned to seasonal norms. The strength was broad-based across the retail sector, including online, (+5.9% m/m) suggesting an underlying strengthening in sales beyond weather effects.

Stronger consumer spending, as low inflation allows households' real incomes to strengthen and the drag from higher interest costs fades, suggests that real consumption will strengthen substantially over the next two years. However, investment will only make a modest contribution to GDP growth. With the industrial sector still 12% smaller than in 2019, excess capacity will continue to cap the need for industrial firms to invest. But improving business sentiment should raise investment by services' firms. Further, a fall in mortgage rates should trigger a recovery in residential investment. Overall, strong consumer spending is likely to be the backbone of GDP growth, along with government consumption.

Despite the stickiness of wage growth in April, sharp falls in employment and a move up in unemployment suggests that wage growth will soon be back on a downward path. The 139,000 fall in employment in the three months to April was accompanied by a rise in the unemployment rate from 4.3% to 4.4%. This was the fourth increase in a row and took it to its highest level since September 2021. The rise would have been larger were it not for the 132,000 increase in inactivity in the three months to April as the UK's disappointing labour market participation performance since the pandemic continued. The vacancies data also paint a picture of a slowly cooling labour market. The number of job vacancies fell from an upwardly revised 908,000 to 904,000, leaving vacancies 31% below the peak in May 2022, but 11% above the pre-pandemic level.

The fall in CPI inflation in May back to the Bank's 2% target for the first time since July 2021 will have come as welcome news to the Bank. Furthermore, with CPI inflation of

3.3% in the US and 2.6% in the Euro-zone in May, the UK appears to have won the race to get CPI inflation back to 2.0%. A further easing in food inflation from 2.8% in April to 1.6% in May played a part in the fall in overall CPI inflation and with food producer price inflation at just 0.2% in May, food price inflation will probably soon fall to zero.

The core rate also fell back from 3.9% to 3.5%. Within that, core goods CPI inflation slipped below zero for the first time since October 2016. As expected, clothing/footwear, recreation/culture and restaurants/hotels categories inflation declined, reflecting base effects from big increases last May. While services inflation fell from 5.9% to 5.7%, this decline was smaller than the Bank of England expected (forecast 5.3%). And the timelier three-month annualised rate of services prices has rebounded from 8.5% to 9.2%. This suggests that the persistence in domestic inflation that the Bank is worried about is fading more slowly than it thought. Even so, there is scope for inflation to fall further.

Throughout the quarter there was a degree of volatility in the gilt market and, by way of example, the 10-year gilt yield rose from 4.05% on 2nd April to finish at 4.15% on 28th June but it has exceeded 4.30% on several occasions. Overall, investors judged that interest rates will need to remain high for longer to keep inflation around the 2.0% target.

A summary overview of the future path of Bank Rate

The Bank of England's Monetary Policy Committee (MPC) left the Bank Rate unchanged, at 5.25%, in May and June. The voting split of 7-2 in favour of leaving the Bank Rate at 5.25% was anticipated despite CPI inflation coming back to 2%, although it is considered that a rate cut was getting closer. Despite the recent run of stronger inflation and activity, the minutes noted "indicators of inflation persistence had continued to moderate" and that a range of indicators suggest pay growth had continued to ease. And there was new wording that members of the MPC will consider all the information available and how this affects the assessment that the risks from inflation persistence are receding "as part of the August forecast round".

Borrowing

It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy. A list of the approved limits is shown in Appendix B. The Prudential Indicators were not breached during the first quarter of 2024/25 and have not been previously breached. The schedule at Appendix C details the Prudential Borrowing approved and utilised to date.

The Council had not undertaken any new borrowing for a number of years prior to taking out some short term borrowing in March 2024. The Council instead has been utilising cash balances to internally "borrow" for prudential borrowing schemes. This has enabled the Council to benefit from saving on interest costs compared to the returns that could be generated on the cash balances. This approach has been effective during a period where the Council has held significant cash balances.

Cash balances have now reduced as a result of reduced levels of reserves being held and loans continuing to reach their maturity dates. It is therefore planned that significant levels of borrowing will be required in 2024/25 to fund any new capital borrowing requirement, and also re-instate cash balances used for internal borrowing.

PWLB rates increased during the course of the April and May, but then reduced back down towards the latter part of June. The table below shows the high/low/average PWLB rates for the fourth quarter.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	5.27%	4.70%	4.80%	5.28%	5.06%
Date	21/06/2024	04/04/2024	02/04/2024	02/04/2024	21/06/2024
High	5.61%	5.14%	5.18%	5.61%	5.40%
Date	29/05/2024	01/05/2024	01/05/2024	30/05/2024	30/05/2024
Average	5.43%	4.92%	4.98%	5.42%	5.20%
Spread	0.34%	0.44%	0.38%	0.33%	0.34%