

### Economic Background and Borrowing Update

#### Economic Background

The second quarter of 2024/25 saw:

- GDP growth stagnating in July following downwardly revised Q2 figures (0.5% q/q)
- A further easing in wage growth as the headline 3myy rate (including bonuses) fell from 4.6% in June to 4.0% in July;
- CPI inflation hitting its target in June before edging above it to 2.2% in July and August;
- Core CPI inflation increasing from 3.3% in July to 3.6% in August;
- The Bank of England initiating its easing cycle by lowering interest rates from 5.25% to 5.0% in August and holding them steady in its September meeting;
- 10-year gilt yields falling to 4.0% in September.

The economy's stagnation in July points more to a mild slowdown in GDP growth than a sudden drop back into a recession. Moreover, the drop in September's composite activity Purchasing Managers Index, from 53.8 in August to 52.9, was still consistent with GDP growth of 0.3%-0.4% for the summer months. This is in line with the Bank of England's view, and it was encouraging that an improvement in manufacturing output growth could be detected, whilst the services PMI balance suggests non-retail services output grew by 0.5% q/q in Q3.

The 1.0% m/m jump in retail sales in August was stronger than the consensus forecast for a 0.4% m/m increase. The rise was reasonably broad based, with six of the seven main sub sectors recording monthly increases, though the biggest gains came from clothing stores and supermarkets, which the ONS reported was driven by the warmer-than-usual weather and end of season sales.

The government's plans to raise public spending by around £16bn a year (0.6% GDP) have caused concerns that a big rise in taxes will be announced in the Budget, which could weaken GDP growth in the medium-term. However, if taxes are raised in line with spending (i.e., by £16bn) that would mean the overall stance of fiscal policy would be similar to the previous government's plan to reduce the budget deficit. Additionally, rises in public spending tend to boost GDP by more than increases in taxes reduce it.

The further easing in wage growth will be welcomed by the Bank of England as a sign that labour market conditions are continuing to cool. The 3myy growth rate of average earnings fell from 4.6% in June to 4.0% in July. On a three-month annualised basis, average earnings growth eased from 3.0% to 1.8%, its lowest rate since December 2023.

CPI inflation stayed at 2.2% in August, but services inflation rose from a two-year low of 5.2% in July to 5.6%, significantly above its long-run average of 3.5%. Food and fuel price inflation exerted some downward pressure on CPI inflation, but these were offset by the upward effects from rising furniture/household equipment inflation,

recreation/culture inflation and a surprisingly large rise in airfares inflation from -10.4% in July to +11.9% in August. As a result, core inflation crept back up from 3.3% to 3.6%. CPI inflation is also expected to rise in the coming months, potentially reaching 2.9% in November, before declining to around 2.0% by mid-2025.

Looking ahead, CPI inflation will likely rise in the coming months before it falls back to its target of 2.0% in mid-2025. The increasing uncertainties of the Middle East may also exert an upward pressure on inflation, with oil prices rising in the aftermath of Iran's missile attack on Israel on 1 October. China's recent outpouring of new fiscal support measures in the latter stages of September has also added to the upshift in broader commodity prices, which, in turn, may impact on global inflation levels and thus monetary policy decisions. Despite these recent developments, our central forecast is still for rates to fall to 4.5% by the end of 2024 with further cuts likely throughout 2025. This is in line with market expectations, however, although a November rate cut still looks likely, December may be more problematic for the Bank if CPI inflation spikes towards 3%.

Looking at gilt movements in the first half of 2024/25, and you will note the 10-year gilt yield declined from 4.32% in May to 4.02% in August as the Bank's August rate cut signalled the start of its loosening cycle. Following the decision to hold the Bank Rate at 5.0% in September, the market response was muted, with the 10-year yield rising by only 5bps after the announcement.

### **A summary overview of the future path of Bank Rate**

The Bank of England's Monetary Policy Committee (MPC) voted 5 -4 to reduce the Bank Rate by 25bps to 5% in the August meeting. However, subsequent speeches from MPC members have supported Governor Bailey's tone with its emphasis on "gradual" reductions over time. Markets thought there may be an outside chance of a further Bank Rate reduction in September, but this came to nothing. Nonetheless, November still looks most likely to be the next month to see a rate cut to 4.75% but, thereafter, inflation and employment data releases, as well as geo-political events, are likely to be the determinant for what happens in the remainder of 2024/25 and into 2025/26.

### **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 second 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 decreased during the course of August and the early part of September, but then finish the month at a rate similar to the start of April. The table below shows the high/low/average PWLB rates for the first half of the year.

	1 Year	5 Year	10 Year	25 Year	50 Year
<b>02/04/2024</b>	5.39%	4.72%	4.80%	5.28%	5.07%
<b>30/09/2024</b>	4.95%	4.55%	4.79%	5.33%	5.13%
<b>Low</b>	4.78%	4.31%	4.52%	5.08%	4.88%
<b>Low date</b>	17/09/2024	17/09/2024	17/09/2024	17/09/2024	17/09/2024
<b>High</b>	5.61%	5.14%	5.18%	5.61%	5.40%
<b>High date</b>	29/05/2024	01/05/2024	01/05/2024	01/05/2024	01/05/2024
<b>Average</b>	5.21%	4.76%	4.88%	5.35%	5.14%
<b>Spread</b>	0.83%	0.83%	0.66%	0.53%	0.52%

During the course of second quarter the Finance team have renegotiated two of the Council's Market Loans, with a reduced maturity date and a reduction in the interest rate to be applied to the loan. This has delivered a saving for 2024/25 of £0.977m.