

Economic Background and Borrowing Update

Economic Background

The third quarter of 2024/25 saw:

- GDP growth contracting by 0.1% m/m in October following no growth in the quarter ending September;
- The 3myy rate of average earnings growth increase from 4.4% in September to 5.2% in October;
- CPI inflation increase to 2.6% in November;
- Core CPI inflation increase from 3.3% in October to 3.5% in November;
- The Bank of England cut interest rates from 5.0% to 4.75% in November and held them steady in December.
- 10-year gilt yields starting October at 3.94% before finishing up at 4.57% at the end of December.

The 0.1% m/m fall in GDP in October was the second such decline in a row and meant that GDP would need to rise by 0.1% m/m or more in November and December, for the economy to grow in Q4 as a whole rather than contract.

After rising by 1.4% q/q in July - September, the retail sector had a difficult final quarter of the year. Indeed, the bigger-than-expected 0.7% m/m fall in retail sales in October (consensus forecast -0.3% m/m) suggested that households' concerns about expected tax rises announced in the Budget on 30th October contributed to weaker retail spending at the start of the quarter.

The Government's October budget outlined plans for a significant £41.5bn (1.2% of GDP) increase in taxes by 2029/30, with £25bn derived from a 1.2% rise in employers' national insurance contributions. The taxes are more than offset by a £47bn (1.4% of GDP) rise in current (day-to-day) spending by 2029/30 and a £24.6bn (0.7% of GDP) rise in public investment, with the latter being more than funded by a £32.5bn (1.0% of GDP) rise in public borrowing. The result is that the Budget loosens fiscal policy relative to the previous government's plans - although fiscal policy is still being tightened over the next five years - and that GDP growth is somewhat stronger over the coming years than had previously been forecasted. By way of comparison, the Bank of England forecasts four-quarter GDP growth to pick up to almost 1.75% through 2025 (previously forecast to be 0.9%) before falling back to just over 1% in 2026.

December's pay data showed a rebound in wage growth that will likely add to the Bank of England's inflationary concerns. The 3myy rate of average earnings growth increased from 4.4% in September (revised up from 4.3%) to 5.2% in October (consensus forecast 4.6%) and was mainly due to a rebound in private sector pay growth from 4.6% to 5.4%. Excluding bonuses, public sector pay stagnated in October and the 3myy rate fell from 4.7% to 4.3%.

The number of job vacancies also fell again from 828,000 in the three months to October to 818,000 in the three months to November. This marks the first time it has dropped below its pre-pandemic February 2020 level of 819,000 since May 2021. Despite this, the Bank of England remains concerned about the inflationary influence of high wage settlements as well as the risk of a major slowdown in labour market activity.

CPI inflation has been on the rise this quarter, with the annual growth rate increasing from 1.7% in September to 2.3% in October, before rising further to 2.6% in November. Although services CPI inflation stayed at 5.0% in November, the Bank had expected a dip to 4.9%, while the timelier three-month annualised rate of services CPI rose from 5.0% to 5.1%. That shows that there currently isn't much downward momentum. Moreover, the wider measure of core CPI inflation rose from 3.3% to 3.5% in November. Both services and core inflation are currently at rates well above those consistent with the 2.0% target and are moving in the wrong direction. Although CPI inflation is expected to be back at close to the 2.0% target by the end of 2025, given that a lot of the rise in inflation in the coming months will be due to base effects that won't persist, the potential for a broader set of tariffs to arise from the US as well as the constant threat of geo-political factors to impact energy and food prices suggest risks remain very much to the upside.

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%.

Throughout the quarter gilt yields have risen. The 10-year gilt yield increased from 3.94% at the start of October to 4.57% by the year end (and has subsequently risen to 4.64% early in 2025). As recently as mid-September 10-year gilt yields were at their low for the financial year, but since then, and specifically after the Budget at the end of October, yields have soared. Overall, the reaction to the UK Budget highlights how bond markets are both fragile and highly attentive to news about the fiscal outlook.

The FTSE 100 started off this quarter at 8,276, before finishing up at 8,121. In particular, UK markets have continued to fall further behind US equities, a trend which has accelerated since Trump's election victory in November, partly due to the UK stock market being less exposed to AI hype, and it being weighed down by its relatively large exposure to the energy and materials sectors.

A summary overview of the future path of Bank Rate

On 7 November, Bank Rate was cut by 0.25% to 4.75%. The vote was 8-1 in favour of the cut, but the language used by the MPC emphasised "gradual" reductions

would be the way ahead with an emphasis on the inflation and employment data releases, as well as geo-political events.

At the 18 December meeting, another split vote arose. Members voted 6-3 to keep Bank Rate on hold at 4.75%, but dissenters (Dhingra, Ramsden and Taylor) were keen for rates to be cut further as concerns over the slowing down of the UK economy took root, despite near-term inflation fears remaining.

The MPC again stated that “a gradual approach” to rate cuts “remains appropriate” and that policy will “remain restrictive for sufficiently long”.

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 has therefore been necessary to acquire new external borrowing during the third quarter of 2024/25, with a new loan of £25m secured over an 18 month time period. It is anticipated that further borrowing will be required during the final quarter of 2024//25, and this will again be secured over a short time period given that interest rates are anticipated to reduce over the next 12-18 months.

PWLB rates have moved significantly higher over the course of the financial year, culminating in long-term rates approaching levels last seen in 1998. The table below shows the high/low/average PWLB rates for the nine months to December.

	1 Year	5 Year	10 Year	25 Year	50 Year
02/04/2024	5.39%	4.72%	4.80%	5.28%	5.07%
31/12/2024	5.20%	5.12%	5.43%	5.91%	5.68%
Low	4.78%	4.31%	4.52%	5.08%	4.88%
Low date	17/09/2024	17/09/2024	17/09/2024	17/09/2024	17/09/2024
High	5.61%	5.16%	5.44%	5.92%	5.69%
High date	29/05/2024	19/12/2024	19/12/2024	19/12/2024	27/12/2024
Average	5.22%	4.80%	4.96%	5.43%	5.21%
Spread	0.83%	0.85%	0.92%	0.84%	0.81%