

Economic Background and Borrowing Update

Economic Background

The first half of 2025/26 saw:

- A 0.3% pick up in GDP for the period April to June 2025. More recently, the economy flatlined in July, with higher taxes for businesses restraining growth.
- The 3m/yy rate of average earnings growth excluding bonuses has fallen from 5.5% to 4.8% in July.
- CPI inflation has ebbed and flowed but finished September at 3.8%, whilst core inflation eased to 3.6%.
- The Bank of England cut interest rates from 4.50% to 4.25% in May, and then to 4% in August.
- The 10-year gilt yield fluctuated between 4.4% and 4.8%, ending the half year at 4.70%.

From a GDP perspective, the financial year got off to a bumpy start with the 0.3% m/m fall in real GDP in April as front-running of US tariffs in Q1 (when GDP grew 0.7% on the quarter) weighed on activity. Despite the underlying reasons for the drop, it was still the first fall since October 2024 and the largest fall since October 2023. However, the economy surprised to the upside in May and June so that quarterly growth ended up 0.3% q/q. Nonetheless, the 0.0% m/m change in real GDP in July will have caused some concern, with the hikes in taxes for businesses that took place in April this year undoubtedly playing a part in restraining growth.

With regard to retail sales, the 0.5% m/m rise in volumes in August was the third such rise in a row and was driven by gains in all the major categories except fuel sales, which fell by 2.0% m/m. Sales may have been supported by the warmer-than-usual weather. If sales were just flat in September, then in Q3 sales volumes would be up 0.7% q/q compared to the 0.2% q/q gain in Q2.

With the November Budget edging nearer, the public finances position looks weak. Public net sector borrowing of £18.0bn in August means that after five months of the financial year, borrowing is already £11.4bn higher than the OBR forecast at the Spring Statement in March. The overshoot in the Chancellor's chosen fiscal mandate of the current budget is even greater with a cumulative deficit of £15.3bn. All this was due to both current receipts in August being lower than the OBR forecast (by £1.8bn) and current expenditure being higher (by £1.0bn). Over the first five months of the financial year, current receipts have fallen short by a total of £6.1bn (partly due to lower-than-expected self-assessment income tax) and current expenditure has overshoot by a total of £3.7bn (partly due to social benefits and departmental spending). Furthermore, what very much matters now is the OBR forecasts and their impact on the current budget in 2029/30, which is when the Chancellor's fiscal mandate bites.

A looser labour market is driving softer wage pressures. The 3m/yy rate of average earnings growth excluding bonuses has fallen from 5.5% in April to 4.8% in July. The rate for the private sector slipped from 5.5% to 4.7%, putting it on track to be in line with the Bank of England's Q3 forecast (4.6% for September).

CPI inflation fell slightly from 3.5% in April to 3.4% in May, and services inflation dropped from 5.4% to 4.7%, whilst core inflation also softened from 3.8% to 3.5%. More recently, though, inflation pressures have resurfaced, although the recent upward march in CPI inflation did pause for breath in August, with CPI inflation staying at 3.8%. Core inflation eased once more too, from 3.8% to 3.6%, and services inflation dipped from 5.0% to 4.7%. So, we finish the half year in a similar position to where we started, although with food inflation rising to an 18-month high of 5.1% and households' expectations for inflation standing at a six year high, a further loosening in the labour market and weaker wage growth may be a requisite to UK inflation coming in below 2.0% by 2027.

The FTSE 100 fell sharply following the "Liberation Day" tariff announcement, dropping by more than 10% in the first week of April - from 8,634 on 1 April to 7,702 on 7 April. However, the de-escalation of the trade war coupled with strong corporate earnings led to a rapid rebound starting in late April. As a result, the FTSE 100 closed Q2 at 8,761, around 2% higher than its value at the end of Q1 and more than 7% above its level at the start of 2025. Since then, the FTSE 100 has enjoyed a further 4% rise in July, its strongest monthly gain since January and outperforming the S&P 500. Strong corporate earnings and progress in trade talks (US-EU, UK-India) lifted share prices and the index hit a record 9,321 in mid-August, driven by hopes of peace in Ukraine. September proved more volatile and the FTSE 100 closed Q3 at 9,350, 7% higher than at the end of Q1 and 14% higher since the start of 2025. Future performance will likely be impacted by the extent to which investors' global risk appetite remains intact, Fed rate cuts, resilience in the US economy, and AI optimism. A weaker pound will also boost the index as it inflates overseas earnings.

A summary overview of the future path of Bank Rate

There were four Monetary Policy Committee (MPC) meetings in the first half of the financial year. In May, the Committee cut Bank Rate from 4.50% to 4.25%, while in June policy was left unchanged. In June's vote, three MPC members voted for an immediate cut to 4.00%, citing loosening labour market conditions. The other six members were more cautious, as they highlighted the need to monitor for "signs of weak demand", "supply-side constraints" and higher "inflation expectations", mainly from rising food prices. By repeating the well-used phrase "gradual and careful", the MPC continued to suggest that rates would be reduced further.

In August, a further rate cut was implemented. However, a 5-4 split vote for a rate cut to 4% laid bare the different views within the Monetary Policy Committee, with the accompanying commentary noting the decision was "finely balanced" and reiterating that future rate cuts would be undertaken "gradually and carefully". Ultimately, Governor Bailey was the casting vote for a rate cut but with the CPI measure of inflation expected to reach at least 4% later this year, the MPC will be wary of making any further rate cuts until inflation begins its slow downwards trajectory back towards 2%.

Borrowing

The Authority's capital financing requirement (CFR) for 2025/26 is £487m. The CFR denotes the Authority's underlying need to borrow for capital purposes. If the CFR is positive the Authority may borrow from the PWLB or the market (external borrowing), or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

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 half of 2025/26 and have not been previously breached. The schedule at Appendix C details the Prudential Borrowing approved and utilised to date.

No new external borrowing has currently been undertaken to date in 2025/26.

The Council had not undertaken any new borrowing for a number of years until 2024/25, and has been utilising cash balances to internally "borrow" for prudential borrowing schemes. This has enabled the Council to benefit from increased 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. Therefore, it has been necessary over the last 18 months to secure additional borrowing to reduce the under-borrowed position.

Gilt yields and PWLB certainty rates have remained relatively volatile throughout the six months under review, but the general trend has been for medium and longer dated parts of the curve to shift higher whilst the 5-year part of the curve finished September close to where it began in April.

The table below shows the high/low/average PWLB rates for the first six months of the financial year.

	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2025	4.82%	4.94%	5.38%	5.95%	5.63%
30/09/2025	4.58%	4.95%	5.53%	6.23%	5.98%
Low	4.36%	4.62%	5.17%	5.78%	5.46%
Low date	04/08/2025	02/05/2025	02/05/2025	04/04/2025	04/04/2025
High	4.84%	4.99%	5.62%	6.41%	6.14%
High date	02/04/2025	21/05/2025	03/09/2025	03/09/2025	03/09/2025
Average	4.55%	4.82%	5.40%	6.11%	5.83%
Spread	0.48%	0.37%	0.45%	0.63%	0.68%

Debt Rescheduling

Debt repayment and rescheduling opportunities have increased over the course of the past six months and will be considered if giving rise to long-term savings.

However, no debt repayments or rescheduling have been undertaken to date in the current financial year.