Appendix D

Economic Background and Borrowing Update

Economic Background

The second quarter of 2026/27 saw:

- Continued resilience in the face of the ongoing energy shock, with real GDP up 0.4% m/m in July,
- The 3myy rate of average earnings growth excluding bonuses hold steady at 3.5% in July.
- CPI inflation increased to 3.1% in August, and is forecast to rise further by January 2027.
- The Bank of England leave interest rates unchanged at 3.75% although it intimated in its September meeting that rates will be hiked in November or December if a resolution to the conflict in the Middle East is not forthcoming before then.
- The 10-year gilt yield fluctuated ending the quarter at 5.43%.

Real GDP growth has increased by 0.4% m/m in July. The rise in July was broad-based with services output up by 0.4% m/m, industrial production 0.2% m/m higher and construction output rising by 0.1% m/m. The Office for National Statistics also noted that businesses reported stronger activity related to AI and cloud computing.

By September, the composite Purchasing Manager Index (PMI) stood at 52.0. While this was still indicative of expanding activity, it was weaker than August's 52.5 and the lowest level in three months, suggesting the latest leap in energy prices and the prospect of another tax-raising Autumn Budget are weighing on activity. Within the composite report, employment contracted (i.e., a reading below 50) for the twenty-fourth consecutive month while higher fuel and payroll costs contributed to the sharpest rise in prices charged since May. The services PMI fell from 52.5 to 52.1, reportedly due to subdued domestic economic conditions and ongoing geopolitical uncertainty. Meanwhile, weak consumer demand constrained production, bringing the manufacturing output subcomponent balance down from 52.1 to a six-month low of 51.5. The press release also noted that weaker consumer demand was partly offset by AI investment and greater defence spending.

Retail sales volumes were up in every major category except "other stores" and fuel in August, leaving the headline figure up 0.5% m/m. That fully reversed the 0.5% m/m decline in July and left the level of retail sales 2.4% higher than last August. Even if retail sales volumes were flat in September, volumes for the quarter as a whole would still rise by 0.5% q/q, higher than the 0.2% q/q rise in the previous quarter. August's figure suggests that other factors are offsetting the drag on real incomes from higher energy prices and borrowing costs, or that households remain able and willing to reduce their saving rate to sustain recent spending growth. That said, with inflation yet to peak, the biggest drag on households' real income has yet to come.

Public sector net borrowing of £18.3 billion in August was once again higher than the OBR's forecast of £14.8 billion. It also marked the second highest August borrowing figure since records began in 1993. At £12.4 billion, current borrowing (i.e., excluding investments) which is important for the Chancellor's fiscal mandate, was also above the OBR's forecast of £10.4 billion. Higher central government tax receipts were not enough to offset the effect of higher government spending. Central government expenditure overshot the OBR's forecast by £2.3 billion, partly due to higher inflation pushing up debt interest payments and government spending on public services.

Regarding employment, the latest PAYE employment figure for August saw a 26,000 fall, leaving employment 95,000 lower than before the start of the Iran War in February and 0.5% lower than a year ago. The number of job vacancies continued to fall, edging down from 706,000 in the three months to July to 702,000 in the three months to August. While alternative measures of employment show a slightly stronger picture, the unemployment rate stayed at 4.9% in July for the fourth consecutive month.

The knock-on impact from surging energy prices is now being felt, pushing CPI inflation up from 2.9% in July to 3.1% in August. That increase was entirely due to the 6.9% m/m rise in fuel prices, which lifted annual fuel inflation from 15.3% to 23.0%. Even so, higher energy costs do not yet seem to be boosting other items of the CPI just yet. For example, food and drink inflation stayed at 1.3%.

The FTSE 100 started April below 10,200, below its record high of around 10,900 in late February. Nonetheless, the index surged to just shy of that level in late July. More recently, it has struggled, ending September at 10,606. Moreover, it materially underperformed the broader more domestic-focused FTSE 250 and most other international indices over this period, weighed down by weightings towards energy, mining, financials and pharmaceuticals and lack of exposure to tech stocks which generally outperformed globally.

A summary overview of the future path of Bank Rate

There were two monetary policy committee (MPC) meetings during the quarter where Bank rate was yet again left unchanged at 3.75%. The July and September meetings both recorded a 6-3 split however, in September, the Bank of England have intimated that despite this vote against increasing Bank Rate to 4%, four of the majority who voted for no change are minded to vote for a rate hike in November or December if the conflict in the Middle East remains unresolved

Borrowing

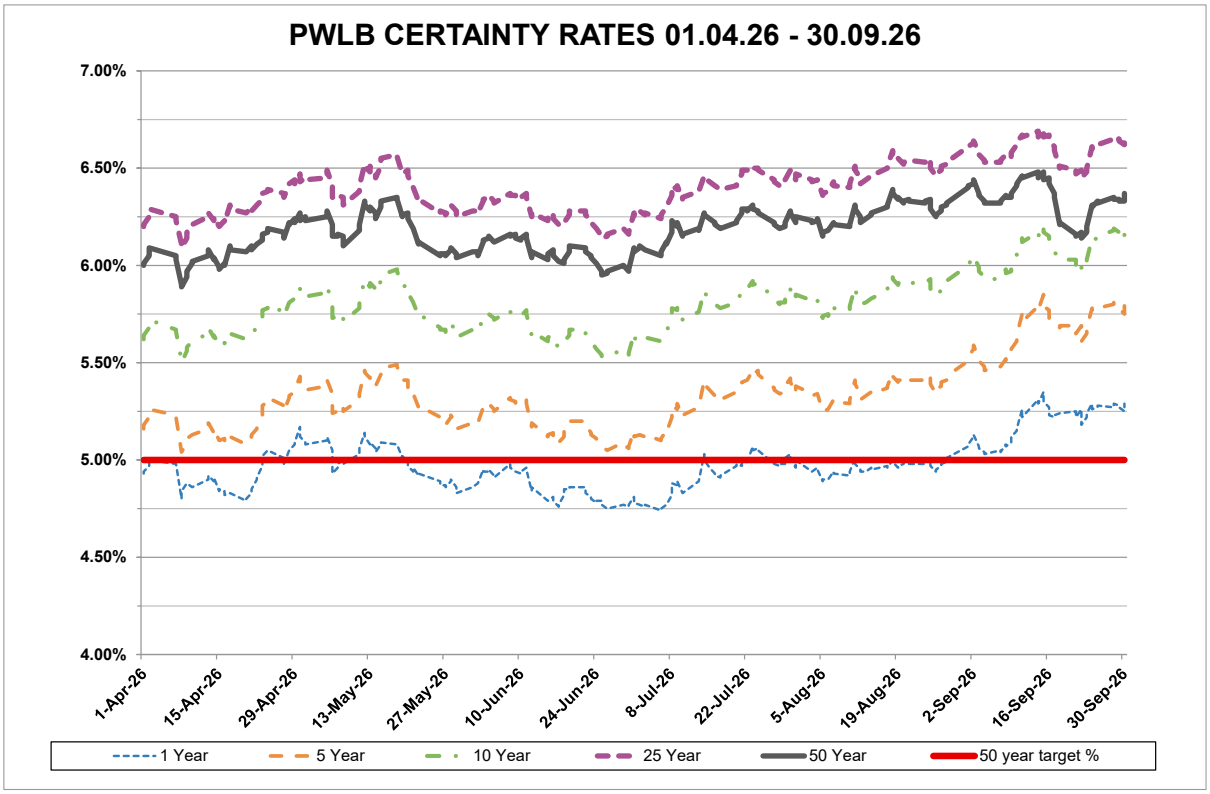
It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy. A list of the approved limits is shown in Appendix B. The Prudential Indicators were not breached during the second quarter of 2026/27 and have not been previously breached. The schedule at Appendix C details the Prudential Borrowing approved and utilised to date.

During the second quarter of 2026/27, the Council has taken out new borrowing to the value of £35m. These loans consisted of £15m of PWLB loans relating to the Housing Revenue Account (HRA) and a further £20m of temporary borrowing from other local authorities, also relating to the HRA. The Council will be planning to undertake further borrowing before the end of the financial year and is actively monitoring PWLB borrowing rates, with an aim to secure longer term borrowing at the most optimum PWLB rates.

The Council has also taken the decision to repay one of its Lender Option Borrower Option Loans at a value of £5.7m. These loans were taken out a number of years ago and allow the lender the option to increase the interest rate charged on the loan at a predetermined reset date. Theis was enacted by the bank to a level much higher than the current market rates, so a decision was taken by the Council to repay this loan.

Gilt yields and PWLB Certainty Rates have remained volatile over the quarter, but the general trend has been for the whole curve to shift higher on the back of inflation concerns and a pessimistic outlook for fiscal aspects, both domestically and internationally.

At this juncture, forecasts rates are predicted to fall back over the next one to three years as inflation dampens, but in the near-term there are upside risks should the second-round effects of inflation, primarily from energy price shocks emanating in the Middle East, become embedded. That scenario could lead to wage increases becoming more challenging from an inflation-management perspective, resulting in monetary policy tightening further than currently forecast (one increase in Bank Rate of 0.25% in either November or December 2026). Conversely, a swift resolution to the conflict in the Middle East could see energy prices fall back swiftly and, therein, an easing in inflation concerns and monetary policy respectively. Currently, the CPI measure of inflation is expected to hit a high of 4.3% in early 2027 before falling back towards the 2% target rate by 2028.Of course, there have been both international geo-political and domestic factors holding sway over the past three months, sometimes separately and sometimes jointly. Initially, markets focussed on the inflationary threat from a large spike upwards in fuel and energy costs emanating from the conflict in the Middle East and, more precisely, the shutting of the Strait of Hormuz to cargo ships transporting oil. Heading into July, however, there has been an outbreak – albeit tentative – of optimism that the US and Iran can reach an agreement that will either end, or at least restrict, the worst of the hostilities. As oil prices have dropped back, inflation concerns have become more muted, although gilt yields are still historically high and monetary policy tighter than it was before the start of the conflict.



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
01/04/2026	4.93%	5.16%	5.62%	6.20%	6.00%
30/09/2026	5.29%	5.80%	6.17%	6.67%	6.37%
Low	4.74%	5.04%	5.50%	6.09%	5.89%
Low date	06/07/2026	08/04/2026	08/04/2026	08/04/2026	08/04/2026
High	5.35%	5.85%	6.21%	6.70%	6.48%
High date	15/09/2026	15/09/2026	15/09/2026	15/09/2026	14/09/2026
Average	4.98%	5.34%	5.81%	6.40%	6.19%
Spread	0.61%	0.81%	0.71%	0.61%	0.59%