**ARGYLL AND BUTE COUNCIL** **AUDIT AND SCRUTINY COMMITTEE**

**FINANCIAL SERVICES** **16 DECEMBER 2025**

# TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT STRATEGY MID-YEAR REVIEW 2025-26

## 1.0 EXECUTIVE SUMMARY

1.1 The Local Government in Scotland Act 2003 requires the council to have regard to the CIPFA Code of Practice in Treasury Management (revised 2021), the Code. Key reporting requirements in this respect include an annual Treasury Management Strategy Statement, including the Annual Investment Strategy; a Mid-year Review Report; and an Annual Report.

1.2 This mid-year report, prepared in compliance with the Code, covers the following:

- An economic and interest rate update;
- A review of the approved Treasury Management Strategy and Annual Investment Strategy;
- An update on the capital position and Prudential Indicators;
- An update on borrowing and investment activities; and
- Compliance with Treasury and Prudential Limits.

1.3 The reports key highlights comprise the following:

a) All borrowing and investment activity during the period 1 April to 30 September 2025 has been undertaken in accordance with the approved 2025-26 Treasury Management Strategy and Annual Investment Strategy and the authority has operated within the treasury and prudential limits set out therein;

b) During the year to 30 September, the authority has continued to maintain an under-borrowed position. Whilst an element of new PWLB borrowing has been undertaken during the year to date, providing a degree of budget certainty, the significant level of internal reserve fund balances has provided an opportunity to largely defer new external borrowing, whilst also minimising exposure to investment risk. This borrowing strategy will require to be regularly reviewed to achieve optimum value and minimise risk exposure in the longer term;

c) New PWLB borrowing of £20.000m has been undertaken in the year to date, providing an element of certainty in respect of the underlying borrowing requirement. PWLB loan principal of £0.840m has also been repaid during the year to date in respect of a 10-year loan taken on an Equal Instalments of Principal (EIP) basis;

d) The limit of investments has reflected the level of available reserve balances, together with provision for managing the authority's day to day cash flow requirements. The average rate of return on these investments in the year to 30 September was 4.23%, compared to an average benchmark overnight SONIA rate of 4.19% over this period;

e) As at 30 September 2025, the council's loan debt (excluding other long-term liabilities) totalled £148.968m, while treasury investments totalled £67.579m; and

f) Since approval of the 2025-26 Treasury Management Strategy in February 2025, capital planning assumptions have been updated and a new accounting standard, IFRS 16 in respect of accounting for leases and lease type arrangements.has been adopted. As such, it has been necessary to revise the Prudential Indicators set out within the approved strategy.

1.4 The Audit and Scrutiny Committee is asked to recommend that Council:

- Note the report, and the treasury management activity undertaken over the period 1 April to 30 September 2025; and,
- Approve the revised 2025-26 Prudential Indicators, as set out within paragraph 5.2.3 of the report.

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# TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT STRATEGY MID-YEAR REVIEW 2025/26

## 2.0 BACKGROUND

2.1 The authority operates a balanced revenue budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, providing adequate liquidity initially before considering optimising investment return.

2.2 The second main function of the treasury management service is the funding of the authority's capital investment plans. These capital plans provide a guide to the borrowing need of the authority, essentially the longer-term cash flow planning to ensure the authority can meet is capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses and, on occasion, existing debt may be restructured to meet authority risk or savings objectives.

2.3 The Chartered Institute of Public Finance and Accountancy is currently consulting local authorities in respect of potential changes to the Treasury Management and Prudential Codes of Practice. At this point, the key focus appears to be in respect of non-treasury investment. However, officers will provide an update on any material developments or changes in due course.

2.4 The adoption of a new accounting standard, IFRS 16 in respect of accounting for leases, applicable from 1 April 2025, has impacted the assets and liabilities recognised within the council's balance sheet. In addition, an element of services revenue expenditure now requires to be accounted for as financing costs. As anticipated, the annual accounts for the year ending 31 March 2025 have been restated on this basis, as part of the audit process. It is worth noting that there has been no impact on the General Fund balance as at 31 March 2025 as a result of these changes.

2.5 Leases and lease-type arrangements, previously accounted for as revenue activity are generally now recognised on the balance sheet as 'Right of Use Assets', with associated long-term liabilities in respect lease payments, payable over future years. This is essentially to recognise the long-term obligations associated with these types of arrangements. Over two hundred assets, held under lease-type arrangements, including fleet and property are now represented on the council's balance sheet. The council's PPP type arrangements in respect of the school estate are also accounted for on an IFRS 16 basis.

2.6 In addition to any required updates to the Prudential Indicators, set out within the approved 2025-26 Treasury Management Strategy, as a result of updated capital plan assumptions, updates will be necessary in respect of IFRS 16 accounting changes.

## 3.0 INTRODUCTION

3.1 The Local Government in Scotland Act 2003, and supporting regulations, requires the authority to have regard to the CIPFA Code of Practice on Treasury Management (revised 2021), the Code. The Code requires full Council to receive an annual Treasury Management Strategy Statement, including the Annual Investment Strategy, for the year ahead; a Mid-year Review Report; and an Annual Report following the year end.

3.2 The regulatory environment requires the authority to delegate responsibility for the monitoring and scrutiny of treasury management activities, strategy and policies to a specific named body. For this authority, the appropriate delegation body is the Audit and Scrutiny Committee. Treasury management training was delivered to members of the committee during October 2024. There is also a Treasury Management Toolkit, available to members, to support this scrutiny role.

3.3 Prudential and Treasury Indicators are designed to ensure capital investment plans are affordable, prudent and sustainable. There are clear linkages between the council's capital planning and treasury management strategy, with the financing costs arising from capital investment plans considered as part of the overall revenue Budget Outlook.

3.4 This mid-year report, prepared in compliance with the Code, covers the following:

- An economic and interest rate update;
- A review of the approved Treasury Management Strategy and Annual Investment Strategy;
- An update on the capital position and Prudential Indicators;
- An update on borrowing and investment activities; and
- Compliance with Treasury and Prudential Limits.

## 4.0 RECOMMENDATIONS

4.1 The Audit and Scrutiny Committee is asked to recommend that Council:

- Note the report, and the treasury management activity undertaken over the period 1 April to 30 September 2025; and
- Approve the revised 2025-26 Prudential Indicators, as set out within paragraph 5.2.3 of the report.

## 5.0 DETAIL

### 5.1 Economic and Interest Rate Update

5.1.1 The authority's appointed treasury advisors, MUFG Corporate Markets, provide updates on the economic position and interest rate forecasts. This is provided as Appendix 1. The first half of 2025-26 saw:

- An increase of 0.3% in GDP during the first quarter, followed by the economy flatlining in July, with higher taxes for businesses restraining growth.
- A fall in the 3 month / year on year rate of average earnings growth, excluding bonuses, from 5.5% to 4.8% in July.
- The Consumer Price Index (CPI) inflation ebbing and flowing but ending at 3.8% by September.
- An easing of core inflation (excludes volatiles components such as food and energy) to 3.6%.
- 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 fluctuate between 4.4% and 4.8%, ending at 4.70% as at the end of September.

5.1.2 The 2025-26 strategy included market assumptions for long-term PWLB interest rates and short-term interest rates (Bank Rate) during 2025-26. These are compared to the latest forecast in the following table:

| **31 March 2026 Interest Rate Forecast** | | |
|---|---|---|
| | ***Original %*** | **Current %** |
| Bank Rate | *3.75%* | 3.75% |
| 5 Year PWLB | *4.50%* | 4.50% |
| 10 Year PWLB | *4.70%* | 5.00% |
| 25 Year PWLB | *5.10%* | 5.70% |
| 50 Year PWLB | *4.90%* | 5.40% |

5.1.3 The latest long-term PWLB and short-term interest rate forecasts, provided by MUFG Corporate Markets, are outlined below. This sets out a view that medium and long-dated PWLB borrowing rates will fall back over the next couple of years. Bank Rate (short-term borrowing) is expected to continue to fall steadily throughout 2026, before reaching 3.25% towards the end of 2027.

(a) Long-term PWLB borrowing rates:

| | 2025-26 | 2026-27 | | 2027-28 | |
|---|---|---|---|---|---|
| **PWLB Rates** | **Sept 2025** | **Low** | **High** | **Low** | **High** |
| | **%** | **%** | **%** | **%** | **%** |
| **5 year** | 4.80 | 4.3 | 4.4 | 4.2 | 4.2 |
| **10 year** | 5.30 | 4.8 | 4.9 | 4.7 | 4.7 |
| **25 year** | 6.10 | 5.5 | 5.7 | 5.3 | 5.4 |
| **50 year** | 5.80 | 5.3 | 5.4 | 5.1 | 5.2 |

*(Based on the PWLB Certainty Rate, the standard rate minus 20 bps)*

(b) Short-term borrowing rates:

| | 2025-26 | 2026-27 | | 2027-28 | |
|---|---|---|---|---|---|
| | **Sept 2025** | **Low** | **High** | **Low** | **High** |
| | **%** | **%** | **%** | **%** | **%** |
| **Bank Rate** | 4.00 | 3.50 | 3.75 | 3.25 | 3.50 |

## 5.2 Treasury Management Strategy Review

5.2.1 The 2025-26 Treasury Management Strategy was approved by Council on 27 February 2025. The underlying strategy remains fit for purpose in terms of the updated economic position and approved changes to the Capital Plan. However, the 2025-26 Prudential Indicators set out within approved strategy require to be revised to reflect updates to capital planning assumptions and accounting changes in respect of compliance with the new accounting standard, IFRS 16 Leases.

5.2.2 The council's financial statements have been restated to reflect adoption of the new accounting standard, IFRS 16 in respect of leases. Whilst there is no impact on the council's General Fund position, the required accounting changes impact the council's Capital Financing Requirement and Debt calculations. In addition, an element of revenue expenditure previously accounted for as service expenditure, now requires to be accounted for as financing costs. This impacts the calculated Ratio of Financing Costs to Net Revenue Stream indicator.

5.2.3 The proposed changes to the 2025-26 Prudential Indicators are summarised in the following table, while more detailed supporting information is provided within section 5.3 of the report.

| Prudential Indicator | Original £m | Revised £m |
|---|---|---|
| Gross Capital Expenditure | 71 | 76 |
| Closing CFR | 394 | 396 |
| Operational Boundary for External Debt | 394 | 396 |
| Authorised Limit for External Debt | 402 | 404 |
| Gross Debt | 321 | 289 |
| Gross Debt less CFR | -73 | -107 |
| Ratio of Financing Costs to Net Revenue Stream | 4.9% | 7.4% |

## 5.3 Capital Position and Prudential Indicators Update

5.3.1 This section of the report is structured to update:

- The authority's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

**Prudential Indicator for Capital Expenditure**

5.3.2 The 2025-26 strategy estimated gross capital expenditure of £71.006m for the year. This position is monitored on an ongoing basis, as part of the Capital Plan Monitoring, regularly reported to the Policy and Resources Committee. The 2025-26 estimated gross capital expenditure has now been revised to £76.308m, reflecting updated assumptions contained within the council's current Capital plan. This increase mainly relates to additional expenditure approvals, and the reprofiling of expenditure from 2024-25 into 2025-26 and from 2025-26 into future years. It is also worth noting that the Capital Plan does not include assets acquired under lease or lease type arrangements.

**Financing of the Capital Plan**

5.3.3 The 2025-26 strategy estimated gross capital expenditure of £71.006m for the year, as outlined above, with £45.199m to be financed from new borrowing. In addition to capital expenditure updates, there have also been changes to the capital income assumptions within the council's current Capital Plan. These changes potentially impact the level of capital expenditure to be financed from

borrowing. Any re-profiling of project expenditure from/to 2025-26 to/from future years, between now and the end of the year, would also impact the underlying borrowing requirement. However, the Section 95 Officer will take a strategic approach to manage the impact of capital investment on the council's revenue budget, including the use of earmarked reserves, to ensure that capital investment is affordable, prudent and sustainable.

5.3.4 The table below outlines the expected financing arrangements for the updated capital expenditure plans. The net financing need or borrowing element increases the council's underlying indebtedness (Capital Financing Requirement), although this will be reduced in part by revenue charges for the repayment of debt (principal repayment). This direct borrowing need may also be supplemented by the replacement of maturing debt and to meet other treasury cashflow requirements.

| **Capital Expenditure and Financing Estimates 2025-26** | **Original £m** | **Revised £m** |
|---|---|---|
| **Gross Capital Expenditure** | **71.006** | **76.308** |
| **Finance by:** | | |
| Specific Project Income | 8.302 | 12.263 |
| General Capital Grant | 11.178 | 11.178 |
| Asset Sales | 0.750 | 1.000 |
| Earmarked Reserves / Revenue | 5.577 | 6.668 |
| **Total Financing** | **25.807** | **31.109** |
| **Net Financing (Borrowing) Need** | **45.199** | **45.199** |

5.3.5 It is worth noting that assets acquired through lease or lease-type arrangements are not financed through direct borrowing. These arrangements result in the recognition of assets; and corresponding lease liabilities, repayable over the term of the lease.

**Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), and the Operational Boundary for External Debt**

5.3.6 The council's actual CFR as at 31 March 2025 has been restated from £349m (pre-audit) to £360m (post anticipated audit changes) to reflect IFRS 16 accounting requirements. In approving its strategy for 2025-26, Council noted an estimated CFR of £360m as at 31 March 2025 and £394m as at 31 March 2026 (£34m movement). The actual CFR as at 31 March 2025 is unchanged at £360m, while the current projected CFR as at 31 March 2026 has been revised to £396m (£36m movement). The estimated increased movement of £2m in the CFR during the year largely reflects a decrease from the originally

estimated repayment of Other Long-term Liabilities. The table below shows the CFR, together with the expected debt position over the period, which is termed the Operational Boundary.

| **2025-26 CFR and Operational Boundary for External Debt** | **Original £m** | **Revised £m** |
|---|---|---|
| Opening Capital Financing Requirement | 360 | 360 |
| Closing Capital Financing Requirement | 394 | 396 |
| **Net Movement in CFR** | **34** | **36** |
| | | |
| **Prudential Indicator – the Operational Boundary for External Debt** | | |
| Borrowing | 293 | 282 |
| Other Long-term Liabilities* | 101 | 114 |
| **Total Debt (year-end position)** | **394** | **396** |

** Includes on balance sheet PPP and lease arrangements recognised under IFRS 16.*

**Limits to Borrowing Activity**

5.3.7 The first key control over the treasury activity is a Prudential Indicator to ensure that, over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2025-26 and the next two financial years.

| **2025-26 Estimated Debt against CFR** | **Original £m** | **Revised £m** |
|---|---|---|
| Borrowing | 220 | 187 |
| Other Long-term Liabilities* | 101 | 102 |
| **Total Debt** | **321** | **289** |
| | | |
| **CFR (year-end position)** | **394** | **396** |
| Under / (Over) Borrowing | 73 | 107 |

** Includes on balance sheet PPP and lease arrangements recognised under IFRS 16.*

5.3.8 The level of 'under-borrowing' outlined in the table above reflects the level of internal borrowing, as described in paragraph 5.4.5.

5.3.9 A further Prudential Indicator controls the overall level of borrowing. This is the Authorised Limit, representing the limit, beyond which borrowing is prohibited and needs to be set and revised by Members. It is the expected maximum

borrowing need with some headroom for short-term day to day cash flow management requirements.

| 2025-26 Authorised Limit for External Debt | Original £m | Revised £m |
|---|---|---|
| Borrowing | 298 | 287 |
| Other Long-term Liabilities* | 104 | 117 |
| **Total Debt** | **402** | **404** |

** Includes on balance sheet PPP and lease arrangements recognised under IFRS 16.*

### 5.4 Borrowing Activity

5.4.1 PWLB loan principal of £0.840m has been repaid in the year to 30 September 2025, with a further £0.840m due to be repaid by 31 March 2026. These repayments of principal relate to a 10-year PWLB loan (original principal £21m), which was taken on a fixed Equal Instalments of Principal (EIP) basis. All other PWLB loans will be repayable on maturity.

5.4.2 The authority has one outstanding market or LOBO loan for £5.255m, at an interest rate of 4.75%, maturing 2048, with call dates every 6 months. This loan was not recalled at the 22 June 2025 call date. There is potential for this loan to be recalled before the end of the financial year, at the next call date of 22 December 2025.

5.4.3 New PWLB long-term borrowing of £20m has been undertaken during the year to 30 September 2025, providing an element of certainty in respect of funding the underlying borrowing requirement for capital. With long-term borrowing rates relatively high but forecast to steadily fall over the next few years, new borrowing has been taken on a relatively short-term basis. Details of the new loan taken out during the period are as follows:

| Lender | Principal | Type | Interest Rate | Maturity |
|---|---|---|---|---|
| PWLB | £20.000m | Fixed Rate Maturity | 4.69% | 07/04/2028 |

5.4.4 Any PWLB or LOBO loans maturing during the year will ultimately require replacement borrowing to maintain the council's cashflow position. In addition, the council will continue to actively monitor potential restructuring opportunities, in order to generate savings in interest costs or to improve the balance of the loan debt maturity profile.

5.4.5 While there is an underlying need to borrow in respect of the Capital Financing Requirement and the replacement of maturing debt, this may involve arranging short or long-term loans from external PWLB or market sources; or borrowing from internal reserve fund balances on a temporary basis, dependent on fund balance forecasts. Although an element of new external borrowing has been undertaken during the year to 30 September 2025, the significant level of

internal reserve fund balances held by the council has provided an opportunity to largely defer new external borrowing. The table at paragraph 5.3.7 shows the extent to which the council has utilised internal funds in lieu of borrowing. This is a prudent and cost-effective approach in the current economic climate but will require ongoing monitoring and review.

5.4.6 As at 30 September 2025, the council's external loan debt totalled £148.968m, as summarised in the table below.

| External Debt as at 30 September 2025 | Amount £000 | Annual Average Interest Rate | Share of Total Debt |
|---|---|---|---|
| Public Works Loans Board | 143,357 | 4.50% | 96.23% |
| Market Loans (LOBO) | 5,255 | 4.75% | 3.53% |
| Temporary Loans* | 356 | 3.56% | 0.24% |
| **Total Debt** | **148,968** | **4.50%** | **100.00%** |

**This represents short-term borrowing from various institutions.*

### 5.5 Debt Rescheduling

5.5.1 Debt repayment and rescheduling opportunities are considered on an ongoing basis, either to deliver savings in interest costs or to improve the debt maturity profile, at minimum risk. No debt repayments or rescheduling has been undertaken in the current financial year to 30 September 2025, however, this will continue to be monitored in the context of changing market conditions.

### 5.6 Annual Investment Strategy Review

5.6.1 In accordance with the CIPFA Treasury Management Code of Practice, the council's approved Annual Investment Strategy sets out the council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

5.6.2 The authority will aim to achieve the optimum return (yield) on its investments, commensurate with proper levels of security and liquidity, and the council's risk appetite. The risk appetite of the council is low, prioritising security and liquidity. In the current economic climate, it is considered appropriate to keep investments short term, to cover cash flow needs, but also to seek out value available in periods of up to 12 months with high credit quality financial institutions, using the MUFG Corporate Markets suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

5.6.3 As outlined within the approved Annual Investment Strategy 2025-26, investment rates were forecast to fall during the first half of 2025-26, which they did, and expectations are that gradual but continuing reductions will follow over the next two financial years.

**Creditworthiness**

5.6.4 The UK's sovereign rating has proven robust through the first half of 2025-26. The UK Government is expected to outline in detail its fiscal proposals in the budget scheduled for 26 November 2025.

**Investment Counterparty Criteria**

5.6.5 The current investment counterparty selection criteria, approved within the Strategy, continues to meet the requirements of the treasury management function.

## 5.7 Investment Activity

5.7.1 The council's Section 95 Officer confirms that the principles of the Annual Investment Strategy have been adhered to. During the year to 30 September 2025, all investments have been made in line with the approved limits for specific investment instruments, and in accordance with the creditworthiness approach.

5.7.2 Details of the council's investments held as at 30 September 2025, totalling £67.579m, are summarised in the table below.

| **Counterparty** | **Maturity** | **Amount £000** | **Interest Rate %** |
|---|---|---|---|
| Clydesdale Bank | Instant Access | 379 | 3.90% |
| **Fixed Deposits:** | | | |
| ANZ Banking Group | 10/11/2025 | 15,000 | 4.36% |
| Al Rayan Bank | 20/11/2025 | 5,000 | 4.40% |
| DBS Bank | 26/11/2025 | 5,000 | 4.13% |
| Qatar National Bank | 27/11/2025 | 5,000 | 4.29% |
| **Local Authority to Local Authority** | 16/02/2026 | 5,000 | 4.20% |
| **Money Market Funds**: | | | |
| Federated | Call Account | 15,000 | 4.09% |
| LGIM Stirling Liquidity fund | Call Account | 15,000 | 4.11% |
| Aviva | Call Account | 2,200 | 4.10% |
| **Total** | | **67,579** | **4.20%** |

5.7.3 The weighted average rate of return on investments held during the year to 30 September 2025 was 4.23%, with an average investment duration of 17 days. This compares to an average benchmark SONIA overnight rate of 4.19% over the first half of the year, while Bank Rate was lowered during the period from 4.50% to 4.25% in May, and then to 4.00% in August.

5.7.4 The council is part of an Investment Benchmarking group, a service provided by MUFG Corporate Markets, which provides monthly Investment Analysis reports. This analysis compares the authority's investment holdings and returns to the other Scottish public bodies in the group, and to Scottish Unitary Authorities as a whole. When making investment decisions, the council prioritises security and liquidity in that order but, when the investment options available are well within the parameters set out in the council's Investment Strategy, officers will also seek to maximise yield. The council's investments continue to perform well and above the benchmarks provided.

### 5.8 Compliance with Treasury and Prudential Limits

5.8.1 It is a statutory duty for the authority to determine and keep under review the affordable capital expenditure limits. In the current financial year to 30 September 2025, the authority has operated within the Treasury and Prudential Limits set out within the approved Treasury Management Strategy for 2025-26. All treasury management operations have also been conducted in full compliance with the authority's Treasury Management Practices.

5.8.2 It has been necessary to revise the Prudential Indicators to reflect updated capital planning assumptions and the adoption of IFRS 16 in respect of accounting for leases and lease type arrangements. The Section 95 Officer confirms that no difficulties are envisaged in complying with the Treasury and Prudential Limits, as revised by this report, for the remainder of the financial year.

## 6.0 CONCLUSION

6.1 All borrowing and investment activity during the period 1 April to 30 September 2025 has been undertaken in accordance with the approved 2025-26 Treasury Management Strategy and Annual Investment Strategy and the authority has operated within the treasury and prudential limits set out therein.

6.2 During the year to 30 September, the authority has continued to maintain an under-borrowed position. Whilst an element of new PWLB borrowing has been undertaken during the year to date, providing a degree of budget certainty, the significant level of internal reserve fund balances has provided an opportunity to largely defer new external borrowing, whilst also minimising exposure to investment risk. This borrowing strategy will require to be regularly reviewed to achieve optimum value and minimise risk exposure in the longer term.

6.3 Since approval of the 2025-26 Treasury Management Strategy in February 2025, capital planning assumptions have been updated and a new accounting standard, IFRS 16 in respect of accounting for leases has been adopted. As such, it has been necessary to revise the Prudential Indicators set out within the approved strategy.

## 7.0 IMPLICATIONS

7.1 Policy - None

7.2 Financial – Provides an update on 2025-26 treasury management activity and the approved strategy

7.3 Legal - None

7.4 HR - None

7.5 Customer Service

7.6 Risk – Provides an overview of treasury management and investment risk

7.7 Climate Change - None

7.8 Fairer Scotland Duty - None

7.9 Equalities - protected characteristics - None

7.10 Consumer Duty - None

7.11 Island Communities – None

7.12 Children's Rights and Wellbeing - None

**Kirsty Flanagan**

**Executive Director/Section 95 Officer**

**21 November 2025**

**Councillor Ross Moreland, Policy Lead for Finance and Commercial Services**

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**APPENDICES**

Appendix 1 – MUFG Economic and Interest Rate Update

# Economics and Interest Rates

## Economics Update

- 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. The weak overseas environment is also likely to have contributed to the 1.3% m/m fall in manufacturing output in July. That was the second large fall in three months and left the 3m/3m rate at a 20-month low of -1.1%. The 0.1% m/m rise in services output kept its 3m/3m rate at 0.4%, supported by stronger output in the health and arts/entertainment sectors. Looking ahead, ongoing speculation about further tax rises in the Autumn Budget on 26 November will remain a drag on GDP growth for a while yet. GDP growth for 2025 is forecast by Capital Economics to be 1.3%.
- Sticking with future economic sentiment, the composite Purchasing Manager Index for the UK fell from 53.5 in August to 51.0 in September. The decline was mostly driven by a fall in the services PMI, which declined from 54.2 to 51.9. The manufacturing PMI output balance also fell, from 49.3 to 45.4. That was due to both weak overseas demand (the new exports orders balance fell for the fourth month in a row) and the cyber-attack-induced shutdown at Jaguar Land Rover since 1 September reducing car production across the automotive supply chain. The PMIs suggest tepid growth is the best that can be expected when the Q3 GDP numbers are released.
- Turning to retail sales, and 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 overshot 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. As a general guide, Capital Economics forecasts a deficit of about £18bn, meaning the Chancellor will have to raise £28bn, mostly through higher taxes, if she wants to keep her buffer against her rule of £10bn.

- The weakening in the jobs market looked clear in the spring. May's 109,000 m/m fall in the PAYE measure of employment was the largest decline (barring the pandemic) since the data began and the seventh in as many months. The monthly change was revised lower in five of the previous seven months too, with April's 33,000 fall revised down to a 55,000 drop. More recently, however, the monthly change was revised higher in seven of the previous nine months by a total of 22,000. So instead of falling by 165,000 in total since October, payroll employment is now thought to have declined by a smaller 153,000. Even so, payroll employment has still fallen in nine of the ten months since the Chancellor announced the rises in National Insurance Contributions (NICs) for employers and the minimum wage in the October Budget. The number of job vacancies in the three months to August stood at 728,000. Vacancies have now fallen by approximately 47% since its peak in April 2022. All this suggests the labour market continues to loosen, albeit at a declining pace.

- 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.

- An ever-present issue throughout the past six months has been the pressure being exerted on medium and longer dated gilt yields. The yield on the 10-year gilt moved sideways in the second quarter of 2025, rising from 4.4% in early April to 4.8% in mid-April following wider global bond market volatility stemming from the "Liberation Day" tariff announcement, and then easing back as trade tensions began to de-escalate. By the end of April, the 10-year gilt yield had returned to 4.4%. In May, concerns about stickier inflation and shifting expectations about the path for interest rates led to another rise, with the 10-year gilt yield fluctuating between 4.6% and 4.75% for most of May. Thereafter, as trade tensions continued to ease and markets increasingly began to price in looser monetary policy, the 10-year yield edged lower, and ended Q2 at 4.50%.
- More recently, the yield on the 10-year gilt rose from 4.46% to 4.60% in early July as rolled-back spending cuts and uncertainty over Chancellor Reeves' future raised fiscal concerns. Although the spike proved short lived, it highlighted the UK's fragile fiscal position. In an era of high debt, high interest rates and low GDP growth, the markets are now more sensitive to fiscal risks than before the pandemic. During August, long-dated gilts underwent a particularly pronounced sell-off, climbing 22 basis points and reaching a 27-year high of 5.6% by the end of the month. While yields have since eased back, the market sell-off was driven by investor concerns over growing supply-demand imbalances, stemming from unease over the lack of fiscal consolidation and reduced demand from traditional long-dated bond purchasers like pension funds. For 10-year gilts, by late September, sticky inflation, resilient activity data and a hawkish Bank of England have kept yields elevated over 4.70%.
- 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 and dovish signals from Fed Chair Powell. 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.

**MPC meetings: 8 May, 19 June, 7 August, 18 September 2025**

- 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 (Dhingra, Ramsden and Taylor) 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%.

- The Bank of England does not anticipate CPI getting to 2% until early 2027, and with wages still rising by just below 5%, it was no surprise that the September meeting saw the MPC vote 7-2 for keeping rates at 4% (Dhingra and Taylor voted for a further 25bps reduction).

- The Bank also took the opportunity to announce that they would only shrink its balance sheet by £70bn over the next 12 months, rather than £100bn. The repetition of the phrase that "a gradual and careful" approach to rate cuts is appropriate suggests the Bank still thinks interest rates will fall further but possibly not until February, which aligns with both our own view and that of the prevailing market sentiment.

## Interest Rate Forecasts

The Authority has appointed MUFG Corporate Markets as its treasury advisors and part of their service is to assist the Authority to formulate a view on interest rates. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20bps) which has been accessible to most authorities since 1 November 2012.

MUFG Corporate Markets' latest forecast on 11 August sets out a view that short, medium and long-dated interest rates will fall back over the next year or two, although there are upside risks in respect of the stickiness of inflation and a continuing tight labour market, as well as the size of gilt issuance.

| MUFG Corporate Markets Interest Rate View 11.08.25 | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Sep-25 | Dec-25 | Mar-26 | Jun-26 | Sep-26 | Dec-26 | Mar-27 | Jun-27 | Sep-27 | Dec-27 | Mar-28 | Jun-28 | Sep-28 |
| BANK RATE | 4.00 | 4.00 | 3.75 | 3.75 | 3.50 | 3.50 | 3.50 | 3.50 | 3.25 | 3.25 | 3.25 | 3.25 | 3.25 |
| 3 month ave earnings | 4.00 | 4.00 | 3.80 | 3.80 | 3.50 | 3.50 | 3.50 | 3.50 | 3.30 | 3.30 | 3.30 | 3.30 | 3.30 |
| 6 month ave earnings | 4.00 | 3.90 | 3.70 | 3.70 | 3.50 | 3.50 | 3.50 | 3.50 | 3.30 | 3.30 | 3.40 | 3.40 | 3.40 |
| 12 month ave earnings | 4.00 | 3.90 | 3.70 | 3.70 | 3.50 | 3.50 | 3.50 | 3.50 | 3.30 | 3.40 | 3.50 | 3.60 | 3.60 |
| 5 yr PWLB | 4.80 | 4.70 | 4.50 | 4.40 | 4.30 | 4.30 | 4.30 | 4.20 | 4.20 | 4.20 | 4.20 | 4.10 | 4.10 |
| 10 yr PWLB | 5.30 | 5.20 | 5.00 | 4.90 | 4.80 | 4.80 | 4.80 | 4.70 | 4.70 | 4.70 | 4.70 | 4.60 | 4.60 |
| 25 yr PWLB | 6.10 | 5.90 | 5.70 | 5.70 | 5.50 | 5.50 | 5.50 | 5.40 | 5.40 | 5.30 | 5.30 | 5.30 | 5.20 |
| 50 yr PWLB | 5.80 | 5.60 | 5.40 | 5.40 | 5.30 | 5.30 | 5.30 | 5.20 | 5.20 | 5.10 | 5.10 | 5.00 | 5.00 |