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Council

22 January 2026

Treasury Management Strategy Mid-Year Review Report 2025/26

Portfolio Holder: Councillor Vince Maple, Leader of the Council

Report from: Phil Watts, Chief Finance Officer

Authors: Andy McNally-Johnson, Head of Corporate Accounts
Claire Sharman, Finance Business Partner – Technical accounts

Summary

This report gives an overview of treasury management activity since 1 April 2025 and presents a review of the Treasury Strategy approved by Council on 27 February 2025.

The report was considered by the Audit Committee on 30 October 2025, the minutes of which are set out at section 10 of the report and by the Cabinet on 16 December 2025, the decisions of which are set out at section 11 of the report.

The key indicators are set out in the table below:

Indicator	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate	2028/29 Estimate
	£000	£000	£000	£000
Capital Expenditure	131,596	62,096	25,561	10,525
General Fund (GF) Capital Financing Requirement (CFR) at year end	660,239	670,106	680,338	683,926
Housing Revenue Account (HRA) Capital Financing Requirement (CFR) at year end	48,130	58,858	65,260	64,943
Total Capital Financing Requirement at year end	708,369	728,964	745,598	748,870
External Borrowing	655,051	675,646	692,279	695,551
Underborrowing	53,318	53,318	53,318	53,318

The movement in the capital financing requirement is shown below:

GF Capital Financing Requirement	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate	2028/29 Estimate
	£000	£000	£000	£000
Opening Balance	570,283	660,239	670,106	680,338
Add Unfinanced Capital Expenditure	55,555	29,247	16,867	10,526
Add Exceptional Financial Support	23,846	0	0	0
Add Long Term Debtors (Capital Loans)	37,600	22,800	22,800	22,800
Less Minimum Revenue Provision (MRP)	(6,574)	(7,840)	(8,124)	(8,452)
Less KCC Debt Repayment	(1,110)	(1,065)	(1,023)	(982)
Less Repayment of Capital Loans	(19,361)	(33,275)	(20,289)	(20,304)
Closing CFR	**660,239**	**670,106**	**680,338**	**683,926**

HRA Capital Financing Requirement	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate	2028/29 Estimate
	£000	£000	£000	£000
Opening Balance	42,386	48,130	58,858	65,260
Add Unfinanced Capital Expenditure	5,974	11,253	6,704	0
Less Voluntary Revenue Provision (VRP)	(231)	(525)	(303)	(316)
Closing CFR	**48,130**	**58,858**	**65,260**	**64,943**

1. Recommendations

1.1. The Council is requested to note the comments of the Audit Committee and the decisions of the Cabinet, as set out at sections 10 and 11 of the report.

1.2. The Council is requested to consider the report and note its contents.

2. Budget and Policy Framework

2.1. Audit Committee is responsible for the scrutiny of the Council's Treasury Management, Investment Strategy and Minimum Revenue Provision Policy Statement along with Treasury Management Practices and associated Schedules.

2.2. There needs to be, as a minimum, a mid-year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved.

3. Background

3.1. In December 2021 the Chartered Institute of Public Finance and Accountancy (CIPFA) issued revised Prudential and Treasury Management Codes. These require all local authorities to prepare a Capital Strategy which is to provide the following:

- A high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of service.
- An overview of how the associated risk is managed.
- The implications for future financial sustainability.

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

3.3. The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing requirements of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending liabilities. This management of longer-term cash may involve arranging long or short-term loans, or using long-term cash flow surpluses, and on occasion, debt previously incurred may be restructured to meet Council risk or cost objectives.

3.4. Accordingly, treasury management is defined as:

- "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

3.5. The Chartered Institute of Public Finance and Accountancy is currently consulting local authorities in respect of potential changes to the Codes. At this juncture, the focus seems to primarily be on the non-treasury investment aspects of local authority activity. Officers will provide an update on any material developments/changes in due course.

3.6. This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2021). The primary requirements of the Code are as follows:

(i) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

(ii) Creation and maintenance of Treasury Management Practices (TMP's) which set out the way the Council will seek to achieve those policies and objectives.

(iii) Receipt by the Audit Committee, Cabinet and full Council/ of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during the previous year. (Quarterly reports are also required for the periods ending April to June and October to December.

(iv) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

(v) Delegation by the Authority of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Authority, the delegated body is the Audit Committee.

3.7. This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- A review of the Treasury Management Strategy Statement and Annual Investment Strategy (Section 5);
- A review of the Council's borrowing strategy for 2025/26 (Section 6);
- A review of any debt rescheduling undertaken during 2025/26 (Section 7);
- A review of compliance with Treasury and Prudential Limits for 2025/26. (Section 8);
- A review of the Council's investment portfolio for 2025/26 (Section 10);
- An economic update for the first half of 2025/26 (Appendix).

4. Treasury Management Strategy Statement and Annual Investment Strategy Update

4.1. Full Council approved the 2025/26 Treasury Management Annual Investment Strategy on the 27 February 2025.

4.2. The Strategy stated that in the long-term aim of officers is to smooth out the maturity profile and reduce reliance on short-term borrowing but whilst holding some short-term debt to manage cash flow. However, as a significant amount of capital receipts are expected in the next few years, a higher level of short to medium-term loans from other local authorities will be held in the immediate term. At 31 March 2025 short-term borrowing stood at £91million and increased to £221million as at 30 September 2025. This figure includes £106million due for repayment before 31 March 2026. The aim over the next few months will be to avoid increasing the overall amount due for repayment in 2025/26 and concentrate new borrowing for repayment in 2026/27 to 2028/29 with ideally no more than £10m maturing each month. Any new loans are likely to be a mixture from the Public Works Loans Board (PWLB) and other Local Authorities, using the most advantageous interest rates available at the time. Any further smoothing would require the use of longer-term funding from PWLB and although still higher than anticipated, interest rates are on a downward trajectory meaning this option will become less expensive. The current position is shown in the graph at 6.7.

5. Borrowing & Borrowing Limits

5.1. The purpose of the Capital Financing Requirement (CFR) is to demonstrate that Council borrowing is undertaken to fund capital expenditure only. The

CFR represents the long-term assets of the Council that have not been funded from sources other than borrowing, such as grants and external contributions, capital receipts or revenue funding. External borrowing should not exceed the CFR over the medium term. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

5.2. An updated estimate of the CFR and borrowing position compared with the estimate included in the Treasury Strategy is shown in the table below:

CFR & Borrowing	Per 2025/26 Strategy £000	Revised Estimate £000
CFR 31 March 2026	675,135	708,369
External Debt	673,736	655,051
Under-borrowing	1,399	53,318
Estimated In Year Borrowing Required	117,303	69,611

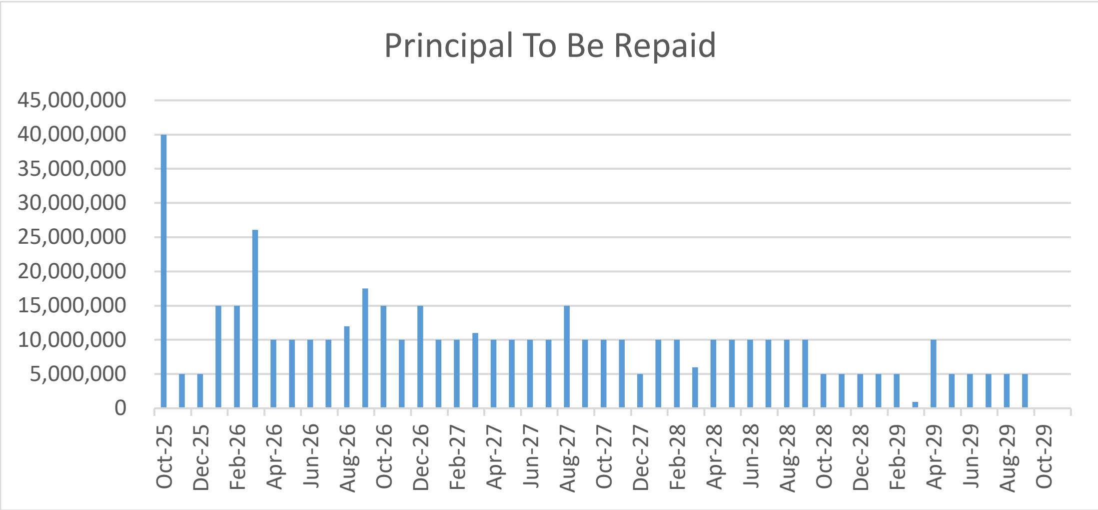
5.3. The revision compared with the estimates arise from the evolution of the capital programme including changes to profiling and funding since the Strategy was formulated in late 2024.

5.4. The Chief Operating Officer (S.151 Officer) reports that no difficulties are envisaged for the current or future years in ensuring that borrowing does not exceed CFR.

5.5. A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit, which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in a longer-term scenario. It is a forecast of maximum borrowing requirement with some capacity for unexpected movements. This is the statutory limit determined under section 3(1) of the Local Government Act 2003. The Council's authorised borrowing limit for 2025/26 is £805.899 million and it will not exceed this limit.

5.6. One of the risks inherent within Treasury management is "Interest rate risk." This risk is high where a large proportion of an organisation's borrowing portfolio reach termination point at the same time. The organisation then has to re-finance a large proportion of their portfolio at a set point in time with the risk that interest rates may not be favourable. The recent strategy has been to reduce interest rate risk and smooth the borrowing repayment profile by taking out new borrowing for longer repayment terms. Progress towards this aim has been limited by the factors noted in 4.2 above.

5.7. The graph below shows the debt portfolio repayment profile for the next three years as at 30 September. All debts are being shown as repayable at term, although the LOBO's (Lender Option Borrower Option) have a variety of "call" periods of between 6 months and every 5 years. The risk of a call occurring is higher than before due to the current raised interest rates. One lender has exercised their option at the end of September meaning a loan for £10million was repaid and it is thought that the same lender could do the same for a further loan during 2026/27.



6. Debt Rescheduling

6.1. 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.

7. Compliance with Treasury and Prudential Limits

7.1. It is a statutory duty for the Authority to determine and keep under review the affordable borrowing limits, (affordable capital expenditure limits – Scottish local authorities). During the half year ended 30 September 2025, the Authority has operated within the treasury and prudential indicators set out in the Authority's Treasury Management Strategy Statement for 2025/26. The Chief Operating Officer reports that no difficulties are envisaged for the current or future years in complying with these indicators.

7.2. All treasury management operations have also been conducted in full compliance with the Authority's Treasury Management Practices.

8. Annual Investment Strategy

8.1. The Treasury Management Strategy Statement (TMSS) for 2025/26, which includes the Annual Investment Strategy, was approved by the Authority on 27/02/2025. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Authority's investment priorities as being:

- Security of capital
- Liquidity
- Yield

8.2. The Authority will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the

Authority's risk appetite. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs.

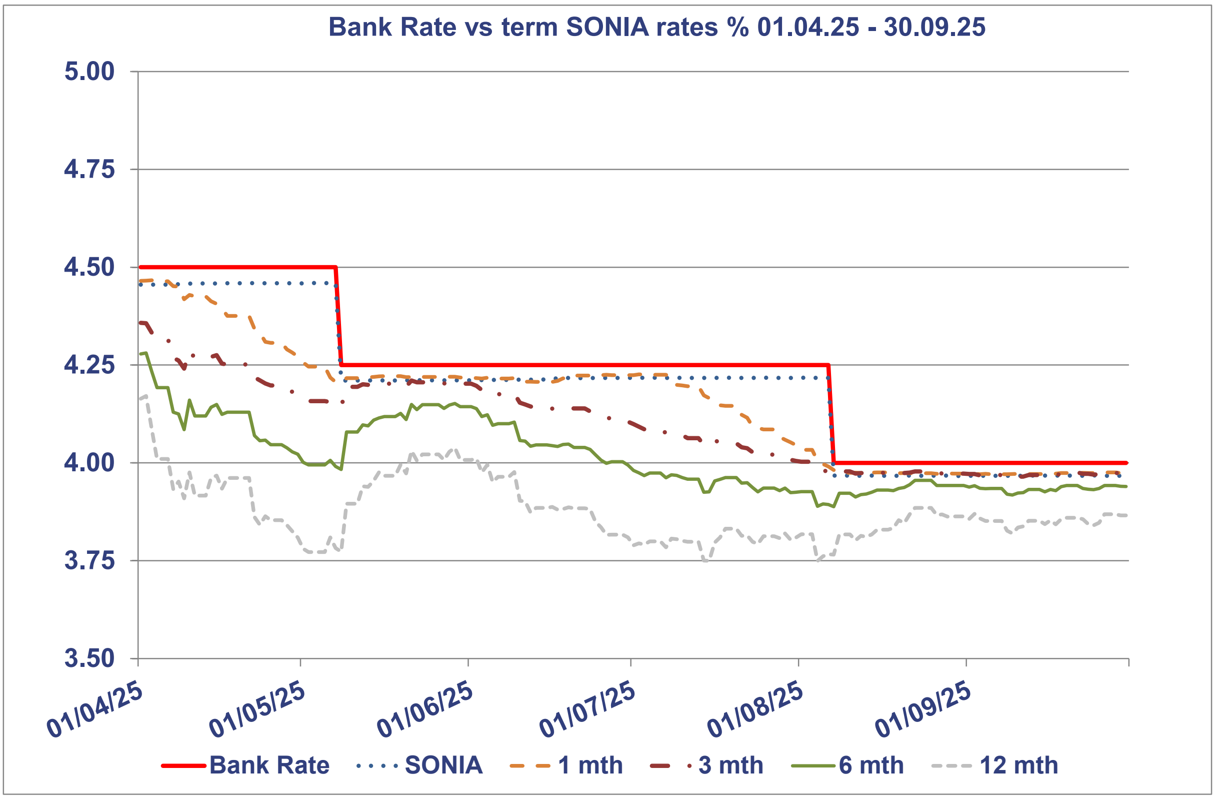
8.2.1. Creditworthiness - The UK's sovereign rating has proven robust through the first half of 2025/26. The Government is expected to outline in detail its future fiscal proposals in the Budget scheduled for 26 November 2025.

8.2.2. Investment Counterparty Criteria - The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management.

8.2.3. CDS prices - It is noted that sentiment in the current economic climate can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

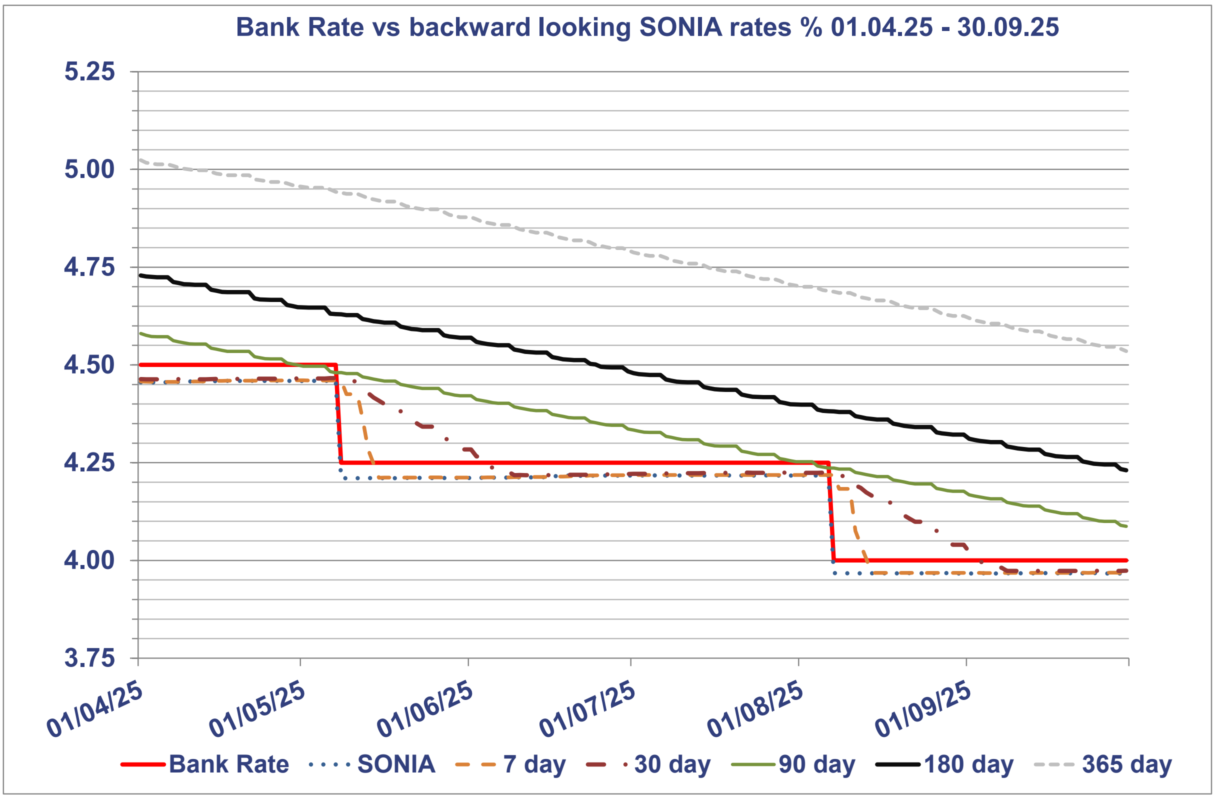
8.2.4. Investment balances - The average level of funds available for investment purposes during the first half of the financial year was £25.6million. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

8.3. Investment performance year to date as of 30 September 2025



	Bank Rate	SONIA	1 mth	3 mth	6 mth	12 mth
High	4.50	4.46	4.47	4.36	4.28	4.17
High Date	01/04/2025	07/05/2025	03/04/2025	01/04/2025	02/04/2025	02/04/2025
Low	4.00	3.97	3.97	3.96	3.89	3.75
Low Date	07/08/2025	29/08/2025	16/09/2025	08/09/2025	07/08/2025	04/08/2025
Average	4.23	4.19	4.16	4.10	4.01	3.88
Spread	0.50	0.49	0.50	0.39	0.39	0.42

The table above covers the first half of 2025/26.



	Bank Rate	SONIA	7 day	30 day	90 day	180 day	365 day
High	4.50	4.46	4.46	4.47	4.58	4.73	5.02
High Date	01/04/2025	07/05/2025	28/04/2025	06/05/2025	01/04/2025	01/04/2025	01/04/2025
Low	4.00	3.97	3.97	3.97	4.09	4.23	4.54
Low Date	07/08/2025	29/08/2025	04/09/2025	10/09/2025	30/09/2025	30/09/2025	30/09/2025
Average	4.23	4.19	4.20	4.24	4.34	4.48	4.79
Spread	0.50	0.49	0.49	0.49	0.49	0.50	0.49

8.4. The table above covers the first half of 2025/26.

9. Investment Portfolio 2025/26

9.1. In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

9.2. The investment portfolio yield on cash investments at 30 September 2025 ranges from 0.0% to 4.20%.

9.3. A full list of in house investments held as at 30 September is shown below:

Investments: Core Investments	**Principle £**	**Interest %**
CCLA Property Fund (September 2025 market value)	11,814,828	n/a
Patriza Hannover Property UT (September 2025 market value)	5,720,300	n/a

Lothbury Property Trust (April 2024 market value less redistributions to 14/08/25)*	282,559	n/a
Total Core Investments	**17,817,687**	n/a
Investments: Liquid investments	**Principle £**	**Interest %**
Svenska Handelsbanken	1,152	0.00%
Lloyds	10,766,923	4.04%
Barclays	4,579	0.00%
Santander	0	3.43%
CCLA Public Sector Deposit Fund	19,956,258	4.20%
Total Liquid Investment	**30,728,912**	4.14%
Total In house Investments	**48,546,599**	**n/a**

9.4. Members may like to note the overall performance of the investment in property funds in the current financial year as shown below.

	CCLA	**Patrizia**	**Total**		**Lothbury***
	£000	**£000**	**£000**		**£000**
Opening Value 01 April 2025	11,566	5,683	**17,249**	Value as at 30 April 2024	3,632
Revaluation	249	37	**286**	Redistribution	(3,350)
Closing Value 30 September 2025	11,815	5,720	**17,535**	Awaiting Redistribution	283
Dividend Received	132	78	**210**		
Overall Gain/ (Loss)	**381**	**115**	**496**		

* Lothbury Property Fund ceased on 31 May 2024. The trustees of the fund are redistributing the final fund valuations (30 April 2024) in Tranches as properties are sold. The Council has received 7 tranches to date with a total value of £3.35million, leaving a balance of £0.283million still to be received. The fund gives monthly statements as to the projected value of assets still to be sold, and based upon the latest statement, officers are confident that the Council will receive the remaining value of monies as soon as the properties the fund holds are sold.

9.5. The current active portfolio includes investment in the Patrizia Hanover Property Unit Trust. The initial investment of £5million was made in 2017/18, with the view that it was to be viewed as a long-term project. Since that time, values of property funds have suffered, partly as a result of the pandemic and changes to working practices, and as a result the value of the fund had reduced to as low as £4.774million in 2020/21 and as at 2023/24 was still below par at £4.89million. During 2024/25, planning permission was given to provide a data centre at one of the assets held by the fund, leading to a large increase in the valuation of the fund, with Medway's share valued at £5.694million as at 31/03/25.

9.6. Under normal accounting standards, any gains or losses in valuations would normally have to be taken through the Council's revenue account, but there has been a statutory override in place in recent years meaning that any gains or losses are held within an unusable reserve in the Council's balance sheet. Whilst this arrangement has been extended for existing pooling funds as at 31/03/2025 until 01/04/2029, many investors have seen this increase as an opportunity to request a redemption on their investment. As of 14 July 2025, redemption notices have been served on approximately 85% of the Trust's units and since this exceeds the threshold of two-thirds of units in issue, the Trust has initiated a formal consultation and decision-making process regarding its potential wind-down. An Extraordinary General Meeting (EGM) notice was produced at the end of September with Unitholders will be asked to submit formal responses by late November. On Medway has taken the opportunity to request a redemption from the fund, and we are assuming that we should receive the current value, albeit as per the Lothbury redemption, this may happen over a period of time as the remaining assets are sold.

9.7. The Council's finance and interest net expenditure for 2025/26 as per Round 2, the latest published results is currently estimated to be contained within the approved budget as set out below, although due to significant expenditure against the capital programme since the previous quarter and a deterioration in the Council's working capital position, a more detailed review of the assumptions behind this forecast is planned and there is a high risk that the forecast position will worsen in round 3:

	2024/25 Outturn	**Budget 2025/26**	**Round 2 Forecast**	**Round 2 Variance**
	£000	**£000**	**£000**	**£000**
Interest Earned	(11,758)	(5,842)	(5,842)	0
Interest Paid	21,265	16,238	16,238	0
KCC Principal	1,110	1,204	1,204	0
MRP	5,792	6,442	6,442	0
Treasury Costs	174	65	65	0
TOTAL INTEREST & FINANCING	**16,583**	**18,107**	**18,107**	**0**

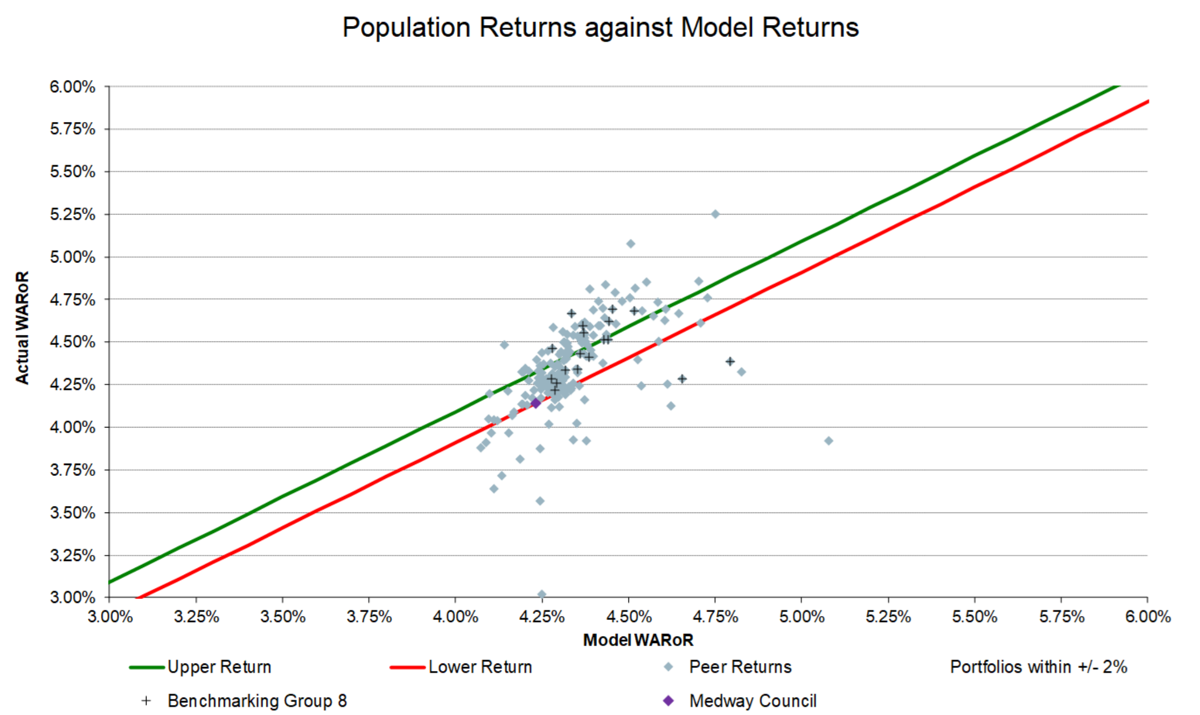
9.8. Investment Counterparty Criteria

9.8.1. The current investment counterparty criteria selection approved in the Treasury Strategy is meeting the requirement of the treasury management function.

9.9. Benchmarking

9.9.1. The in-house Treasury team, contribute to the Link Asset Services benchmarking club which produces quarterly reports. Shown below is a graph showing Medway's performance to September.

Medway Council



Medway Council	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
	4.14%	4.23%	-0.09%	4.14%	4.32%	Inline

9.9.2. The “x” axis of the graph shows the “Model Weighted Average Rate of Return,” this is easiest interpreted as the level of return we should expect for the level of risk that we are taking with our investment portfolio. This is then plotted against the “Actual Weighted Average Rate of Return” on the “y” scale, running diagonally upwards across the graph are two parallel lines, if a Council performance falls between these lines, then they are deemed to be receiving a return as would be expected for their level of risk, below these two lines and performance is considered below that expected and above then the return being received is above that expected. As can be seen Medway’s return is in line with expectations for our level of risk. However, the data includes only cash deposits and excludes property funds.

9.9.3. In assessing the risk inherent in an Investment Portfolio for the benchmarking, three factors are considered:

(i) The number of days to maturity of an investment. With a larger the number of days left to maturity the greater the risk that an adverse event could occur
(ii) The total number of days that the investment was originally invested for, again the longer an authority is comfortable to invest for the greater the risk it is willing to take.
(iii) The creditworthiness of the counterparties in which the authority invests.

9.9.4. The table below shows some detail from the June 2025 benchmarking data comparing Medway in-house performance against all participants of the benchmarking group: unitary authorities and other local councils.

Authority/Group	Model Weighted Average Rate of Return Bands	Risk: Weighted Average Maturity (Days)	Risk: Weighted Average Total Time (Days)	Risk: Weighted Average Credit Risk	Weighted Average Rate of Return
Medway	**4.14%-4.32%**	**0**	**0**	**2.05**	**4.14%**
Brighton & Hove CC	4.70%-4.88%	122	435	1.98	4.39%
East Sussex CC	4.35%-4.54%	81	175	1.33	4.62%
Kent CC	4.57%-4.75%	145	360	1.05	4.28%
Maidstone BC	4.42%-4.61%	69	191	1.00	4.68%
Sevenoaks DC	4.20%-4.38%	0	0	1.13	4.22%
Thanet DC	4.19%-4.37%	6	13	1.36	4.46%
Tonbridge and Malling BC	4.27%-4.45%	65	171	3.16	4.43%

10. Audit Committee

10.1. The report was considered by the Audit Committee on 30 October 2025 and the draft minutes of this discussion are as follows:

10.2. The Finance Business Partner introduced the report and provided an overview of Treasury activity for the year. Key indicators showed that borrowing remained below the capital finance requirement.

10.3. Interest Rates and gilts remained higher than expected, so the Council continued to pursue a short-term borrowing, with £221m remained owed in short term borrowing and £106m repayable this financial year. As interest rates fall, the Council would take opportunities to smooth the debt maturity.

10.4. Investment performance continued as expected, in terms of property investment, the Patriza Hannover Property Unit Trust performance was being carefully monitored, and the Council would consider its options.

10.5. The following issues were discussed:

Risk – in response to a question whether higher than expected interest rates there was additional risk to Council investments, the Finance Business Partner - technical accounts stated that the Council received updates from treasury advisors on a daily basis, and would act on their advice.

10.6. **Capital Programme** – it was asked whether the higher cost of borrowing would trigger a review of the Capital programme. The Chief Operating Officer stated that he would discuss the programme with the administration when borrowing was required to fund the programme, however, there was no formal trigger which would necessitate a review. Treasury Advisors provided regular advice and had a clear understanding of the Council goals.

10.7. **Interest and Finance Budget** – further information was requested regarding the interest and finance budget position. The Chief Operating Officer stated that interest rates had not fallen as expected and as such an increase in costs and consequently pressure on the budget was likely to be reflected in quarter three monitoring reports.

It was asked if the authority could manage a debt repayment of £10m a month, the Business Finance Partner stated that a little over £10m repayment was being paid. The Chief Operating Officer explained that he had concerns about the level of short term debt being carried, however, it was a result of the economic environment and outside the control of the authority.

10.8. **Capital Receipts** – it was asked whether the Council was meeting expectations in disposal of assets to realise capital receipts. The Chief Operating Officer stated the Council expected to achieve £7m of Capital receipts in 2025 and £25m in 2026 which would represent a good performance. The disposal of property was based on whether the asset was or could delivering value to the Council. Properties which did not deliver value would be subject to disposal.

10.9. A Member expressed concern at the level of borrowing, the Chief Operating Officer stated that unlike some other authorities, borrowing had been to fund a number of significant projects and was held against a number of assets. In addition, projects such as purchasing homes for Temporary Accommodation would ease pressure on ongoing revenue budgets and some investments such as Cozenton Park were performing better than expected.

10.10. The Chief Operating Officer acknowledged an ongoing concern regarding the level of working capital available with more monies owed to the Council by third parties than expected.

10.11. Patriza Hannover Property Unit Trust Investment – further information was requested regarding the Patriza Hannover Property Unit Trust Investment, the Chief Operating officer stated that the fund was a victim of its success, having made a significant profit, a number of investors had sought to realise the profit, and this had caused a run on the investment. If the Council removed its investment now it would still, make a profit of around £300,000 and it had received dividends over the last four years.

10.12. **Banking** – a Member commented that there was some concern in the banking industry regarding future economic performance and asked whether the Council had any exposure to risk. The Chief Operating Officer stated that the biggest area of risk was the pension fund, however, colleagues in Kent had presented a positive position and there was a possibility that employer contributions would fall next financial year, so pension fund managers did not see a significant risk.

10.13. **Decision:**

The Committee noted the report and noted that the report will also be referred to Cabinet and Full Council.

11. Cabinet

11.1. The report was considered by the Cabinet on 16 December 2025, the decisions of which are set out below.

11.2. The Cabinet noted the comments of the Audit Committee set out at section 11 of the report.

11.3. The Cabinet considered the report, noted its contents and noted that the report would also be referred to Full Council.

11.4. The Cabinet agreed that the Leader of the Council, in consultation with the Chief Operating Officer, would write to the Public Works Loan Board (PWLB) to request clarification of how decisions were taken in relation to the setting of interest rates.

12. Risk management

12.1. Risk and the management thereof is a feature throughout the Strategy and in detail within the Treasury Management Practices 1 published alongside the Treasury Management Strategy at the start of 2025.

13. Financial and legal implications

13.1. The finance and legal implications are highlighted throughout this report. The Council has delegated responsibility for the execution and administration of treasury management decisions to the Chief Operating Officer, who will act in accordance with the Council's policy statement and Treasury Management Practices.

Lead officer contact

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Appendices

Appendix 1 – Economic Update for the First Half of 2025/26

Background Papers

None

Appendix 1 – Economic update for the first half of 2025/26

This section has been prepared by the Authority's Treasury Advisors, MUFG Corporate Markets.

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