

MUFG Commentary on the Economy, Interest Rate Forecasts, Annual Investment Strategy, Borrowing and Approved countries for investments

Treasury Management Update

Quarter Ended 31st December 2025 (Q3 2025/26)

The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management 2021 recommends that members be updated on treasury management activities at least quarterly. This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

1. Economics update

- The third quarter of 2025/26 saw:
 - A -0.1% m/m change in real GDP in October, leaving the economy no bigger than at the start of April.
 - The 3myy rate of average earnings growth excluding bonuses fall to 4.6% in October, having been as high as 5.5% earlier in the financial year.
 - CPI inflation fall sharply from 3.6% to 3.2% in November, with core CPI inflation easing to 3.2%.
 - The Bank of England cut interest rates from 4.00% to 3.75% in December, after holding in November.
 - The 10-year gilt yield fluctuate between 4.4% and 4.7%, ending the quarter at 4.5%.
- 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 (subsequently revised down to 0.2% q/q). Nonetheless, the 0.0% m/m change in real GDP in July, followed by a 0.1% m/m increase in August and a 0.1% decrease in September will have caused some concern (0.1% q/q). October's disappointing -0.1% m/m change in real GDP suggests that growth slowed to around 1.4% in 2025 as a whole.
- Sticking with future economic sentiment, the composite Purchasing Manager Index (PMI) for the UK rose from 51.2 in November to 52.1 in December, suggesting the economy may be benefitting somewhat from pre-Budget uncertainty fading. This may also reflect a diminishing drag from weak overseas demand. While the services PMI rose from 51.3 to 52.1, the improvement in the manufacturing output balance from 50.3 to 51.8 was larger. Indeed, the manufacturing sector has been more exposed to the recent weakness of external demand and has lagged the services sector since the end of last year.
- Turning to retail sales volumes, and the 1.5% year-on-year rise in September, accelerating from a 0.7% increase in August, marked the highest gain since April. Nonetheless, the 0.1% m/m fall in retail sales volumes in November built on the 0.9% m/m drop in October, suggesting the longer-lasting effects of weak employment and slowing wage growth are impacting. Moreover, the decline in the GfK measure of consumer confidence from -17 in October to -19 in November suggests that consumers are not that optimistic at present.
- Prior to the November Budget, the public finances position looked weak. The £20.2 billion borrowed in September was slightly above the £20.1 billion forecast by the OBR. For the year to date, the £99.8 billion borrowed is the second highest for the April to September period since records began in 1993, surpassed only by borrowing during the COVID-19 pandemic. The main drivers of the increased borrowing were higher debt interest costs, rising government running costs, and increased inflation-linked benefit payments, which outweighed the rise in tax and National Insurance contributions.

- Following the 26 November Budget, the Office for Budget Responsibility (OBR) calculated the net tightening in fiscal policy as £11.7bn (0.3% of GDP) in 2029/30, smaller than the consensus forecast of £25bn. It did downgrade productivity growth by 0.3%, from 1.3% to 1.0%, but a lot of that influence was offset by upgrades to its near-term wage and inflation forecasts. Accordingly, the OBR judged the Chancellor was going to achieve her objectives with £4.2bn to spare. The Chancellor then chose to expand that headroom to £21.7bn, up from £9.9bn previously.
- Moreover, the Chancellor also chose to raise spending by a net £11.3bn in 2029/30. To pay for that and the increase in her headroom, she raised taxes by £26.1bn in 2029/30. The biggest revenue-raisers were the freeze in income tax thresholds from 2028/29 (+£7.8bn) and the rise in NICs on salary-sacrifice pension contributions (+£4.8bn). The increase in council tax for properties worth more than £2.0m will generate £0.4bn.
- After the Budget, public net sector borrowing of £11.7bn in November was comfortably below last November's figure of £13.6bn and was the lowest November borrowing figure since 2021, mainly due to tax receipts being £5.4bn higher, largely because of the hike in employer NICs in April 2025. Cumulative borrowing in the first eight months of 2025/26 was still £10bn above last year's total. However, lower inflation and a disposal of assets ahead of the Budget should mean borrowing in 2025/26 comes in below last year's total.
- 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, the 38,000 fall in payroll employment in November was the tenth monthly decline in the past 13 months, causing the annual growth rate to slow further, from -0.5% to -0.6%. The number of job vacancies in the three months to November 2025 stood at 729,000 (the peak was 1.3 million in spring 2022) but the less reliable Labour Force Survey data showed that employment fell by 16,000 in the three months to October, with the unemployment rate rising further, from 5.0% to 5.1%. All this suggests the labour market continues to loosen, albeit at a slow pace.
- A looser labour market is driving softer wage pressures. The 3myy growth rate of average earnings including bonuses eased from 4.9% in September to 4.7% in October. And excluding bonuses, the 3myy rate slowed from 4.7% to 4.6%. Regular private sector pay growth continued to slow from 4.2% to 3.9%. That left it broadly on track to meet the Bank's end of December prediction of 3.5%.
- CPI inflation fell sharply in November, easing from 3.6% in October to 3.2%. This was the third consecutive softer-than-expected inflation outturn and suggests that disinflation is well underway. There was a widespread easing in price pressures with inflation slowing in 10 of the 12 main categories. Core inflation fell from 3.4% to 3.2% and services inflation dipped from 4.5% to 4.4%. However, a great deal will depend on the adjustments to regulated and indexed prices scheduled for next April. Capital Economics forecast CPI inflation to drop from 3.2% in March to 2.0% in April, thereby leaving inflation on track to settle at the 2.0% target, or below, by the end of 2026.
- An ever-present issue throughout recent 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 a high of c4.8%, before ending June 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 kept yields elevated over 4.70% although, subsequently, gilt yields fell back after the Budget, supported by a tighter fiscal plan, fewer tax hikes required following a smaller-than-expected downgrade to the OBR's fiscal forecast, and a favourable shift in bond issuance away from long-dated debt. Gilt yields hovered around 4.5% at the end of the quarter.

- 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 ended June at 8,761, around 2% higher than its value at the end of March and more than 7% above its level at the start of 2025. Since then, the FTSE 100 has enjoyed a further significant jump in value. The stock market hit new record highs above 9,900 in Mid-November, driven by a global rebound on hopes of a US government-shutdown resolution, expectations of a December rate-cut, and strong corporate earnings. Despite some jitters around Budget time, the FTSE 100 closed Q4 at 9,931, 5% higher than at the end of September and 22% higher since the start of 2025.

MPC meetings: 8 May, 19 June, 7 August, 18 September, 6 November, 18 December 2025

- There were six Monetary Policy Committee (MPC) meetings held between April and December. 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 was wary of making any further rate cuts until inflation begins its slow downwards trajectory back towards 2%.
- 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). Moreover, 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 suggested the Bank still thought interest rates will fall further.
- At the 6 November meeting, Governor Bailey was once again the deciding vote, keeping Bank Rate at 4% but hinting strongly that a further rate cut was imminent if data supported such a move. By 18 December, with November CPI inflation having fallen to 3.2%, and with Q2 GDP revised down from 0.3% q/q to only 0.2% q/q, and Q3 GDP stalling at 0.1%, the MPC voted by 5-4 to cut rates further to 3.75%. However, Governor Bailey made it clear that any further reductions would require strong supporting data, and the pace of any further decreases would be slow compared to recent months. The markets expect Bank Rate to next be cut in April.

2. Interest rate forecasts

The Authority has appointed MUFG Corporate Markets as its treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. MUFG Corporate Markets provided the following forecasts and commentary on 22 December 2025. These are forecasts for Bank Rate, average earnings and PWLB certainty rates, gilt yields plus 80 bps.

MUFG Corporate Markets Interest Rate View 22.12.25													
	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27	Mar-28	Jun-28	Sep-28	Dec-28	Mar-29
BANK RATE	3.75	3.50	3.50	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
3 month ave earnings	3.80	3.50	3.50	3.30	3.30	3.30	3.30	3.30	3.30	3.30	3.30	3.30	3.30
6 month ave earnings	3.80	3.50	3.50	3.40	3.30	3.30	3.30	3.40	3.40	3.40	3.40	3.40	3.40
12 month ave earnings	3.90	3.60	3.60	3.50	3.40	3.50	3.50	3.50	3.50	3.50	3.60	3.60	3.60
5 yr PWLB	4.60	4.50	4.30	4.20	4.10	4.10	4.10	4.10	4.10	4.10	4.10	4.10	4.10
10 yr PWLB	5.20	5.00	4.90	4.80	4.80	4.70	4.70	4.70	4.70	4.60	4.60	4.60	4.70
25 yr PWLB	5.80	5.70	5.60	5.50	5.50	5.40	5.30	5.30	5.30	5.20	5.20	5.20	5.20
50 yr PWLB	5.60	5.50	5.40	5.30	5.30	5.20	5.10	5.10	5.10	5.00	5.10	5.00	5.00

- MUFG’s last interest rate forecast update was undertaken on 11 August. Since then, a combination of tepid growth (0.2% q/q GDP for Q2 and 0.1% q/q GDP for Q3), falling inflation (currently CPI is 3.2%),

and a November Budget that will place more pressure on the majority of households' income, has provided an opportunity for the Bank of England's Monetary Policy Committee to further reduce Bank Rate from 4% to 3.75% on 18 December.

- Surprisingly, to most market commentators, the recent steep fall in CPI inflation in one month from 3.6% to 3.2% did not persuade most "dissenters" from the November vote (Lombardelli, Greene, Mann and Pill) to switch to the rate-cutting side of the Committee. Instead, it was left to Bank Governor, Andrew Bailey, to use his deciding vote to force a rate cut through by the slimmest of margins, 5-4.
- Given the wafer-thin majority for a rate cut it was not unexpected to hear that although rates would continue on a "gradual downward path", suggesting a further rate cut or cuts in the offing, MPC members want to assess incoming evidence on labour market activity and wage growth. Indeed, with annual wage growth still over 4.5%, the MPC reiterated that the case for further rate cuts would be "a closer call", and Governor Bailey observed there is "limited space as Bank Rate approaches a neutral level".
- Accordingly, the MUFG Corporate Markets forecast has been revised to price in a rate cut in Q2 2026 to 3.5%, likely to take place in the wake of a significant fall in the CPI inflation reading from 3% in March to 2% in April (as forecast by Capital Economics), followed by a short lull through the summer whilst more data is garnered, and then a further rate cut to 3.25% in Q4.
- Accordingly, our updated central forecast is made with several hefty caveats. We are confident, as we have been for some time, that our forecast for Bank Rate and the 5-year PWLB Certainty Rate is robust, and we have marginally brought forward the timing of the next rate cut(s). But for the 10-, 25- and 50-years part of the curve, the level of gilt issuance, and the timing of its placement, will be integral to achieving a benign trading environment. That is not a "given", and additionally, the inflation outlook and political factors domestically and, crucially, in the US, are also likely to hold sway. Matters should be clearer by June in the UK, but the US mid-term elections are scheduled for November.
- Our revised PWLB rate forecasts are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1 November 2012. Please note, the lower Housing Revenue Account (HRA) PWLB rate started on 15 June 2023 for those authorities with an HRA (standard rate minus 60 bps) and is set to prevail until at least the end of March 2026. Hopefully, there will be a further extension to this discounted rate announced in January.
- Money market yield forecasts are based on expected average earnings by local authorities for 3 to 12 months.
- **Borrowing advice:** Our long-term (beyond 10 years) forecast for the neutral level of Bank Rate remains at 3.5%. As all PWLB certainty rates are still above this level, borrowing strategies will need to be reviewed in that context. Overall, better value can be obtained at the shorter end of the curve (<5 years PWLB maturity/<10 years PWLB EIP) and short-dated fixed LA to LA monies should also be considered. Temporary borrowing rates will, generally, fall in line with Bank Rate cuts.
- MUFG will continue to monitor economic and market developments as they unfold. Typically, they formally review their forecasts following the quarterly release of the Bank of England's Monetary Policy Report but will consider their position on an ad-hoc basis as required.
- Their interest rate forecast for Bank Rate is in steps of 25 bps, whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps. Naturally, they continue to monitor events and will update our forecasts as and when appropriate.

3. Annual Investment Strategy

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

- Security of capital
- Liquidity
- Yield

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity, aligned with the Council's risk appetite. In the current economic climate, over and above keeping investments short-term to cover cash flow needs, MUFG advise that there is a benefit to seeking out value available in periods up to 12 months with high credit rated financial institutions, using the MUFG Corporate Markets suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

As shown by the charts below and the interest rate forecasts in section 2, investment rates have started to taper downwards during the final quarter of 2025 and are expected to fall back further if inflation falls through 2026 and the MPC loosens monetary policy further.

Creditworthiness

There have been few changes to credit ratings over the quarter under review. However, officers continue to closely monitor these, and other measures of creditworthiness to ensure that only appropriate counterparties are considered for investment purposes.

Investment counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management.

CDS prices

For UK and international banks, these have remained low, and prices are not misaligned with other creditworthiness indicators, such as credit ratings. Nevertheless, it remains important to undertake continual monitoring of all aspects of risk and return.

Investment balances

The average level of funds available for investment purposes during the quarter was £18.9m. 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. The Council does not currently hold core cash balances for investment purposes (i.e., funds available for more than one year).

4. Borrowing

PWLB maturity Certainty Rates 01.04.25 to 31.12.25

Overall, the journey for PWLB Certainty rates in 2025/26 has been somewhat circular, with the only net movement of substance over the nine months under review occurring at the shortest part of the curve. Nonetheless, there has been a degree of volatility driven by movements in US Treasuries as well as domestic factors, the most negative of which impacted markets in early September.

Throughout the period under review, markets have reacted to Government fiscal messaging, yields rising when concerns emerged over the ability of the Government to keep net spending under control ahead of the 26 November Budget, and then easing back to rates similar to those at the start of the financial year once markets felt reassured by the steps the Chancellor had taken to manage public spending and to also bolster her fiscal headroom.

Accordingly, 1-year PWLB Certainty rates started the financial year at 4.82% and finished 2025 at 4.37%, whilst the 5-year part of the curve started at 4.94% and finished at 4.78%. Rates never got above 5% throughout the nine months under review.

It was a different story for the longer part of the curve, and in recent weeks the Debt Management Office has confirmed that it will seek to issue less gilts in the longer part of the curve and seek to focus on the short to medium part of the curve, where investors are more willing to purchase. That may alter in due course if the CPI measure of inflation falls to 2% by the spring of 2026, having been “sticky” at much higher levels for much of 2025.

10-year PWLB Certainty rates started April at 5.38% and finished 2025 at 5.34%. On 3 September, rates hit a peak of 5.62%.

The story was repeated for the 25- and 50-year parts of the curve. 25-year PWLB Certainty rates started April at 5.95% and finished the year at the same level but touched a peak of 6.41% on 3 September. While the 50-year Certainty rate started at 5.63% in April and finished the year at 5.71%, peaking at 6.14% also on 3 September.

5. Approved countries for investments as of 31st December 2025

Based on lowest available rating:

AAA

- Australia
- Denmark
- Germany
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- U.S.A.

AA

- Abu Dhabi (UAE)
- Finland
- Qatar

AA-

- U.K.

A+

- Belgium
- France