State of Play

Votes, valour & valuation

30 May 2024

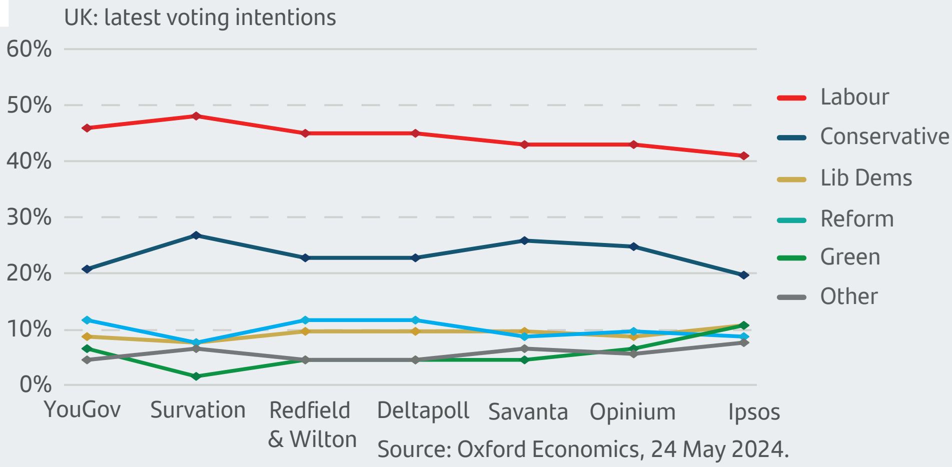
Last week's important economic data was overshadowed by political developments, with prime minister Rishi Sunak announcing that an early general election will take place on 4 July, several months earlier than most political commentators had anticipated. Did this announcement have an impact on financial markets and the UK economy? Santander Asset Management discusses in this week's State of Play.

Limited reaction

Although the announcement would have caught many by surprise, there's been a limited market reaction to the news so far. This reflects two key factors. First, the polls have consistently reported that Labour is well ahead of the Conservatives, so market participants and the broader public have become accustomed to the idea that Labour is very likely to form the next government. Second, so far, neither party has suggested materially changing the fiscal framework, i.e. rules, regulations and procedures that influence how budgetary policy is planned, approved, carried out, monitored and evaluated. So, an incoming Labour administration would have little room to manoeuvre and would likely need to significantly tighten public spending during the new parliament.

The two main parties are yet to publish their manifestos, however, we have seen in recent days some new ideas from the Conservatives on national service and volunteering for those aged 18. Labour is likely keen to avoid accusations of fiscal indiscipline. With such a lead in the polls, bolder reforms would probably have to wait until they take power.

Most polls suggest Labour's current lead is vast

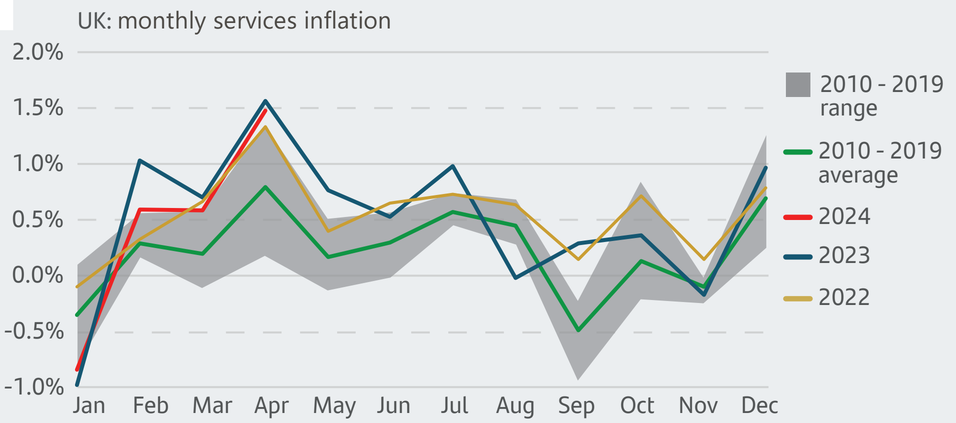


Source: Oxford Economics, 24 May 2024.

Inflation

Prior to the general election announcement, the release of the inflation numbers and associated interest rate implications had looked set to be last week's dominant story. Despite UK CPI inflation falling to 2.3% from 3.2%, it didn't drop as much as anticipated in April. Half of the drop in the annual rate came from the energy category, as Ofgem's near 12% cut in the price cap came into effect. Meanwhile, food price inflation continued to weaken.[1] But arguably the most important news was on services inflation, where price increases were larger than expected.

The rise in services prices was almost as high as April 2023's huge increase



Source: Oxford Economics, 24 May 2024.

Together with private sector regular pay growth, services inflation is seen as the most important indicator of inflation persistence by the Bank of England's (BoE) Monetary Policy Committee (MPC). April's number was 0.4 points higher than the latest BoE staff forecast, so the prospect of a June rate cut now looks remote.[1] It is looking increasingly likely that the first rate cut from the BoE will be in August. The MPC will see two further inflation releases ahead of its August meeting and services inflation is expected to slow in the coming months. There has also been a clear shift in sentiment from the MPC in recent months, which suggests the committee is open to cutting rates, barring any surprises in the economic data.

Short-term outlook

While there are likely to be some differences in manifesto tax and spending pledges, the poor fiscal inheritance and apparent reluctance of either party to materially alter the fiscal rules suggest the election outcome is unlikely to significantly affect the near-term outlook for the UK economy and financial markets. As always, we will follow the election closely and review the manifestos once they are published to assess the potential impact they could have on the economy.

The value of seeking guidance and advice

It is important to seek advice and guidance from a professional financial adviser who can help to explain how to build an appropriate financial plan to match your time horizons, financial ambitions and risk comfort. If you already have a plan in place or have already invested, it is important to allocate time to review this to ensure this remains on track and appropriate for your needs.

Learn more!

Investing can feel complex and overwhelming, but our educational insights can help you cut through the noise. Learn more about the Principles of Investing here.

Note: Data as at 28 May 2024

[1]Oxford Economics, 24 May 2024