We’re still expecting a summer UK rate cut despite market doubts

We're still expecting an August rate cut from the Bank of England, despite some stubborn services inflation data and the surprise announcement of an early election

Party leaders Sir Keir Starmer and Rishi Sunak debate ahead of July's general election

Markets have priced out UK rate cuts

In the space of just a couple of weeks, UK markets have gone from pricing 60 basis points of Bank of England rate cuts this year to just 35bp. Having previously viewed a June rate cut as a 50/50 call, investors are now only fully pricing the first move in November.

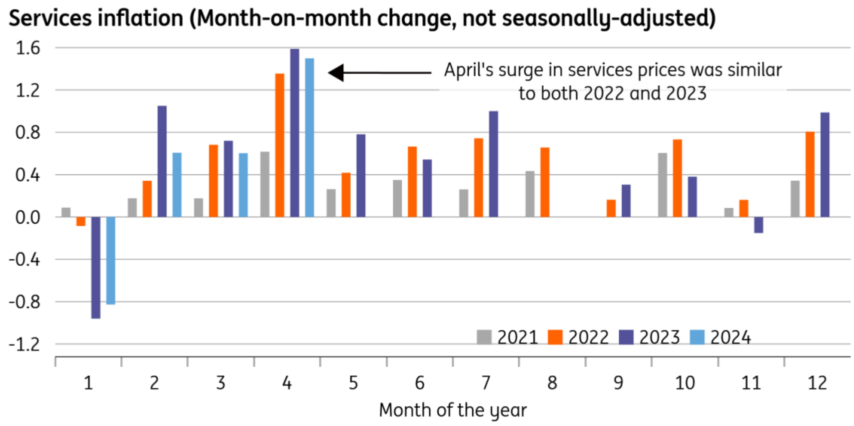
This looks like a severe overreaction, for three reasons.

Firstly, the surprise announcement of a July general election will have virtually no discernible impact on the Bank of England this year. In the campaign itself, the issue of the Bank of England’s decision-making has so far largely stayed outside of the political arena. We think it would be a mistake to assume policymakers won’t cut in June purely on the basis of the election – although the restrictions on the Bank’s ability to communicate during the campaign (e.g., a ban on press conferences) would complicate the logistics.

Then there’s fiscal policy. The opposition Labour Party – which looks set to win a convincing majority on 4 July – is signalling little to no change on the big picture tax and spend policy levers. As long as that remains true, the implications on the BoE are likely to be minimal. At the very least, the Bank can only act on what is officially government policy, and the first budget under a new government is unlikely until the Autumn.

Secondly, and most importantly, the shock upside surprise to April's services inflation data is unlikely to be repeated in May or June's data. As we've warned for a while, April's numbers were always going to be skewed by the impact of annual, contractual price rises. We saw exactly the same phenomenon in April 2023 and at the time, investors wrongly inferred that this meant the UK's inflation problem was significantly worse than elsewhere. With the jobs market cooling and pricing intentions looking less worrisome, services inflation should gradually cool as the year progresses.

April's services inflation stubbornness likely won't be repeated



Source: Macrobond, ING calculations

Bank of England Governor is ready and willing to cut rates

Finally, it's clear that key figures at the Bank are keen to get on with the job of cutting rates. Governor Andrew Bailey was unambiguously dovish at the most recent press conference, hinting that the Bank could cut rates imminently and further than markets are pricing. The issue is that not all of his committee is on board, and that includes three of the nine strong committee members that are visibly against imminent rate cuts. We don't hear all that often from some of the so-called "internal" members who likely hold the deciding vote – and the pre-election blackout means we won't do so before the June meeting. But we think that by August's meeting, assuming the data shows April inflation was a blip, then a majority will rally behind the idea of cutting rates.

We're therefore sticking to our base case for an August rate cut and three cuts in total this year.

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