Economic Research Unit

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Bank of Ireland

Markets taking sanguine view of May 7th local election risks

Markets appear complacent on the risks the UK's May 7th local elections pose to the sterling exchange rate. Opinion polls point to heavy losses for both Labour and the Conservatives, boosting Reform UK and increasing political uncertainty. Poor results could weaken Keir Starmer's position and raise fears of less fiscally disciplined policies, particularly if Chancellor Rachel Reeves' position is undermined.

UK asset prices have been sensitive to political developments, while the public finances remain fragile and deficit-reduction plans face both execution and political risks. Although sterling appreciated following the Bank of England's April 30th meeting, investor attention is now likely to shift to the May 7th elections, with the risk that post-election volatility is being underestimated.

May 7th local elections will be a key moment for the UK: May 7th will see elections for the Scottish and Welsh parliaments alongside English local authorities. Polling suggests the results will be highly challenging for both Labour (17%) and the Conservatives (18%), who trail Reform UK (26%) in April surveys and also face growing pressure from the Green Party (17%) (see chart below). However, most polling was conducted before reports that Nigel Farage received an undisclosed £5m gift from a donor to his party, meaning any voter response to this development has yet to be captured.

Polling expert Robert Hayward estimates that Labour could lose around 1,850 council seats—more than 75% of those it is defending—while the Conservatives may lose approximately 600. By contrast, Reform UK is projected to gain around 1,550 seats and the Greens roughly 500. Labour is also expected to lose its majority in the Welsh Senedd and perform poorly in London. Such outcomes would likely intensify pressure on Keir Starmer's leadership and fuel broader concerns on the rise of populism and challenges to the prevailing political status quo.

UK asset prices have been sensitive to political events: Sterling rose to 88p against the euro in the lead up to November's Budget, as investors anticipated substantial tax increases. More recently, doubts over Keir Starmer's leadership briefly weighed on sterling in January following initial revelations involving Peter Mandelson. UK 10 year gilt yields have also shown heightened sensitivity, rising around 80bps to 5% since the onset of the war in the Middle East. This move has been partly attributed to leveraged hedge funds unwinding positions in the UK gilt repo market, as well as lingering market sensitivity following the '*mini-Budget'* episode.

The market impact of the local elections will hinge on whether the position of Chancellor Rachel Reeves is called into question, given her reputation as a relatively fiscally conservative figure within the Labour Party. Andy Burnham—widely viewed as a potential successor to Keir Starmer—has argued that Labour should stop "being in hock to the bond markets". For gilt investors, the key risk is that more left leaning factions could gain influence within Labour, which would still command a parliamentary majority with the capacity to implement a less market friendly policy agenda.

UK deficit reduction plan still in a delicate position: The UK's public finances remain in a fragile position. The March 2026 Spring Budget Statement outlined plans to reduce public borrowing gradually from 4.3% of GDP in 2025/26 to 1.8% by 2029, but delivery relies heavily on spending restraint from 2027 onwards. The Office for Budgetary Responsibility (OBR) has highlighted several risks to this outlook, including upward pressure from incapacity and health related welfare payments, uncertainty surrounding planned cuts to asylum accommodation costs, and the commitment to increase defence spending to 3.5% of GDP by 2035.

The deficit reduction plan also assumes the tax to GDP ratio will rise to a post war record of 38%, driven largely by the continued freeze on income tax thresholds and the higher 25% rate of corporation tax. The OBR has again highlighted that the revenue gains from these measures are highly sensitive to the outlook for employment and earnings. In addition, behavioural responses could undermine the expected yield from capital taxes.

Parts of the deficit reduction plan have also proven politically contentious. In June 2025, Labour MPs rebelled against proposed welfare reforms intended to deliver savings of £5bn a year by 2030, including tighter eligibility for disability benefits (PIP) and Universal Credit, forcing the government to make significant concessions. These included reversing plans to tighten eligibility for the Winter Fuel Payment, at a cost of £1.25bn. The episode highlighted the risk that political pressures could undermine the credibility and delivery of fiscal consolidation efforts.

Sterling could be vulnerable to political events: Sterling is trading at 86.3p against the euro, close to the strongest level seen over the past six months. The catalyst for the recent appreciation was the Bank of England's April 30th policy meeting. Options markets are now fully pricing in two 25bp hikes to 4.25%, most likely starting at the June 18th meeting, with around a 70% probability of a third move to 4.5%.

Investor attention is now set to shift from monetary policy to political risk. Last week, 30-year gilt yields rose above 5.7%, a fresh record high since the late 1990s. This may be an initial sign concerns on the

May 7th are beginning to register. Nevertheless, many currency and bond strategists argue that markets remain underprepared for the potential fallout from the local election results.

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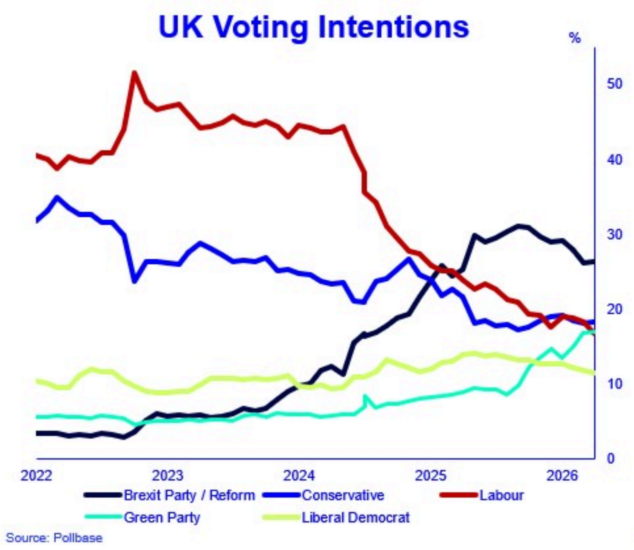

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