UK interest rate set to hit 1% by summer, City predicts

A
s of today, it seems highly likely UK interest will rise next week in the first back-to-back rate rise since 2004. Economists expect rates to then rise perhaps three more times this year, reaching as high as 1% by summer.

The Bank of England put rates up in December from 0.1% to 0.25%. The City thinks they will go to 0.5% at the Monetary Policy Committee meeting on Thursday.

Then from there to 1.25%, in stages.

Is that going to be bad for the economy?

The Bank hopes that gradual increases will give businesses and households time to plan. Interest rates have been awfully low for a very long time because we have been in one crisis or another. Moving back to something approaching normal is a sign that we are recovering.

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Prior to the financial crash, “normal” rates were about 5%. We might now see the new normal at around 2%, which still leaves borrowing costs historically very cheap.

If you are a saver – there are more of them than there are borrowers – you should start to see your interest payments go up. Most mortgage holders are on fixed rate deals so they are fine until those deals come to an end. New fixed rate deals will be a bit more expensive than the old ones.

Still, a shock to some?

According to AJ Bell there are 10 million Britons who have never seen rates above 1% in their adult lives.

Laith Khalaf, head of investment analysis at AJ Bell, says: “A rate rise at the Bank’s February meeting is all but inked in, which if realised would be the first time since 2004 that the bank has raised interest rates in two consecutive meetings.

“Market pricing suggests a further three hikes this year, taking base rate to 1.25% by the end of 2022, which would be its highest level since February 2009, just before an ‘emergency’ rate of 0.5% and QE were introduced.”

Why now?

The Bank and the US Federal Reserve are worried about inflation. Last night Fed chief Jay Powell signalled he is likely to move aggressively on rates in the near future.

Nathan Sheets, global chief economist at Citigroup, said: “Powell essentially said to the markets and the economy, ‘put on your seatbelt, we are getting ready to take off. If inflation doesn’t fall as they expect, the Fed is prepared to be vigorous.”

Whether central banks moving rates up will be enough to slow inflation is open to question. Many of the things driving up costs – supply chains, global energy costs – are beyond the

Bank’s influence.

Who are higher rates good for?

Savers. Banks make more profits as margins rise. Bond investors should see yields rise, though prices will fall.

Nationwide Building Society said today it will boost rates on a range of savings accounts by at least 0.15 percentage points.

Nationwide’s savings shake-up from February 1 will include rate rises on children’s and regular savings accounts, the society’s Help to Buy Isa, and loyalty accounts.

Who are higher rates bad for?

Higher rates might be bad for the stock market if investors move into bonds and out of equities, but some say the market is overvalued anyway.

Khalaf again: “Higher base rate will mean the Exchequer needs to pay significantly more interest on the £875 billion of gilts held in the QE scheme, and that could have significant implications for the viability of any largesse the Chancellor might like to indulge in at the March Budget.”

About a third of the interest paid on gilts goes back to the Bank however. It’s not that bad.

However, higher interest payments will strengthen the Chancellor’s argument for pushing ahead with tax rises in April, which will make the ongoing cost of living crisis worse.

If inflation and borrowing costs keep rising, will pay go up?

Yes. Employees will start to quit otherwise. We are already seeing wages go up around the economy, with the likes of Sainsbury’s and Aldi raising hourly wages for staff.