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Bank rate to rise this year, say experts

Unexpected strength of UK recovery has economic forecasters scrambling to reassess positions

Anna Mikhailova Published: 26 January 2014

Some analyst believe The Bank of England will raise rates to 1% by the end of 2014 (Fraser Hall)

I NTEREST rates could double by the end of this year, as the economy recovers faster than expected.

Market analysts have been rushing to bring forward the date when they think the Bank of England will first raise its record-low 0.5% rate.

Eight City forecasters believe the rate will rise this year, according to a Reuters poll conducted on Thursday. In December only one — Henderson Global Investors — predicted such an early change.

The Centre for Economics and Business Research (CEBR) expects Bank rate to rise to 1% in the final three months of 2014. The investment bank Citi has also changed its forecasts and predicts rates will rise to 0.75% at the end of this year. Investment bank Nomura now predicts the first rise will occur not in February 2015 but August this year, to 0.75%, rising to 1% by the end of the year.

Even forecasters who expected a much later change have brought forward their predictions. The consultancy Capital Economics has shifted its prediction from 2016 to the final quarter of 2015.

The shift in expectations is down to dramatically improved economic indicators. Unemployment has fallen — to 7.1% in the three months to November — the biggest quarterly fall in 17 years.

Last year the monetary policy committee said it would not contemplate a rise in Bank rate until the unemployment rate fell to 7% — part of the governor's "forward guidance" policy — and that it did not expect it to reach that threshold until 2016. However, it now looks like unemployment might fall to 7% this month. Nomura predicts it will hit 6.7% in May. A speedier recovery is on the cards, too — the International Monetary Fund lifted its 2014 growth forecast for Britain to 2.4% from 1.9%. Colin Edwards, senior UK economist at the CEBR, said: "There needs to be a sustained improvement across the UK economy for the Bank to consider raising rates. Most indicators suggest this will be achieved over 2014."

But the majority of the other 54 analysts polled by Reuters last week still expect rates to remain at 0.5% until 2015. There are few signs that wage growth is picking up and inflation is still low, both of which mean there is less pressure on the Bank of England to push up rates. On Friday, Bank of England governor Mark Carney reinforced the message that interest rates are unlikely to rise in the near future, even if unemployment does fall to 7%.

The interest rate freeze has been good news for borrowers and homeowners, but has squeezed savers. The average cash Isa rate has shrunk from 1.87% a year ago to 1.65% today, according to Moneyfacts.

What should borrowers do?

Even with an interest rate rise some way off, the cost of borrowing to buy a home is already going up. Mortgage pricing is based on swap rates — the wholesale money market rates — rather than Bank rate.

Ian Gray of the broker largemortgageloans.com said: "There has been an upward trend in swap rates since early November. This points to today's fixed rates being at the 'bottom of the curve'."

Some lenders have already been pulling more attractive deals. Mark Harris of the broker SPF Private Clients said: "Mortgage rates have already risen from their lowest point. With the Funding for Lending scheme no longer applying to residential loans, expect rates to creep up. If you can't cope with an increase in mortgage costs, consider a longer-term fixed rate. A five-year deal looks a lot more sense than a two-year fix."

You can plan ahead to insure yourself against higher rates. Jonathan Harris of the broker Anderson Harris said: "If you want a cheap fixed rate but aren't due to remortgage for several months you could always book a rate now and then take it out when your existing deal expires."

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