Inflation up, mortgage rates up, perversely pushes down debt

The news that inflation hit 5.4%, a 30 year high, was met with trepidation, as there is likely to be a further increase in the cost of borrowing for mortgages.


Inflation up, mortgage rates up, pushes debt down

LONDON, UNITED KINGDOM, January 20, 2022 /EINPresswire.com/ -- This has been a visible trend since September last year when mortgage rates hit rock bottom. Back in September, the market-leading 5-year fixed rate was 0.91%, but today, the best that can be achieved on the same product is 1.46%. That is a rise well over and above the 0.15% increase from the Bank of England in December.

Indeed, money markets have also moved. Three Month Sterling LIBOR, one of the best indicators of where money markets predict the Bank of England base rate will go in the coming months was at 0.536% on 18 January. This points to an expectation that the Bank of England will raise interest rates again, by 0.25% in the next 3 months. There are certainly never any guarantees in financial markets, but this is a strong indicator of expectation with billions of pounds being bet and lent on these rates.

> “Interest rates are likely to rise, not very far, or very fast, and overall stay low. But it means right now is probably the cheapest time you are ever going to borrow money in your lifetime.”
>
> *Richard Campo*

But perversely, is this a good thing in the current climate? It’s a very unusual set of circumstances where wage inflation was up 4.9% in 2021 (according to the ONS), house prices were up 10.2% to the 12 months to October ’21 (according to the Land Registry) and GDP was up 0.9% alone in October (granted pre-Omicron), but what all of this is doing is pushing down debt in real terms.

So, are policymakers gambling on this continuing? If wage inflation keeps pace with CPI inflation, which it just about is, and house prices and GDP keep rising, which they are, it's possible for those borrowing to effectively inflate themselves out of current extremely high levels of debt. A dangerous game, but one that seems to be paying off.

For illustrative purposes here is an example of how inflation decreases costs over time in relation to house prices and mortgages.

In 1971 the average house price was £5,623, and the average salary was £1,204 (4.6 x the average salary per house). In 2021 the average house price was £268,349, and the average salary was £31,258 (8.6 x average salary per house).

So theoretically if a borrower took out a mortgage of £4,000 in 1971 to buy a house in 1971, the mortgage would have been 72% of the value of the house, but today that £4,000 is just 1.5% of the value of that same house at £268,349.

This is assuming a 40-year mortgage as this is the longest mortgage term offered right now. So, a young First Time Buyer may well experience this in the life cycle of their mortgage.

For interest rates, this means they will most likely increase but only slowly, and not by much, as 10-year SWAPS predict rates at 1.1% in 2032.

Hence, it's a good idea to lock a mortgage deal for the long term, as the Bank of England base rate is at 0.25%.

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