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Bank of England Rate Cuts Hit UK Households by £11 Billion Despite Lowering Borrowing Costs

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Exactly one year after the Bank of England (BOE) began reducing interest rates, UK households are still feeling financial strain, with an estimated £11 billion annual loss compared to July last year. This figure reflects the combined effect of four quarter-point rate cuts since then and expectations of a fifth reduction, with rates forecast to fall to 4 per cent on Thursday.

Data analysed by Bloomberg shows that while the BOE's base rate cuts have reduced interest paid on savings accounts, many homeowners have yet to benefit, as numerous mortgage deals remain locked at higher interest rates. This mismatch has left savers worse off due to banks and building societies swiftly lowering deposit rates. Meanwhile, mortgage costs remain elevated as borrowers wait for fixed-rate deals to expire, contributing to rising household expenses. The BOE's base rate was 5.25 per cent a year ago, marking the highest level since the 2008 global credit crisis.

Consumer spending, which accounts for around 60 per cent of the UK economy, remains subdued. Many households continue to save more than spend, driven by concerns over further tax increases planned for the autumn. This caution is evident in the GfK savings index, which in July reached its highest level since 2007.

James Smith, developed markets economist at ING, noted that "the impact of rate cuts is going to be very gradual, amplified by the fact that the pace of cuts is also pretty glacial." The BOE's forthcoming decision to reduce rates by 0.25 percentage points to 4 per cent follows signs of a weakening labour market, influenced by Chancellor of the Exchequer Rachel Reeves' tax hikes implemented in April and ongoing global trade tensions.

Despite this easing, inflation remains elevated at a 17-month high, surpassing projections made in May. BOE Governor Andrew Bailey has indicated that caution will guide the pace of further rate cuts, concerned that sustained wage growth may push inflation higher if workers seek to maintain their purchasing power.

Households have lost nearly £5 billion annually in interest earnings from savings products, including tax-free Individual Savings Accounts (ISAs) and various deposit accounts, as banks reduced rates. Concurrently, mortgage and unsecured debt interest payments, such as those on credit cards, are estimated to be £6 billion higher than last year. The BOE forecasts that mortgage costs will continue rising, with a typical borrower potentially facing an additional £1,300 per year in home-loan payments over the next two years. Approximately one million borrowers are currently on mortgage deals fixed above prevailing rates, delaying any benefit from lower borrowing costs.

Since July 2024, the effective interest rate on the UK's £1.7 trillion mortgage stock has increased by almost 0.2 percentage points, while rates on time and sight deposits have fallen by 0.4 and 0.2 percentage points, respectively, reducing returns on combined savings of £1.8 trillion.

Market expectations suggest the BOE will maintain its quarterly rate-cutting rhythm, with rates possibly reaching around 3.5 per cent by spring 2026. Even then, borrowing costs would remain significantly higher than the sub-1 per cent levels seen in early 2022, before the recent inflation surge.

Edward Allenby, UK economist at Oxford Economics, commented that "alongside softer real pay growth and tighter fiscal policy, the lagged impact of past rate hikes on mortgagors will continue to weigh on consumer spending. The BOE's rate-cutting cycle is unlikely to provide much of a tailwind for business investment and consumer spending over the next couple of years."