

ADAPTED FROM BBC NEWS (23.03.23)

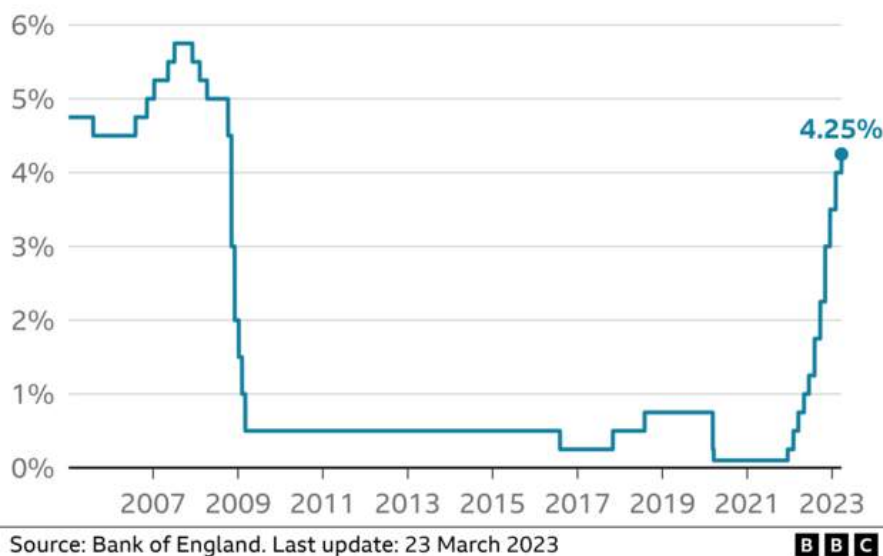


The Bank of England raised interest rates for an 11th consecutive time - from 4% up to 4.25%. It is the highest level for 14 years and was put up as a way of trying to slow rising prices. It follows a shock jump in inflation last month which reached 10.4% in the year to February, after the figure was pushed up by salad and vegetable shortages. The interest rate rise will see the cost of variable or tracker mortgages go up but the rate of return for savers could improve. The US central bank also raised interest rates on Wednesday by 0.25%, amid lingering worries over the global financial system after two US banks failed. All eyes will now be on the Bank's next meeting in May 2023 where new quarterly forecasts for the UK economy and inflation could underpin a pause in rate rises.

Today's interest rate rise in graphs

Just to put things in context - this is the 11th consecutive increase in UK rates. The graph below shows how things really took off in 2021-22 when inflation began taking hold.

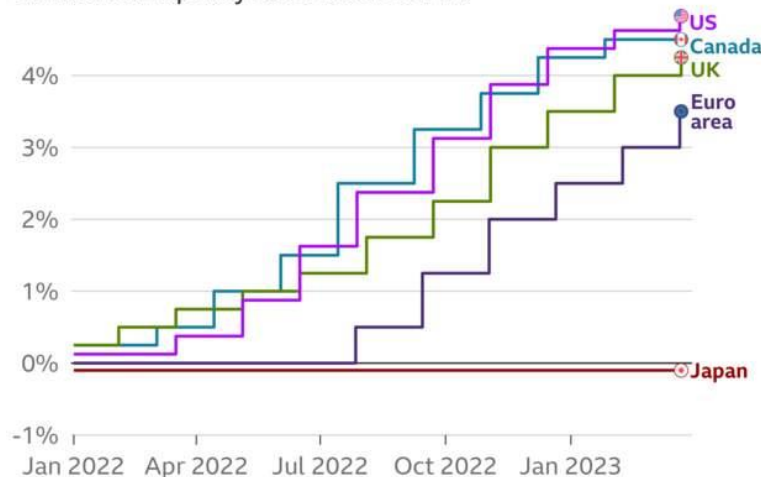
Interest rate increases to 4.25%



And here's what the latest interest rate rise looks like compared with other countries like the US, Canada and the Eurozone.

Interest rates on the rise

Central bank policy rates as of 23 Mar



Sources: Bank for International Settlements; national central banks.

BBC

Interest Rate Questions

1. What is an interest rate?
2. How do changes in interest rates affect the economy?
3. What is the difference between a fixed interest rate and a variable interest rate?
4. How do interest rates influence inflation?
5. What are some tools that the government or central bank can use to manage interest rates?
6. How can savers and borrowers be affected by changes in interest rates?
7. What are some factors that can influence interest rates?
8. What are some potential consequences of low interest rates over a prolonged period of time?
9. How do interest rates impact businesses and their ability to make investments?
10. What are some strategies that individuals and businesses can use to manage their finances in a high interest rate environment?

Case Study Questions

1. Why did the Bank of England raise interest rates for the 11th consecutive time?
2. What was the new interest rate after the latest rate increase?
3. How long has it been since the interest rate was at this level?
4. What was the reason for the sudden increase in inflation last month?
5. How did salad and vegetable shortages contribute to the rise in inflation?
6. What effect will the interest rate increase have on the cost of variable or tracker mortgages?
7. What potential benefit could savers see from the interest rate increase?
8. Why did the US central bank also raise interest rates recently?
9. What are some possible consequences of the global financial system's instability?
10. What is the significance of the Bank of England's meeting in May 2023 for the UK economy?

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Mark Scheme

Interest Rate Answers

1. An interest rate is the cost of borrowing money or the return on saving money. When borrowing money, interest is the additional amount that must be paid back to the lender along with the principal amount. When saving money, interest is the amount earned on the money that has been deposited into an account.
2. Changes in interest rates can have a significant impact on the economy. Higher interest rates can discourage borrowing and spending, which can slow economic growth and reduce inflation. Lower interest rates can encourage borrowing and spending, which can stimulate economic growth but also increase inflation.
3. A fixed interest rate is a set rate that remains the same over the life of a loan, while a variable interest rate can fluctuate based on changes in the market or other factors. Fixed interest rates can provide borrowers with stability and predictability, while variable interest rates can offer more flexibility but can also be more unpredictable.
4. Interest rates can impact inflation by influencing spending and saving behaviour. If interest rates are high, it can discourage borrowing and spending, which can reduce demand for goods and services and lower prices. If interest rates are low, it can encourage borrowing and spending, which can increase demand for goods and services and raise prices.
5. Tools that the government or central bank can use to manage interest rates include setting the base interest rate, open market operations, and quantitative easing. The base interest rate is the rate that banks use to lend to each other, and the central bank can increase or decrease this rate to influence other interest rates in the economy. Open market operations involve buying or selling government securities to adjust the money supply and influence interest rates. Quantitative easing involves buying assets like government bonds to inject money into the economy and lower interest rates.
6. Savers and borrowers can be affected by changes in interest rates. When interest rates increase, savers may earn more on their savings, but borrowers may face higher borrowing costs. When interest rates decrease, savers may earn less on their savings, but borrowers may have access to cheaper loans.
7. Factors that can influence interest rates include inflation, economic growth, government policy, and global events. Inflation can lead to higher interest rates to slow down spending and reduce inflationary pressures. Economic growth can lead to higher interest rates as demand for credit increases. Government policy can also influence interest rates through decisions on spending, taxes, and monetary policy. Global events like political turmoil or financial crises can also impact interest rates.
8. Potential consequences of low interest rates over a prolonged period of time include asset bubbles, reduced savings, and disincentivizing investment. Low interest rates can encourage investors to take on more risk, leading to asset bubbles and potentially destabilizing the economy. Low interest rates can also discourage savings, which can make it more difficult for individuals to reach their financial goals. Low interest rates can also disincentivize investment as returns on investments are lower.
9. Interest rates can impact businesses by influencing their cost of borrowing and the return on their investments. Higher interest rates can increase the cost of borrowing for businesses, which can reduce their profits and limit their ability to invest. Lower interest rates can make it cheaper for businesses to borrow, which can increase their ability to invest and expand.
10. Strategies that individuals and businesses can use to manage their finances in a high interest rate environment include considering fixed rate loans, seeking out high-interest savings accounts, and reducing

unnecessary spending. Fixed rate loans can provide stability and predictability in a high interest rate environment. High-interest savings accounts can help individuals earn more on their savings. Reducing unnecessary spending can help individuals and businesses reduce their debt and save more money.

Case study Answers

1. The Bank of England raised interest rates to try and slow rising prices, as inflation had been increasing sharply.
2. The new interest rate after the latest increase was 4.25%.
3. It has been 14 years since the interest rate was at this level.
4. The sudden increase in inflation was caused by salad and vegetable shortages.
5. Salad and vegetable shortages pushed up prices, contributing to the rise in inflation.
6. The interest rate increase will see the cost of variable or tracker mortgages go up.
7. Savers could potentially benefit from the interest rate increase with a higher rate of return.
8. The US central bank also raised interest rates due to concerns over the global financial system after two US banks failed.
9. Possible consequences of the global financial system's instability include reduced investment and economic growth.
10. The significance of the Bank of England's meeting in May 2023 is that new quarterly forecasts for the UK economy and inflation could underpin a pause in rate rises.