

Funding the Future

Interest rate rises really do look to be fuelling infla...

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There is somewhat surprising analysis from Bloomberg out today that supports my hypothesis that interest rate rises are causing inflation, not curing it.

Bloomberg note:

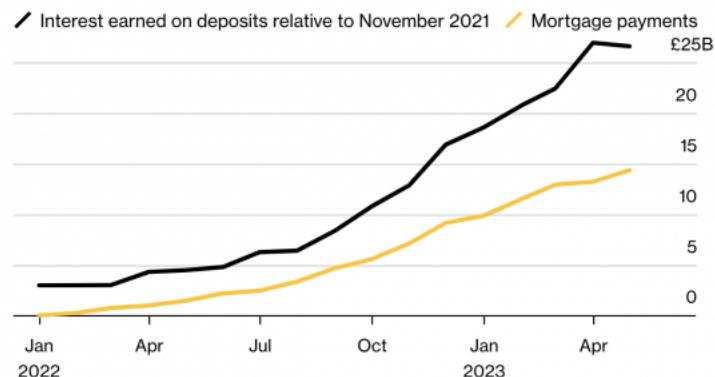
The Bank of England's interest-rate increases are benefitting savers more than they're costing mortgage payers – for now at least.

A Bloomberg analysis of data from the central bank indicates that UK households are on aggregate about £10 billion (\$12.7 billion) a year better off as a result of a jump in interest rates. While those rates will feed through in time to mortgage payers, it's savers who are enjoying a more immediate increase in income.

The findings help explain why BOE Governor Andrew Bailey and his colleagues are struggling to tame the highest inflation rate among Group of Seven economies.

They explain this with a chart:

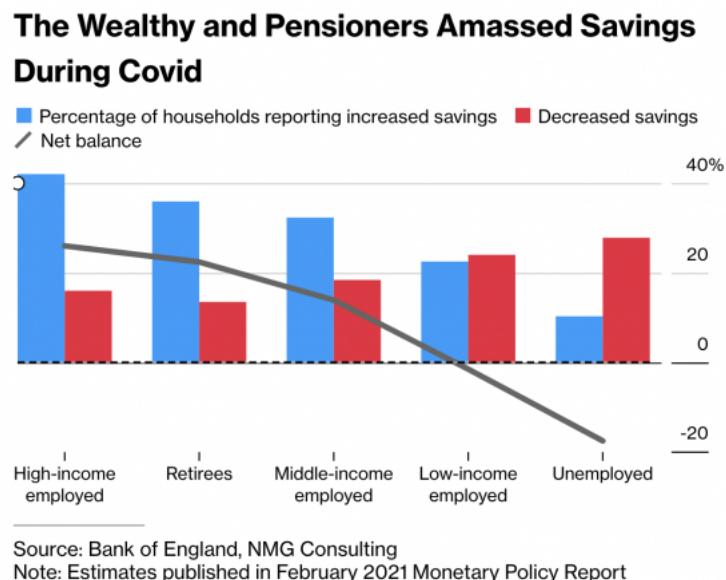
Savings Income Is Rising Faster Than Mortgage Costs



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Annualized amounts per month

Source: Bloomberg analysis of Bank of England data

They add two important caveats, one implicit in this chart:



What is very clear is that the benefit of the increased savings held by those in the UK is skewed heavily towards the already well-off, which is aided by the fact that, unlike people in other countries, the UK population has by and large not spent the savings it made during the Covid era, as yet. They are now not only drawing those savings down but are boosting their spending because of the increased return on them, defeating the whole purpose of the interest rate rise.

The second caveat is that this trend might reverse as the number of fixed-rate mortgage deals come up for renewal. So far, relatively few out of the total have. Well over a million will do so in the next year, but by then savings rates might also have more generally risen as pressure on banks to do so rises.

Is the argument plausible? The data looks persuasive.

But in that case, what is causing the pressure on households? The answer would seem to be (and this is my speculation, not reflecting anything said by Bloomberg):

- * Rent rises
- * Utility bill rises, which despite capping have been substantial
- * Food price increases
- * Indexed linked cost increases, e.g. on mobile phones
- * The cost of no mortgage borrowing
- * The impact of profiteering, e.g. in fuel prices now.

Those all happen, I suggest, because the Bank of England has created the environment in which they continue to be possible. But as noted already, the impact is heavily skewed by the available disposable income of the person suffering these additional costs, which is heavily unevenly distributed in the UK.

I do not, then, think Bloomberg has a complete answer to what is happening. But what they have noted throws a massive spanner in the works of neoclassical economics thinking (which assumes near-instant policy transmission into practice, which clearly does not happen, as seen here) and so into the thinking of the Bank of England, who, as usual, have things wrong, even though the data used by Bloomberg came from them.

It really is time for a rate cut, and very soon.