

# Candidate evidence

## Application of Knowledge and Understanding

Saving is more attractive as the interest payments on the money individuals have saved in bank accounts is high, meaning they will see an increase in the value of savings, particularly if the interest rate outperforms inflation. This will lead to an increase in purchasing power of their savings, therefore increasing the standards of living for those with savings.

In general, those individuals with mortgages will be worse off during periods of high interest. Fixed rate mortgages expiring: although at first it may appear people on a fixed rate mortgage are better off compared to those on a tracker rate during periods of high interest, as soon as the mortgage expires and needs renewed with the higher interest rate, borrowers may face a sudden increase in repayment value. Those on variable or tracker rate mortgages, those which adjust automatically according to interest rates, will see periods of high interest rates significantly increase their payments instantly during that time frame, reducing standard of living and discretionary income.

Individuals favor saving over investments during high periods of interest. The rate of return on savings during periods of high interest is attractive to consumers as opposed to investing in companies which can have vast shifts in stock prices, especially within such a fluctuate economy. This decreases the amount of funding for public limited companies, who release shares as a way of raising money. A decrease in investment into firms and therefore lack of funding can lead to a negative impact on growth and GDP within the economy.

High interest rates lower demand pull inflation, where high demand for a product leads to consumers 'bidding' up the price as they are willing to pay more and more to obtain a product in its reducing availability. Higher interest rates, encourages saving and discourages spending, dampening consumer demand and therefore, reducing prices and slowing the rate of inflation.

Consumer confidence is knocked during periods of high interest, decreasing aggregate demand and thus firms' revenue. This decrease in consumer confidence could create a negative multiplier effect, where falling spending leads to a bigger fall in value of real GDP due to less money circulating and workers having to be laid off.

A high UK interest rates would result in a high inflow of hot money (Money coming into UK bank accounts from abroad) as high repayments on Pounds Sterling make it comparatively more attractive compared to countries with lower interest rates. This increase in hot money will increase the exchange rate of Pounds Sterling as it will increase the demand for Sterling. UK exports will thus increase in price and be less competitive. Therefore, UK imports become less attractive to firms abroad, resulting in a worsening of the balance of payments.

High rates of interest reduce firms' confidence to invest, reducing aggregate investment during periods of high interest rates. High interest rates means that business of whom rely on borrowing money to expand their business now pay more to do so, creating uncertainty around the financial viability of investment in an economy of high interest rates, leading them to either hold off investment or halt plans it altogether. This can lead to unemployment as firms are less willing to take on workers due to reluctance to expand the business or, if investment goes ahead, may have to lay off workers to cover costs of capital investment, increasing unemployment and further dampening aggregate demand.

Government income through taxation falls during periods of high interest rates due to decreased consumer confidence. Decreasing levels of spending within the economy reduce the amount of money the government reaps through indirect taxation, namely VAT. Firms' confidence to invest falling and the correlating increasing rates of unemployment consequently lowering direct taxation such as income tax. This can result in governments having to reduce allocation to services such as the public sector of the economy, staggering wages and decreasing jobs within Government funded occupations.

Government spending on national debt repayments, e.g., bonds can significantly increase during periods of high interest. The government has a huge national debt burden, and a large chunk of their budget goes directly towards interest repayments on these loans. Higher interest rates, even marginally, massively increases Government spending on interest. This can lead to tighter fiscal policy and times of austerity as the government looks to address the national debt issue, triggering opportunity costs of not being able to allocate finances to other areas of the budget such as health and education. Possible Decreasing spend on capital projects and other non-essential functions of the government in an effort to reduce financial burden limits the creative capacity of the economy and can spoil potential productivity.

### **Analysis and Evaluation**

A guardian article (APX1) states “high interest rates ‘will lead to thousands of UK firms failing in 2024’”. This supports the theory that Consumer confidence is knocked during periods of high interest, decreasing aggregate demand and thus firms’ revenue, leading to certain firms not being able to stay open. Many firms are struggling to keep up with the current high expense of repayments on mortgages and loans, in addition with consumer spending being dampened in times of high interest: financial uncertainties may simply make it unviable to stay open for some businesses,

especially if they cannot foresee an upturn in demand, a key decider for a firm weather to stay in business.

An article by CPER (APX2) states “higher interest rates had lowered investment and employment by 8% and 2%”. This would support the theory High rates of interest reduce firms' confidence to invest. Higher interest rates mean the interest repayments on loans used to invest and expand are not financially viable for some firms, lowering investment. Lower investment from firms decreases their ability to expand, innovate, and operate. This may lead to firms having to lower their rate of employment or lay off workers to save costs, increasing unemployment.

An article by professional advisor (APX3) with regards to stocks and shares quotes “more than 70% of advisers say their clients are not investing due to high interest rates” this supports the theory that Saving is more attractive as the interest payments on their money stored in bank accounts is high. Some clients may therefore favour keeping money in a savings account over risking it at investment, especially in such a fluctuate market. This decrease in investment for public limited companies, those who trade their stock publicly on the market for investors, can slow growth within the economy and impact the creative capacity of the economy as they do not have the means to expand.

An article published by the BBC (APX4) states “Robert, a teacher from Hertfordshire, and his wife are facing an increase of £500 on their mortgage payments. He has been forced to take on a second job to cope. His current monthly mortgage payment is £1,400 but his deal expires in August.” This supports the theory that in general, those on mortgages will be worse off during periods of high interest. Mortgages expiring and requiring renewal during high periods of interest spikes repayments if interest was lower when the initial loan was taken out. Mortgage repayments account for a large proportion of many individuals' expenditure, meaning individuals suffer financial hardship and a loss in standard of living.

One article by Barclays (APX5) (07/04/24) states “consumer confidence in household finances reaches 28-month high”. This contradicts the theory that consumer confidence falls during periods of high interest rates. Long periods of high interest mean individuals can acclimate and get used to such financial states. Consumers will gain confidence as periods of high interest arouse an increasing feeling of a new norm; therefore individuals begin to increase spending within the economy again, increasing revenue for both firms and governments through sales and indirect taxation retrospectively. A re-increase in consumer confidence increases the welfare and standard of living of the population.

An ONS graph (APX6) shows that from FEB23-AUG23, when interest rates were rising, inflation was falling (from 9.2% to 6.3%). This supports the theory that relatively high interest rates lower inflation. This shows that the MPCs aim to decrease inflation rates by having high levels of inflation worked. Lowering inflation rates will help protect consumers purchasing power, with prices of goods and services rising more slowly, consumers are protected for the number of goods and services they can buy with the same amount of money: thus, stabilising standard of living.

One graph from the Office for Budget Responsibility (APX7) shows a clear correlation between the increase in interest rates and a severe increase in government spending on debt repayments, with Net interest payments on the national debt expected to cost £104.9 billion in 2024-25. Supporting the theory that Government spending on national debt repayments, e.g., bonds can significantly increase during periods of high interest. Debt repayments account for around 8% of total public spending. Interest and therefore the value of repayments being high may divert money from other areas of the budget, such as the NHS and public sector wages, decreasing the overall welfare of the population.