

Rush to fix mortgages despite inflation optimism

Homeowners are rushing into fixed-rate mortgages again, encouraged by lower rates on new deals — despite inflation falling
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Fixed rate deals are disappearing fast so grab one before they vanish (Chev Wilkinson)

Borrowers are rushing into fixed-rate mortgages again, encouraged by lower rates on new deals and worries about interest rates — despite below-expected inflation figures last week.

Inflation fell from 3.7% to 3.4% in May — below the City's expectations for a more modest drop to 3.5%.

John Charcol, the mortgage broker, said that one in four borrowers chose a fixed-rate deal in May, the highest number since October 2009.

Last week, Britannia and the Co-op were forced to pull their market-leading five-year fix at 3.99% with a fee of £995 for those with a 25% deposit, due to demand. However, Chelsea Building Society offers an even better deal at 3.99% with a fee of £495.

According to analysis by L&C, the broker, borrowers are better off fixing, assuming interest rates follow the path predicted by the Bank of England. On this basis, the difference in the cost of a tracker and a fix over five years has narrowed to just £165.

However, if inflation is below expectations, trackers could enjoy a resurgence. Last week, First Direct cut its market-leading lifetime deal from 2.39% to 2.29%. The deal, which has a fee of £995 for those with a deposit of at least 35%, allows borrowers to switch without penalty.

Meanwhile, savers are being advised to shun fixed savings accounts as better interest rates are being offered on variable accounts, according to the Bank of England's projections for rate rises.

We look at what the outlook for interest rates means for savers and borrowers:

Borrowers

The cost of the Chelsea fix over five years amounts to £63,274 on a £200,000 loan, according to L&C's figures. On the other hand, the cost of the First Direct tracker over five years would hit £63,439, assuming the first rise in Bank rate occurs in February from the current rate of 0.5% to 0.75%, with subsequent increases until it hits 3.25% in 2013. The figures then assume rates stay on hold until 2015, so you would be marginally better off with a fix.

Borrowers on super-low trackers would therefore be better off staying put, while all those on their lender's standard variable rate (SVR) would be better off switching. The lowest SVR is Lloyds' and Nationwide's at 2.5%.

If you don't qualify for the Chelsea deal, the next best rate is First Direct's five-year fix at 4.29%. This deal will cost more than the tracker over five years.

Aaron Strutt, of Trinity Financial Group, the broker, said: "Chelsea's income multiples and tighter lending criteria are currently limiting the availability to many borrowers."

Market Guard, which insures homeowners against rate rises, said last week that one in 10 mortgage holders had told its survey they will default if rates rise.

Borrowers, though, have been discouraged from taking out such insurance as it applies for a maximum of two years and only pays out if rates rise by more than 2% in that time, something that is considered unlikely.

Savers

The best-buy fixed savings account could soon fall below 5% for the first time in more than two years.

ICICI, the Indian bank that is the sole provider still paying 5% on its Hi-save five-year account, said last week it will review the rate in the coming days.

Anubrata Biswas, at ICICI Bank UK, said: “The current rate on ICICI’s five-year fixed-rate account will be operational for the next 10 days. It will be reviewed again before next Friday.”

Figures from Moneyfacts, the financial data company, showed that you are better off investing in the top-paying notice account, the Close Savings 180 Day Notice at 3.11%, rather than the best short-term fixed-rate savings accounts.

Based on the Bank of England’s assumptions, and assuming Bank rate rises are passed on in full, a £10,000 deposit would be worth £10,321 after one year, £10,763 after two years and £11,334 over three years with the notice account, according to Moneyfacts.

This beats the best one-year fixed rate account, from Aldermore at 3.05%, which would be worth £10,309 after a year. The best two-year account, from the Post Office at 3.7%, would be worth £10,766 over the term. The best three-year account, from ICICI, pays 4.15% – so your account would be worth £11,324 over the term.

Michelle Slade, of Moneyfacts, said: “There is no real incentive for savers to lock into a short-term fixed rate when they can achieve a higher rate on a variable deal and benefit from rate rises when they happen.

“Six months ago the picture looked very different. Rates on offer on fixed-rate accounts were markedly higher than we would normally expect for such a low Bank rate.

“The demand from banks for savers’ money has now eased and for the past eight months the trend for rates has been downwards.”

You would, however, still be better over five years with the ICICI account, earning £13,490 with the fix at 5% compared with £12,635 with the variable.