Markets look to an early interest rate rise

The Bank of England has signalled that interest rates may rise soon.

Early in September, the money markets were expecting the first Bank of England interest rate rise to occur in late 2018, at the earliest. A little more than a week later, the markets' view was that there was a near 50% probability of a 0.25% base rate increase by November, with a rate rise a virtual certainty by the following February.

There are two main reasons for the markets' U-turn:

- The August inflation figures (2.9% for the CPI, 3.9% for the RPI) were higher than expected. These prompted the Bank to say that CPI inflation "is now expected to rise to above 3% in October". At that level, Mark Carney, the Bank's Governor, will have to write a letter to the Chancellor explaining why inflation is more than 1% above target.
- At its September meeting, the Bank of England's rate-setting Monetary Policy Committee (MPC) gave a clear warning that developments were pointing to a tightening of monetary policy "by a somewhat greater extent over the forecast period than current market expectations".

The likelihood of an imminent rate rise does not mean that further rate rises will follow at every meeting of the MPC, taking rates back up to historically 'normal' levels. The Bank has regularly said this will not be the case and in September it stated that "any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent".

Outside the money markets, other markets immediately reacted to the new interest rate picture in a predictable way: the pound rose on the foreign exchange markets, while the prices of government bonds (gilts) and UK shares fell.

A rise in UK rates looks set to be accompanied by further Interest rate increases in the United States and the announcement of a tapering of quantitative easing in the eurozone (although euro interest rates are unlikely to move).

The prospect of a new interest rate environment makes it an appropriate time to review your investments and consider what changes, if any, need to be made. The sooner you start on this process, the better: as September showed, market movements can come suddenly.

The value of your investment can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance. Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.