Exploring issues of interest rate setting

Challenge

Why do financial firms follow certain interest rate setting policies and what are the implications of these policies for both the consumer and the wider economy?

University of East Anglia has developed a long term relationship with Norwich-based Moneyfacts.co.uk to consider issues of interest rate setting by the UK financial services industry, monetary policy transmission within the UK economy and to assess the competitive nature of the UK retail financial services industry.

Moneyfacts.co.uk has a unique and extensive historical data set of financial services interest rates and fees. By working with these, Dr John Ashton of the Centre for Competition Policy at the University, together with colleagues from Leeds and Surrey universities, has examined a range of questions such as how banks may exploit consumers' behavioural biases, the issue of choice in saving markets, the geographical scope of UK banking markets and the pass- through of efficiency gains from mergers to retail interest rates.

Solution

As part of his research, Dr Ashton found that interest rates for a disproportionate number of UK mortgages end in .99, rather than a whole figure, which is used far more for deposit accounts. "It's the same practice that supermarkets apply when they offer a product at £1.99 instead of £2," says Dr Ashton. "Many of us will - consciously or not – round that figure down and think we are getting something cheaper."

The research undertaken identifies that this is a widespread practice in the UK deposit and mortgage markets and suggests that this practice is consistent with banks attempting to gain the greatest profits from consumers with the least ability to process price and number information.

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