Daily Mirror

8% Interest rates 'could return to Tory highs'

By Lee Cain

23 August 2010

Interest rates may rise to 8% within the next two years, a top economic expert has warned.

Andrew Lilico, chief economist at the influential Policy Exchange think tank, believes Britain could return to a high interest rate environment not seen since the early 1990s.

He predicts there could be a staggering rise as the recovery grows and the Government's plans to keep a recession at bay prompts an explosion in money supply.

Mr Lilico fears the UK could return to "boom and bust" economics which blighted the nation throughout the 1980s and 90s under Tory governments.

He said: "Given the constraints of late 2008 and the absurdities of subsequent fiscal, finance and regulatory policy, if we can get away with a recession of only 6.6%, deflation of only 2% and inflation of only 10% for one year, [Bank of England Governor] Mervyn King will deserve a medal. To keep [RPI] inflation down to only 10% for one year, the economy will have to tolerate interest rates of perhaps 8%."

Mr Lilico, a monetarist at the right-of centre think tank, believes the UK is heading for a brief double-dip recession early next year, with a boom soon after.

However the boom could get out of control as the Bank of England £200bn "money printing" during the crisis would spark "a huge expansion in the money supply, which will lead to inflation".

He estimates that the Retail Prices Index (RPI), the inflation measure favoured in wage settlements and against which annual rises in train fares are priced, would soar to "above 10%".

Meanwhile the Consumer Prices Index (CPI), the inflation measure that the Bank is responsible for keeping at around 2%, will rise above 6%.

However Jonathan Davis, a Chartered Financial Planner with Jonathan Davis WM, is more cautious.

He said: "The basis of what Mr Lilico is saying is correct - interest rates will increase when we have another round of money printing. However I do not believe his time scale of two years."