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UK NEWS

INTEREST RATES SET TO SOAR, WARNS BANK'S CHIEF ECONOMIST

The Bank of England is battling to control inflation

INTEREST rates will rocket as the Bank of England battles to keep inflation under control, its chief economist warned yesterday.

Spencer Dale told insurers the Bank would remain focused on inflation, regardless of the pain that would cause millions of home owners as their mortgage payments soared.

Mr Dale, a member of the Bank's Monetary Policy Committee, which sets interest rates, said: "The committee adjusted monetary policy boldly and decisively on the way down in order to meet the inflation target.

"And let me assure you that, when the time comes, we will be prepared to respond with equal vigour on the way back up."

Rates have been slashed to a record low of 0.5 per cent in a desperate bid to boost the economy. But with inflation back up to 3.2 per cent, economists warn interest rates will have to follow.

While this would be welcomed by savers who have seen their incomes dwindle, it could spell misery for many hard-working families already struggling to cope with the impact of the recession.

In a speech to the Association of British Insurers, Mr Dale stressed that the Bank of England's priority had to be keeping inflation within the Government's two per cent target.

Figures out this week revealed a surprise rise in the Consumer Prices Index from 3 to 3.2 per cent, with an increase in the cost of food and drink being blamed.

The Retail Price Index, on the other hand, which includes mortgage payments, fell to zero for the first time in 49 years.

While inflation is still expected to fall sharply as the recession takes its course, the CPI figures caught experts off guard.

And there are growing fears that the Government's decision to print more money – an action known as quantitative easing – combined with high levels of borrowing and spending is also throwing things out of kilter.

Mr Dale insisted the economic slump was showing no sign of easing yet and warned that not all the actions taken by the authorities so far were having the desired effect. "So there may still be more to do."

But he gave hope of a recovery starting by 2010. "As we go through 2009, I believe it is most likely that the pace at which output is contracting will ease and that we will see some signs of recovery by around the turn of this year."

If the Bank of England feels it is losing control of inflation, a sharp rise in the base rate is likely to be employed as a blunt instrument to encourage a slowdown.

Lenders, many of whom were reluctant to pass on the latest interest rate cuts in full, are expected to be much quicker off the mark.

Liberal Democrat Treasury spokesman Vince Cable said low interest rates could not last forever, especially given the Government's current economic policy.

"The danger of such aggressive interest rate cuts and the start of quantitative easing is high inflation further down the road.

"The Bank of England is right to warn that record low interest rates are not sustainable in the long term.

However, with Britain sliding into one of the deepest recessions for decades, it is critical that the rate remains low in the short term."

Shadow housing minister Grant Shapps said the Government would be to blame should interest rates begin to soar.

"With hard-pressed home owners already feeling the pain of Gordon Brown's recession it's vital that Labour's debt-fuelled spending doesn't cause spiralling interest rates and further mortgage misery."

Financial experts were last night warning borrowers to prepare for tougher times ahead.

Yvonne Goodwin, an independent financial adviser based in Leeds, said: "Most of the banks and building societies are offering savers three to four-year terms with relatively low rates.

"This is usually a good indication that they think interest rates are likely to rise over the coming months.

They are likely to take off again once the Government's policy of quantitative easing gets moving."

Ms Goodwin, who runs Yvonne Goodwin Wealth Management, said the financial landscape would experience dramatic changes over the next few years.

"I would say to savers not to fix themselves in for anything more than a year to 18 months. Do not lock in your savings for the long term."

But financial expert Jonathan Davis, managing director of Armstrong Davis, urged borrowers not to panic and said he thought any changes in interest rates would be gradual.

"I do not buy Mr Dale's assertion that they will be able to raise interest rates. Inflation will stop falling and we will move into ultra-mild inflation by the end of this year or by next year.

"I do not yet envisage them raising interest rates for quite a long time to come.

"However, I do believe that in the long term we are going to have very high inflation.

"By 2020 we could have 1970s-style inflation