Bank of England under growing pressure on interest rates

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HE Bank of England is coming under increasing pressure to raise interest rates sooner than expected as fresh signs emerge that the economy is booming.

Britain's leading business lobby today ramped up its forecasts for economic growth this year, leading some City banks to predict interest rates will rise much sooner, and faster, than the Bank suggests.

The CBI now says GDP will rise by 8.2% this year, up from its previous forecast of 6%. That means the UK economy will have recovered all of its pandemic losses by the end of the year, which in turn means inflation and borrowing costs could surge.

This week inflation came in at 2.1% topping the Bank of England's 2% target for the first time since Covid. That increased the tension between the Bank, which is keeping interest rates at rock bottom lows of 0.1%, and some in the City who think it should move faster to head off inflation.

The Bank's Monetary Policy Committee meets next week and could admit that the rebound is faster than it realised. At the moment the Bank isn't expected to move up rates until next year at the soonest.

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Credit Suisse said in a note to clients today: “We think the conditions for tightening policy can be met sooner. The recovery in the UK is proceeding faster than expected. We have upgraded our UK GDP growth forecasts from 6.5% to 7.5% and expect the economy to return to pre-Covid levels by Q4 2021. Our view is that the strong growth recovery and drop in UK labour market supply due to Brexit can lead to a large-scale reabsorption of furloughed jobs into employment in the next few months and slack being eroded quicker than the BoE forecasts.”

That view is gaining traction in the City, which increasingly thinks rates will rise once this year and at least twice next year.

Figures today show that retail sales fell 1.4% in May as consumers spent less on food from supermarkets and more in re-opened pubs and restaurants.

Paul Dales at Capital Economics said: “Rather than suggest the economic recovery is already spluttering, the decline in retail sales in May is probably just a result of the reopening of indoor hospitality in mid-May prompting households to spend less time shopping and more time socialising.”

The CBI says growth this summer will be driven by pent-up consumer demand and a surge in spending of savings amassed during lockdowns. Britain suffered its biggest fall in output in 300 years in 2020, as the economy shrank by almost 10%. CBI Director-General, Tony Danker said: “The data clearly indicates that there is pent up demand and ambition across many sectors.”

This week former Bank of England governor Mervyn King said a surge in spending could ramp up inflation, leading to a sharp rise in interest rates.