City fears Sunak energy deal may force Bank of England’s hand on rates

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HE BANK of England may be forced to shove up interest rates even quicker than it was planning following Rishi Sunak’s dramatic intervention in energy markets, the City warned today.

That in turn will increase borrowing costs and reduce consumer spending power, increasing the risk of a recession.

The Bank, widely criticised for moving too slowly to curtail inflation, put rates up to 1% earlier this month from 0.75%. It is expected to do at least four more quarter point rises this year to 2%.

But the Chancellor’s £400 handout to cover energy bills, a £15 billion package, could fuel inflation and force the hand of Bank governor Andrew Bailey and the eight other members of the Monetary Policy Committee that sets rates.

Some fear rates could now be at 3% by the end of the year. While that is historically still low, the pace of the increase would cause severe problems to already uncertain businesses and consumers.

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Paul Dales at Capital Economics said: “The extra financial support for households announced by the Chancellor today will help millions of households cope better with the cost of living crisis. But it won’t relieve all the pain and may mean the Bank of England has to pull the interest rate lever harder to reduce inflation.”

Some were more sanguine, while still concerned. Simon French at Panmure Gordon said: “The targeted giveaways to those on income-related benefits is not going to fuel inflation. But the universal giveaways of £400 do risk spilling over into higher domestic inflation. At the margin this risks a faster rate of interest rate increases from the Bank.”

The Bank could be forced to do much bigger rate rises in one go.

In the US, the Federal Reserve has already done 0.5 percentage point rise, the biggest individual rate hike in two decades. It has been open about doing the same again, soon.

Robert Wood at Bank of America said: “We raised our BoE forecast last week to four 25bp hikes this year, with risks skewed to the upside. We noted an elevated probability of a 50bp move in August. We remain comfortable with that call. Risks are skewed up.”

The Institute for Fiscal Studies warned earlier this week that inflation for the poorest households could hit 14% by October.

Today it again warned on price rises and was cautious about the merits of the chancellor’s intervention on energy bills. Paul Johnson of the IFS said: “The big risk is that he will be tempted to do this again and again.”