The Anglo Telegraph

Families face years of pain, says Bank

By Edmund Conway
Economics Editor

FAMILIES must steel themselves for years of hardship even though the recession is all but over, the governor of the Bank of England has warned.

They will see their standard of living fall over the next two years as salary freezes and rising inflation eat into incomes, Mervyn King said.

"The patience of UK households is likely to be sorely tried over the next couple of years," Mr King said, dashing hopes that Britain could recover quickly from the deepest slump in post-war history.

His comments are likely to infuriate Downing Street, which had hoped to campaign in the election on having set Britain back on the road to prosperity. The remarks also included a warning of interest rate rises. Hours before the governor's speech, official statistics showed that the annual rate of inflation had surged by an unprecedented 1 per cent last month, pushing the Consumer Price Index up to 2.9 per cent.

Inflation is now rising almost twice as quickly as average earnings and the figures do not reflect the recent end to the VAT tax cut. With consumers facing even higher prices as a result of rising VAT in January, CPI is likely to go well above 3 per cent in the coming months, Mr King suggested.

Meanwhile, workers have seen salaries contract at an unprecedented rate. Although unemployment has not risen as high as in previous slumps, this has been at the cost of a significant reduction in household pay, with many staff accepting pay cuts, or voluntarily working part-time, to hang on to their jobs.

Mr King said that, although the recession was soon likely to be over in technical terms "there is little scope for growth in real take-home pay, which may remain weak even as output recovers".

"It is clear that inflation is likely to pick up markedly in the first half of this year, a message reinforced by this morning's news that CPI inflation reached 2.9 per cent in December ... the rise in VAT back to 17.5 per cent means that CPI inflation is likely to rise to over 3 per cent for a while, or even higher for even longer were energy prices or indirect taxes to increase further."

Although he said that inflation should eventually come back down, its increase prompted speculation that the Bank will start to raise interest rates in months.

Simon Ward, economist at Henderson asset investors, said he expected higher rates before the election, causing further difficulty for borrowers and, by extension, for Gordon Brown.

Mr King's comments, in a speech at the University of Exeter last night, prove particularly embarrassing for the Chancellor, Alistair Darling. He insisted in a newspaper interview this week that he was "totally relaxed about the governor talking about the wider economy".

Mr King used the speech to warn the Chancellor that, unless he fulfils promises to present an austere Budget with spending cuts this spring, he may cause chaos in the capital markets where the Government raises its money.

He indicated that unless the Government is clearer about plans to slash the deficit, the Monetary Policy Committee could be spurred into raising interest rates even sooner.

He said: "Uncertainty about how and when fiscal policy will respond has a direct bearing on monetary policy. And markets can be

Continued on Page 2