Base rates may hit 10% by autumn

• David Brierley

NORMAN LAMONT, the chancellor, tonight hosts a Downing Street dinner for G7 finance ministers secure in the knowledge that inflation and interest rates in Britain are heading firmly downwards.

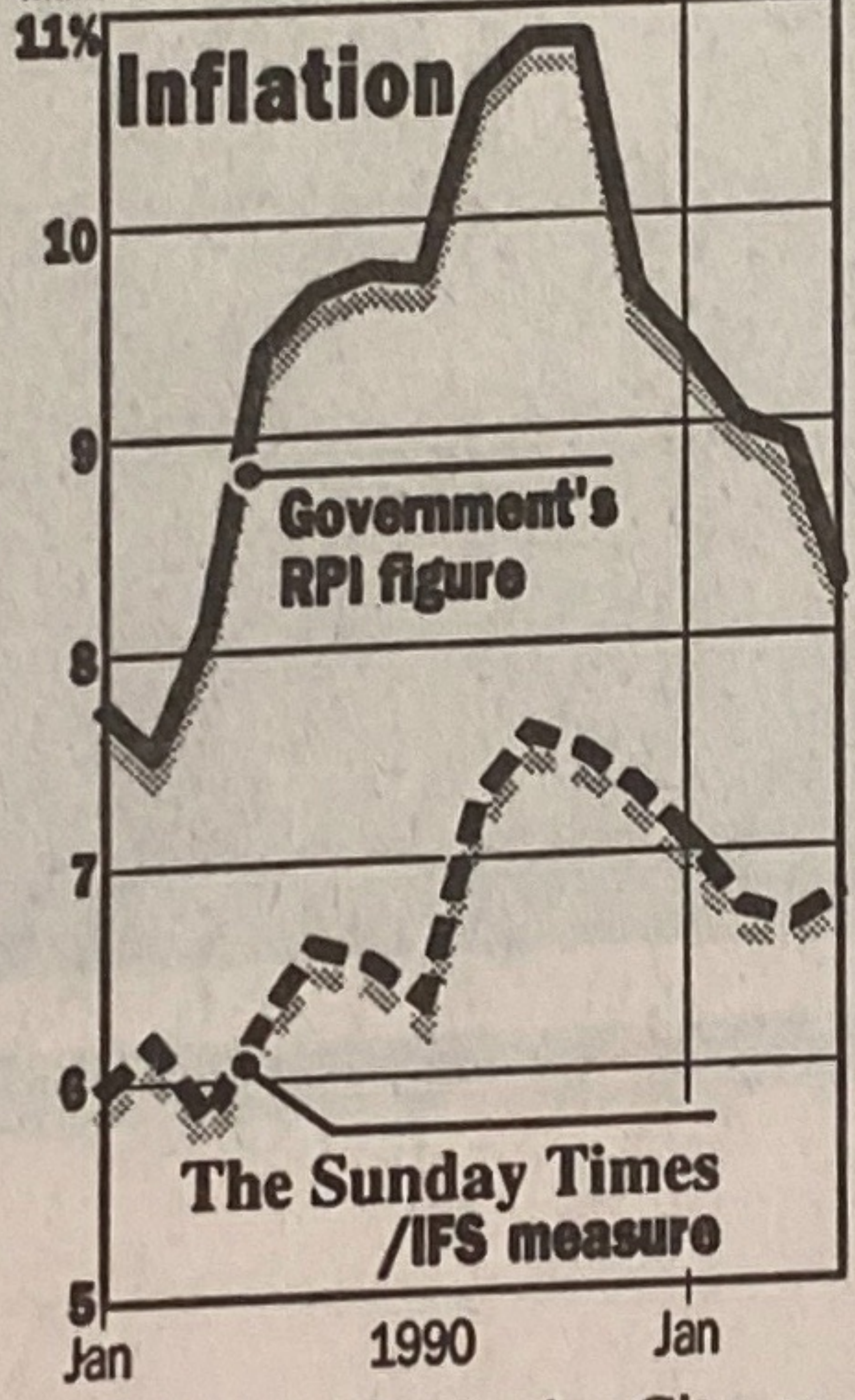
On Friday, the Treasury announced that the retail prices index had fallen 0.7 points to 8.2% in March, and that another two-point fall could be expected in April. Earlier, the Bank of England cut base rates half a point to 12%, enabling building societies to cut mortgage rates ahead of the May local elections.

A spokesman for the Treasury attributed the sharp fall in inflation to last year's mortgage rate increases and high poll-tax bills dropping out of the figures. This month, budget rises in excise duty will be offset by significantly smaller poll-tax bills.

The latest figures from The Sunday Times/IFS measure of underlying inflation show prices rising steadily by 6.8% in the year to March. The measure, which uses official data but tries to calculate actual housing costs in estimating inflation, ignores the large swings caused by mortgage rates and the poll tax in the RPI.

SUNDAY TIMES/IFS

RETAIL PRICE INDEX



Despite worries about the underlying trend, the City remains confident that inflation is firmly heading down as wages and prices are squeezed. The consensus is that base rates can be cut to 10% by the autumn, but analysts believe the scope for further cuts will be limited unless the underlying inflation drops.

City economists remain divided about how swiftly the economy can recover from the recession. Gerard Lyons, economist at DKB International, said: "The outlook for inflation is encouraging, but our feeling is that the recession will be deep and prolonged."

Lyons and Paul Turnbull, of Smith New Court, see GDP returning to growth only in 1992. Keith Skeoch at James Capel, who is in the bullish camp, predicted a recovery before Christmas.

Skeoch said: "The decline in inflation and interest rates will feed through to consumer demand and business confidence. The economy will bottom out in June or July."

The bears suggest that high and rising unemployment will slow any recovery in consumer demand, while companies' wish to reduce debts will constrain investment.

There will be few indications of a resurgence in the output, money supply, PSBR and employment figures due this week. The City expects the March unemployment figure to be up by 75,000, and growth in money supply and bank lending continuing to slow. Manufacturing output is expected to show another marginal decline.

Domestic issues will fade into the background at tonight's dinner for G7 finance ministers. Both Nicholas Brady, the US treasury secretary, and Lamont want closer co-operation following the changes in the world economy brought about by the Gulf war and the transformation of east Europe.