{ INTEREST RATES }

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When it comes to interest rates, monetary policymakers are still dragging their feet

Almost everywhere, renewed economic optimism abounds. Even Spain, previously one of the most depressed parts of the beleaguered eurozone, is perking up. So will this be the year when central banks, after more than five years of near-zero interest rates, finally bite the bullet and begin the long march back to normalised monetary policy? The answer to this question is both 'yes' and 'no'.

Market interest rates are already leading the way, with long-bond yields in all major economies quite a bit higher than they were a year ago. Meanwhile, the US Federal Reserve has begun to ease off on asset purchases and may soon cease them altogether. Markets reacted with dismay last summer, when the Fed first broached the subject of reduced 'quantitative easing', but have since learned to live with it. The summer's 'taper tantrum' has subsided.

In the UK, a relatively robust economic recovery has now established itself despite removal of the quantitative easing prop, which ceased more than a year ago. Third-quarter growth was the strongest in the G7. Ominously, house prices are again shooting up. According to the Nationwide index, they rose an astonishing 15% in Greater London last year.

Yet this is no longer limited to London – all regions saw some increase in house prices in 2013. National house price inflation is once more approaching double digits.

Will this be the year when central banks begin the long march back to normalised monetary policy?

With some British cabinet ministers already calling for action to cool the market, the pressure for higher rates would appear overwhelming.

Even so, central bankers are resisting. The unconventional monetary policies of the crisis years may be a thing of the past, but policymakers are in no hurry to go further and start actually raising interest rates. Indeed, Sweden's Riksbank went the other way and cut its rate shortly before Christmas.

The European Central Bank (ECB) is under similar pressure to provide further monetary stimulus. Economies may be picking up a bit, but inflation is falling fast, particularly in Europe, where core inflation is at its lowest level since the launch of the euro. The ECB may already have left it too late to act. Outright price deflation seems all too possible – a disastrous state of affairs for countries still struggling to bring ballooning public indebtedness under control. Greece, Cyprus and Latvia have price deflation already; Italy and Spain are not far behind.

In the US, too, the inflation rate remains tame as tame can be. And even in Britain, notorious for well-above-target inflation, it is slowing fast. To raise rates might therefore seem somewhat premature.

This is certainly the view of Mark Carney, the still relatively new governor of the Bank of England. Last summer, he attempted to put the lid on rising interest rate expectations by saying that the Bank wouldn't even contemplate raising rates until unemployment had fallen to 7%.

This threshold now looks like being reached much earlier than anticipated, possibly as soon as the middle of the year. Embarrassingly, Carney may have to recalibrate his forward guidance – by cutting the unemployment threshold to, say, 6.5% – if he is to avoid an early rise in interest rates.

For Carney, the first and second lines of defence against rising house prices are not, in any case, interest rates, but so-called macro-prudential tools, or credit rationing by another name.

Will this kind of micro-management of credit allocation by central bankers work, allowing them effectively to pick and choose which areas of the economy they apply monetary stimulus to? I'm sceptical, and I worry that the longer these very low interest rates persist, the worse the pain will be when they do rise, as indeed eventually they must.

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