



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

6 August 2015

Mark Carney
Governor
The Bank of England
Threadneedle Street
London EC2R 8HA

Dear Mark,

CPI INFLATION

Thank you for your letter of 6 August on behalf of the Monetary Policy Committee (MPC) regarding June's CPI inflation figure, written under the terms of the MPC remit.

As expected at the time of your previous open letter in May 2015, inflation has remained around zero in the past few months, triggering a third open letter for inflation falling more than 1 percentage point below target.

I agree that the underlying causes of below target inflation remain broadly the same as those described in your last letter, as falls in the prices of food and energy and some other imported goods continue to explain most of the deviation from target.

I also agree with your ongoing assessment that developments more broadly do not point to a more general deflationary trend. In particular, wages have picked up strongly since the middle of last year and consumer confidence remains close to its highest level in over a decade. I note you expect households' real income to rise more strongly in 2015 than in any year since 2007.

Your letter makes clear that in the absence of further falls in commodity prices, inflation rates close to zero are unlikely to endure beyond this year and that in the view of the MPC, CPI inflation is likely to rise around the turn of the year. Indeed, the MPC judges it likely that a gradual rise in interest rates, such as that currently implied by market yields, is consistent with inflation returning to the 2% target within two years.

In line with the requirements in the MPC remit, your letter provides a clear assessment of considerations and trade-offs guiding decisions from the MPC when considering the appropriate approach to, and horizon for, bringing inflation back to target, including implications for output volatility and risks of possible financial imbalances.

Today, for the first time and following the recommendations of the Warsh Review, the MPC publishes simultaneously the policy decision and the Minutes of its August meeting, as well as its quarterly Inflation Report, including its latest forecasts for output and

inflation. I welcome this very important step, which further enhances the effectiveness of MPC communication and its transparency and puts our monetary policy making at the forefront of international best practice.

The Government's commitment to the current regime of flexible inflation targeting, with an operational target of 2% CPI inflation, remains absolute.

The target is symmetric: deviations below the target are treated the same way as deviations above the target. Symmetric targets help to ensure that inflation expectations remain anchored and that monetary policy can play its role fully.

As set out in my previous letters, I therefore welcome that the MPC remains vigilant to both upside and downside risks to its forecast and stands ready to act if these risks materialise, to ensure inflation remains likely to return to target in a timely fashion.

Ultimately, the credibility of our economic policy rests on the strength of our public finances. The Government's fiscal responsibility has worked alongside monetary activism to support the economy. This has been supported by the repair of the financial sector as well as supply-side reforms to deliver sustainable increases in standards of living.

But the job is not yet done. In the Summer Budget, this Government set out further action to complete the repair of the public finances and run an overall budget surplus to start paying down debt. To achieve the surplus in 2019-20 the Government will undertake around £37 billion of further consolidation measures. The Budget set out around £17 billion of measures that will reduce the deficit, including £12 billion by 2019-20 from welfare reform. In the autumn, the Government will set out plans to deliver the remaining £20 billion of consolidation measures following a rigorous Spending Review process.

Alongside the Budget, I have also published our comprehensive productivity plan "Fixing the foundations", to create a more prosperous nation and to make Britain work better by encouraging long-term investment and promoting a dynamic economy.

I am copying this letter to the Chairman of the Treasury Select Committee and depositing this letter immediately in the libraries of both Houses and on the Treasury website.

A handwritten signature in black ink that reads "George Osborne". The signature is written in a cursive, slightly slanted style.

GEORGE OSBORNE