



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

8 February 2018

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

Dear Mark,

CPI INFLATION

Thank you for your letter of 8 February on behalf of the Monetary Policy Committee (MPC) regarding November's Consumer Prices Index (CPI) inflation figure. The twelve-month measure of CPI inflation was 3.1% in November, which triggered an exchange of open letters under the terms of the MPC remit.

I agree with your assessment that the temporary period of above-target inflation has been driven by the depreciation of sterling and the resulting effects of higher import prices on CPI inflation.

Higher inflation, though temporary, has squeezed household incomes. So I welcome the MPC's forecast that inflation will fall back gradually over the forecast.

Your letter provides a clear assessment of the considerations and trade-offs that guide the MPC's decisions when considering the appropriate approach to, and horizon for, bringing inflation back to target, including implications for output volatility. I welcome that the Committee stands ready to monitor and respond, as necessary, to developments as they unfold to ensure a sustainable return of inflation to target.

I note the MPC's assessment in the latest forecasts for a gradual rise in pay growth. I am pleased to see this, alongside a declining unemployment rate which is at its lowest level since 1975.

Of course, the best way to achieve good quality, well-paid work for the long term is to raise Britain's productivity. The MPC's latest forecast includes revised expectations for only modest growth in potential supply. Despite more positive data in recent months, the UK's long-term productivity performance has continued to disappoint. I am committed to increasing productivity, and thus the nation's pay, as we build a Britain that is fit for the future. This is why we are investing over £30 billion in housing, skills, research and infrastructure through the National Productivity Investment Fund (NPIF). As part of this commitment, we are increasing support for research and development (R&D) to its highest

level in 30 years, and backing skills and training so that our workforce is equipped for the jobs of the future.

I confirm the government's commitment to the Bank of England's operational independence and the current regime of flexible inflation targeting, with an operational target of 2% CPI inflation, remains absolute. The target of 2% CPI inflation is symmetric: deviations below the target are treated the same way as deviations above the target. This institutional structure helps to ensure that inflation expectations remain anchored and that monetary policy can play its role fully.

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

A handwritten signature in blue ink, reading "Philip Hammond". The signature is fluid and cursive, with the first name "Philip" and the last name "Hammond" clearly distinguishable.

PHILIP HAMMOND