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

5 November 2015

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

Dear Mark,

CPI INFLATION

Thank you for your letter of 5 November on behalf of the Monetary Policy Committee (MPC) regarding September's CPI inflation figure, written under the terms of the MPC remit.

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

I agree that the underlying causes of below target inflation remain unchanged from 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.

A temporary period of low inflation, driven by falls in commodity prices, has been welcome news for Britain's households, helping their budgets stretch further with lower fuel costs and boosting real take-home pay. Indeed, as you note in your letter, pay growth has recovered in recent months.

Your letter makes clear that in the absence of further falls in commodity prices, inflation rates close to zero are unlikely to endure much beyond the end of the year and that in the view of the MPC, CPI inflation is likely to rise at that point. Indeed, the MPC judges it likely that a gradual rise in interest rates is consistent with inflation returning to the 2% target in a sustainable manner in around two years and keeping it there in the absence of further shocks.

I note also the further evolution of the MPC's forward guidance framework, set out in the *Inflation Report* published today: that the MPC's preference is to use Bank Rate as the active marginal instrument for monetary policy, and expects to maintain the stock of purchased assets at £375 billion until Bank Rate has reached a level from which it can be cut materially, which the MPC currently judges is around 2%.

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.

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. In July, the Government set out action to complete the repair of the public finances and run an overall budget surplus to start paying down debt. This month, the Government will set out plans to deliver further consolidation measures at the Autumn Statement, following a rigorous Spending Review process. Alongside this work, the Government has started to deliver on its comprehensive productivity plan, designed to create a more prosperous and dynamic economy.

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

GEORGE OSBORNE