Bank of England

The Rt Hon Rachel Reeves
Chancellor of the Exchequer
HM Treasury
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Andrew Bailey
Governor

19 June 2025

Dear Rachel,

On 21 May 2025, the Office for National Statistics (ONS) published data showing that twelve-month inflation in the Consumer Prices Index (CPI) was 3.5% in April. On 18 June, the ONS published data showing that CPI inflation was 3.4% in May.

This letter sets out the outlook for inflation and the policy action the Monetary Policy Committee (MPC) is taking to return inflation to the 2% target, along with other considerations required by the MPC's remit when inflation moves away from the 2% target by more than 1 percentage point.

Why has inflation moved away from the 2% target?

Consumer price inflation has fallen significantly over the past two years, in part owing to the restrictiveness of the MPC's monetary policy stance. As the Committee had expected, CPI inflation has begun to rise again this year, from 2.6% in March to 3.5% in April and to 3.4% in May.

Against the backdrop of a continued gradual easing of price pressures in the UK economy, this increase in CPI inflation has owed largely to increases in household energy prices and other regulated and administered prices, including water bills regulated by Ofwat and Vehicle Excise Duty.[1] Household energy bills contributed

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[1] On 5 June 2025, the ONS announced that an error had been identified in an extract of the licensed vehicles data provided to the ONS by the Department for Transport (DfT). These data were used to calculate the April 2025 Vehicle Excise Duty (VED) component of consumer price inflation. The error

around ¼ percentage point to the 3.4% rate of headline CPI inflation in May, while other regulated and administered prices contributed a little under ½ percentage point.

Consumer food price inflation has risen from 3.0% in March to 4.4% in May. Meat, chocolate and non-alcoholic drinks have exhibited the strongest inflation rates, consistent with higher wholesale prices for beef, cocoa beans and coffee. Agency intelligence has also highlighted labour and packaging regulation costs.

Core consumer goods price inflation has risen from 1.1% in March to 1.6% in May.

Consumer services price inflation returned to 4.7% in May, having risen from that level in March to 5.4% in April. Airfares and package holidays, which are volatile components of CPI prone to additional Easter-related price distortions, accounted for a significant portion of the increase on the month in April.

Signs of continuing disinflation in those services categories which tend to be more labour-intensive and less exposed to changes in National Insurance Contributions are suggestive of a continued normalisation in the underlying pressure on prices from wage costs. Private sector regular average weekly earnings growth has declined to 5.1% in the three months to April. A broad range of indicators suggests that the labour market has continued to loosen over the course of this year.

The outlook for inflation

In the MPC's May Monetary Policy Report projections, CPI inflation was expected to rise to 3.4% in the second quarter of 2025 and to peak at 3.5% on average in the third quarter, in large part reflecting developments in household energy bills and, to a lesser degree, other regulated prices.

The increase in CPI inflation is still expected to be temporary. This in part reflects the Committee's judgement that the increase in headline inflation will not rekindle domestic inflationary pressures via second-round effects, beyond those that would typically be expected to occur. This contrasts with the more persistent dynamics in the inflation process that occurred following the very large shocks in 2021–22, when headline inflation rose much more significantly, and the UK labour market was much tighter.

Given pressures from labour costs and regulatory changes, services inflation is expected to remain around 5% over the remainder of this year. Private sector regular pay growth is expected to slow significantly further by the end of 2025, to around 3¾%, consistent with the latest indications from the Bank's Agency intelligence and the Decision Maker Panel Survey.

More generally, the restrictive stance of monetary policy is expected to return inflation towards the 2% target next year. In deciding the appropriate degree and pace of

resulted in an overstatement of the headline CPI by 0.1 percentage points for the published April 2025 figure only. The error was corrected in the May data, such that only the year-on-year rate of CPI inflation in April of next year will be distorted.

adjustment to its policy stance, the Committee continues to monitor different possibilities for how domestic inflationary pressures could evolve.

The policy action the Committee is taking in response

The MPC has statutory objectives to maintain price stability and, subject to that, to support the economic policy of the Government including its objectives for growth and employment as set out in its remit. The MPC sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment.

The MPC's remit is clear that the inflation target applies at all times, reflecting the primacy of price stability in the UK monetary policy framework. The framework recognises that there will be occasions when inflation will depart from the target as a result of shocks and disturbances. Monetary policy will ensure that CPI inflation returns to the 2% target sustainably in the medium term. In forming a view on its policy stance, and the horizon within which inflation returns to target, the Committee considers a number of factors including the nature and persistence of any shocks, the speed of Bank Rate transmission through to the real economy, the structure of the economy and the inflation expectations of agents in the economy.

There remain two-sided risks to inflation. Given the outlook, and continued disinflation, a gradual and careful approach to the further withdrawal of monetary policy restraint remains appropriate. Monetary policy is not on a pre-set path. At the June meeting, the Committee voted to maintain Bank Rate at 4.25%.

The Committee will continue to monitor closely the risks of inflation persistence and what the evidence may reveal about the balance between aggregate supply and demand in the economy. Monetary policy will need to continue to remain restrictive for sufficiently long until the risks to inflation returning sustainably to the 2% target in the medium term have dissipated further. The Committee will decide the appropriate degree of monetary policy restrictiveness at each meeting.

Yours sincerely,

Andrew Bailey

cc: Dame Meg Hillier MP, Chair of the Treasury Committee.