



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

17 April 2007

Mervyn King
The Governor
Bank of England
Threadneedle Street
London EC2R 8AH

Dear

Mervyn,

Thank you for your letter of 16 April regarding today's inflation figures.

In your letter you state that: "the news seems unlikely to alter the broad picture painted in the *February Report*. As the substantial increases in household gas and electricity prices that occurred a year ago drop out of the annual comparison, and the falls in those prices which have already been announced take effect, CPI inflation is likely to fall back within a matter of months. At the time of the *February Report*, the Committee judged that, assuming Bank Rate followed the market yield curve, the central outlook was for inflation to fall to a little below the target by the end of this year, before settling at around the target during the following year."

Inflationary pressures have been a feature of the major industrial economies in recent times. I am grateful for your explanation of the recent increases in inflation in the UK. I note that part of the rise reflects unexpectedly sharp increase in energy prices, including a 25% increase in sterling oil prices since February, and a further part reflects the impact of weather conditions on food supply as well as the other factors you identify.

I welcome your confirmation that "the Committee will continue to look through the short-term volatility in inflation over the next year or so



resulting from fluctuations in domestic energy prices and set Bank Rate to keep inflation on track to meet the 2% target in the medium term.”

I agree that the Monetary Policy Committee’s approach is appropriate to meet the Government’s monetary policy objectives namely to maintain price stability and, subject to that, to support the economic policy of the Government, including its objectives for growth and employment.

The Monetary Policy Committee’s forward-looking approach has been a cornerstone of economic policy over the past decade. Your letter is an integral part of the framework that has delivered a decade of low and stable inflation alongside sustained growth and a level of inflation that has been, on average, lower than America and Europe.

The Government will continue to support the MPC in the forward-looking decisions it takes in the future. For its part the Government will continue to be vigilant and disciplined in the fight against inflation. To that end, as I announced to Parliament on 1 March 2007 overall headline settlements for public sector workforces covered by Pay Review Bodies are to be less than the 2 per cent inflation target in 2007-08. And fiscal policy has been supporting monetary policy with a fiscal tightening in the Pre-Budget Report and a fiscally neutral Budget.

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

*In sincerely
Gordon*

GORDON BROWN