



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

4 February 2016

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

Dear Mark,

CPI Inflation

Thank you for your letter of 4 February on behalf of the Monetary Policy Committee (MPC) regarding December's CPI inflation figure, written under the terms of the MPC remit.

As expected at the time of your previous open letter in November 2015, inflation has remained around zero in the past few months, triggering a fifth 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 previous 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.

Your letter makes clear that in the absence of further falls in commodity prices, it is likely that the inflation rate will rise further during the early part of this year. 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.

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.

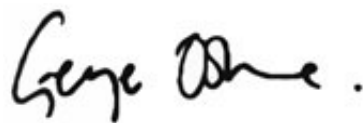
As set out in my previous letters, I therefore welcome that the MPC remains vigilant to both upside and downside risks to its forecast and stands ready to act if these risks materialise, to ensure inflation remains likely to return to target in a timely fashion.

This is particularly important given the fragile global macroeconomic climate. World growth was at its weakest since the crisis in 2015. Moreover the IMF forecast is for a moderate pick up in global growth in 2016, but they are clear that the risks to that are on the downside. Those risks include the slowing in emerging market growth, China's rebalancing, weaker commodity prices, and the process of monetary policy normalisation. This dangerous cocktail of global economic risks has been reflected in the volatile start to the year in financial markets. The UK's stable macroeconomic policy framework is well placed to deal with them, based on an independent monetary policy and a commitment to sound public finances.

The MPC have revised down their forecast for real GDP growth and CPI inflation in the short term, implying weaker nominal growth. This, combined with threats from the international environment, mean we face the risk of a weaker outlook for nominal GDP. If realised this could present challenges for tax receipts in the future, and reinforces the importance of delivering our plan to achieve a surplus on the public finances by the end of the Parliament.

Ultimately, the credibility of our economic policy and our resilience to global risks rests on the strength of our public finances. In November the Government 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.

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

GEORGE OSBORNE