Bank of England

The Rt Hon Rachel Reeves
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
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Andrew Bailey
Governor

18 December 2025

Dear Rachel,

On 17 December 2025, the Office for National Statistics (ONS) published data showing that twelve-month inflation in the Consumer Prices Index (CPI) was 3.2% in November, down from 3.6% in October.

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 few years, staying close to the 2% target for much of last year, in part owing to the restrictiveness of the MPC's monetary policy stance. As the Committee had expected, CPI inflation rose again this year, peaking at 3.8% over the July to September period, before falling to 3.6% in October and 3.2% in November.

Against the backdrop of a continued gradual easing in underlying price pressures in the UK economy, the increase in CPI inflation through to this autumn owed largely to higher food and administered prices, coming alongside a swing from falling to moderately increasing energy prices.

The contribution to the overshoot of the CPI inflation target from food prices alone was about 0.4 percentage points in September and 0.3 percentage points in November. Higher global agricultural prices have been a key driver of the recent increase in food price inflation, which has averaged 4.6% in the past three months, up from an average of 3.2% in first three months of the year. Inflation among four components – butter, beef, chocolate and coffee – which make up only 10% of the food CPI basket, is currently directly contributing nearly 2 percentage points to overall food inflation. Additionally, domestic factors, including labour cost increases, have contributed to elevated food price inflation.

Administered prices, such as Vehicle Excise Duty and water and sewerage charges, account for a further 0.4 percentage points or so of the overshoot in CPI inflation from target.

Much of the remaining overshoot reflects elevated labour cost growth due to past strength in wage growth as well as some additional temporary pressures. A reduction in total labour cost growth appears to have been delayed by the increase in employers' National Insurance Contributions (NICs) and by pay growth in sectors with a large share of employees at or close to the National Living Wage. Private sector regular pay growth eased to 3.9% in the three months to October, however, and a broad range of indicators suggests that the labour market has continued to loosen throughout the course of this year.

The outlook for inflation

In the central projection published in the November Monetary Policy Report, CPI inflation was projected to fall to close to 3% in coming quarters and then decline gradually towards the 2% target after that, underpinned by subdued economic growth.

Headline services inflation was projected to fall to 4.3% in March, from 4.7% in September, as the effects of higher employer NICs begin to fade and lower wage growth continues to drag. The contribution from higher administered prices was expected to fall only slightly over that period, before reducing in the second quarter of 2026 to the extent that the large rises in administered prices in 2025 were not repeated.

The Committee noted that there were risks around this central projection, some of which are reflected in the scenarios published in the November Report. In November, the Committee judged that the risk from greater inflation persistence had become less pronounced recently, and the risk to medium-term inflation from weaker demand more apparent. The Committee said it would continue to monitor the evidence on both.

Since the November MPC meeting, CPI inflation has fallen by more than expected. The downside news to headline inflation largely reflects an unexpected fall in food price inflation to 4.2% in November, 0.8 percentage points below the forecast in the November Report. Pay growth and services price inflation have continued to ease much as expected, underpinned by subdued economic growth and building slack in the labour market. Set against this, some forward-looking indicators of wage and pricesetting from the Bank's Agents and the Decision Maker Panel appear to have plateaued.

Bank staff have provisionally estimated that the policy measures announced in the Autumn Budget could increase the level of GDP by around 0.1-0.2% over the next couple of years relative to what had been assumed in the November Report, with a broadly corresponding impact on the degree of slack in the economy.

The Budget also included a set of policy measures with a direct impact on inflation in the short term. Bank staff provisionally estimate that these measures, which include reductions to regulatory costs levied on households' energy bills and fuel duty changes, push down CPI inflation by around ½ percentage point in the second quarter of 2026 relative to the projection in the November Report. Subsequently, the impact of the direct and indirect effects of Budget policies is expected to push up on CPI inflation by around 0.1-0.2 percentage points in 2027 and 2028. A fuller assessment of this fiscal news will be conducted as part of the February Monetary Policy Report forecast round.

Following these Budget announcements and the recent data news, headline inflation is now expected to fall back more quickly and reach a level close to the 2% target from April. But, while the latest data are generally encouraging, suggesting that the risk from greater inflation persistence has become somewhat less pronounced, there continue to be risks in both directions. The recent experience of high inflation could still be affecting the way wages and prices are being determined in the economy, including owing to structural factors. At the same time, households and businesses could remain cautious about their spending and investment decisions, and the labour market could weaken significantly further.

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 the MPC's 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.

At its December meeting, the Committee voted to reduce Bank Rate by 0.25 percentage points, to 3.75%. The extent of further easing in monetary policy will depend on the evolution of the outlook for inflation. The restrictiveness of policy has fallen as Bank Rate has been reduced by 150 basis points since August 2024. On the basis of the current evidence, Bank Rate is likely to continue on a gradual downward path. But judgements around further policy easing will become a closer call as Bank Rate approaches a neutral level.

Yours sincerely,

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