

Bank of England

The Rt Hon Rachel Reeves
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
SW1A 2HQ

Andrew Bailey
Governor

18 September 2025

Dear Rachel,

On 17 September 2025, the Office for National Statistics (ONS) published data showing that twelve-month inflation in the Consumer Prices Index (CPI) was 3.8% in August, unchanged from 3.8% in July.

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 and a half years, staying close 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 has risen again this year, reaching 3.8% in July and August.

Against the backdrop of a gradual easing in underlying price pressures in the UK economy, the recent increase in CPI inflation has owed largely to food prices and administered prices, including water bills and Vehicle Excise Duty. A reduction in total labour cost growth also appears to have been delayed by the increase in employer National Insurance Contributions (NICs) and pay growth in sectors with a large share of employees at or close to the National Living Wage (NLW).



Consumer food price inflation rose from 4.4% in May to 5.1% in August. Intelligence from the Bank's Agency network suggests that higher global commodity prices have driven much of the increase over the past year, with higher wholesale prices for beef, cocoa beans and coffee in particular, and with some contribution also from domestic costs. Food inflation contributed around 0.4 percentage points to the overshoot in headline CPI inflation above the target in August.

Consumer services price inflation was 4.7% in August, as in May, contributing around 1 percentage point to the overshoot in CPI inflation. The elevated level of services inflation reflects past strength in wage growth as well as temporary pressures from labour costs and administered prices. Services inflation rose temporarily to 5.0% in July, driven by volatility around the start of the summer holiday season for airfares and offset slightly by a moderation in rent inflation.

Some measures of underlying services inflation point to further progress in disinflation, aided by a decline in the rate of growth in wage costs and lower inflation in rents. Private sector regular average weekly earnings growth eased to 4.7% in the three months to July. 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 baseline projection in the August Monetary Policy Report, CPI inflation was projected to rise to a peak of 4.0% in September. This is a slightly higher profile than in the May Report and reflects some near-term upward pressure on food and headline services prices.

The increase in CPI inflation is still expected to be temporary. This in part reflects the Committee's baseline judgement that, in the context of a weakening labour market, 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. Nonetheless, the Committee remains attuned to upside risks around medium-term inflationary pressures, which have moved slightly higher since the May Report. This is partly because increases in food prices are a particularly salient factor in households' formation of inflation expectations.

Headline services inflation is expected to remain around 5% over the remainder of this year, but it is expected to moderate early next year as the effects of slowing labour costs come through to prices. 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

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

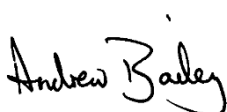
The MPC has statutory objectives to maintain price stability and, subject to that, to support the economic policy of the Government including its objectives for growth and employment as set out in its remit. The MPC sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain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

At its September meeting, the Committee voted to maintain Bank Rate at 4%. A gradual and careful approach to the further withdrawal of monetary policy restraint remains appropriate. The restrictiveness of monetary policy has fallen as Bank Rate has been reduced. The timing and pace of future reductions in the restrictiveness of policy will depend on the extent to which underlying disinflationary pressures continue to ease. Monetary policy is not on a pre-set path, and the Committee will remain responsive to the accumulation of evidence.

At this meeting, the Committee also voted to reduce the stock of UK government bonds held for monetary policy purposes, and financed by the issuance of central bank reserves, by £70 billion over the next 12 months, to a total of £488 billion. This decision was taken in line with the principles that Bank Rate should be the active policy tool for adjusting the stance of monetary policy; that sales should be conducted so as not to disrupt the functioning of financial markets, and only in appropriate conditions; and, to help achieve that, that sales should be conducted in a gradual and predictable manner over a period of time.

Yours sincerely,

A handwritten signature in black ink, reading "Andrew Bailey". The signature is written in a cursive style with a small dot above the 'i' in Bailey.

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