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

17 September 2026

Dear John,

On 16 September 2026, the Office for National Statistics (ONS) published data showing that twelve-month inflation in the Consumer Prices Index (CPI) was 3.1% in August.

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?

At the time of the February Monetary Policy Report, there had been continued disinflation in domestic prices and wages, in part reflecting the impact of monetary policy. CPI inflation had been expected to fall back to around the 2% target from April.

The outbreak of conflict in the Middle East at the end of February has had a significant impact on the availability and price of a range of goods, particularly natural gas, oil and refined products. Transport through the Strait of Hormuz, a key shipping route, has been restricted and there is limited capacity on alternative export routes. This has pushed up the level and volatility of global energy prices.

Twelve-month CPI inflation was 3.1% in August. The majority of the deviation of CPI inflation from target in August was accounted for by the direct contribution of energy prices owing to the conflict in the Middle East. Of the 1.1 percentage point deviation from the target, 0.7 percentage points was accounted for by direct energy effects, mostly from motor fuels.

The price of motor fuels tends to move quickly as the global oil price rises. Average petrol pump prices have risen from around 130 pence per litre in February, prior to the conflict, to around 170 pence last week. Diesel has risen by more, from around 140 pence per litre in February to around 190 pence per litre.

Household gas and electricity prices are somewhat slower to increase following wholesale cost increases. This is because energy suppliers purchase gas weeks or months in advance of using it, and these prices are taken into account when Ofgem calculates the energy price cap. The Ofgem price cap was raised to £1,663 in Q3 from £1,477 in Q2[1], and domestic gas and electricity prices rose significantly when the new cap came in, by around 15% and 4% respectively in July.

Energy is a key input into the production of food and core goods items. The conflict has raised the prices of non-energy goods globally, largely though not exclusively through the indirect effects of higher energy costs. UK-weighted world export prices increased by more than 5% between the end of 2025 and 2026 Q2, and global agricultural commodity prices have risen by more than 20% since the end of February.

So far there has not been significant indirect impact of higher energy prices on other UK consumer goods prices through firms' supply chains. However, this is likely to begin to happen over the next few months as the effects of higher energy prices pass through. Firms' own-price expectations and broader survey measures of pricing pressures remain elevated.

The energy price shock has been the most important factor driving recent short-term movements in inflation. While the most recent indicators of domestic inflationary pressures remain above rates judged to be consistent with the inflation target, there has been continued disinflation in domestic prices and wages, in part reflecting the impact of monetary policy. Services inflation was 3.4% in August, down from 4.5% in March, and this decline has been broad-based. Measures of wage inflation have continued to fall gradually. Annual growth in private sector regular Average Weekly Earnings in the three months to July was 2.9%, down from 3.3% at the start of the year.

The outlook for inflation

At the time of the July Monetary Policy Report, CPI inflation in the central projection was expected to remain below 3% in 2026 Q3 before rising to an average of 3.2% in 2026 Q4 and 2027 Q1. CPI inflation was then projected to fall back gradually towards

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[1] Figures based on the **new typical domestic electricity and gas consumption values** that apply from Q3.

the 2% inflation target over the remainder of 2027. That assessment was based on energy futures prices over the 15 UK working days up to 20 July.

Since the July Report, however, continued conflict in the Middle East has led to significant further rises in crude oil prices, the prices of refined products, and wholesale gas and electricity prices. Based on energy futures curves at close of business on 14th September, Bank staff's latest assessment is that inflation will rise to around 3¾% in 2026 Q4 and slightly above 4% in early 2027.

Almost all of the upside news since the July Monetary Policy Report reflects further direct impacts from energy prices, particularly household utility bills. Conditional on futures prices at 14th September, the Ofgem price cap is now expected to increase by 4% in Q4 and a further 24% in Q1, reflecting significant recent increases in gas and electricity futures prices. The temporary removal of VAT on household electricity bills from October will mitigate this impact, taking at least £45 off an average annual bill.

Indirect effects of higher energy prices via firms' supply chains have taken somewhat longer to come through than expected at the start of the conflict but are expected to build over the coming few quarters, adding around 0.6 percentage points to CPI inflation by 2027 Q1. This assessment is based on a range of models that incorporate energy costs in domestic and imported supply chains, as well as intelligence from the Bank's Agents and survey evidence.

What happens to inflation further ahead partly depends on whether the direct and indirect effects of higher energy prices lead to changes in wage and price-setting behaviour that will feed through into broad-based inflationary pressures. In the July Monetary Policy Report, the MPC set out a framework for monitoring these potential second-round effects (Box A) and its latest assessment of the evidence for them (Box B). While it is too soon to judge precisely the future scale of second-round effects, there has been little evidence so far to suggest large effects. The prevailing economic conditions during this energy shock are likely to reduce the strength of second-round effects. For example, there is judged to be a degree of spare capacity in the labour market, which may constrain workers' ability to secure higher nominal wage growth. The backdrop of relatively weak household demand should also reduce firms' ability to pass through cost increases fully into consumer prices. For example, in the August Decision Maker Panel survey, a net balance of 56% of firms expected their margins to fall because of the energy price shock. But it is early days and the risk of second-round effects is greater the longer higher energy prices persist.

In its July Report, the MPC considered two scenarios alongside the central projection which help to illustrate how, conditional on the market-implied path for interest rates at the time, the medium-term outlook for CPI inflation may depend on two key uncertainties: the scale, duration and propagation of the energy shock; and the extent to which it generates material second-round effects in price and wage-setting. In a milder scenario for energy prices and second-round effects, the path for inflation is lower throughout than in the central projection, while inflation rises significantly and persistently above the central projection in an adverse scenario in which the Brent crude oil price is around 30% higher on average and the wholesale gas price is around 60% higher than in the central case.

The policy action the Committee is taking in response

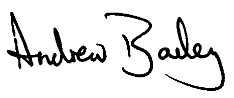
The MPC has statutory objectives to maintain price stability and, subject to that, to support the economic policy of the Government including its objectives for growth and employment as set out in its remit. The MPC sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain 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, however, 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 meeting ending on 16 September 2026, the Monetary Policy Committee (MPC) judged that it is appropriate to maintain Bank Rate at 3.75% at this meeting. The Committee stands ready to act as necessary to ensure that CPI inflation remains on track to meet the 2% target in the medium term.

Yours sincerely,



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