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

16 June 2022

Andrew Bailey, Governor,
The Bank of England,
Threadneedle street,
London,
EC2R 8HA

Dear Andrew,

CPI Inflation

Thank you for your letter of 16th June on behalf of the Monetary Policy Committee (MPC) regarding April's Consumer Prices Index (CPI) figure. The twelve-month measure of CPI inflation was 9.0% in April, which triggered the fourth consecutive exchange of open letters under the terms of the MPC remit. I recognise the impact that high inflation has on households and that it is challenging for households up and down the country to meet their living costs, which is why, as you outline, it is imperative to bring inflation back down to target and to keep it anchored there. I welcome that the Bank is prepared to take firm and decisive action to achieve this.

I agree with your assessment that higher inflation to date has been pushed up by global factors, including the process of exiting covid restrictions, recent lockdowns in China, and Russia's invasion of Ukraine. I also agree that the recent tightening in the labour market and rising cost pressures means that domestic factors are also playing a role and that inflationary pressures are becoming more broad-based. As you point out, it is particularly important to ensure that inflationary pressures in the labour market do not persist in the medium term. And I agree with your emphasis on the importance of ensuring that longer-term inflation expectations are anchored at the 2% target. I note your outlook for inflation and that you expect CPI to rise to around 11% in October this year, largely due to the projected increase in the household energy prices in October, but also due to rising food prices (including from price pressures related to Russia's invasion of Ukraine), and a tight labour market. I note that there are risks to your May MPR forecast, and that for the medium-term inflation projection they are skewed to the upside. I also note your assessment that there are different pressures in the Euro Area and the US, and that inflation in the UK may peak higher and last longer than elsewhere. This further emphasises the importance of the decisive action the Committee has taken and will take as necessary to return inflation to the 2% target sustainably in the medium-term.

I outlined the tools the government has to combat inflation in my Cost of Living Statement on the 26th May. These tools are independent monetary policy, fiscal responsibility, and supply side reform. Historically, the MPC have met the inflation target, with inflation averaging exactly 2% since independence. I retain full confidence in the Bank of England, and I know and expect that you and the other members of the MPC will take the action necessary to get inflation back on target and ensure inflation expectations remain firmly anchored. This includes your decisions to raise Bank Rate which has now reached 1.25%. You have begun to unwind the Asset Purchase Facility. You took the decision to cease reinvestment of maturing government bonds in February, and to begin sales of corporate bonds; you will set out a strategy for sales of government bonds at the August MPC meeting, and I will review the size of the APF indemnity every six months, in response.

The second tool is fiscal policy. Whilst monetary policy is rightly independent and our primary tool in fighting inflation, fiscal policy must be responsible and not exacerbate existing inflationary pressures. This is why, in responding to urgent cost of living pressures that people are facing, I announced a series of measures which are timely, targeted, and temporary to help households manage the squeeze on real incomes whilst not adding unnecessarily to inflation. As you noted in your letter, the policy measures we have announced are not expected to have a material impact on inflation. The Government also remains fully committed to our fiscal rules and is aware of the heightened importance of sticking to those rules in the macroeconomic context you describe.

The third tool is supply side reforms, to which we are taking an active approach. This will increase our productive capacity, ease inflationary pressures, and raise our long-term growth potential. The government's energy security strategy will, over time, reduce bills by increasing energy supply and improving energy efficiency, whilst we will continue to support more people into the job market, including high-skilled migrants from abroad through one of the most competitive visas in the world. In the autumn, we will bring forward tax cuts and reforms to encourage businesses to invest more, train more, and innovate more.

In conclusion, we have the tools and determination we need to reduce inflation and I am confident the Bank will play their part in making that happen.

I am copying this letter to the chair of the Treasury Committee and depositing it immediately in the libraries of both Houses of Parliament.

Best wishes,

RISHI SUNAK