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

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

22 June 2023

Dear Andrew,

CPI inflation

Thank you for your letter of 22 June on behalf of the Monetary Policy Committee (MPC) regarding May's Consumer Price Index (CPI) figure. The twelve-month measure of CPI inflation was 8.7% in May, which triggered an exchange of open letters under the terms of the MPC remit. This is the eighth consecutive exchange of letters regarding above target inflation and my third as Chancellor.

High inflation is the greatest immediate economic challenge that we must address. That is why the Government has made it a priority to halve inflation this year, on the path back to the target of 2% CPI. Our commitment to this target is iron-clad and it applies at all times. The Bank of England has my full support as you take action to return inflation to this target through your independent monetary policy decisions, in line with the primacy of price stability in the Government's monetary policy objective. Businesses and households should have confidence that the Government and the Bank of England understand the challenges they face from rising prices, and be in no doubt that we will act together to bring inflation under control.

Government is acting to support the Bank of England to return inflation to target. The IMF recently confirmed that we have taken "decisive and responsible" action to bear down on inflation, and achieved the right balance which aligns fiscal with monetary policy. The Spring Budget showed a gradual removal of fiscal support for the economy at a pace that is well matched to the strength of the economy in the medium term. As we focus on getting inflation down, we will continue to ensure that fiscal policy remains aligned to monetary policy by controlling public sector borrowing. This will require continued discipline on public spending and tax policy. Increased borrowing would add to inflationary pressures and risk prolonging higher inflation. It is also vital that medium-term fiscal policies, including public sector pay awards, be based on the expectation of full achievement of the inflation target.

Turning to your assessment, I agree that external factors continue to add significantly to inflationary pressures in the UK. I note that the rise in food prices is a global phenomenon, exacerbated by external factors including supply constraints caused by Russia's invasion of Ukraine. Annual inflation in food and non-alcoholic beverages prices was 18.3% in May. The Government understands that increasing prices, particularly for food, are placing challenges on households' ability to meet their living costs. We have provided significant, targeted cost of living support to disabled people, pensioners and those on means-tested benefits. I welcome your assessment that food prices are expected to ease in the near-term.

I note that the continued pass-through of costs to consumer prices may also be indicative of some rebuilding of profit margins. The Government is focusing on measures that help tackle increasing costs in the food sector, and we will continue to engage with the food supply chain on potential measures to ease the pressure on consumers. On energy, I welcome that the lower wholesale gas price futures curve will lead to a further fall in the direct contribution of energy prices to CPI inflation from October, in the Bank staff estimates. Next week, I will meet with regulators to discuss how we can make sure falls in input costs are passed onto consumers. I will discuss what action regulators are taking, and how we go further to reduce inflation and ease the impacts of the cost of living.

As you note domestic inflationary pressures remain elevated, reflecting indirect effects from past energy price increases as well as some second-round effects and factors that are more domestic. Though headline inflation has started to fall, core inflation is higher than it was in April, with core consumer goods having increased to 6.8%. I note your assessment that world export prices can account for a significant share of elevated core goods inflation. As you note, services inflation has also increased, to 7.4%, and annual private sector pay growth has picked up further. You have noted that the relative resilience of the economy and tightness in the labour market are reflected in elevated domestic inflationary pressures. This is why, at Spring Budget, I announced a labour markets package aimed at bringing parents, older workers, welfare claimants and the long-term sick and disabled back to the workforce. We will also continue to ensure public sector pay awards do not exacerbate inflationary pressures. I welcome your commitment to continue monitoring indications of persistent inflationary pressure in the system as a whole.

I acknowledge your assessment, that CPI inflation is expected to fall significantly further this year, with falls in energy prices expected to pull down on CPI inflation significantly towards the end of the year. Services inflation is expected to remain elevated in the near term, whilst core goods inflation will also remain elevated for some time.

Tackling inflation relentlessly must be the immediate priority. High growth needs businesses and investment and consumer confidence, none of those are possible with inflation. The

Government is focusing on policies which will strengthen the supply-side of the economy – supporting growth in a sustainable way.

I look forward to continuing to work closely with you in the coming months. I am copying this letter to the chair of the Treasury Committee and depositing it alongside your letter immediately in the library of both Houses of Parliament.

Best wishes,

Jeremy Hunt

RT HON JEREMY HUNT MP
Chancellor of the Exchequer