



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

17 August 2010

Mervyn King
Governor
The Bank of England
Threadneedle Street
London EC2R 8HA

Dear Mervyn

CPI INFLATION

Thank you for your letter of 16 August on behalf of the Monetary Policy Committee (MPC) regarding today's CPI inflation figure, written under the terms of the MPC's remit.

I am grateful for your explanation of recent inflation trends. As you point out, temporary factors – notably the January 2010 VAT rise, higher fuel prices and the past depreciation of sterling - continue to make a significant contribution to the current level of inflation, which at 3.1 per cent remains above the 2 per cent target. The MPC's remit allows it to look through short-term movements in inflation and I note the Committee's central view that inflation should continue to move back towards target over time. Likewise, I note the OBR forecasts that once the short-term effects of the VAT rate increase I announced in the June Budget have passed, CPI inflation is likely to fall back to a little under 2 per cent in early 2012.

As you note in your letter and in the August *Inflation Report*, there are significant uncertainties about the inflation outlook, with risks on both sides. I welcome the Committee's flexibility and commitment to move policy in either direction depending on how the outlook evolves. As you recognise in your recent Inflation Report, I believe the Government has played an important role in reducing some of the downside risks to the economy. My Budget in June set out a comprehensive set of policies to bring the public finances back under control, demonstrating the Government's determination to reduce public sector net borrowing and debt, promoting domestic and international confidence in the sustainability of the public finances. The Budget announced additional consolidation of £40 billion per year by 2014-15, including £32 billion per year from spending reductions.

I am copying this letter to the Chairman of the Treasury Select Committee and depositing this letter immediately in the libraries of both Houses and on the Treasury website.

Best wishes,
George

GEORGE OSBORNE