



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

12 May 2016

Mark Carney
Governor
The Bank of England
Threadneedle Street
London
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Dear Mark

CPI INFLATION

Thank you for your letter of 12 May on behalf of the Monetary Policy Committee (MPC) regarding March's CPI inflation figure, written under the terms of the MPC remit.

As you expected at the time of your February letter, inflation has remained below 1% in the past few months. I agree with your assessment that falling prices of food and energy and the past appreciation of sterling explain most of the deviation from target.

You make clear that the MPC continues to expect that inflation will pick up over the next year. Indeed, the MPC judges it more likely than not that Bank rate will need to be higher at the end of the forecast period in order to return inflation to the 2% target in a sustainable manner.

As you mention in your letter, the outcome of the EU referendum represents the most significant uncertainty in the UK economic outlook. It is my view that all the economic evidence available suggests that leaving the EU would do considerable and permanent damage to the UK economy. In April HM Treasury published an analysis of the long term impact of leaving the EU. The central estimate is that after 15 years outside of the EU Britain would be worse off by £4,300 per household per year.

As you point out in your letter, the EU referendum is already having an effect, and that uncertainty is beginning to weigh on economic activity. Your letter highlights the fact that sterling has fallen 9% since its November 2015 peak. Investment decisions are being postponed, consumers are holding back on purchasing decisions, and commercial real estate transactions fell by around 40% in Q1 2016.

The MPC's assessment is that a vote to leave the EU would mean both materially lower growth and notably higher inflation. Your letter acknowledges that "the MPC would face a trade-off

between stabilising inflation on the one hand and stabilising output and employment on the other.” So one choice would impose costs on families as higher inflation reduced real household incomes; the other choice would impose costs on families with a hit to the economy and to jobs. This is the kind of lose-lose situation that a vote to leave the EU creates. Either way, Britain would be poorer.

In these uncertain times clarity about our macroeconomic framework is vital. I confirm that the Government’s commitment to the current regime of flexible inflation targeting, with an operational target of 2% CPI inflation, remains absolute. The target is symmetric: deviations below the target are treated the same way as deviations above the target. Symmetric targets help to ensure that inflation expectations remain anchored and that monetary policy can play its role fully.

As set out in my previous letters, I welcome that the MPC remains vigilant to both upside and downside risks to its forecast and stands ready to act if these risks materialise, to ensure inflation remains likely to return to target in a timely fashion.

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

A handwritten signature in black ink that reads "George Osborne". The signature is written in a cursive, flowing style.

GEORGE OSBORNE