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REMIT FOR THE MONETARY POLICY COMMITTEE

The Bank of England Act (1998) requires that I specify what price stability is taken to consist of and the Government's economic policy objectives at least once in every period of 12 months beginning on the anniversary of the day the Act came into force.

I hereby re-confirm the inflation target as 2 per cent as measured by the 12-month increase in the Consumer Prices Index (CPI). The inflation target of 2 per cent applies at all times. This reflects the primacy of price stability and the inflation target in the UK monetary policy framework.

In accordance with the Act, I also confirm that the economic policy objective of Her Majesty's Government is to achieve strong, sustainable and balanced growth that is more evenly shared across the country and between industries.

The Government's commitment to medium-term price stability remains absolute. It represents an essential pre-requisite for economic prosperity.

The remit recognises that inflation will on occasion depart from its target as a result of shocks and disturbances. Attempts to keep inflation at the target in these circumstances may cause undesirable volatility in output. This reflects the short-term trade-offs that must be made between inflation and output variability in setting monetary policy. It therefore allows for a balanced approach to the objectives set out in the remit, while retaining the primacy of price stability and the inflation target.

In recent years, the economy has been hit by a series of shocks, some of which have been exceptionally large and with persistent effects. For example, the Office for Budget Responsibility and the International Monetary Fund forecast output in the UK to remain below its potential level for at least five years. Large shocks with persistent effects pose challenges for the setting and communicating of monetary policy and involve significant trade-offs. The remit clarifies the Government's expectations of the Committee in terms of the judgements it must make in setting and communicating policy in such exceptional circumstances.

As the Committee explained in its statement alongside its decision on 7 February 2013, CPI inflation is likely to rise further in the near term and may remain above the 2 per cent target for the next two years, in part reflecting a persistent inflationary impact from both administered and regulated prices and the recent decline in sterling. The Committee judged that as long as cost and price pressures remained consistent with inflation returning to the target in the medium term, it was appropriate to look through the temporary, albeit protracted, period of above-target inflation.

I confirm that the Committee's interpretation of the flexibilities provided by the remit is correct, and that these flexibilities are conditional on the Committee's judgement that the risks to meeting the 2 per cent inflation target in the medium term remain balanced. The Committee should remain vigilant to those risks to ensure that medium-term inflation expectations remain anchored. This represents an appropriately balanced approach to the Committee's objectives, while retaining the primacy of medium-term price stability and the inflation target.

Transparency plays an important role in communicating the trade-offs inherent in setting monetary policy. I welcome the Bank of England's response to the independent Stockton Review into the Monetary Policy Committee's forecasting capability, which was published this month.

Over the past year, reflecting the exceptional challenge facing monetary policy makers, there has been ongoing innovation by central banks around the world. The Bank of England, with the Treasury, has launched the Funding for Lending Scheme; the European Central Bank has introduced Outright Monetary Transactions; the US Federal Reserve has developed its forward guidance such that it is currently using state-contingent intermediate thresholds to influence expectations. The Committee has discussed a range of instruments, communicating that discussion through its minutes and the speeches of Committee members.

Monetary activism has a vital role to play in the Government's economic strategy as the Government delivers on its commitment to fiscal consolidation. Given the ongoing exceptional challenges facing the UK economy, it is possible the Committee may judge it necessary to deploy new unconventional policy instruments or approaches in future, including some of those deployed by other central banks in recent years. The remit clarifies that the development of new unconventional instruments should include consideration with Government of appropriate governance and accountability arrangements. It also requests that the Committee provide in its August 2013 Inflation Report an assessment of the merits of intermediate thresholds. I will respond to the general approach outlined by the Committee in its August Inflation Report confirming whether it is consistent with the Monetary Policy Committee's remit.

The new Financial Policy Committee will be established on a statutory basis this April. As a result the remit clarifies how the two committees should interact, and states that the Monetary Policy Committee should have regard to the policy actions of the Financial Policy Committee. I will recommend that the Financial Policy Committee mirrors this.

In setting this remit, the Government has reviewed the monetary policy framework in historical and international context, and the operation of monetary policy in a number of economies in recent years. That review is being published alongside the Budget. It provides further background on the changes that have been made in this remit and the absolute commitment to medium-term price stability that remains at its core. To ensure the UK's monetary policy framework remains at the forefront of international best practice, the Government will undertake a further review before the end of 2019.

A copy of the remit is attached.

Finally, I also confirm that the Asset Purchase Facility, created on 29 January 2009, will remain in place for the financial year 2013-14.

George Osborne.

GEORGE OSBORNE

REMIT FOR THE MONETARY POLICY COMMITTEE

The Bank of England Act came into effect on 1 June 1998. The Act states that in relation to monetary policy, the objectives of the Bank of England shall be:

a to maintain price stability; and

b subject to that, to support the economic policy of Her Majesty's Government, including its objectives for growth and employment.

In order to comply with the Act, this remit sets out what price stability shall be taken to consist of and what the economic policy of the Government shall be taken to be.

Price stability

I confirm that the operational target for monetary policy remains an inflation rate of 2 per cent, measured by the 12-month increase in the Consumer Prices Index. The inflation target of 2 per cent applies at all times. This reflects the primacy of price stability and the inflation target in the UK monetary policy framework.

The inflation target is forward-looking to ensure inflation expectations are firmly anchored in the medium term. The Government believes that low and stable medium-term inflation is an essential pre-requisite for economic prosperity.

The framework is based on the recognition that the actual inflation rate will on occasion depart from its target as a result of shocks and disturbances. Such factors will typically move inflation away from target temporarily. Attempts to keep inflation at the inflation target in these circumstances may cause undesirable volatility in output due to the short-term trade-offs involved, and the Committee may therefore wish to allow inflation to deviate from the target temporarily.

Circumstances may also arise in which attempts to keep inflation at the inflation target could exacerbate the development of imbalances that the Financial Policy Committee may judge to represent a potential risk to financial stability. The Financial Policy Committee's macro-prudential tools are the first line of defence against such risks, but in these circumstances the Committee may wish to allow inflation to deviate from the target temporarily, consistent with its need to have regard to the policy actions of the Financial Policy Committee.

In exceptional circumstances, shocks to the economy may be particularly large or the effects of shocks may persist over an extended period, or both. In such circumstances, the Committee is likely to be faced with more significant trade-offs between the speed with which it aims to bring inflation back to target and the consideration that should be placed on the variability of output.

In forming and communicating its judgements the Committee should promote understanding of the trade-offs inherent in setting monetary policy to meet a forward-looking inflation target while giving due consideration to output volatility. It should set out in its communication:

- the outlook for inflation and, if relevant, the reasons why inflation has moved away from the target or is expected to move away from the target;
- the policy action the Committee is taking in response;
- the horizon over which the Committee judges it is appropriate to return inflation to the target;

- the trade-off that has been made with regard to inflation and output variability in determining the scale and duration of any expected deviation of inflation from the target; and
- how this approach meets the Government's monetary policy objectives.

If inflation moves away from the target by more than 1 percentage point in either direction, I shall expect you to send an open letter to me, alongside the minutes of the Monetary Policy Committee meeting that followed the publication of the CPI data and referring as necessary to the Bank's latest Inflation Report and forecasts, covering the same considerations set out above. The reason for publishing this letter alongside the minutes is to allow the Committee time to form and communicate its strategy towards returning inflation to the target after consideration of the trade-offs. Given this, any future open letters should result in a more meaningful exchange between us about the Committee's strategy than has been possible before now.

You would send a further letter after three months, alongside the minutes of the third subsequent Monetary Policy Committee meeting, if inflation remained more than 1 percentage point above or below the target.

In keeping with the principles underpinning the monetary policy framework, and the practice followed in previous inflation open letter exchanges, I suggest that you copy your letters to the Chair of the Treasury Committee.

In responding to your letter and confirming whether an appropriate balance has been struck in the judgements the Committee has made, I shall, of course, have regard to the circumstances prevailing at the time.

The thresholds do not define a target range. Their function is to define the points at which I shall expect an explanatory letter from you because the actual inflation rate is appreciably away from its target.

Unconventional policy instruments

In the event of exceptional shocks that result in the Committee's conventional policy instrument having approached its effective lower bound, as has been the case since March 2009, the Committee may judge it necessary to deploy unconventional policy instruments in order to set monetary policy consistent with the requirements of this remit.

Where those instruments involve unconventional interventions in specific markets or activities, with implications for credit risk or credit allocation, I shall expect the Committee to work with the Government to ensure the appropriate governance arrangements are in place to ensure accountability in the deployment of such instruments. This was the case with the Bank of England and the Treasury in establishing the Asset Purchase Facility in 2009 and the Funding for Lending Scheme in 2012.

The Committee may also judge it to be appropriate to deploy explicit forward guidance including intermediate thresholds in order to influence expectations and thereby meet its objectives more effectively. This is likely to be most pertinent should the Committee judge spare capacity is likely to persist for a considerable period.

The Government considers any use of intermediate thresholds to be a matter subject to the Committee's operational independence in setting policy, to be considered in these exceptional circumstances. The Committee is requested to provide an assessment of such approaches to setting policy alongside its August 2013 Inflation Report. This assessment should consider the merits of the approach in general, and of specific indicators and thresholds.

Government's economic policy objectives

The Government's economic policy objective is to achieve strong, sustainable and balanced growth that is more evenly shared across the country and between industries. This objective recognises that over a number of years preceding the recent financial crisis, economic growth in the UK was driven by unsustainable levels of private sector debt and rising public sector debt. This pattern of unbalanced growth and excessive debt helped to create exceptional economic challenges in the UK.

The Government's economic strategy consists of four key pillars:

- monetary activism and credit easing, stimulating demand, maintaining price stability and supporting the flow of credit in the economy;
- deficit reduction, returning the public finances to a sustainable position and ensuring that fiscal credibility underpins low long-term interest rates;
- reform of the financial system, improving the regulatory framework to reduce risks to the taxpayer and build the resilience of the system; and
- a comprehensive package of structural reforms, rebalancing and strengthening the economy for the future, including an ambitious housing package and programme of infrastructure investment.

Accountability

The Monetary Policy Committee is accountable to the Government for the remit set out in this letter. The Committee's performance and procedures will be reviewed by the Oversight Committee of the Court on an ongoing basis (with particular regard to ensuring the Bank is collecting proper regional and sectoral information). The Bank will be accountable to Parliament through regular reports and evidence given to the Treasury Committee. Finally, through the publication of the minutes of the Monetary Policy Committee meetings and the Inflation Report, the Bank will be accountable to the public at large.

Restatement of the Remit

The inflation target will be confirmed in each Budget. There is a value in continuity and I will have proper regard to that. But I will also need to consider the case for a revised target at these times on its merits. Any changes to this remit will be set out in the Budget. The Budget will also contain a statement of the Government's economic policy objectives.

Coordination between monetary policy and macro-prudential policy

In order to foster coordination between monetary and macro-prudential policy, there is overlap between the membership of the Monetary Policy Committee and the Financial Policy Committee. To enhance that coordination, where appropriate, the Monetary Policy Committee should reflect, in any statements on its decisions, the minutes of its meetings and its Inflation Reports, how it has had regard to the policy actions of the Financial Policy Committee. In the same way, the Government will also ask the Financial Policy Committee to note in the records of its meetings, its policy statements and its Financial Stability Reports how it has had regard to the policy settings and forecasts of the Monetary Policy Committee.