



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

15 February 2011

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

Dear Mervyn

CPI INFLATION

Thank you for your letter of 14 February on behalf of the Monetary Policy Committee (MPC) regarding January's CPI inflation figure of 4.0 per cent, written under the terms of the MPC's remit.

I take note of your assessment that inflation in the next few months is expected to be appreciably higher than previously forecast, largely due to further pass through from global commodity and energy prices and that it will remain above target during 2011.

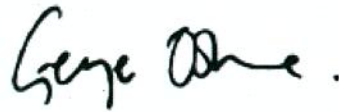
I also note, however, that the Committee continues to believe inflation will fall back in 2012, with equal chances it could be above or below target in the medium term under the assumption that Bank Rate increases in line with market expectations. I acknowledge the differing views of members of the Committee about the large risks in both directions to the medium-term inflation outlook. I welcome the Committee's determination to bring the risks back into balance when required to ensure inflation returns to target in the medium term.

For its part, the Government's commitment to delivering its fiscal consolidation plan continues to provide the MPC with the space it needs to target low inflation. In the current context, stepping back from our commitment to fiscal consolidation would make the MPC's job harder by putting further upwards pressure on inflation, and would risk prompting an offsetting monetary tightening such that overall there would be little if any net impact on demand.

The independent Office for Budget Responsibility's updated assessment of the outlook for inflation will be published at the Budget on 23rd March.

I recognise that commodity price rises have been a key driver of recent UK inflation. High and volatile commodity prices are also a global concern. That is why we are taking steps, including in the G20, to make commodity markets work better, ensure we have robust analysis of the drivers of prices, and tackle the longer term drivers of increased demand for energy and supply constraints in food markets.

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.

A handwritten signature in black ink, reading "George Osborne". The signature is written in a cursive style with a period at the end.

GEORGE OSBORNE