



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

7 August 2013

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#### MPC ASSESSMENT OF MONETARY POLICY TRADE-OFFS AND FORWARD GUIDANCE

Thank you for your letter setting out the Monetary Policy Committee's decision on 1 August 2013 to adopt forward guidance, with an intermediate threshold based on the unemployment rate, as an instrument of monetary policy. I support the decision.

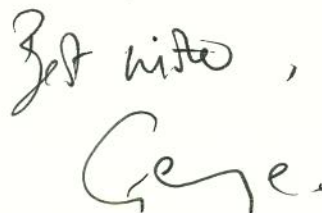
I have always been clear that monetary policy is a key element of the Government's macroeconomic strategy, supported by a credible commitment to necessary fiscal consolidation. In the remit I set for the MPC on 20 March 2013, I requested that, in forming and communicating its judgements, the Committee 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. I also clarified that the Committee may judge it appropriate to deploy explicit forward guidance including intermediate thresholds in order to influence expectations and thereby meet its objectives more effectively. I highlighted that this is likely to be most pertinent should the Committee judge spare capacity is likely to persist for a considerable period.

Today, in line with my request in the remit, I welcome the MPC's detailed assessment, "Monetary policy trade-offs and forward guidance", published alongside the August *Inflation Report*. I had stated in my cover letter to the remit that I would respond to the general approach, confirming whether it is consistent with the remit.

Given the exceptional economic challenges continuing to face the UK economy, I agree with you that forward guidance can play a useful role in enhancing the effectiveness of monetary policy and thereby supporting the recovery. I take note of the comprehensive arguments the MPC has set out for the choice of an unemployment threshold. I also note the Committee's important approach of allowing the threshold to be 'knocked out' if there are material risks to price stability or financial stability.

I can confirm that this approach is consistent with the remit set out at Budget, which allows for a balanced approach to the objectives of maintaining price stability and subject to that, to supporting the Government's economic policy. In particular, I confirm that the

MPC's decision is consistent with the Government's absolute commitment to medium-term price stability and the inflation target of 2 per cent which applies at all times. I welcome the MPC's view that the stance of monetary policy should not pose a significant threat to financial stability. This is consistent with the Government's requirement that the MPC and Financial Policy Committee have regard to each other's policy actions.

A handwritten signature in black ink, appearing to read 'George Osborne', written in a cursive style.

GEORGE OSBORNE