

Public attitudes to inflation

By Colin Ellis of the Bank's Inflation Report and Bulletin Division.

Over the past six and a half years, GfK NOP has carried out surveys of public attitudes to inflation on behalf of the Bank of England. As part of an annual series, this article analyses the results of the surveys from May 2005 to February 2006. Public perceptions of past and future inflation picked up recently, while most people thought interest rates had risen over the past year. Public understanding about the monetary policy framework remained limited, but people were generally satisfied with the way the Bank has been setting interest rates.

Introduction

In May 1997, the Government gave the Bank of England operational responsibility for setting interest rates to meet its inflation target. The Bank believes that monetary policy will be most effective if people understand and support the goal of price stability, as well as the use of interest rates to achieve it.

One of the ways the Bank monitors public support for price stability is via surveys of public opinion and awareness. Such a survey has now been published for five years: the survey is described in more detail in the box on page 182. And since 2001, each year there has been an article in the *Quarterly Bulletin* describing the survey results. This article describes the results from May 2005 to February 2006.

Economic conditions

The survey questions can loosely be divided into two sections: respondents' views on economic conditions, including recent and likely outturns for inflation and interest rates; and their general attitudes to monetary policy, covering the inflation target, interest rates, and the Bank's performance.⁽¹⁾ This section examines the survey responses on economic conditions.

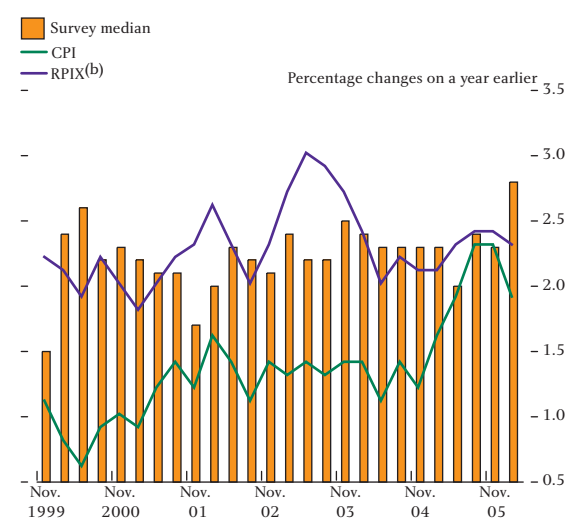
Inflation perceptions (Question 1)

Question 1 asks about people's perceptions of the current annual inflation rate — that is, how fast the prices of goods and services in the shops have risen over

the past year. However, the precise measure of inflation — for example the consumer prices index (CPI) or the retail prices index (RPI) — is not defined. Respondents are offered a range of responses, from falling prices to inflation of 5% or more.

The median⁽²⁾ view of the current annual rate of inflation was 2.8% in February 2006, the highest since the survey's inception (Chart 1). It also marks a notable rise since May 2005, when the typical respondent believed inflation was 2.0%, equal to the CPI inflation target. Although the proportion of respondents who thought inflation was between 2% and 3% was

Chart 1
Median survey and official estimates^(a)
of inflation



(a) Official estimates in the months before surveys.
(b) The RPI excluding mortgage interest payments.

(1) The precise wording of all the questions is shown in the annex. The data from the survey are available on the Bank's website at www.bankofengland.co.uk/statistics/nop/inflationattitudesfeb06b.xls.

(2) To calculate the median (a type of average), responses are assumed to be evenly distributed within bands, ie a response of 2% to 3% is assigned a value of 2.5%.

The Bank of England/GfK NOP survey on Inflation Attitudes

The Monetary Policy Committee (MPC) sets interest rates to hit the Government's inflation target. The nine members of the MPC use a variety of methods to explain their interest rate decisions, including speeches and lectures, and publications such as the *Inflation Report*. Bank staff also spend a considerable amount of time explaining monetary policy to a wide audience, for example through the annual 'Target Two Point Zero' competition for schools. These activities are designed to raise public awareness and support for monetary policy. But public support for price stability is hard to measure. As such, the Bank decided that one way to gauge it was to carry out quarterly surveys of public opinion and awareness.

The resulting survey on Inflation Attitudes was piloted in November 1999, and following trials was first published in February 2001. The survey covers 14 questions, the precise wording of which is shown in the annex.⁽¹⁾

The early trials showed that the results for five of the questions varied only a little from quarter to quarter. As a result, these questions are asked only once a year, in February. The questions ask about the relationship between interest rates and inflation, and who actually sets interest rates.

The nine other questions are asked every quarter, so they are also included in the annual survey. The questions cover views of past and future interest rates and inflation, the impact of inflation and interest rates on the economy and individuals, and how satisfied people are with the way the Bank of England is doing its job of setting interest rates to meet the inflation target. The quarterly surveys are carried out after the publication of the *Inflation Report* in February, May, August and November. The sample size for the quarterly surveys is around 2,000 people, roughly half the size of the annual February survey.

The February 2006 survey was carried out between 16 February and 14 March, as part of the regular GfK NOP Omnibus surveys. GfK NOP interviewed 3,939 people aged 15 and over in 350 districts throughout Great Britain. They use a random location sample designed to be representative of all adults in Great Britain, and interviewing is carried out face-to-face in homes. The raw data were then weighted to match the demographic profile of Great Britain as a whole — unless otherwise stated, these weighted data are the ones reported in this article.

(1) Since February 2004, the annual survey has included two extra parts to *Question 3*, asking respondents about the change in the inflation target made by the Chancellor of the Exchequer in December 2003.

unchanged, fewer people thought it was lower than 2%, and more thought it was higher than 3%. Most striking was the sharp rise in the proportion of people who thought that inflation was over 5% (Chart 2).

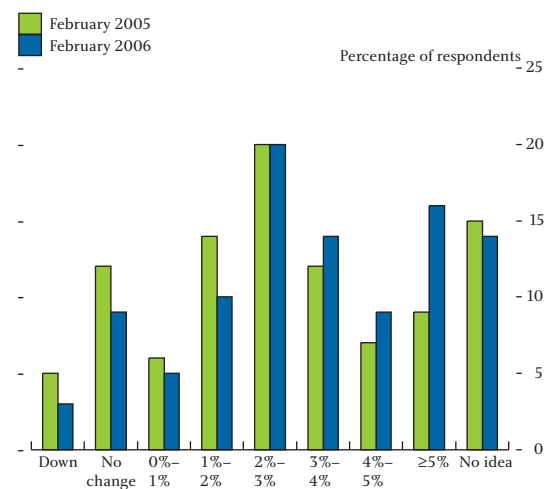
The change in respondents' views of past inflation is statistically significant — so it is unlikely to be caused by sampling fluctuations. Official estimates of inflation at the time of the February 2006 survey were higher than a year earlier. But the extent of these rises was relatively small, and in the past the match between official data and the survey responses has been imprecise at best (Chart 1). Although the question asks about prices in the shops, it could be that the 'headline'

announcement of rises in the prices of some goods and services, such as gas and electricity, have led people to believe that prices overall are rising at a faster rate than was previously the case.

As in previous years, responses varied across different demographic groups. The distribution of responses across those demographic groups is normally broadly unchanged from survey to survey, and the past year was no exception. In some groups the largest single proportion of people had 'no idea' about what inflation had been. These included 15–24 year olds and low-skilled workers and those living on benefits.⁽¹⁾ But in other instances, the largest proportion were those

(1) These are categorised as the 'DE' respondent class.

Chart 2
The distribution of price changes over the past twelve months



who thought inflation had been 5% or higher; these included people aged over 55, people earning between £9,500 and £17,499 a year, and respondents who left school before the age of 16.⁽¹⁾

Inflation expectations (Question 2)

The second survey question asks people about what they think inflation will be over the next twelve months. The median expectation for future inflation also picked up recently, reaching 2.7% in February 2006 — again, the highest outturn on record.

Since the survey began, respondents' expectations of future inflation have moved closely in line with their perceptions of past inflation (Chart 3). That correlation between past perceptions and future expectations is also evident in other surveys, such as the GfK NOP survey of consumer confidence (Chart 4).

The link between backward and forward-looking views can also be seen in the distribution of responses across the range of options offered to survey respondents (Chart 5) — although intriguingly 29% of those respondents who had 'no idea' about past inflation did hazard a guess at future inflation. At the same time, the range of responses across demographic groups was similar for the backward and forward-looking questions: for example, older respondents' perceptions of past inflation and expectations of future inflation tended to be higher than for younger people, and rose by more between the November 2005 and February 2006 surveys.

Chart 3
Median outturns and expectations of inflation

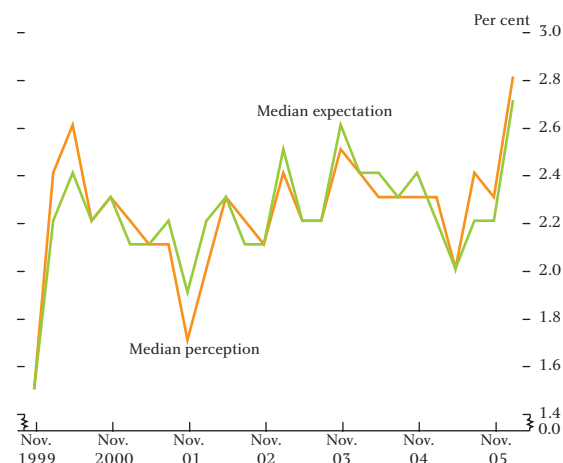
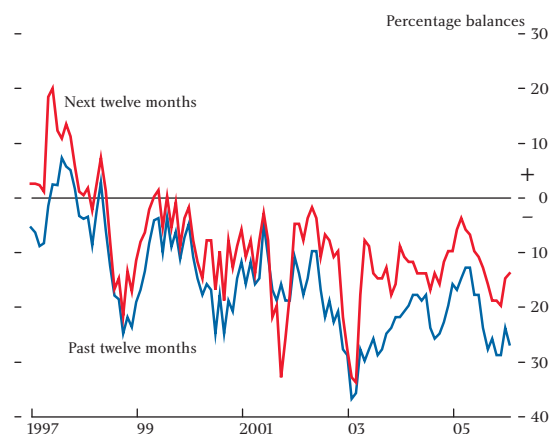
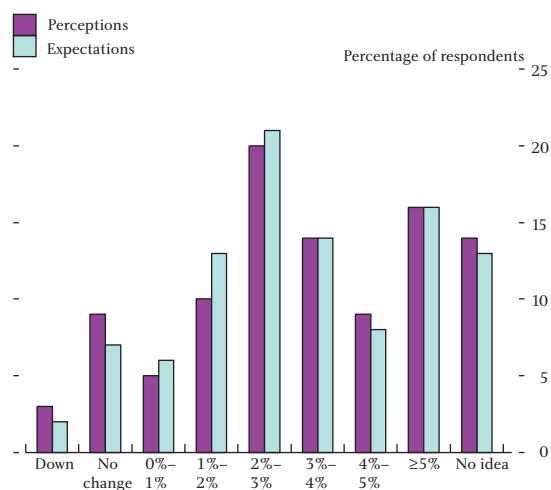


Chart 4
Households' perceptions about the general economic situation



Source: GfK NOP.

Chart 5
The distribution of price changes over the past and next twelve months^(a)



(a) From the February 2006 survey.

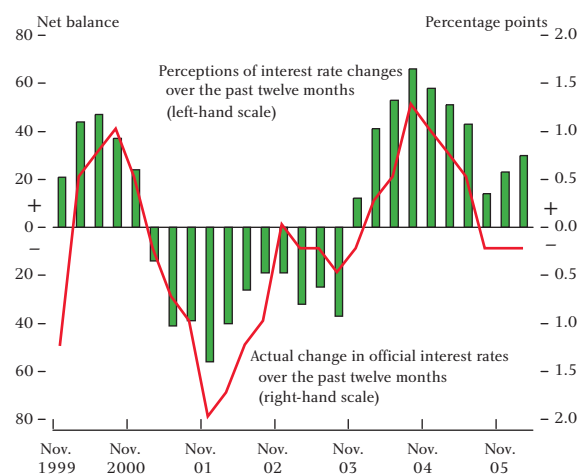
(1) Note that these demographic groups are overlapping, ie some of the over-55s left school before the age of 16.

We can also examine whether respondents tend to base their individual expectations on their own past perceptions, using the detailed breakdown from the Inflation Attitudes survey. The correlation between individuals' past perceptions and future expectations was 0.61 in the February 2006 survey, indicating a statistically significant relationship between respondents' forward and backward-looking responses. The same was also true for correlations of the median estimates (0.91, Chart 3) and the distribution of changes (0.97, Chart 5). The evidence is consistent with individuals forming expectations on the basis of their recent perceptions.

Interest rate perceptions and expectations (Questions 5 and 6)

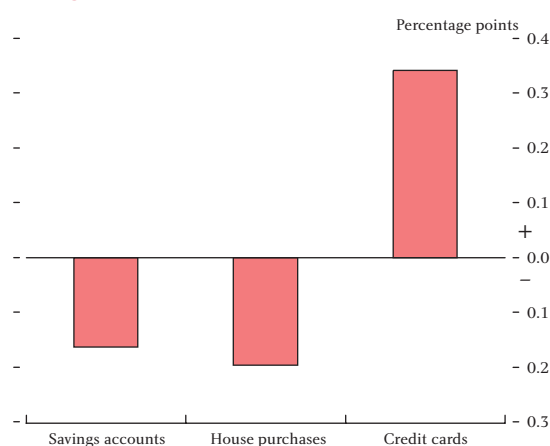
The survey also asks what people think has happened to interest rates over the past twelve months. In the past, people's perceptions have broadly matched the actual change in the Bank of England's official interest rate (Chart 6). But in the February 2006 survey, 41% of respondents thought rates had risen, and only 11% thought they had fallen; in fact, the Bank's official interest rate was 0.25 percentage points lower than in February 2005.

Chart 6 Perceptions of interest rates and actual changes in official rates



One reason for this divergence could be that respondents' views reflect their personal experience over the past year, based on interest rates on any savings, mortgages and loans they may have. These rates do not always move in line with official rates. Over the past year, the interest rates households receive on savings accounts, and pay on mortgages, have fallen on average. In contrast, the average rate they pay on credit card bills has risen (Chart 7).

Chart 7 Changes in effective interest rates^(a)



(a) Between February 2005 and February 2006. Effective interest rates are defined as the flow of interest payments divided by the stock of debt (savings). The savings account rate is for so-called time deposits, where savers are unable to access the entire savings balance without penalty within a day.

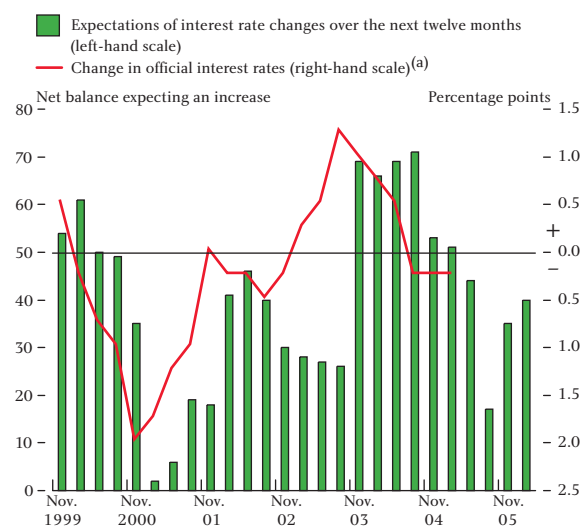
It is possible that people take relatively little notice of mortgage or savings rates, unless they are looking for a new account. But credit card rates may be more noticeable, for example if individuals transfer balances from existing cards to new providers offering attractive introductory offers. So, to the extent that credit card rates are more prevalent in individuals' minds than other interest rates, that could explain the perceived rise in rates. Similarly, more 15–24 year olds thought rates had risen than other age groups; these individuals are less likely to have mortgages or significant savings, but may hold credit cards. Across other demographic groups, those who put most weight on rates having risen included unskilled workers and council tenants.

Over the next year, 47% of respondents expected interest rates to rise, and 7% expected a fall. In past surveys, respondents have always expected rates to rise, even when official rates have subsequently fallen (Chart 8).

How do individuals' views on future changes in interest rates compare with their views on other future developments? The median expected inflation rate from the survey is positively correlated with the net balance of respondents expecting a rise in rates, although the relationship is weak. This could reflect individuals' beliefs that the Bank responds to higher inflation by raising rates.

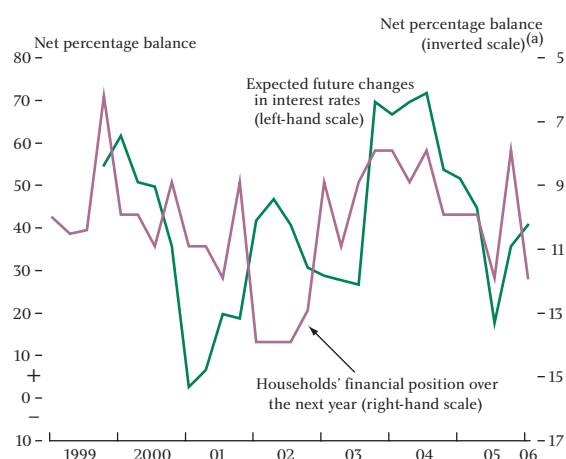
There is also a loose relationship between individuals' beliefs about future rate changes and their own financial situation. In particular, when more people expect rates

Chart 8
Expectations of future changes in interest rates and outturns



(a) Moved backwards twelve months, to correspond to the survey question.

Chart 9
Expectations of future changes in interest rates and households' financial situation



Sources: Bank of England and GfK NOP.

(a) The scale has been inverted so that a fall in the pink line reflects an improvement in households' expectations of their future financial situation. Data are shown for the same months as the Inflation Attitudes survey.

to rise, they also tend to be more pessimistic about the outlook for their own financial situation (Chart 9; the correlation between the two series is -0.36). When interest rates rise, some households (savers) will be better off, and others (borrowers) worse off. But the net impact for consumption is likely to be negative, as indebted households are likely to cut back on spending more than creditor households increase their spending. The relationship between expected changes in rates and households' own financial situation is consistent with this view that debtors are more affected by changes in interest rates than creditors.

General attitudes to monetary policy

The remainder of the survey questions cover individuals' attitudes to policy, including the role and performance of the Bank of England and the response of prices to changes in rates.

Inflation (Questions 3 and 4)

As in previous years, the majority of respondents thought that higher inflation had a negative impact on the economy. The proportion of people who thought this rose to 54% in February 2006, the highest on record and up from 48% a year earlier. And just 23% of respondents thought higher inflation would make little difference, down from 27% in February 2005.

Following the introduction of the new inflation target in December 2003, two extra parts to *Question 3* were added to the survey to monitor public awareness of the change. In February 2006, 22% of people identified that the target was between 1.5% and 2.5%, but almost half the respondents (47%) did not know what the target was. In addition, 29% of people correctly thought the inflation target was the same as last year — but another 29% thought it was higher than last year, and 33% had no idea. These data suggest that public awareness of the inflation target is still not widespread.

Question 4 asks people whether the target of 2% was too high or too low — as in previous years, the majority of respondents (56%) thought the target was 'about right'. Around one in ten people saw the current target as too low, and around one in five thought it was too high.

Interest rates (Questions 7 and 8)

The survey asks respondents what they think should happen to interest rates, from the perspective of what would be best for the economy, and what would be best for them personally. Based on their personal situation, the largest group (36%) of respondents would prefer interest rates to fall. That is consistent with the relationship between future rate changes and households' financial situation described earlier (Chart 9). Unsurprisingly, this tendency was particularly pronounced among mortgagors, 51% of whom would prefer a cut in rates. And 54% of all respondents aged 25–34 also preferred a cut. Recent evidence from the NMG Research survey suggests that 25–34 year olds are more likely to have unsecured debts than people from other age groups, and are generally also less likely

to have savings or investments:⁽¹⁾ together with moves in effective credit card rates (Chart 7) this could explain the high percentage of young people preferring a rate cut. Alternatively, these individuals may be keen to get on the housing ladder but are concerned about affordability — the median age of a first-time buyer was 29 at the end of 2005.⁽²⁾

The largest group of respondents thought that leaving rates unchanged would be best for the economy, although the distribution of responses was more skewed towards a cut in rates than a year ago (Chart 10). This shift meant that previous divergence in responses between what would be best for the economy and what would benefit respondents personally has now largely closed (Chart 11).

Inflation versus interest rates (Questions 9 and 10)

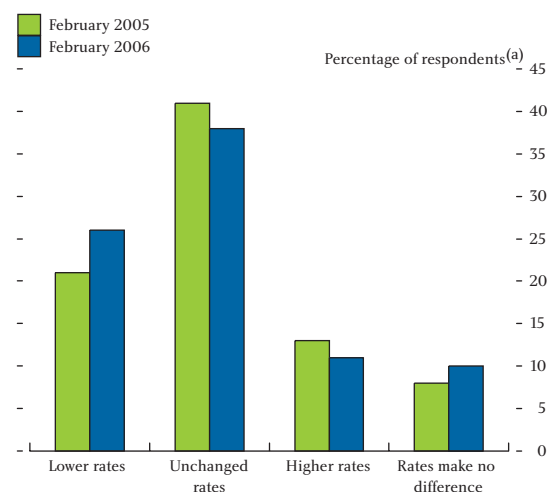
The survey also asks about how monetary policy works: in particular, the link between interest rates and inflation. As in previous surveys, the biggest proportion of respondents thought that a rise in interest rates would make high street prices rise more slowly, both over a month or two (37%) and over a year or two (40%). This suggests that respondents are still not aware of the timing delay between a change in rates and its impact on inflation: inflation would probably be unaffected by a rise in rates after a month or two, but would be lower a year or two later.

When asked to choose between higher interest rates to keep inflation under control, or lower rates and faster increases in shop prices, 57% of people preferred the former, up slightly from 55% in February 2005. Nineteen per cent of respondents preferred faster rises in prices, down from 25% last year. These changes could reflect unease at the recent sharp rises in utility bills and households' views of past and future inflation.

The Bank of England (Questions 11–14)

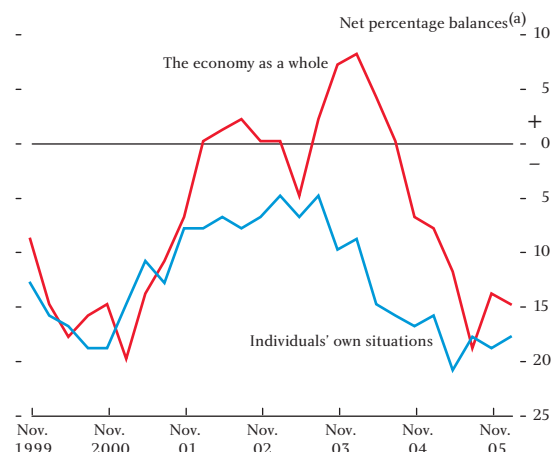
Understanding of the monetary policy process appears to have changed little over the past year. When asked, without prompting, who sets 'Britain's basic interest rate level' (Question 11), 36% replied the Bank of England, and a further 4% the Monetary Policy Committee: these proportions were similar to previous years. Similarly,

Chart 10
Respondents' views on what would be best for the economy as a whole



(a) Answers to the question 'What do you think would be best for the British economy?', excluding those with no idea.

Chart 11
Respondents' views on what would be best for interest rates



(a) Percentage citing an increase in rates minus that citing a fall.

over half the respondents (53%) replied 'don't know', broadly unchanged from previous years.

When respondents were given five options, 68% chose the Bank, 14% answered 'government ministers', and 12% had no idea. Overall, awareness of who sets interest rates has changed little since the survey started in 1999.

Knowledge of how the MPC is appointed was little changed in February 2006 compared with a year earlier; 37% answered that it was an independent body, partly appointed by the government, and 22% thought the

(1) See Barwell, May and Pezzini (2006), 'The distribution of assets, income and liabilities across UK households: results from the 2005 NMG Research survey', *Bank of England Quarterly Bulletin*, Spring, pages 35–44.

(2) See 'CML publishes data from the new regulated mortgage survey', Council of Mortgage Lenders Press Release on 15 February 2006.

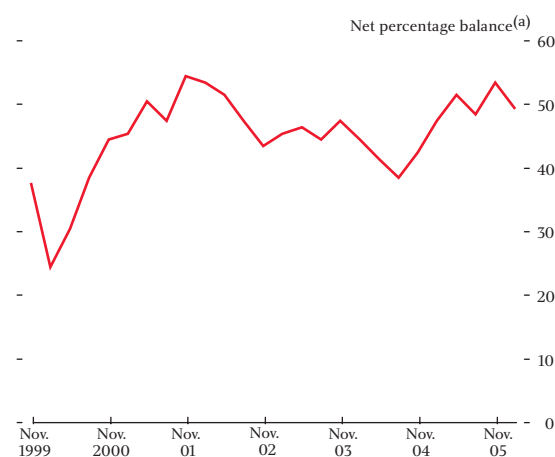
MPC was completely independent. Seventeen per cent had no idea, while 6% thought the MPC was a quango, wholly appointed by the government.

The final question in the survey asks participants whether they are satisfied with the way the Bank is doing its job. The proportion of satisfied responses was 57% in February 2006, broadly unchanged from February 2005 (56%). This continued the trend of the majority of individuals being satisfied with the Bank setting interest rates to control inflation (Chart 12). And within all demographic groups, the highest proportion of respondents was fairly satisfied with the Bank's performance.

Conclusion

The GfK NOP survey of public perceptions suggests that individuals' views on past and expected inflation have picked up recently. A majority believe that interest rates have risen over the past twelve months, perhaps reflecting the difference between the Bank's official interest rate and the interest rates households face. As ever, respondents expect interest rates to rise over the next year — there is some evidence that this is

Chart 12
Public satisfaction with the Bank of England



(a) Percentage of satisfied respondents minus percentage of dissatisfied respondents.

consistent with an expected worsening in their own financial situation. Public understanding of monetary policy is little changed from a year earlier, with a significant number of people being unfamiliar with the policy framework. But there is a general understanding that high inflation is bad for the economy, and people are satisfied with the way the job the Bank of England is doing.

Annex

Wording of questions in the Inflation Attitudes survey

Q1 I would like to ask you some questions about the prices we pay for goods and services ... which of the options on this card best describes how prices have changed over the last twelve months? (Show card)

Gone down / Not changed / Up by 1% or less / Up by 1% but less than 2% / Up by 2% but less than 3% / Up by 3% but less than 4% / Up by 4% but less than 5% / Up by 5% or more / No idea

Q2 And how much would you expect prices in the shops generally to change over the next twelve months? (Show card)

Gone down / Not changed / Up by 1% or less / Up by 1% but less than 2% / Up by 2% but less than 3% / Up by 3% but less than 4% / Up by 4% but less than 5% / Up by 5% or more / No idea

Q3A If prices started to rise faster than they are now, do you think Britain's economy would end up stronger, or weaker, or would it make little difference?

Q3B The Government sets a target each year for what it thinks inflation should be. What do you think that the target is for this year?

Q3C Do you think the figure the Government has given for the current target is higher, lower or the same as last year's figure?

Q4 The Government has set an inflation target of 2%. That means that prices generally should rise by around 2% a year. Do you think this target of 2% is too high, and that inflation should be less than 2%, or too low, and it wouldn't matter if inflation was higher than 2%, or is 2% about right?

Q5 I would now like to ask about interest rates. How would you say interest rates on things such as mortgages, bank loans and savings have changed over the last twelve months? Have they:

Risen a lot / Risen a little / Stayed about the same / Fallen a little / Or fallen a lot / No idea

Q6 And how do you expect interest rates to change over the next twelve months? Do you think they will:

Rise a lot / Rise a little / Stay about the same / Fall a little / Or fall a lot / No idea

Q7 What do you think would be best for the British economy — for interest rates to go up over the next few months, or to go down, or to stay where they are now, or would it make no difference either way?

Q8 And which would be best for you personally — for interest rates to go up over the next few months, or to go down, or to stay where they are now, or would it make no difference either way?

Q9 How strongly do you agree or disagree, using the phrases on this card, with the following statements? (Show card)

A rise in interest rates would make prices in the High Street rise more slowly in the short term — say a month or two

Strongly agree / Agree / Neither agree nor disagree / Disagree / Strongly disagree / Don't know

A rise in interest rates would make prices in the High Street rise more slowly in the medium term — say a year or two

Strongly agree / Agree / Neither agree nor disagree / Disagree / Strongly disagree / Don't know

Q10 If a choice had to be made either to raise interest rates to try to keep inflation down, or keep interest rates down and allow prices in the shops to rise faster, which would you prefer — interest rates to rise, or prices to rise faster?

Q11 Each month a group of people meets to set Britain's basic interest rate level, do you know what this group is?

Q12 Which of these groups do you think sets the interest rates? (Show card)

Government ministers / Civil servants / Bank of England / High street banks / European Central Bank / No idea

Q13 In fact the decisions are taken by the Monetary Policy Committee of the Bank of England. Which of these do you think best describes the Monetary Policy Committee? (Show card)

Part of the Government / A quango, wholly appointed by the Government / An independent body, partly appointed by the Government / A completely independent body / No idea

Q14 Overall, how satisfied or dissatisfied are you with the way the Bank of England is doing its job to set interest rates in order to control inflation? (Show card)

Very satisfied / Fairly satisfied / Neither satisfied nor dissatisfied / Fairly dissatisfied / Very dissatisfied / No idea