Public attitudes to monetary policy

By Lewis Kirkham of the Bank's Monetary Assessment and Strategy Division.[1]

- Satisfaction with the way the Bank sets interest rates in order to control inflation has picked up in the past year to the highest level since 2007, according to the latest Bank/GfK NOP surveys. This is likely to reflect falls in households' perceptions of inflation, as well as the general improvement in the economic outlook.
- Households expect increases in Bank Rate to be gradual, which seems consistent with recent guidance from the Monetary Policy Committee.
- Over the past year public awareness of the monetary policy framework has remained unchanged and public support for the inflation target has remained strong.

Overview

The Bank is committed to building public understanding of, and support for, the monetary policy framework. Indeed, the Bank uses a variety of methods to explain to the public the Monetary Policy Committee's (MPC's) role of setting monetary policy to meet the 2% inflation target. This article examines the latest results from the Bank/GfK NOP survey concerning households' awareness of, and support for, the monetary policy framework, and their satisfaction with the way the Bank is conducting monetary policy.

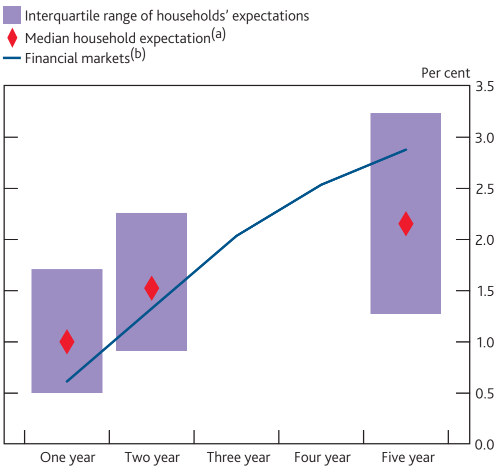
Results from the latest surveys indicate that over the past year public awareness of the policy framework has remained unchanged. And across a range of survey questions, there is evidence that public support for the Bank's objective of maintaining low and stable inflation remains strong.

The largest group of households thought that interest rates had stayed about the same over the past year. Following the MPC's announcement of 'forward guidance' in August 2013, the proportion of households expecting interest rates to stay about the same over the following twelve months reached a series high. Since then, as GDP growth has strengthened and the unemployment rate has fallen sharply, there has been an increase in the proportion of households expecting interest rates to rise.

Responses to a new question showed that households do not expect a large increase in Bank Rate in the near term. Looking further ahead, households, on average, expected increases in Bank Rate to be gradual (**summary chart**), which seems consistent with recent guidance from the MPC.

Satisfaction with the way the Bank sets interest rates in order to control inflation has picked up in the past year to its highest level since 2007. This is likely to reflect falls in households' perceptions of inflation, as well as the general improvement in the economic outlook. Satisfaction with the Bank remains a little lower than during the pre-crisis period.

Summary chart Indicators of Bank Rate expectations



Sources: Bank/GfK NOP survey and Bloomberg.

(a) Median household response to the question: 'The level of interest rates set by the Bank of England (Bank Rate) is currently 0.5%. At what level do you expect that interest rate to be in one, two and five years' time?'. Households were not given the option to answer 'no idea'.
(b) Forward curve estimated using overnight index swap rates over the period from 6 February to 18 February 2014. This is the period over which the household survey was conducted.

(1) The author would like to thank Alistair Strathern for his help in producing this article.

The Bank of England's mission is to promote the good of the people of the United Kingdom by maintaining monetary and financial stability. Monetary stability is defined by the Government's inflation target, which is currently 2% as measured by the annual change in the consumer prices index (CPI). Subject to that, the Bank is also tasked with supporting the Government's economic objectives, including those for growth and employment.

The Monetary Policy Committee (MPC) has historically sought to achieve its objectives by setting the level of Bank Rate. In response to the financial crisis and the subsequent period of weak demand, a number of 'unconventional' policies have also been implemented in order to meet these objectives. In March 2009, the MPC began a programme of asset purchases, financed through the issuance of central bank reserves, commonly referred to as quantitative easing (QE).(1)

In August 2013, the MPC provided 'forward guidance' about the future path of monetary policy, stating its intention not to raise Bank Rate at least until the unemployment rate fell to a threshold of 7%, provided this did not entail material risks to either price or financial stability.(2) Since then, unemployment has fallen sharply, ahead of the expectations of the MPC and other professional forecasters, as the recovery has gained momentum. The 7% unemployment threshold was reached in data for the three months to February 2014.

Prior to the release of these data, the MPC used its February *Inflation Report* to provide further guidance on the setting of monetary policy as the economy recovers.(3) The MPC noted that when Bank Rate does begin to rise, it is expected to do so only gradually. Moreover, Bank Rate is expected to remain below average historical levels for some time to come. In the May 2014 *Inflation Report* the MPC reaffirmed that guidance.

The Bank is committed to building public understanding of, and support for, the monetary policy framework.(4) The Bank's success in meeting its objective of price stability will depend, in part, on this. If people understand the MPC's objective, then they may behave in such a way that deviations of inflation from target are more short-lived: households, for example, may moderate their wage demands and companies may be less likely to raise prices in response to higher costs.(5) Furthermore, it is important for the Bank to maintain public trust and confidence in order for it to fulfil successfully all of its different policy functions.

The Bank uses a variety of methods to explain to the public the MPC's role of setting monetary policy to meet the inflation target. For example, in addition to its quarterly *Inflation Report*, the Bank also publishes the minutes of the MPC's monthly meetings and articles that explain some of the key concepts relevant for understanding the setting and transmission of monetary policy; MPC members give speeches, lectures, press conferences and interviews, and make appearances before the Treasury Select Committee; and a number of social media channels are used in order to reach a range of audiences. In addition, the Bank's twelve regional agencies hold regular meetings with businesses throughout the United Kingdom, and the Bank has an education programme that includes the 'Target Two Point Zero' competition for schools and colleges.

The Bank has sought to quantify the impact of its efforts to increase the public's understanding of, and support for, the monetary policy framework. Since 1999, the Bank has commissioned GfK NOP to conduct a quarterly survey of households' attitudes to inflation and monetary policy on its behalf.(6) Around 2,000 households from across the United Kingdom are surveyed each quarter, with a larger sample of around 4,000 households used in the February survey each year.(7) This article, the latest in a series published in Q2 of each year, draws on the results from the latest surveys to assess the public's awareness of monetary policy and their satisfaction with the way in which the Bank has set monetary policy to control inflation.

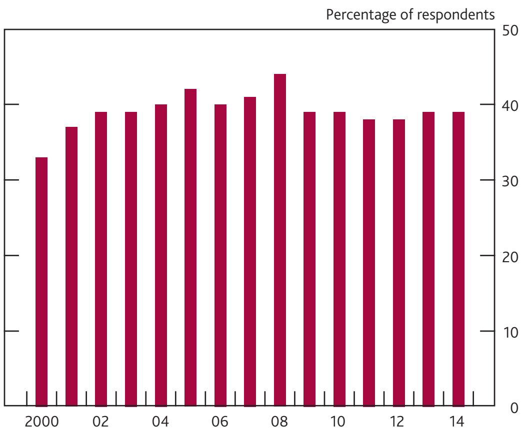
Public awareness of monetary policy

Public awareness of the monetary policy framework has remained broadly constant over the past year at a similar level to previous surveys. In the February 2014 survey, 39% of survey respondents were able to name, unprompted, the MPC or the Bank of England as the group that sets the level of the United Kingdom's basic interest rate. This result is very similar to past surveys (**Chart 1**). When asked to choose from a list, 65% of respondents selected the Bank of England as the group that sets interest rates, rather than government ministers, high street banks, civil servants or the European Central Bank. This was also in line with recent surveys, although a little below the series average of 67%.

The Bank/GfK NOP survey monitors the level of understanding among households of the way in which monetary policy affects inflation — the transmission mechanism of monetary

(1) For further discussion of QE, see Joyce, M, Tong, M and Woods, R (2011), 'The United Kingdom's quantitative easing policy: design, operation and impact', *Bank of England Quarterly Bulletin*, Vol. 51, No. 3, pages 200–12, available at www.bankofengland.co.uk/publications/Documents/quarterlybulletin/qb110301.pdf.
(2) For more information, see *Monetary policy trade-offs and forward guidance*, available at www.bankofengland.co.uk/publications/Documents/inflationreport/2013/ir13augforwardguidance.pdf.
(3) For more information, see 'Monetary policy as the economy recovers', available at www.bankofengland.co.uk/publications/Documents/inflationreport/2014/ir14febeconrec.pdf.
(4) In March the Bank announced its Strategic Plan which included an initiative to 'work to deliver a strategy for building public understanding and a constituency for maintaining monetary and financial stability'. For more information, see www.bankofengland.co.uk/about/Documents/pdfs/stratplanback.pdf.
(5) For more information on inflation expectations, see 'Assessing the risk to inflation from inflation expectations' in this edition of the *Bulletin*.
(6) Data from the survey are available on the Bank's website at www.bankofengland.co.uk/publications/Pages/other/nop.aspx. The spreadsheets show the precise wording of the questions.
(7) Some questions are asked only once a year, in February. Other questions are asked in each quarterly survey, so data from May 2014 are available.

Chart 1 Indicator of public awareness of the monetary policy framework[(a)]



Source: Bank/GfK NOP survey.

(a) Percentage of respondents answering that either the Bank or the MPC set Britain's basic interest rate level. From 2001, this question was only asked in the Q1 survey.

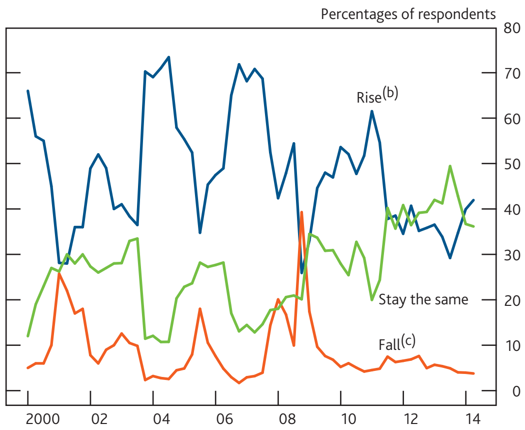
policy. Economists generally believe that a rise in Bank Rate would tend to push down inflation one or two years ahead, since higher interest rates would reduce demand in the economy, thus weakening companies' ability to charge higher prices. That view was shared by 32% of respondents to the February 2014 survey, who either agreed or strongly agreed with the statement that 'a rise in interest rates would make prices in the high street rise more slowly in the medium term — say a year or two'. This is below the series average of 38%.

Across a range of survey questions, there is evidence that public support for the Bank's objective of maintaining low and stable inflation remains strong. Respondents are asked whether they think the inflation target of 2.0% is too low or too high. In May 2014, 53% of respondents thought that the target was 'about right', which is equal to the series average. That is materially above the 19% of respondents who thought the target was too high, and the 12% who thought it was too low. Households are also asked whether, if a choice had to be made, they would prefer to raise interest rates to keep inflation down, or keep interest rates down and allow prices to rise faster. In February 2014, 58% of households preferred to keep inflation down via higher interest rates, while only 14% preferred to keep interest rates low and accept higher inflation.

Respondents to the Bank/GfK NOP survey are asked how they think interest rates on things like mortgages, bank loans and savings have changed over the preceding twelve months. Over the past year, the largest group of households (43% on average) thought that interest rates had stayed about the same — well above the series average (22%). This probably reflects the fact that Bank Rate has remained unchanged, and that the average interest rates paid on households' outstanding deposits and loans have fallen only slightly.

Households' expectations for interest rates have varied somewhat in recent surveys. In August 2013, 49% of respondents reported that they expected rates to stay about the same over the next twelve months, a series high (**Chart 2**). That survey was conducted shortly after the MPC announced 'forward guidance', which may have affected some households' view of the likely timing of future increases in Bank Rate.[(1)] In more recent surveys there has been an increase in the proportion of households expecting interest rates to rise. This is likely to reflect the strengthening of the economic recovery. For example, annual GDP growth increased in the second half of 2013, while unemployment fell sharply. Even so, the proportion of households expecting higher interest rates over the next twelve months in May 2014 — 42% of households — was lower than during the period in 2010 and early 2011 when GDP was recovering from the 2008/09 recession.

Chart 2 Interest rate expectations over the next twelve months[(a)]



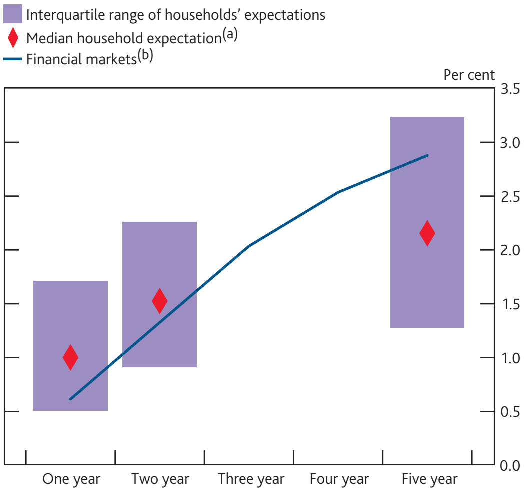
Source: Bank/GfK NOP survey.

(a) Respondents who answered 'no idea' are not shown on the chart. On average, around 15% of respondents answer in this way.
(b) Percentage of respondents who thought that interest rates would rise 'a lot' or 'a little'.
(c) Percentage of respondents who thought that interest rates would fall 'a lot' or 'a little'.

A new question was included in the February 2014 survey, asking households for their expectations for the level of Bank Rate, the interest rate set by the Bank of England. This is distinct from other questions in the survey that ask about 'interest rates on things like mortgages, bank loans and savings' which are offered by commercial banks. Changes in Bank Rate ordinarily feed through to changes in interest rates offered by banks, although banks also take into account a number of other factors when pricing loans and deposits.[(2)] Responses showed that households do not expect a large increase in Bank Rate in the near term from its current level of 0.5%. Half of the respondents expected Bank Rate to lie

(1) A box on page 12 of the February 2014 *Inflation Report* summarises surveys of households' and businesses' responses to 'forward guidance'.
(2) For an explanation of how banks price new loans, see Button, R, Pezzini, S and Rossiter, N (2010), 'Understanding the price of new lending to households', *Bank of England Quarterly Bulletin*, Vol. 50, No. 3, pages 172–82, available at www.bankofengland.co.uk/publications/Documents/quarterlybulletin/qb100301.pdf.

Chart 3 Indicators of Bank Rate expectations



Sources: Bank/GfK NOP survey and Bloomberg.

(a) Median household response to the question: 'The level of interest rates set by the Bank of England (Bank Rate) is currently 0.5%. At what level do you expect that interest rate to be in one, two and five years' time?'. Households were not given the option to answer 'no idea'.
(b) Forward curve estimated using overnight index swap rates over the period from 6 February to 18 February 2014. This is the period over which the household survey was conducted.

between 0% and 1% in one year's time. The median expectation in one year's time was 1% (**Chart 3**).

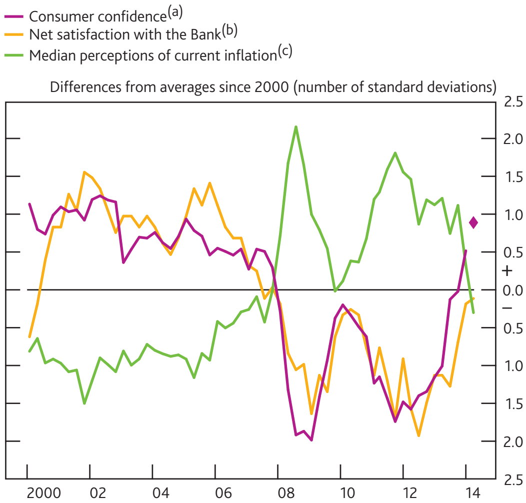
Looking further ahead, households, on average, expected increases in Bank Rate to be gradual. The median expectation for Bank Rate in two years' time was 1.5%. This seems consistent with recent guidance from the MPC. In the February 2014 *Inflation Report*, the MPC provided guidance that when Bank Rate does begin to rise, the appropriate path over the next two to three years is expected to be gradual. And even when the economy has returned to a more normal state, the appropriate level of Bank Rate is likely to be materially below the 5% level set on average prior to the financial crisis.

Households' Bank Rate expectations at the one and two-year horizon were similar to the mean expectation of financial market participants from the time of the February survey, as implied by the forward overnight index swap curve (blue line in **Chart 3**).[1] At the five-year horizon, where the outlook for Bank Rate is more uncertain, households' expectations were a little lower than those of financial market participants.

Satisfaction with monetary policy at the Bank of England

The Bank/GfK NOP survey asks respondents how satisfied or dissatisfied they are with the way the Bank is doing its job to set interest rates in order to control inflation. Over the past year, 'net satisfaction' — the difference between those fairly or very satisfied, and those fairly or very dissatisfied — has picked up (**Chart 4**). In the May 2014 survey, net satisfaction was 31%, the highest balance recorded since 2007, and only marginally below its series average. But it remains a little lower than during the pre-crisis period.

Chart 4 Satisfaction with the Bank, inflation perceptions and consumer confidence



Sources: Bank/GfK NOP survey and research carried out by GfK NOP on behalf of the European Commission.

(a) The aggregate consumer confidence index is derived by averaging the answers to questions 1, 2, 3, 4 and 8 in the GfK NOP survey carried out on behalf of the European Commission. This chart shows quarterly averages of monthly data. The diamond is an average of the April and May observations.
(b) The percentage of respondents who were fairly or very satisfied with the way in which the Bank of England is doing its job to set interest rates in order to control inflation, less the percentage who were fairly or very dissatisfied. Data are to 2014 Q2.
(c) Respondents were asked how they thought prices had changed over the past twelve months. Data are to 2014 Q2.

Households' satisfaction with the Bank has tended to be lower when their perceptions of the current rate of inflation have been higher (**Chart 4**). Since the financial crisis, higher than average inflation perceptions have coincided with lower net satisfaction. But over the past year households' perceptions of inflation have fallen and net satisfaction has picked up. The fall in inflation perceptions is likely to partly reflect falls in measured CPI inflation, which has declined and currently lies a little below the 2% target. The MPC's latest forecast for inflation is set out in the May 2014 *Inflation Report*.

The pickup in satisfaction with the Bank is also likely to reflect the improvement in the economic outlook more generally. Survey measures of consumer confidence have recently reached their highest levels since the financial crisis. These measures are closely correlated with satisfaction with the Bank (**Chart 4**).

(1) Measures of financial market participants' median expectations are a little lower than the corresponding mean measures.