M&G YouGov Inflation Expectations Survey

Q4 2015

The M&G YouGov Inflation Expectations Survey for the fourth quarter of 2015 was carried out from 25 November to 3 December with a sample size of 9,158 consumers across the UK, Europe and Asia. The latest set of results show that UK consumer inflation expectations have edged down over both the short and long term. Within Europe, we find that inflation expectations have broadly stabilised across most countries, although lower levels are observed amongst Swiss and Spanish consumers. In Asia, Singapore expectations ticked down over one and five-year periods.

Whilst the general public's concern for inflation has inevitably receded, we find that central bank credibility remains elevated in the UK, Asia, and most European countries.

Chart 1

Inflation expectations 1 year ahead (%)

	UK	France	Germany	Austria	Italy	Spain	Switzerland	Hong Kong	Singapore
Feb 13	3.0	2.5	2.5		3.0	3.3	1.2	5.0	4.6
May 13	2.7	2.0	2.2	2.8	3.0	3.0	1.5	5.0	4.0
Aug 13	3.0	2.0	2.3	3.0	3.0	2.8	1.4	5.0	3.7
Nov 13	2.8	2.0	2.1	2.3	2.5	2.0	1.2	5.0	4.0
Feb 14	2.0	2.0	2.3	2.0	2.0	2.0	1.2	4.6	3.4
May 14	2.3	2.0	2.0	2.3	2.0	2.0	1.1	4.6	3.6
Aug 14	2.2	1.0	2.0	2.3	2.0	2.0	1.3	4.0	3.5
Nov 14	2.0	1.5	2.0	2.0	2.0	1.8	1.2	4.7	3.0
Feb 15	1.5	1.3	1.9	2.0	2.0	2.0	1.0	4.0	3.0
May 15	1.2	1.2	2.0	2.0	2.0	1.5	1.2	5.0	3.0
Aug 15	1.5	1.1	2.0	2.0	2.0	1.6	1.3	4.0	3.1
Nov 15	1.0	1.5	2.0	2.0	2.0	1.5	1.0	4.0	3.0

Inflation expectations 5 years ahead (%)

	UK	France	Germany	Austria	Italy	Spain	Switzerland	Hong Kong	Singapore
Feb 13	3.0	4.0	3.5		3.3	4.0	2.5	5.0	5.0
May 13	3.0	3.0	3.0	3.0	3.0	3.0	2.6	5.8	5.0
Aug 13	3.0	3.0	3.3	3.5	3.3	3.1	2.8	5.0	5.0
Nov 13	3.0	3.0	3.0	3.0	3.0	2.5	2.5	5.5	5.0
Feb 14	3.0	2.5	3.0	3.0	2.5	2.5	2.5	5.0	5.0
May 14	3.0	3.0	3.0	3.2	3.0	3.0	2.5	5.4	5.0
Aug 14	3.0	2.0	3.0	3.0	2.5	3.0	2.2	5.0	4.6
Nov 14	3.0	2.5	3.0	3.0	3.0	2.5	2.5	5.0	5.0
Feb 15	3.0	2.0	3.0	3.0	2.5	2.8	2.0	5.0	4.5
May 15	2.5	2.0	3.0	3.0	2.5	2.5	2.6	5.0	4.0
Aug 15	2.6	2.2	3.0	3.0	2.5	2.5	2.5	5.0	4.5
Nov 15	2.5	3.0	3.0	3.0	2.5	2.2	2.0	5.0	4.0

The inflation figures in this report reference the Harmonised Index of Consumer Prices/Consumer Prices Index as at the end of October 2015.
Source: Bloomberg, 01.12.15.

M&G INVESTMENTS

M&G YouGov Inflation Expectations Survey

United Kingdom

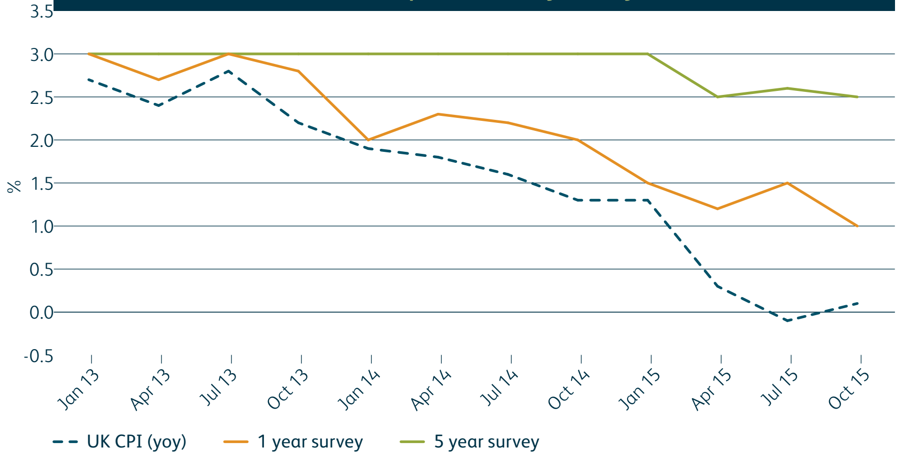
Inflation expectations in the UK have moderately fallen in the fourth quarter of 2015. The median consumer expectation of inflation for the year ahead has declined from 1.5% to 1.0%, the lowest since the inception of our survey. Over five years, expectations have slid by -0.1% to 2.5%. Interestingly, the average inflation gauge for the five-year period in the London area is now at 2%, down from 3% last quarter and below the national average for the first time since the inception of the M&G YouGov Inflation Expectations Survey.

Over the course of the year, UK inflation has been softer than expected with headline CPI close to zero primarily due to a further downshift in oil prices from June to August this year. At the core level, the appreciation of trade-weighted sterling over 2015 has also likely acted as a drag on core goods and domestic inflation pressures.

Against this backdrop, we find that short-term consumer inflation expectations have unsurprisingly shifted downwards, although it is interesting to note how their correlation to realised inflation appears to have weakened. Chart 2 shows how one-year ahead median household expectations have remained above the 1% level, despite the low inflation outcomes of recent months.

Chart 2

UK CPI vs consumer inflation expectations (1y and 5y)



UK inflation expectations have moderately slipped…

We are probably at a low point for UK CPI/RPI readings. I suspect that 2016 will bring low but positive inflation in the UK. Base effects should kick in from February and are expected to add circa 50-70bps to the headline print. Core inflation will continue to rise – albeit more slowly – on the back of a strong UK domestic economy.

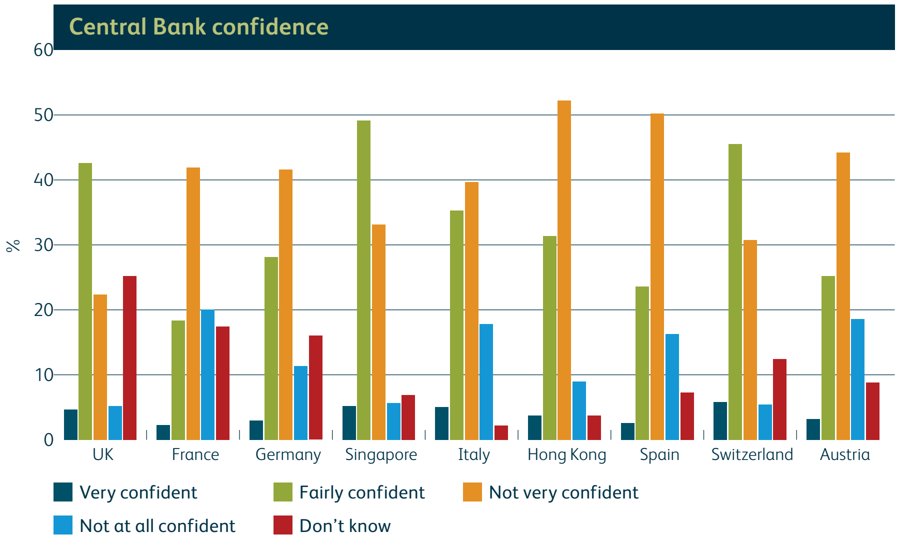
Jim Leaviss, Fund Manager

…although sensitivity to realised inflation appears to have diminished over time.

Confidence in the Bank of England’s mandate to ensure price stability remains firmly in place. Today, almost one in every two UK respondents (47%) are either “very” or “fairly confident” that the Bank will deliver on its inflation target over the medium term (Chart 3). Furthermore, only 1% of British households expect the economy to slip back into deflation in 2016, with a vast majority (c. 40%) of respondents expecting UK inflation to return to a 1%-2% range over the next 12 months.

Confidence in the Bank of England remains elevated.

Chart 3



Expectations for net income in the UK have taken a positive shift in recent months. Our survey finds that 22% of UK consumers expect a rise in take home pay over one year. Subdued inflation and falling energy prices have boosted real incomes and household purchasing power through much of 2015. Real wages have been rising at their fastest rate since before the financial crisis as the UK labour market approaches full employment. Labour income is often seen as an important driver of inflation in an economy, particularly so for one that relies heavily on services such as the UK.

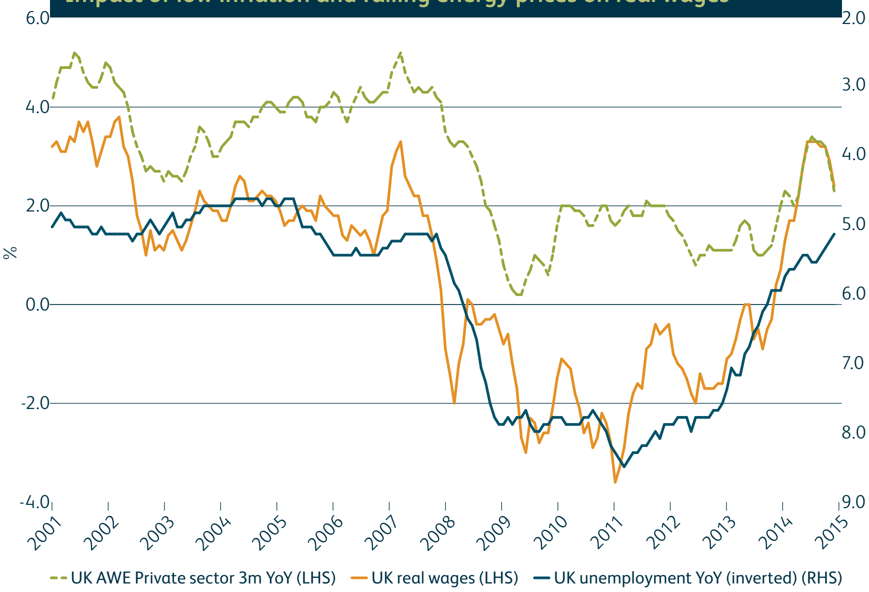
For the first time in many years, we are seeing a unanimous uptick in wage data in the UK labour market. There are also signs that momentum is building. Three-month annualised data shows wages growing at more than 4% and employee surveys – which tend to be forward-looking and good lead indicators – point to further acceleration. The UK labour market is tightening and with skilled labour in short supply, companies will need to keep paying more for the right candidates. Given that wage cycles typically last for 3-5 years, I think rising wages are likely to have a positive impact on CPI over the next few years.

Ben Lord, Fund Manager

Expectations for future net income shifting upwards.

Chart 4

Impact of low inflation and falling energy prices on real wages



Source: Bloomberg, October 2015.

Minimum levels of oil such that the base effects remain supportive

	US (USD/bbl)	UK (USD/bbl)	Eurozone (USD/bbl)
Jan 16	26.4	29.1	30.8
Feb 16	35.9	38.0	43.5
Mar 16	28.2	32.2	37.1
Apr 16	41.3	44.7	50.1
May 16	39.3	42.7	49.0
Jun 16	36.0	37.6	43.6
Jul 16	25.7	26.9	31.3
Aug 16	28.4	30.2	32.7
Sep 16	24.7	26.4	27.5
Oct 16	28.6	29.0	32.5
Nov 16	28.4	29.6	34.8
Dec 16	28.4	29.0	31.5

Source: HSBC Global Research, 2015.

The role of base effects

Inflation is expected to rebound in 2016, mainly due to the base effects. Among the drivers of base effects, oil is the biggest factor as energy represents 10-15% of the CPI baskets in developed economies. Because the price of oil fell sharply around mid-2014 and especially in the first half of 2015, it is a key downside contribution to headline inflation numbers. The recent drop in energy prices has made a lot of investors concerned about the strength of these base effects going forward. The table opposite quantifies the lowest levels in Brent for each month in 2016 such that the base effects remain supportive (i.e. they add an upward bias to headline inflation).

Source: HSBC Global Research, December 2015.

Europe

While recent weakness in European inflation (HICP 0.1% yoy) is largely a consequence of cheaper energy prices, it has nevertheless been adding pressure on the European Central Bank (ECB) to bolster stimulus to avert further downside or even deflation. As quantitative easing (QE) was launched in January 2015, the principal transmission mechanism was intended to be a weaker currency, much of which preceded the announcement. However, some of these benefits have since been offset by the 7%[1] appreciation in trade-weighted euro between March and September 2015.

Europe: short term increase in central bank confidence and income expectations. Stable inflation forecasts with a few exceptions.

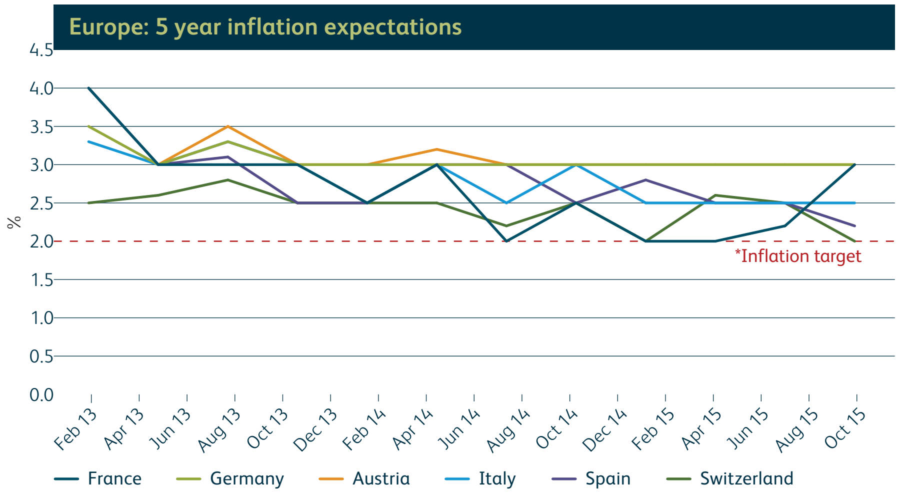
[1]Source: Bloomberg, actual value is 6.53%.

The M&G YouGov Inflation Expectations Survey for Q4 2015 fielded from 25 November to 3 December, the day on which the ECB announced it would extend its quantitative easing programme until at least March 2017.

In this set of results, we note a general uptick in central bank confidence which was perhaps driven by the close proximity of the ECB's decision and the anticipation of additional stimulus. Net income expectations have generally increased amongst most countries although remain lower than levels observed one year ago.

Inflation expectations appear to have stabilised in Germany, Austria and Italy, but have slipped in Spain and Switzerland, over both the short and long term. Over the long term, all surveyed countries continue to expect inflation to run at or above 2%, suggesting European consumers remain broadly confident the ECB will deliver on its price stability mandate.

Chart 5



*ECB's inflation target described as "at or close to 2%".

In-depth country analysis reveals interesting developments across the European landscape.

In **Germany**, our survey finds inflation expectation remain stable at 2% over one year and 3% over five years. However, at a regional level, Berlin has experienced rising[2] expectations for the last three quarters and has now caught up with the national long-term average. Similarly, income expectations have been rising faster[3] in Berlin compared to the rest of Germany, with around 32% of consumers expecting a rise in net income next year compared to the German national average of 23%.

Support for government economic policy is hovering around 20% and is unchanged from the previous quarter. One of the regions that shows increasing support for government policy is Bavaria where 21% of respondents "strongly" or "tend to agree" compared to 16% six months ago. This is interesting, considering the region is one of the most affected by the ongoing refugee crisis.

The great Austrian inflation

Inflation in Austria is elevated (currently 1.1% yoy) compared to the European average (0.3% yoy). One reason for this may lie in the so-called "homemade inflation". Administered prices, such as fees and duties, have risen twice as fast in Austria since 2007 compared to Germany, coupled with structural features and, to some extent, less competition. Austria is, for example, the most expensive country for food in the eurozone, given Austrian's preference for regional products, and also has a lower concentration of discounters, which results in lower price pressure. Over the long term, higher domestic inflation could weigh on competitiveness, with unit labour cost already rising faster than in Germany.

Germany: stable inflation expectations. Net income forecasts accelerate in Berlin.

[2]Source: YouGov report, 2% (May 15), 2.5% (August 15), 3% (November 15).

[3]Source: YouGov report. Up from 28% August 15, and 23% in May.

In neighbouring **Austria**, inflation expectations also remain unchanged at 2% over one year, and 3% over five years. With Austrian CPI at 1.1%, a share of 36% of Austrian households "neither agree nor disagree" whether inflation is, or is not, a concern for them and their families over the next 12 months, tied with Germany as the highest level across all countries surveyed. It is perhaps for this reason that central bank credibility here is relatively low compared to the rest of Europe, with around 63% of respondents reporting low confidence in ECB monetary policy (in the next 3-5 years).

1/3 of Austrians are indecisive on whether inflation is a concern.

Switzerland has been experiencing deep deflation for the last three quarters, as the weakening euro has been putting the alpine exporting nation increasingly under pressure. The Swiss National Bank itself announced in its September statement that deflation is expected to last until 2017, after which inflation should move back into positive territory.

Against this backdrop, we find that Swiss consumer inflation expectations have dropped by -0.3% over one year (currently 1.0%) and by -0.5% in the medium term (currently 2.0%). In spite of this, within Europe, Swiss consumers retain the highest level of confidence in their central bank, as evidenced by our survey, with 51% of Swiss households declaring to be "very" or "fairly confident" the SNB will achieve price stability in the medium term. This level, however, is lower than the one observed one year ago (60%).

As shown in Chart 6, it is worth highlighting how resilient Swiss expectations have been, considering the country is experiencing its longest ever run of falling prices.

Chart 6

Resilience of Swiss inflation expectations (1 year ahead)

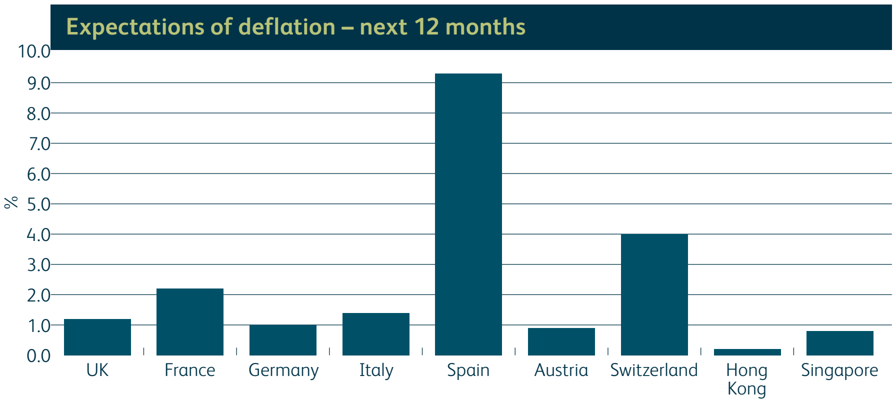
The Swiss economy remains under pressure, given it is surrounded by loosening monetary policy action. Also, national identity is an ongoing issue in the alpine country where roughly a quarter of the population are foreigners and immigration has increased in the past few years. These concerns have been reflected in the latest parliamentary elections where we have seen a shift to the right.

Mario Eisenegger, Investment Specialist

Swiss confidence in SNB highest despite ongoing deflation. Inflation expectations remain resilient.

Inflation expectations in **Spain** have ticked down over both the short-term (from 1.6% to 1.5%) and long-term periods (2.5% to 2.2%). This follows on from six consecutive quarters of zero or negative inflation, which may well have dented households' expectations for future prices. In fact, our survey shows that over 9% of Spanish consumers expect prices to continue to fall over the next 12 months, the highest level in Europe, and more than three times higher than the European survey average of 2.9%.

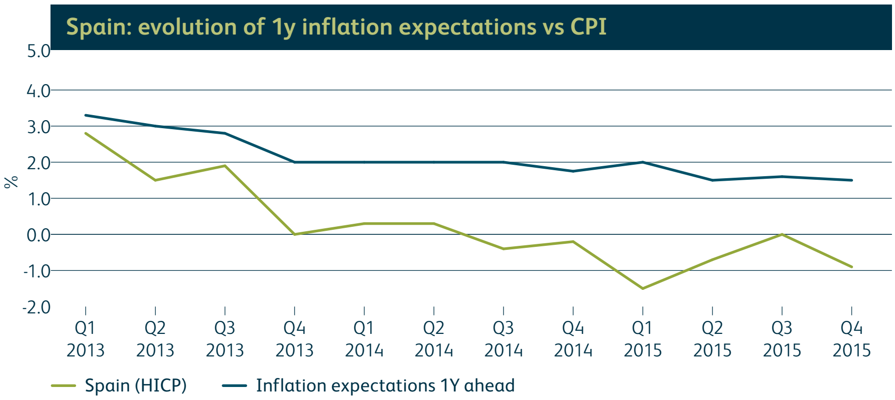
Chart 7



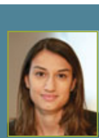
Spain: lower expectations over 1y and 5y. Deflationary mentality on the rise. Low support for government economic policy despite recent economic upturn.

Despite the most recent dip, we find consumer inflation expectations in Spain to have been relatively resilient (Chart 8) since the launch of the M&G YouGov Inflation Survey, particularly over the last year when Spanish CPI has reached a deeply negative level of -1.5%. Similarly, we have noted an improving trend in central bank confidence, with 26% of consumers reporting to be "very" or "fairly confident" in the ECB's ability to achieve medium-term price stability. This compares to 22% a year ago, and 20% in November 2013.

Chart 8



Spain is set to become the fastest growing economy in Europe this year, as a result of ongoing adjustment and reform efforts, although support for government economic policy remains fairly low (27%). On this front, the M&G YouGov Inflation Expectations Survey finds that 54% of Spaniards disagree with their government's economic policy, particularly those in 25-34 year age group, who report back the highest level of disagreement (60%).



"Deflation is like cholesterol – there are good and bad types – and in Spain we have the good kind," Spanish Finance Minister Luis De Guindos told CNBC earlier this year. Good deflation has been an important driver of Spain's recent economic revival. Germany, France, Italy and Spain are the largest net oil importers in Europe and therefore the biggest beneficiaries of renewed weakness in oil prices.

Furthermore, the combination of a weaker currency, lower interest rates and some "good" oil-driven deflation appears to have boosted households' disposable income, which is having a positive impact on domestic consumption and growth.

Ana Gil,
Investment Specialist

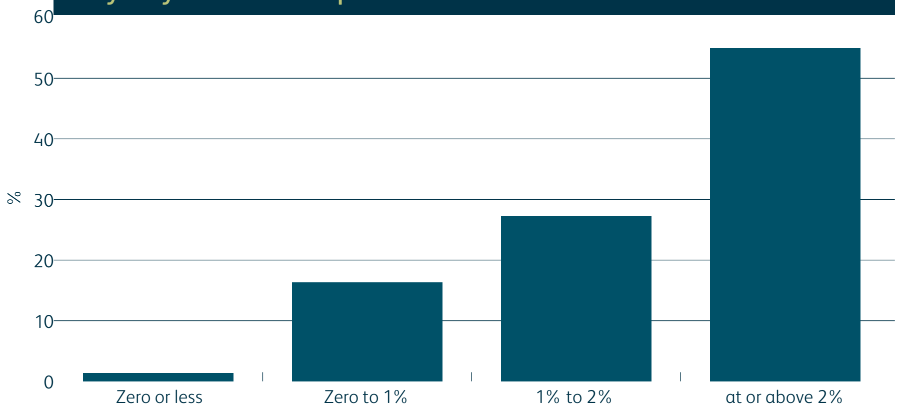
Italian expectations have been remarkably well anchored for the past few quarters. One year-ahead expectations have been firmly set at 2% for eight consecutive quarters, while the five-year gauge stands at 2.5% for the fourth consecutive quarter.

Central bank confidence has also experienced a significant uptrend in the last year, with 40% of Italians reporting to be "very" or "fairly" confident the ECB is pursuing the correct policies to meet its target of price stability, compared to 30% one year ago.

Even if Italian CPI has been close to zero over the last 12 months, inflation still ranks high as a concern for Italian consumers. The majority of surveyed Italians (58%) agree with the statement: "Rising inflation is giving me and my family cause for concern at the moment". Furthermore, our analysis shows that 55% of households expect inflation to move back to 2% or above in the next 12 months.

Chart 9

Italy – 1 year inflation expectations



France is the only European country to report higher inflation expectations in the latest survey. The one-year ahead median household gauge ticks up from 1.1% to 1.5% and the five-year measure moves from 2.2% to 3.0%. Interestingly, the average inflation forecast for the five-year period in the Parisian area remains unchanged at 2.5% over the quarter, and is below the national average.

The French display a low level of confidence in the ECB, with 62% of French households declaring they are: "not very confident or not at all confident that the ECB is pursuing the right economic policies to meet price stability".

Support for French government policy is one of the lowest in Europe, with 54% of respondents expressing disagreement with ongoing economic policies. While the French economy weathered the global financial crisis better than most of its European peers, it has recently been lagging in terms of growth and reform momentum.

One of the key drivers of inflation expectations over the last year has been the price of oil. In the real economy, this can be perceived at the pump station. In Italy, taxation on fuel is exceptionally high and therefore consumers have not really felt a big difference in their wallet from the recent sell-off in oil.

Carlo Putti,
Investment Specialist

Remarkably well anchored expectations in Italy. Central bank confidence on the rise.

Does a weaker euro automatically mean higher inflation?

While it is very difficult to assess the exact pass-through from a change in trade-weighted euro to a change in CPI, the ECB has suggested that for every 10% appreciation in the euro effective exchange rate, the European harmonised inflation index was cut by about 0.4-0.5%. If we assume a symmetric effect, then we would expect to see a similar boost to inflation from a devaluation shock.

Source: Credit Suisse Economics Research, March 2014.

Inflation expectations rise in France despite low confidence in central bank. Low government support calls for acceleration in growth and reform momentum.

Asia

In **Singapore**, inflation expectations have ticked down on both the short (3.1% to 3.0%) and medium term (4.5% to 4.0%), reversing the upward move seen in the quarter three survey.

Concern for inflation for families is at 78% and looks elevated, relative to other countries surveyed (Chart 10). Despite Singapore CPI being held in deflationary territory for the past three quarters, our analysis shows that over 80% of Singapore consumers still expect it to rise above 2% over the next 12 months. This reflects a high level of confidence (54%) in the Monetary Authority of Singapore to achieve its 2% inflation target.

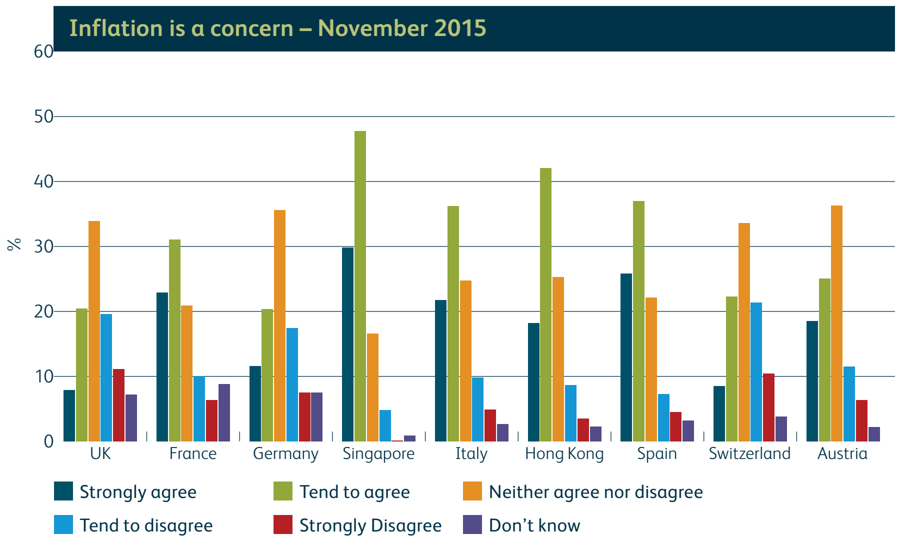
In Hong Kong, inflation expectations remain unchanged during the quarter. One-year expectations stand at 4%, while the five year measure has been remarkably well-anchored at 5% for six consecutive quarters.

Hong Kong inflation has been easing lately, from highs of 6.9% observed in July 2013 to a current level of 2.4%. Perhaps for this reason, we note a general downtrend in consumers' concern for inflation, which has edged down to 60% from 66% last quarter, and 73% one year ago.

One reason for the change in sentiment could be the recent slowdown in the Hong Kong property market after four years of steady house price growth. With a +30% weight in the CPI basket, housing is an important contributor to monthly inflation in Hong Kong. In this vein, 13% of Hong Kong consumers expect inflation to continue falling from current levels over the next five years.

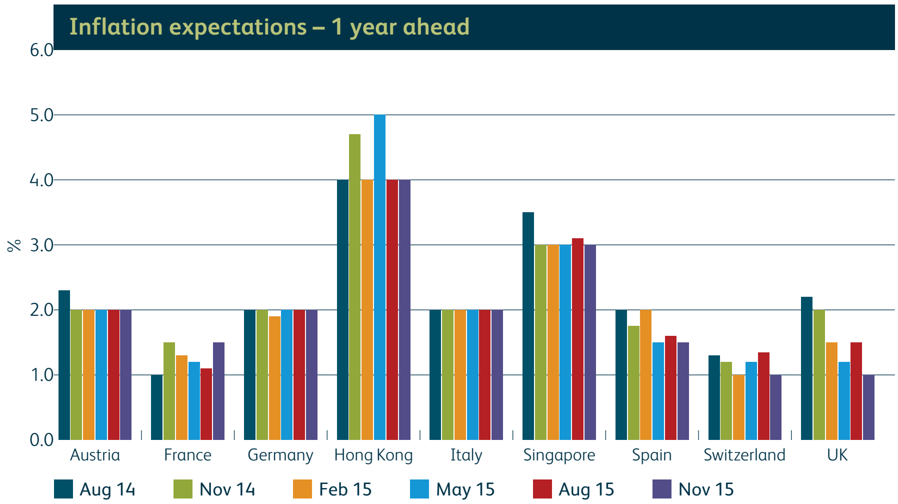
Singapore expectations ticked down over one and five-year periods.

Chart 10



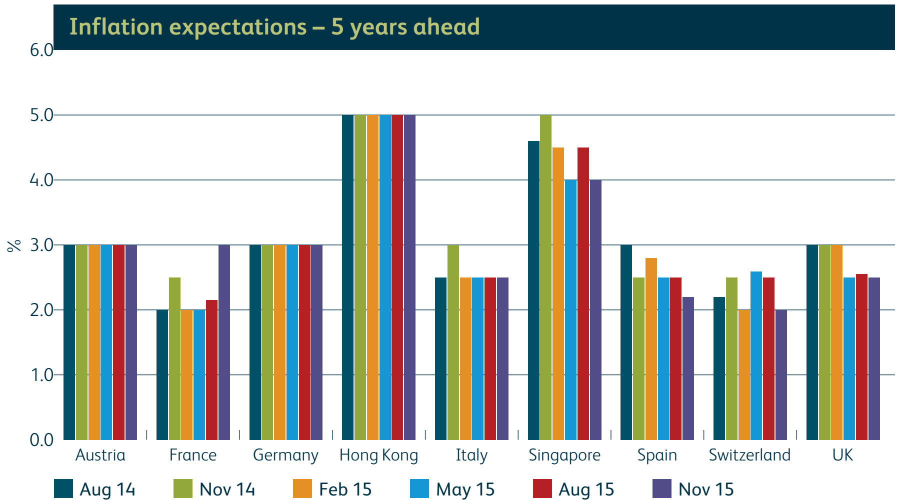
Other highlights

Chart 11



Consumers in the UK, Switzerland, Spain and Singapore reported a fall in inflation expectations over the short term

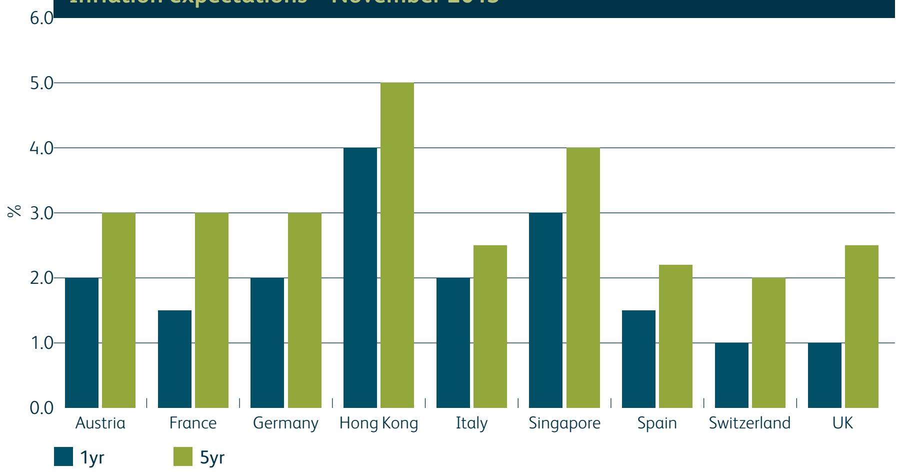
Chart 12



Consumer five-year inflation expectations remain at or above central bank targets in all countries

Chart 13

Inflation expectations – November 2015



In Europe, long-term inflation expectations remain at or above the Bank of England, Swiss National Bank and European Central Bank's inflation targets.

Statistical Appendix

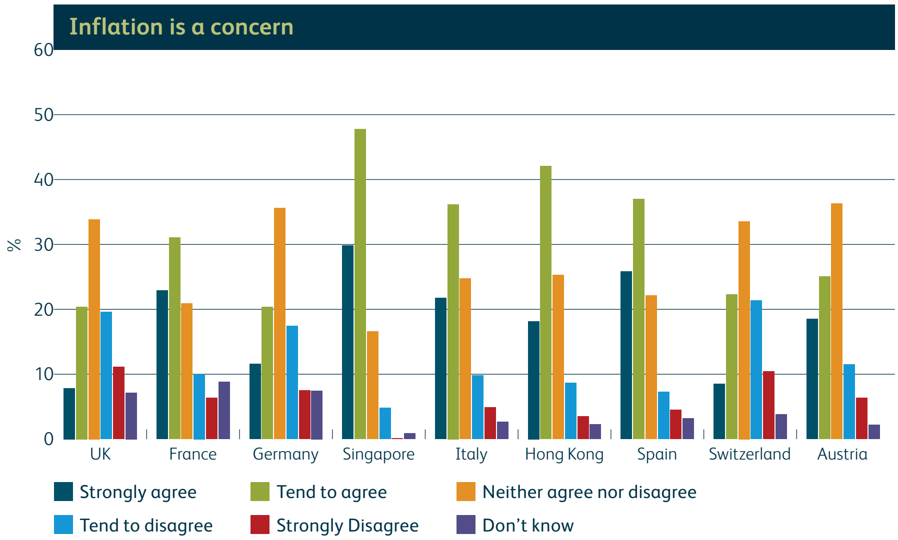
1. What annual rate of inflation do you expect 12 months from now?

	Sample size	Mode	Median	25th percentile	75th percentile	Interquartile range (75th-25th)	Don't know responses
UK	2,123	1.0	1.0	0.8	2.0	1.2	35.6%
France	1,005	1.0	1.5	1.0	3.0	2.0	51.2%
Germany	2,012	2.0	2.0	1.0	3.0	2.0	37.2%
Italy	1,004	1.0	2.0	1.0	5.1	4.1	36.5%
Spain	1,007	1.0	1.5	0.8	3.1	2.3	37.8%
Austria	502	2.0	2.0	1.4	3.0	1.6	31.5%
Switzerland	502	1.0	1.0	0.5	2.4	1.9	39.8%
Hong Kong	502	5.0	4.0	3.0	5.0	2.0	19.3%
Singapore	501	3.0	3.0	2.0	5.0	3.0	28.1%

2. What annual rate of inflation do you expect five years from now?

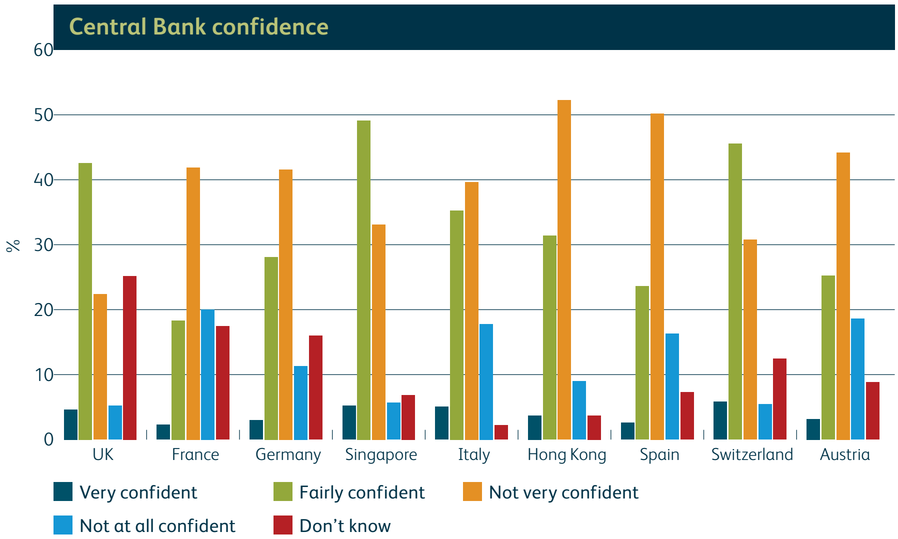
	Sample size	Mode	Median	25th percentile	75th percentile	Interquartile range (75th-25th)	Don't know responses
UK	2,123	2.0	2.5	2.0	3.5	1.5	42.6%
France	1,005	2.0	3.0	1.5	6.3	4.8	56.8%
Germany	2,012	2.0	3.0	2.0	5.0	3.0	41.1%
Italy	1,004	2.0	2.5	1.5	7.1	5.6	40.9%
Spain	1,007	2.0	2.2	1.2	5.0	3.8	42.2%
Austria	502	2.0	3.0	2.0	5.3	3.3	33.1%
Switzerland	502	2.0	2.0	1.0	5.0	4.0	42.0%
Hong Kong	502	5.0	5.0	3.2	10.0	6.8	20.5%
Singapore	501	5.0	4.0	2.5	6.0	3.5	26.5%

3. To what extent do you agree or disagree with the following statement? "Rising inflation is giving me and my family cause for concern at the moment."

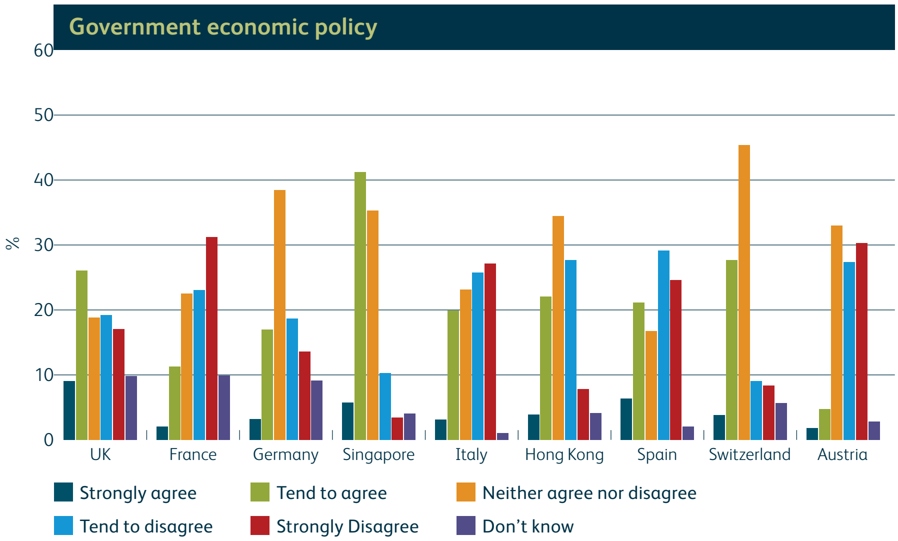


4. Thinking about the next 12 months, do you expect your net income to increase, decrease or be about the same in 12 months' time?

5. How confident, if at all, are you that your central bank is currently pursuing the correct policies in order to meet its target of price stability (i.e. inflation around 2%) over the medium term (ie the next 3-5 years)?



6. To what extent do you agree or disagree with the following statement? "I think that my government is currently following the right economic policies"



Who is YouGov?

YouGov is an international market research agency with sector specialist teams serving the financial, media, technology and telecom industries. They are considered a pioneer of online market research and are the most quoted market research agency in the UK. In August 2012, they were named as one of the world's top 25 research companies by the Honomichi Top 25 Global Firms.

For quantitative research, YouGov uses an online panel of adults, who are profiled across a range of demographic, attitudinal, lifestyle and marketing characteristics. The emphasis is put on quality rather than quantity and restrictions are put in place to ensure that only those selected from this panel are able to take part in the survey.

Incentives are used to encourage participation and prevent an overwhelming influence from those with a particular interest or 'axe to grind'. In the UK, France and Germany, the panels are constructed by YouGov and consist of 752,277, 132,876 and 199,200 adults respectively. In the other countries, a panel partner of YouGov conducts the survey using an online interview. The panel sizes for these countries are as follows: Austria (25,500), Hong Kong (14,400), Italy (75,200), Singapore (21,300), Spain (130,300) and Switzerland (21,600).

For qualitative research, they use online forums, face to face focus groups and cognitive interviews. This information is then either used stand alone or is fully integrated with their quantitative research.

Once collected, the data is weighted using either each country's census, if available, or industry accepted data, to help make the sample as reflective of the general population as possible.

What the world thinks