Living costs and savings

A Cebr report for MRM and Scottish Friendly

March 2022

Celebrating 160 years

2022

Contents

Executive summary

Cebr has been commissioned by Scottish Friendly to consider the ongoing cost of living crisis, particularly its impact on household savings.

This report is split into two sections:

1) A bespoke survey, conducted by 3Gem, covering consumer attitudes towards living costs
2) Cebr forecasts of household savings, based upon our established framework for modelling household incomes

Key results from Section 1 include:

- The vast majority, 85.6%, of consumers have reported increased living costs over the past year.
- More than half, 55.1%, of those experiencing rising living costs have reported an above inflation increase.
- Reported price pressures have been most prevalent amongst essential spending categories, such as utilities and food.
- Consumers anticipate a reduction in outgoings across non-essential spending categories, such as restaurants and hotels and clothing and footwear.
- The vast majority, 87.6%, of consumers expect their living costs to increase further over the coming year.
- 72.2% of consumers expect rising living costs to adversely impact their living standards over the coming year.

Key results from Section 2 include:

- Savings levels averaged £39 per week for the mean UK household in the two financial years prior to the pandemic.
- As a result of reduced spending opportunities, savings levels soared during the early stages of the pandemic, reaching £130 per week for the average UK household in Q2 2020, before increasing further to £152 per week in Q1 2021.
- Savings are set to dwindle in Q2 2022, as various policy measures impact household income and spending. These include the tax-free personal allowance freeze, the uptick to National Insurance contributions, and the increase to the Ofgem price cap. The average UK household is expected to save just £26 per week in Q2 2022, a fall of 71.4% on the same quarter of 2022.
- Annual falls in savings levels are expected in every quarter of 2022.
- The average UK household would have to earn £60 more per week pre-tax in 2022 in order to save the same amount they did in 2021.

Cost of living analysis

Vast majority of consumers report increased living costs over the past year

- Mounting inflation has been a key theme within the economic landscape for much of the past year. Consumer prices have been rising rapidly, with annual price growth reaching multi-decade highs.

- At the time of writing, the most recent reading on the Consumer Price Index showed annual inflation of 5.5% in January 2022. This represents the fastest rate of price growth since March 1992.

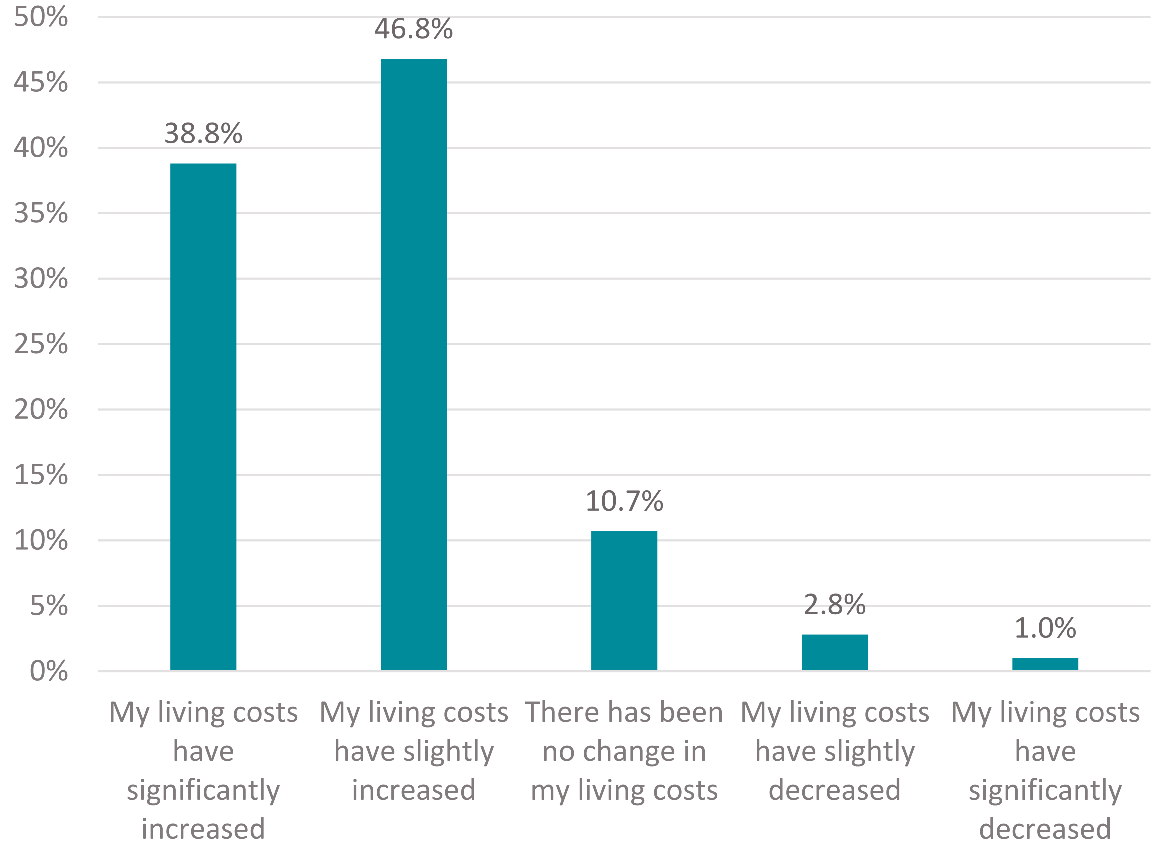
- This price growth has been driven by a range of factors, including global supply chain disruption, a resurgence in consumer demand from the depths of the pandemic, and certain regulatory changes.

- Results from a bespoke survey of 2,000 UK adults show that consumers have been significantly impacted by these cost pressures.

- The vast majority, 85.6%, of respondents stated that their living costs had increased over the past year, highlighting the widespread nature of inflation. Within this figure, 38.8% reported that their living costs had increased significantly.

- Meanwhile, just 3.8% of respondents reported that their living costs had decreased over the past year.

Figure 1: How general living costs of UK adults have changed over the past year[1]



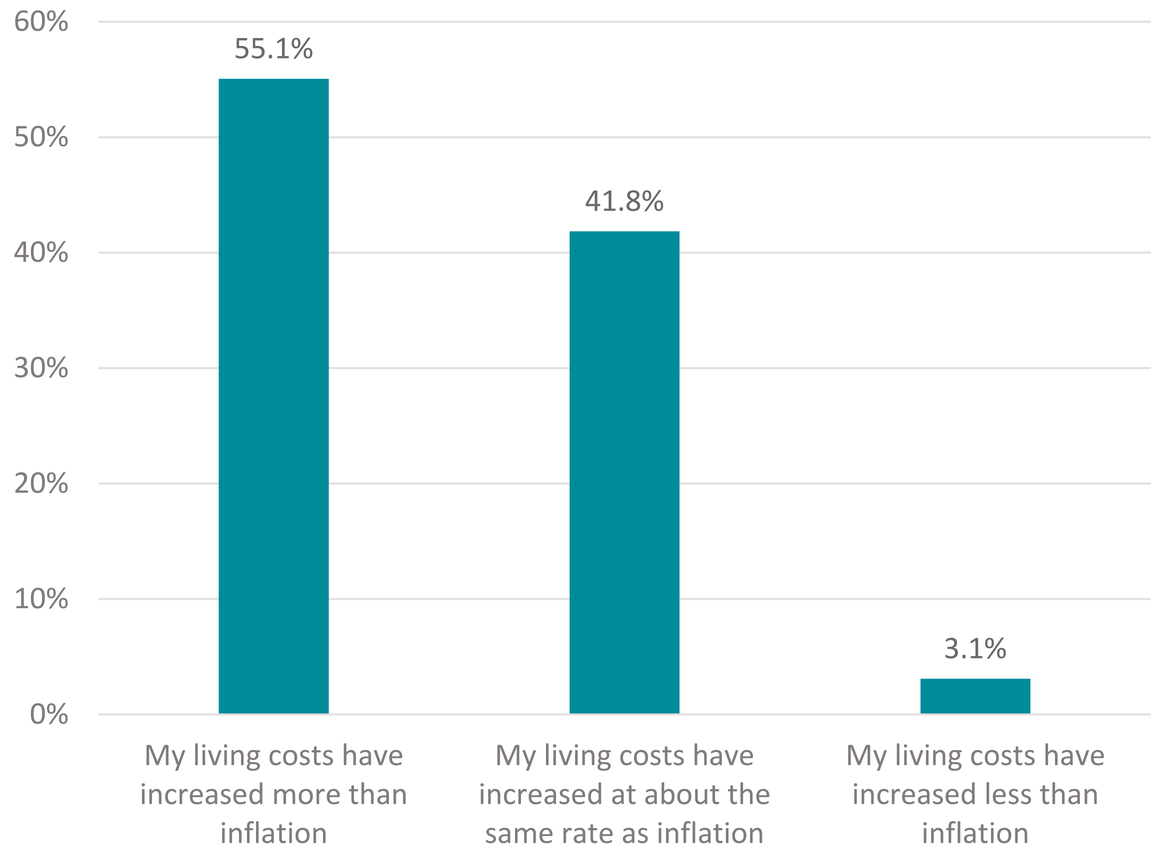
Source: 3Gem, Cebr analysis

[1] Year to February 2022

More than half of those experiencing rising living costs have seen an above inflation increase

- When the survey was conducted, the most recent reading of the Consumer Price Index showed annual price growth of 5.4% in December 2021. Respondents were asked how their living costs had changed relative to this inflation rate.
- Amongst respondents who reported an increase in their living costs, 55.1% stated that their living costs had increased at a faster rate than inflation.
- Meanwhile, 41.8% of respondents stated that their living costs had increased at about the same rate as inflation, while just 3.1% reported that their living costs had increased at a slower rate.
- This divergence could be explained by the structure of household spending. For instance, inflation has been heavily concentrated amongst 'essential' spending categories in recent months, with energy and fuel being notable examples. This could change households' perceptions of price rises.
- This could also point to further price pressures in the coming months. Inflation expectations can have considerable impacts on the future inflation rate, particularly through the channel of wage negotiations and subsequent cost pressures on businesses.
- The conflict in Ukraine has escalated since the survey was conducted. This is expected to put further upward pressure on inflation through the channels of fuel, utilities, and commodity prices.

Figure 2: How living costs of UK adults have changed compared to official ONS inflation measure[1,2]



Source: 3Gem, Cebr analysis

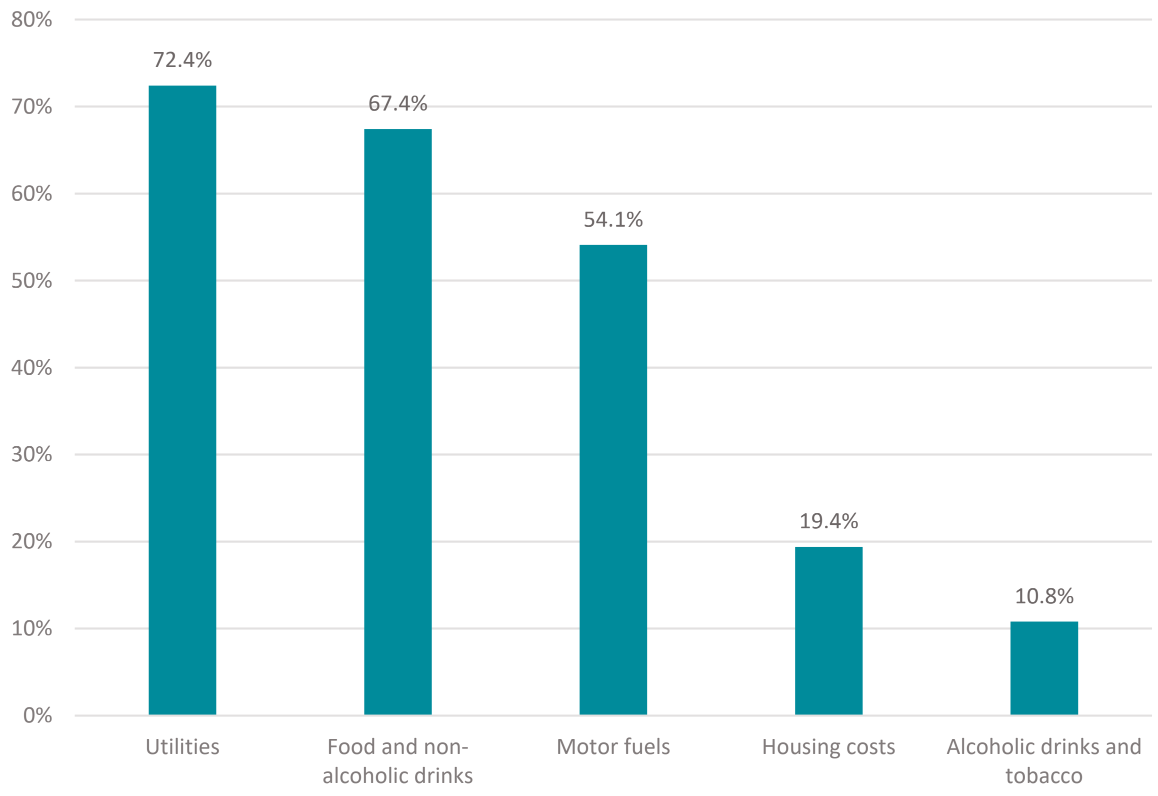
[1] Survey conducted in February 2022, when latest inflation reading related to December 2021

[2] Proportion of respondents reporting that their living costs had increased, as per Figure 1

Reported price pressures most prevalent amongst essential spending categories

- Amongst respondents reporting an increase in their living costs over the past year, we enquired about the particular spending categories exhibiting the most noticeable cost changes.
- The four most frequently cited categories were all classed as 'essential' expenditure. 72.4% of respondents reported utilities as one of the most notable sources of cost changes.
- Utilities was followed by food and non-alcoholic beverages, motor fuels, and housing costs, being reported by 67.4%, 54.1%, and 19.4% of respondents, respectively.
- The prevalence of these responses aligns well with official inflation data. According to the CPI measure, the transport category – containing motor fuels – has exhibited the highest rate of inflation on each of the past five readings. Meanwhile, the broad category encompassing housing and utilities has been amongst the top three categories when ranking by price growth on each of the past four inflation readings.
- Within the housing and utilities category, particularly high inflation readings have been seen for gas and electricity. These categories exhibited annual inflation of 28.3% and 28.7% on the most recent inflation data, covering January 2022. Both of these values represent near-term highs.

Figure 3: Goods and services for which UK adults have observed the most noticeable cost changes, for respondents which have seen living costs have increased over the past year. [1,2]



Source: 3Gem, Cebr analysis

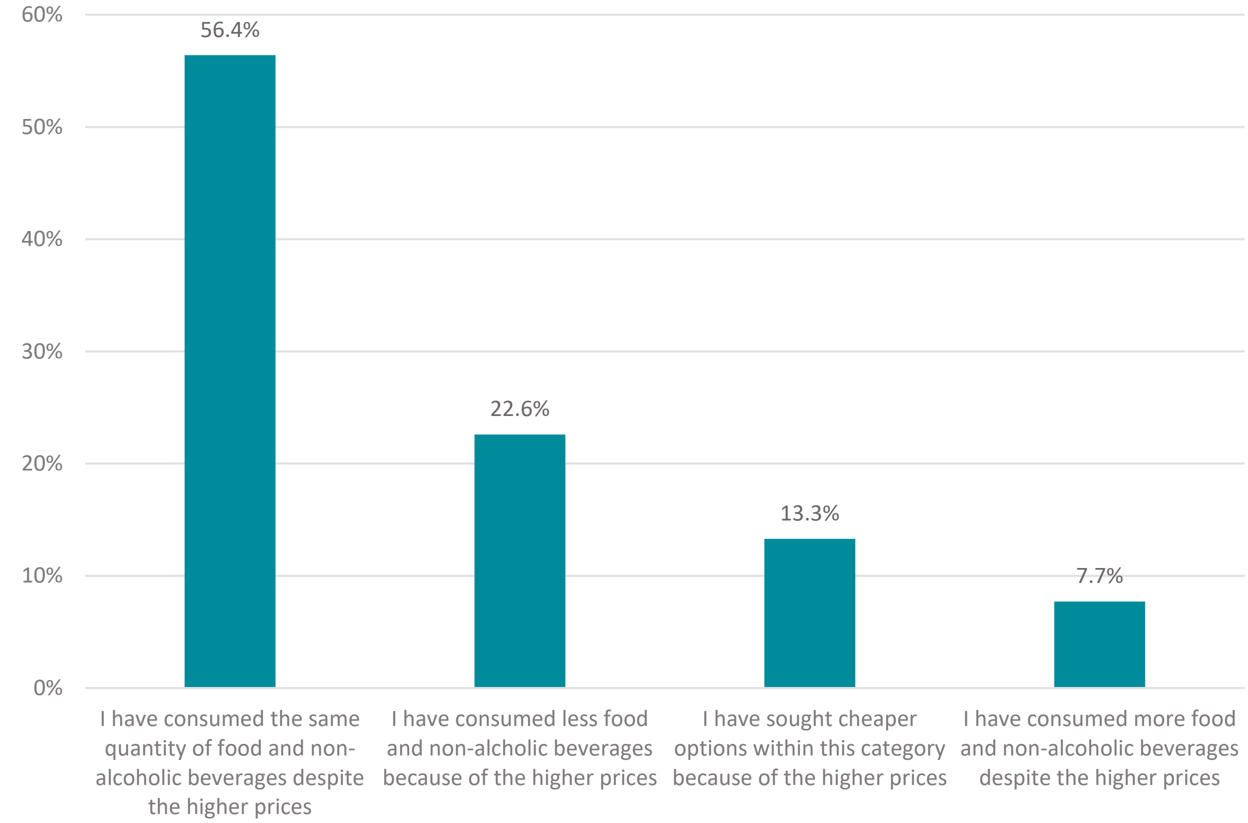
[1] Five most prevalent response categories shown. Seventeen options provided in total.

[2] Respondents could select up to three categories.

Consumers appear willing to absorb price pressures amongst essential spending categories

- Having identified the most prevalent sources of cost pressures amongst respondents, we then enquired about how consumers have changed their behaviour as a result of these rising prices.
- There is an interesting divergence between essential spending categories, and those that are seen as more discretionary.
- In the case of essential spending categories, it is clear that consumers are simply absorbing cost pressures.
- For instance, amongst those reporting food and non-alcoholic beverages as a main source of cost pressure, the most common response was that they are consuming the same quantities despite the higher prices. This was the case for the majority, 56.4%, of such respondents.
- Consuming the same quantity of the good or service despite the higher prices was also the most common response when considering utilities, motor fuels, and housing costs.

Figure 4: How respondents' consumption behaviours have changed, if they previously noted that food and non-alcoholic beverages have been a source of cost pressures



Source: 3Gem, Cebr analysis

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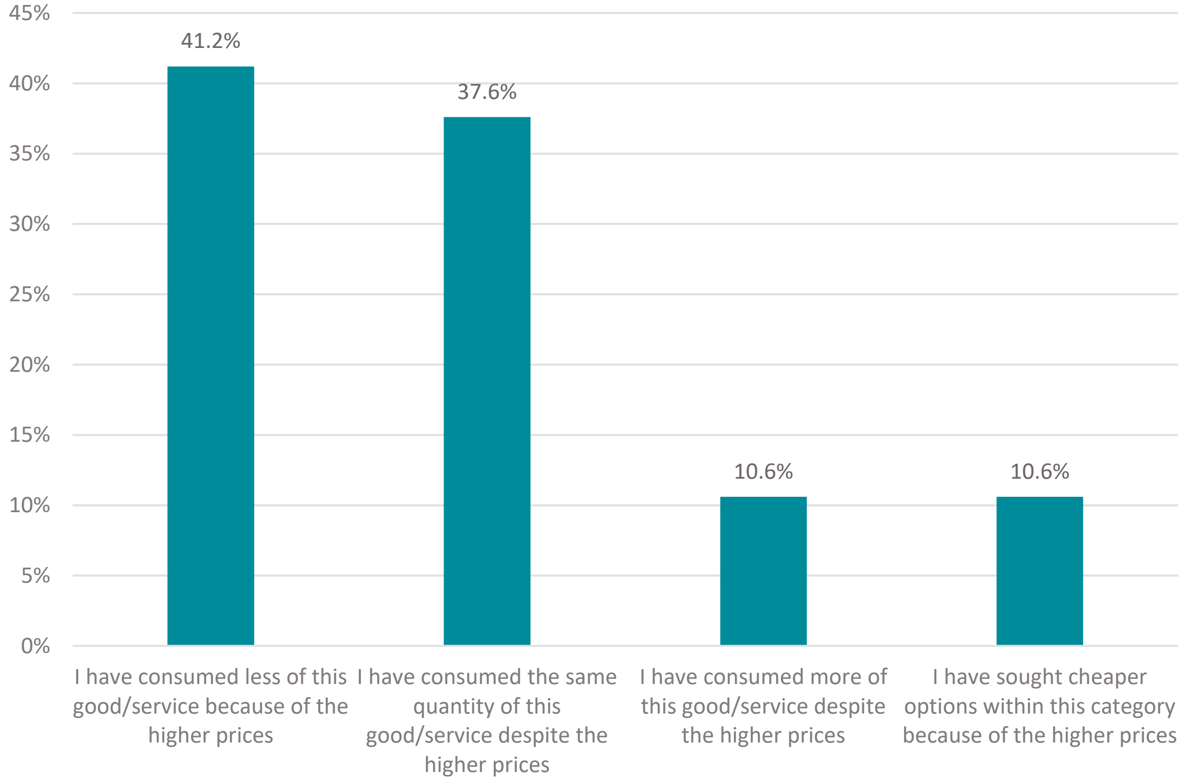
Inflation has caused reduction in consumption amongst more discretionary spending categories

- The pattern of consumer behaviour is different amongst more discretionary spending categories.
- Here, consumers are less willing to absorb price pressures. Instead, they are more likely to reduce their consumption altogether.
- For instance, in the case of restaurants and hotels, the most common response was that respondents have consumed less of this service because of the higher prices. This was the case for 41.2% of those citing restaurants and hotels as a noticeable source of price pressure. Meanwhile, 10.6% reported that they have sought cheaper options within the category.
- This response option was also the most common amongst those citing clothing and footwear as a noticeable source of cost pressure. 35.2% of such respondents reported that they have consumed less of these goods because of the higher prices. Meanwhile, 13.1% reported that they have sought cheaper options within the category.

Figure 5: How respondents' consumption behaviours have changed, if they previously noted that restaurants and hotels have been a source of cost pressures

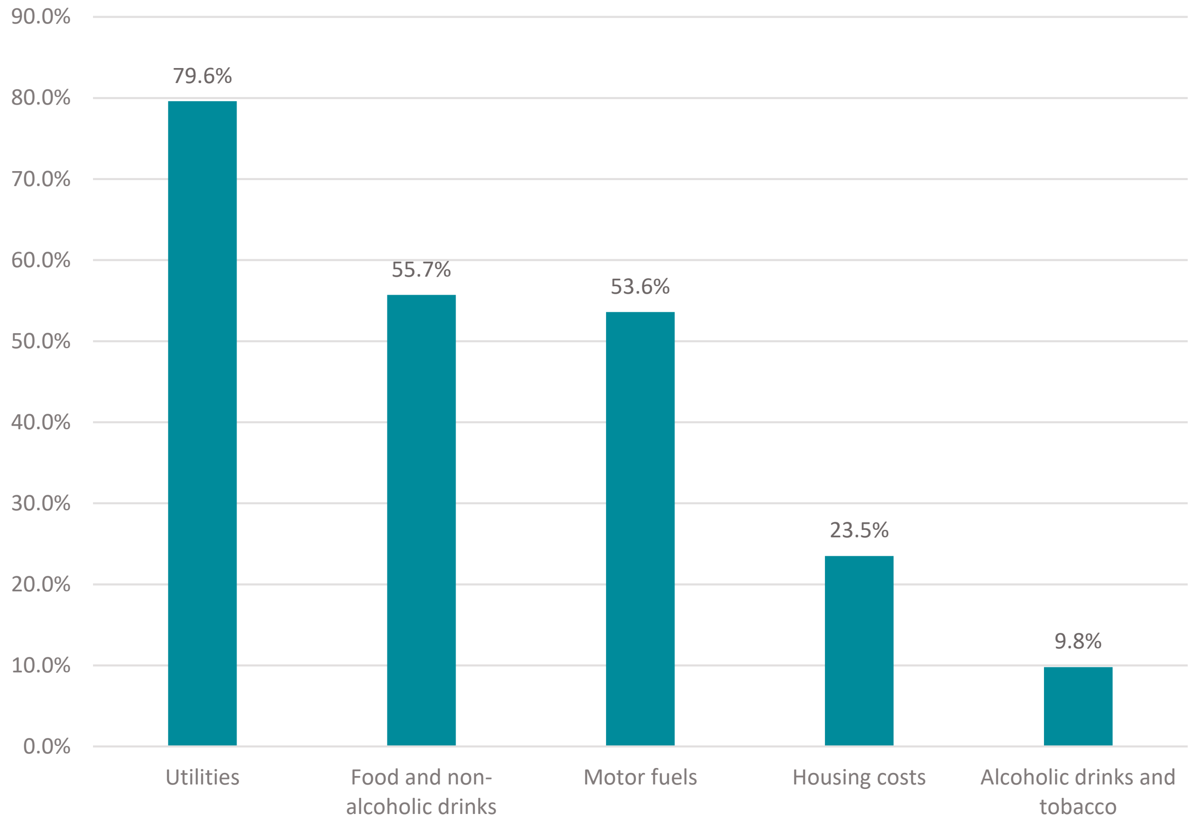


Source: 3Gem, Cebr analysis

The vast majority of consumers expect their living costs to increase further over the coming year

- It is clear from the previous slides that rising prices are impacting consumers' living costs in early 2022.
- There are also signs that this is expected to worsen in the future. The vast majority of consumers, 87.6%, expect their living costs to increase over the coming year.[1] Just 3.5% of consumers expect their living costs to decrease.
- This sentiment amongst consumers aligns with macro-level inflation expectations. Cebr forecasts point to rising prices for the entirety of the next twelve months across a variety of inflation measures.
- In terms of spending categories, there is a clear correlation between those for which significant price rises have been witnessed recently and consumers' expectations of inflation over the coming year.
- The top five spending categories for which consumers have seen prices rise over the past year, as outlined in Figure 3, mirror the top five categories when consumers were asked about anticipated drivers of living costs over the coming year.
- The vast majority of consumers, 79.6%, expect utilities to be a main driver of rising prices over the coming year, reflecting the upcoming increase in the energy price cap in April. Meanwhile, more than half of the respondents cited food and non-alcoholic beverages and motor fuels as anticipated drivers of inflation, with response rates of 55.7% and 53.6%, respectively.

Figure 6: Share of respondents which think the following spending categories will be the main drivers of changing living costs over the coming year [2,3]



Source: 3Gem, Cebr analysis

[1] Year to February 2023

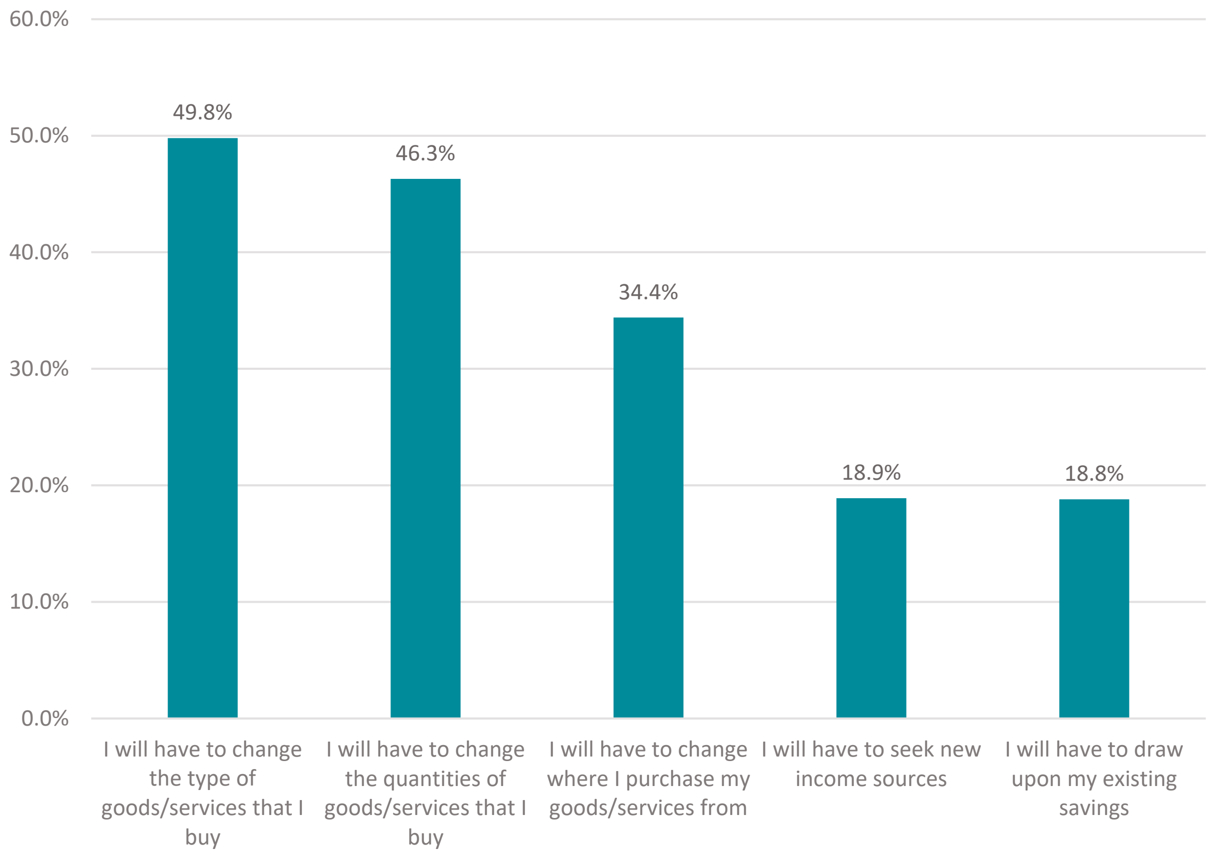
[2] Five most prevalent response categories shown. Seventeen options provided in total.

[3] Respondents could select up to three categories.

Expectations of worsening living standards are widespread amongst consumers

- Downward pressure on real spending power is one of the clearest impacts of inflation.
- Consumers expressed negative sentiment when we enquired about their expectations for living standards over the coming year.
- A large majority, 72.2%, of consumers expect that rising prices will worsen their living standards. Within this figure, 24.0% expect that their living standards will be worsened significantly.
- There are a number of behavioural changes that could result from diminishing living standards. Our survey showed that 49.8% of those who expect their living standards to worsen this year will have to change the type of goods/services that they buy. This reflects consumers' potential to substitute towards lower-cost alternatives.
- Meanwhile, 46.3% of those who expect their living standards to worsen stated that they will have to change the quantities of goods/services that they buy.
- 18.9% of consumers stated that they would have to seek new income sources as a result of their expected weaker living standards.

Figure 7: Share of respondents anticipating the following living standards impacts resulting from the rising cost of living (for UK adults anticipating their living standard to worsen)[1,2,3]



Source: 3Gem, Cebr analysis

[1] Year to February 2023

[2] Five most prevalent response categories shown. Seventeen options provided in total.

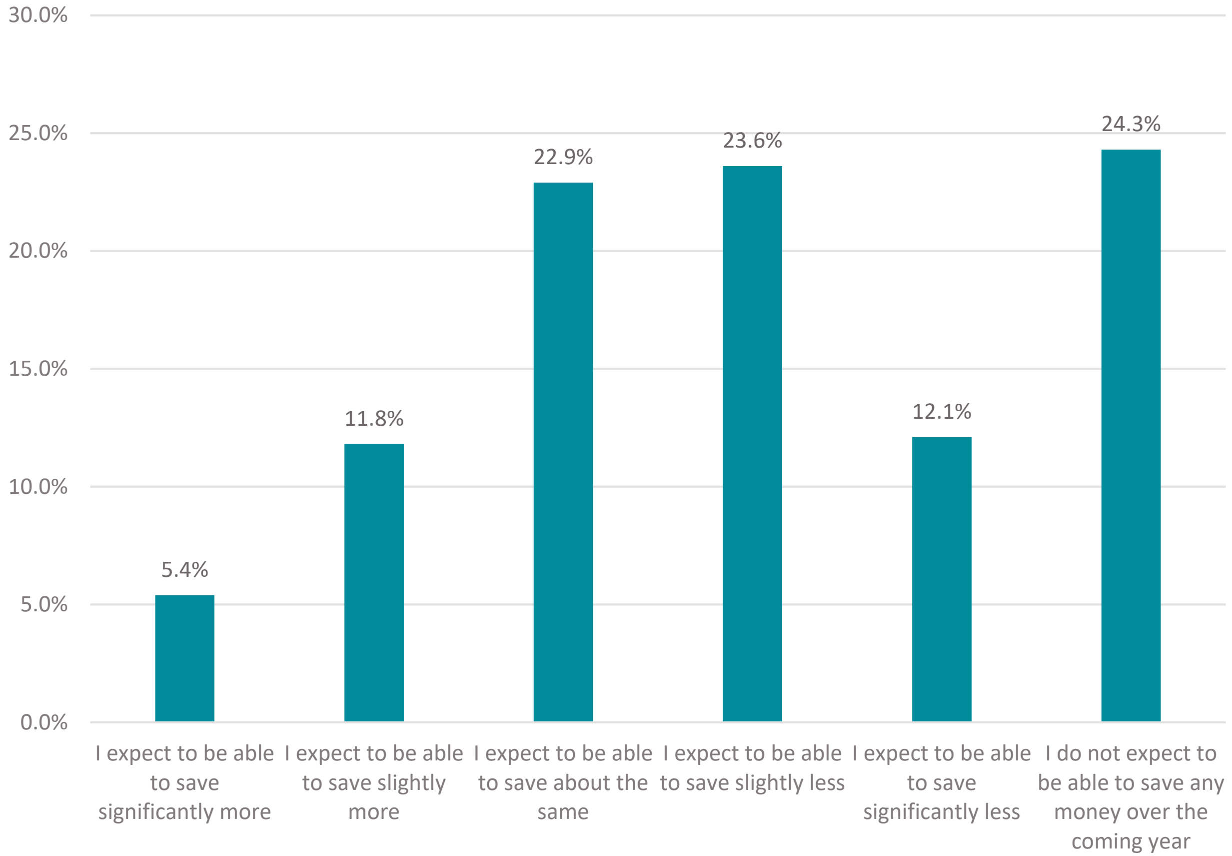
[3] Respondents could select up to three categories.

2022

Consumers show weak savings expectations for the year ahead

- The impact of inflation is particularly stark when it outweighs wage growth.
- At the aggregate level, incomes have grown strongly over the pandemic period. Wage data has shown record highs, with average weekly earnings reaching £596 in December 2021, according to figures from the ONS. Meanwhile, household spending power has been elevated, with Cebr's measure of discretionary income also reaching record highs during 2021.
- This narrative has been corroborated with our survey data. 31.4% of respondents reported that their income had increased over the past year, outweighing the proportion reporting a decrease, 17.0%.
- Nevertheless, wage growth is expected to slow over the coming months.
- Negative sentiment towards saving is prevalent when considering the year ahead. 35.7% of consumers expect their ability to save to be worse, while just 17.2% anticipate that they will be able to save more. 24.3% do not expect to be able to save at all.
- This expectation of weaker savings is driven by price expectations. 75.7% of respondents see higher prices as a main driver of weaker savings over the coming year.

Figure 8: Share of respondents expecting their ability to save to change in the following ways over the coming year



Source: 3Gem, Cebr analysis
[1] Year to February 2023

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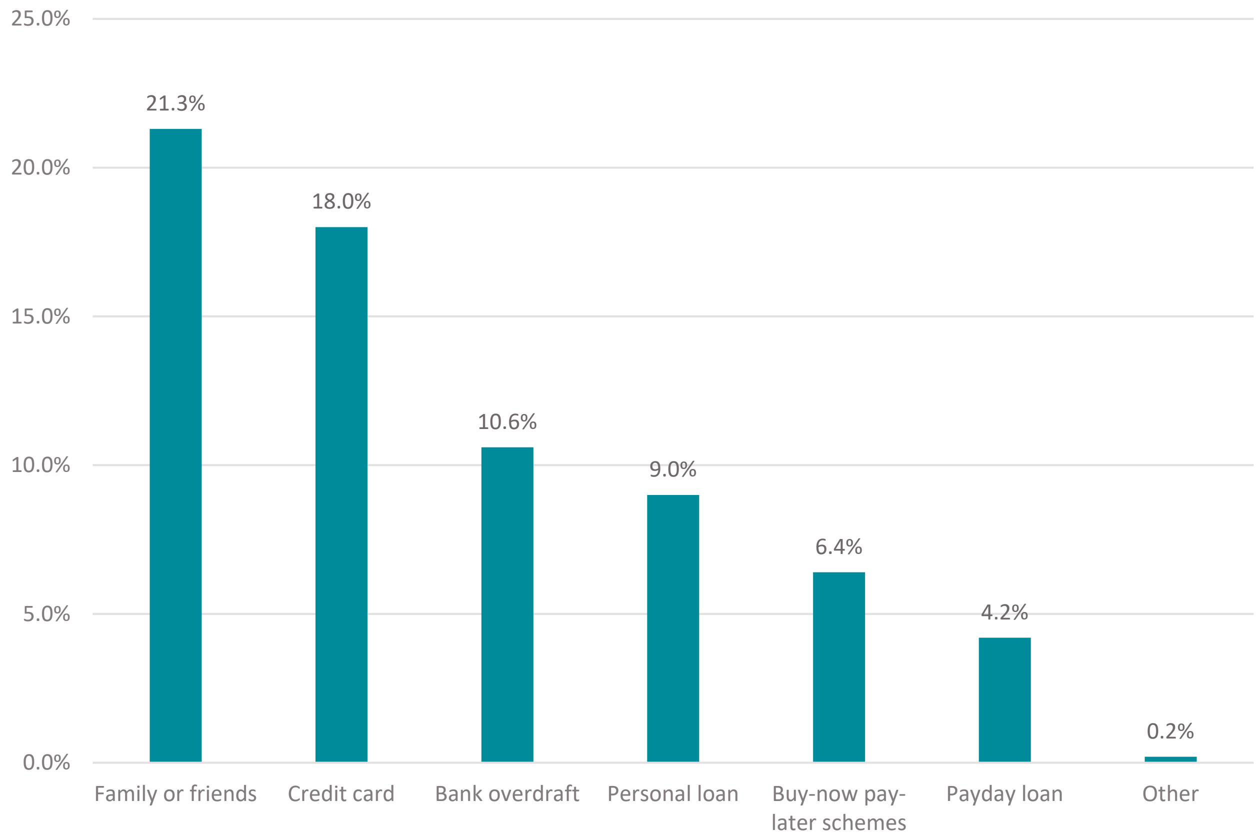
More than four in ten consumers have had to borrow to boost their income over the past six months

- A widely held economic theory is that of consumption smoothing. This states that consumers tend to save when their income is high and are then able to draw upon these savings when their incomes are relatively weaker. Alternatively, they can borrow in order to fund their consumption during weaker periods. This allows for relatively constant consumption levels over time, rather than fluctuating with income.
- Our survey shows evidence of consumption smoothing over the past year. More than half, 51.5%, of respondents stated that they have had to withdraw money from savings or investments to help boost their income over the past six months.
- A similar proportion, 49.4%, of respondents expect that they will have to draw upon their savings or investments to boost their income over the coming year.
- Meanwhile, 43.3% of consumers have borrowed in order to boost their income amidst rising living costs over the past six months.
- Borrowing from family and friends was most common, being reported by more than a fifth, 21.3%, of consumers. Credit card borrowing was reported by 18.0% of respondents, while use of a bank overdraft was cited by 10.6%.
- 41.9% of respondents expect they will have to borrow to help meet rising living costs over the coming year.

Figure 9: Share of respondents that have borrowed money from any of the following sources to help boost their income and meet rising living costs in the past six months[1,2]



Source: 3Gem, Cebr analysis

[1] Six months to February 2022

[2] Respondents could select multiple options

[3] 56.7% of respondents stated that they have not had to borrow

Household savings forecasts

Estimates of household saving - methodology

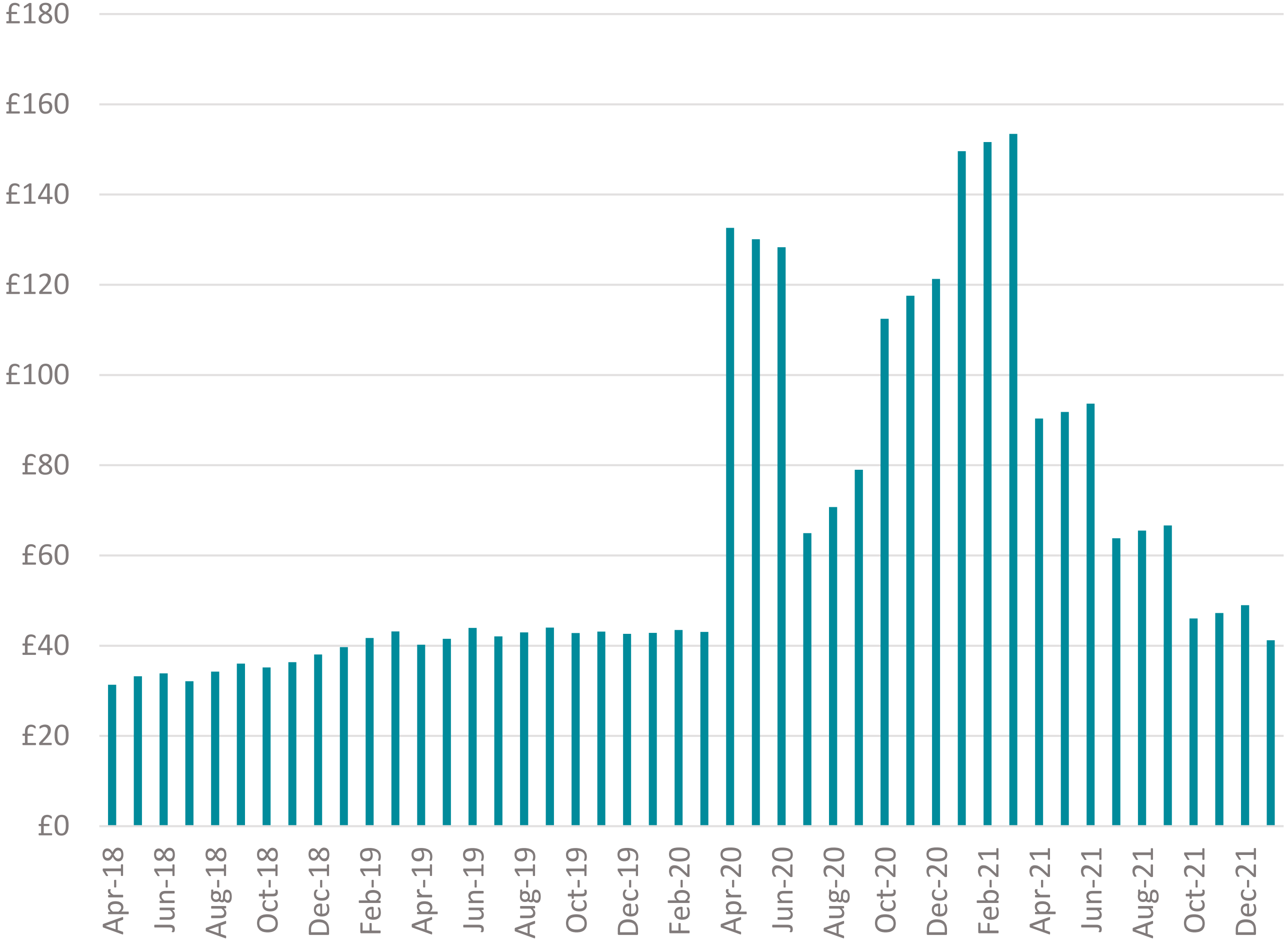
- The results of our survey show that consumers are already feeling adverse effects from rising living costs. Consumers anticipate worsening living standards, behavioural changes, and a reduced ability to save over the coming months.
- Using Cebr's established modelling of household incomes and expenditure, we can produce estimates for households' ability to save over the coming year.
- To produce savings estimates, we first produce forecasts of household incomes. This is then netted off against tax and National Insurance requirements. Household expenditure is then taken from this figure. The remaining value equates to household savings.
- It is important to note that this final figure encompasses both savings and investments.

Household income − ***Taxes*** − ***Total spending*** = ***Total saving***

Savings levels have fluctuated significantly in recent years

- Before discussing Cebr's forecasts for household savings over 2022, it is first important to consider how household saving has changed over recent years.
- In the two financial years prior to the pandemic, Cebr estimates that the average UK household was able to save approximately £39 per week.
- Households' ability to save had been strengthening over this period. In April 2018, the savings of the average UK household amounted to around £31 per week. By February 2020, the final month before the pandemic, this value had increased to £43. During this period, wages grew at a faster rate than total spending costs.
- The pandemic had a stark impact on household savings. Despite downward pressure on wages during the early stages of the pandemic, household savings soared, amounting to £130 per week for the average UK household in Q2 2020. The main driver of this was the curtailment of spending opportunities, with the various rounds of coronavirus restriction measures reducing consumer activity.
- As economic activity returned in Q3 2020, savings levels subsided, yet remained elevated compared to pre-pandemic norms.
- Further upward pressure on savings levels followed in Q4 2020 and Q1 2021, being driven by reduced spending opportunities and renewed growth in wages.
- The return to economic activity and spending opportunities seen since then has reduced households' ability to save. Cebr's estimate for average household savings in January 2022 stands at £41, aligning with the values seen pre-pandemic.

Figure 10: Estimate of weekly savings for average UK household, April 2018 – January 2022

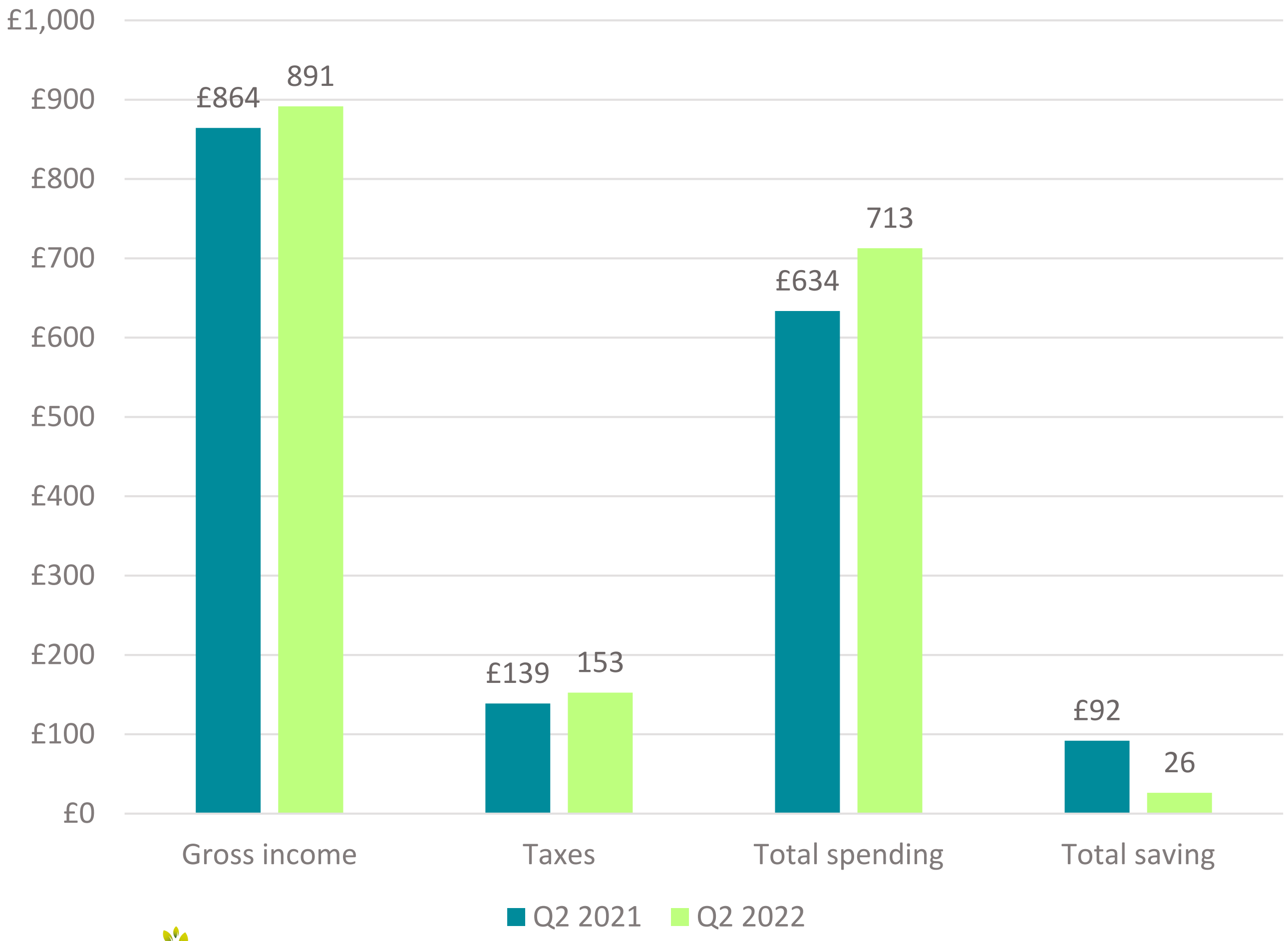


Source: Living Costs and Food Survey, Cebr analysis

Savings levels expected to fall drastically in Q2 2022

- In the very near term, Cebr expects household savings to stand in line with pre-pandemic levels. Our nowcasts for February and March 2022 show weekly savings estimates of £42 and £41, respectively.
- However, several sources of downward pressure are anticipated in Q2. For example, the Ofgem price cap will rise in April, increasing the price of domestic energy. This will reduce households' ability to save by increasing their total spending. Coupling this with broader inflationary pressures, Cebr expects total household spending to be 11.9% higher in April 2022 than the same month of 2021.
- Changes to tax policy are also set to impact savings from Q2 onwards. The tax-free personal allowance for income tax will be frozen at £12,570 and will remain at this level until 2026. This policy change will reduce the real value of take-home pay, given that the allowance ordinarily increases in line with inflation.
- Another source of downward pressure on take-home pay, and hence on households' ability to save, is the increase to National Insurance contributions. Rates are to increase by 1.25 percentage points from April.
- Collectively, these factors are set to curtail households' ability to save at the beginning of the new financial year. Cebr expects average household savings to drop to £26 per week in Q2 2022. This would represent an annual fall of 71.4%.
- According to the ONS, there are 28.1 million households in the UK. As such, aggregate weekly household savings in Q2 2022 are expected to be £737 million. This would be down from £2.6 billion in Q2 2021.
- In order to save at the same level as in Q2 2021, households would have to earn £80 more per week before tax than is expected to be the case in Q2 2022. Alternatively, they would have to spend £66 less.

Figure 11: Estimate of weekly income, taxes, spending, and savings for average UK household, Q2 2021 and Q2 2022



Source: Living Costs and Food Survey, Cebr analysis

Savings levels to be weaker across 2022 as a whole

- Household savings levels are expected to partially recover from their hit in Q2 2022. In Q3 and Q4, savings for the average UK household are expected to amount to £42 and £45, respectively. These values align broadly with the pre-pandemic trend for savings rates.

- If the conflict in Ukraine feeds into higher inflation rates, these savings levels would likely be lower.

- The improvement from Q2 savings levels into the later quarters of the year is expected to be driven by wage growth as well as an easing of inflationary pressures.

- Despite the uptick compared to Q2, annual falls are witnessed when comparing the expected savings levels with those witnessed in the same quarters of 2021. Cebr estimates that the average UK household saved £65 per week in Q3 2021 and £47 per week in Q4. As such, annual contractions in weekly savings of 36.0% and 4.5% are anticipated.

- Across 2021 as a whole, Cebr estimates that the average UK household saved £89 per week. This was driven by the reduced spending opportunities at several points of the year, as well as the high wage growth environment. Various policy levers, such as the Universal Credit uplift, also supported incomes during the year.

- By contrast, the average UK household is expected to save just £39 per week in 2022. This represents a fall of 56.6%. This lower value is being driven by higher inflation, weaker wage growth, and reduced take-home pay.

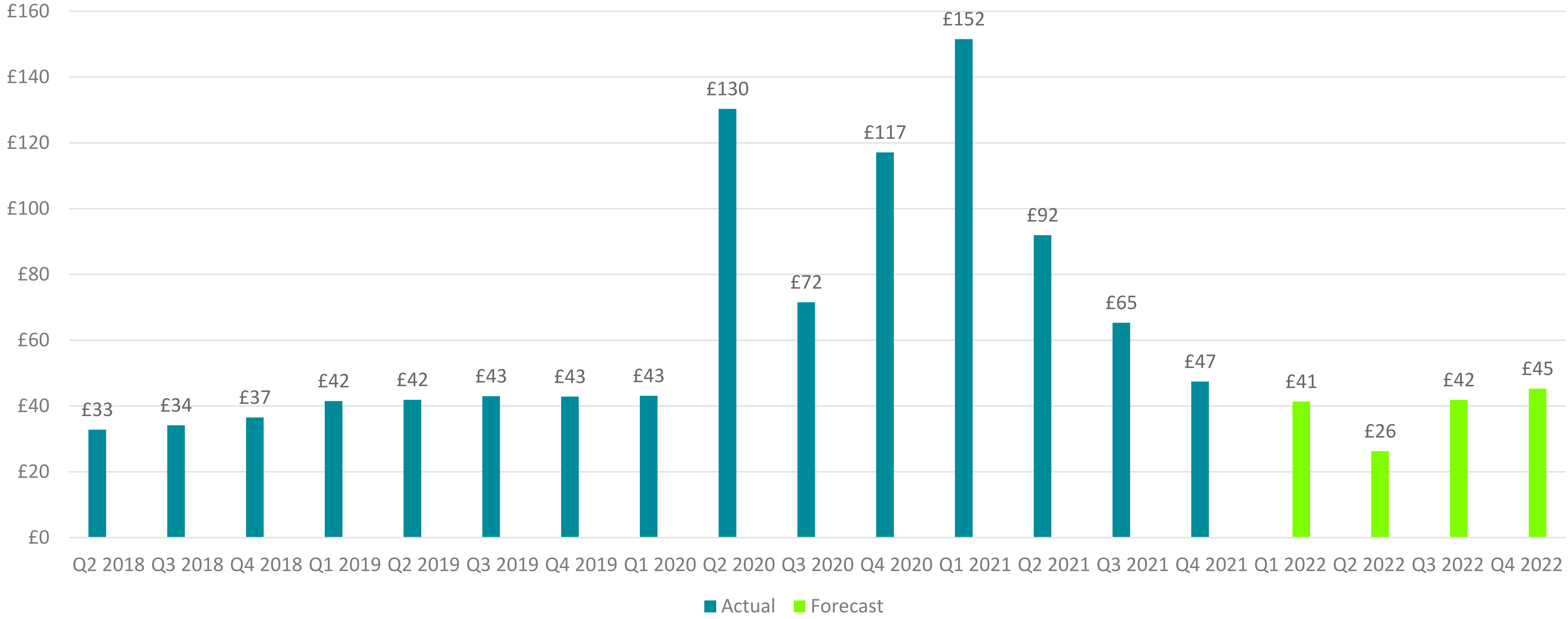
- In order to save at the same level as in 2021, households in 2022 would have to earn approximately £60 more per week, prior to tax. Alternatively, they would have to spend £50 less.

Figure 12: Estimate of weekly income, taxes, spending, and savings for average UK household, 2021 and 2022

Source: Living Costs and Food Survey, Cebr analysis

Savings levels expected to return to pre-pandemic trends

Figure 13: Estimate of weekly savings for average UK household, Q2 2018 – Q4 2022



Source: Living Costs and Food Survey, Cebr analysis

Methodological note

- The savings estimates produced in this report are based upon Cebr's established methodology for monitoring household incomes.

- Savings are defined as the money left that households have left over once taxes and spending costs have been subtracted from gross incomes. That is,

Total household income – Taxes = Net income

Net income – Household spending = Household savings

- Our estimates for the components of this equation stem from the Living Costs and Food Survey. This is then updated using official statistics on average earnings, unemployment, social security payments, interest rates and pension income.

- Cebr forecasts were used to produce forward-looking estimates of the components of the savings equation. Cebr's forecasts for the UK economy are updated on a monthly basis.

- The forecasts used as an input to this this report were produced on 28 February 2022 and represent Cebr's central scenario for the UK economy, encompassing trends and events as of this date.

- For instance, this encompasses early estimates of the impact of the conflict in Ukraine, which escalated from 24 February 2022. Events since then have not been accounted for in these forecasts, however.

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