Scottish Friendly

Household financial dilemmas

A Cebr report for MRM and Scottish Friendly

April 2024

Executive summary

Cebr is pleased to present the following report to MRM and Scottish Friendly on household financial dilemmas. Key findings from this report include:

Background on consumer trends

- Having faced considerable weakness in 2023, the outlook for consumer health and the economy as a whole is improving this year.
- Factors driving this improvement include the expectation of further deceleration in inflation, interest rate cuts, and continued real earnings growth.

Household financial dilemmas

- Respondents to our consumer survey reported that they have cut back on their saving and investing, largely due to the impact of rising prices.
- Spending behaviour has also been impacted by rising prices. Consumers reported a decrease in the value of their spending across categories such as restaurants and hotels, clothing and footwear, and recreation and culture, suggesting a general cutback across discretionary activity.
- Meanwhile, the value of spending has increased across food, housing and utilities, and transport. This reflects the fact that consumers are less able to substitute away from these categories.

Family Finance Tracker

- The Family Finance Tracker stood at 45.7 in February 2024. The value being below 50 indicates a general preference towards short-term financial goals over longer time horizons.
- This was slightly up on the value that would have prevailed in February 2022, when the cost-of-living crisis was first taking hold.
- Looking ahead to February 2025, the Tracker is expected to pick up to 46.8, reflecting the general view that economic performance and consumer health will strengthen over this period.
- Demographics reporting higher values on the Tracker, indicating greater preferences towards longer-term financial goals, included men, younger people, and those in higher earning households.

Preferences on financial goals

- Survey respondents were more likely than not to report their financial position as comfortable, but there are clear demographic differences.
- Consumers are more likely to use ISAs and investment products to support longer-term goals.
- A majority of respondents have plans to pass on their wealth upon death.

Background on consumer trends

Growth prospects improving for 2024 as a result of anticipated slowdown in inflation and interest rate cuts

- In 2023, elevated inflation rates and borrowing costs led to historically high levels of living costs. These conditions contributed adversely to economic activity, leaving the economy in a technical recession by the end of the year.

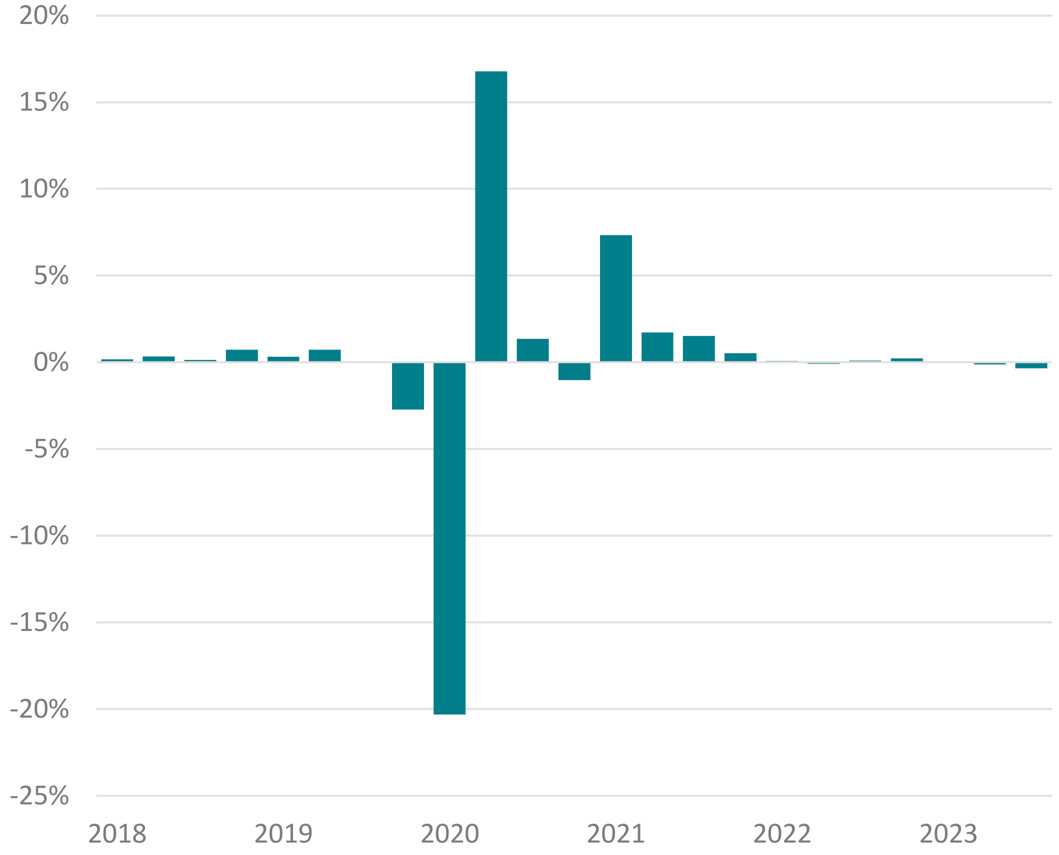
- However, it should be noted that the recession was a mild one and that the economy has already shown signs of recovery, creating a more optimistic growth outlook for 2024. The improved growth prospects are being driven by expectations of decelerating inflation, real earnings growth, and anticipated interest rate cuts.

- Inflation has largely been decelerating since late 2022. However, recent readings have shown signs of price stickiness, with price inflation having not decelerated since November 2023. Despite this, inflation is expected to slow further in 2024, particularly in April, when the reduction in the energy price cap comes into play.

- With inflation slowing down, the Bank of England (BoE) is expected to commence interest rate cuts in the middle of the year, offering further relief to households. However, rates are likely to remain in restrictive territory for the rest of the year and to settle at a higher rate relative to before the hiking cycle.

- Overall, macroeconomic conditions appear to be more favourable for households in 2024 than in 2023, with the slowdown in inflation driving this improvement. Furthermore, this year will also see a minimum wage uplift and a National Insurance rate decrease, offering support to households through increased take-home pay.

UK quarterly GDP growth



Source: Office for National Statistics (ONS), Cebr analysis

Strong nominal earnings growth has supported three consecutive quarters of improvement in real terms

- Rising living costs have been partially offset by historically elevated earnings growth in recent years. Such growth has been supported by three main factors: the tightness of the labour market, the inflationary environment, and policy changes.

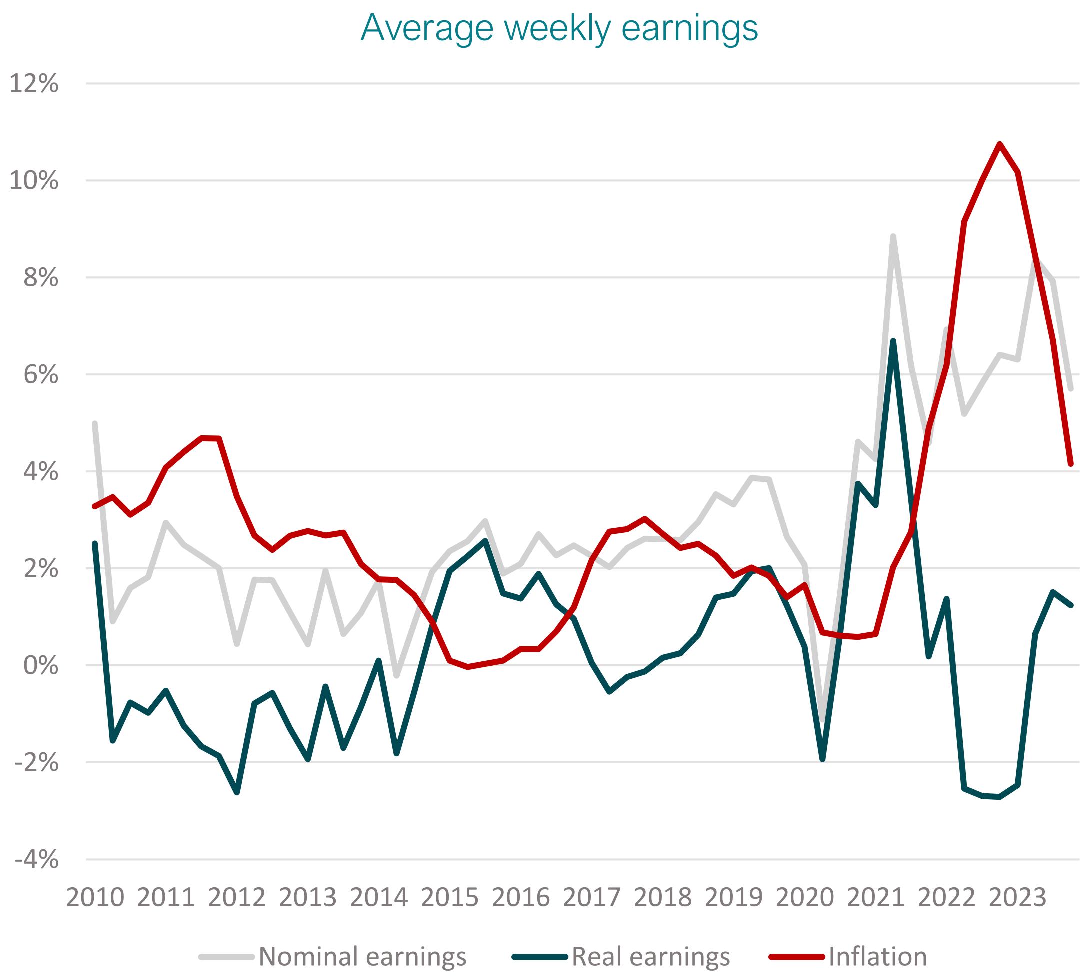
- Despite an aggressive monetary policy campaign, labour market conditions have remained tight, increasing workers' bargaining power when it comes to pay increases. Elevated inflation has also contributed to strong nominal wage growth, with workers seeking to reduce the impact of inflation on their living standards.

- On the policy front, several measures were implemented in 2023 to mitigate the impact of inflation on households. This included one-off payments to NHS and civil service workers and an inflation-adjusted uplift to the National Living Wage.

- Earnings growth has slowed down since its peak last summer. Nevertheless, it remains at historically elevated levels, with the latest reading showing an annual increase of 5.6% in the three months to January.

- Continually above average nominal earnings growth and the slowdown in inflation have combined to bring real wage growth back to positive territory since Q2 2023. This followed four consecutive quarters of annual contraction in real earnings. As of the three months to January, the rate of real earnings growth stands at 1.4%.

- Growth in real earnings has been supporting improvements in household spending power. However, these advancements follow a prolonged period of contraction. Consequently, households are expected to demonstrate inertia in their spending patterns, meaning it will take some time for the benefits of increased real wages to fully permeate through the economy.



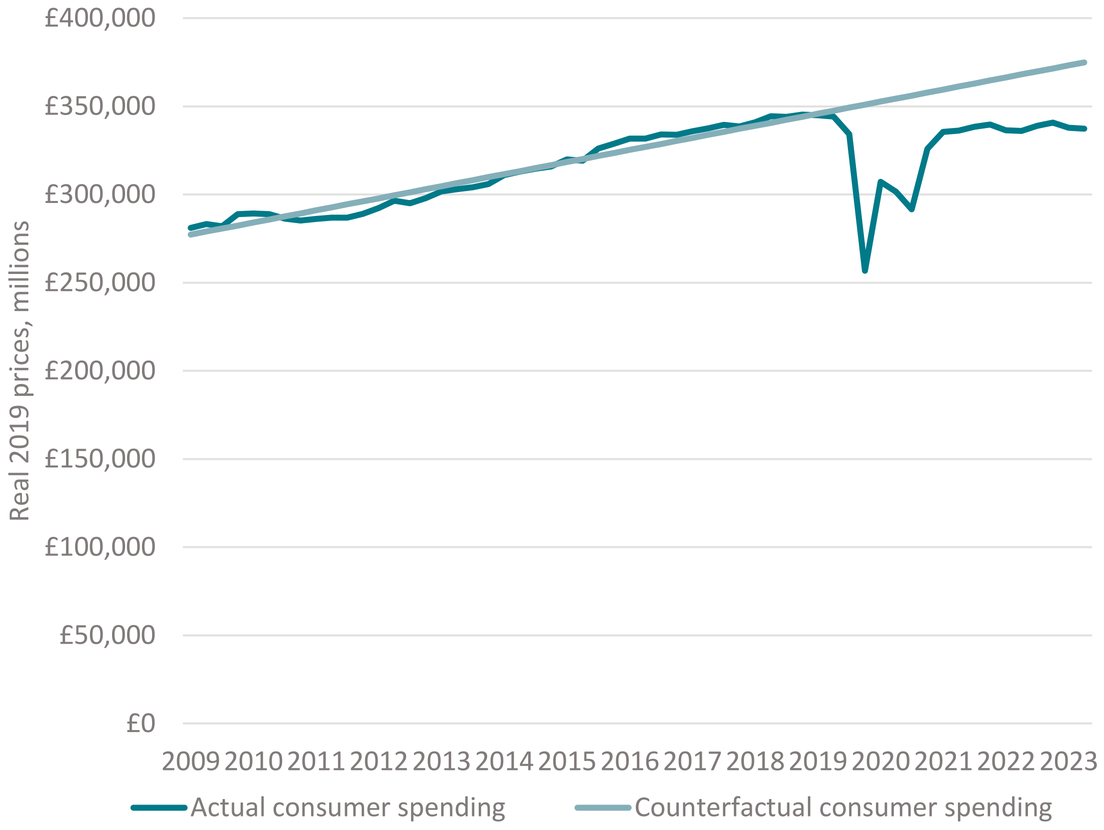
Source: ONS, Cebr analysis

Cebr

Stronger consumer spending expected in 2024

- Consumer spending contracted by only 0.1% on a quarterly basis in Q4 2023. This did follow a significant fall of 0.9% in the previous quarter, however, which helped to drive the economy into recession.
- On an annual basis there were some more positive developments, with consumer spending increasing by 0.4%, reflecting the effects of slowing inflation, strong real wage growth, and improved spending power.
- Real household spending in Q4 2023 remained 10.0% short of where it would have stood if it had continued growing at its pre-pandemic trend. This represents a significant shortfall, holding back overall economic activity and growth.
- In monetary terms, the quarterly shortfall is equivalent to forgone consumption of around £46 million in current price terms.
- The outlook for 2024 is brighter, however. Cebr anticipates consumer spending to pick up this year, recording growth of 1.5% annually.
- This would be significantly up on the growth of just 0.3% recorded across 2023.

Real consumer spending

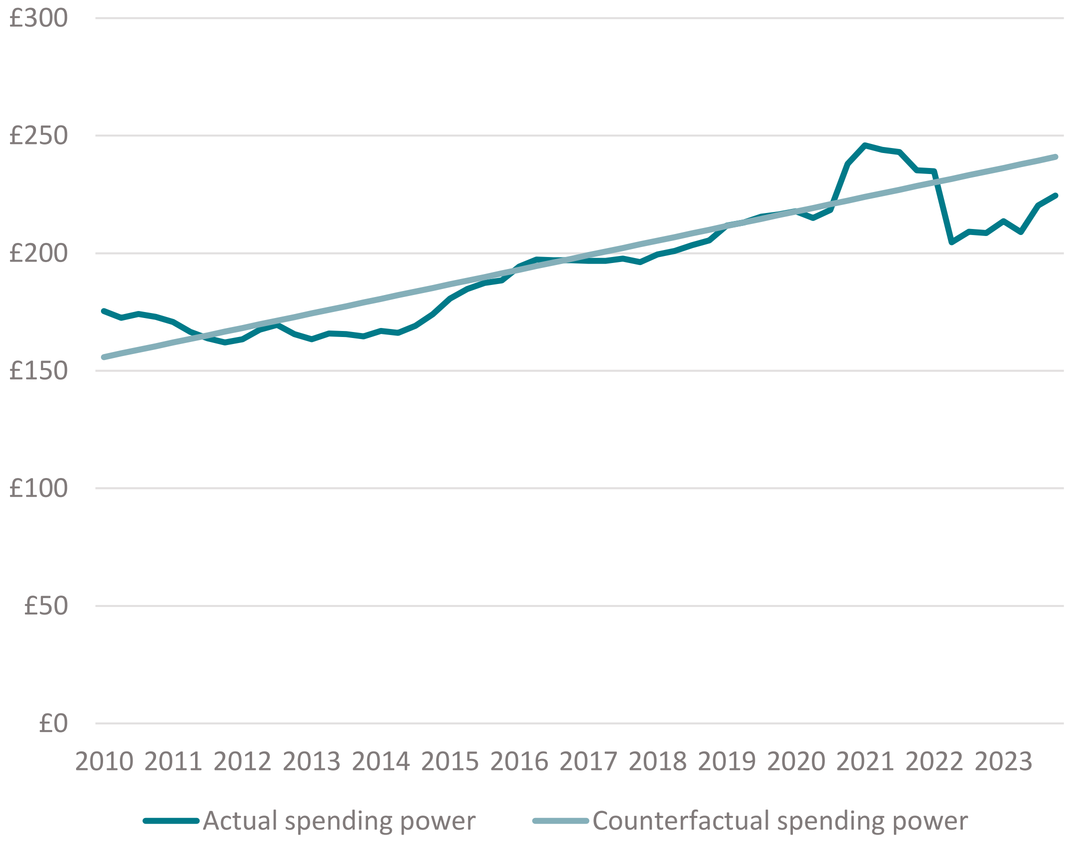


Source: ONS, Cebr analysis

Household discretionary income has now recorded positive change for the past three consecutive quarters

- Inflation has largely exhibited a decelerating trend since late 2022. The latest reading for January 2024 showed an inflation rate of 4.0%. This represents a 7.1 percentage point decrease from its peak of 11.1% during the cost-of-living crisis.
- Within the headline inflation figure, food and non-alcoholic beverages has experienced a deceleration in inflation since July 2023, recording single-digit rates for three consecutive months and standing at 6.9% as of January.
- Meanwhile, the housing and utilities category has seen deflation since October 2023, with prices falling by 2.1% in January. The weaker price pressures in these categories are crucial to consumer health as they constitute a significant portion of spending, offering relief to households.
- The slowdown in inflation, particularly in essential categories, combined with elevated wage growth has led to an improvement in household discretionary income, with a 7.6% annual increase recorded in Q4 2023 and positive growth rates observed for the past three consecutive quarters.
- Household spending power has now reached pre-pandemic levels, however, it still falls short of the values witnessed immediately before the cost-of-living crisis.
- Spending power in Q4 2023 was approximately 6.8% short of where it would have stood if it had continued growing at its pre-pandemic pre-cost-of-living crisis trend.

Average weekly discretionary income

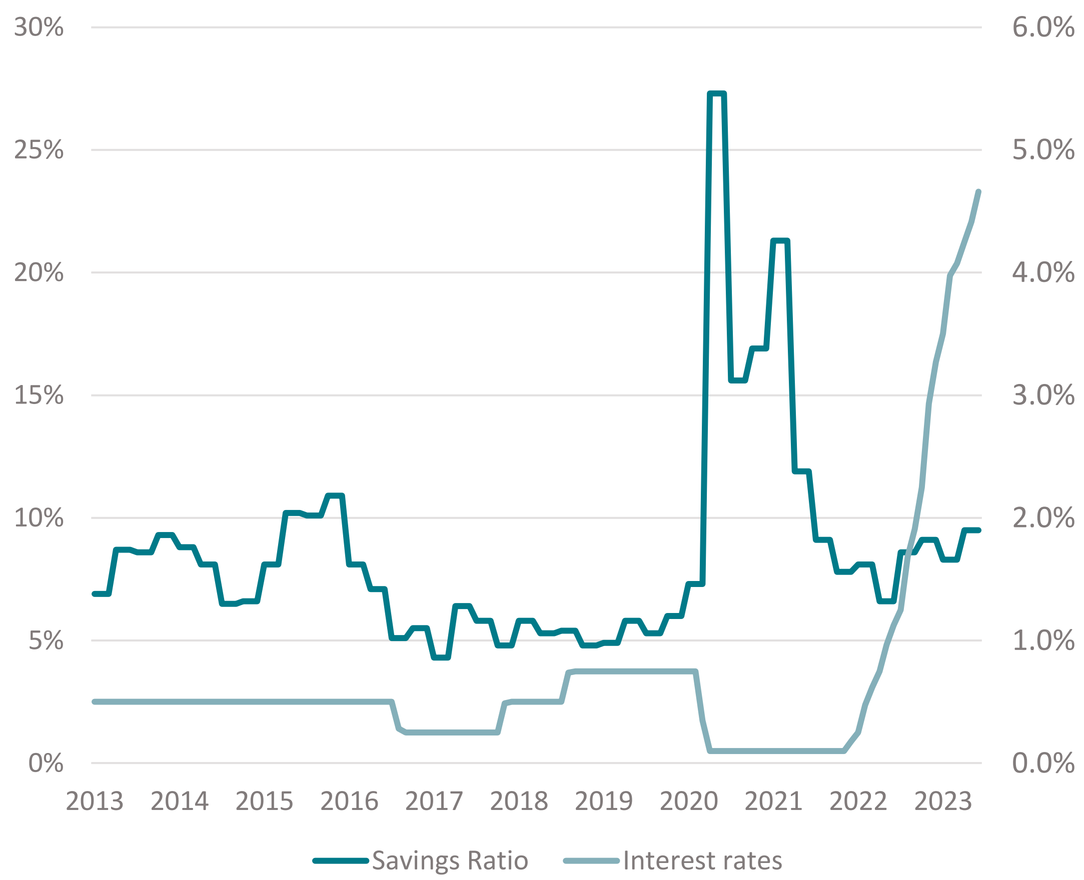


Source: Asda, Cebr analysis

Savings ratio remains above pre-pandemic levels while borrowing levels reach recent highs

- The savings ratio reached a record high of 27.3% during the pandemic, driven by reduced household spending due to government-imposed restrictions.
- As the economy recovered and spending resumed, the savings ratio gradually declined. However, since the beginning of 2023, it has begun to pick up again. This resurgence is likely influenced by interest rate hikes and increased borrowing costs, prompting households to prioritise saving their incomes to capitalise on higher returns.
- Despite the anticipated cuts from this summer, interest rates are unlikely to fall to pre-pandemic lows and will be in restrictive territory for the remainder of the year. As such the savings ratio is unlikely to fall by a large margin in 2024.
- Despite higher borrowing costs, there has also been an increase in consumer credit uptake. This likely reflects households' need to borrow more to support their living standards amidst the elevated cost of living.
- Net consumer borrowing surged to £1.9 billion in January, up from £1.3 billion in December, as reported by the Bank of England. This rise was primarily fuelled by an uptick in borrowing via consumer credit cards, which spiked to £0.9 billion in January from £0.3 billion in December. The annual growth rate for all consumer credit also rose in January, reaching 8.9%, the highest level since June 2018. This rise in credit uptake reflects the potentially long-lasting impacts of the cost-of-living crisis.

Savings ratio (LHS) and interest rates (RHS)

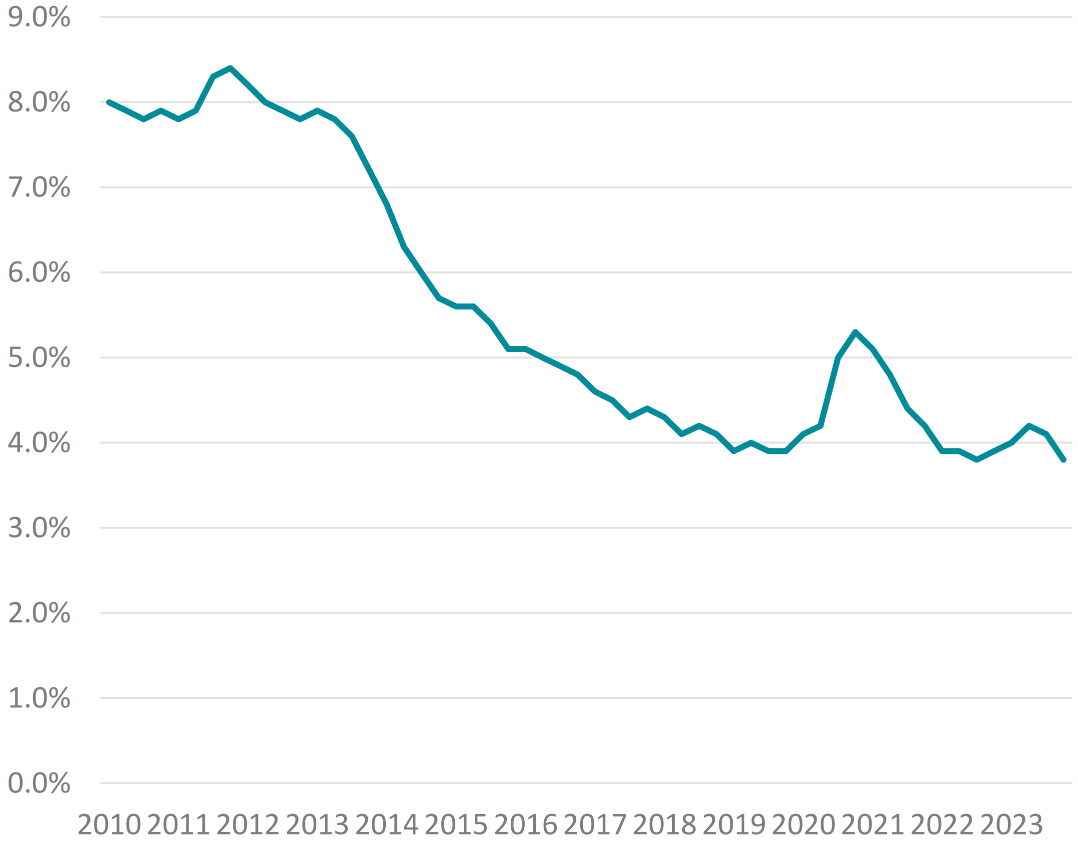


Source: ONS, Cebr analysis

Labour market conditions seem appropriate for the Bank of England to cut rates from the summer

- The UK unemployment rate for the three months to January stood at 3.9%, down from the 4.0% in the previous three months.
- The continually low unemployment rate suggests that the labour market is still in a relatively strong position. This is likely to persist, in spite of the recent weakness faced by the economy at the aggregate level. Notably, Cebr expects the recent recession to be followed by only a marginal increase in the unemployment rate, reaching a peak of 4.0% later this year.
- However, there are some immediate signs of slight loosening. For instance, wage growth is slowing down, while vacancies, a proxy for hiring intentions, are on a downward trend.
- These factors improve the chances of an interest rate cut. Indeed, Cebr expects cuts to commence from June, with multiple policy changes projected this year. Whilst such rate cuts will not bring interest rates to pre-pandemic lows, they will offer some relief to households by easing the cost of borrowing.
- Despite the overall resilience in the labour market, there are some external pressures arising, notably from the rise in the inactivity rate. The economic inactivity rate for the three months to January stood at 21.8%, exceeding estimates from a year ago. This annual increase was driven by individuals being inactive due to long-term sickness, which remains at historically high levels after the pandemic.

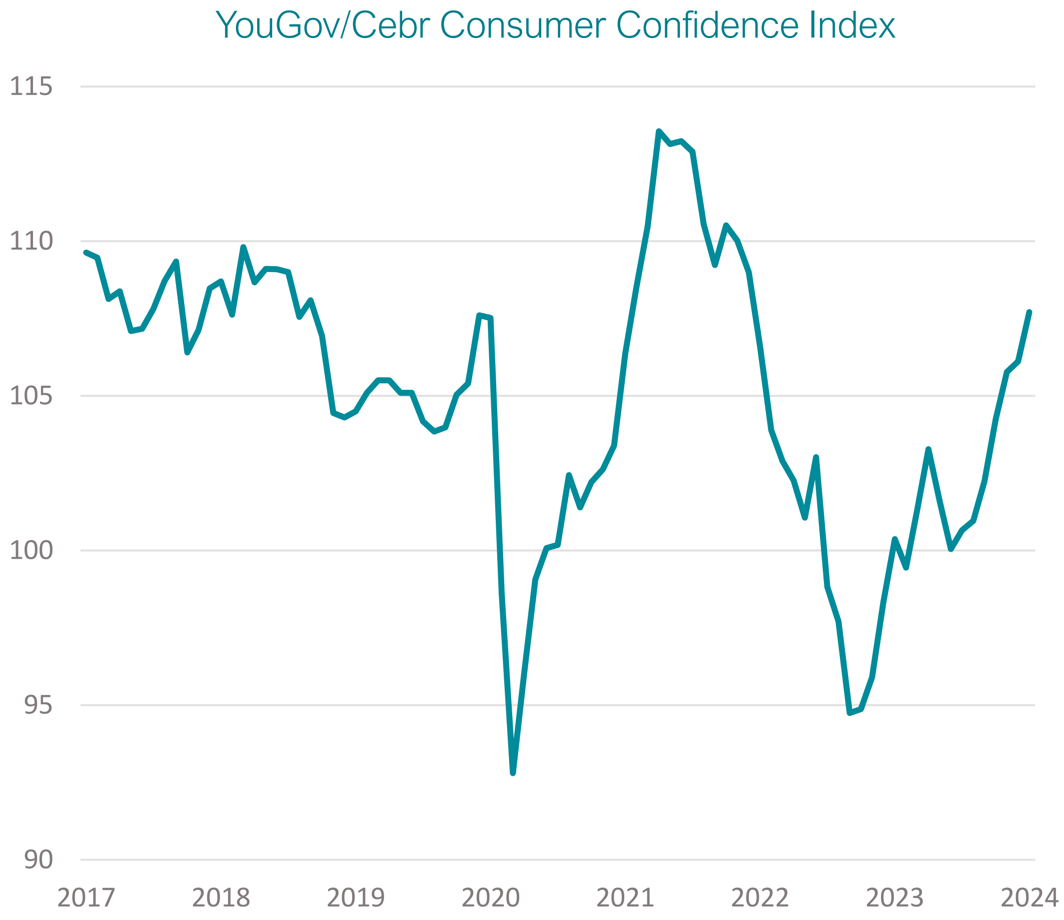
Unemployment rate



Source: ONS, Cebr analysis

Consumer confidence has been on an improving trend since August 2023

- The YouGov/Cebr Consumer Confidence Index increased by 1.6 points in February to reach 107.7.
- This represents the seventh consecutive month of improvement and the eleventh consecutive positive value, as indicated by a value in excess of 100.
- The latest data showed the most optimistic outlook since January 2022, with all but one of the indices recording improvements on the month.
- Notably, the Index has recently shown stronger sentiment amongst households regarding the state of their finances. These improvements reflect the easing inflationary pressures over the last few months. Nevertheless, sentiment here still remains in a net negative position, underscoring the lingering impact of the cost-of-living crisis.
- Other components of the indicator have faced more turbulence recently. Notably, perceptions of house prices have faced some downward pressure. This aligns with the interest rate environment, which has impacted the housing market by raising borrowing and financing costs.



Source: YouGov, Cebr analysis

Household financial dilemmas

Rising living costs the main driver of weaker savings behaviour

- As outlined in Section A, UK consumers have recently faced considerable turbulence, dealing with the effects of elevated inflation and tighter interest rates. This section explores the extent to which these trends have induced behavioural changes, via a bespoke survey of 2,600 consumers.

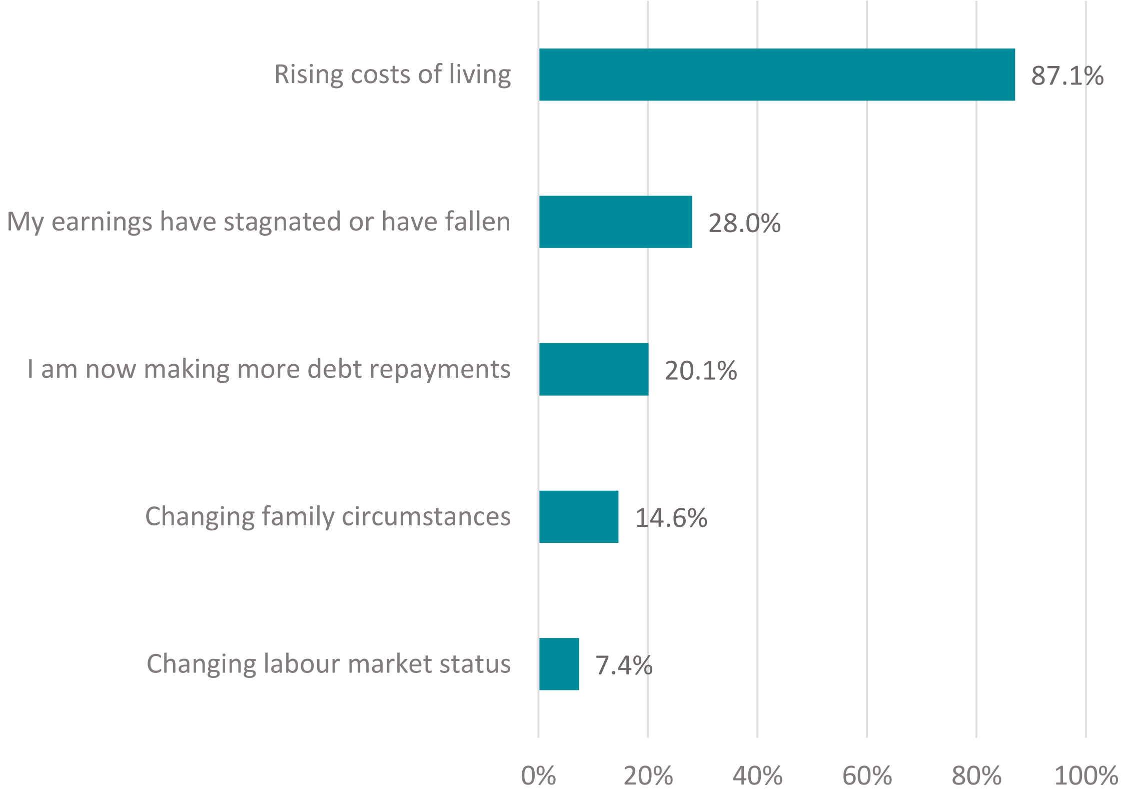
- Beginning with savings behaviour, aggregate level data show that the savings ratio fell sharply after the pandemic but has largely been on an upward trajectory since mid-2022. This trend is only partially corroborated by survey data. 41.0% of the sample reported that they save less now than they did two years ago, outweighing the 33.0% of the sample stating that they save more now than they did two years ago.

- Amongst those saving more now, the most commonly cited reason was that their earnings are now higher, being the case for 43.0% of this group. This corroborates with aggregate level data on earnings, showing that wage growth has been historically elevated for an extended period.

- The next most commonly cited reason for saving more now was to support future financial goals, selected by 37.2%. Meanwhile, 27.5% of the sample stated that their higher savings were due to economic conditions encouraging them to be more cautious. The same share said that higher saving was the result of reduced spending levels.

- Amongst those saying that they save less now, an overwhelming majority (87.1%) said this was because of rising living costs.

Top five reasons why consumers are saving less now than two years ago

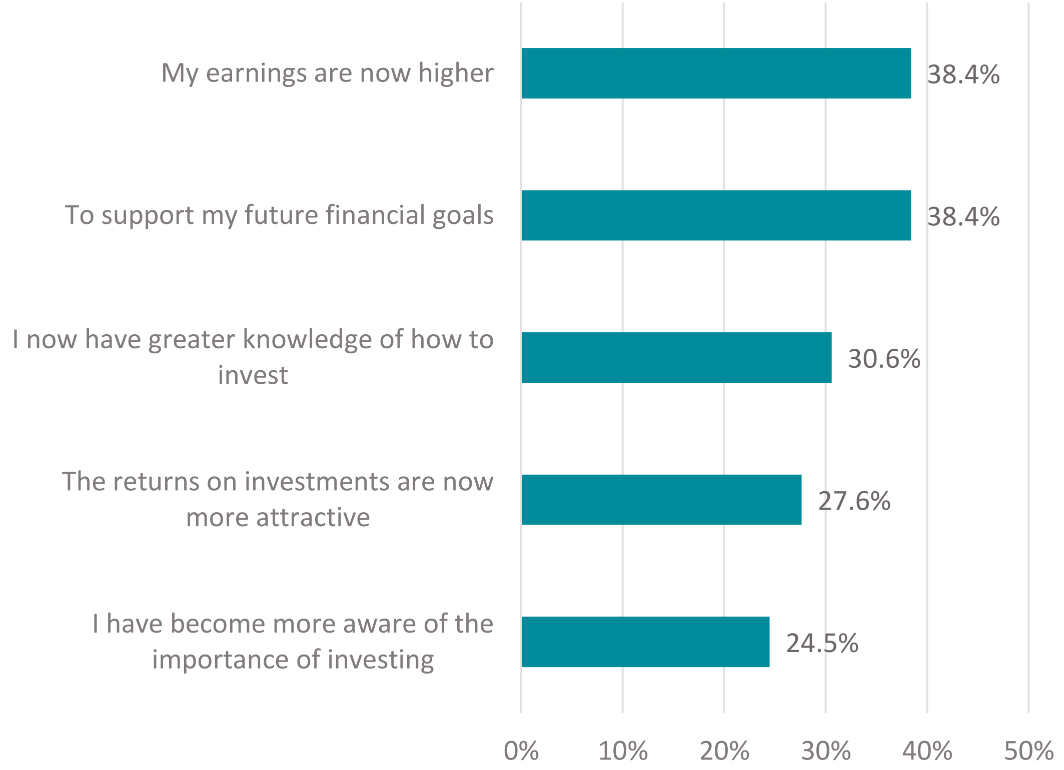


Source: 3Gem survey, Cebr analysis

Investment behaviour also affected by living cost pressures

- Similar trends were reported by consumers when considering investment behaviour.
- Just 18.2% of the sample said that they invest more now than they did two years ago. This share was outweighed by the 32.9% stating that they invest less now.
- As with savings, the main reason for investing more now relative to two years ago was higher earnings, being cited by 38.4% of this subgroup. The same share reported supporting their future financial goals as a reason behind their greater investment rate. 30.6% stated that they invest more now because they have greater knowledge of how to do so.
- Rising living costs was the most commonly cited reason amongst those stating that they invest less now than they did two years ago, being the case for 79.5% of this subgroup.
- Amongst demographics, those aged 18-24 were particularly likely to say that they are investing more now than they did two years ago, applying to 42.3% of this grouping.
- This was also one of few demographics for which the share of respondents stating that they invest more now outweighed the share reporting a lower rate of investment. Other groups for which this was the case included those in London, full-time students, those with household income of £75,000 or more, those with PhDs or Master’s degrees, and those living with parents or relatives.

Top five reasons why consumers are investing more now than two years ago

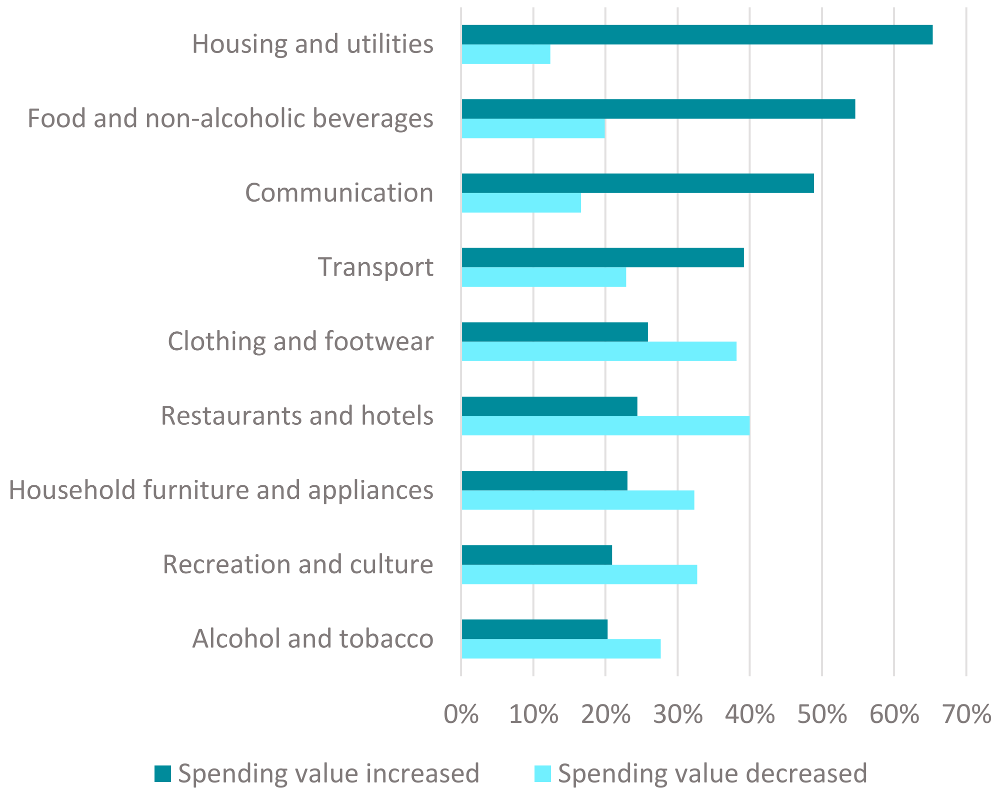


Source: 3Gem survey, Cebr analysis

Consumers cutting back on discretionary categories

- Spending behaviour has also adjusted as a result of living cost trends.
- When asking consumers about how their consumption behaviour has changed over the last two years, only four categories witnessed a larger share reporting an increase in spending value. Notably, these were all essential spending categories that consumers are less able to substitute away from, namely food and non-alcoholic beverages, housing and utilities, transport, and communication.
- Amongst these categories, housing and utilities showed the largest share recording an increase in the value of expenditure. 65.3% of consumers said that the value of their expenditure in this category was higher now than two years ago.
- All other consumption categories showed a larger share of consumers reporting lower spending values. Given that prices have risen on aggregate across all categories over this period, this suggests that consumers have been cutting back on discretionary activity amidst reduced spending power.
- Amongst these categories, restaurants and hotels recorded the largest share of consumers reporting a decrease in the value of expenditure, being the case for 40.0% of the sample.

Spending behaviour changes by consumption category



Source: 3Gem survey, Cebr analysis

2024

General attempts to spend less are the main driver of cutbacks

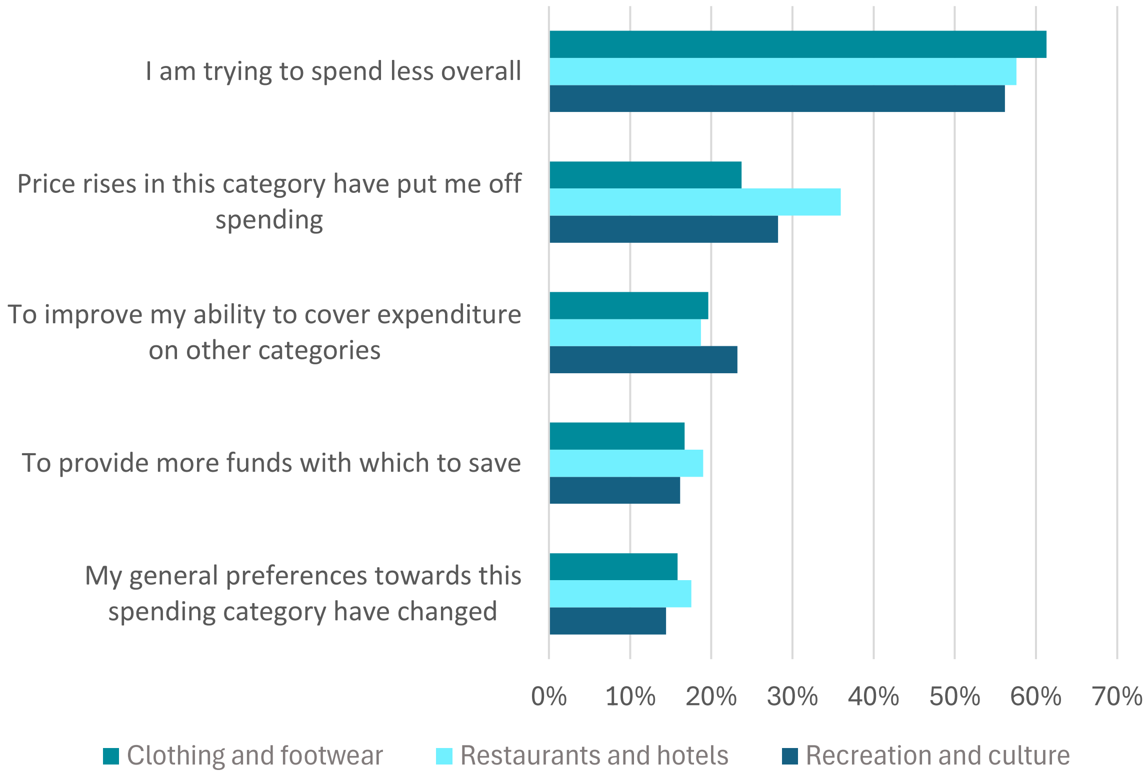
- When asking the consumers that stated they are spending more in a particular category about their reasons for doing so, this was overwhelmingly due to price rises. For instance, 89.7% of those spending more on food and non-alcoholic beverages stated that this was simply due to price rises in this category. The equivalent share for housing and utilities was 90.8%.

- There were other reasons for spending more in particular categories, however. In the case of household furniture and appliances, 23.5% of those spending more said that this was due to changing family circumstances, such as having children or moving property. In the case of recreation and culture, 23.4% said they are spending more because their general preferences towards the category have changed. This partially aligns with the post-pandemic trend towards greater spending on services activities.

- When asking consumers who are spending less on certain categories about their reasons for doing so, the most common response across all categories was that they are simply trying to spend less overall.

- In the case of restaurants and hotels and recreation and culture, the second-most selected reason why consumers are spending less is that price rises in those categories have put them off spending. This again corroborates with the view that consumers are cutting back on more discretionary activity.

Reasons why consumers are spending less on selected consumption categories



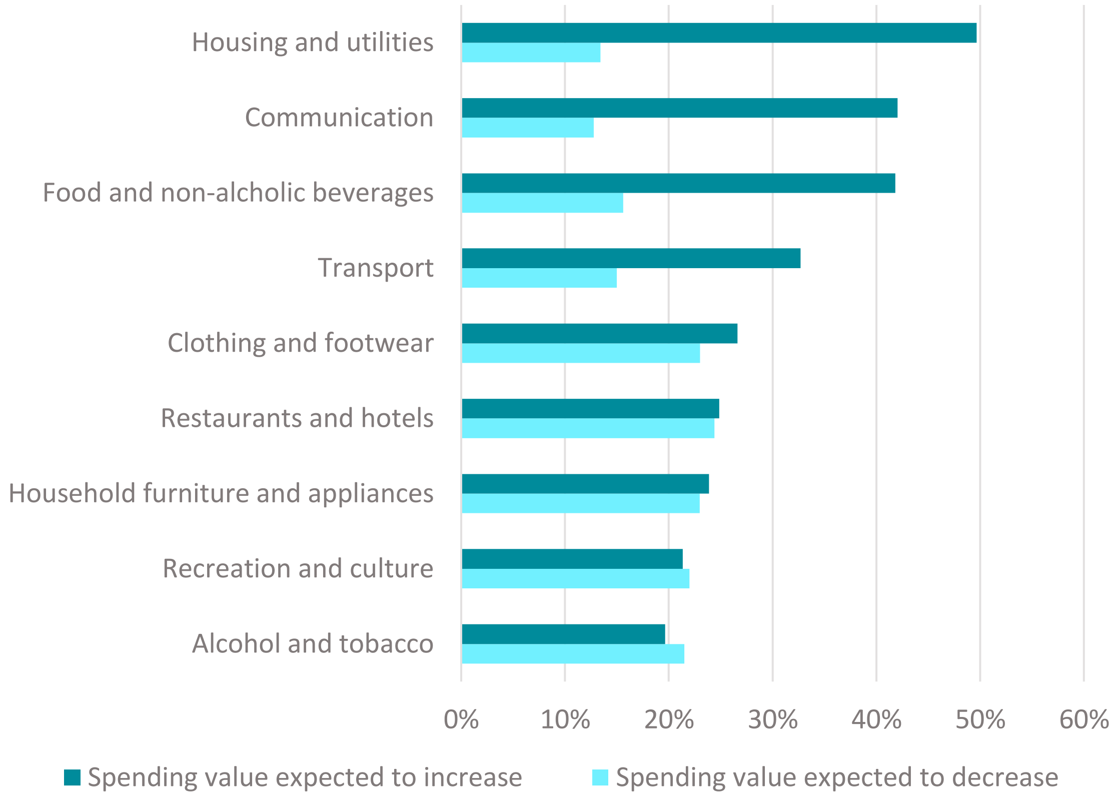
Source: 3Gem survey, Cebr analysis

2024

Consumers expect the value of expenditure to continue increasing for the majority of categories in 2024

- Our survey asked consumers about the extent to which they think their spending behaviour will change over the coming year.
- Across most consumption categories, consumers were more likely to state that they expect the value of their expenditure to increase than decrease. This corroborates with the general macro view that prices will continue rising at an above average pace in 2024.
- Consumers were particularly likely to report that they expect to spend more in the housing and utilities category. Here, 49.7% said that they expect the value of their spending to increase, relative to just 13.4% anticipating a decrease.
- This observation largely contradicts Cebr's macro view, with this category expected to witness deflationary pressure this year as a result of lower energy prices. The fact that consumers still expect to spend more in this category likely reflects embedded inflation expectations after facing a prolonged period of rapid price rises in this category.
- Alcohol and tobacco and recreation and culture were the only categories for which the share of respondents expecting the value of their spending to decrease outweighed the share anticipating an increase.

Expected spending behaviour changes by consumption category



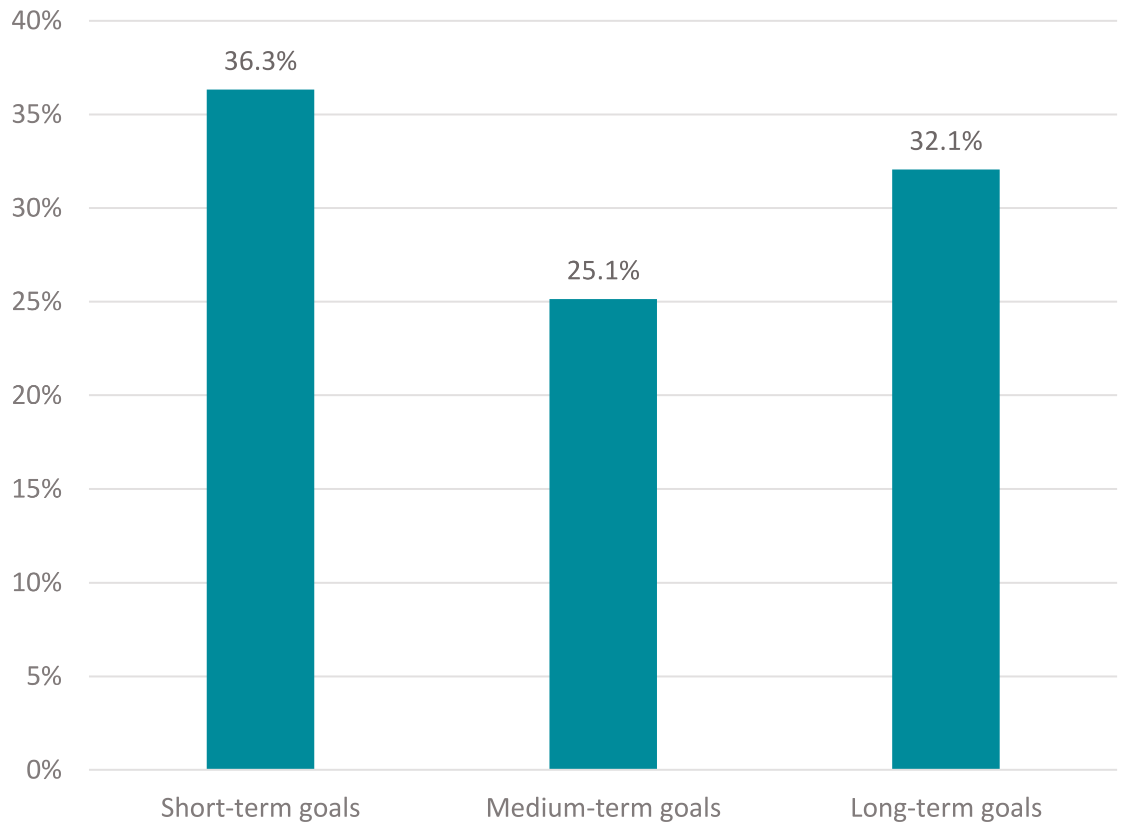
Source: 3Gem survey, Cebr analysis

Family Finance Tracker

Consumers reveal current preference for short-term financial goals

- This section presents the Family Finance Tracker. Using the results of the survey, this considers the extent to which households' priorities are changing when it comes to their financial choices.
- Consumers were asked about their priorities over short-, medium- and long-term financial goals. When asked about their current priorities, short-term goals were most likely to be ranked as the most important, being the case for 36.3% of the sample. Medium-term goals were least likely to be ranked as most important, being the case for 25.1%.
- Using these results, an indicator was constructed. The indicator is presented between 0 and 100, with 0 indicating complete prioritisation of short-term goals and 100 representing the complete prioritisation of long-term goals.
- The indicator can be interpreted as a measure of consumer health, with higher values being associated with greater preferences towards long-term planning.
- In turn, this can be taken as a measure of the health of the economy, since more stable economic conditions are generally associated with a lesser prevalence of short-term financial difficulties and are therefore more conducive to longer-term decision-making.

Share of consumers ranking as most important time period



Source: 3Gem survey, Cebr analysis

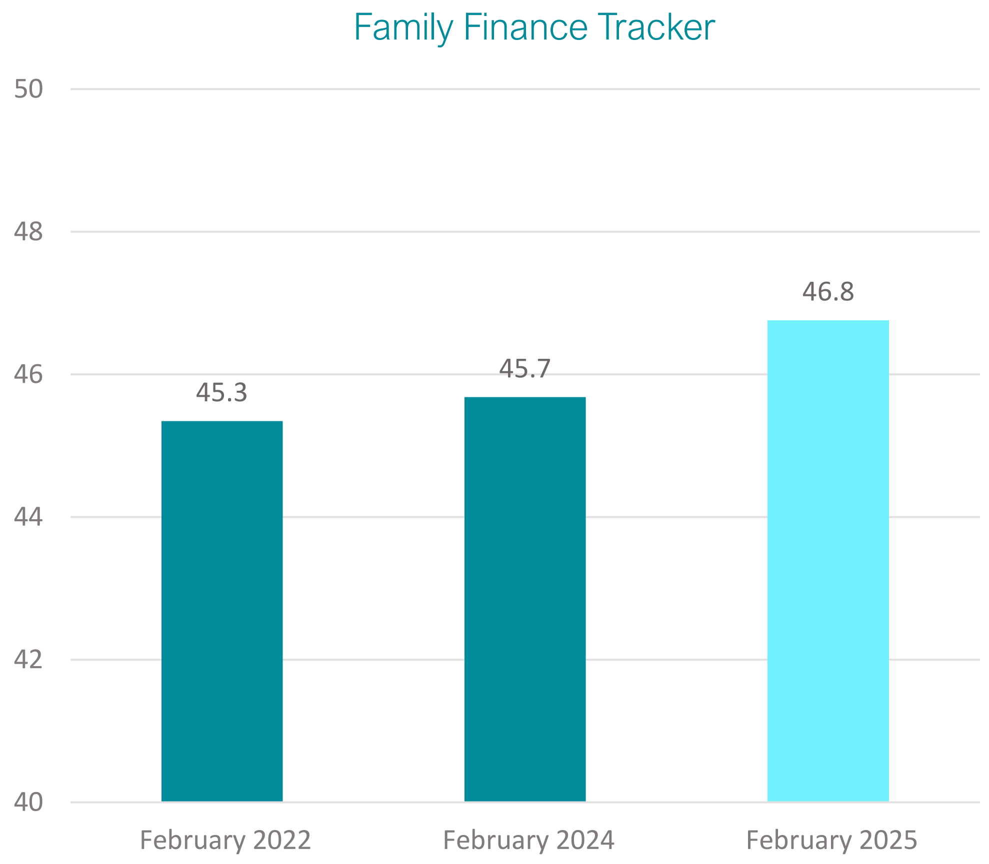
Family Finance Tracker showed marginal improvement over past two years, with further increase anticipated

- Using consumers' ranking of different time periods, our Family Finance Tracker stands at 45.7 as of February 2024. The value being below 50 suggests that consumers are tending to prioritise shorter-term financial goals.

- We asked consumers about what their attitudes towards financial goals were two years ago, in order to construct a backdated comparison point for the Tracker. This showed a lower value of 45.3, driven by the fact that a slightly higher share of the population reported prioritising short-term financial goals. At this point, inflation was still in an acceleration phase, putting firm downward pressure on consumer spending power and impacting the affordability of key consumption goods.

- We also asked consumers about what they expect their attitudes towards financial goals to be next year. Doing so revealed a larger share of the population expecting to prioritise longer-term financial goals, with 33.5% ranking this as their anticipated first preference. This translates into a higher value on the Family Finance Tracker, at 46.8.

- This aligns with the general view that economic performance and consumer health will strengthen over the next 12 months, driven by decelerating inflation and continued real earnings growth, facilitating longer-term financial planning.



Source: 3Gem survey, Cebr analysis

Largely positive relationship between income and preference for long-term financial goals

- The Tracker can also draw out divergences in financial priorities between demographics.

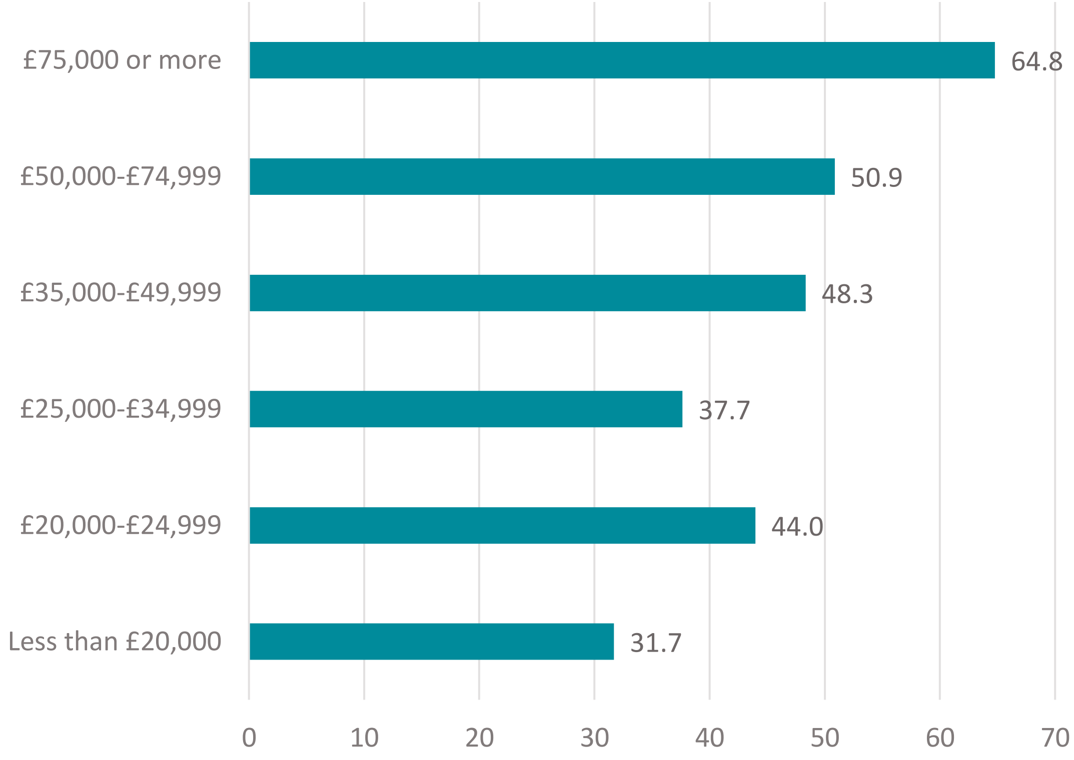
- For instance, when considering current financial priorities, male respondents showed a stronger preference towards making longer-term financial decisions. This is reflected in their Tracker score of 51.4, outweighing the equivalent figure for women of 40.9.

- In terms of age groups, those aged 18-24 reported the highest score on average, at 51.4. At the other end of the scale, those aged 65 and over received the lowest score, of 37.3.

- Amongst income groups, respondents with a household salary in excess of £75,000 were the most likely to rank longer-term goals as the most important. This contributed to a particularly high Tracker score of 64.8. At the other end of the scale, respondents with a household income of less than £20,000 received the lowest score of any income grouping, at 31.7. These findings likely reflect the fact that higher earnings provide households with a greater degree of stability, facilitating long-term planning.

- Respondents with grown-up children that have now left the household received a below average score of 41.8, indicating a stronger preference towards shorter-term financial goals.

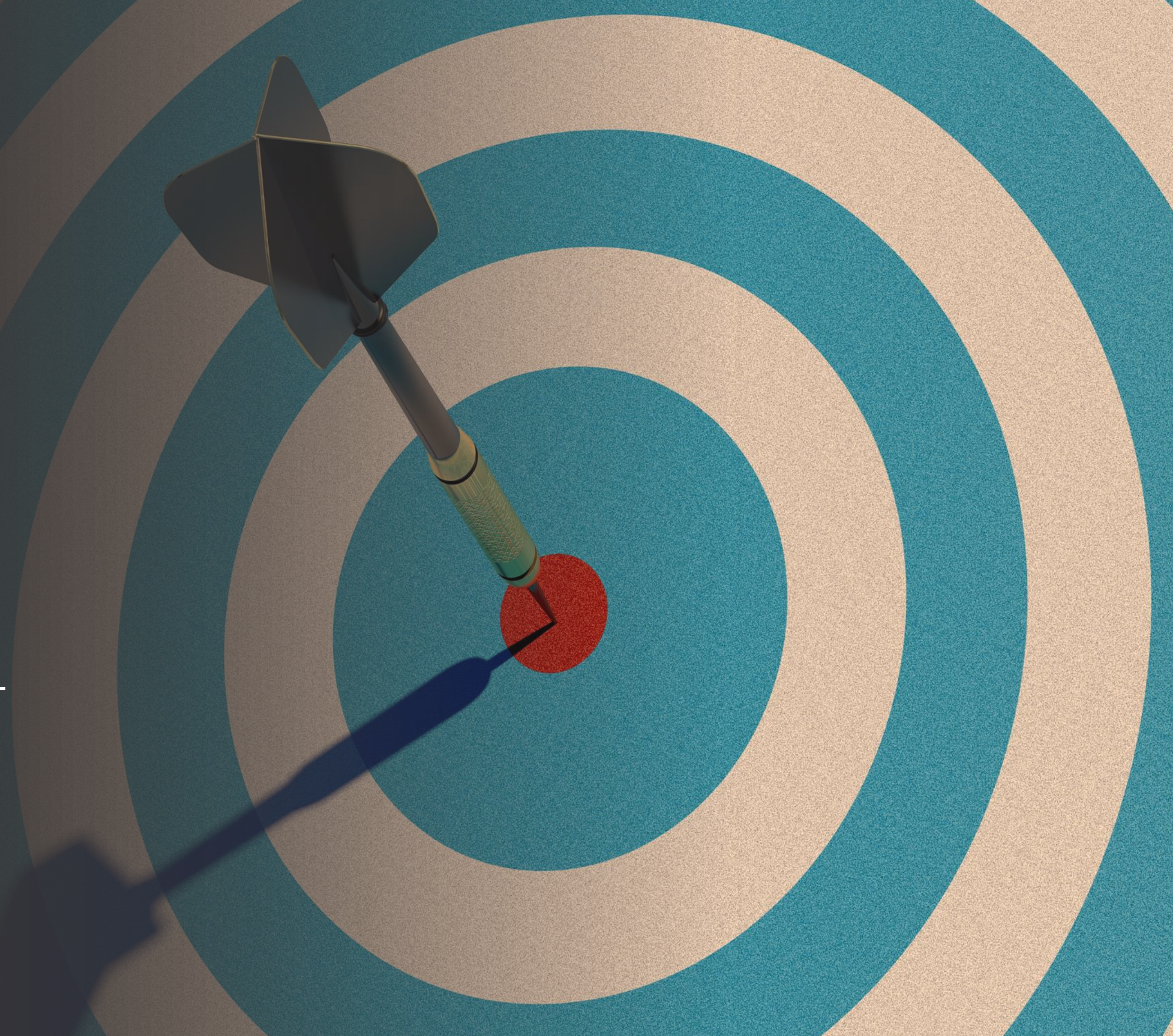
Family Finance Tracker by household income group, February 2024



Source: 3Gem survey, Cebr analysis

2024

Preferences on financial goals



Early retirement and leaving inheritance are the most frequently cited long-term financial goals

- Away from the Tracker, the survey questions on time horizons provided insight into consumers' preferences.

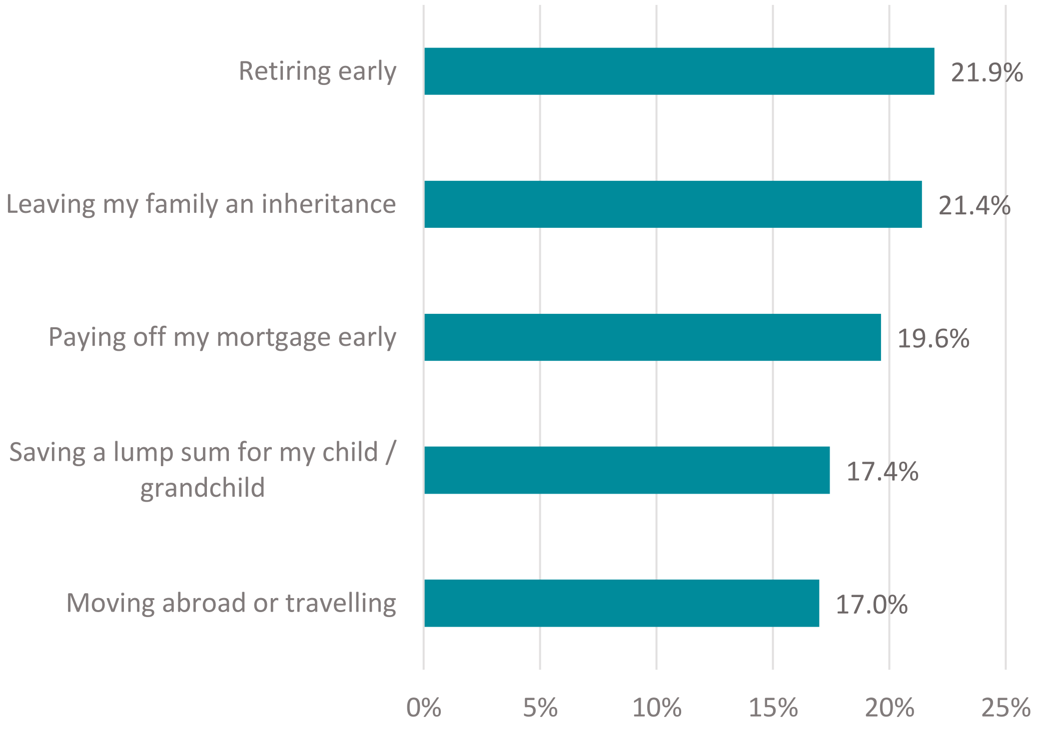
- For instance, when asking households about their top three highest priority short-term goals, there was a strong preference for 'saving for a rainy day', which was selected by 36.2% of the sample. This response was closely followed by saving to pay for everyday bills and holiday savings, cited by 35.5% and 34.6% of the sample, respectively.

- In terms of the highest priority medium-term goals, building a security pot for financial security and paying for home improvements were the most common responses, cited by 30.4% and 29.4%, respectively. Meanwhile, 10.7% of the sample said that they do not have any medium-term financial goals.

- Retiring early, leaving inheritances, and paying off mortgages early were the three most commonly cited long-term priorities, selected by 21.9%, 21.4%, and 19.6% of the sample, respectively. Meanwhile, 16.9% of the sample stated that they do not have any long-term financial goals.

- Those in the 'emptied nest' demographic were more likely to report not having any long-term financial goals, being the case for 20.0% of this group. The opposite was true for 'secured families', applying to just 8.0% of this demographic.

Long-term financial goals, five most common responses



Source: 3Gem survey, Cebr analysis

Respondents more likely than not to report their financial position as comfortable, but there are clear demographic differences

- A minority of respondents, 34.7%, said that they find it easy to divide between their short-, medium-, and long-term goals. However, this did outweigh the share of respondents stating that they find this difficult, which came to 31.5%.

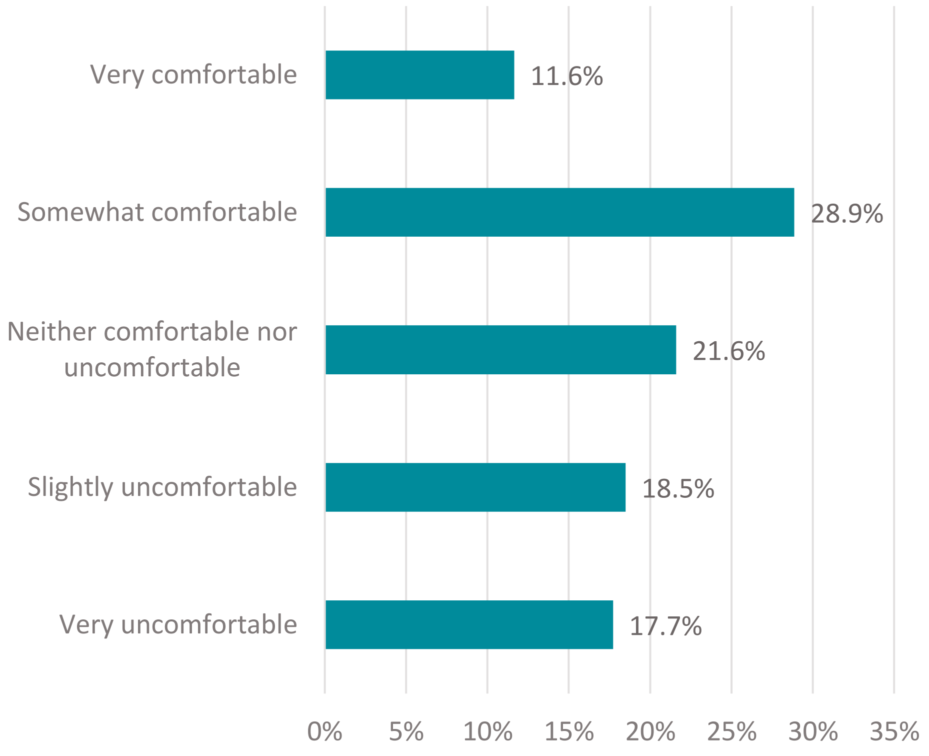
- Several demographics found this process more difficult on net. This was the case for female respondents, the unemployed, long-term sick and disabled people, parents with children still at home, renters, and those with low household incomes. The 'Secure families' demographic also witnessed a greater share of respondents finding this process difficult than easy.

- 42.2% of respondents said that they find it more difficult to balance their financial priorities now than they did ten years ago.

- Only a minority of respondents described their overall financial position as comfortable, being the case for 40.5% of the sample. This outweighed the share reporting their financial position as uncomfortable, which stood at 36.2%.

- Demographics particularly likely to describe their financial position as comfortable included retirees, those with PhDs or Master's degrees, homeowners, 'emptied nest' households, and those with a household income of £75,000 or more.

Perceptions of comfort regarding financial position



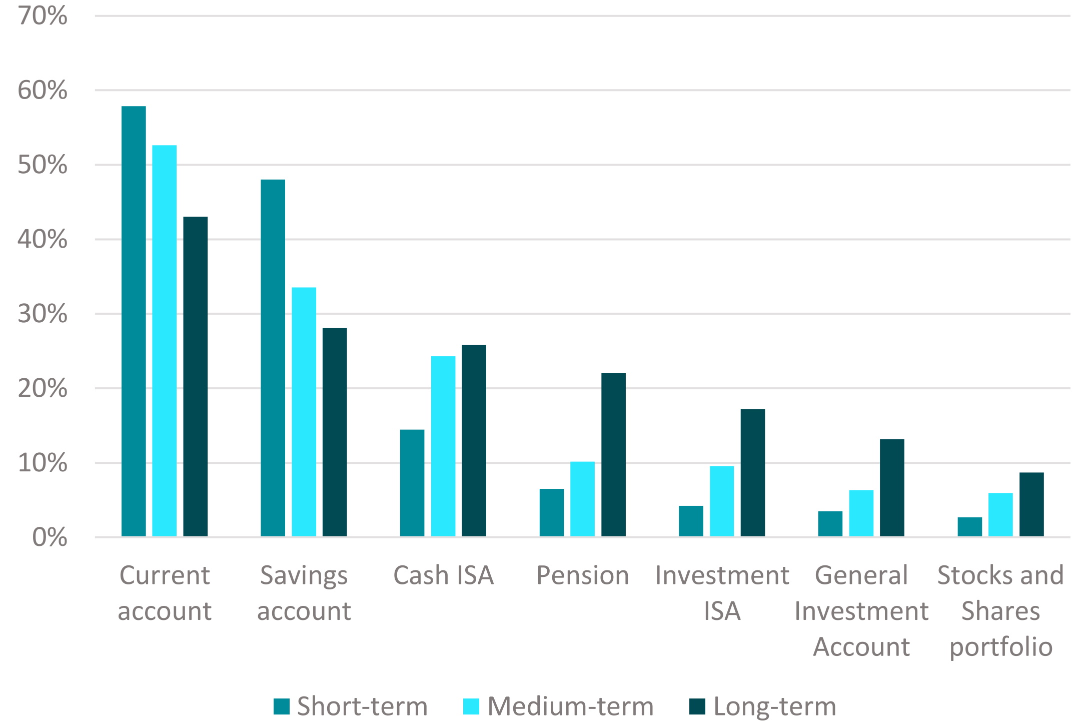
Source: 3Gem survey, Cebr analysis

Cebr

Consumers more likely to use ISAs and investment products to support longer-term goals

- When considering the products used to save towards financial goals, there were some key differences across time horizons.
- Current accounts are the most commonly used product for saving towards short-term goals, being the case for 57.9% of the sample. Savings accounts were the next most common, selected by 48.0%.
- For both medium- and long-term goals, savings accounts were the most commonly selected response option, at 52.6% and 43.0%, respectively.
- For medium-term goals, current accounts remain frequently used. 33.5% of the sample reported using this product to save towards the medium term.
- For longer-term goals, pensions were the second most common response option, selected by 28.1% of the sample.
- ISA products, across both the Cash and Investment varieties, were more likely to be used by respondents for long-term goals. This also applied to other investment options, such as stocks and shares portfolios and a general investment account.

Product usage rates by financial goal time horizon



Source: 3Gem survey, Cebr analysis

2024

Majority of respondents have plans to pass on their wealth upon death

- A majority, 58.9%, of respondents stated that they have plans to pass their wealth to someone when they die. Both ‘emptied nest’ and ‘secure families’ respondents were disproportionately likely to have such plans, being the case for 76.4% and 66.7%, respectively.

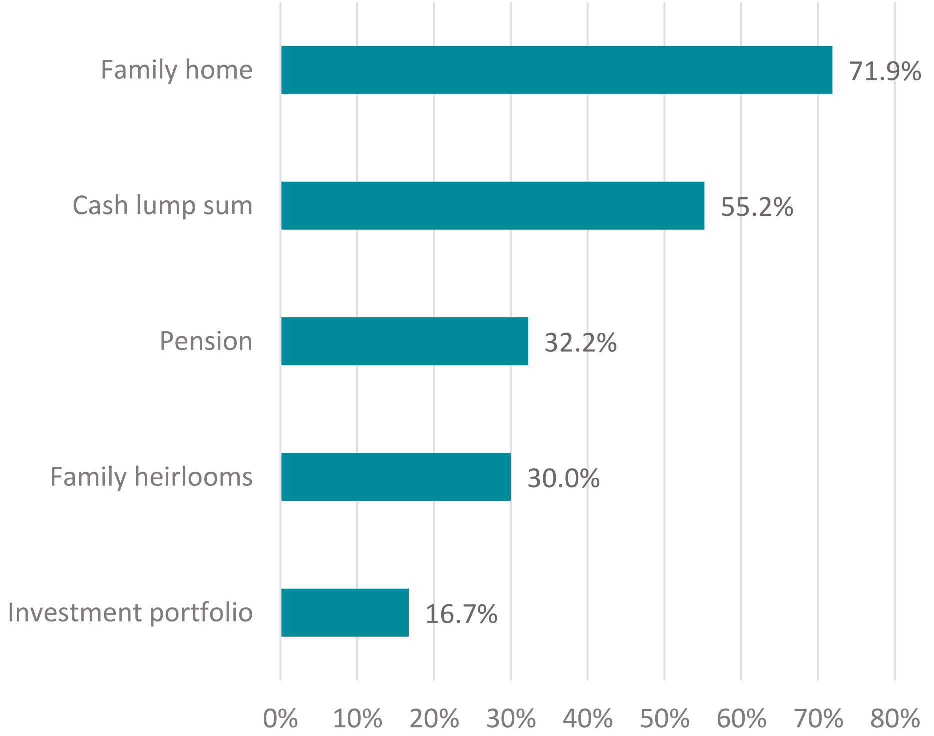
- Renters, those in households with low incomes, those without qualifications, and those without children were amongst the least likely to have plans to pass on their wealth.

- A large minority reported that they either do not have plans to pass on their wealth or that they do not expect to have any assets to leave. This applied to 30.2% of respondents.

- The family home was the most common response option when asking respondents about which assets they plan to pass on upon death. This was the case for 71.9% of the relevant subsample.

- Other assets commonly cited here included cash lump sums, pensions, and family heirlooms, selected by 55.2%, 32.2%, and 30.0% of the subsample, respectively.

Assets that respondents intend to pass on amongst those with plans to do so



Source: 3Gem survey, Cebr analysis

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