2023 UK Economic and Consumer Outlook

Teneo Insights

March 2023

Teneo

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Section 01

Executive Summary

Executive Summary

The UK narrowly avoided recession in 2022, and the most recent forecasts for 2023 suggest low / stagnant growth, with the UK ultimately avoiding a technical recession that appeared inevitable in November when the country was still reeling from the impact of the previous Government's "mini budget."

While inflation is forecast to fall, we feel this is unlikely to be a smooth path to the 2% target, despite this currently being forecast by the Bank of England. Our view is grounded in a belief that structural challenges to the UK economy, including an ageing population, wage pressures driven by inflation and a tight labour market, and energy price pressure in H2, mean inflation proves more challenging to unwind.

Consumer confidence has risen slightly in light of the improving economic situation, with those on lower incomes seeing wage rises of c. 6%, partially shielding them from sustained high inflation. Our emerging view is that upper-middle-income households are likely to be those most severely impacted and, therefore, experience the greatest shifts in purchasing behaviours for the following reasons:

1. They have received limited support from the government, which has been more targeted towards lower-income households;
2. A significant proportion have exposure to mortgages, which have seen significant increases in payment terms due to rises in interest rates; and
3. They typically work in positions and sectors that have seen the lowest wage increase (e.g. public) and are at the highest risk of redundancies (e.g. digital).

Headline figures indicate strong Christmas retail trading data on a like-for-like basis against 2021; however, this masks the fact that 2021 was a COVID year, and volumes have, in fact, fallen.

Despite the negative outlook, 2023 presents an opportunity due to changes in consumer purchasing behaviours. However, to be successful, brands must remain closely attuned to their existing customer's needs, which we believe to be focussed squarely on a renewed quest for value (not necessarily price) and a desire for personalised offers, flexible loyalty programmes and bundled offers.

Section 02

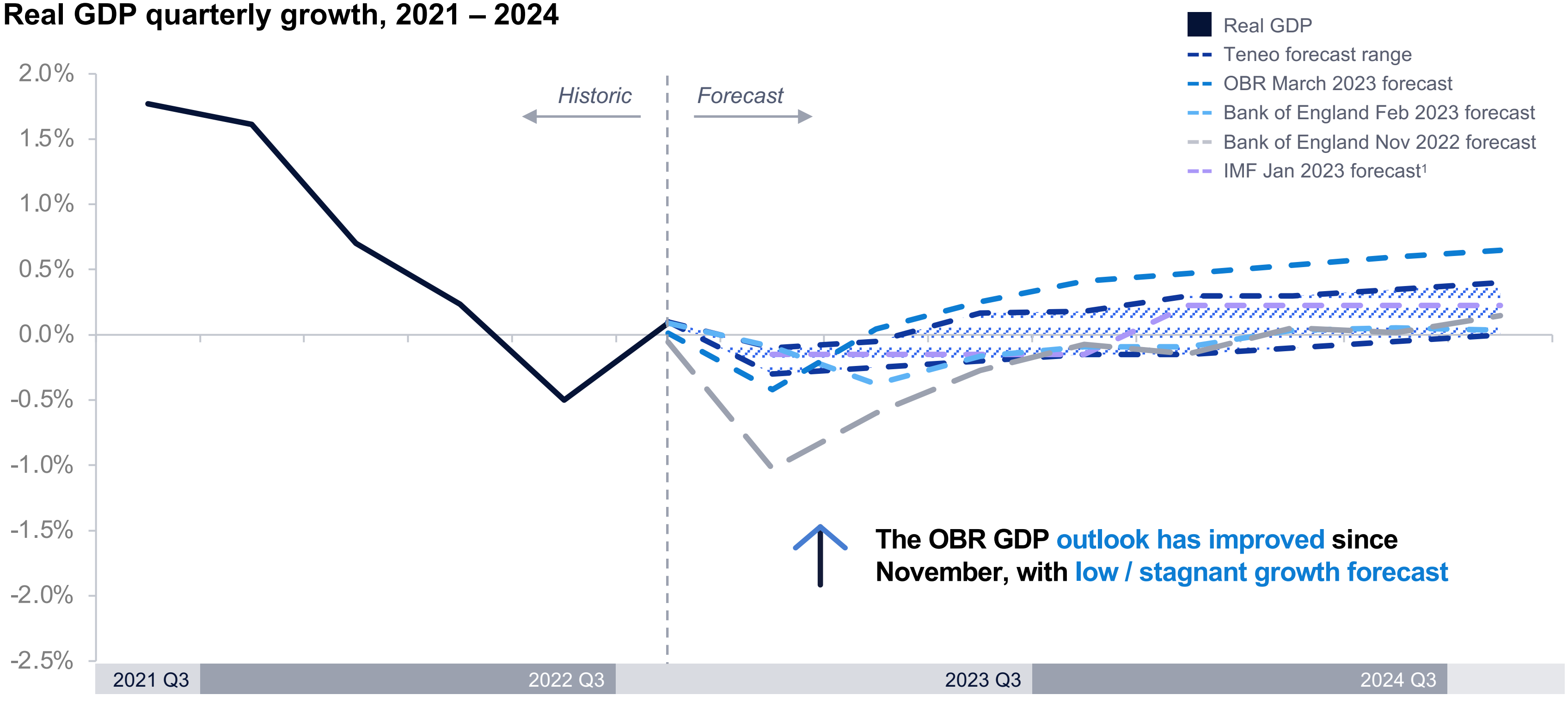
Macroeconomic Context

The UK is expected to face low or zero growth in 2023

GDP Forecast

Our most recent forecast estimates that the UK economy will not experience a technical recession; however, low or zero growth is expected for at least 12 months.

Real GDP quarterly growth, 2021 – 2024



Source(s): ONS; Bank of England; IMF; OBR; Teneo Research & Analysis
Note(s): [1]Adjusted from a whole-year figure to a quarterly figure

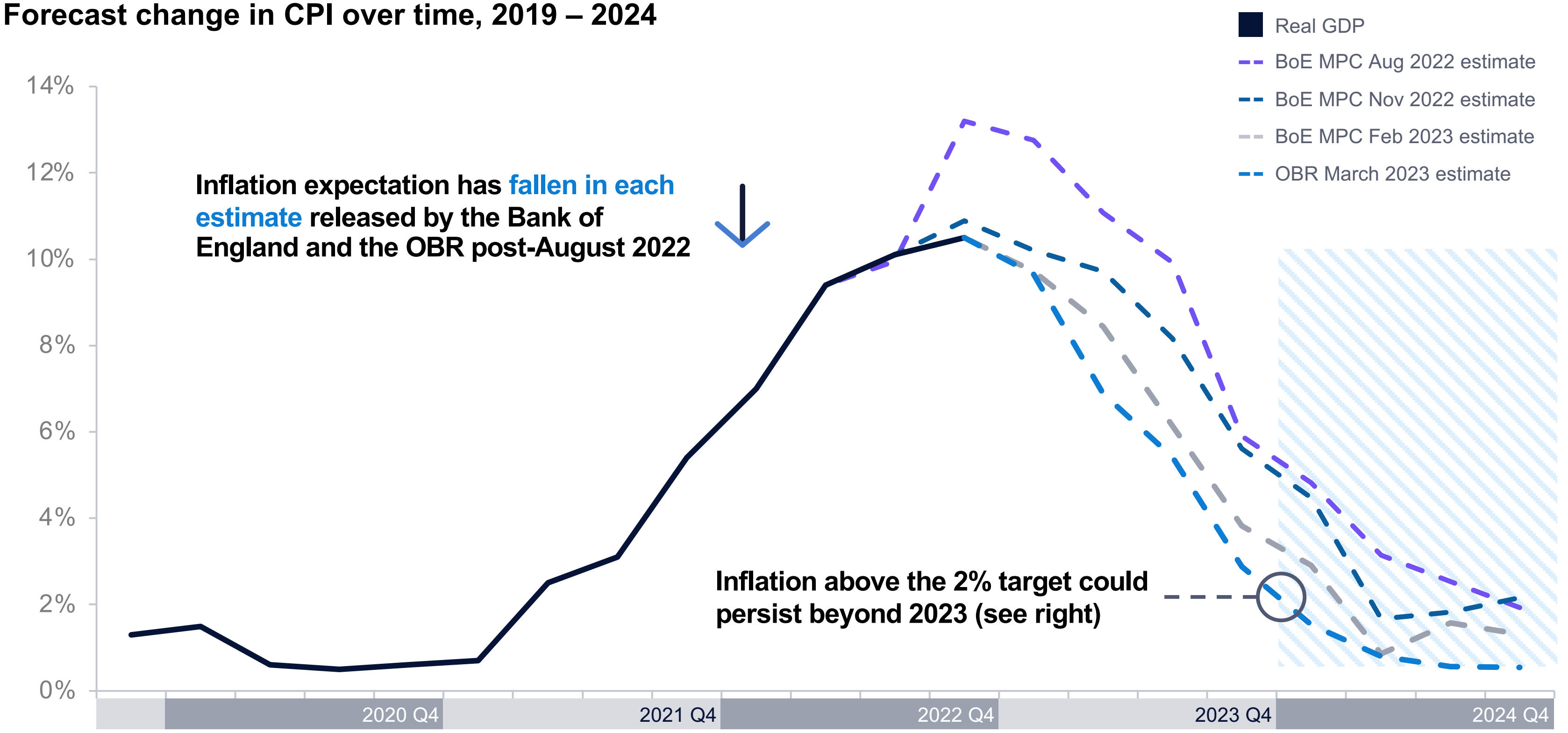
Factors easing the downward pressure on forecast GDP

- A warm winter and Europe sourcing alternative energy supplies reduces the price pressure on energy
- The Bank Rate expected to peak at 4.5% rather than 5.0% previously forecasted
- A stabilising economy following a change in government, with interest rate spreads reducing
- China's reversal of their zero COVID policy will likely bring relief to supply chain bottlenecks

Inflation Forecast

While inflation is likely to fall in 2023, there is a strong possibility that it proves more difficult to unwind to target levels than is being forecast by the BoE and OBR.

Forecast change in CPI over time, 2019 – 2024



Source(s): Bank of England; OBR; Teneo Research & Analysis

Why inflation may persist in 2023 and beyond

An ageing population leading to net attrition in the workforce, raising labour input costs

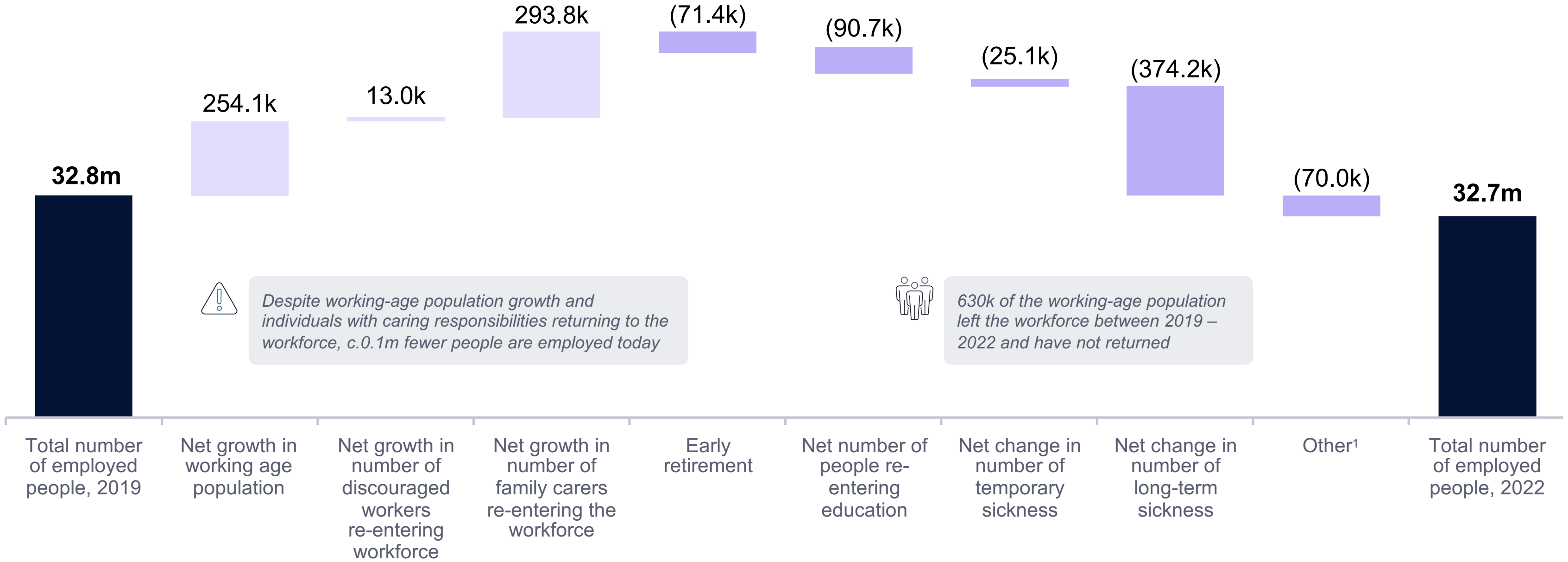
Significant pressure on wage hikes driven by strikes and general labour market tightness

The potential for energy prices to rise in Q4 due to Europe being unable to build their reserves, along with increased energy demands from China

Employment

Unemployment levels remain low at 3.7%; however, labor shortages persist due to a significant increase in inactivity in the working-age population.

Change in the number of employed people and reasons for workplace departure, 2019 – 2022



Source(s): ONS; Teneo Research & Analysis
Note(s): [1]Includes people who (i) are waiting the results of a job application, (ii) have not yet started looking for work, (iii) do not need or want employment, (iv) have given an uncategorised reason for being economically inactive

The March budget focussed on a number of policies to stimulate workers re-entering the labour force:

1. More generous pension tax allowances
2. Additional help with childcare costs of younger children for working parents
3. Disability support and welfare measures

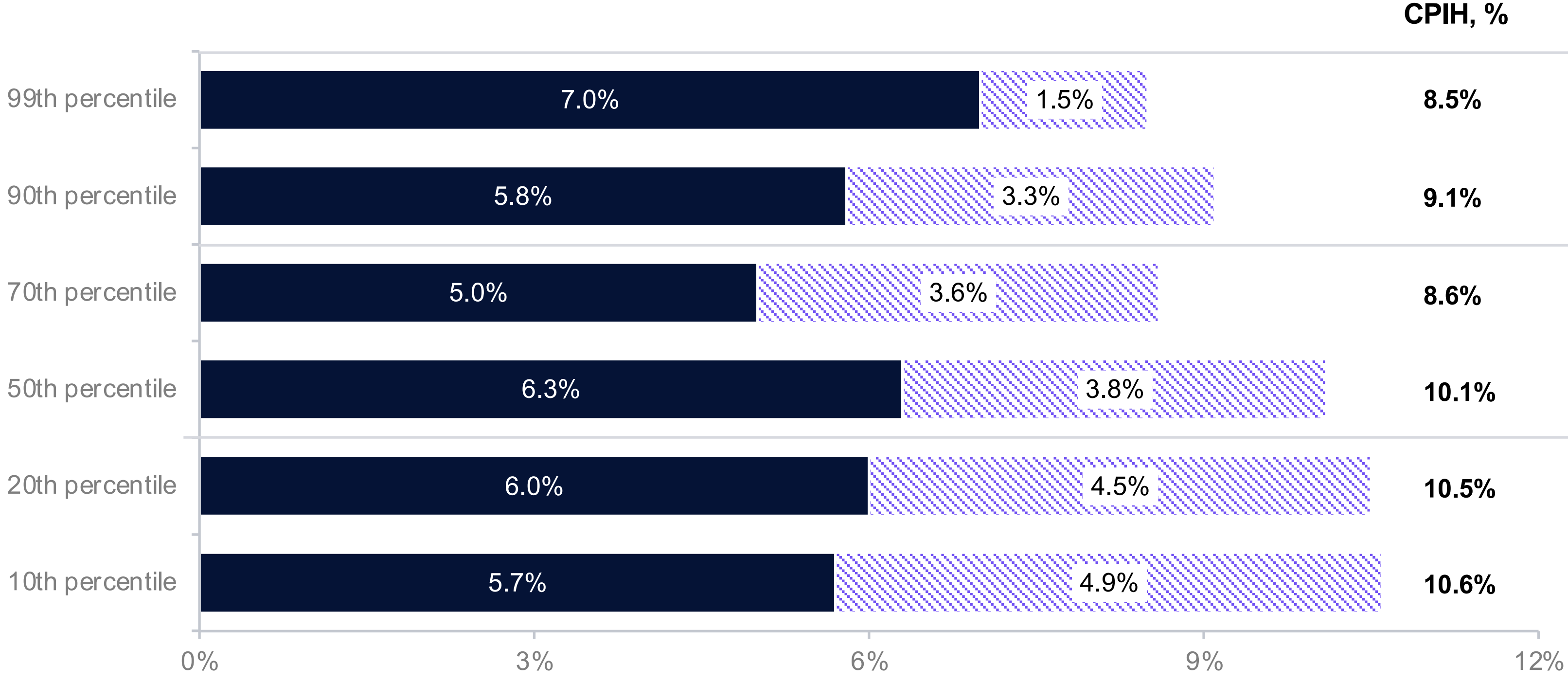
These changes are expected to primarily stimulate a return to work for those who have taken early retirement and people looking after children. **While some support is provided to those long-term sick, we anticipate this group to be more challenging to encourage back to the workforce.**

Long-term sickness is the single largest driver of workplace departure, accounting for 60% of the rise in working-age population inactivity

Wage Growth

Real wages have fallen across all income levels, and while high-income households remain the most protected, low-income households have been partially shielded by high wage growth.

Household CPIH[1] and salary percentile growth, Q4 2022

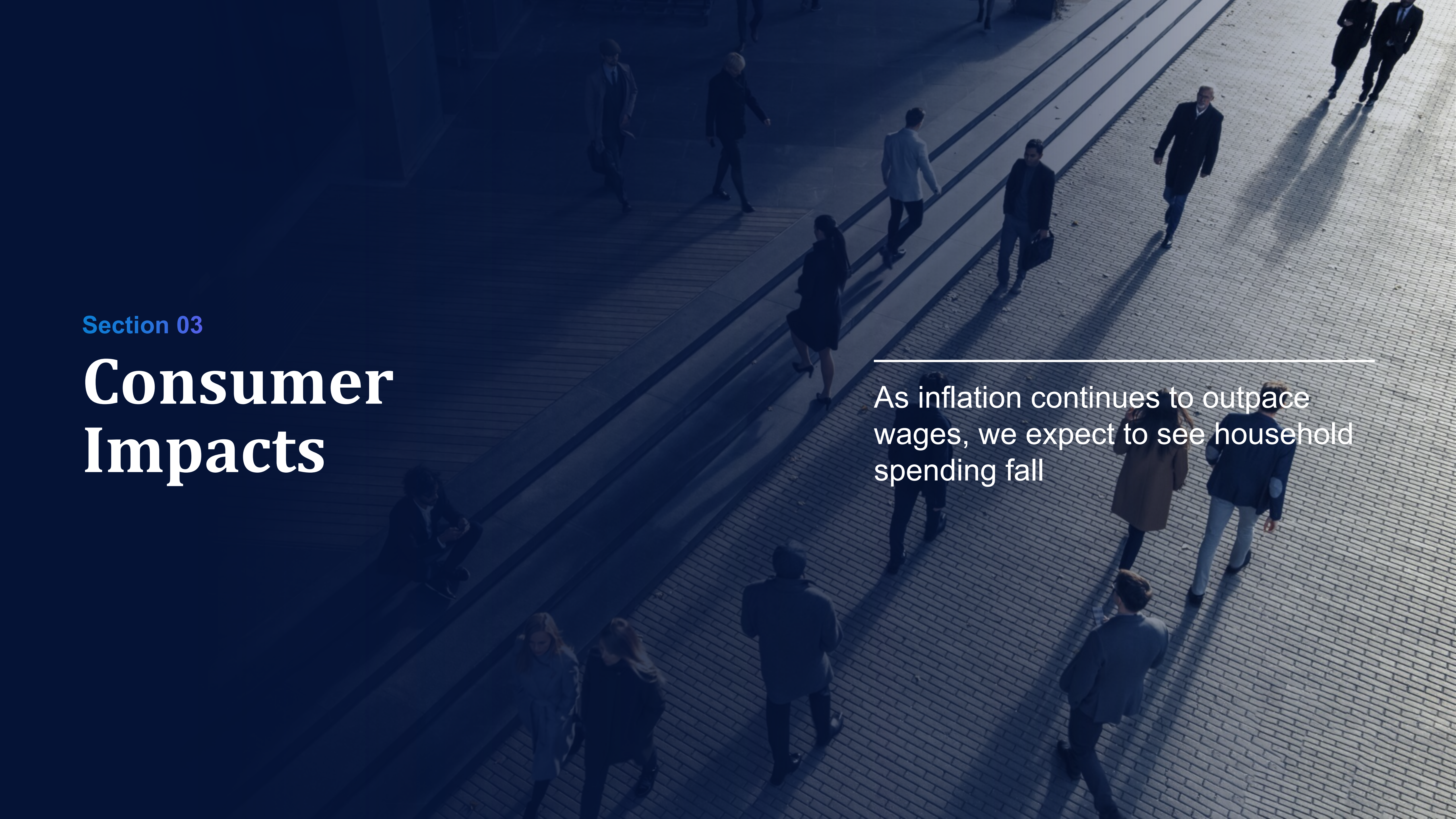


Top earners are the **least impacted** as they have:
- ✓ High wage growth
- ✓ Lower exposure to inflationary goods

Upper-middle earners (at the 70th percentile) **have received the lowest wage increases, while still facing material inflation**

Lower earners have not been **as severely impacted as was anticipated**, as they have:
- ✓ High wage growth
- ✗ Higher exposure to inflationary goods

Source(s): ONS; Teneo Research & Analysis
Note(s): [1]Includes Consumer Prices Index including Owner Occupiers' Housing Costs



Section 03

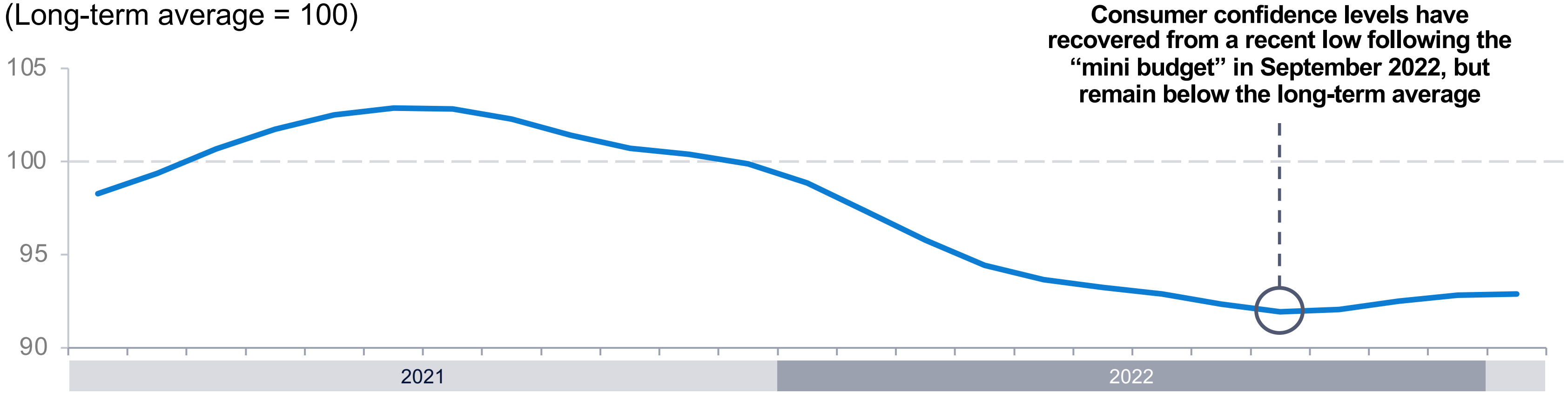
Consumer Impacts

As inflation continues to outpace wages, we expect to see household spending fall

Consumer Confidence

Consumer confidence has remained at near historic lows since the middle of 2022; however, sentiment has improved since September.

UK Consumer Confidence Index, Jan 2021 – Jan 2023
(Long-term average = 100)



UK Consumer Confidence Index during different periods of economic hardship

May 1975	Apr 1981	Jan 2009	Nov 2011	May 2020	Historic Low Sep 2022	Jan 2023
Stagflation	Energy crisis	GFC	Eurodebt crisis	COVID-19	Mini-budget	Now
94.5	96.7	95.3	95.9	97.0	91.9	92.9

Despite the cost-of-living squeeze, 63% of consumers say they are confident in their household finances and 70% say they are confident in the ability to live within their means, both reaching their highest levels since July 2022."

– UK Consumer Spending Report Jan 23, Barclaycard

Source(s): OECD; Teneo Research & Analysis

Comparisons to the GFC

This period of economic turmoil differs from the Financial Crisis in a number of areas. Critically, the expectation is that stagnation will be more prolonged and real incomes will face the largest decline in decades; however, unemployment is expected to remain low.

	Global Financial Crisis	Current economic situation	Implication
Causes	**Credit-induced** recession	**Inflation-driven recession** / period of low or slow growth	**Levers to drive growth** (e.g. reducing interest rates) **are unavailable**, prolonging stagnant or negative growth
Geographical hotspot	The countries most adversely affected were Europe's **PIIGS**[1] due to high levels of existing debt	The UK is expected to be one of the **most severely affected nations**	The average UK household will not recover its **real income level until 2028**, while foreign investment into the country will remain low
Duration	**Short and sharp**	**Likely to be more long-lasting**	The longer nature is likely to see **a rise in inequality** between those at the top of the income ladder and the rest (including upper middle)
Homeowner impact	**Negative equity** impacting highly leveraged houseowners	Rising interest rates have led to **higher monthly outgoing payments** for those with mortgages	Monthly increase in bills is likely to **restrict the purchasing power** of mortgage holders, particularly **those with high debt to income**
Job security	Job losses were at risk in **most industries**	**Labour market tightness** remains; layoffs have been seen in **selected industries**, such as **tech and finance**	Risk of job loss is **more limited**, while the labour shortage problem **provides a buffer to job security** due to shorter idle time

Source(s): Teneo Research & Analysis
Note(s): [1]Portugal, Italy, Ireland, Greece, and Spain

Household Impacts

Upper-middle-income households are likely to face the largest drop in real disposable incomes, meaning this group is also expected to see the most significant shifts in purchasing behaviours.

High-income households

They are the least affected as they have:

- ✓ **Sufficient incomes & savings** to ride out the inflationary prices; &
- ✓ The **largest increase** in wages, although they will also experience the largest increase in taxation
- ✓ Tax-free **pension allowance increase and removal of lifetime cap**

Upper-middle-income households

Expected to face a drop in disposable income of 7% - 13%, or up to £4,000 per worker, due to a number of factors including:

- × **Tail off of Government support** in July (e.g. energy support scheme);
- × Typically work in sectors with the **lowest increase in wages** with **effective tax rises** due to personal tax threshold freeze to 2028;
- × Work in sectors most **at risk of unemployment**; and
- × Most exposed to mortgages, with payments estimated to **increase on average by £4968 over 2023 (see overleaf)**

Middle to low-income households

Whilst severely impacted, they are also seeing:

- ✓ The most support from Government (e.g. Cost of Living Payments, Universal Credit to increase 10% in April 2023); and
- ✓ The NMW1 increased by 6.6% last year and is set to increase by 9.7% this year, which is above average wage growth of 6.4%

“

Inflation has hit the squeezed middle earners the most as they are most affected by higher rates and mortgage costs, but will not have benefited from the support packages.”

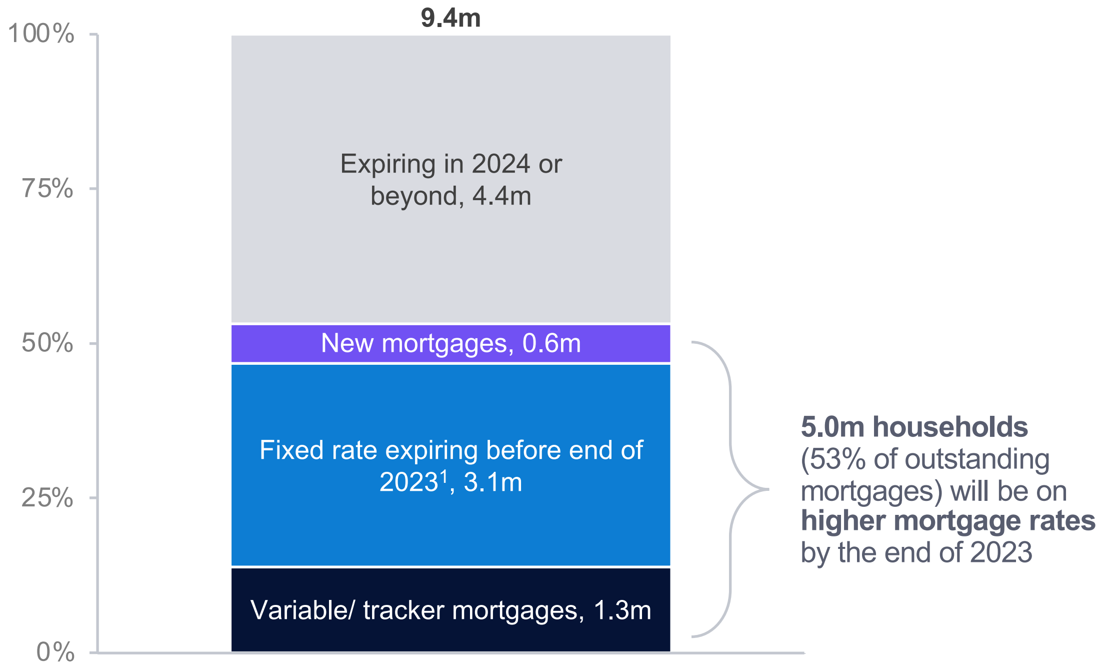
– Prof. Adrian Pabst, Deputy Director for Public Policy, NIESR

Source(s): Bank of England; National Institute for Economic and Social Research; ONS; Teneo Research & Analysis
Note(s): [1]National Minimum Wage

Mortgage Repayments

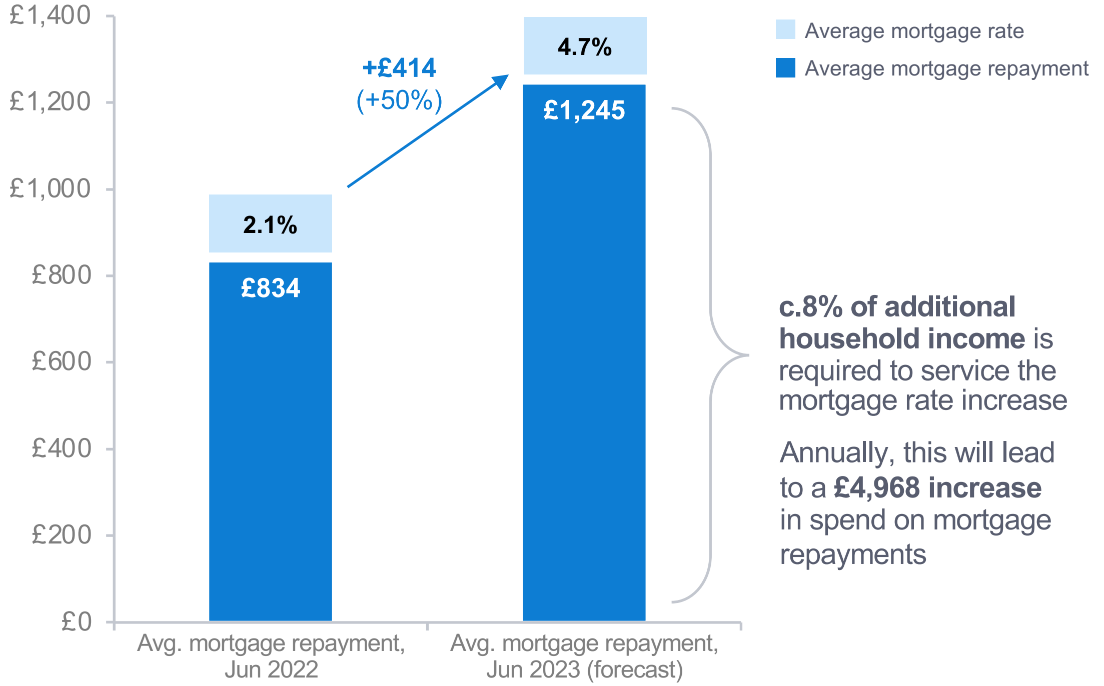
Over 2023, five million households are expected to see large increases in their mortgage repayments, with an additional c.8% of income required to service them on average.

Number of mortgages subject to increased rates by type



Source(s): FCA; Bank of England; Dwelling Stock; English Housing Survey; ONS; Teneo Research & Analysis
Note(s): [1]Includes fixed rates that expired in Q4 2022

Monthly impact of mortgage rate increase on households[2]



Source(s): FCA; Bank of England; Dwelling Stock; English Housing Survey; ONS; Teneo Research & Analysis
Note(s): [2]Excludes buy-to-let mortgages and based on average UK household price of £222,000

Section 04

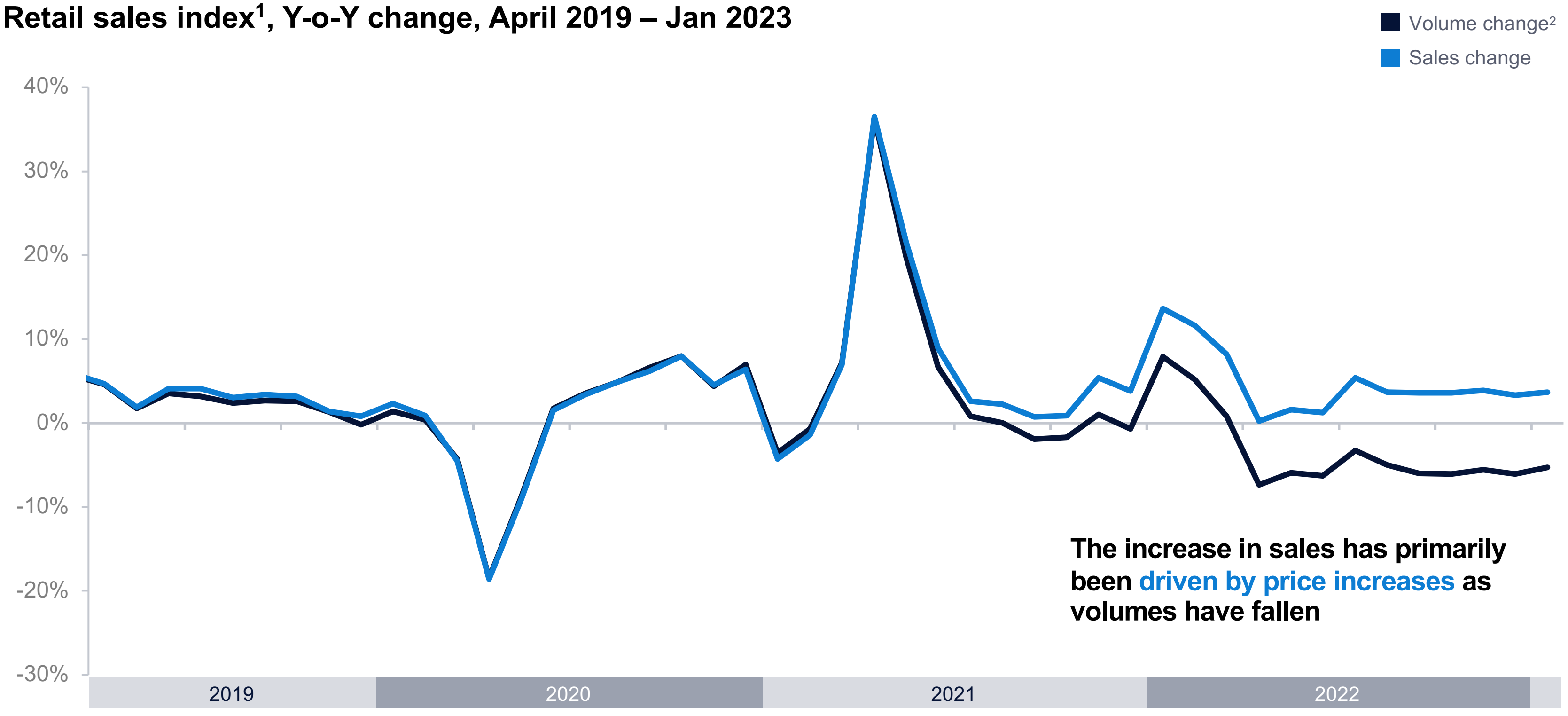
Consumer Reactions and Opportunities

As real wages fall, we expect consumers to re-prioritise spend

Retail Sales

Headline sales figures point to strong like-for-like consumption growth in Q4 2022, but this masks the fact that sales volumes fell considerably.

Retail sales index[1], Y-o-Y change, April 2019 – Jan 2023



Source(s): ONS; Teneo Research & Analysis
Note(s): [1]Seasonally adjusted, monthly sales data compared to the data 12 months ago; [2]Retail volume calculated in 2015 price level

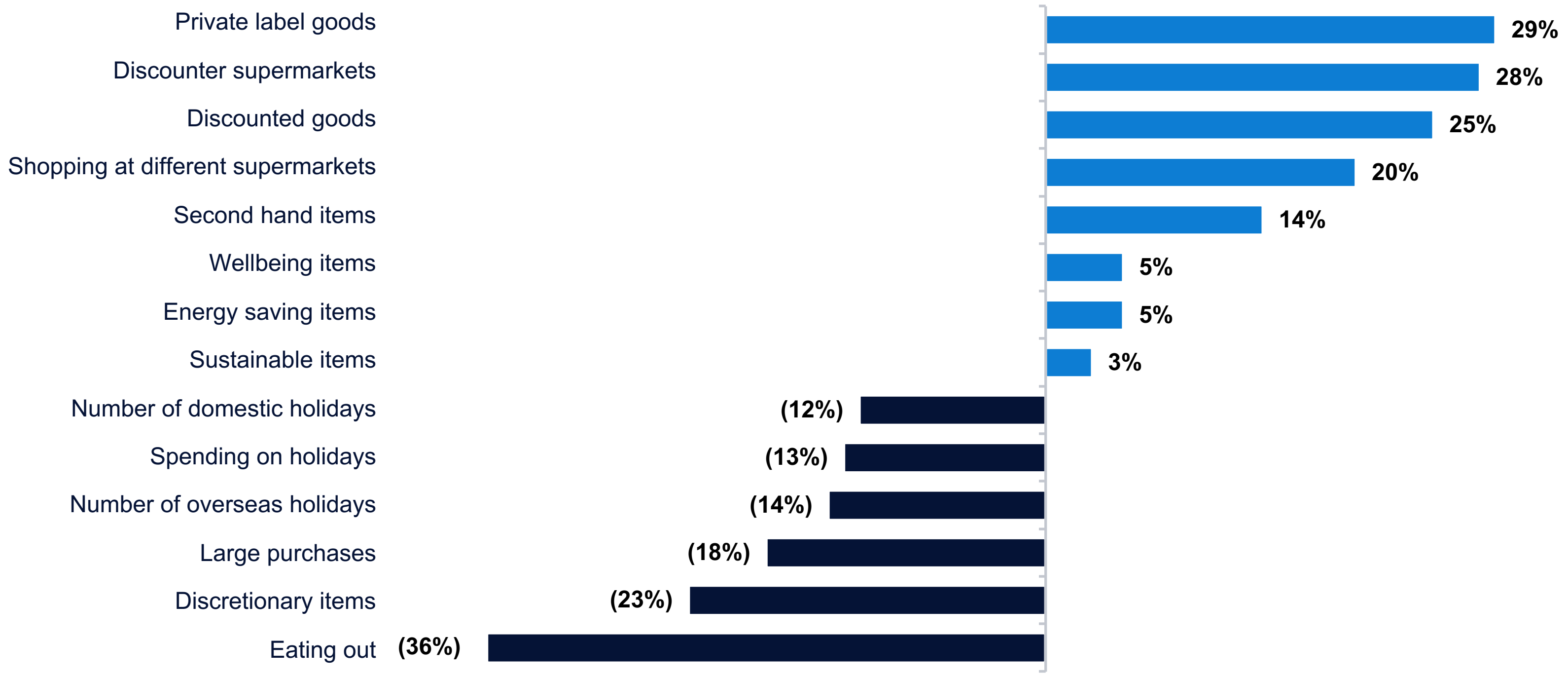
Christmas exceeded expectations, but it would be wrong to be too triumphal... Headline figures are gross figures rather than net, fuelled by inflation when the retail sales volume is down by 6%."

– Fraser McKevitt, Head of Retail and Consumer Insight, Knight Frank

Consumer Spend

Consumers are responding differently today compared to the GFC[1]; they cut back on affordable luxuries such as eating out, but protect spending in areas that they value, such as sustainability.

Net forecasted change in UK consumer spending, by category, 2022-23



Source(s): ONS; Deloitte UK 2023 Consumer Tracker; Teneo Research & Analysis
Note(s): [1]Global Financial Crisis

Key differences between consumer purchasing behaviour, today vs. GFC

Consumers intend to **cut their spending on eating out**, whereas this expanded during the GFC by 10%

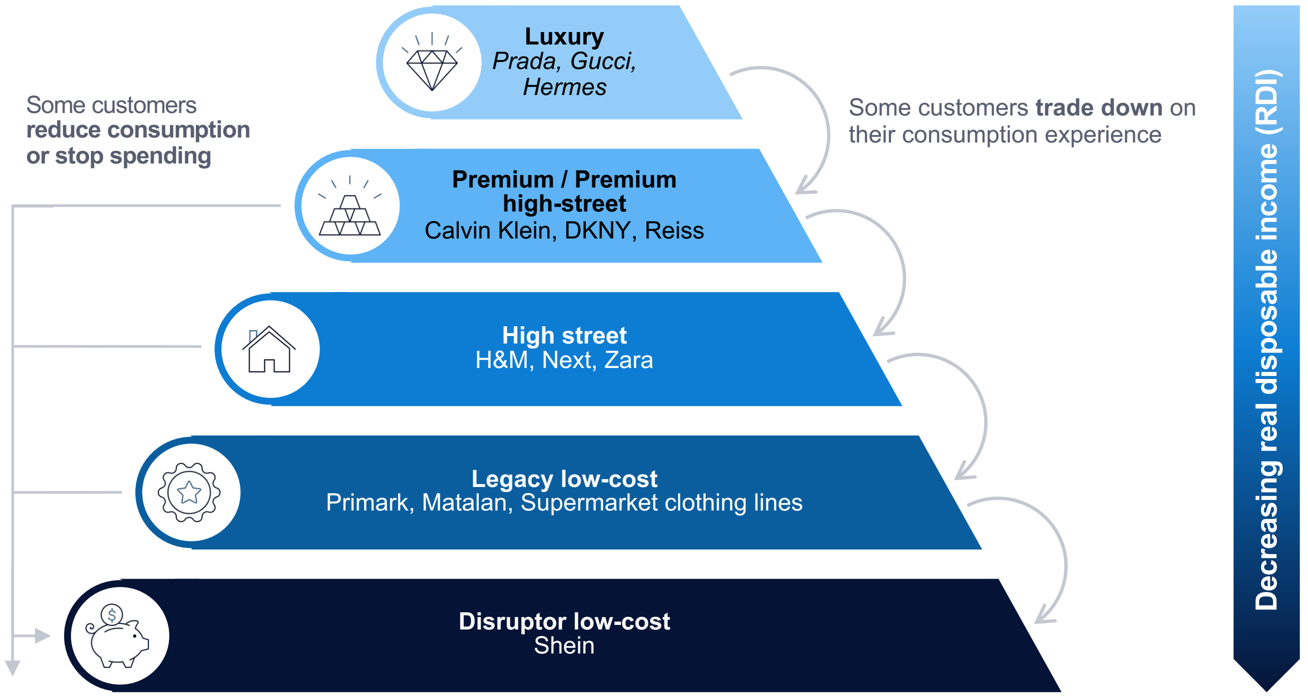
The decrease in holiday spending is not as severe as during the GFC (where it fell by c. 40%), likely due to a demand hangover from the pandemic

Sustainability and other social issues **remain high on consumers' agenda**, expanding even at times of reduced real income

Trade-down Behaviours

In times of reduced real disposable income, consumers adjust their interactions with the retail sector and businesses must stay attuned to shifts to ensure they can respond tactfully.

Market segmentation pyramid for the retail sector (fashion as example below):



Source(s): NielsenIQ; Teneo Research & Analysis

Consequences of a decrease in disposable income

1. Trade-down to cheaper retailers
2. Reduce frequency / volume
3. Trade-down to less-premium product lines within the same brand
4. Stop spending

Geographical difference

- UK consumers are more willing to **trade down**, as evidenced by currently exhibiting one of the highest rates of private label goods consumption in the world (43%)
- In other parts of Europe, consumers tend to **drop the frequency of purchase** rather than compromise on brand

Key Implications

At an overall level consumption is likely to decrease in 2023, but there is still an opportunity for businesses to capitalize on the changes in consumer purchasing behaviours.

Loyalty programme

c. 30% of consumers are visiting businesses with loyalty programmes instead of their preferred brands to save money; this is critical at a time when customers are shopping around more for better deals

Value for money

81% of British consumers have adopted money-saving shopping tactics, of which value for money is ranked as their top purchase consideration

Bundling / upsizing

46% of British consumers are bulk-buying in large quantities to unlock savings; this represents an opportunity for businesses to gain a larger share of a consumer's wallet

Tactful messaging

c. 70% of consumers seek personalised messaging and offers, while 83% of millennials and Gen Zs would like brands to represent a cause

Gen Z

49% of Gen Z has signalled an intention to splurge in the coming six months to treat themselves, the highest across all generation groups

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Our full range of advisory services includes strategic communications, investor relations, financial transactions and restructuring, management consulting, physical and cyber risk, organizational design, board and executive search, geopolitics and government affairs, corporate governance, ESG and DE&I.

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