UK FINANCE

TRENDS IN THE ECONOMY AND LENDING

Spending behaviour and the cost of living crisis

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UK Finance collects and aggregates a wide range of data sets relating to consumer and business finance to inform the industry about the latest trends and developments across the sector. In this latest Trends in the Economy and Lending (TEAL) report we take a look at consumer spending on credit and debit cards and how that might be changing as a result of high inflation and cost of living challenges.

INTRODUCTION

The UK economy has faced overlapping shocks from the Covid-19 pandemic and the inflationary impact of the conflict in Ukraine. The impact of sharply rising prices, notably food, energy, and transport costs on household budgets has been further exacerbated by rising interest rates to control inflation as well as the fallout from the market turmoil which followed last September's fiscal event. Despite a tight labour market which has seen some acceleration of (private sector) wage growth, real incomes fell last year with the squeeze forecast to persist into 2023. Concerns about the cost of living are weighing heavily on consumer confidence, and in the regular Office for National Statistics (ONS) public opinion and social trends survey, the cost of living is the most cited issue facing the UK economy. And while all households will be feeling the effects of higher inflation, those on lower incomes are more likely to see any wiggle room in their budgets eroded. We can see the impact of these pressures in the aggregate economic data. GDP growth flatlined in the second half of 2022, flagging retail sales and activity in consumer-facing services have still to recover to pre-Covid-19 levels. While some households still have access to savings accumulated during the pandemic and can draw on these to maintain spending and living standards, many others report cutting back on non-essentials and shopping around to find the best deals.

UK Finance collects a broad range of data on credit and debit card spending and can use this to delve into changes in the volume and value of spending, changes in the mix of spend and the channels that consumers are using, for example online and contactless transactions.

Numerous factors have impacted on trends when looking at spending patterns this year compared to previous years, such as the end of Covid-19 restrictions in the UK and the limitations to international travel in 2020/21, changes in working patterns, cost of living pressures and more recently the potential impact on travel and retail behaviour from industrial action in the UK.

We currently have data available to November 2022 and this TEAL report will set out some of what we know about spending across the UK economy and consumer behaviour in the last year. While the main headline is that spending on debit and credit cards is higher year-on-year through to the latter months of 2022, there are some shifts in the composition of spending.

CONSUMER SPENDING IS ADJUSTING TO NEW ECONOMIC CIRCUMSTANCES

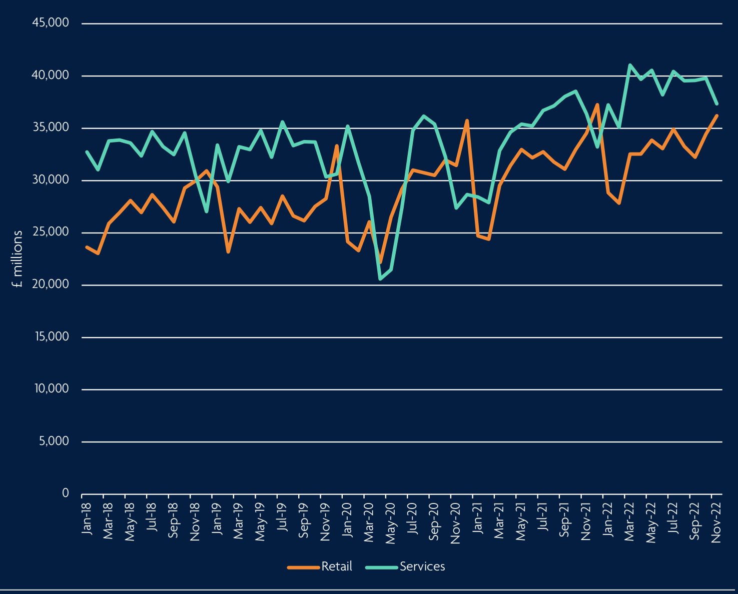
In 2022 inflation reached levels not seen since the 1980s in the UK. The rise of inflation was caused by a variety of factors, including a sharp rise in demand for goods and services following the end of the social and economic restrictions that had been imposed due to Covid-19, an increase in food prices, as well as a steep rise in oil and gas prices caused by the war in Ukraine. Consumer price growth, which has been more prevalent across some goods and services than others, is putting household finances under pressure and having an impact on spending patterns.

However, the impact of the rise in the cost of living and the squeeze in disposable incomes takes a little digging to uncover as it is not evident in the headline card activity numbers, in part due to comparisons with recent periods still complicated by Covid-19-induced behaviours in 2020 and 2021, and the time taken for the impact of rising prices and high energy bills to be felt in aggregate.

In 2022 spending by UK consumers through credit and debit cards across retail and services sectors performed positively when compared with the previous year. Goods and particularly services, recovered from the Covid-19 lockdown slumps and the value of card transactions has remained consistently above pre-pandemic levels, despite the headwinds to household budgets (chart 1).

Arguably, without inflationary pressures, consumer spending would have recovered even more strongly, as expected by most forecasters at the start of 2022. It is clear that behind the apparent calm in headline numbers, consumer spending in the UK has undergone some readjustments in 2022, with essential spending starting to take a larger share of spending and shrinking real disposable incomes.

Chart 1 - Overall Card Spending in Retail and Services, £ millions



Source: UK Finance

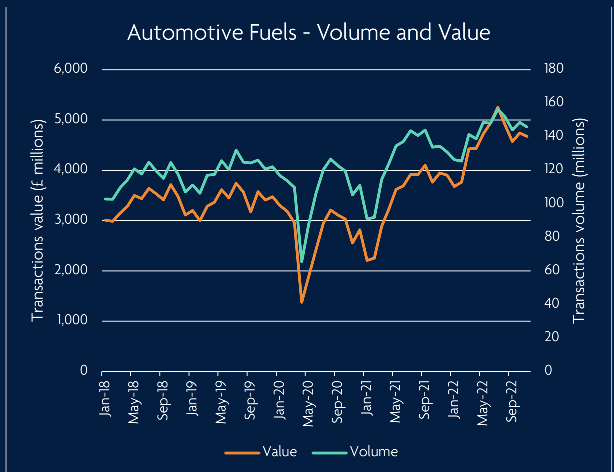
INFLATION IN ACTION

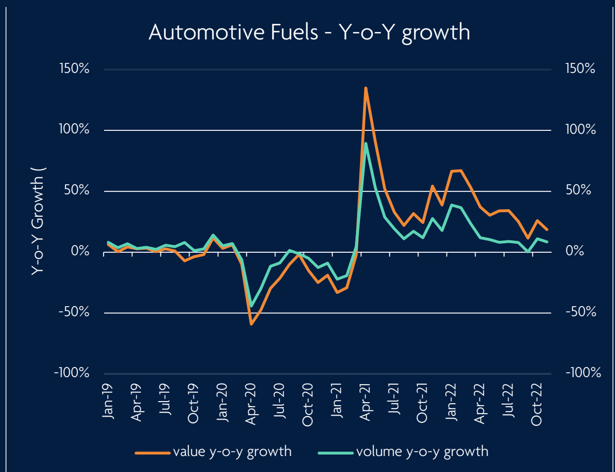
Spending in sectors where the inflation rate has trended above CPI for much of 2022 registered stronger growth in the value spent on credit and debit cards. A good example of this is automotive fuels.

In this sector (shown in chart 2), the increase in value spent and number of transactions started in 2021, as the economy reopened post-Covid-19. In the first quarter of 2021, value spent on automotive fuels surpassed pre-pandemic levels, a consequence of a return to more normal travel patterns for work and leisure. While growth continued throughout 2022, the impact of price increases at petrol pumps, as a result of Russia's invasion of Ukraine, became more evident as the value of spending on automotive fuels rose much more sharply than the volume of transactions. ONS CPI inflation data shows that petrol prices rose by a peak of nearly 43 per cent in July 2022.

As oil prices started to come down in the second half of 2022, value spent in automotive fuels eased slightly, despite remaining significantly higher than pre-Ukraine war and pre-Covid-19, and only after reaching a peak in July 2022.

Charts 2.1 and 2.2 - Automotive Fuels, value and volume of transactions and percentage change on a year ago





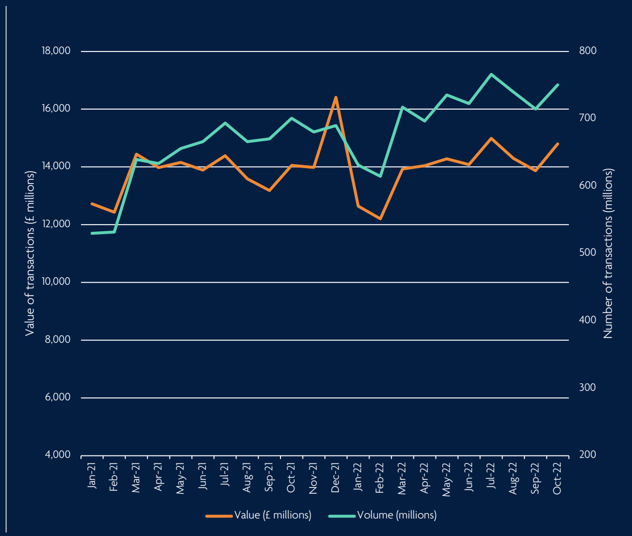
Source: UK Finance

The rise in energy prices and supply chain issues, as well as the war in Ukraine, also had a significant impact in the price of a broader basket of goods and services, including that of essential goods such as food. As with automotive fuels, the rise in food and drink spending started in 2021 and continued throughout 2022. However, this movement was more moderate in the case of food and drink. In order to manage their household budgets, consumers in the UK have been able to shop around and, in some cases, trade down on their food shopping. These budgeting strategies are less easily applied to automotive fuels where the range of price points available in the market is narrower.

Chart 3 shows that while card spending across the food and drink sector has continued to rise through the cost of living challenges of last year, growth in the value of spend is only just keeping pace with the rate of reported inflation in food, which at the end of last year had accelerated to nearly 17 per cent. Food price rises across staples such as bread, pasta and dairy products has risen at a faster pace.

While overall spending has held firm, our data also shows a move away from online spending. At the onset of the Covid-19 pandemic the proportion of online food and drink sales rose sharply to account for around a third of spending during the first lockdown from around 12 per cent in 2019. The habit of online grocery sales persisted to a degree, when the economy reopened, but has fallen back to around 17 per cent in recent months. This could be a sign of price sensitive customers opting to shop in store to find better deals and manage their budgets.

Chart 3 – Food & Drink, value and volume of transactions



Source: UK Finance

SECTORS SET FOR A WEAKER OUTLOOK

With real disposable incomes in decline in 2022, the trends noted above in sectors such as food and auto fuels have seen a steadily increasing share of total card spending on these essentials and consumers reining in spending in other areas. This is evident for example in travel, which saw a strong post-Covid-19 rebound in the summer but moderated in the second half of 2022 – partly seasonal effects, but also likely that many households view this as a luxury which can be delayed.

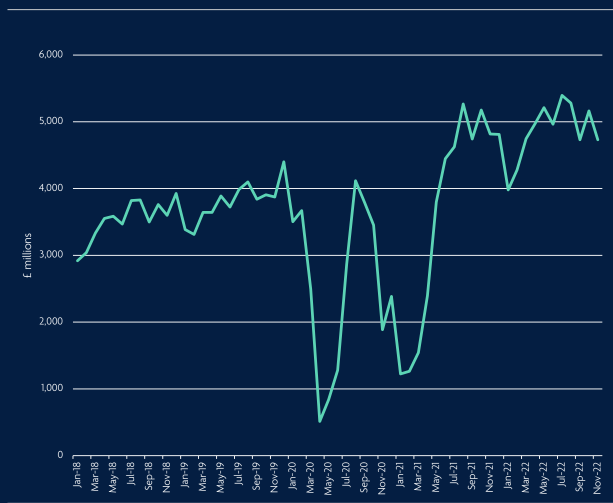
In addition, the data also shows moderation in spend in other discretionary areas such as restaurants, pubs and clothing.

Despite challenges faced by the hospitality sector, including inflationary pressures and staff shortages, value spent in pubs and restaurants continued to recover in 2022, a trend that had, again, started in 2021 (chart 4). Cost of living pressures look to be curtailing the growth potential of this sector in 2023. Growth has flattened in the latter part of 2022 with some weakness in November, potentially further hampered by industrial action which disrupted travel, though offset by a bit of a boost from the World Cup.

Clothing is one of the sectors where spending appears to have stuttered. The value spent on clothing declined sharply in 2020 as a result of the Covid-19 lockdowns. Even though value increased with the re-opening of the economy in the second half of 2021, it did not return to pre-pandemic levels.

Notably, consumers have, to some extent, turned to second-hand shops (chart 6). Before Covid-19 the volume and value of transactions in second-hand shops was broadly stable however, growth started to take off in 2021 and has continued to rise strongly over the past year with the number of transactions rising to an all-time high in November 2022, up three-fold compared with the 2019 average.

Chart 4 – Card spending in restaurants and pubs, value of transactions



Source: UK Finance

There is likely a combination of factors at play. Some of this growth may be driven by more environmentally conscious consumers recognising some of the impacts of fast fashion, for example. But this growth is also coming as household budgets are squeezed, and consumers are looking to make their money go further by opting for lower cost, 'pre-loved' clothes and other household items. Within our data we note similar strong growth in spending on handicraft and DIY stores, suggesting it is less about making hay while the sun shines and more make do and mend.

Chart 5 – Clothing, value of transactions

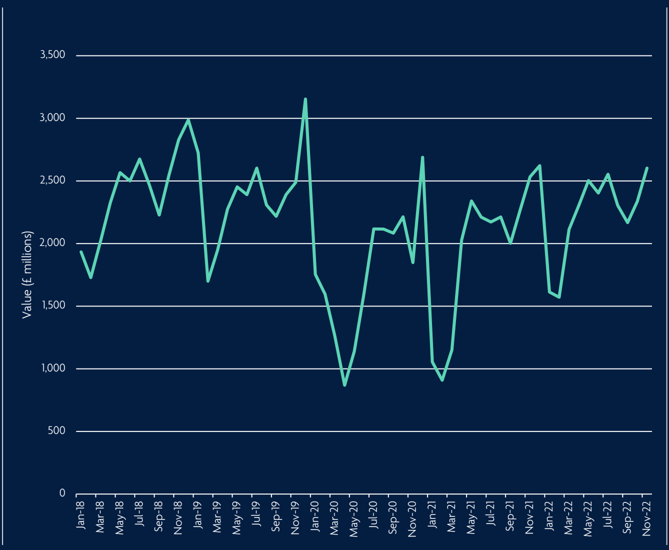
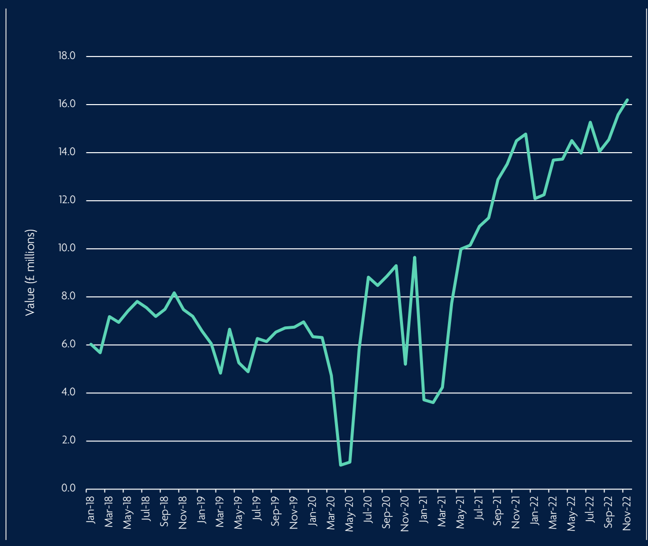


Chart 6 – Second-hand shops, value of transactions



Source: UK Finance

SIGNS OF STRESS?

One area of card spending we have been keeping an eye on is utilities expenditure. The rise in oil and gas prices has clearly been evident in household gas and electricity bills, especially for those using credit or debit cards to pay utility bills, as the value of total spending has inevitably been on the rise. Due to government intervention, the rise in the value spent in utilities was more moderate than that observed in automotive fuels. The peak in value spent in utilities occurred in March 2022, before government measures were in place to assist households.

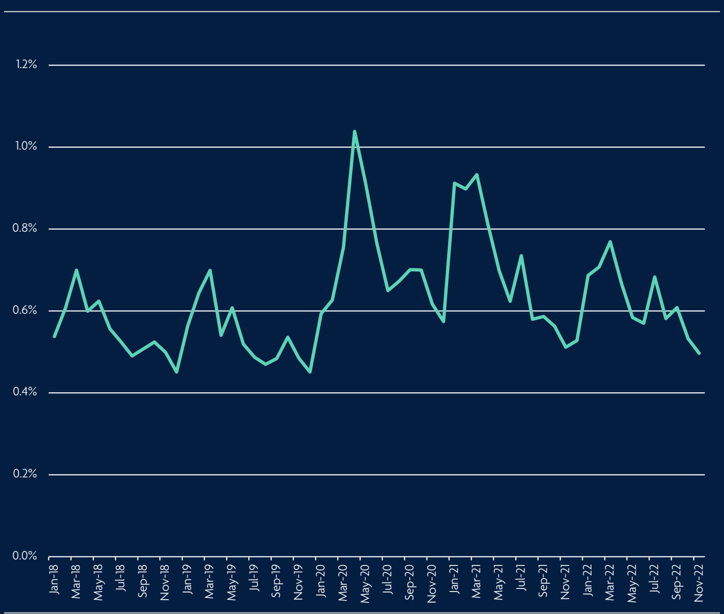
However, one sign of pressure in household budgets is if essential spending such as utilities starts taking a larger share of credit card spending – i.e., consumers are borrowing more to cover these bills. In 2022, utilities remained a small share (less than one per cent) of credit card spending and we have not seen a material change following the sharp rise in energy costs. This is a rational move for consumers, as data from BEIS shows, for example, that there is a cost benefit to paying bills via direct debit.

Nevertheless, this is an indicator that we will maintain under close observation. As government support in 2023 will be targeted not at the general population but at the most vulnerable, and as the energy price cap is due to increase by £500 after April, it is possible that utilities spend will rise again in 2023.

We have seen that cost of living pressures are manifesting themselves in the composition of spending on credit and debit cards. Our Card Spending Update shows that households continue to pay down credit card balances with the proportion of balances bearing interest continuing to trend down and remains below both pre-Covid-19 levels and the peaks of a decade ago.

Yet, there is evidence of hardship among a significant share of the population. According to ONS's December 2022 Household Finances survey, 22 per cent of UK adults had to borrow more money or use more credit than usual in the previous month. In the same survey, seven per cent of UK adults reported that they had been unable to pay a direct debit, standing order, or bill in the previous month. The Consumer Insight Tracker from Which? reported that 1.9 million households ended 2022 with at least one unpaid bill being that energy bills and Council Tax were the most common unpaid bills. The number of unpaid bills tends to rise in January and a substantial number of households will have had a challenging start to what is set to be a difficult year.

Chart 7 – Share of credit card spending in utilities (value)



Source: UK Finance