4th Edition

REDI-UPDATES

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Cost-of-living crisis:

The impact of the crisis and the supply-side failures driving it

UNIVERSITY OF BIRMINGHAM | BIRMINGHAM BUSINESS SCHOOL

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Director's Foreword

SIMON COLLINSON

Every month I present our Economic Impact Monitor (and recently the 100th edition) to a large group of regional and national stakeholders, Chaired by Mayor Andy Street. We track economic and social trends and analyse the impact on the West Midlands region and implications for businesses and communities. In recent months this report has been dominated by the effects of rising costs and inflation on this region, nationally and globally. This is the challenge we focus on for this edition of REDI-Updates.

We also demonstrate, through the briefings in this Update, how our policy-led research and analysis focuses on regional communities and social impacts, as well as economic and business trends. Firms and households more than interact in a regional economic system, they co-exist. The fate of one affects the fate of the other. Not least because householders are employees and household income from employment underpins consumption (and the resulting economic multipliers) and correlates with health and wellbeing (and the resulting costs of benefits and government support services). Firms in turn benefit from the skills, capabilities and wellbeing of employees, or struggle, when these are limited or in decline.

The rising costs of energy, inputs from supply chains, labour wages, are all placing pressure on our businesses. The rising cost of living presents a significant challenge to our households and in particular low-income communities.

The WMREDI team has put together an excellent set of briefings covering the cost-of-living crisis and tracing multiple sources of inflation with different impacts and future trend lines. These provide data and evidence, from the local to the global, through international comparisons of cost of living. We cover the impacts on business, varying by sector and size, and noting that March 2023 saw the highest number of company insolvencies in the country, since the ONS started collating the data. This has significant impacts on households, shown with interregional comparisons at the national level and intra-regional differences for the West Midlands. We also look at the impact on people's health and well-being, on public sector services and the third sector, and on inequality and the worsening conditions for levelling up. Finally, we ask what is the government doing and where should policy interventions be targeted?

My thanks to the WMREDI team for their efforts. I hope this edition of REDI-Updates is of relevance and interest to all of our partners and stakeholders locally and nationally.

Editor's Welcome

ALICE PUGH

Follow the work of WMREDI on twitter: @WMREDI

The REDI-Update is an annual publication which gets behind the data and translates it into understandable terms. WMREDI staff and guest contributors discuss various topics within this fourth edition, focusing on the development and impact cost-of-living crisis on businesses and households, and the effectiveness of the government's response.

In the last edition of the REDI-Updates, WMREDI demonstrated our research into the challenge of implementing, understanding, and measuring of levelling up. Through our analysis we supported regional and national partners to better understand the challenges they will face with regards to levelling up.

In this fourth edition of the REDI-Updates we are looking into a topic that is extremely challenging for all places and individuals within the UK. The cost-of-living crisis has been rapidly growing over the last two years, fed by several factors both international, national and local.

In this report we investigate what factors are contributing to the cost-of-living crisis? How has the crisis impacted businesses and their operations? How has the crisis impacted households and their consumption habits? What has been the impact on inequality? What has been the impact on public and third sector services? How does the cost-of-living crisis compare internationally?

Our analysis, provided in this edition of REDI-Updates, demonstrates that we are effective in responding to moving agendas, but crucially that we have a breadth of research expertise readily available to add depth to any analysis.

The research demonstrates the impact that the cost-of-living crisis is having on businesses and households and how the two interact, with the fate of both intertwined, leading to a spiralling cycle of economic decline. This particularly impacts the most vulnerable - both households at the lower end of the income scale and small businesses.

At its core, our research and analysis discussed in this edition, demonstrates WMREDI's innovative hybrid mix of academic expertise at meeting emerging real-time challenges as they develop.

SIGN UP

WMREDI has been tasked with providing an up to date monitor of the current COVID-19 economic impacts to help regional partners to shape responses and interventions to ensure the region continues to thrive. Sign-up to WMREDI's West Midlands impact monitor, collated by staff across the institute.

Sign-up by emailing: cityredi@contacts.bham.ac.uk

What is the Cost-of-living Crisis?

MATT LYONS

The cost-of-living crisis has become an ever-present feature of news headlines over the past year. But what does it really mean and where are we heading?

Defining the Cost-of-living crisis

The cost-of-living crisis refers to the real terms decrease in disposable income that is being observed by UK households as the cost of essential goods and services has accelerated beyond wage growth. In 2022, annual CPI inflation was 11.1% (ONS, 2022), the drivers of which are covered in detail more detail in later chapters but, in short there are four main issues:

ENERGY

The most important factor driving the cost-of-living crisis has been the rapid increase in the price of fuel for domestic heating and transport, which has significantly increased predominantly due to the war in Ukraine.

HOUSING

Household services (such as gas and electricity) have also increased rapidly. The rise in private rental costs that have been observed has been attributed to demand for rental property being outstripped by supply, in part due to buy-to-let landlords leaving the market.

FOOD & BEVERAGES

Food and non-alcoholic beverages have seen prices rise by 16.4% between October 2021 and October 2022. The combination of increasing energy and transportation costs to food producers and a tight labour market has increased picking and packing costs.

CONSUMER GOODS

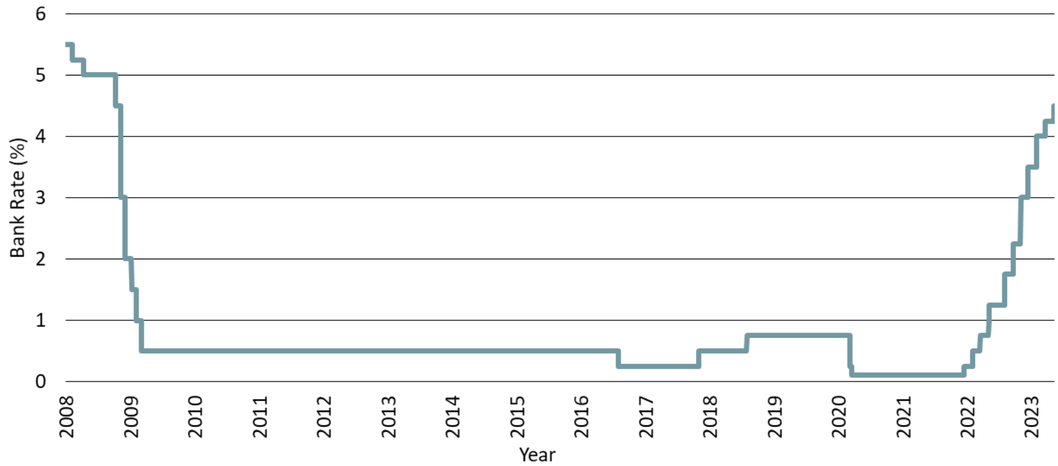
Supply-chain blockages due to a snap-back of demand post-COVID hindered by restrictions in China and a booming economy in the USA have coalesced to see too much money chasing too few goods.

The Policy Response

In response to inflation there have been two major policy interventions: one fiscal, one monetary. On the fiscal side, the Government introduced the Energy Price Guarantee as a substantial intervention, estimated to cost the UK Government up to £140 billion. The guarantee runs through the winter months from October 2022 to June 2023 protecting consumers from the full impact of price rises. The typical household is expected to see annual energy costs of £2,500 instead of £4,000, which would have been the case without intervention (IFG, 2022).

On the monetary side, the Bank of England (BoE) has been increasing interest rates rapidly from 0.25% in February 2022 to 4.5% in May 2023 to stifle demand and thus inflation through increased borrowing costs (Figure 1). The interest rate rises will impact many who are on variable rate mortgages and those with their fixed rates coming to an end. Analysis by the Joseph Rowntree Foundation (2022) found that by assuming a mortgage interest rate of 5.5% (up from 3%) the average monthly mortgage payment would increase by £250, from £610 a month to £860.

Figure 1: BoE Interest Rates over 10 years



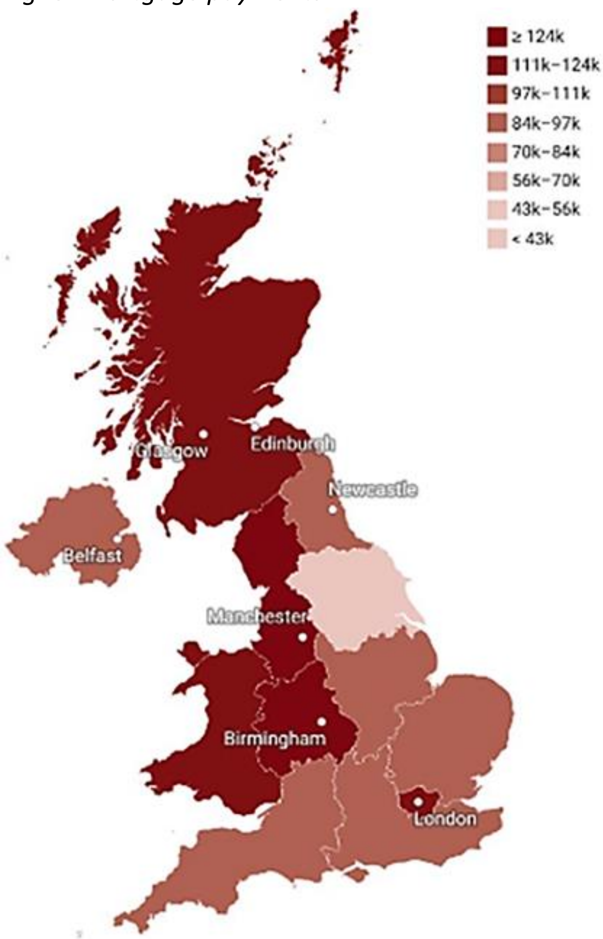
Source: BoE, 2023

How are different groups impacted?

The impact of the cost-of-living crisis and the policy response to it is affecting some groups in society more acutely than others. Low-income groups are particularly impacted by the cost-of-living crisis because the goods and services that have increased most rapidly, energy and food, are essential goods that make up a larger share of low-income household budgets. Low-income groups have also been more severely impacted by changes to the tax and benefit system with the reversal of the £20 universal credit uplift and the rise in NI contributions disproportionately affecting low-income households. The consequences of this are severe, research by NIESR (2023) suggests that approximately 1 in 4 households are facing food and energy bills that exceed their disposable income.

Housing tenure is another important contributing factor which determines the vulnerability of households to the cost-of-living crisis. Some groups, particularly younger and less wealthy, are more likely to be in the private rented sector which is seeing rapid price rises. Alternatively, they may be first-time buyers holding large mortgages that will be due for renewal in a period of significantly higher borrowing costs.
The impact of the shocks to housing, energy and food prices are spread unevenly across regions. NIESR (2023) found that responses to rising food and energy prices forecasted rates of destitution range from 18.5% in the West Midlands to 32.3% in Northern Ireland. While the West Midlands is performing relatively well by this measure, the region is one of the most exposed to rising mortgage payments wiping out household savings (Figure 2).

Figure 2: Households with No Savings as a result of higher mortgage payments

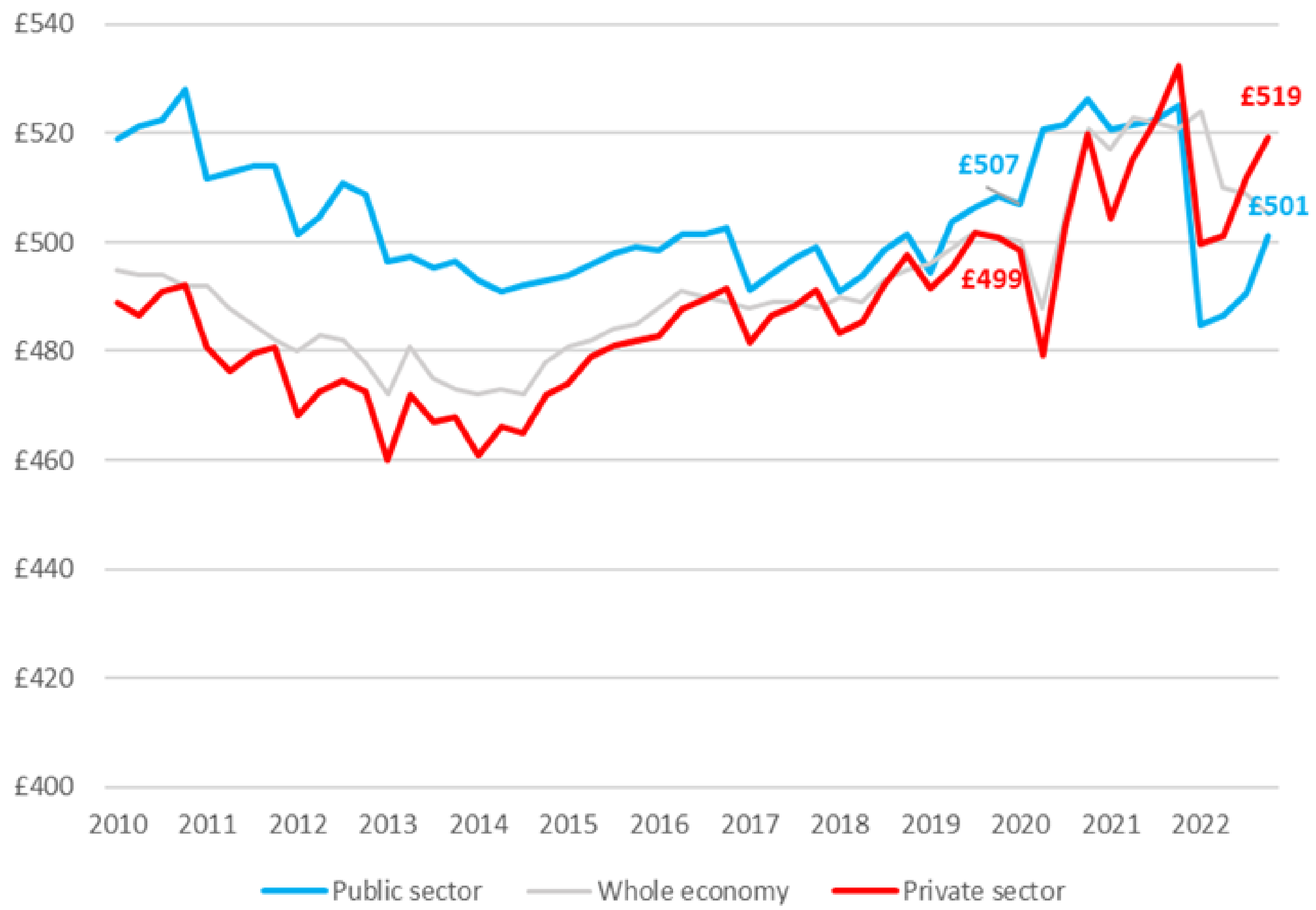


Source: NIESR analysis of the ONS Wealth and Assets Survey (2022), LINDA, NiGEM

Wages

Inflation and rising interest rates are increasing costs for households, but wages are another side of the picture. Nominal wage rises are being observed particularly in the private sector, however in real terms, wage rises are modest and are falling in the public sector. Figure 3 shows the average weekly earnings adjusted for inflation of public sector vs private sector from 2010 to 2022. The figure shows that since 2020 there has been a divergence between groups, with private sector workers seeing a 4% rise in weekly earnings (£499 to £519) and public sector workers seeing -1.1% fall (£507 to £501), falling behind the private sector for the first time since 2007.

Figure 3: Average weekly earnings: total pay in the public sector, private sector and whole economy from 2010 to 2022 (CPI deflated (2015=100))



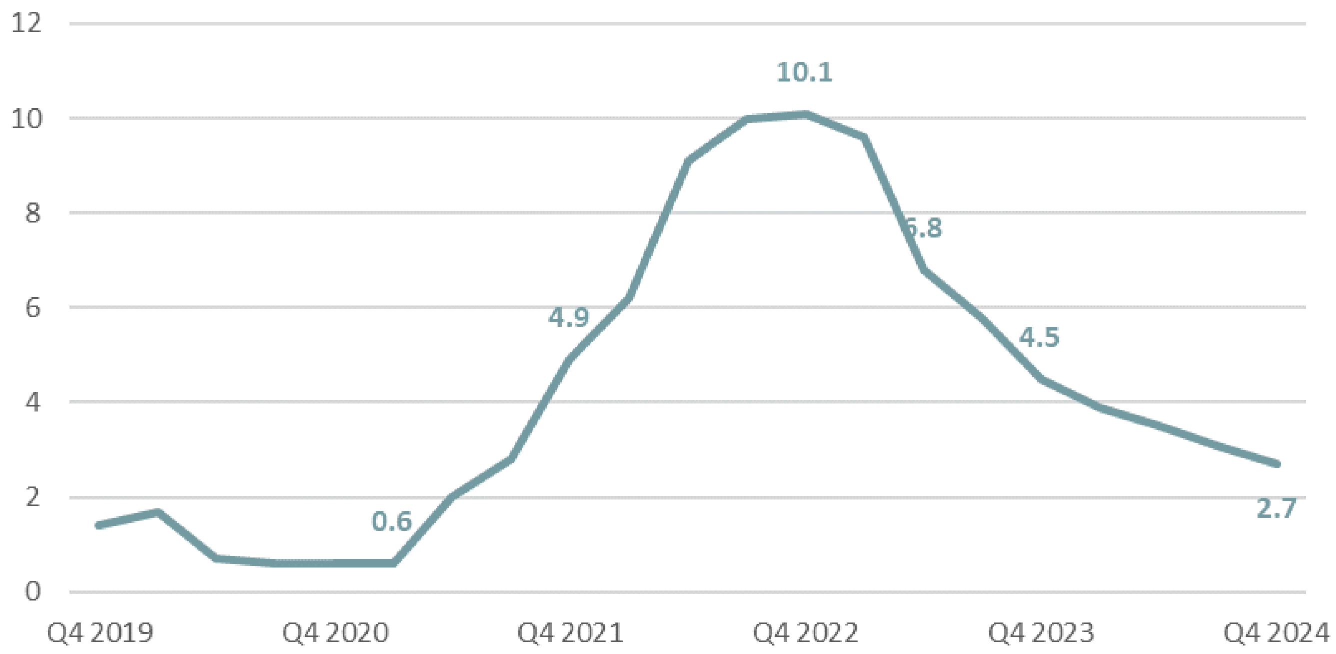
Source: ONS, 2023

What to expect in the short-term

The confluence of high inflation, rising interest rates and lagging wage growth means that living standards have fallen across the board with the OBR (2022) forecasting a 7% fall in living standards over the next 2 years. Those with high levels of debt, and those on lowest wages are particularly vulnerable.

Figure 4 shows the UK inflation annual growth from Q4 2019 forecasted to Q4 2024 by the OECD. It shows the rapid rise of inflation from Q1 2021 (0.6%) through 2021 reaching a peak in Q4 2022 (10.1%). From the peak we observe inflation falling rapidly through 2023 before reaching 2.7% in Q4 2024 still over the BoE target rate of 2%.

Figure 4: United Kingdom inflation annual growth rate (%), Q4 2019 – Q4 2024



Source: OECD Economic Outlook: Statistics and Projections, (2023)

However, since this forecast it is apparent that the inflation rate in the UK has remained stubbornly high with RPI at 8.4% in May 2023 (CPI=7.9%). The latest inflation data suggests that interest rates are likely to rise at time of writing by another 0.25% or possibly even 0.5%. The key takeaway is that rates remain significantly above the pre-mini-budget average in autumn 2022 and this will affect housing affordability and borrowing in the short to medium term. Inflation growth rates may be falling (albeit more slowly than expected) but prices remain well above pre-2022 levels. Some positive news, in April 2023, the Energy Price Guarantee was extended and while prices remain high forecasts suggest that the price cap will fall significantly by July 2023. In short, despite indicators slowly moving in the right direction, the cost-of-living crisis is expected to get worse before it gets better.

What to expect in the longer term

The consequences of the cost-of-living shock to households is likely to have a scarring effect on the region's most badly affected, further exacerbating regional inequality. Forecasts by NIESR (2023) suggest that by the end of 2024 London is projected to have regional GVA 9 per cent above its pre-pandemic level. By contrast, the Midlands is expected be 1 per cent below its pre pandemic level. The post-pandemic crisis poses a significant challenge for policy with levelling up of regions perhaps even more important.

Furthermore, there are additional risks that face the UK economy. Savings accrued for some households and groups in the pandemic are now being run down due to the weathering effect of the cost-of-living crisis. In the medium-term households will have less savings and be less resilient to future shocks, undermining consumer confidence. Compounding the challenge for regional economies there is a risk that low growth becoming a feature of the economy driven by a long period of falling capital investment. Additionally, there are no shortage of further geopolitical risks, from the possible escalation of conflict between Ukraine and Russia to increasing tensions with China related to an increasingly outspoken approach to Taiwan's independence.

Summary

1. Living standards are dropping for most in response to rising costs of essential goods.
2. Low-income households and those living in private rented accommodation or with large mortgages are most vulnerable.
3. Wages are falling to keep pace with inflation particularly in the public sector.
4. There is a strong regional component to the cost-of-living crisis with London and the Southeast pulling even further ahead in terms of productivity.

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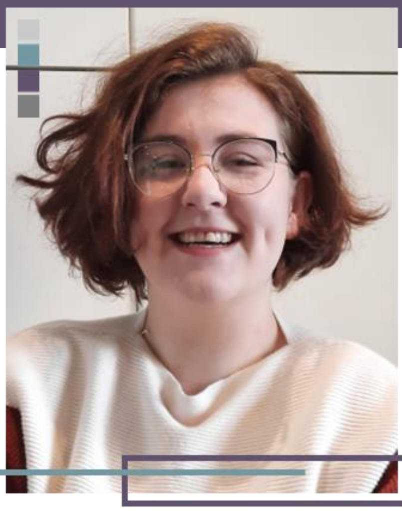
ALICE PUGH



Inflation is rising at its fastest rate in more than 40 years but, what is the driving the rapid increase in rising prices?

What is inflation?

Consumer Price inflation (CPI) is often the inflation rate which you will see being referred to by economists or journalists. CPI is the speed at which prices of goods and services bought by households rise or fall (ONS, 2017). CPI inflation is estimated by using the consumer price indices. The best way to describe the consumer price indices is by imagining it as a shopping basket containing all the goods and services bought by households. To calculate the inflation rate on these goods and services, each month the prices of these goods and services are compared to the prices from the same time the year before, this allows economists to understand whether prices have risen or fallen.

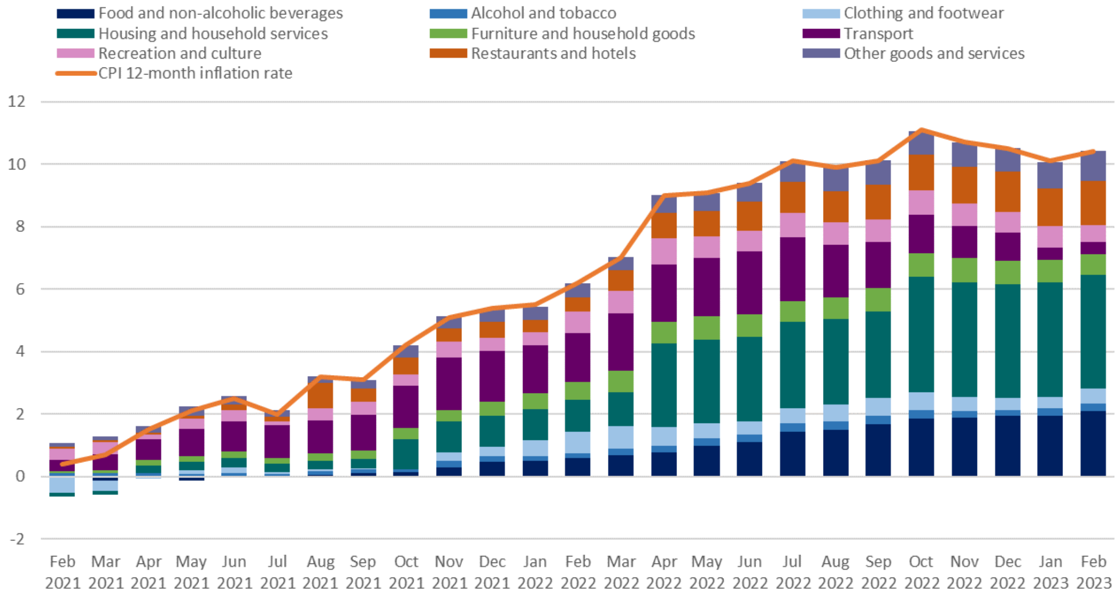
As can be seen in Figure 1 below, before 2021 CPI historically usually bobbed around at 2%, which is the Bank of England (BoE) target rate however, since the summer of 2021 prices of goods and services have been rapidly rising. By the start of 2022 inflation had hit 5.5%, more than double the BoE target rate. Over the year, inflation has continued to shunt upwards reaching its height in October 2022 at 11.1%, more than 5 times the target rate of the BoE. In October therefore, goods and services were on average 11.1% more expensive than they had been at the same time the year before.

Figure 1: Consumer Price Inflation

Source: ONS, 2023

Figure 2 shows which groupings of goods and services have been rising the fastest and pushing up inflation over the last two years. The two largest drivers of inflation in this period have been housing and household services and food and non-alcoholic beverages. However, what is clear from the graph is that over this period almost every purchase category has seen rapidly rising prices.

Figure 2: Contributions to the annual CPI inflation rate UK



Source: ONS, 2023

What is Driving Rising Prices?

Pent up Demand and reduced Output

The first initial driver of inflation was pent-up demand as the world began recovering from the pandemic. From the summer of 2021, as restrictions began to be lowered in many economies, demand for products and services boomed. Consumers wanted to spend money they had saved in the pandemic and go out and enjoy themselves after pro-longed periods of isolation. Plus, as lockdowns ended employees returned to work and output again started to rise. However, this brought with it demand-pull inflation (Kekarainen, 2022). This is when an increase in demand causes prices of goods and services to increase, as supply can't keep up with demand, often leading to increased prices. The sudden explosion in demand as people were released from lockdown in numerous economies, led to massive demand-pull inflation. Especially, as output globally had fallen in all sectors in the months previous, due to protective lockdown measures.

Then supply issues were compounded by differing recovery stances. Globally, manufacturing hubs, such as China, were much slower to remove Covid restrictions, this led to bottle necks of supply and rising costs as producers struggled to find modes of transport for their goods. For instance, there was an under supply of shipping containers, this led to rapidly rising prices of transactional costs, as it become increasingly expensive to transport goods globally. Companies had to incorporate these rising costs into the prices of their products, this is when cost-push inflation began to come into play (Kekarainen, 2022). Cost-push inflation began to push up the cost of products as it became expensive for manufacturers to sell goods globally.

Russian invasion of the Ukraine

The next unprecedented economic shock was the return of war to Europe. The invasion of the Ukraine in February 2022 shocked already brittle and fragile supply chains. Russia and the Ukraine are producers of key raw and natural materials, as a result of the invasion, production and output has been severely impacted, reducing supply and increasing the price of these goods. Goods which have been severely impacted by the conflict include:

FOOD & FERTILISER

Combined Russia and the Ukraine produced a third of the world's wheat and a quarter of barley production, plus 75% of sunflower oil (Ramcharan, 2022). These are basic goods which are needed in the majority of food and drink production. The loss of such a large supply of these raw food materials, sent shockwaves through the food and drink production industry. As supply of these raw food and drink goods fell, the market price of these goods began to rise, and companies had to pass these costs onto consumers (Emediegwu, 2022). These shocks become particularly acute from April 2022 as the shortages began to hit the market and producers passed increased costs onto consumers, as seen in Figure 2.

Similarly, Russia is one of the world's largest exporters of fertiliser. Following Russian invasion many countries implemented sanctions, whilst specific exemptions were put in place for fertilisers to allow for the continued supply of fertilisers, exports of fertilisers have still fallen foul of the measures designed to isolate the region (Broom, 2023). This has resulted in large falls in the supply of fertiliser, which has significantly affected the costs around growing crops, as the cost of fertiliser has dramatically increased due to the fall in supply (Eardley, 2022). Many suppliers are then forced to pass on these costs to consumers.

ENERGY SUPPLY

Following the Russian invasion of the Ukraine energy prices rapidly increased. Russia is the second largest producer of natural gas and oil (Ritchie *et.al*, 2022), sanctions were placed on Russian produced fossil fuels, as a result energy prices rapidly increased. In the UK energy prices have more than quadrupled since 2021 (Pugh, 2022), in Europe energy prices more than doubled between February 2022 and July 2022 (Gazzani and Ferriani, 2022). The rise in energy prices can be seen in figure 2 and has been the largest contributing factor to CPI since April 2022 and has been one of the largest contributing factors in producer price inflation over this period also (ONS, 2023). The rise in energy costs did not only impact households, but it also led to increased production costs for all businesses. Businesses have tried to absorb energy prices however, the rapid increase in costs associated with energy have led to many consumers having to pass these costs onto consumers, driving up cost-push inflation.

The UK is a net importer of energy, making it more vulnerable to energy market shocks. Being a net importer of energy leaves the UK with lower energy security and control over prices, when there is disruption to the energy supply therefore, it is far more vulnerable to energy price rises than net exporting countries (ONS, 2023).

FUEL SUPPLY

Oil prices rose rapidly following Russia's invasion of the Ukraine (Bolton, 2023), as sanctions were placed on Russian produced goods including fuel, reducing supply and increasing prices. This increased transport costs, alongside increased input costs in other areas, led to firms having to raise the costs of their goods adding to inflation (British Chambers of Commerce, 2022).

Brexit

Globally all comparable economies to the UK have been impacted by the pandemic and the Russian invasion, however only the UK still has double figure inflation. Whilst inflation is coming down across Europe and North America, it is remaining stubbornly high in the UK (Romei and Smith, 2023). Brexit is likely part of the reason that it is remaining stubbornly high in the UK.

Research from the University of Sussex found that businesses had struggled to adapt to the new Trade and Cooperation Agreement (TCA), with the largest impacts being increased costs, increased red tape and bureaucracy and shipping and transport delays (Clarke *et.al*, 2023). With businesses also stating that they were suffering competitive disadvantages and loss of trade with the EU three times more in 2022 than in 2021. With just over 35% of firms identifying that Brexit was to blame for their supply chain issues in 2022, not Covid 19 which 31% of respondent blamed for their supply chain issues (Clarke *et.al*, 2023). When surveying business on the TCA the British Chambers of Commerce (2022) found:

52% of firms were experiencing shortages of goods and services, rising to 70% for manufacturers

8 in 10 (80%) of firms experience increased costs since the TCA

53% had experienced an overall decrease in their sales margins

Further research from Ivalua found that 80% of UK businesses found Brexit to be the biggest disrupter to supply chains in 2022, followed by the invasion of the Ukraine (76%), rising energy costs (71%) and Covid-19 (59%) (Ivalua, 2022). Another survey found Brexit has had a significant increase in costs, with prices of raw materials (43%), imports and exports (42%) and manufacturing and production (42%), for UK businesses (England, 2022). Controlling for the impact of the pandemic, UK in a Changing Europe found that UK EU trade barriers led to a 6% increase in food prices in the UK between the end of 2019 and 2021 (Bakker *et.al*, 2022).

Essentially, Brexit has compounded the problems generated by the pandemic and the invasion of the Ukraine. Europe is the UK's biggest trading partner (Ward, 2022), the self-imposed increase in trade barriers with the trading block, has increased costs for many firms. As it has led to trading delays and supply shortages, similarly to that generated by the pandemic and invasion. So, whilst other economies are starting to recover from the pandemic and invasion, or certainly stabilise, the UK is suffering the third shock of leaving the EU, which has compounded the effects of the pandemic and invasion.

Tight Labour market

This tight labour market, due to rising inactivity, due to increasing in long-term illness, early retirement and reduced skilled immigration. Long-term illness has been driven by the pandemic, it's impact both on people's health and its impact on NHS backlogs, preventing people from returning to work. Many older workers have retired following the pandemic. Reducing the availability of labour, tightening the labour market. This is leading to higher costs for firms, as they are having to increase wages to compete for employees during in a labour supply shortage and this is compounded by rising inflation. With private sector wages growing on average by 6.9% last year comparative to the year before, public sector wages grew 2.7% over the same period (ONS, 2022). This was the largest growth in private sector pay, excluding during the pandemic, that the UK has ever seen.

Private sector pay rises are more likely to be inflationary than public sector pay rises, as the private sector businesses will raise prices to mitigate the increased wage costs, adding to inflation. Plus, the private sector employees 83% of the active workforce, comparative to 17% employed by the public sector, meaning wages in the private sector are much more likely to lead to an increase in inflation (Whiteley, 2023). However, as the current wage rises are being driven by rises in labour supply shortages the inflationary impact is relatively weak overall (Whiteley, 2023).

Summary

The largest drivers of inflation which are fuelling the cost-of-living crisis have been the reopening of economies when recovering from the pandemic, followed by the Russian invasion of the Ukraine. When reopening after the pandemic there was massive demand-pull inflation and a time when there was little output to cope with demand, fuelling inflation. Heightened by economies reopening at differing speeds. The invasion of the Ukraine then led to further supply shortages, particularly in basic necessity food goods (e.g. grain and cooking oil) and energy fuels (e.g. oil and natural gas). This loss of these basic food goods has fed through to all corners of the food production market, as Russia and Ukraine are two of the largest producers of these food stuffs, rising inflation across the entire food production market. The loss of energy supplies by the world's second largest producer, also led to rapidly rising energy prices not only for households but for producers, which have then been forced to pass on the rising input costs to consumers. Energy also impacts every UK business, which have seen their energy bills more than quadruple.

However, all economies have been facing these issues and inflation is higher in the UK compared to other comparable economies. This is likely because the UK is a net importer of the majority of goods and energy supplies which have been impacted by these two economic shocks, making the UK more vulnerable to such shocks. Plus, Brexit is also leading to delays and shortages compounding supply issues, increasing costs for British firms, which are then passing on those cost rises through higher prices.

Rises in private sector pay may be contributing to increased inflation, as there is a skills shortage driving higher wages, which is then being passed onto consumers in the form of higher prices. However, this is a weaker driver of inflation as the majority of these wage rises are to tackle skills shortages, rather than demands for higher wages. Public sector pay rises are very unlikely to be influencing inflation as there has been only a 3% rise in pay over the last year, comparative to 7% in the private sector, plus the private sector employees 83% of the workforce and the public sector only employees 17%.

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How does the cost-of-living crisis compare internationally?

KOSTAS KOLLYDAS & PAUL VALLANCE

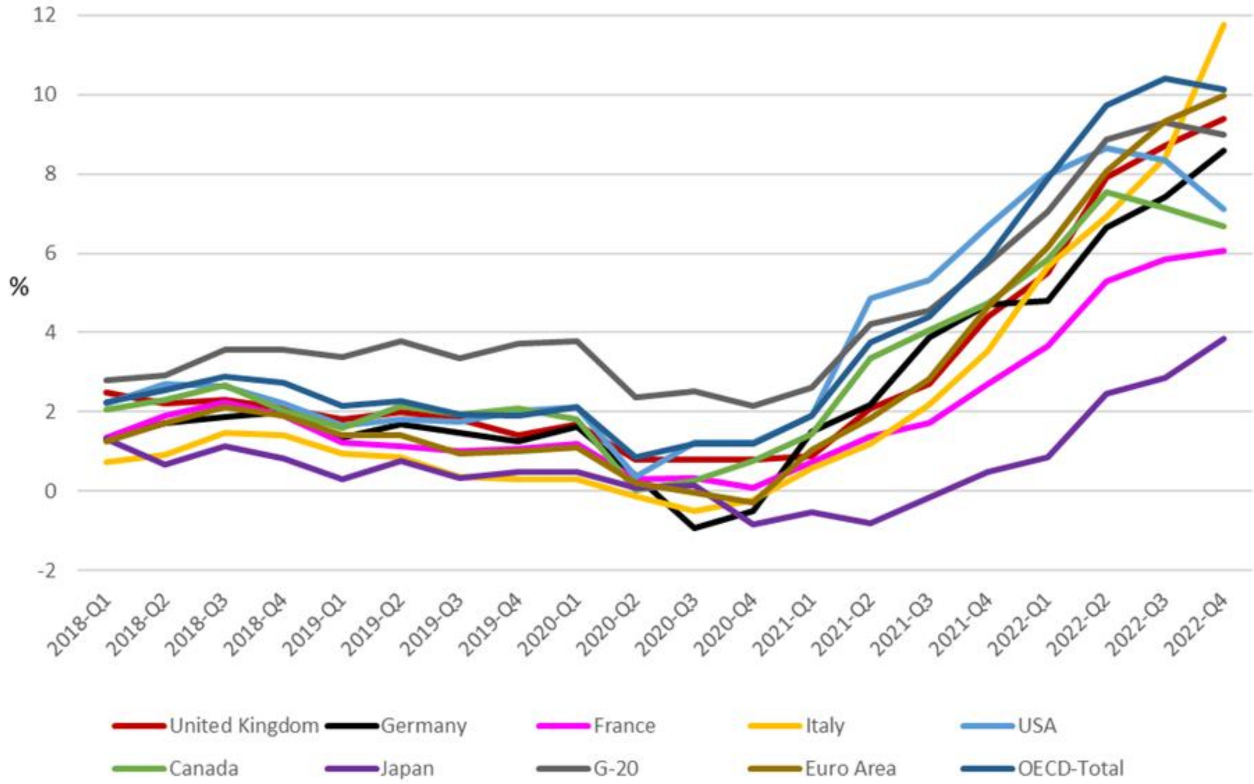
Is it only the UK that is suffering the cost-of-living crisis? How is the UK fairing comparative to comparable countries?

Inflation growth rates

The cost of living is influenced by a range of factors, including housing, food, healthcare, transportation costs, taxes, and geographical location. To compare living costs across countries and calculate inflation rates, the Consumer Price Index (CPI) growth rate is often used.

Since the start of 2021, the majority of OECD countries have experienced an upsurge in their total inflation growth rate, which includes food and energy costs, as illustrated in Figure 1. In the UK, the annual inflation growth rate increased significantly by 8.6 percentage points, from 0.8% in the fourth quarter of 2020 to 9.4% in the fourth quarter of 2022, which is in line with the OECD average of 10.1% in Q4 2022. Among major economies, Italy witnessed the most considerable increase in inflation rates (12% by the end of 2022), followed by the Eurozone area (10.3%). Conversely, Japan, which experiences structural issues that manifest in slow GDP and inflation growth, saw a relatively lower increase, followed by Canada and the United States.

Figure 1. Inflation (CPI) annual growth rate (%) in selected countries (Q1 2018 – Q4 2022)



Note: The G20 group comprises Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, and the United States. Although the European Union is a full member of G-20, the G-20 aggregate only comprises individual countries that are also members.
Source: OECD (2023a)

Inflation rates began to rise through 2021 as major economies across the world recovered from the shock of the COVID-19 pandemic. However, the unforeseen and continued existence of inflationary pressures in 2022 was largely attributed to the Russian invasion of Ukraine, which led to an abrupt surge in a range of significant commodity prices including crude oil, natural gas, coal, different metals, wheat, corn, certain edible oils, and fertilisers (OECD, 2022). Although the prices for most of these commodities later dropped, partly because of China's decreased demand, internationally traded coal and gas prices continued to remain high throughout 2022.

As in the UK, increasing energy prices have been the largest driver of the high inflation seen in other European countries. The impact of the war in Ukraine on wholesale gas and electricity prices is a common factor across the continent, but the extent to which this has been felt by consumers varies across different countries due to different patterns of resource dependency and use, different energy market conditions, and different effects of national government regulations and policies to support households (Menyhért, 2022). Notably, the annual growth rate in consumer energy prices (as of February 2023) has been markedly higher in the UK at 48.3% than in other large European economies, such as Italy (28.2%), Germany (20.0%), and France (14.0%). For the combined 27 member states that now make up the European Union, the corresponding figure is also considerably lower than the UK at 16.6% (OECD, 2023a). The reasons for this in the UK include a high dependence on gas to heat homes and generate electricity, and a large proportion of the housing stock with poor insulation and energy efficiency (Valero, 2023).

Annual Growth Rate in Consumer Energy Prices (February 2023)

UK	Italy	Germany	France	EU
48.3%	28.2%	20%	14%	16.6%

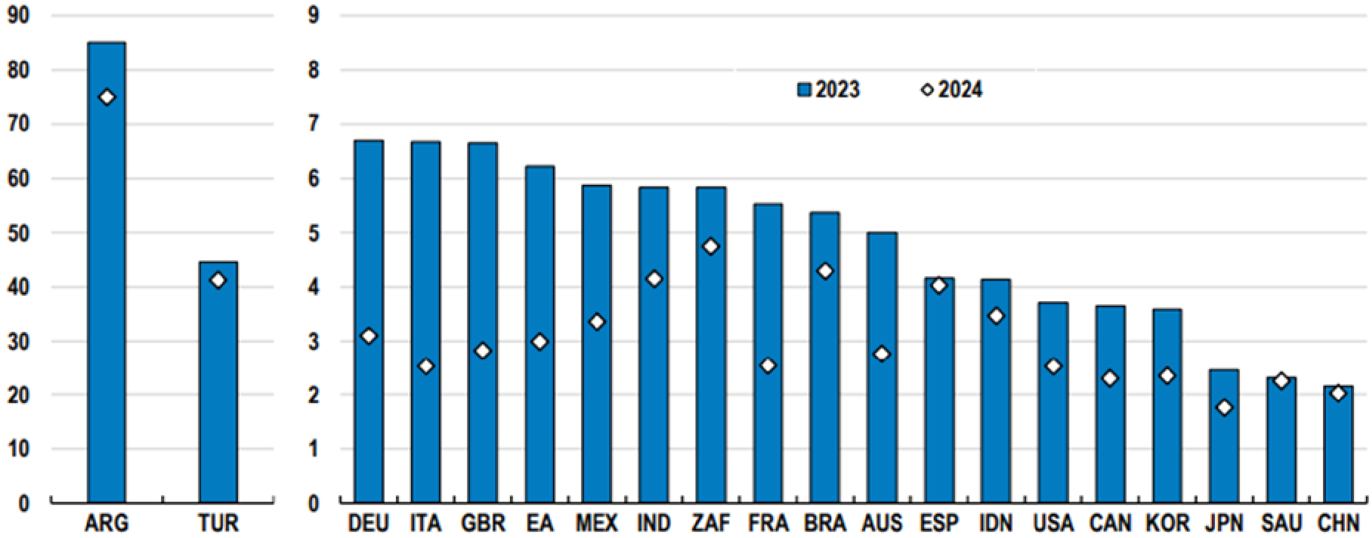
The OECD's (2023b) Economic Outlook interim report highlights an upswing in the economic activity and consumer confidence in the major G20 economies at the start of 2023. This improvement is attributed to the drop in global food and energy costs, which has led to an increase in purchasing power and a projected decrease in headline inflation. Moreover, the global economy has been positively impacted by the reopening of China's economy. The dip in energy prices is in part due to the moderate winter temperatures observed in Europe, leading to stabilisation in gas storage levels and curtailed energy consumption in several countries. However, the cost of energy and food is still higher than pre-pandemic levels, putting a financial strain on many low-income households. According to the above report, even though food and fertiliser prices have declined since their peak in 2022, food and energy security remain fragile, particularly for emerging economies and households with low incomes.

In addition, the headline CPI rate and the core inflation rate (the latter excludes food and energy) are still exceeding the goals of the central banks, although the headline inflation is gradually decreasing in most economies, mainly due to the reduction in food and energy prices. Inflation levels continue to vary significantly among different countries, with certain Asian economies such as China and Japan still experiencing relatively low inflation rates, while Turkey and Argentina are witnessing a surge in inflation.

The most recent inflation figures available at the time of writing show that the UK experienced an unexpected rise in the overall rate from 8.8% in January 2023 to 9.2% in February 2023. This meant that the UK had the highest inflation of the G7 advanced economies in February (as Italy fell from 10.0% to 9.1% and Germany remained at 8.7%). For the UK, the persistence of these inflationary pressures in early 2023 is attributable to the very high energy costs discussed above, but also to still rising food prices (to an annual growth rate of 18.2% in February) (OECD, 2023c). The factors behind this food cost inflation are multifaceted, including the disruption to supplies of staple commodities related to the Russian invasion of Ukraine. However, recent analysis also points towards the trade barriers introduced by the UK leaving the European Union Single Market and Customs Union in January 2021 having contributed to increasing food prices in the UK over the past two years (Bakker *et al.*, 2022).

Due to the deceleration of worldwide economic growth, the reduction in food and energy price inflation, and the monetary constriction enforced by many central banks, inflation is anticipated to decrease across almost all G20 economies in 2023 and 2024 (Figure 2). Nonetheless, even with this projected decline, annual inflation rates are predicted to remain significantly above the target in most economies throughout 2024 (OECD, 2023b).

Figure 2. Inflation projections in the G20 countries (2023-2024)



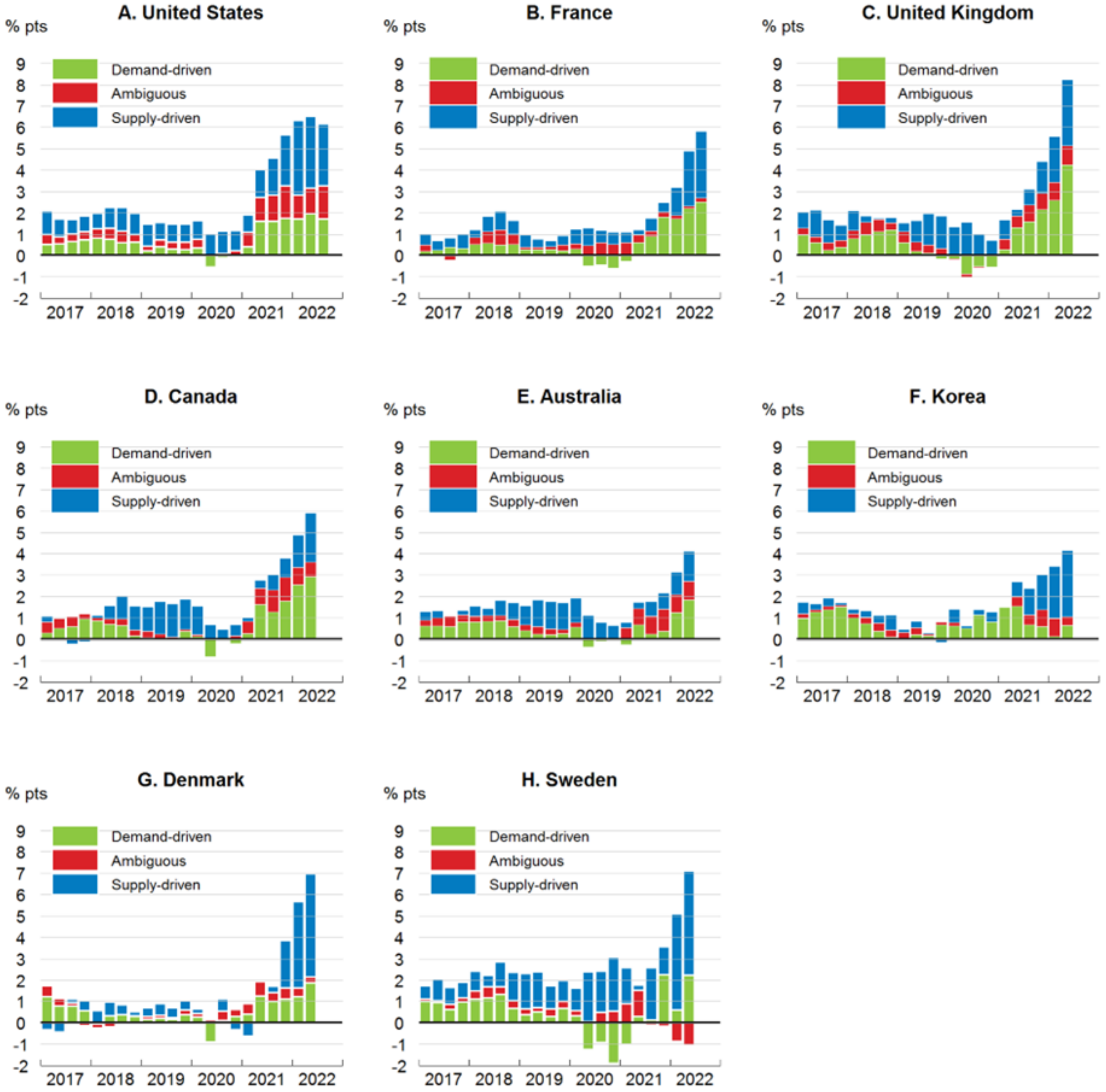
Note: ARG: Argentina, TUR: Turkey, DEU: Germany, ITA: Italy, GBR: United Kingdom, EA: Euro area, MEX: Mexico, IND: India, ZAF: South Africa, FRA: France, BRA: Brazil, AUS: Australia, ESP: Spain, IDN: Indonesia, USA: United States, CAN: Canada, KOR: Korea, JPN: Japan, SAU: Saudi Arabia, CHN: China
Source: Figure taken from OECD (2023b)

Disentangling the effects of supply and demand on inflation rates across countries

Inflation caused by demand occurs when the demand for products and services in an economy increases faster than the country's production capacity. Because of the surplus demand, prices for products and services rise. Typically, this sort of inflation happens during periods of economic expansion, low unemployment, and wage increases. Conversely, supply-driven inflation occurs when the supply of goods and services in an economy is restrained, but demand remains constant or rises. For example, this can be caused by natural disasters, wars, trade restrictions, and supply chain interruptions. When the supply of goods and services is constrained, prices rise due to the scarcity of those goods and services. In brief, demand-driven inflation is generated by an excess of demand, whereas supply-driven inflation is caused by supply restrictions.

Figure 3 demonstrates the contribution of supply and demand-related factors to headline inflation in selected countries based on personal/household consumption expenditure data (OECD, 2022). This approach is based on the assumption that demand pressures occur when the price and volume of an item move in the same direction, whereas supply shocks occur when they move in opposite directions (e.g., a decrease in volume but an increase in prices indicates lower supply). When it is not possible to determine whether changes in prices are due to demand- or supply-driven factors, a third category called "ambiguous" is used. The results show that inflation in all these countries has been influenced by both supply and demand determinants since mid-2020. The share of inflation that is attributed to demand-driven factors in Q2 of 2022 varies from 16% in South Korea to around 50% in the United Kingdom and Canada. On average, supply-driven inflation represents approximately half of total inflation in the eight economies depicted, although it is much higher than 50% in Denmark, Korea, and Sweden.

Figure 3: Contributions of supply-and demand-driven inflation to headline inflation in selected countries (January 2017 – April/July 2022)



Source: Figure taken from OECD (2022)

Cost-of-living indices: An international comparison

According to Numbeo's database, the UK is ranked 33rd among 140 countries in 2023 in terms of the cost-of-living index (excluding rent). This means that the UK is positioned lower than most G7 nations, except Italy (see Table 1 and Figures 4-5). However, when factoring in housing expenses, the overall cost of living in the UK increases, ranking it 20th globally. It is noteworthy that the UK's rank in the overall cost of living index was relatively better before the pandemic and inflation expansion of the past two years, with a rank of 31st in mid-2019.

Regarding grocery prices, the UK has a lower grocery index (47.7 in 2023) compared to many other countries, including the United States, Japan, Canada, France, Italy, and Germany. On the other hand, restaurant prices in the UK (with an index of 67.9) are relatively high compared to other G7 nations, surpassed only by the United States. Despite this, the UK has a relatively strong local purchasing power with a ranking of 14th in the world and an index of 98.9, which is higher than France and Italy but lower than the United States, Germany, Canada, and Japan. In summary, despite the fact that the UK's cost of living is higher than many countries, it is still competitive when compared to the other G7 nations.

Table 1: Ranking of cost –of living index across countries (2023)

Rank	Country	Cost of Living Index (excl. Rent)	Rent Index	Cost of Living Plus Rent Index	Groceries Index	Restaurant Price Index	Local Purchasing Power Index
1	Bermuda	141.8	96.3	120.0	143.3	142.0	79.5
2	Switzerland	114.2	50.2	83.5	113.9	109.5	118.7
3	Cayman Islands	103.4	75.7	90.1	96.4	92.4	76.7
4	Bahamas	90.9	39.6	66.3	74.1	94.8	43.2
5	Barbados	88.8	21.2	56.4	80.1	82.7	36.8
6	Norway	88.6	30.9	60.9	81.8	90.6	95.0
7	Singapore	85.9	85.3	85.6	74.0	58.4	95.6
8	Iceland	83.3	36.7	61.0	78.3	86.9	90.1
9	Jersey	80.0	53.9	67.4	62.4	90.8	72.6
10	Denmark	78.6	30.4	55.5	62.4	91.9	105.0
(Countries 11-15 not shown)							
16	United States	72.4	47.1	60.3	71.4	70.8	115.7
(Countries 17-20 not shown)							
21	France	68.7	24.6	47.5	65.1	66.9	86.2
(Countries 22-24 not shown)							
25	Canada	66.1	33.4	50.4	64.2	62.8	102.1
(Countries 26-28 not shown)							
29	Japan	64.6	20.8	43.6	66.5	37.9	100.4
30	Germany	62.9	26.1	45.3	50.9	56.2	107.6
(Countries 31-32 not shown)							
33	United Kingdom	61.5	30.3	46.6	47.7	67.9	98.9
(Country 34 not shown)							
35	Italy	61.3	20.5	41.7	51.9	61.9	66.5
(Countries 36-135 not shown)							
136	Libya	24.2	5.2	15.1	23.1	19.3	32.1
137	Colombia	23.1	7.0	15.4	21.0	17.3	31.1
138	India	22.4	5.5	14.3	23.3	15.7	64.6
139	Egypt	21.6	4.3	13.3	19.6	18.0	21.9
140	Pakistan	18.0	3.4	11.0	15.4	13.7	24.4

*The indices shown in the Table are relative to New York City (NYC), with each index set at 100 for NYC. For instance, if a country has a rent index of 30, it implies that rents in that country are on 70% cheaper on average than in NYC. These indices represent a snapshot of the current indices at a specific point in time in 2023. Country rankings in the Table are based on the cost of living index (excl. rent).**Cost of Living Index (Excl. Rent)** is a relative indicator of consumer goods prices, such as groceries, restaurants, transportation, and utilities, excluding rent or mortgage expenses. **Rent Index** estimates the cost of renting apartments in a given country compared to NYC. **Cost of Living Plus Rent Index** estimates consumer goods prices including rent compared to NYC. **Groceries Index** estimates grocery prices in a given country compared to NYC. **Restaurants Index** is a comparison of prices of meals and drinks in restaurants and bars compared to NYC. **Local Purchasing Power** demonstrates the relative purchasing power in buying goods and services in a given country. For example, if the domestic purchasing power is 86, it implies that people in that country with an average salary can afford to buy 14% fewer goods and services than NYC residents with an average salary.*
Source: Numbeo (2023)

Figure 4: Cost of living index (excl. rent) in the G7 countries (2023)

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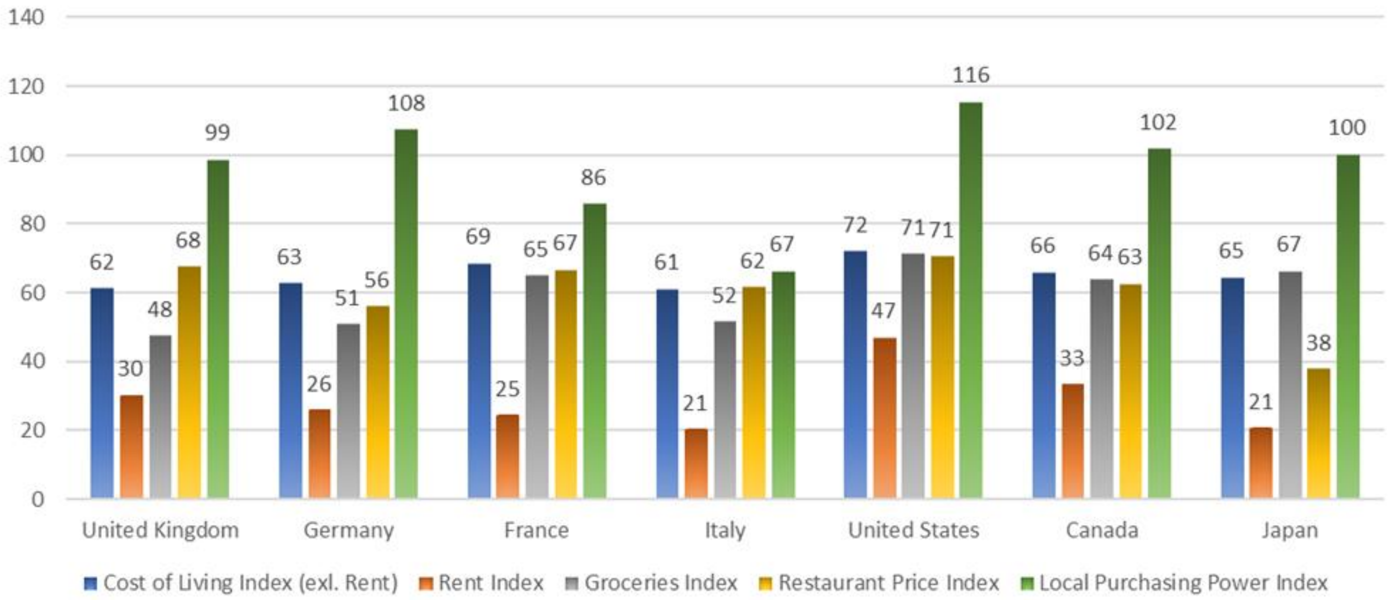
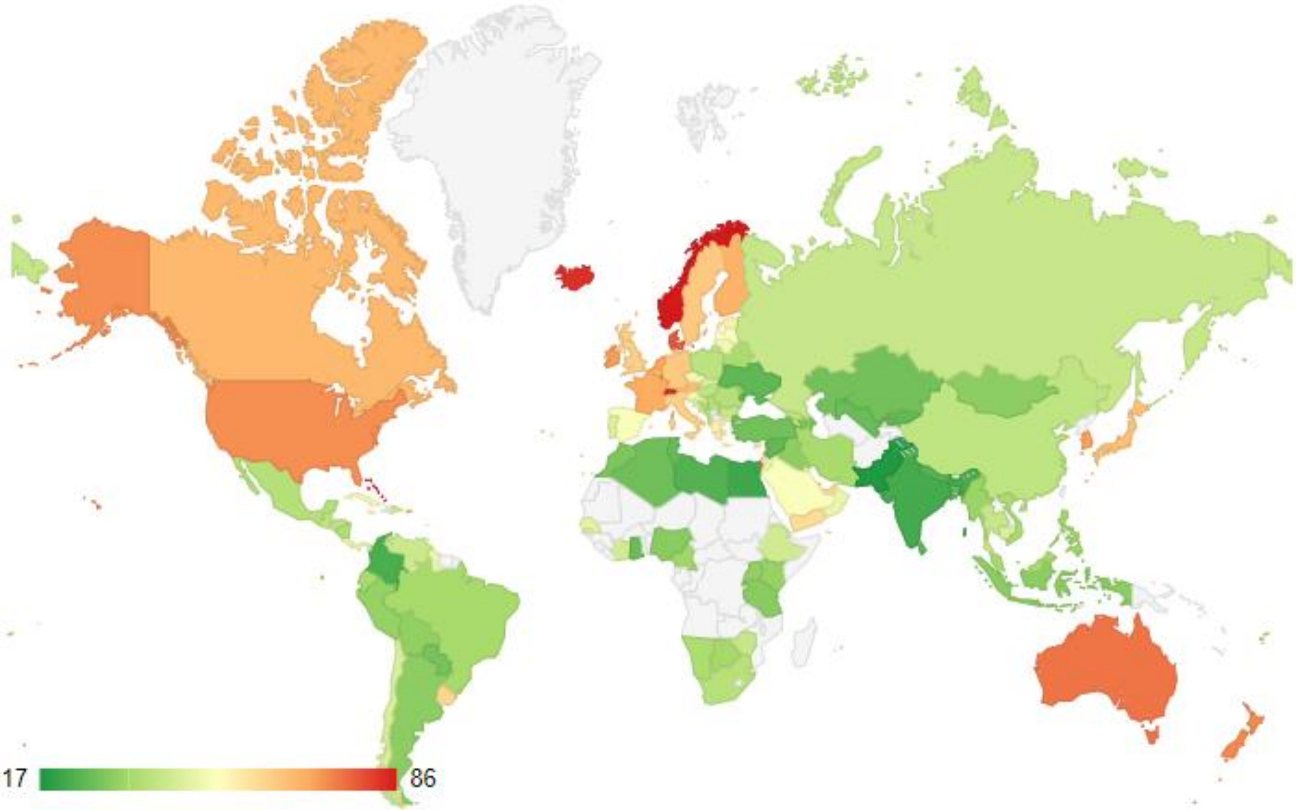


Note: For detailed information about the indices, see the note in Table 1.
Source: Numbeo (2023)

Figure 5: Cost –of living index (excl. rent) (2023)

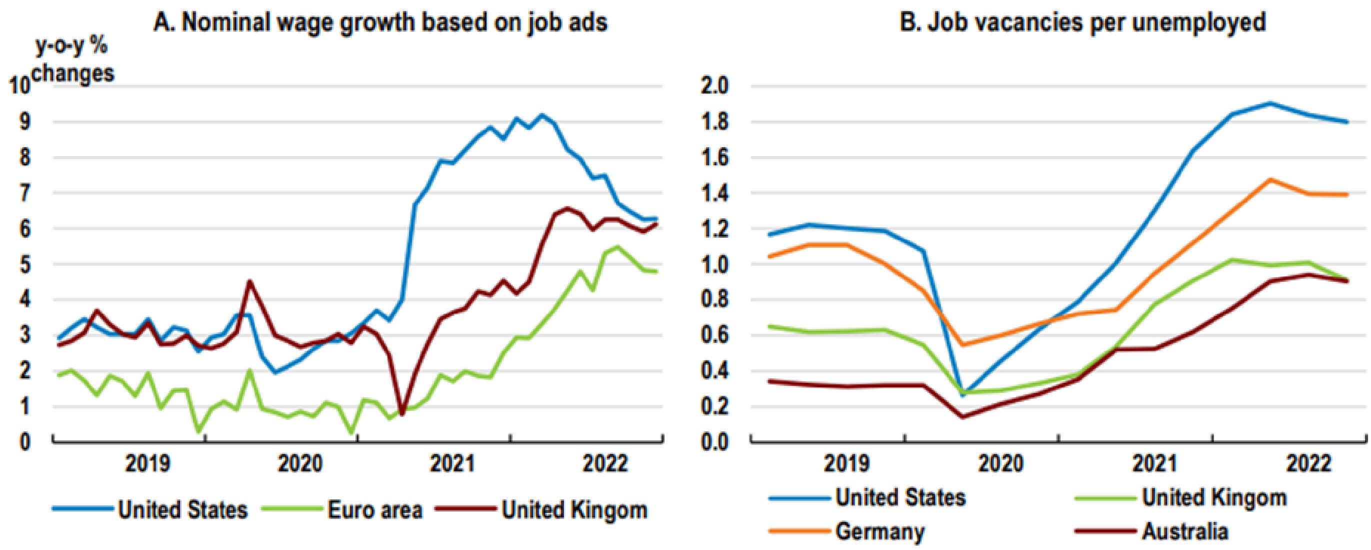


Source: Numbeo (2023)

Nominal wages, job vacancies and real wages

The current economic landscape in most major countries is characterised by low unemployment rates and high vacancy rates. This, coupled with a prolonged period of high inflation discussed earlier, has resulted in an escalation in nominal wage growth, as shown in Figure 6. Nevertheless, certain economies (such as the United States) are experiencing a significant slowdown in the pace of wage increases, or in some cases a decline.

Figure 6: Wage growth and job vacancies per unemployed people in selected countries



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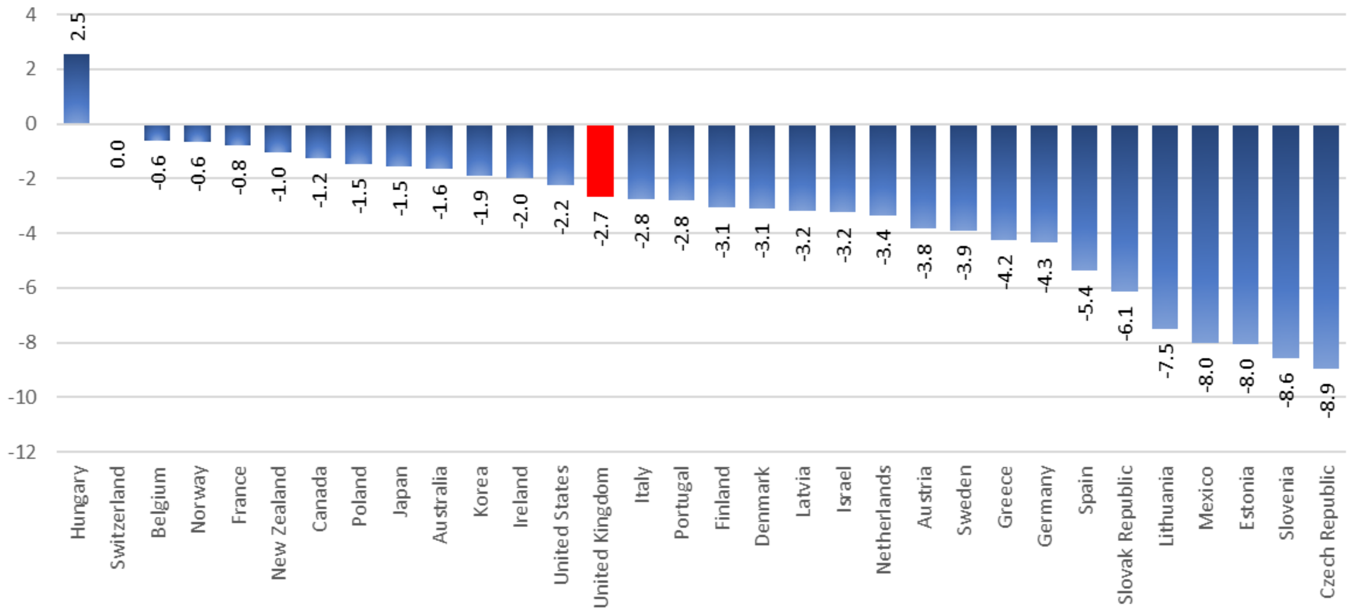
Note: Panel A shows the average annual increase or decrease in wages and salaries advertised in job listings on Indeed, accounting for job titles. Panel B shows the ratio of job openings that remain unfilled to the total number of individuals aged 15 and above who are unemployed.
Source: Figure taken from OECD (2023b)

In spite of the labour market tightness and increasing nominal wages, most countries have witnessed a notable decline in real wages (which account for inflation), indicating a general decrease in the purchasing power of their workforce. Specifically, the annual reduction in real wages in the third quarter of 2022 was 2.7% in the UK, albeit it was lower than the average of 32 OECD countries with available data (3.3%). The UK government's energy plan encompasses a cap on household energy bills and other forms of assistance for businesses, thereby supporting them with the energy price increases. This is particularly critical for lower-income families, as their energy expenses usually comprise a larger portion of total expenditures relative to high-income families. The structure of household expenditure across different income groups does vary from country-to-country. However, analysis at the EU level has shown that, in most member states, the impact of inflation on energy and food prices has also disproportionately affected families with lower incomes (Menyhért, 2022; Vidal and Villani, 2022). Correspondingly, national governments across Europe have also (like the UK) introduced special measures to financially protect their citizens from the rapid rise in energy costs (see Sgaravatti *et al.* 2023).

Figure 7: Year-over-year changes (%) in real wages per employee in selected countries (Q3 2022)



Source: OECD (2022)

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The Impact of Rising Prices on Businesses

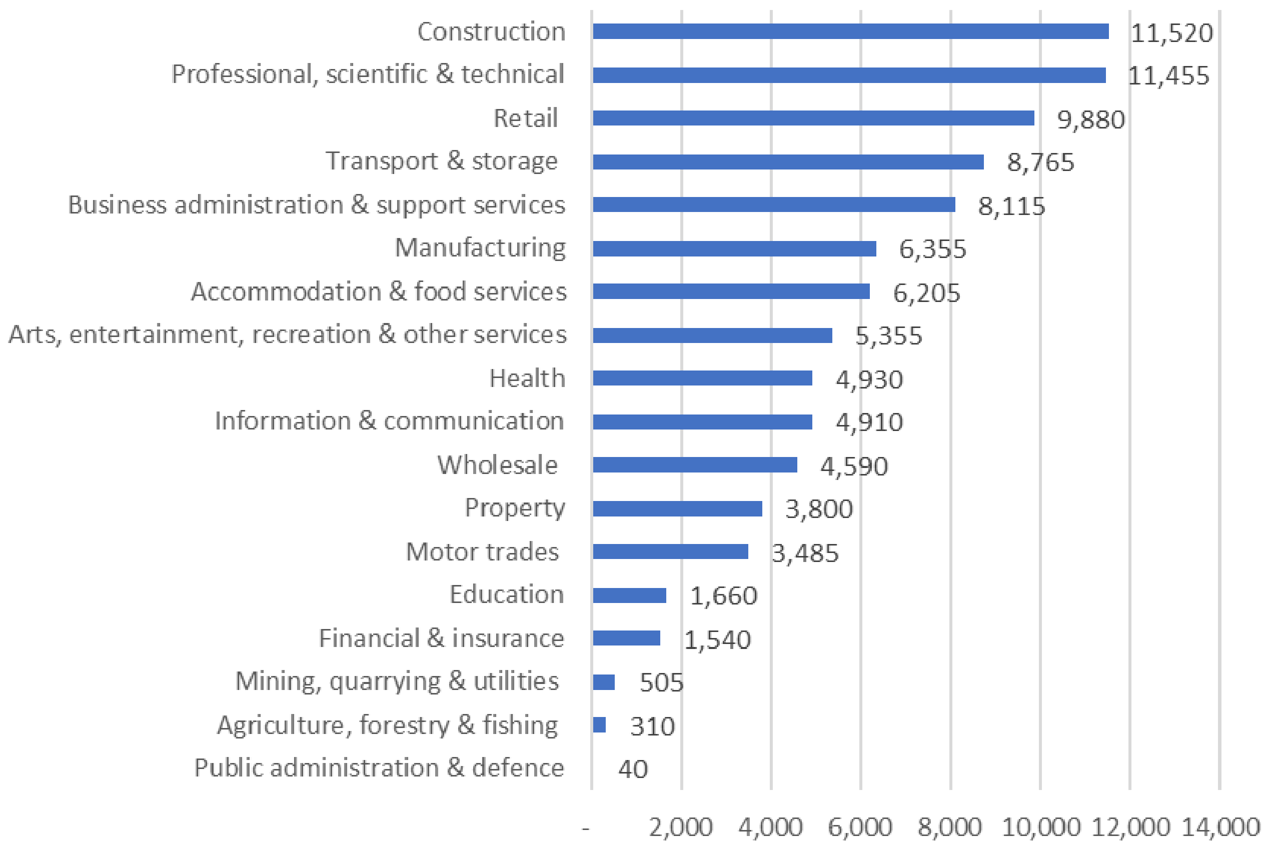
CHLOE BILLING

How are UK businesses being impacted by the rising input costs? And are different sectors more impacted than others?

Introduction

The aim of this chapter is to analyse the impact of rising energy and materials prices on businesses in the West Midlands Combined Authority (WMCA). Evidence shows that the price rises have resulted in higher operating costs and a reduction in consumer spending power, which are having a series of knock-on effects on local businesses, including: a fall in business confidence (as shown by the latest Business Confidence Monitor), firm insolvencies, redundancies, reduction in business hours and a decrease in private spending on research and development (R&D). The impact of the inflationary pressures varies between sectors and different sized firms, hitting small businesses in the construction, manufacturing, hospitality, and transport sectors especially hard (Centre for Economic Performance, 2023). The sectors which are hardest hit by the price increases are shown in the below graph on 'Business Counts by Sector in the West Midlands' (Nomis, 2023), highlighting the place-based impact on the region.

Figure 1: Business Counts by Sector in the West Midlands

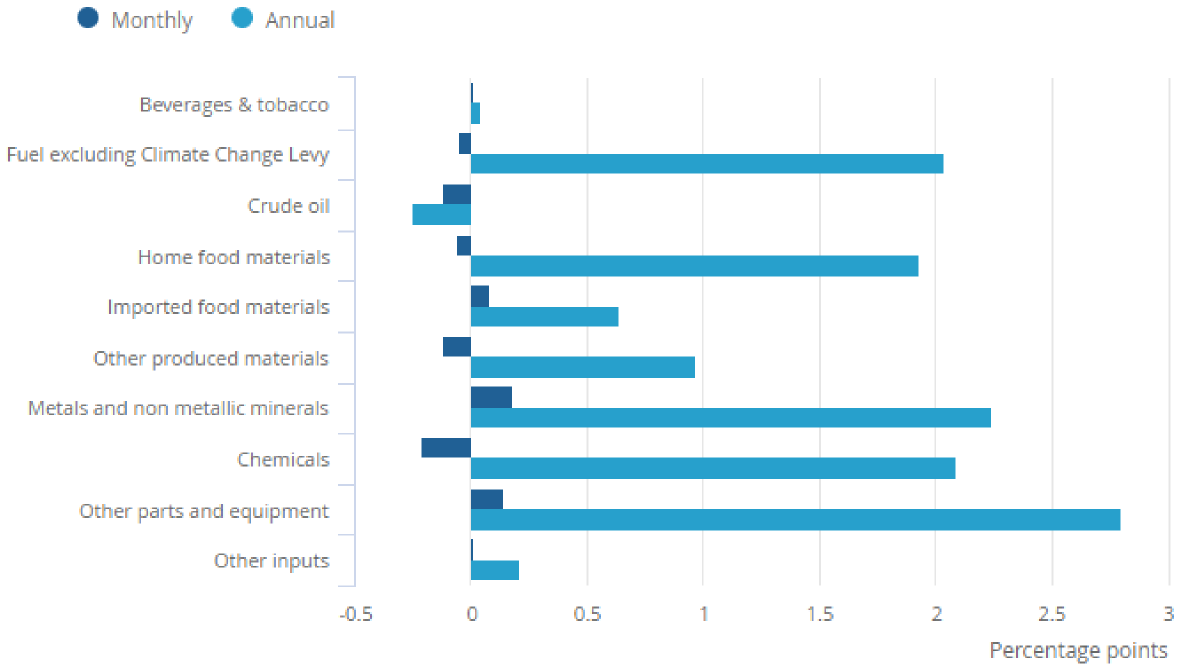


Source: Nomis, 2023

Inflation in the cost of materials and business services

Businesses are seeing rapid inflation in the cost of materials and business services (British Business Bank, 2023). Around 4 in 10 (41%) trading businesses reported a rise in the price of goods or services bought in December 2022, compared with the previous month. Looking ahead in February 2023, around a quarter (26%) of trading businesses expected the price of goods and services sold to rise (ONS, 2023b). These increases are shown in the 'Input Producer Price Index' illustrated in Figure 2. In total, producer input prices (materials and fuels purchased by manufacturers) rose by 12.7% in the 12 months to February 2023, down from 14.7% in the year to January 2023. Meanwhile, producer output (factory gate) prices rose by 12.1% in the 12 months to February 2023, down from 13.5% in the year to January 2023.

Figure 2: Input Producer Price Index (PPI), contribution to monthly and annual inflation rate, UK, February 2023



Source: ONS, 2023

Underpinning these price increases is the wide array of supply-side problems that businesses continue to face. For example, a more difficult trading environment, because of Brexit, is increasing the import costs for companies (ICAEW, 2023). To protect themselves against any 'near-term surges in commodity' prices businesses have been stockpiling raw materials. This, coupled with weaker market demand, has led to the proportion of companies with above-normal levels of raw materials and components (25.5%) at almost double the historical average for UK businesses (ICAEW, 2023). Furthermore, higher consumer shopping basket prices put pressure on wages, as employees seek higher salaries to meet the increased cost of living (British Business Bank, 2023). This comes at a time in which the government has recently ended its business finance support packages, and firms are having to start paying back CBILS and Bounce Back loans % (ICAEW, 2023).

Rising energy prices

Over the past year, there has been a steep rise in wholesale gas prices, due to a 'squeeze' on gas supplies into Europe. This squeeze was caused by the increased demand during the post-Covid reopening of economies coinciding with Russia's illegal invasion of Ukraine (Valero, 2022). It has driven up the amount that energy providers pay for gas and electricity, which is being passed onto consumers, although policy interventions (Energy Bill Support Scheme and The Energy Price Cap) have somewhat helped cushion the extent of this impact (Valero, 2022). This 'energy crisis' is affecting businesses as well as households (ONS, 2022). For instance, non-domestic electricity costs increased by 29% between Q1 2021 and Q1 2022, and non-domestic gas prices rose by 71% over the same period, according to the government's Quarterly Energy Prices data (British Business Bank, 2023). Businesses that use energy more intensively with large spending on energy relative to the size of their business, are finding themselves under increasing pressure to pass on higher costs to their customers or are vulnerable to closure (ONS, 2022). For example, industry sectors related to production and transportation are particularly energy intensive. Similarly, lighting and heating are a significant cost for service sectors with relatively high energy intensity, such as accommodation and food service activities (ONS, 2023d). According to the UKHospitality group's analysis "the sector's energy costs are £12bn a year higher than before the crisis" (The Guardian, 2023). The percentage price increase for energy intensive small businesses is outlined in TABLE 1 below.

Table 1: Average cost of UK energy bills for small businesses in 2022.

Industry Type	2021 Total energy bill (£)	2022 total energy bill (£)	Percentage price increase
HEALTH	86,714.73	152,344.50	75.68
COMMUNITY & LEISURE	27,710.84	48,346.24	74.47
ARTS & CULTURE	33,445.16	56,977.92	70.36
HOSPITALITY	23,876.16	39,497.51	65.43
OFFICES	10,986.35	17,846.21	62.44
RETAIL	10,554.01	16,817.15	59.34

In response to the rising gas and electricity prices, businesses are having to find ways of cutting their costs or seeking financial support. Alternatively, they are being forced to absorb the additional costs, or pass them onto consumers by raising their prices (Money.co.uk, 2022).

The impact of rising prices on different sectors

The sectors which are hardest hit by the price increases are outlined in the table below:

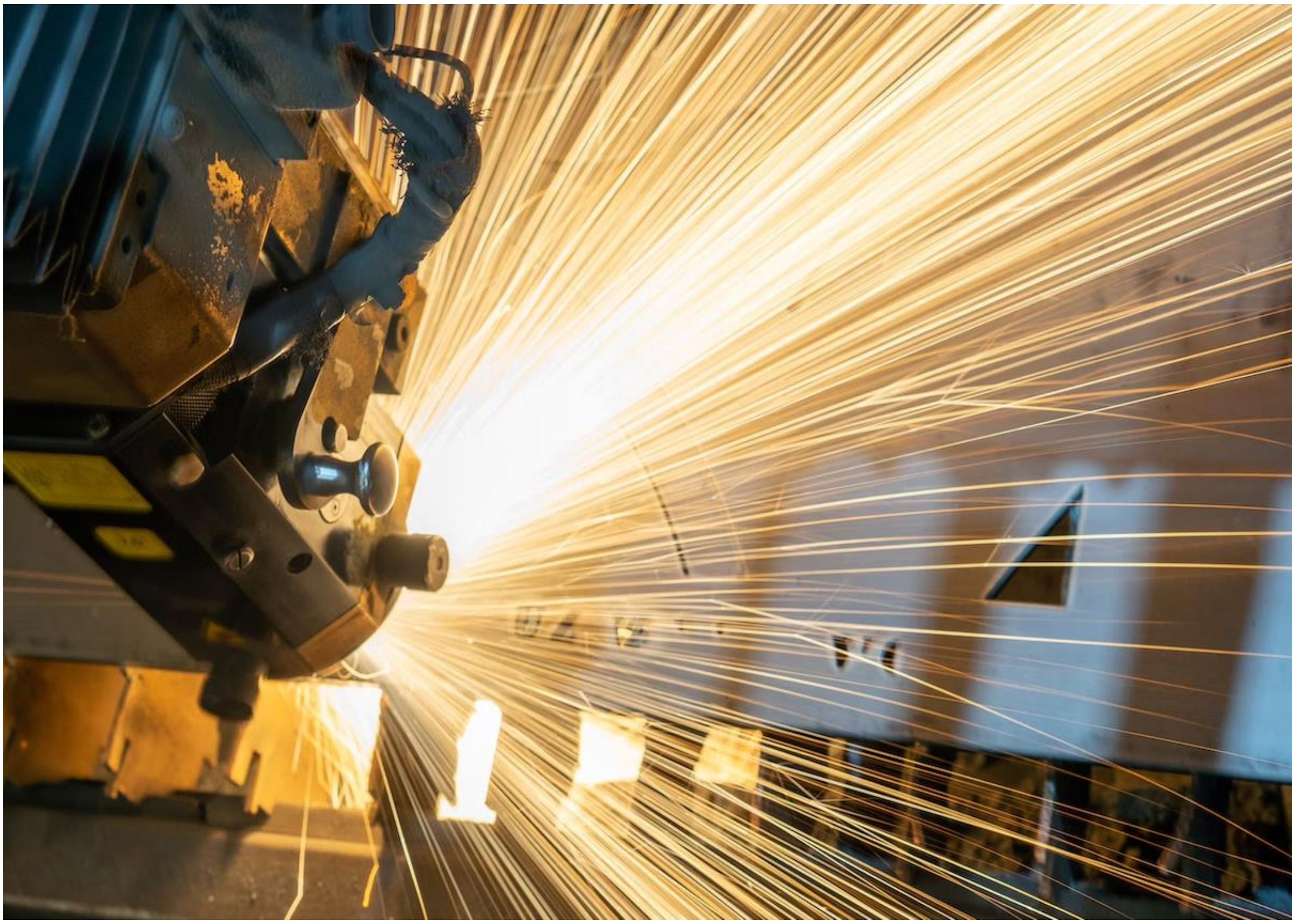
Table 2: Sectors which are hardest hit by the price increases

Sector	Impact
Manufacturing & Engineering *(6th largest sector by*	- The biggest risk to manufacturers' competitiveness in 2023 is the increasing cost of producing goods and services (MakeUK, 2023). - Manufacturing and engineering are among the most import-intensive sectors in the UK.

business count in the W Mids)	- The largest upward contribution to the annual input inflation rate came from inputs of other parts and equipment, which contributed 2.80 percentage points. This product group saw an increase in the year to February 2023 of 9.0% (ONS, 2023a). - Metals and non-metallic minerals saw an increase in the year to February 2023 of 13.4%, down from 14.4% in January 2023. The annual inflation rate continues to be driven by globally high steel prices (ONS, 2023a).
Transport & Storage *(4th largest sector by business count in the W Mids)*	- Transport and storage have been particularly impacted by the sharp increase in fuel costs (MakeUK, 2023). - At the more detailed industry group level, the three most energy intensive groups in 2019 were sea and coastal freight water transport (38%), passenger air transport (36%) and freight transport by road and removal services (31%) (ONS, 2023d). - The cost of transportation and shipping, including importing and exporting goods, has increased across the board. - The cost of a shipping container increased by up to 800% in 2021, though forecasters predict prices should start to decline (British Business Bank, 2023).
Hospitality (*7th largest sector by business count in the W Mids*)	- Food products provided the largest upward contribution to the output annual rate in the year to February 2023, at 3.86 percentage points (ONS, 2023a). This was mainly driven by condiments and seasonings, with ingredients, packaging and energy costs pushing prices up. The annual inflation rate for food products was 16.5% in the year to February 2023, which is down marginally from 16.6% in January 2023 (ONS, 2023a). - Food and drink service businesses were more likely than any other industry to say they plan to cut trading by at least two days per week in November 2022 to reduce energy costs (ONS, 2022b). - The broader hospitality industry, which employs around 1 in 14 UK workers, has been particularly affected by rising energy prices, according to our Business Insights and Conditions Survey (BICS). - Around 1 in 10 businesses across the hospitality industry said they had reduced or simplified goods and services (or planned to) in a bid to cut energy costs.
Construction (1st *largest sector by business count in the W Mids*)	- The second-largest contributor to the annual rate in the year to February 2023 came from other manufactured products, which contributed 2.60 percentage points and showed an increase of 10.8% in the year to February 2023. The annual increase was mainly driven by articles of concrete, cement and plaster because of ongoing high material and energy costs (ONS, 2023a). - Access to capital is a prominent issue for property and construction companies; both sectors face severe difficulties with bank charges. (ICAEW, 2023). - There is considerable anecdotal evidence of property companies finding it difficult to raise funds or borrow at acceptable rates, as a result of declining real estate prices and higher interest rates (ICAEW, 2023).

Looking ahead

This chapter highlights the challenges of rising energy and materials prices on businesses in the West Midlands. Nevertheless, there is evidence of promising signs ahead. For example, data from Lloyds Bank shows that 62% of West Midlands firms said they are confident they would have greater success in the coming 12 months, compared to the past year. Meanwhile, 51% are expecting a higher turnover than in 2022 (Green, 2023). This is partly because companies expect annual input price inflation to soften to 4.9% over the next 12 months (ICAEW, 2023). Additionally, businesses are effectively modifying their business operations in response to rising prices, as discussed in the next chapter.



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Impact of rising prices on business operations

ALICE PUGH

How are businesses managing and changing their business operations to deal with rising input costs?

Introduction

As stated in the previous chapter, UK businesses have been suffering intensely in the cost-of-living crisis. Businesses have been facing rapidly rising input costs whether it be rising energy costs; fuel costs; rising wages; labour shortages; supply shortages increasing the costs of materials; and increased trading barriers with the EU rising import/export costs. Then they have been suffering with falling consumer demand, as people's sterling buys them less and less. Businesses are being squeezed on many sides with SMEs suffering the most.

SMEs

There have been many consequences of rising costs on businesses, on average 80% of SMEs have reported higher costs, with operating costs on average having risen by 18% (Santander, 2023). Tide found that 24.1% of SMEs that they surveyed were considering bringing their a close, due to the cost-of-living crisis, finding that this equated to an estimated 1.4m businesses (Tide, 2022). Researchers at the London School of Economics (LSE) (2023) found that around a quarter of SMEs anticipate their business won't last the next few months, with rising costs being the main reason for closure.

If a quarter of SMEs were to collapse in the WMCA, this would mean a loss of 23,244 firms in the region. However, it is highly likely that there will be higher business losses in some sectors than in others. For instance, manufacturing, hospitality, transport and construction, have all been the most heavily impacted by rising input costs, whether that be energy, fuel or supply shortages, these are 4 of the largest sectors within the WMCA as seen in figure 1 chapter 4. SMEs in the region are currently extremely vulnerable, especially those with high energy costs given the support that was extended to them to reduce energy costs, has been removed, now again paying the market rate for energy.

Both Tide and the London School of Economics have found that around a quarter of businesses do not think they will be able to survive the next few months given rapidly rising input costs and falling demand.

If this was the case this would mean that 23,244 businesses within the WMCA area could close down in the next few months.

Pricing

British Chambers of Commerce (2023) found 52% of businesses would be increasing prices due to rising costs, a rise from the previous quarter (Q4 2022), where 44% of businesses forecasted, they would be increasing prices.

JPMorgan (2023) found in their business leaders survey, that 48% are increasing prices when adapting to inflation

Boston Consulting Group (BCG, 2023) found 56% of businesses were planning to rise prices, to mitigate against rising costs

Lloyds (2023) also made similar findings with 59% of businesses forecasting they would be rising prices

NFIB (2023) found 50% of SMEs had risen prices to help mitigate rising costs

This is concerning as these surveys were conducted in quarter one of this financial year, this means that any price rises that SMEs have implemented may not have filtered through to inflation figures yet. Therefore, prices have not yet finished increasing. In the latest inflation update for March, CPI was 10.4%, given energy support finished in March, SMEs may have since increased prices in April passing on the increase in energy prices to consumers.

Changing use of finances

Many SMEs are having to change how they utilise their finances, to deal with the cost-of-living crisis. A survey by Santander found that 41% of SMEs are having to dip into company savings; 29% are having to borrow money; 28% are dipping into personal savings; 23% of SMEs are running out of funds at the end of each month (Santander, 2023).

However, UK Finance (2023) found that falling demand and rising interest rates is dampening borrowing by SMEs, as it becomes more expensive to invest, with low returns due to falling demand. Whilst gross lending is reducing, in 2022 there was a 22% increase in overdraft applications than in the previous year (UK Finance, 2023). Likely as a result of managing cost pressures, particularly energy bills, with it being found that from April 30% of SMEs will be at risk of being unable to afford their energy costs (Experian, 2023). The sectors which have seen the largest decline in lending has been the real estate sector and construction sector, due to falling demand given the high interest rates that makes borrowing money to buy a house or do construction work is more expensive.

Staffing

29% of business leaders surveyed by BCG (2023), had increased remote working in order to help deal with labour shortages. Tide (2023) found that in their survey that 12% of business owners were also being forced to reduce contractor hours and 10% had had to lay off staff. Across the wider West Midlands roughly 999,000 people are employed within SMEs, if all SMEs in the region were to reduce their staffing numbers by 10% this would be a loss of 99,900 jobs. Whilst this is unlikely it is a reality that businesses are reducing opening hours and therefore, the time that staff members can work. As a result, SMEs may start to see employees leaving to businesses which can provide sufficient hours for them to be able to support their families. Particularly, when paid by the hour during a cost-of-living crisis.

Supply and Suppliers

Santander (2023) found that when trying to reduce costs, 29% were holding tougher negotiations with suppliers. Whilst JPMorgan (2023) found, 37% were making changes to purchasing and 32% were stockpiling supply, then updating their pricing models.

SME Business Owners

Santander found that the most common adaptations made by business owners in a response to the cost-of-living crisis have been, 31% taking home less pay; 28% reducing marketing budget; 27% working unpaid hours; 27% switching to cheaper energy suppliers; 25% delaying new IT equipment purchases (Santander, 2023). Tide also found that 71% of SME business owners were also increasing their own hours; 35% were relying on family and friends for support and 28% had taken on an additional job elsewhere.

Santander found owners have had to make decisions which they would usually be uncomfortable with including, 23% trialling different opening hours; 22% paying to promote their business on local social media groups; 21% using ‘buy now, pay later’ to purchase business supplies (Santander, 2023).

Business Investment

The weaker outlook for profits, combined with a marked fall in business confidence, underpins a planned slowdown in capital investment growth. The latest survey results show a 3.2% annual rise in spending on capital assets over the past 12 months, but only a 1.5% increase planned in the 12 months ahead. Except for the sharp contractions during the pandemic, this would be the slowest rise in capital investment in over a decade (ICAEW, 2023).

Business investment is defined by the Office for National Statistics as investment made by a company in its transport, information and communication technology (ICT) and other machinery and equipment, other buildings and structures, and intellectual property products (ONS, 2019). The Office for Budget Responsibility (OBR) noted in November 2022 that business investment in the second quarter of 2022 was still 8% below its pre-pandemic peak, and it forecast “much weaker” business investment in the coming years than it had forecast in March 2022. The OBR also anticipated that by the end of 2024, business investment would be 12% lower than it had forecast in March 2022 (House of Commons, 2023).

The same can also be said of R&D budgets. After rising by 2.2% in the latest survey period, growth is set to slow to just 1.4%, which would mark the weakest rise in over 10 years. These plans for both capital spending and R&D budgets are concerning, particularly given their importance to future productivity gains and, thus, competitiveness in global markets. This has become more crucial for businesses as they deal with record high input price inflation and challenges in the post-Brexit trading environment (ICAEW, 2023).

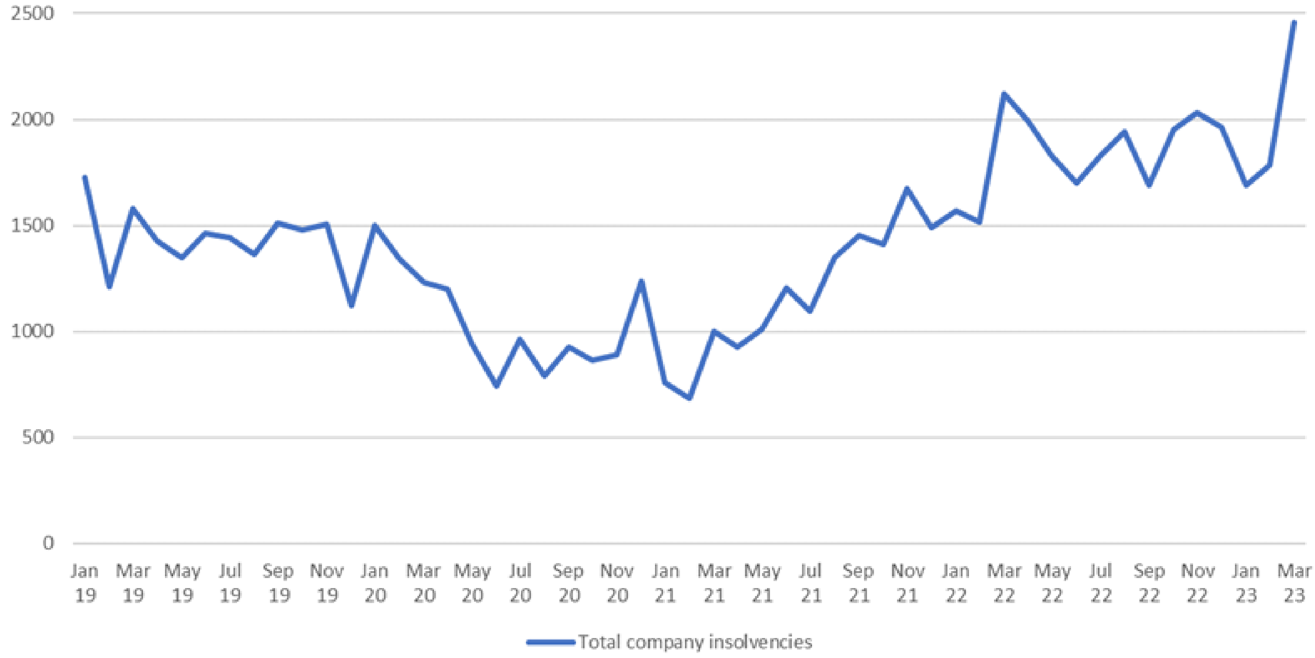
The latest survey results from ICAEW on capital investment shows a 3.2% annual rise in spending on capital assets over the past 12 months, but only a planned 1.5% increase in the next 12 months.

The OBR anticipates that by the end of 2024, business investment will be 12% lower than it had forecast in March 2022.

The ICAEW has found that after rising by 2.2% in the latest survey period, growth is set to slow to just 1.4%, which would mark the weakest rise in over 10 years.

Insolvencies

Figure 1: Total company insolvencies UK



Source: ONS/ The Insolvency Service, 2023

March 2023 saw the highest number of company insolvencies, since ONS started collating the data from January 2019, as seen in the figure below. There were 2,457 company insolvencies in March 2023 16% higher than in March 2022, when there was 2,120. With March 2023 seeing more than double the number of insolvencies that were seen in March 2019. As can be seen in the graph above insolvencies have been creeping up since March 2021, accelerating upwards from the beginning of January and remaining high.

However, whilst these figures are negative, firms were receiving energy support from October 2022 to March 2023. Since the end of March 2023 energy support for the majority of businesses was removed and only high energy intensive firms are still receiving some form of support. In April therefore, there will likely be an increase in insolvencies, as businesses are hit by higher energy bills, especially given inflation on materials still remains high.

Summary

Overall, SMEs are currently very vulnerable to price rises and it is severely impacting how they manage their business operations. Many SMEs are having to change how they fund and manage their businesses. With many businesses choosing to reduce investment, whilst consumer confidence falls, and the cost of borrowing remains high with interest rates rising. Business owners are also being forced to pass the cost of price rises onto consumers, given the loss of business energy support in April, these prices may continue as business costs continue to rise.

However, some businesses are already being pushed into insolvency, with a 16% increase in insolvencies between March 2022 and March 2023. With the potential for this to worsen as businesses lose their energy support and interest rates continue to climb. If a greater number of businesses do start to fail in the current high-risk economic cycle it could also led to rising unemployment, which would further worsen consumer confidence feeding the economic downturn.

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Impact of the Cost-of-living on Households

MARYNA RAMACHARAN, ANNUM RAFIQUE & ALICE PUGH

How are rising prices impacting households and are different households at different income levels being disproportionately impacted?

Introduction

Households have been severely impacted by the cost-of-living crisis, as inflation rises at almost double the rate of wages. The main inflationary areas which are impacting households have been food, energy, fuel and rent. Food prices have rapidly increased due to the invasion of Ukraine, Brexit and climate change impacting crop yields, energy prices have shot up as a result of the Ukrainian invasion, this is the same for fuel prices expect fuel prices are now also being impacted by reductions from OPEC and following the mini budget and ensuing hikes in interest rates rents and mortgages have skyrocketed. Households are being squeezed on all fronts. The purpose of this chapter is to understand how severely households are being impacted in these areas.

The predicted increase in household expenditure in 2022

Due to the cost-of-living crisis, the regions in the UK saw an 11-12% rise in weekly household expenditure. Northern Ireland faced the highest increase in weekly spending from 2021 to 2022 at 12% (£57.31), whereas London only saw a weekly increase of 11.2% (£75.65). Still, since London's weekly expenditure is much higher than the other regions in the UK, the increase is more than in other regions in absolute terms. Table 1 presents the weekly expenditure for UK regions (2021-2022).

Table 1: Weekly expenditure of UK regions (2021-2022)

	Weekly expenditure in 2021 (£)	Weekly expenditure in 2022 (£)	Weekly increase in expenditure in 2022 (£)
Scotland	485	542	57
N. Ireland	478	535	57
Wales	491	549	58
North East	459	514	55
North West	508	567	59
Yorkshire and Humber	477	532	56
East Midlands	540	604	64
West Midlands	507	566	59
London	669	744	75
East	572	639	67
South East	665	741	76
South West	574	641	67

England	552	616	64
United Kingdom	536	598	62

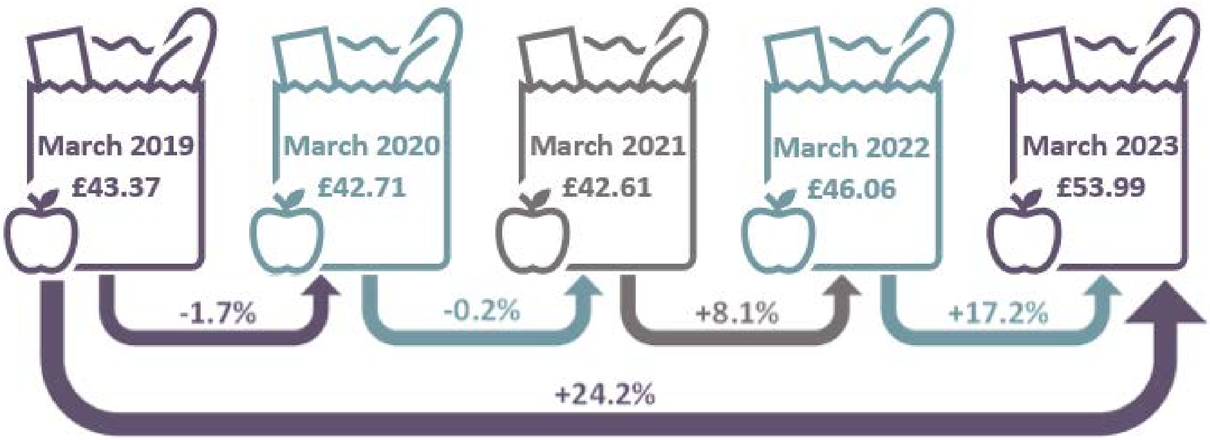
Source: ONS, 2022

Food prices

Since 2021, the cost of living in the UK has been steadily increasing due to higher consumer demands, increases in energy prices and bottlenecks in the supply chain. Table 2 shows the average increase in some staple food items in the UK.

Table 2: Cost of selective food items in the UK in March 2019 to March 2023

Item (pence)	March 2019	March 2020	March 2021	March 2022	March 2023
White loaf, 800g	109	107	109	114	138
Margarine, per 500g	155	148	138	190	216
Eggs, per dozen	230	224	208	247	317
Milk, per pint	44	43	42	50	70
Tea bags, per 250g	205	209	204	215	246
Instant Coffee, per 100g	309	311	294	307	332
Sugar, per kg	76	73	68	78	103
Apples, per kg	200	188	215	216	212
Bananas, per kg	94	90	79	90	104
Grapes, per kg	402	391	399	378	425
Potatoes, per kg	131	132	132	125	138
Tomatoes, per kg	221	205	236	270	323
Broccoli, per kg	174	186	169	170	225
Onions, per kg	85	78	83	83	100
Mushrooms, per kg	291	299	308	329	350
Chicken, per kg	276	250	267	298	373
Sausages, per kg	493	490	515	542	661
Ham 100 - 125g	184	191	195	226	254
Beef mince, per kg	668	656	600	678	812
Total	4347	4271	4261	4606	5399
Y on Y % change		-1.7%	-0.2%	8.1%	17.2%
% change between March 2019 and March 2023					24.2%



Source: ONS, 2023

There has been a significant increase in the cost of consumer goods from 2021 to 2023 this is due to significant rises in input costs that producers have faced and as a result have had to pass these price rises onto consumers. For instance, between March 2021 and 2023, the price of milk has risen 66.7%, margarine 56.5%, eggs 52.4%, sugar 51.5%, chicken 39.7%, tomatoes, 36.9%, minced beef 35.3%, broccoli 33.1%, Bananas 31.6%, Ham 30.3%, sausages 28.3%, white bread 26.6%. Between March 2021 and 2023 the price of this shop has increased 26.7% or £11.38 per week; over a year this will mean an extra £591.76. However, this shop only includes basic goods, it does not include cooking oil, herbs, spices and it does not include the energy need to cook this food.

Energy prices

From July 2021 to July 2022, electricity costs rose by 49%, and gas prices increased by 94%. The increase in energy prices was a result of lower production of natural gas, increasing demand for gas after COVID-19 restrictions were lifted and the ongoing conflict in Ukraine, which led to an increase in oil prices. The average annual household expenditure on electricity and gas for 2021 and 2022 is presented in Table 3.

Table 3: The average annual household expenditure on electricity and gas for UK Regions (2021-2022)

	Electricity Cost (£)		Gas Cost (£)		Percentage increase	
	2021	2022	2021	2022	Electricity	Gas
Scotland	778	1,146	561	1,119	47%	99%
N. Ireland	699	875	0	0	25%	0%
Wales	800	1,194	567	1,153	49%	103%
North East	757	1,131	545	1,086	49%	99%
North West	753	1,165	558	1,135	55%	103%
Yorkshire and Humber	756	1,147	547	1,119	52%	105%
East Midlands	750	1,147	545	1,112	53%	104%
West Midlands	766	1,172	558	1,131	53%	103%
London	777	1,182	583	1,193	52%	105%
East	772	1,181	555	1,133	53%	104%
South East	791	1,199	565	1,131	51%	100%
South West	798	1,190	577	1,143	49%	98%
England	769	1,168	559	1,131	52%	102%
United Kingdom	767	1,144	513	1,038	49%	94%

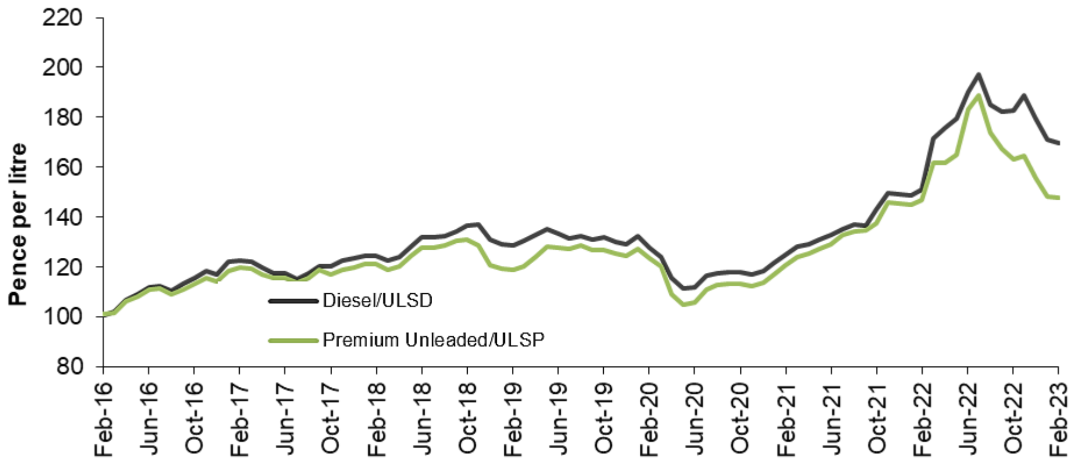
Source: Department for Energy Security and Net Zero, 2023.a.

The total amount of gas and electricity costs paid by the households depends on the amount of consumption, the type of payment method, and the unit rate and standing charges according to the geographic location. Therefore, we see different energy costs for different regions in the UK, where Northern Ireland had the lowest average annual electricity cost of £699, and Wales paid the highest cost of electricity, which was £800 in 2021. The highest gas cost in 2021 was in London (£583), which rose to £1,193 in 2022, whereas North East and East Midlands had the lowest gas cost of £545 in 2021, which rose to £1,086 and £1,112 in 2022, respectively.

Fuel prices

The latest average UK fuel prices for one litre, as of 14 March 2023, are 147.28p for petrol and 166.05p for diesel, according to the RAC (Tooze, 2023). Fuel prices in the UK reached record highs in 2022, with the average price of petrol hitting 191.53p and diesel reaching 199.05p in July.

Figure 1: Typical retail prices of petroleum products, UK.



Data source: Energy Prices Road Fuels and Other Petroleum Products, Department for Energy Security & Net Zero, 2023.b

Although fuel prices in the UK have fallen in recent months, there is now a considerable difference between petrol and diesel prices - currently 18.81p a litre. The RAC has warned that diesel prices are likely to go up again following a recent announcement by the oil producer group OPEC+ that it would be cutting oil production by two million barrels a day (RAC, 2023.a).

This could lead to diesel prices heading back to 190p, according to RAC fuel spokesperson Simon Williams (RAC, 2023.b). It spells bad news for drivers amid the cost-of-living crisis, which has seen inflation soar above 10% for the second time this year.

Despite there being just a 6p difference between the wholesale prices of both diesel and petrol throughout all of February, diesel pump prices are currently a colossal 20p more than petrol. This means anyone filling a diesel car is, the RAC calculates, paying around £7 more per tank than they should be if diesel was being sold at a fairer price of around 155p a litre (RAC, 2023.a).

In terms of annual costs of petrol, a typical driver would spend around £29.80 more on diesel at current prices than they did in January 2022. The rise affects households disproportionally, as households with more than one car on average drive more than those with only one car. According to the National Travel Survey (Department for Transport, 2022), households with two or more cars drove 4,648 miles per year on average while households with one car drove 551 miles. Under the assumption that these mileages have remained the same, households with two or more cars would have spent around £61.90 more on diesel at current prices (as they were in March 2023) compared to what they spent in January 2022.

Table 4: Average change in cost of petrol, March 2023 to January 2022. The average change in the cost of petrol have been constructed from the data on average milage, average fuel consumption and retail fuel prices.

Metric	Average petrol consumption per person per year, litres (1)		Retail prices for petroleum products, pence per litre (2)				Average cost of petrol per person per year, £ (3)					
	Diesel	ULSP	Jan-22		Mar-23		Jan-22		Mar-23		Change Mar 23 to Jan22	
			Diesel	ULSP	Diesel	ULSP	Diesel	ULSP	Diesel	ULSP	Diesel	ULSP
Average in West Midlands	181.1	193.2	148.7	144.9	165.2	146.4	269.4	279.9	299.2	282.7	29.8	2.8
Average by car availability, England												
no car / van	44.7	47.6					66.4	69.0	73.8	69.7	7.3	0.7
one car / van	269.0	286.9					400.0	415.7	444.3	419.9	44.2	4.2
two or more cars / vans	376.7	401.7					560.2	582.2	622.2	588.0	61.9	5.8

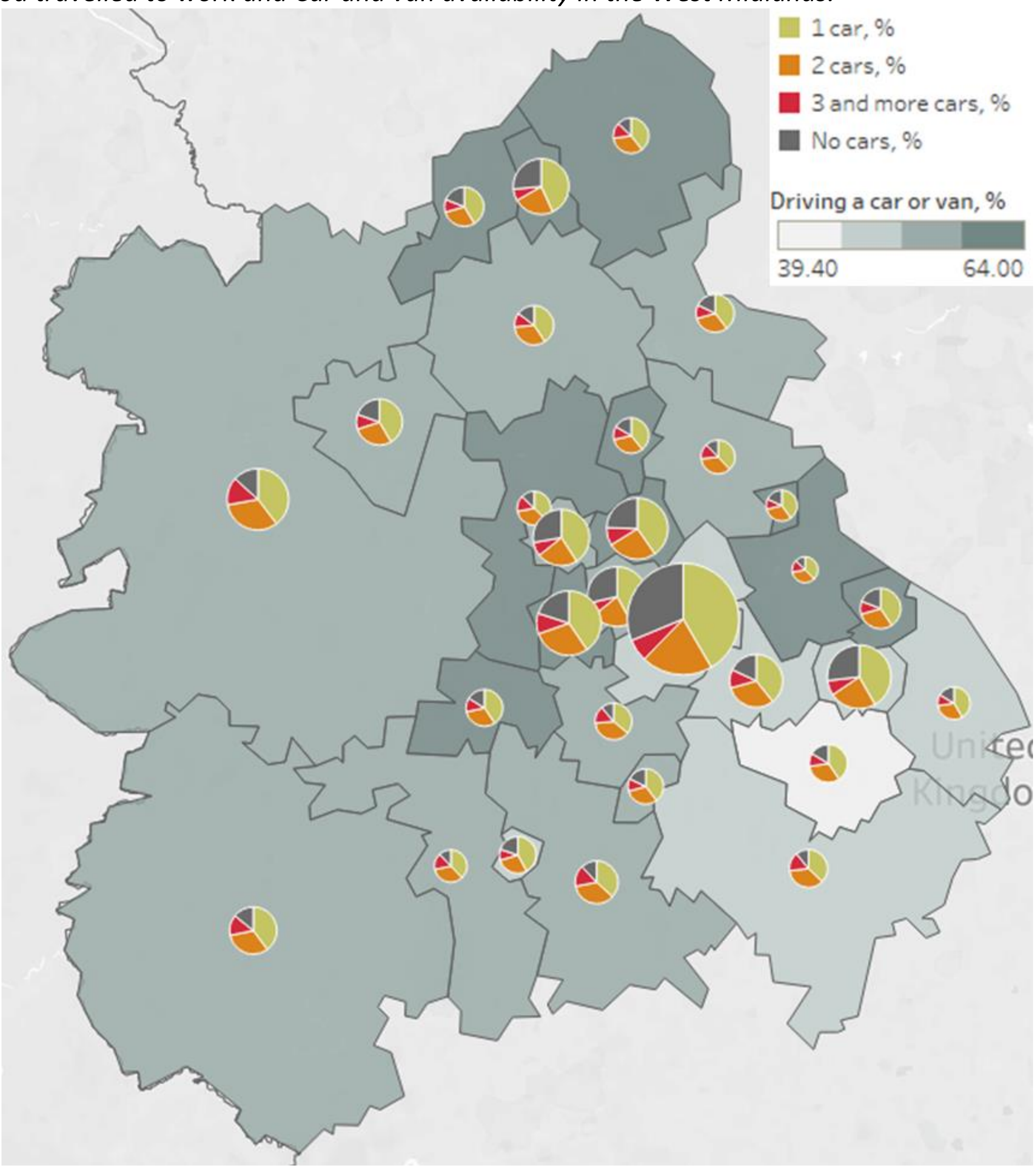
(1) Average petrol consumption has been calculated as quotient of average distance travelled by car drivers in the West Midlands and average petrol consumption per mile which then was converted to litres. Data sources: Average distance travelled by car drivers, National Travel Survey, 2020; Average fuel consumption, Department of Transport statistics, 2022. (2) Data source: Typical retail prices of petroleum products and crude oil price index, Weekly Road fuel prices, Department of energy security & Net Zero, 2023.c (3) These are tentative figures as they were constructed based on average estimates which refer to different geographies and years.

There are 289.3K households with one or more cars in Birmingham alone where 42% households own only one car or a van, 21% households own two cars, and 6% of households own three or more cars. This proportion is similar in all local authorities across West Midlands, where one-car households make up around 40% of all families. However, for households living in rural areas it is more likely that there will be access to more than one car. On the contrary, the least percentage of non-driving households live in big cities, such as Birmingham (31.7% households with no vehicles), Coventry (27.6% non-driving households), Wolverhampton or Sandwell (28.5% and 29.2% respectively).

In total, there are 1.4M people who travelled to work by driving a car or van in the West Midlands (54.6% of all usual residents aged 16 years over in employment) and 133.8K people travelled as passengers in a car or van (4.9%). The estimated percentage who drove a car or van to work in the West Midlands (54.6%) was greater than in England (44.5%).

Cannock Chase had the largest percentage (64%) of those who drove to work within all English local authorities. This was closely followed by Staffordshire Moorlands (60.9%) and Wyre Forest (59.9%).

Figure 2: Method travelled to work and Car and van availability in the West Midlands.



Data source: Census 2021.

Rent prices

Annual private rental prices increased by 4.5% in England, 4.2% in Wales and 4.9% in Scotland in the 12 months to February 2023 (ONS, 2023). Within England, the East Midlands saw the highest annual percentage change in private rental prices in the 12 months to February 2023 (4.9%), while the West Midlands saw the lowest increase (4.0%). London's annual percentage change in private rental prices was 4.6% in the 12 months to February 2023

Table 5: Index of Private Housing Rental Prices – Annual Percentage and Table 5: Privately renting households, monthly estimates.

Region	Annual percentage change in Index of Private Housing Rental Prices				
	Feb-2019	Feb-2020	Feb-2021	Feb-2022	Feb-2023
Northern Ireland	2.0	2.5	3.4	6.7	9.5
East Midlands	2.4	2.2	2.2	3.8	4.9
Scotland	0.7	0.6	1.1	2.6	4.9
North West	1.1	1.0	1.9	3.1	4.8
South West	1.8	2.3	2.3	3.5	4.6
London	0.2	1.1	0.8	0.2	4.6
Humber	1.8	1.9	1.6	2.9	4.5
England	**1.1**	**1.4**	**1.3**	**2.1**	**4.5**
East	1.3	1.6	1.3	3.5	4.4
Wales	1.1	1.2	1.5	1.4	4.2
North East	0.3	0.7	1.4	2.3	4.2
South East	1.6	1.2	1.0	2.6	4.1
West Midlands	**1.8**	**1.5**	**1.9**	**3.3**	**4.0**

Local Authority	Number of households who rent privately
Birmingham	95,719
Coventry	33,195
Shropshire	24,367
Sandwell	24,237
Stoke-on-Trent	22,400
Wolverhampton	20,006
Dudley	18,940
Walsall	18,336
Telford and Wrekin	16,197
Warwick	11,910
Solihull	11,496
East Staffordshire	9,992
Worcester	9,494

The increase in annual private rental prices has likely affected 95.7K private renters in Birmingham, 33.2K private renters in Coventry, 24.4K people in Shropshire and 24.2K people in Sandwell, and 20K in Wolverhampton.

However, the increase in rental prices affects private renters disproportionally depending on their earnings and incomes. Thus, private renters on a median household income in the West Midlands could expect to spend 20.6% of their income on a median-priced rented home while low earners would pay 31.5% of their income for a median-priced rented home in the financial year ending March 2021.

Table 6: Proportion of income of private renting households that is equivalent to rent, West Midlands, financial year ending 2013 to 2021.

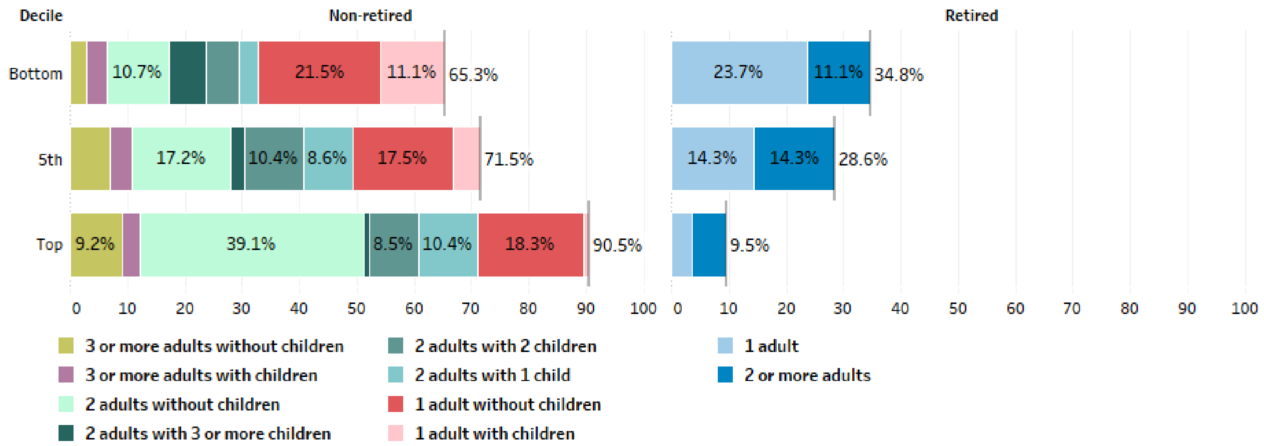
Income quartile	Rent price quartile	Proportion of income of private renting households that is equivalent to rent, %								
		2013	2014	2015	2016	2017	2018	2019	2020	2021
25th percentile	25th percentile	32.7	31.9	32.4	30.9	30.5	30.8	29	31.3	26.3
25th percentile	50th percentile	40.4	37.6	39.5	36.7	36.9	37	34.8	38.4	31.5
25th percentile	75th percentile	48.1	46.1	46.7	44.2	44.6	45.1	42.7	44.7	37.2
50th percentile	25th percentile	20.9	22.3	21.6	20.6	19.5	19.7	21.4	19.5	17.2
50th percentile	50th percentile	25.9	26.3	26.4	24.5	23.6	23.7	25.7	23.9	20.6
50th percentile	75th percentile	30.8	32.2	31.2	29.5	28.5	28.9	31.4	27.8	24.3
75th percentile	25th percentile	14.6	15.5	13.6	13.8	13.6	13.1	15.9	13.6	12
75th percentile	50th percentile	18.1	18.2	16.6	16.5	16.4	15.7	19	16.7	14.4
75th percentile	75th percentile	21.5	22.3	19.6	19.8	19.9	19.2	23.3	19.4	17.1

Data source: Private rental market statistics, ONS and Valuation Office Agency, Family Resources Survey – DWWP, NatCen Social Research, ONS, UK Data Service

The lower quartile rent is equivalent to 26.3% of a lower quartile household income while households with median (average) income will pay 17.2% of their income for the similar priced home, and top earners will only spend 12% of their income. Therefore, richer households who see big increases in their rent may be able to adapt more easily, for example by reducing how much they save or invest each month or changing spending on non-essentials.

In terms of inter-regional comparisons, the West Midlands and East Midlands were the most affordable regions with median rents being equivalent to 21% and 22%, respectively, of median income.

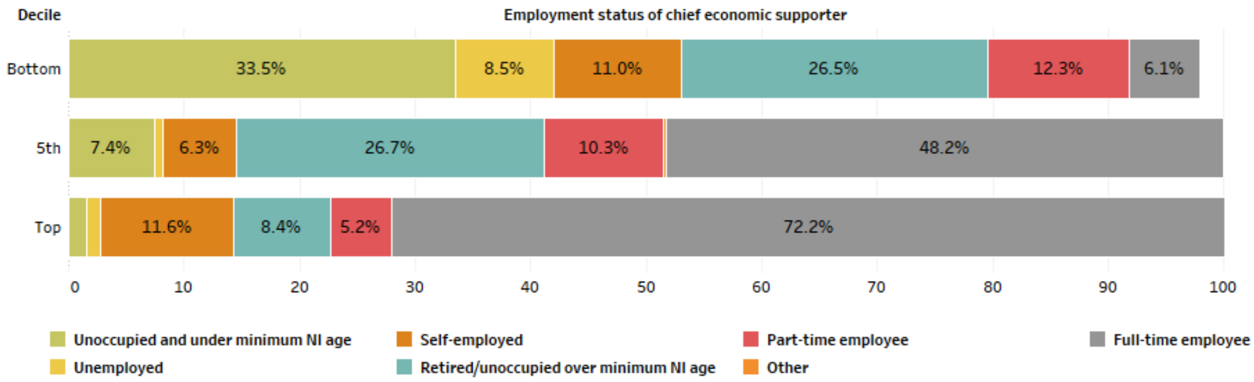
Figure 3: Household type by income decile, 2021/22, UK



Data source: The effects of Taxes and Benefits on Household Income. Reference Tables, ONS

Data in figure 3 suggests that major part of households on low income are those who are non-retired – 65.3% while retired households only make up 34.8%. Furthermore, data suggest that the worst-affected households would be those on low incomes with higher-than-average energy bills, - for example if they have a large family with dependent children, or single person households with one adult whose incomes would need to be overstretched to cover increased rent and other ongoing spendings at a higher cost.

Figure 4: Employment status of chief economic supporter by decile group, 2021/22, UK



Data source: The effects of Taxes and Benefits on Household Income. Reference Tables, ONS

As shown in figure 4, unoccupied young people who are under national insurance age as well as those who are retired may find it especially difficult to pay increased rent for their households as these two groups create 60% of the bottom decile of income distribution, - there are 33.5% of unoccupied and under minimum NI age (which is 16+) and 26.5% retired / unoccupied over minimum NI age (which is 66+).

Summary

Households in the region are clearly being squeezed from each direction as they face rapidly rising prices. Since 2021, energy prices have doubled, food prices are over 25% more expensive, fuel bills have almost doubled, and rent prices are quickly rising. With the households most likely to be impacted being those on lower incomes as price rises account for a greater proportion of their earnings. Especially, as the majority of wages rises have been less than half the current inflation rate. However, these prices will not only be impacting those on lower incomes, middle income households will also be facing significant prices rises, squeezing standards of living.

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How are consumer trends changing in the cost-of-living crisis?

JULIANE SCHWARZ

How are households changing their shopping and demand habits to help them during the cost-of-living crisis?

Analysis of consumer spending level changes over time

Consumer trends, or patterns of shopping habits, change over time and are particularly affected by events such as the Covid-19 pandemic, lockdowns and, most recently, the cost-of-living crisis. In the UK, the cost of living has been increasing since 2021 (Andrews, 2023). The Consumer Price Index (CPI), measuring consumer prices, was more than 10% higher in July 2022 than in the previous year. Fuelled by high inflation and caused by soaring global energy prices and global supply chain struggles, UK households experienced their biggest fall in living standards in 2022 for decades. The Government forecast from March 2023 indicates that real household disposable income per capita will fall by 3.7% in the 2022/23 fiscal year, the biggest fall in living standards since 1956 (Clark, 2023). This decrease is expected to continue in 20223/24 by 2% and starting to rise again by 1.7% in 2024/25.

Changes in goods and services purchases

How does the cost-of-living crisis affect consumer behaviour?

Due to a loss in purchasing power caused by high inflation and below-inflation pay rises, consumers are adjusting their spending habits by trying to spend less:

The Resolution Foundation observes for November 2022 that three-quarters of UK adults are trying to reduce their spending overall (Brewer *et.al*, 2023).

Barclaycard (2022) analysis of credit card usage for September 2022 suggests that more than half of Brits have cut back on discretionary spending: things like restaurants, new clothes and one-off treats, in order to pay for the essentials.

51% of British consumers are planning to spend evenings at home, 25% are opting to play board games, 20% stream films and box-sets, and 19% play video games rather than go out.

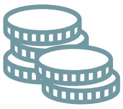
Confidence index figures (GFK, 2023 and PwC, 2023.a) indicate a more pessimistic attitude towards spending. Consumers are more careful in their spending on home improvement, holidays and appliances (Curated, 2023).

McKinsey (2022) reports that consumers are changing to cheaper retail stores and switching to private-label alternatives.

In their outlook for consumer spending for 2023, Deloitte (2023) projects that consumers will reduce overall spending in the first half of 2023. They predict that UK consumer confidence should improve in the second half of 2023 if inflation is gradually reduced, national living wage increased, and the labour market continue its trend of high employment. It is further assumed that consumers might continue seeking deals and buy now pay later options, brand loyalty declining, and expecting low-friction returns.

Capital borrowing trends amongst consumers

Increase in wealth



The Money Charity (2023) statistics show that by the end of January 2023 people in the UK owned £1,837.9bn. This has increased by £70.5bn at the end of January 2022. Average earnings have increased by 0.05% to £34,546 from £34,455 in December 2022.

Decrease in savings

Looking at UK consumer behaviour, a McKinsey (2022) survey conducted between September 23rd and October 2nd 2022, observes that consumers are putting less money into savings as they are expecting to spend more money on energy, transport, food and essentials.

Increase in borrowing

Deloitte consumer tracker (2023) indicates that consumer credit, which includes borrowing on credit cards, car dealership finance, personal loans and overdrafts, rose by £1.5bn in November 2022, more than double the £700mn borrowed in October. The biggest driver was credit card borrowing, which jumped to £1.2bn in November from £400mn in October. Forecasts show that Household debt of all types is forecast to increase from £2,333bn to £2,478bn in 2025 by the Office of Budget Responsibility (2023).

Debt trends amongst consumers

According to the Money Charity (2023) cost of living statistics, the average total debt per UK household (including mortgage) is £65,434 in Jan 2023. This is an increase from £64,970 in June 2022.

In The Living Standards Outlook 2023, the Resolution Foundation discusses the impact of the cost-of-living crisis particularly the price increase of essentials for low-income families (Brewer *et.al*, 2023).

In November 2022:

27% of adults report using their savings for daily living expenses in the previous four weeks. This figure has increased from 20% in June 2022

12% of workers in the lowest income quintile report selling or pawning possessions they would have preferred to keep

7% have cancelled or not renewed their insurance

7% say they have stopped or reduced pension contributions to save money

In terms of debts, the pressure on family budgets means that low-income families are now twice as likely to increase their debts compared with during the COVID19 pandemic and falling behind on bills.

- 11% of respondents in general said that their debts had increased moderately or substantially in the past three months
- 20% per cent amongst workers in low-income families that their debts had increased moderately or substantially in the past three months
- 10% per cent of respondents in general have missed at least one payment of a priority bill over the past three months
- 25% of workers in poorer households have missed at least one payment of a priority bill over the past three months

To put this into context, the constituency of Birmingham Hodge Hill is one of the most deprived areas in England (Murray, 2023). A local food bank fed 608 people in November 2022 as compared to 369 in November 2021. The new users seem to be different to people used the service previously.

80% of new foodbank users are:

- seeking help for the first time in their lives.
- are in work and employment
- seem to be able to cover their rents with their income
- but they seem not to be able to feed themselves and their family
- and experience fuel poverty, of which the West Midlands experience with 19.2% the highest rate nationwide in the winter of 2022 (Sandiford and McRae, 2023).

Changes to employment

The unemployment rate remains unchanged in the second half of 2022 and is at a 50-year low. The labour market is strong with an unemployment rate of 3.7% for the three months to November. However, this does not seem to reassure consumers regarding their job security. The Deloitte Consumer Tracker (2022) observes for the fourth quarter of 2022 that consumers are increasingly concerned about a possible deterioration in the job market. Consumer sentiment on job security has declined by 1.2% to -10% compared to the previous quarter.

This seems to affect the way consumers regard their employment. The PwC Consumer Sentiment Survey (2023.b) indicates that in Spring 58% of all respondents would take a more secure job that pays less. Looking at 18 to 34 years old, this is slightly less. Only 51% of this age group respond that they would value security more than income.

Employment and the kind or jobs consumers are looking for are also affected by the cost-of-living crisis. Due to a squeeze in finance both for employees and employers, the job market has radically changed in less than a year:

75.1% of UK professionals have considered looking to change jobs because of rising costs in April 2022 according to the online recruiter (CV-Library, 2022)

17% of all workers have had to take a second job to boost income, including 1 in 5 essential workers in February 2022 according to (TotalJobs, 2022). December saw 1.25 million people with second jobs, according to ONS (2022) data an increase of 43,000

10% decrease of economically inactive people in August to October 2022, largely driven by those aged 50 to 64 years returning to work

11.9% decrease of economically inactive people in August to October 2022 aged 50 to 64

Changes to accommodation

According to ONS (2023) data, average house prices in the UK increased by 6.3% in the 12 months to January 2023. The average UK house price was £290,000 in January 2023, which is £17,000 higher than 12 months ago. Regionally, London remains the most expensive of any region in the UK, with an average price of £534,000 in January 2023.

Between June and July 2022, average house prices in the UK grew the most in the West Midlands (3.8%), followed by the North East (3.7%). The smallest monthly growth was experienced in the East Midlands (0.6%). The region with the largest growth in average house prices since July 2021 was the South West.

As of September 2022, Rightmove reports that the average price of new properties coming to the UK housing market was around £367,000 (0.7% on the previous month).

- The housing market seems to remain robust given the economic factors that have affected home-movers.
- House sellers are continuing to raise their asking prices, despite higher interest rates and a rising cost of living. On average, this equated to more than £2,500 a property.

Rents remain consistently high in March 2023 according to Goodlord Rental Index (2023). This is mainly due to high demand and low housing stock. The average cost of a rental property in England is £1,090.57, an increase of 0.14%. Most regions saw a negligible shift in prices. The biggest change was recorded in the East Midlands, where prices decreased by 2.8%. In the South West, however, prices rose by 2.4%. In the West Midlands, rents increased from £893.30 by 1.38% in February 2023 to 905.59 in March 2023.

Tenants seem to be more cautious about moving to another rented property, if they're already renting. This is due to the rising price of rent, which may make moving more expensive, and to the extra costs involved with moving, such as hiring vans and security deposit payments.

Tenants may start to downsize if they decide to move. This is in contrast to tenants upsizing during the pandemic.

A trend that shows tenants relying on their parents for support with accommodation costs seems to continue. According to Saga Equity Release (2022) in October 2020 one in five parents were financially supporting their adult children to cover accommodation and other costs of living, in May 2022 this has grown to one in four. Parents seem to be gifting sums of money or releasing equity from their homes which might make them more financially vulnerable.

Summary

The dramatic increase in the cost of living since 2021 is having a considerable impact on consumers as real household disposable income per capital has seen a sharp decline leading to the biggest fall in living standards since 1956. As a result, consumers have reduced overall spending, a trend that might continue for the first half of 2023. If, however, inflation is gradually reduced, national living wage increased, and high employment continues, consumer confident might improve in the second half of 2023.

As a result of the cost-of-living crisis, consumers have become more discerning in the way they spend their money. In order to pay for essential goods, they cut back on eating out, new clothes and one-off treats. They are more careful in spending on home improvements, holidays and appliances and switch to cheaper stores and private-label alternatives. Less money is available to put into savings.

Borrowing, especially borrowing on credit cards, has increased alarmingly affecting an increase of total debt per UK household. Low-income households are particularly vulnerable with their debt level increasing and some not being able to pay priority bills. Foodbanks experience an increase in demand and report that people who are in employment and were previously donate food are using their services now.

Employment and the kind or jobs consumers are looking for are also affected by the cost-of-living crisis. UK professionals considering changing jobs because of rising costs and the number of workers who have a second job has increased. The number of economically inactive people, however, has decreased driven by workers over 50 returning to work.

The housing market remains robust and rents consistently high with tenants less likely to move or, if they do, downsize. Parents are increasingly drawn upon to help to cover their adult children's accommodation and other costs of living.

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How does the cost-of-living crisis impact people's health and well-being?

ANNE GREEN

What will be the health impact of the cost-of-living crisis and what will be the policy implications?

Introduction

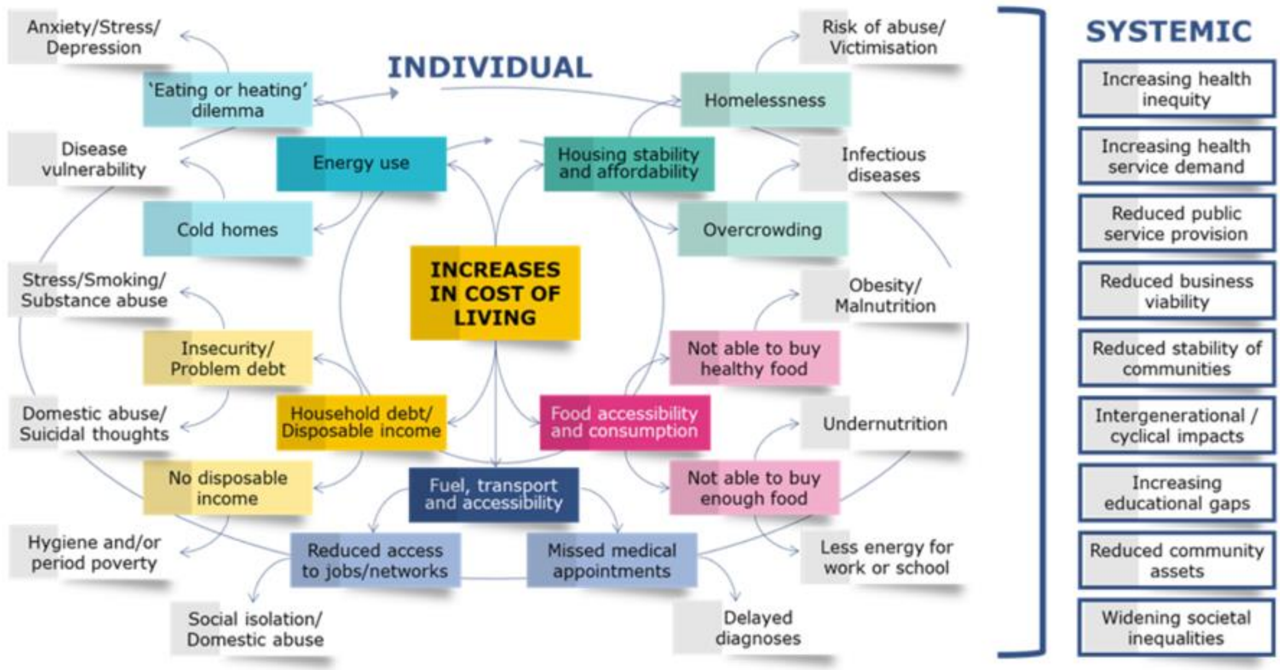
The Covid-19 pandemic triggered a health emergency. It exposed structural and systemic inequalities in society that have implications for health, and ultimately for life and death (Longevity Science Panel, 2021). The Health Foundation (2022) notes that the cost-of-living crisis (i.e. the fall in real disposable incomes that the UK has experienced since late 2021) is a second health emergency (see Local Government Association, 2023). Importantly, this second health emergency has come at a time when the Covid-19 pandemic meant many people were already vulnerable. There is increasing recognition that the public's health is an asset to the wider economy and society; poor health has implications for economic growth and societal well-being (Royal Society for Public Health, 2022).

The scale of the pressures on individual and household budgets since 2021 is evident from ONS (2023) Cost of Living Insights. The price of consumer goods and services in the UK rose at the fastest rate in forty years in the year to 2022. The Consumer Prices Index including owner occupiers' housing costs (CPIH) was 9.2% in February 2023, slightly down from a peak of 9.6% in October 2022. Despite increases in average regular pay in 2022/23, inflation means three-month growth rates in average earnings have been negative in real terms since the final quarter of 2021, reaching a low of -3% in the quarter ending June 2022, followed by a gradual easing to -2.4% in the quarter to January 2023.

How the cost-of-living impacts on health

Figure 1 shows some of the ways in which the cost-of-living crisis links to health (Public Health Wales, 2022). It highlights the 'material pathways' between income and health (Broadbent et al., 2023). These include the increasing price of energy, housing insecurity, access to food, and transport costs and accessibility.

Figure 1: Conceptualisation of the ways in which the cost-of-living crisis links to health



Source: Figure 8 in Cost-of-living crisis in Wales: A public health lens [2022]

With regard to the increasing price of energy, electricity prices rose 66.7% in the year to February 2023, while over the same period gas prices rose by 129.4%. In 2022/early 2023, around half of adults used less fuel in their homes due to cost-of-living increases. This has implications for health because cold homes can lead to greater vulnerability to disease. Indeed, before the impact of the recent cost of living crisis, estimates suggest that some 10% of excess winter deaths in England in 2020/21 were directly attributable to fuel poverty and 21.5% were attributable to cold homes (Lee et al., 2022).

Concerns about housing affordability – amongst both owner-occupiers and in the private rented sector - can increase stress levels and in worst case scenarios housing insecurity may lead to overcrowding or homelessness, so enhancing vulnerability and putting people at greater risk of poor health. Losing one's home may also mean a loss of social support networks, leaving households to become 'pressure cookers', culminating in mental health problems (Longevity Science Panel, 2021).

Figure 2: Food and non-alcoholic beverages annual CPIH inflation rates, UK

Source: Figure 8 in Cost-of-living insights: food [2023]

The price of food and non-alcoholic drinks increased by 18% in the year to February 2023. The scale of the recent increase relative to the situation in the last decade is shown in Figure 2. The contrast with relatively low inflation for most of the period and a decrease in prices between May 2014 and November 2017, and between November 2020 and July 2021, is apparent. The ability to afford food is not only affected by food prices, but also by the amount of income families have and the costs of other essentials. Since May 2022 about half of households reported buying less food. In February 2023 53% of households reported buying cheaper food, 26% bought more tinned or longer shelf-life food, and 13% ate fewer portions of fruit and vegetables. The poorest fifth of UK households would need to spend 43% of their disposable income on food to meet the cost of the Government recommended healthy diet, compared with 10% of their disposable income for the richest fifth (The Food Foundation, 2022). Being unable to buy sufficient healthy food is known as food insecurity. It is a risk factor for poor health; outcomes include increased vulnerability to obesity (in turn a risk factor for diabetes and cancer), malnutrition and undernutrition. Insufficient healthy food also means people have less energy for work or study, which in turn can impact on current and future earnings.

Rising fuel prices and the cost of transport can mean reduced access to services, which in turn can have implications for health. Most directly, missed medical appointments can mean delayed diagnosis and treatment of medical issues. Reduced access to jobs and networks also has implications for earnings and for well-being.

During a cost-of-living crisis more people find themselves on adverse 'material pathways', as those on low incomes who are struggling see their positions deteriorate further. Those on low incomes who formerly were just about managing can find themselves in crisis. The cumulative impact of exposure to the cost-of-living crisis on various front means that socio-economic inequalities widen.

Although sufficient money helps people to meet material needs for a healthy life, Broadbent et al. (2023) also identify 'psychosocial pathways' between the cost-of-living crisis and health. Poor mental health is a direct and immediate response to poverty. Anticipation of negative shocks and a sense of a lack of control regarding how one will cope in the future is harmful also, so highlighting problems posed by insecurity of employment and/or income. In turn, despair can trigger risk-taking behaviours, which are linked to a rise in deaths related to drugs, alcohol and suicide. On all key personal well-being indicators in the UK - regarding life satisfaction, people feeling the things they do in life are worthwhile, happiness, anxiety and mental well-being - scores declined markedly with the Covid-19 pandemic and remain lower in 2023 than at any time over the last decade (ONS, 2023).

While it is easiest to focus on the short-term health implications of a cost-living-crisis, exposure to stressors associated with such a crisis and other events can have implications over the life course. Delays in access health services, and funding cuts in a cost-of-living crisis to social security, employment support and other services provided by the public and third sector can accentuate adverse health consequences (Broadbent et al., 2023).

Evidence from the Great Recession

So how is the current cost-of-living crisis different from what has gone before? Echoing Claudius in Shakespeare's Hamlet, Wolf (2022), writing in the Financial Times in February 2022, highlighted how "economic sorrows come in battalions rather than singly". Rising energy and food costs, high inflation and a weak economy have come on the back of the shock of Brexit and the crisis of the Covid-19 pandemic. This is a unique set of circumstances, with the Covid-19 pandemic and the cost-of-living crisis operating in the same (negative) direction in terms of health outcomes. Nevertheless, it is instructive to look at the health impacts of previous economic crises.

The so called 'Great Recession' from 2007 to 2009, like the current cost-of-living crisis, was felt internationally. A critical review of the international literature on the health impacts of the Great Recession on mental and physical health in developed nations found that the recession was associated with a decline in self-rated health (which likely represents a combination of mental and physical symptoms), and increasing morbidity, psychological distress and suicide (Margerison-Zilko et al., 2016). In the USA, in particular, already marginalised populations were hit hardest. Nearly all individual-level studies and most aggregate-level studies, across several countries, found that financial strain, job loss and housing insecurity were associated with declines in self-rated health. In the UK self-rated health declined over the long-term. This decline was evident amongst those who remained employed throughout the recession, indicating that health impacts were felt beyond those most directly affected financially (Astell-Burt and Feng, 2013).

The evidence suggests that non-health policies may have played a role in mitigating the worst health impacts of the economic crisis of the Great Recession. Margerison-Zilko et al. (2016) found that stronger social safety nets in Europe than in the USA acted as a buffer in this respect for some populations. They identified active labour market programmes as reducing the negative effect of unemployment on suicide rates.

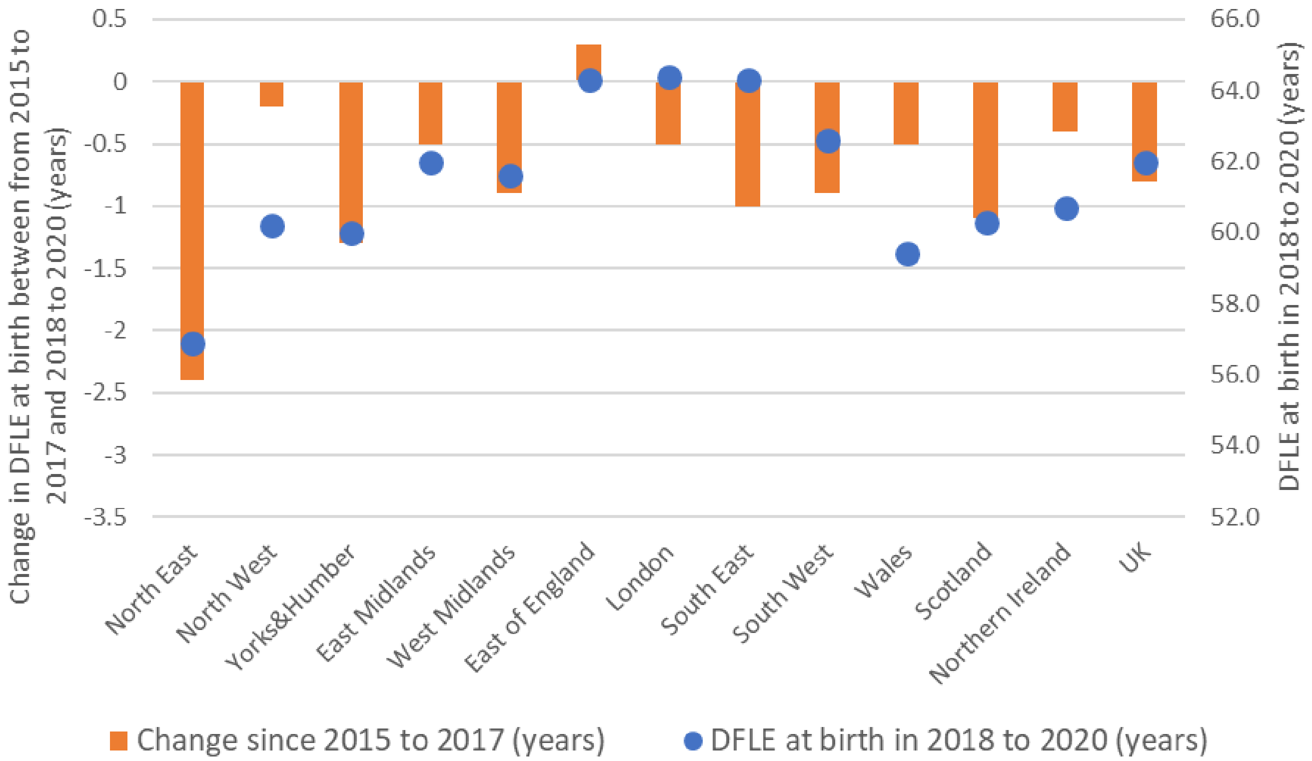
Focus on Disability Free Life Expectancy

One key indicator of population health is disability-free life expectancy (DFLE). DFLE is an estimate of the average number of years lived without restrictions on activity resulting from a long-lasting physical or mental health condition.

DFLE at birth decreased significantly for males and females in the UK between 2015 to 2017 and 2018 to 2020 (ONS, 2022). This means that prior to the Covid-19 pandemic DFLE was beginning to stall. Hence, following the Covid-19 pandemic, the starting point that the population is in to deal with the cost-of-living crisis has deteriorated.

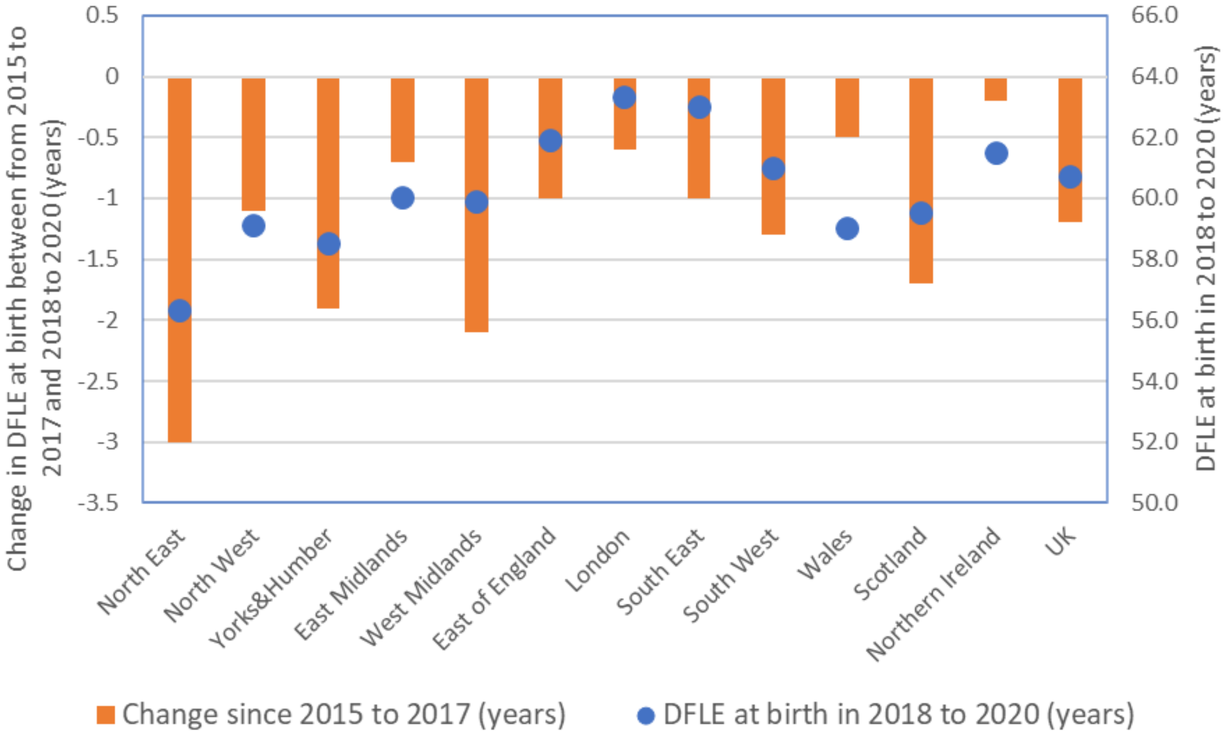
Figures 3 and 4 show the DFLE at birth in 2018 to 2020 (right-hand axis, shown by blue dot) and the change in such DFLE over the period since from 2017 to 2019 (left-hand axis, shown by orange bar), for males and females, respectively. In the case of males DFLE changed significantly negatively from 2015 to 2017 based on non-overlapping confidence intervals in the North East, Yorkshire & the Humber, the South East, Scotland and the UK. In the case of females DFLE changed significantly negatively from 2015 to 2017 based on non-overlapping confidence intervals in the North East, the North West. Yorkshire & the Humber, the West Midlands, the South West, Scotland and the UK. Absolutely and relative to other English regions and the devolved nations, the change in DFLE is more severe in the case of females than males.

Figure 3: Disability-free life expectancy at birth estimates for males, 2018 to 2020, and change since 2015 to 2017, for males – English regions, countries and the UK



Source: ONS, [2022]

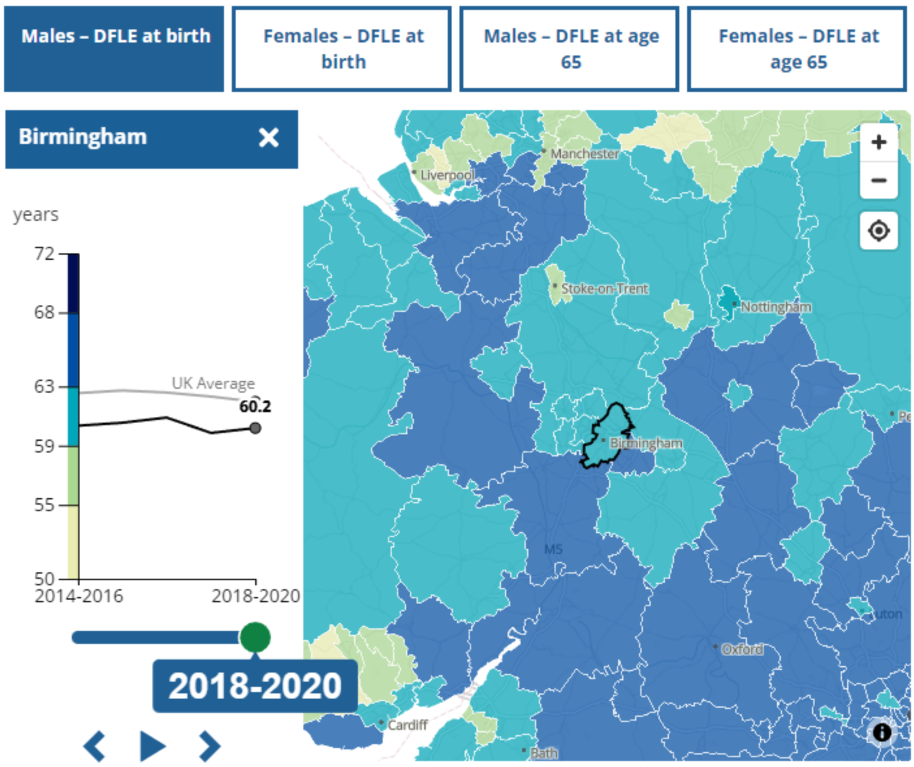
Figure 4: Disability-free life expectancy at birth estimates for females, 2018 to 2020, and change since 2015 to 2017, for males – English regions, countries and the UK



Source: ONS [2022]

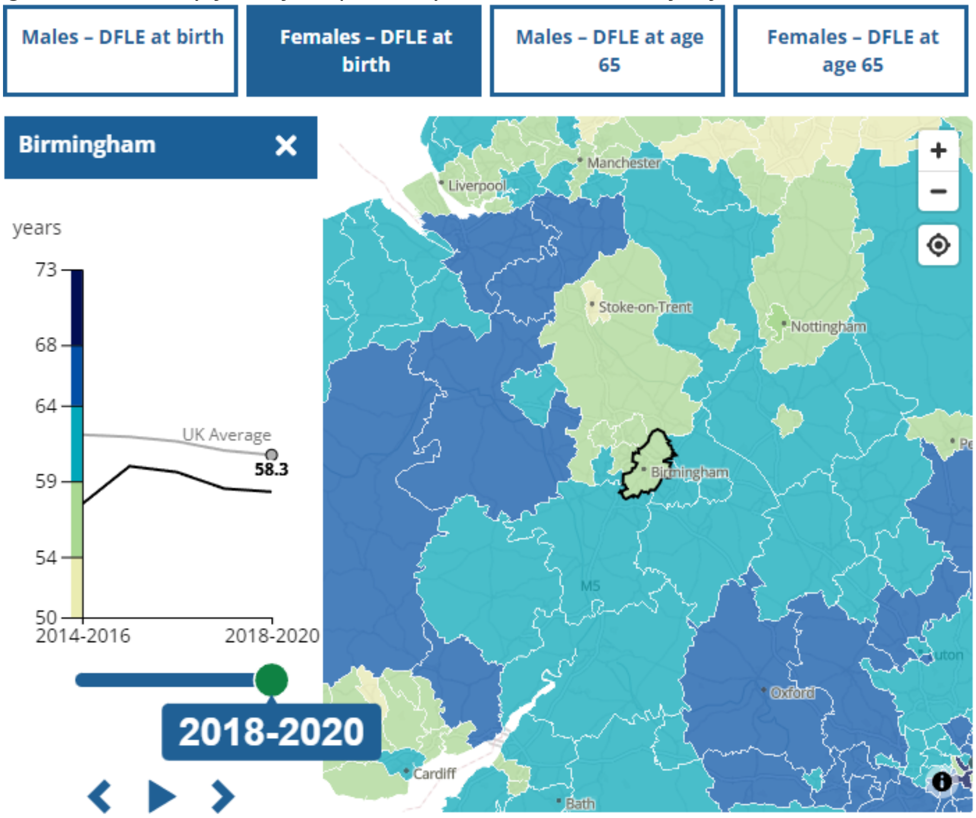
Figures 5 and 6 show local variation in DFLE at birth for males and females, respectively. For males DFLE at birth was highest in 2018 to 2020 in Solihull, Worcestershire and Shropshire, and lowest in Stoke-on-Trent. For females DFLE at birth was highest in Shropshire, followed by Herefordshire, Worcestershire, Warwickshire, Coventry, Solihull and Dudley and lowest in Stoke-on-Trent once again. It would be expected that levels of deprivation and factors such as ethnicity may play a role in explaining these variations, but further disaggregation's are not available from this data source.

Figure 5: Disability-free life expectancy at birth estimates for males, 2018 to 2020



Source: ONS, 2020

Figure 6: Disability-free life expectancy at birth estimates for females, 2018 to 2020



Source: ONS, 2020

Policy implications

Austerity has been identified as making an important and causal contribution to poor health (Margerison-Zilko et al., 2016; McCartney et al., 2022). Cuts to local services, pressures on health and social care provision, and any failure in raising benefits in line with inflation exacerbates the situation.

To alleviate the negative impact of the cost-of-living crisis on health it is necessary to mitigate short-term effects at the same time as tackling the underlying causes of poor health. Many different organisations and agencies, working across different policy domains at different geographical levels, have a role to play here. The Local Government Association (2023) acknowledges that it has a key role to play in promoting and linking initiatives tackling health and prosperity. It has a cost-of-living hub designed as a repository for sharing case studies, resources and data on good practices across different policy domains/areas. It also argues that public health has a role to play in developing a clearer narrative on the interconnections between education, training, work and health. Broadbent et al. (2023) argue that more refined integrated economic and health modelling has the potential to inform policy integration.

Possible policy responses at national and sub-national level to address the stalling of DFLE and to address the negative implications of the cost-of-living crisis on health are presented in Figure 7. These highlight the need for policies across policy domains and for action at different geographical scales. A comprehensive multi-faceted approach to addressing health and well-being is necessary.

Figure 7: Possible policy responses to mitigate the negative impact of austerity and the cost-of-living crisis on health

Policy domain	*National policy*	*Sub-national/ local policy*
Macroeconomic policy	• Design fiscal policy to avoid austerity approaches which limit public spending	• diversify economic ownership (e.g. through Community Wealth Building) to reverse or mitigate the processes of: rent extraction
Social security	• Increase benefits and tax credits in line with inflation	• Provide high quality money advice and welfare rights services – and enhance benefit take up
Work	• Improve availability of 'good work' • Adopt real living wage	• Use public spending to advance progressive work practices • Maximise potential of growth/ devolution deals to reduce inequality and improve health
Public services	• Increase public sector funding for preventative services	• Co-design local services for the populations they serve
Material needs	• Eliminate fuel poverty through action on housing insulation and heating • Increase affordable housing • Eliminate food poverty	• Reduce cost of public transport
Improved understanding	• Facilitate linkage between different government departments, NHS and mortality records to allow for the health and mortality impact of policy changes to be better evaluated	• Commit to ongoing monitoring and evaluation of relevant interventions

Source: inspired by, and drawing in part on, McCartney et al. [2022]

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How will the cost-of-living crisis impact inequality and levelling-up?

ABIGAIL TAYLOR & CHARLOTTE HOOLE

How will the cost-of-living impact different 'places' and people and what will be the implication for levelling-up policies?

Introduction

A cost-of-living crisis occurs when the price of everyday essentials, such as food and utilities, increases at a faster rate than average disposable income. The UK has been experiencing a cost-of-living crisis since late 2021 (Hourston, 2022), with inflation rising rapidly. The annual rate of inflation increased to 11.1% in October 2022, the highest rate since the 1980s (Francis-Devine et al, 2023). This has led to considerable falls in household living standards (Cribb et al, 2023). Key factors behind the cost-of-living crisis include soaring energy prices driven by greater demand for energy as economies re-opened from COVID-19 lockdowns, disruption to global supply chains such as the global shortage of semi-conductors needed in many consumer goods, increased global shipping costs, and gas supply issues related to the war in Ukraine.

How is the cost-of-living crisis impacting households at different income groups?

The impact of the cost-of-living crisis varies for different households, depending on sources of income and how income is spent (Institute for Government, 2022). On average, poorer households spend a larger proportion of their income on essentials such as energy and food where prices have risen the most. Data from Citizens Advice UK shows that in 2022, over three times more people they worked with had been unable to top up their prepayment meters compared to the previous year (Citizens Advice UK, 2023). They also show a steady increase in the use of food banks over this same period. As a result, the cost-of-living gap between the rich and poor is widening, with research finding that the inflation rate for the poorest 10% of households is 12.5% compared to 9.6% for the richest 10% (Resolution Foundation, 2022). This means that those facing the greatest economic and social challenges in society, who were already managing multiple stressors in relation to work constraints and unstable income caused by the pandemic, are finding it hardest to manage (Joseph Rowntree Foundation, 2022a).

Research by the Joseph Rowntree Foundation carried out in 2021-22 finds that low-income households are facing high levels of deprivation and financial stress (Joseph Rowntree Foundation, 2022b). Their findings are summarised in Table 1 by income quintile. They show that 7.2 million households (62%) in the bottom 40% of incomes are going without essentials. These include food insecurity measured in relation to reports of people going hungry, cutting down on meal size and/or skipping meals due to financial pressures. Within this income group, 4.7 million (41%) are in arrears with at least one household bill or lending payment, 2.8 million (25%) have a high-cost credit loan and 2.4 million (21%) have borrowed money or used a credit card to pay bills since the onset of the crisis. As you might expect, the proportions across all these measures of hardship were even higher for households in the bottom 20% of incomes.

Table 1: The impact of the cost-of-living crisis on low-income households.

	Bottom 20% household income	20-40% household income	Total low-income households (0-40%)

Going without essentials*	75% (4.3 million)	49% (2.9 million)	62% (7.2 million)
In arrears with at least one household bill or lending repayment	53% (3.1 million)	29% (1.7 million)	41% (4.7 million)
Has a high-cost credit loan	33% (1.9 million)	16% (940,000)	25% (2.8 million)
Has taken on borrowing or used a credit card to pay bills during cost-of-living crisis	26% (1.5 million)	16% (940,000)	21% (2.4 million)

Source: Table 1, Joseph Rowntree Foundation (2022b).

The Living Standards Outlook 2023 published by the Resolution Foundation supports these findings and provides further insights into the differences between households on various measures of economic hardship and income group, including how many households are forced into taking on debt that has both short- and long- term consequences (The Health Foundation, 2023). To cope with the cost-of-living crisis, they also find that families on the lowest incomes are the most likely group to have to rely on savings to get by, raise funds by selling possessions they would have preferred to keep and make money savings through, for example, cancelling insurance policy subscriptions and/or stopping pensions contributions.

How will the cost-of-living crisis impact places across the UK differently?

The cost of-living-crisis is impacting places across the UK differently, with Northern cities, the Midlands and London particularly affected.

Analysis by Quinio and Rodrigues (2022), illustrated in Figure 1, indicates that inflation rates (estimated, May 2022) are considerably higher in Northern cities and that some of the UK's poorest cities are being hit hardest by rising inflation. Inflation is estimated to have increased by 11.5% in Burnley, and 11.0% in Blackburn and Blackpool, compared to only 8.8% in the southern cities of London and Cambridge. The higher inflation rates in the North likely reflect how, in general, reliance on cars to commute to work is greater, housing stock is less energy efficient, and households have lower income levels (meaning energy and fuel costs make up a larger proportion of spending) compared to the South. Consequently, northern cities are more exposed to the inflation of energy and petrol prices - items which have the highest inflation rate.

Figure 1: Estimated inflation, May 2022, Quinio and Rodrigues (2022).

Source: Centre for Cities analysis of ONS, Beauclair, EPC Certification, HMRC (PAYE) data.

Fuel poverty rates are highest in the West Midlands, Yorkshire and the

Humber and the North West (see Table 2). Nearly 1 in 5 households in the West Midlands are in fuel poverty.

Table 2: Fuel Poverty by region, 2022.

Region	Proportion of not fuel poor households (%)	Proportion of fuel poor households (%)
North East	86.9	13.1
North West	85.4	14.6
Yorkshire and the Humber	84.1	15.9
East Midlands	86.1	13.9
West Midlands	80.8	19.2
East	88.8	11.2
London	86.8	13.2
South East	91.4	8.6
South West	86.9	13.1
All households	86.6	13.4

Source: Table 6, Department for Energy Security and Net Zero (2023).

Evidence also identifies challenges faced by some London residents. A survey by the Joseph Rowntree Foundation of over 4,000 people on low incomes in summer 2022 found that residents of London, the North of England and Scotland have been most impacted by spiralling prices (Elliott, 2022). The proportion of low-income households experiencing hardship, including going without essentials, food insecurity, in arrears with any bills or outgoings, and taking out new debt since the start of the year was consistently higher in London. Differences in incomes, savings and expenditure and the demographic make-up of regions influence the rates of hardship experienced in regions. Greater reliance on public transport and higher housing costs explain why survey respondents in London were less likely than average respondents to cite increases in fuel prices but more likely to refer to increases in rent or mortgage costs and public transport. The Learning and Work Institute (2022) has argued that many low-income Londoners are "*highly vulnerable*" to increasing prices as whilst London may have experienced lower rates of inflation than other regions in England, the city is characterised by high levels of inequality and higher cost of living. ONS statistics show challenges for London residents are set to continue in 2023 (Andrews, 2023). Households in London and the South East are expected to face the biggest price increase in weekly expenditure in 2023 compared to 2022 (at over £75), whilst residents of the North East face the lowest increase (at £54.64).

How will the cost-of-living crisis impact levelling up goals?

The analysis above shows that the cost-of-living crisis will be felt most severely by households and places facing the greatest economic and social challenges in society. It is these households and places that should be the central focus of the levelling up agenda set out by government, yet research by the IPPR North (Institute for Public Policy Research North, 2023) and CEILUP (Centre for Inequality and Levelling Up, 2022) that analyses the relationship between the cost-of-living and the 12 levelling-up missions indicates that increased poverty and inflationary pressures will make it considerably harder for these to be achieved. Table 3 below provides a summary of the key challenges.

Table 3: The impact of the cost-of-living crisis on the 12 levelling-up missions.

Themes covered by the government's 12 levelling-up missions	Potential impact of cost-of-living crisis
1. Employment and productivity	The current recession is likely to impact pay, employment, and productivity. High inflation means real terms pay is falling. It is challenging to close gaps between places in periods of negative/low growth.

2. Public investment in R&D	Weak business investment has been forecast by the OBR. Evidence shows that this is likely to reduce the number of innovating firms and decrease private spending on R&D.
3. Local public transport connectivity	Significant inflationary pressures for local government and transport authorities are likely to impact on the ability to invest, maintain and operate crucial public transport networks.
4. Broadband infrastructure	Evidence suggests some risks to public and private sector investment due to cost pressures and falling consumer demand.
5. Education	Evidence strongly indicates that increasing child poverty and falling household income will impact on educational outcomes. Inflationary and funding pressures in schools will mean a lack of resources to support students and families.
6. Skills training	Financial vulnerability could reduce real terms per person spending on skills training by further education providers and local authorities. Financial pressures also impact on people's ability (especially older learners) to take time off work to train and spend money on training, and on businesses to fund training.
7. Healthy life expectancy	Research shows that poverty, including fuel/food poverty and increased stress, has a significant negative impact on healthy life expectancy. Spending cuts could impact both preventative action and the ability to access treatment.
8. Wellbeing	Evidence shows that rising poverty and inequality are likely to negatively affect wellbeing.
9. Pride in place	Evidence indicates that local government budgetary pressures impact physical and social infrastructure that are the drivers of pride in place. Falling disposable incomes and surging energy prices could lead to large-scale high street business closures.
10. Home ownership	Higher interest rates, lower disposable incomes and rising house prices are likely to harm people's ability to access home ownership, especially first-time buyers.
11. Crime	Evidence shows a strong link between poverty and crime, and more specifically rising inflation with property crime and homicide. Longstanding funding cuts to police forces and local government, combined with inflationary pressures, reduces the capacity of local institutions to deal with crime.
12. Devolution	Evidence suggests that during episodes of economic crisis governments tend to centralise. Challenges with the national economy mean that spending cuts to local government are likely.

Source: Based on analysis from IPPR North (2023, pp.10-12) and CEILUP (2022).

The challenges outlined above show us that the cost-of-living crisis is likely to have a negative impact on all the 12 levelling-up missions set out by government. Those most at risk are those related to productivity, research and development, health inequalities, home ownership, education, wellbeing, pride in place and crime, whilst transport and skills pose a medium risk and broadband and devolution a low risk. Achieving all 12 missions and mitigating these impacts will require government commitment in the form of significant public funding. However, according to the Institute for Government the Levelling Up Fund to deliver the government's levelling-up agenda *"is another ineffective competitive funding pot that is neither large enough nor targeted enough to make a dent in regional inequalities"* (Institute for Government, 2023).

Will usually “left-behind” areas be impacted more by the cost-of-living crisis than affluent areas?

Findings from the All Parliamentary Group for ‘left behind’ neighbourhoods (2022) indicate that residents of “left-behind” neighbourhoods will be most impacted by the cost-of-living crisis due to high rates of indebtedness, financial insecurity and fuel poverty. The research reveals that residents of ‘left behind’ areas have experienced a sharper rise in fuel poverty than people living in other deprived areas and the England average. The proportion of households in fuel poverty in “left behind” areas increased by 8.8 percentage points between 2011 and 2020. By contrast, the rise in other deprived areas was 6.6 percentage points and the average across England was 2.3 percentage points. Children who live in left behind areas are also twice as likely to be income deprived (34.0%) compared to the average across England (17.1%).

Concerns have also been raised regarding how increased pressures on household budgets risk expanding health inequalities in the most disadvantaged areas of England. Research by Bambra (2022) has shown how children who grow up in poverty have lower life expectancy than those that grow up in affluence and that food poverty is associated with poorer mental health and long-term health conditions.

What role can devolution play in mitigating the impacts of the cost-of-living crisis on levelling up?

The scale and the place-based impacts of the cost-of-living crisis mean that central government cannot and should not take on responding to the cost-of-living crisis alone. Local leaders and stakeholders are better placed to understand the needs of local communities and how best to support them through the crisis. Lessons learned during the COVID-19 pandemic regarding the ability of local places to come together and shape appropriate interventions shows us the potential for local actors to work together effectively (Hoole et al., 2021). However, currently local places are lacking the resource and capacity to develop tailored responses to challenges created by the cost-of-living crisis. This has not been helped by how to date only 8% the proposed funding for Levelling Up has been spent since it was launched in 2020 (£392 million of the £4.8 billion fund) (Independent, 2023). The situation is complicated by the introduction of a new delegation approach by which the Department for Levelling Up, Housing and Communities (DLUHC), that has been driving the levelling-up agenda, now must sign off on any capital spend with Treasury. This is limiting DLUHC’s autonomy over spending (Local Government Chronicle, 2023).

The 2023 Spring Budget indicates some progress towards providing places with greater powers and money to support activity for levelling up, especially in relation to transport, skills and employment. The West Midlands and Greater Manchester Combined Authorities will benefit from single funding settlements through the Trailblazer Devolution Deals that should support longer-term strategy development and implementation in these areas. However, there will be *“no reprieve from the pressures of inflation and austerity for local government”* with no new funding settlements for local councils and continued uncertainty over the sustainability of their finances (The New Statesman, 2023). Furthermore, outside the West Midlands and Greater Manchester the lack of devolved powers and funding for the time being remains unchanged, with even the West Midlands and Greater Manchester likely to be waiting up to two years for measures to be introduced which will not impact on the immediate challenges the cost-of-living crisis poses to households and places across the UK.

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The Impact of the crisis on public sector services

HANNES READ

How will the cost-of-living crisis impact public sector services, especially as it becomes more and more expensive to run essential services?

Introduction

There have been many articles over the past few years on the financial pressures faced by public sector services. From budget cuts and austerity post-2010, the legacy of covid-19 and persistent inflation rates above 10%, this storm of pressure places strain on public sector unlike any other times than before. Once you factor in that the poorest local authorities have had budget cuts three times as large as the budget cuts as the richest, the outcome is a seemingly never-ending period of struggle is having the greatest effect for local authorities in the poorest areas (Sigoma, 2023). Whilst the government have provided short-term, one-off grants to cover costs, these funds are all short-term and reactive. The addition of costs to cover Covid, for the energy price crisis, and to reduce the interest paid on the Public Works Loan Board are symptoms of the disease. That there is not, and has not been for around 15 years, an investment in the financial resilience and capacity building of local government in England. And, unfortunately, there is little sign of this changing.

Context of Austerity

Central government have been continually reducing the amount of funding for local government for the last decade. In the 10 years from 2013-14 to the end of 2023/24, there has been a direct switch from direct grant to local taxes (Sigoma, 2023). Changes in the allocation of funding means that funding directly allocated from central government to local authorities has fallen, whilst the amount that is allowed to be kept from local sources such as council tax and business rates has increased. The outcome of this is that the wealthier areas, which are able to generate more tax in their local areas, are able to keep more of this revenue. As a result, analysis from LG Improve shows that Wokingham, the least deprived local authority area, has had a real terms increase in funding of, an admittedly paltry, 2.3% (Dunn, 2023). Whereas local authorities in the top 10% most deprived areas, such as Knowsley, Liverpool and Blackburn with Darwen have had real terms reductions of over 30%. Not only has the policy of austerity reduced public sector funding for all but one of the 333 English local authorities, but the policy has provided the largest cuts to the places that require it the most. The sustained reduction in funding reduces the capacity and capabilities of local government to provide their services to their citizens. This context of austerity is the precursor to following crises such as covid-19, energy price increases, and recent levels of inflation that affect local government finances, and their capacity to deliver for local residents.

Legacy of Covid

Local authorities in England have faced increased costs and a decline in revenues, due to the covid-19 pandemic. This has had an impact on the stability of local government finance. Local authorities are faced with additional spending in adult social care, homelessness support, and PPE for staff. In addition, local authorities have experienced a decline in revenue, with council tax falling by £600m and business rates revenues falling by £700m as a result of the pandemic

(Ogden *et.al*, 2020). Central government have provided extra funding to help make these payments, and the temporary changes to accounting rules to spread the impacts over three financial years until 2023/24. The Institute for Fiscal Studies show there is a shortfall of £3.1bn over three years (Ogden *et.al*, 2020). This amounts to reductions of £3.1m per local authority, per year, from Covid-19 alone. The uncertainty and reduction in funding, that was a central government policy choice in the decade before the pandemic, has deepened the pressure on local authority finances, following on from covid. Further compounding the pressures facing local authorities, the recent increase in high inflation and interest rates show there seems to be little let up in the pressures facing local authorities in the face of high inflation and interest rates.

Inflationary Pressures

Local authorities have incurred losses amounting to tens of millions of pounds over the past decade due to inflation (Pugh and Taylor, 2022). With inflation rising above 10% in 2022/23, local authorities will have to deal with inflationary budgetary constraints that haven't been seen since the 1970s. This will limit their spending capacity even further, as the cost of funding essential services will rise. Consequently, many councils across the country may have to resort to tapping into their emergency reserves to cope with the increased expenses.

However, as shown by the Financial Resilience Index from the Chartered Institute for Public Finance Authorities, local authorities have a higher level of risk in their finances than before. In particular, the reserves, external debt, increased amount of interest payable (a one-year’s loan from the Public Works Loans Board has risen to 5.3%), and a risk of increase net revenue expenditure rising more than expected, have all contributed to greater risk levels in local authorities (CIPFA, 2022.a and Gilmore, 2022).

Following the announcement of the 'mini-budget' in September 2022, a £40 billion gap in the UK government's finances arose from increased interest payments (The Economist, 2022). This is expected to result in local authorities facing additional reductions to their already depleted budgets. The details of these cuts are expected to be disclosed in the coming months, and government officials have indicated that local authorities will be required to make further cost savings.

Local governments are expected to provide further support for citizens in response to the pressures regarding inflation and COVID-19, alongside its statutory and discretionary services. The Spring Budget 2023 provided specific funds around: public spending; borrowing; business rates; social care; childcare; employment support; energy bills; and social housing (LGA, 2023). Whilst these address legitimate and pressing concerns, there are question marks over whether the uplift will be sustained to ensure local authorities can provide a service that goes above the minimum standard. Specifically, national government, which allocates a large majority of local authority budgets, should keep to its commitment of increasing departmental spending by 4% in real terms by the end of the spending period. And further, this affects local authorities that have the most need (HM Treasury, 2023).

Future Policy Interventions Context

The context of historical austerity, and current pressures from the legacy of covid and inflation, have created the pressures that are currently seen in local government finances. There is some good news on inflation forecasts. Inflation is expected to fall to 5% by the middle of 2023 and below the Bank of England’s target to 1.5% by the end of the year (BCC, 2022). This may relax the pressures on local authority budgets, but this alone does not solve the issue. Just like the covid pandemic and high increases in inflation were shocks that local government had to deal with, there will be future risks and shocks to come in the future. As a result, there needs to be a change to increase resilience in the future. Local authority budgets are determined largely by central government grants and central government policy. It is ultimately central government that have the biggest influence on how much funding local authorities receive. At the moment there is little political rhetoric to change this. And there is a real risk that, unless local government are provided with sufficient resources, the same issue will appear in the future.

There should be a firm legal or constitutional commitment for a good minimum standard of local authority funding. Currently in the UK there are levels of minimum statutory services (Gov.uk, n.d.). These relate to services such as recycling, rubbish collection, housing and planning applications. However, as budgets are cut, discretionary services are the first in the firing line and local authorities are moving closer to providing just the legal minimum standard. This is not something that is to be aspired towards. Local government should lead the way in providing quality services.

The minimum standard of services can go hand in hand with devolution. In Germany, there is also a legal requirement for federal states to provide a minimum standard of services higher than that in the UK. This includes transport, higher education, housing, and management of public utilities. In addition, there is a requirement for a fair distribution of tax revenue (CIPFA, 2022.b). The “financial equalisation” policy is written into the German constitution to ensure that all municipalities are able to get a fair share from the state. Redistribution is embedded into the German local government, so much so that perhaps it should be dubbed “predistribution” (Federal Ministry of Justice, n.d.). This approach is, to an extent, how the allocation of funding to devolved nations of the UK is distributed through the Barnett formula. However, this should go further and provide a similar formula, and powers to enact, to devolved areas of England, as well as the UK.

With regard for the future, local government cannot continue to be expected to spend less and less without compromising on resilience and capacity. There needs to be a step change. WMREDI have produced extensive research in devolution and governance to evidence the role of institutions in supporting inclusive local economies (City REDI, 2023). WMREDI welcomes proposals from others to collaborate on projects to improve opportunities for local government funding and financing.

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The impact on the crisis on the third sector services

GEORGE BRAMLEY & CHARLES RAPSON

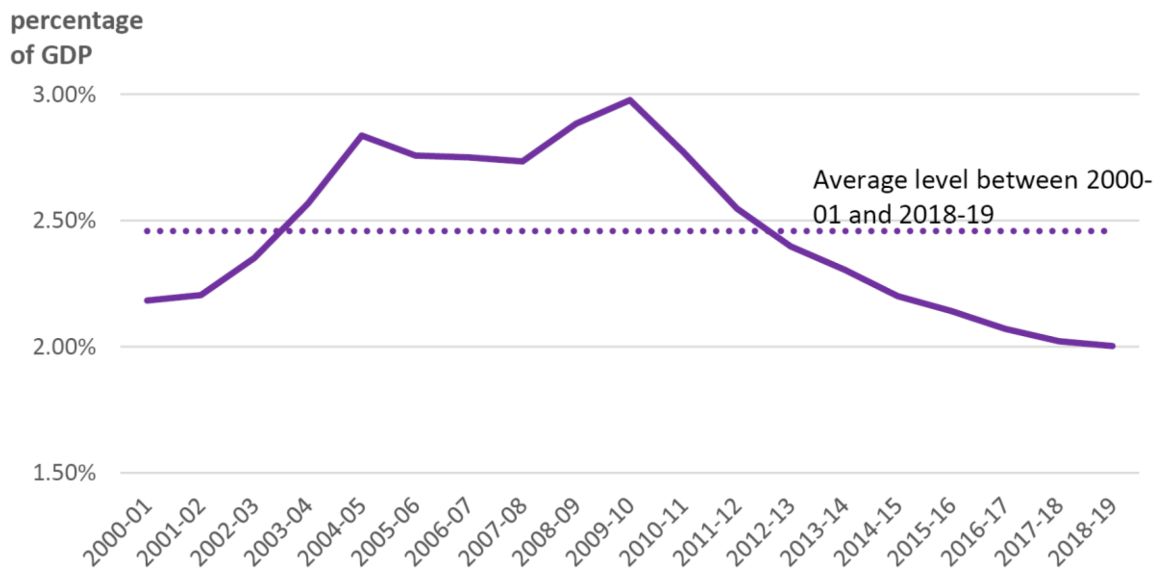
A cost-of-living crisis usually leads to higher need for third sector services, such as charities and social enterprises, how is the current crisis impacting them?

It is important to make the distinction between charities and social enterprises both who make up the third sector and provide services. While they have experienced similar impacts from the cost-of-living crisis their ability to respond and adapt differ in several respects.

Before the crisis

The crisis for the Third Sector began over 10 years ago with the introduction of austerity measures and the reduction in local government funding.

Figure 1: Local government spend as percentage of GDP



Source: Local government finance and the 2019 Spending Review

These cuts lead to reductions in services across the board, including social care, with third sector organisations under pressure to fill the gaps. Local government support, particularly for infrastructure, also significantly reduced. The last major investment on Third Sector infrastructure by central government was in 2008.

The rise of Social Enterprise and the Social Economy

With reduced public sector support, more and more third sector organisations turned to trading activity to fill the funding gaps. In 2009, the number of Social Enterprises was estimated by, Social Enterprise UK, at around 80,000. In

2019, that number increased to 100,000. Indications are that the Social Enterprise sector may have grown closer to 130,000 in 2023.

Expand the definition of Social Enterprise to include any value driven business such as B Corps (a recent entry into the economy) and the number of socially and environmentally driven organisations in the UK, increases to close to 500,000.

The future for Social Enterprise and the Social Economy in the West Midlands

The West Midlands Combined Authority (WMCA) believes that social enterprise provides a more sustainable model and contributor to Inclusive Growth. **The contribution of the social economy in the West Midlands is estimated at £3.5 billion pa.** WMCA is committed to doubling the size of this sector within 10 years.

Demand for services

Around half (49 percent) of charities and community groups experienced demand for their services over winter exceeding their ability to meet it (Jemal et. al, 2022).

Food banks are one clear indicator of increased demand. The Trussell Trust network distributed 1.3 million emergency food parcels between 1 April to 30 September 2022, including almost half a million parcels for children. A third more than same period in 2021/22, and a 52% increase from the same period in the pre-pandemic year of 2019/20 (Trussell Trust, 2022).

It is not only the volume of food packages but the increased expenditure on providing them to those in need that has increased. The Trussell Trust (2022) reported that average expenditure per foodbank has doubled from £770 per month in 2021-22 to £1,400 in 2022-23 to meet the need they are seeing amongst people facing financial hardship in their local areas.

The UK government's Cost of Living Payment provided temporary and much need relief to foodbanks. The need for emergency food parcels fell in July when the payments were made but the money was spent quickly leading to record levels of food parcels being distributed in August and September 2022.

Increasingly, foodbanks have more working people turning to them for support. Food banks across the UK responding to this new demand by changing opening hours to ensure people who are working can access support outside of working hours. Around a fifth (20%) of people referred to food banks in the Trussell Trust network in mid-2022 were in working households (Trussell Trust, 2022).

Almost three-fifths of charities in January 2023 reported that demand had increased compared to the same time last year, including a quarter (24 percent) of charities who say that it has increased 'a lot'. This being particularly the case for those charities whose purpose is working for the prevention or relief of poverty (CAF, 2023). Depending on their staffing model ability to recruit and retain staff when they already struggling to compete with the private sector leading to higher level of staff mobility which cannot necessarily resolved with volunteers.

Demand has increased most in the North of England, demand has increased for nearly seven in 10 (67%) charities, and two-fifths (40%) say it has increased substantially (compared to 55% and 24% across the rest of England). (CAF, 2023)

Service offer

Jemal et.al (2022) in recent survey of charities and community groups:

1/6
(17%) have had to reduce the number or level of services they offer because of financial pressures.

1/4
(23%) of large charities have focused on what is core and essential to their mission.

1/5
(20%) of charities have reduced their use of premises due to energy costs.

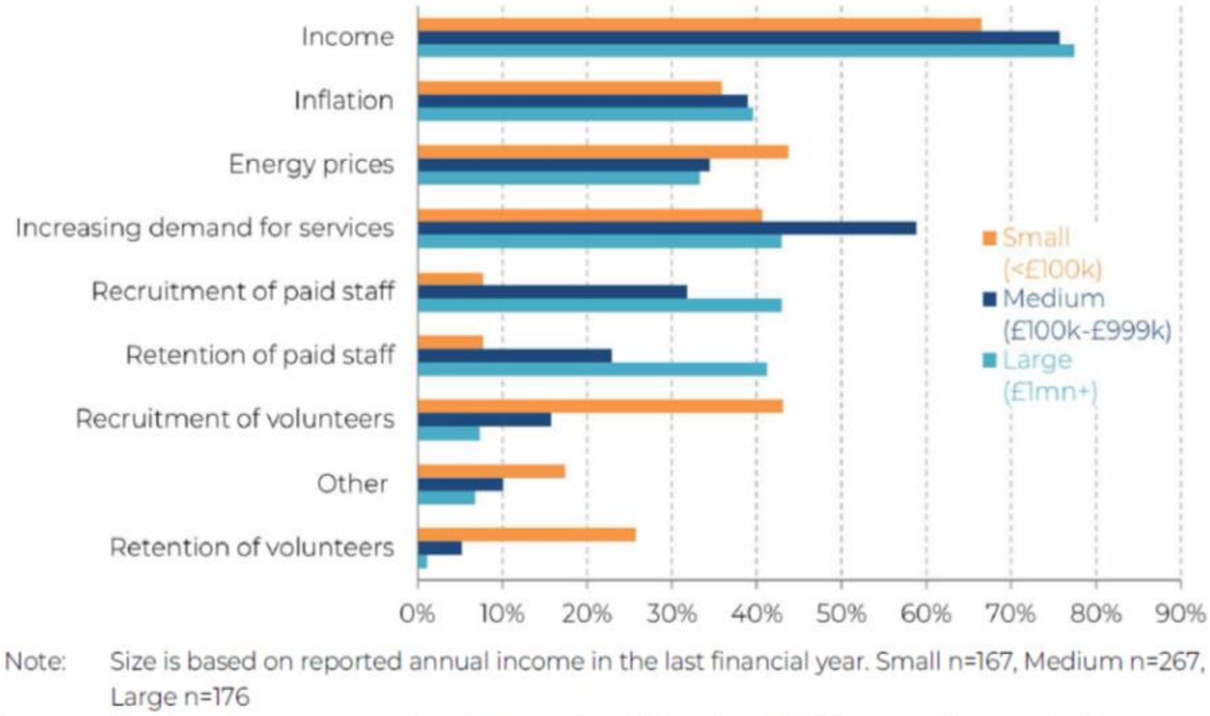
8%
are reducing their hours of operation.

Financial position

The charity sector has been hit hard by the cost-of-living crisis requiring them to make efficiencies in their operating models as a result of reduced income and concerns about their financial ability (ICAEW, 2022). The sector had emerged out of the pandemic with reduced reserves and falling donations reducing its resilience to cost pressures and increased demands created by the cost-of-living crisis. (Charities Aid Foundation, 2022). Four fifths of charity leaders report they will struggle with their utility bills. Charities are affected in several other ways depending on their social purpose. There are those who need to resource increase demand for those who provide support services and practical help (such as providing foodbanks, warm spaces) for those affected by cost-of-living crisis.

Around two-fifths of charities relied on financial reserves over the period 2020 to 2022 as result in the fall in donations and other income sources (CAF, 2022) and this increased to half of charities surveyed in 2023 (CAF, 2023) (see **Error! Reference source not found.**). Charities in the North of England (63%) had used their reserves to meet r unning costs more than those based elsewhere in England (63 percent compared 50 percent) (CAF, 2023). Even those charities that have secured regular donations from the public do not expect these to increase in cash terms and will therefore be eroded by inflation. Work undertaken by Pro Bono Economics estimates that £20 donation in 2021 will only be worth £17.60 in 2024. There is subdued confidence in funding with only a third (31 percent) confident their current funding is secure and around half they have funds to meet current demand (CAF, 2023).

Figure 1: Challenges faced by charity sector



Source: Pro Bono Economics and Nottingham Trent University VCSE Data and National Insights Observatory, State of the Social Sector Survey (November 2022)

Charities and social enterprises that have taken on the running of community assets and reliant on entry fees have seen reduced income while the costs have risen.

As result charities like other businesses have been required to more closely manage expenditure and cashflow reducing discretionary spending and identify efficiencies where possible.

In some respects, social enterprises have been better able to adapt than charities to the cost-of-living crisis. The Social Enterprise Barometer was developed to provide information on the operating circumstances of social enterprise and draws on a panel which includes members of Social Enterprise UK who respond on a quarterly basis with the most recent quarterly update being February 2023 (Doshi et al, 2023).

In common with charities **social enterprises are facing tighter budgets, stretched capacity and concerns about meeting demand for their products and services because of raising interest rates, energy and water and prospects of recession effecting their ability to trade**. Demand for social enterprise services and products remain strong through capacity to meet this demand remains limited. Almost two-thirds of social enterprises have increased the number of people they have supported. Like charities, the impact of the cost-of-living crisis on demand for services and products is dependent on the nature of services and products being provided by individual social enterprises and their purpose. While generally demand for products and services increased or stayed the same for most social enterprises, there was greater incidence of social enterprise reporting a decline for products than services (just over a fifth compared to a seventh of respondents). Some have had to change their business model including reducing footprint in terms of physical presence, pivoting away from products to services. In the quarter to January 2023, the proportion of those reporting decreased growth and turnover had increased, which combined with increased costs is putting a strain on cashflow (Doshi et al, 2023).

Social enterprise turnover positions remain more positive than other small businesses. In the equivalent quarter, The Federation of Small Business Quarterly Business Index reported 43 percent of small business surveyed had experienced a drop in revenues compared to 21 percent of social enterprises (Doshi et al, 2023).

Even with this stronger resilience, it is still estimated based on the January barometer, that around **14 per cent, or 18,000, social enterprises are at potentially at risk of closure** and will experience falling turnover and the need to reduce staff over the next year. A fifth of respondents (20 per cent) reported they were running at loss and a third (36 per cent) were making a surplus and the reminder (44 per cent) expected to break even (Doshi et al, 2023).

Staffing

Larger charities have sought to recruit staff to meet demand, but many have difficulties finding the people they need to fill vacancies. This means charity sector employees to cover the gaps are working longer hours which is not sustainable after almost three years of increasing demand. Around 36 percent are struggling to recruit staff to meet demand as a result and 41 percent have had to cut services (Jemal et.al, 2022).

Increased staffing means funding a larger cost base which puts a strain on their financial positions with many reporting a deterioration in their financial position. (Jemal J eta, 2022). Only two-thirds of charities are confident they can fund their current staffing over the next year (36 per cent) or had a plan in place for maintaining or growing their income over the next 12 months (37 per cent) (CAF, 2023).

There are **concerns around staffing and wellbeing of staff within social enterprises**. Staff cost for half of panel members have increased even when staffing remained the same or declined as it is considered important to ensure their staff are fairly paid. Those leading social enterprises are reported significant strain on their mental health (Doshi et al, 2023). The **increased pressures on charities amplify the need for experienced leaders who are stepping down** (CAF, 2023).

Resilience

The CAF Charity Resilience Index was 67 percent in January 2023 representing a slightly more positive outlook from 62% in December 2022 (CAF, 2023).

Growth

There are **regional differences in growth expectations between regions**. Only around half of social enterprises in North of England and devolved nations are expected to grow. Whereas 70 percent in the Midlands and East, 80 percent in London and 90 percent in South are expected to grow. (Doshi et al, 2023).

Social Mission

Around three quarters of social enterprises have been able maintain their levels of investment in their social missions. Whereas others are struggling to fulfil their mission and need to rebuild their reserves to fund salaries, fuel, and operating costs (Doshi et al, 2023).

Summary

The UK is facing very tough challenges over the next few years. Austerity, COVID, Brexit, Energy costs, Climate Crisis and other factors have and will impact on society. The unique support that Third Sector organisations provide will be in ever greater demand. Social Enterprises and the wider social economy offer the most sustainable alternative to public sector spend. Investment in growing the Social Economy is one of the most important investments local and national government can make to protect the support that those who are most disadvantaged will increasingly need.

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UK Government Policy Response

REBECCA RILEY & ALICE PUGH

To support businesses and households through the cost-of-living crisis, the government set out the cost-of-living support scheme, what have been the policies and how effective have they been?

UK Government Cost-of-living policies

Since the beginning of the cost-of-living crisis there have been 3 budgets (Spring 2022, Autumn 2022, Spring 2023) each of these budgets has largely focused on policies tackling the cost-of-living crisis. The main policies set out by the government (Pugh, 2022; Pugh, 2022; Pugh and Read, 2023), include:

ENERGY

- Household energy price cap at £2,500 originally till April 2023 but was later extended to June. Plus, support for businesses with the price guarantee being in place for non-domestic households till April 2023.
- Households on means-tested benefits set to receive £900 support energy payments in 2023.
- Pensioners to receive a payment of £300 to support for energy bills, with individuals on disability benefits receiving an additional £150 payment, in 2023.
- £200m to bring prepayment meter energy charges into line with prices for consumers paying via direct debits in 2023.
- £63m to help leisure centres with rising energy costs for heating pools and investment in energy efficiencies in 2023.
- £400 one-off payment to every household in the UK Autumn 2022, ending in March 2023.
- 25% windfall tax on the profits of oil and gas firms for a year.

WAGES

- Rise of the national living wage to £10.42 from £9.50 for people aged 23 from April 2023.
- Rise in the starting national insurance threshold to £12,750 from July 2022.
- Basic rate of income tax to decrease to 19% from 20% as of April 2023.

BENEFITS

- Local Authorities saw increased funding of £500m for the Household Support Fund in 2022 to support low-income households.
- State Pension, means-test and disability benefits increased in line with inflation by 10.1% from Autumn 2022.

FUEL

- Fuel duty cut by 5p per litre till March 2023 however, this was extended in the Spring 2023 budget for a further year till March 2024.

Energy

Energy costs are where the government has focused most of its policy when trying to combat the cost-of-living crisis. This is largely because wholesale energy prices more than doubled following the invasion of the Ukraine (Pugh, 2022). To tackle escalating energy bills the government decided to change the cap that energy retailers can charge per kilowatt hour of energy used, introducing the Energy Price Guarantee (EPG), with electricity capped at £0.34 per/kWh and £0.10 per kWh for gas (OFGEM, 2023a). Whilst the policy has been in place it has had a positive impact on household's finances saving households thousands of pounds (Scottish Government, 2022), with the Resolution Foundation estimating that the average household has saved around £1,100 whilst the current cap has been in place (Corlett *et.al*, 2022).

However, there has been some debate on the policy and whether the savings are truly going to those in the most need of support. There were criticisms that whilst support was needed it was largely untargeted, with little focus on those towards the lower end of the income scale that would be most impacted by rises in energy prices. Researchers found that households on higher incomes would receive greater savings than those on lower incomes, as the cap is per kWh and higher earning households use more energy, therefore overall savings is a few hundred pounds more than those on lower incomes (Corlett *et.al*,2022). Estimates indicate that just over half of the saving benefits will go to the top half of the income distribution (Adam *et.al*, 2022).

Additionally, whilst the energy support put in place between October 2022 and March 2023 was welcome for businesses and greatly supported them, particularly energy intensive businesses, the removal of the energy cap for businesses, could see energy bills increase by up to 133% for some (Lowery, 2023). Whilst some energy intensive companies may still be eligible for some energy support (BEIS, 2023), many businesses now will see their energy bills double from this month.

The policy has prevented households from seeing their energy bills treble or even quadruple, to highs of several thousands of pounds. Preventing severe financial difficulties which would have been seen if prices had risen to their forecasted £6,000 to £7,000. However, there has been fair criticism of the lack of targeted support which has left energy policy wanting. Those on the lower end of the income distribution are more greatly impacted by increases in energy bills as they spend a higher proportion of their income on energy bills to start with (Scottish Government, 2022). More targeted help would have been beneficial for those truly struggling to afford their energy bills.

Additionally, the removal of energy support for businesses, especially SMEs, could have a massive impact on inflation going forward. Whilst support for energy intensive firms is welcome, many SME's which have similar energy usage to households will be left to pay wholesale market energy prices, which are currently treble what they were in early 2021 (OFGEM, 2023b). With businesses now facing up to a 133% increase on their current energy bills, inflation may rise not decrease. If businesses see their input costs rise as a result of the rises in their energy bills, many businesses may be forced to pass on additional costs to consumers, further feeding inflation. Both SMEs and high energy intensive firms should be offered greater support whilst energy remains treble what it was in early 2021, especially considering SMEs employ 61% of people in the private sector (BEIS, 2022).

Wages

To help people with the cost of living, the government reduced some of the tax burden on earnings. They did this by rising the national insurance (NI) threshold from £9,880 to £12,570, which means that as of July last year employees and the self-employed did not have to pay NI on the first £12,570 they earn. This is an increase of £2,690 in cash terms, generating personal savings worth £330 in a year, or just under around £30 per month (Hickey, 2022). From April 2023 the basic rate of income tax will decrease from 20% to 19%. Therefore, basic rate taxpayers gain an additional £125 per year from the tax cut, whilst higher-rate taxpayers will receive a gain of around £377 (Adam *et.al*, 2022). It should noted though, that we still have the highest tax burden on earners since pre-war Britain.

From April 2023 the national living wage for those aged 23+ increased to £10.42 up from £9.50, this is a 9.7% rise (DIT, 2023), not as high as the 10.1% CPI inflation but not far off. For someone on the living wage working full-time (37 hours per week), would equate to an additional £1,634 per year before tax. For many households this is a significant rise in income, and if inflation starts to fall could be real terms pay rise, particularly for at the lowest end of the income bracket. There could also be additional benefits, such as 'spillover effects' as businesses rise the wages of more senior roles, so they remain attractive when comparing with less senior roles, essentially shoring up pay band differentials (Resolution Foundation, 2023).

However, the rise in the national living wage could be a double-edged sword. Lower earners who are more greatly impacted by inflation need higher wages to survive, especially when most inflation is food and energy based, which lower earners spend a higher proportion of their wages on. However, lower earners on the national living wage are usually in less profitable sectors, such as hospitality and retail, which are often most effected by inflationary pressures, increasing costs through higher staff wages can often feed inflation, as employers rise prices due to increased input costs (Price Bailey, 2023).

Benefits

The government outlined in the budgets that benefits and state pensions would rise in line with inflation. For instance, universal credit (UC) standard allowance would rise to £292.11 from £265.31 for a single aged persons aged under 25, this is a 10.1% rise in universal credit from April 2023. This increase is in line with inflation however, it should be noted that it is standard policy that pensions and benefits increase in line with inflation each year. One might think therefore that those on lower incomes are more comprehensively protected from spikes in inflation, but not only do lower-income groups usually experience much higher rates of inflation than average, benefits are also uprated in a deficient way (Cribb *et.al*, 2023). Benefits are increased once per year- April- using a lagged measure of inflation from the previous September. This means that if inflation rises just after September, the real value of benefits cannot catch up for a minimum of 18 months.

Figure 1 below from the Institute for Fiscal Studies, plots average benefit entitlements for out-of-work claimants of working age, excluding housing elements, and tracks their real value on a quarterly basis (Cribb *et.al*, 2023). The initial spike in the real value of UC is as a result of the £20 per week uplift in UC during the pandemic, which was then withdrawn in Autumn 2021. One can then see the real value of benefits declining further in the following months, as inflation began to rapidly increase. The annual uplift in Q2 2022 did little to correct the fall in the real value of benefits, as the uplift was based on inflation in September 2021, which preceded the large rise in inflation (Cribb *et.al*, 2023). With the real declines throughout 2022-23 reflecting the double digit rise in inflation over this period. The annual uplift in April 2023 will now merely readjust benefits to where they were earlier in the year, the gap which opened between September 2021 and April 2022 will remain unplugged. That gap will only be re-plugged when inflation returns to the levels before Autumn 2021, under current inflation forecasts this will not happen till Q2 2025. In the meantime, comparative to pre-pandemic levels (Q2 2019), real benefit values were 7.6% lower in Q2 2022 and around 6.2% lower in Q2 2023 (Cribb *et.al*, 2023).

Figure 1: Average real benefit entitlement, excluding housing element, for out-of-work claimants of working age

Source: IFS, 2023

The dotted line on the figure above shows the impact of the energy grants and cost of living payments provided to recipients throughout 2022/23 and 2023/24 (Cribb *et.al*, 2023). Whilst these additional payments, clearly make a significant financial difference, the context for their existence is that inflation is not rising at the same rate as inflation, which are in principle supposed to. Additionally, these payments stop at the start of the 2023/24 financial year (April), with inflation set to be 5%-6% overall this year, the likelihood is that benefits claimants will be left struggling again by the Autumn of the 2023/24 financial year.

Summary

Overall, the energy support provided has made significant financial improvements for households and businesses throughout the 2022/23 financial year. How well the energy support was targeted could be debated however, without the support people would have been thousands of pounds more out of pocket. The larger concern now with energy support, is that for the majority of businesses energy support has ended and current wholesale energy prices are still 3 times higher than they were in 2021 (OFGEM, 2023b). The lack of support on energy for many businesses could see rising prices, at the same time that minimum wages have been risen and material costs continue to rise, this could lead to businesses being forced to pass the higher input costs onto consumers through higher prices.

Whilst the support for those on UC has been welcome, benefit recipients will not see their benefits return to 2019 levels till 2025, making low-income households poorer in the short to medium term. Especially, as inflation rose after September meaning the uplift in April 2023, was actually below the peak of inflation. There is certainly a question now as to whether greater support should be offered particularly with regards for food given food price inflation, currently some countries such as France and Belgium are offering a monthly allowance for those on lower incomes to enable them to buy food which meet certain environmental and ethical criteria (Walker, 2023). Policies such as these may go a long way to helping households on lower incomes which are struggling with rising food bills.

Part of the problem with these policies is they are short-termistic. For instance, there are no policies regarding long-term energy security in the UK, there are no policies regarding improvements in the energy efficiency of dwelling stock and few policies on the long-term importation of energy supplies, alongside few policies in the generation of British energy. This will lead the UK vulnerable to energy shocks again in the future. There were also no policies on the future of UK food security and shoring up food supply chains. Whilst some of the short-term policies have greatly eased the financial distress that many would have suffered, there is a gaping hole in the long-term policy space, which may continue to make the UK vulnerable to further economic shocks in the long-term.

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Are we in a Recession?

PEI-YU YUAN

The cost-of-living crisis is leading to falls in both consumer demand and business investment, does this mean we are set to enter a recession?

Introduction

The state of the economy is a crucial factor in the well-being of a country and its citizens. In recent months, the UK has been facing several economic challenges, including inflation, sluggish growth, and concerns about a potential recession. These issues have been exacerbated by the COVID-19 pandemic, Brexit, and the ongoing energy crisis. This article will provide an overview of the current state of the UK economy and explore whether the country is in a recession.

To begin with, we will discuss the definition of a recession and explore the various indicators that can be used to identify one. We will also examine the limitations of the technical definition and the broader context that needs to be considered. Next, we will delve into the state of the UK economy, including recent trends in GDP, inflation, and productivity growth. We will explore the factors that have contributed to the current economic climate, such as Brexit and the pandemic, and their potential long-term impact. Finally, we will consider whether the UK is currently in a recession and assess the likelihood of this scenario in the coming months. By the end of this article, readers will gain a better understanding of the current economic climate in the UK and its potential future implications.

Are we entering a recession?

On 15th March, the British Finance Minister, Jeremy Hunt, presented his first comprehensive budget speech to the Parliament. He announced that the UK's economy is no longer expected to go into a technical recession in 2023, as previously anticipated. Furthermore, he mentioned that the inflation rate is expected to decrease to 2.9% by the end of the year, and the Office for Budget Responsibility (OBR) predicts that the inflation rate in the UK will decline from 10.7% in the last quarter of 2022 to 2.9% by the end of 2023 (OBR, 2023). These updates suggest a positive outlook for the UK's economic growth and stability.

Under normal circumstances, a country's economy tends to grow as the value of the goods and services it produces, or its Gross Domestic Product (GDP), increases. This growth is typically associated with a rise in people's incomes. However, there are times when the level of GDP falls, which is a sign that the economy is not performing well. Typically, if GDP falls for two consecutive quarters, it is considered a recession. There can be several causes of a recession, such as sudden economic shocks or uncontrolled inflation. Factors that can drive a recession include excessive debt, asset bubbles, and inflation or deflation. The most recent instance of the UK's economy going into a recession was in 2020, during the height of the coronavirus pandemic.

Recession indicators

The definition commonly used to describe a recession involves two consecutive quarters of negative economic growth in Gross Domestic Product (GDP), but it is a rule of thumb without official status and was not developed through rigorous academic analysis (Dey-Chowdhury et al., 2022). Julius Shiskin, the former head of the US Bureau of Labor Statistics, is credited with providing a simplified version of this definition in 1974 for readers of the New York Times. Although often referred to as a 'technical recession' by policymakers and commentators, this definition has limitations as it solely focuses on the technical aspect of consecutive GDP declines and neglects the broader context surrounding them.

The technical definition of a recession, based on consecutive GDP declines, provides a straightforward way to identify a recession when GDP estimates are released. However, it fails to consider the magnitude and broader context of the downturn. Many experts believe that a recession should be a prolonged and significant decline in economic activity, rather than just one or two quarters of minimal change in GDP. Turning points are another approach to identifying and predicting the state of the economy. The National Bureau of Economic Research (NBER) in the US, the Euro Area Business Cycle Dating Committee (EABCDC), and the proposed UK Business Cycle Dating Committee all use various economic indicators to identify business cycle peaks and troughs (Mann, 2023). However, they only announce their decisions several months after the turning point occurs. The NBER uses three criteria: depth, diffusion, and duration, to assess a significant decline in economic activity that is spread across the economy and lasts more than a few months. Recent US economic experience, where GDP declined in the first two quarters of 2022 without an official recession announcement, highlights the complexities of judging the cyclical state of the economy. Turning points are useful for guiding monetary policymakers in adjusting future policies, but they are challenging to identify in real-time and foresee ahead of time.

How deep is the UK recession set to be?

A few months ago, the outlook was bleak, but now things are not as bad. Despite expectations that the economy would contract in the final quarter of last year, it only stagnated, and there was even a small bounce in growth in January's GDP figures, albeit mainly due to the rebound in activity after December's industrial unrest. Inflation, although still high, appears to have reached its peak. The services sector in the UK showed signs of improvement in February, leading analysts to believe that the country may avoid a recession in the first half of this year. However, the struggling manufacturing sector and the energy crisis continue to restrain the economic recovery by squeezing consumer spending. The more significant concern is that the economy, which has been disappointing in its expansion for years, will experience years of sluggish growth due to weak productivity and a smaller workforce. The Bank of England predicts that the British economy will not return to its pre-pandemic size before 2026 (Nabarro, 2022).

The big picture of the UK economy

The British economy is facing a crisis of growth and productivity, with productivity growth remaining abysmal since 2008 (McCann, 2016). Before the financial crisis, the UK was second only to the US in output per head growth in the G7, but in the decade that followed, it experienced the second weakest growth, ahead of only Italy. The recent events such as Brexit and COVID-19 pandemic have worsened the pre-existing economic issues.

The UK has been experiencing several economic setbacks over the past few months. Inflation has reached a 40-year high, and GDP is shrinking, with the OECD predicting that the UK's growth will be slower than most G20 countries except Russia (OECD, 2022). The economy is facing two related problems, low growth and high inflation.

The UK's inflation rate is the highest among G7 countries, with economists suggesting that Brexit may be contributing to this (Partington, 2023). The inflationary shock caused by the pandemic and the Ukraine war is expected to persist in the UK longer than in other countries, which will force the Bank of England to keep interest rates high, and the government to adopt a tight fiscal policy.

According to Catherine L. Mann's Doppelgänger analysis, Brexit is believed to have caused a rise in inflation by approximately five percent.

High inflation has resulted in a cost-of-living crisis for British households, with the cost of living increasing sharply across the country in 2021 and 2022. In October 2022, the annual rate of inflation reached 11.1%, which is a 41-year high, before easing in the following months (ONS, 2022). However, it increased again in January 2023 to 10.4% in February, which has made goods and services less affordable for households (ONS, 2023).

The factors contributing to rising inflation include increases in the cost of consumer goods, supply chain bottlenecks, rising energy prices, household energy tariffs, and road fuel costs. The war in Ukraine has also added to the inflationary pressures building up in the euro area during the post-pandemic recovery, pushing up consumer prices, especially for energy and food.

How do these forecasts compare internationally?

The UK remains the only G7 nation that has yet to fully recuperate its lost output due to the pandemic.

The Bank of England’s Chief Economist, Huw Pill, has stated that the UK is facing unique challenges that are pushing inflation higher than in other countries. These challenges include the trade shock caused by the war in Ukraine, interest rates being raised from historic lows to manage high inflation, companies pushing up prices and employees demanding higher wages (Hickey, 2023).

The UK is also experiencing the highest inflation rate in the G7, with a reading in double digits, which puts it at risk of global price shocks as a net energy importer. In contrast, France and Italy have implemented measures to keep electricity prices in check, while Spain and Portugal have placed caps on gas prices, and Germany has reduced fuel tax. Ireland, Spain, and Belgium have also taken steps to lower energy bill VAT. Despite announcing £22bn of support for high energy costs, the UK government's measures have no bearing on the headline inflation rate. Additionally, the UK has a relatively open economy with a smaller manufacturing base than other G7 nations, and Brexit-related paperwork and labour shortages have added to companies' costs, leading to higher prices for goods and services.

The economic outlook

The Bank of England anticipates a 0.5% contraction in the economy this year due to persistent inflation restraining consumer spending, high interest rates increasing mortgage costs, and government interventions reducing, causing higher energy bills (BOE, 2023). Additionally, economists expect the inflation rate to decrease during 2023 as past price increases "drop out" of the annual comparison. Although, there are concerns that Brexit's economic cost is becoming more apparent, and the UK risks falling behind in the green transition without increased investment. The National Institute of Economic and Social Research suggests that the UK needs more public and business investment (NIESR, 2023).

Summary

The British economy has been facing several challenges in recent months, including low growth and high inflation, leading to concerns about the possibility of a recession. While a recession is defined as two consecutive quarters of negative GDP growth, some experts argue that it should be a more prolonged and significant decline in economic activity. The UK economy experienced a recession in 2020 during the pandemic, but recent forecasts suggest that the country may avoid a recession in the first half of this year. The services sector showed signs of improvement, but the struggling manufacturing sector and the energy crisis continue to restrain the economic recovery by squeezing consumer spending.

Despite the positive outlook, the economy's growth and productivity issues remain a concern, with weak productivity growth persisting since 2008. Brexit and the pandemic have worsened the situation, with the inflation rate at a 40-year high, making the UK's inflation rate the highest among G7 countries. Economists suggest that Brexit may have contributed to this, with Catherine L. Mann's Doppelgänger analysis indicating that it caused a rise in inflation by approximately five percent. The high inflation rate has resulted in a cost-of-living crisis, potentially leading to a decrease in consumer demand, which could cause a recession.

However, recent forecasts from the Office for Budget Responsibility predict a decline in the inflation rate to 2.9% by the end of the year, suggesting a positive outlook for the UK's economic growth and stability. Despite this, the Bank of England predicts that the British economy will not return to its pre-pandemic size before 2026, indicating a prolonged period of sluggish growth. In conclusion, while the UK's economy is facing challenges, including high inflation and slow growth, the situation may not lead to a recession in the first half of this year, but the long-term prospects for the economy remain uncertain.

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Conclusion

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All the chapters in this issue of REDI Updates echo the same message: The impact of the cost-of-living has been affecting virtually every sector in the economy, and it will continue to do so in the foreseeable future. To recap, the ‘cost-of-living crisis’ refers to the fall in ‘real’ disposable incomes (that is, adjusted for inflation and after taxes and benefits) that the UK has experienced since late 2021. UK businesses, households, consumers, public and third sectors have been all suffering intensely in the cost-of-living crisis.

Whilst there is global inflation that is impacting many countries, the UK has been suffering greater inflation comparative to comparable countries. Even before the pandemic the UK economy was in a weak position, with sluggish growth, low productivity, falling business investment since the Brexit vote, and real-terms reductions in wages since 2008. Alongside were, vastly reduced public services due to austerity and there was a significant housing supply crisis. These issues have essentially been compounded, largely by supply side problems both national and international, during the cost-of-living crisis. Whilst there was an explosion of demand following recovery from the pandemic lockdowns, supply issues were the real driver behind inflationary pressures. Supply simply could not keep up with demand, especially as different manufacturing hubs were at differing points in their recovery stages, which led to bottlenecks and rising costs as businesses had to battle new supply chain networks. In the UK this was compounded by Brexit, as leaving the EU led to new trading routes having to be developed as well as, increasing trading costs due to new tariffs and increased red tape. The energy crisis, following the invasion of the Ukraine, then fuelled rising costs for businesses, households and the public sector, with energy prices in the UK more than doubling within a year. A tightening labour market has also led to increased costs as businesses have to pay more to attract the right workers with the correct skills. These supply side issues are leading to inflation remaining stubbornly high, dampening growth.

However, whilst businesses, households, and public sector services are all being greatly impacted by the recent crisis, the impact has not been evenly distributed. As our work highlights different socio-economic groups and sectors are being impacted more heavily than others, with a strong geographical dimension to the cost-of-living crisis. With those in ‘left-behind areas’ more likely to be impacted by the cost-of-living crisis, as our research demonstrates. The cost-of-living crisis and its implications seems to make delivering on levelling up agenda even more challenging than before. As shown in our research, the analysis of the relationship between the cost-of-living crisis and the 12 levelling-up missions indicates that increased poverty and inflationary pressures will make it considerably harder for these to be achieved. This could even further widen socio-economic inequalities, which had already grown following the pandemic.

The government has responded to the crisis with several packages of support over the last year, ranging from the energy price guarantee to increases in the national living wage. This support was much needed and provided significant financial support to households and businesses, which otherwise would be fair worse off than they are now. However, most of these policies have been short-term, as the government tries to fire-fight the worst of the inflation. The policies do not tackle the long-run economic supply-side problems plaguing the UK’s economy, which are oxygenating the spread of inflation. Whilst some of the short-term policies have greatly eased the financial distress that many would have suffered, there is a gaping hole in the long-term policy space, which may continue to make the UK vulnerable to further economic shocks in the long-term.

The government needs to update their long-run supply side policies in order to boost productivity and reduce the inflation plaguing the UK. If targeted correctly these policies may help achieve levelling up, by reducing economic development disparities between regions, which have widened throughout the pandemic and continue to widen in the cost-of-living crisis. Please see the policy recommendations below to combat the key supply-side issues that have led to the UK's high inflationary pressures and to recover and retain resilience and adaptive capacity in the face of continuing economic crises and multiple external shocks.

Policy Area	Recommendation
Energy	Greater Energy independence/security: creating a secure energy environment for the UK will mean that external shocks to the energy market are less likely to impact the UK energy market. This could be done by heavily investing in renewables, similar to the current US policies implemented this year. Large-scale government and private sector investment in renewables would not only increase energy security, but it would also bolster a growing sector which is quickly becoming a necessity with regards to climate change. The jobs created within this sector also have high productivity levels and if targeted correctly towards 'left-behind' industrial towns, which once had energy production at their core, the investment could help levelling-up in 'left-behind' places.
	Retrofitting Housing stock: The UK has the oldest housing stock in Europe, and it is extremely inefficient. One way to support households and businesses would be to subsidies energy efficient technologies. This could be subsidies based on business turnover or household income, to help those less able to afford expensive retrofitting. For instance, even with the current subsidies solar panels for households still cost thousands of pounds, which is simply unaffordable for those on lower incomes who spend a greater proportion of their income on energy bills. Furthermore, such support programme would also have to be combined with skills investments in the construction and energy sector, to help enable employers to meet the demand of such an investment. In the long run this would also help the UK reduce its overall energy usage, as less energy is needed to power more energy efficient homes and infrastructures.
Tight Labour Markets	Improving long term health: The tightening labour markets has led to significant rises in wages in some sectors, forcing producers to then raise prices, to combat the increase in input costs. A significant driver of the tightening workforce in the UK has been the rise in labour force inactivity, driven by long-term health issues following the pandemic. One way to help reduce inactivity due to long-term health issues may be to invest in reducing the NHS backlog. By improving the health of those on the backlog, it would likely mean a quicker return for these people back to work. Average spend per head by the NHS has been dropping since austerity, and even before the pandemic the NHS was facing it's largest ever backlog. A healthy workforce is a more productive workforce. Investing in the NHS and supporting services will be the quickest way to help those with reduced economic activity return to work in the long run.
Brexit	Review of supply chains following Brexit: As highlighted in this report businesses and their supply chains are being substantially impacted by Brexit. Supply chain disruption has been one of the main contributors to inflation over the last couple

	of years, firstly with the disruption from the pandemic, which was then being compounded by Brexit. However, the government has done very little looking into the impact of Brexit on supply chains following the pandemic. The government needs to build the evidence base on supply chain challenges and opportunities faced by businesses following Brexit and the pandemic. Whilst efforts have been made to capture such information in the past, this should be expanded upon with a more systematic gathering of evidence to help better inform the design of supply chain policy interventions.
Public Services	Increased Funding: Local authorities were hit hard by austerity, already vastly reducing their service provision, while rising prices are now squeezing even essential services, also reducing the quality. Many local authorities are struggling to support their constituents during the cost-of-living crisis, following years of budget slashing, worsening the crisis for households as they have fewer places to turn for support. The reduction in local authorities' ability to respond and support those most vulnerable in the crisis, will lead to increased need in the long run, as local authorities' ability to run preventative and supportive discretionary services has been reduced. Greater funding, not dependent on raising council tax, is needed or more funding route options need to be developed.

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