ASDA

INCOMETracker

A SPECIAL REPORT

AN IN-DEPTH LOOK AT THE REAL COST OF THE FINANCIAL CRISIS: 2008 - 2018

FOREWORD

The last five years have been one of the most financially turbulent periods in modern memory.

After years of stability for the UK economy, with inflation and unemployment both low through the early 2000s, the last five years have seen steep declines in UK economic output and a prolonged squeeze on household finances, almost unprecedented in scope.

The monthly Asda Income Tracker has managed to capture what is going on and how it affects UK households in every region very clearly, but I am delighted to be able to welcome this major new study, which brings all of this research together in one, single report.

As this study will show, underlying the UK's economic issues has been the dramatic impact of globalisation on UK consumers. In the run-up to 2008, before the Asda Income Tracker had started, the resource-hungry emerging markets gradually started to push up the prices of primary products. First energy, then raw materials like metals and finally food.

As the inflation rate peaked, the global financial system went into meltdown; Lehman Brothers collapsed, followed, soon after, by the entire global economy. While UK unemployment spiked, household spending power was temporarily bolstered by a VAT cut in December 2008 and the Bank of England cutting the base rate to its lowest level since the Bank was founded in 1694. As a consequence, mortgage interest payments plummeted and the Income Tracker showed that household finances actually improved in 2009, despite the deep recession. But this was a false dawn.

The damage of the deep recession and exceptionally weak recovery hit the UK labour market in a different fashion to past downturns; we have seen a far lower unemployment rate than would have been expected given the weakness in economic growth. Instead, the result was a prolonged period of squeezed pay which remains with us today despite the improved short term economic outlook.

What also persists is the hangover from the financial crisis, the deep recession and the overoptimistic spending plans from earlier years on the UK's government finances. Despite the Coalition's efforts, by the time of the next election, the government will still be borrowing around £100 billion a year. Hence, a key element of the story of the last — and next — five years is how government's attempts to deal with this black hole in the public finances feed through to household incomes.

We think that, despite the short term pick up in the economy and housing market which will trickle through to household incomes, the fundamentals remain tough. One of the key elements of our analysis is that the remarkably low pace of pay growth observed since the financial crisis is unlikely to disappear any time soon since productivity levels remain depressed and international competition intense. Second, it is clear to us that the next government is going to have to do more to reduce its deficit; around half a million more public sector job cuts loom. Finally, although the new Bank of England Governor Mark Carney has told the financial markets that interest rates are not rising soon, the increasing success of measures to boost the housing market means that something is likely to be done in the coming years to prevent a house price bubble from reemerging — though this is probably a couple of years away at least. Whatever is done to cool the housing market is likely to have knockon effects on household incomes.

It's been a rollercoaster five years for UK consumers and I am proud of how well the Asda Income Tracker has managed to capture what is going on for the average UK household. While there is no doubt that the economy is improving in the short term, many challenges remain on the horizon and my best guess is that household finances will remain under further pressure over the next 5 years as the UK economy tries to get back on its feet.

Doug McWilliams
Executive Chairman and Founder, CEBR

FIVE YEARS OF PAIN, NOW FIVE YEARS OF GAIN?

Five years ago we launched Asda's first Income Tracker report with the Centre of Economics and Business Research. The report, which we have published each month ever since, seeks to better understand the monthly spending habits and discretionary incomes of families up and down the country.

As a company, Asda's core drive is to understand and respond to the changing needs and circumstances of consumers. The income tracker helps us to achieve this, while also allowing us to speak up on their behalf. For five years, we have used the evidence we have gathered to highlight the way in which global economic developments impact the lives of every one of us.

Shortly after the first report was published, we faced the worst financial crisis since the Great Depression of the 1930s. The year 2008 saw the collapse of trusted institutions around the world, and the UK government's bail-out of several banks. Five years on, it's clear from the tracker and from speaking to our customers that the fall out from these events is still being felt. Since 2008, our Income Tracker has looked closely at the impact of the recession on household discretionary income. Over the first few years we saw large swings in how much spare cash people had in their pockets.

Today, the situation has stabilised, but making ends meet is still a struggle, as the cost of living has outpaced income growth every month since January 2012 – hitting the "squeezed middle" and the under 30s the hardest of all.

What is more, households face the spiralling cost of essential items like gas and electricity, housing costs, food and fuel, leaving a huge dent in their spending power. As a result, the average household now spends £2,808 a year more on essential items than they did in 2008. We remain a nation in the grip of austerity.

In spring this year, we narrowly avoided falling back into recession for the third time in five years. The signs of economic recovery appear promising and we have seen a modest improvement in monthly spending power, albeit far from its peak of £165 a week at the start of 2010.

However, while economists believe we may well be at the beginning of what will be a long path to recovery, over the last five months the Income Tracker has steadily declined. Any green shoots have yet to translate into more money in people's pockets or greater consumer confidence. We know families are resolute, but until we see a more sustained improvement, we remain only cautiously optimistic.

As we expected, the squeeze on living standards has not been equally distributed across the regions. We've seen good news for families in the North East for example, where disposable income increased by 15.4% over the last five years – the fastest growth across in the UK. However, slow income growth and rapid inflation have eroded spending power in Northern Ireland – where disposable income has been hit the hardest.

This special report to mark five years of the Income Tracker looks at regional variations in more depth; and not only tracks some of the trends in discretionary spending since 2008, but examines what the trends are likely to be over the next five years. As we see it, the challenge facing government over the years to come is to work ever harder to create the conditions for sustainable growth. As for business, we must provide quality goods and services at prices consumers can afford so their hard-earned income goes further – something that is key to Asda's heritage.

What is clear from the report and from what people are telling us is that we have a long journey ahead of us. It will take both government and business working hard together to ensure the economic recovery has a real impact on the lives of British consumers.

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-5YRS

Up £70
since 2008

Up £54
since 2008

today

today

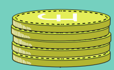
3.5%

1.8%

5YRS

+5YRS

NORTHERN IRELAND: HAS SEEN THE
SLOWEST GROWTH IN SPENDING POWER
(0.1%) OVER THE LAST FIVE YEARS...



...AND WILL BE HIT HARDEST OVER THE
NEXT FIVE YEARS; DECLINING BY -20%

KEY INCOME TRACKER FINDINGS

1 SQUEEZED BRITAIN

The average UK household is £868 a year worse off, in real terms, than they were in 2009

2 ONWARDS AND DOWNWARDS

The squeeze on household discretionary income will last another five years

By 2018, the average UK household will be £1,300 a year worse off in real terms than they were in 2009 when spending power was at its peak

3 PAYING THE PRICE OF INFLATION

The cost of essential items – like petrol, food, utility bills and rent – is now £54 a week more expensive for the average UK family than it was in 2008 – equivalent to £2,808 a year

What is more, in 2018, the average household is expected to spend £3,900 a year more on essential items than they do today

4 BURIED UNDER THE BILLS

The cost of utilities is 24.7% higher than it was in 2008, equivalent to over £700 a year, while the average UK food bill has gone up by £655 over the last five years to £3,085 a year

5 THE HIGH COST OF LOW PAY

Since 2010, wages have been growing by an average of 1.8% a year, half the rate of essential item inflation (3.5%)

Essential item inflation has outpaced wage growth every month for the last three and half years and will continue to do so for another five years

6 THE KIDS AREN'T ALRIGHT

The younger generation (under 30s) has been the hardest hit, with discretionary income down 4.7% over the last five years

This group has seen one of the fastest increases in the annual cost of living (+16.6%) of any working age household. Sadly, the tough times aren't over for this group either, with slow wage growth and the rising cost of living keeping their discretionary income growth in negative territory until 2018

7 GOLDEN OLDIES

The spending power of over 75s has remained resilient, with discretionary income up 18.5% over the last five years, thanks to above inflation increases in the state pension. This spending power growth is set to continue over the next five years

8 REAPING THE BENEFITS?

Inflation increases in benefits have shielded the discretionary income of single-parent families (which is up by 42%) and low-income households (+21.2%) over the last five years. Welfare reforms, introduced in 2013, will help to squeeze these very groups over the next five years, cutting their discretionary income by a third and sixth, to £1,200 a year and £2,300 a year respectively

9 CELTIC CRISIS

Spending power in Northern Ireland has been hit the hardest – flat over the last five years thanks to some of the slowest income growth (12%) and fastest increases in the cost of living (16.6%) in the UK. Households are projected to face a further 20% decline in the level of their discretionary income over the next five years, as austerity measures begin to take their toll

10 THE RIGHT RATE

Although household financial conditions are set to remain tough, the Bank of England is expected to keep interest rates on hold until 2016, preventing sharper declines in household spending power by keeping mortgage costs near record lows. But the risk of interest rates rising sooner remains. A steady increase in the base rate to 2% from its current 0.5% would reduce discretionary incomes by over £175 annually

Contents

Executive Summary

- Weekly discretionary incomes in 2013 are higher than in 2008, before the financial crisis, helped by the boost from the Bank of England's cuts in the base rate to record lows. However, slow income growth and rapid increases in the cost of living mean that since 2010, discretionary incomes have fallen back, and currently stand beneath their early 2010 peak.

- Discretionary incomes are expected to remain largely on hold over the next four years, kept down by a slow wage growth as the economy gradually recovers but unemployment remains high, austerity measures and elevated increases in the cost of living, including an increase in the Bank of England's base interest rate further out.

- In 2018 and beyond, spending power growth is likely to return as economic growth and wage increases strengthen and the impact of austerity measures become less acute.

- A base rate rise is expected for 2016 with a corresponding rise in the cost of mortgage interest. This increase is expected to hit average household discretionary incomes by £4 a week.

Introduction

- The Asda Income Tracker has now been around in its current incarnation for five years through a period of enormous economic turbulence and a change of government. This report looks at the trends that the Income Tracker report has highlighted over this half decade, from the strong growth in discretionary spending power in the run up to the financial crisis, through the sharp declines seen through 2010 and the current period of effective real income stagnation.

- In addition, the report examines future likely paths of growth for discretionary spending power over the next five years. This part of the report aims to highlights both the factors likely to be affecting spending power as well as the key risks to the outlook.

- We also examine in more detail different household types, including higher and lower income households, as well as the effects around different regions and countries of the UK.

Discretionary income has seen large up- and down-swings over past five years

Strong discretionary income growth was followed by a slump, then marginal recovery

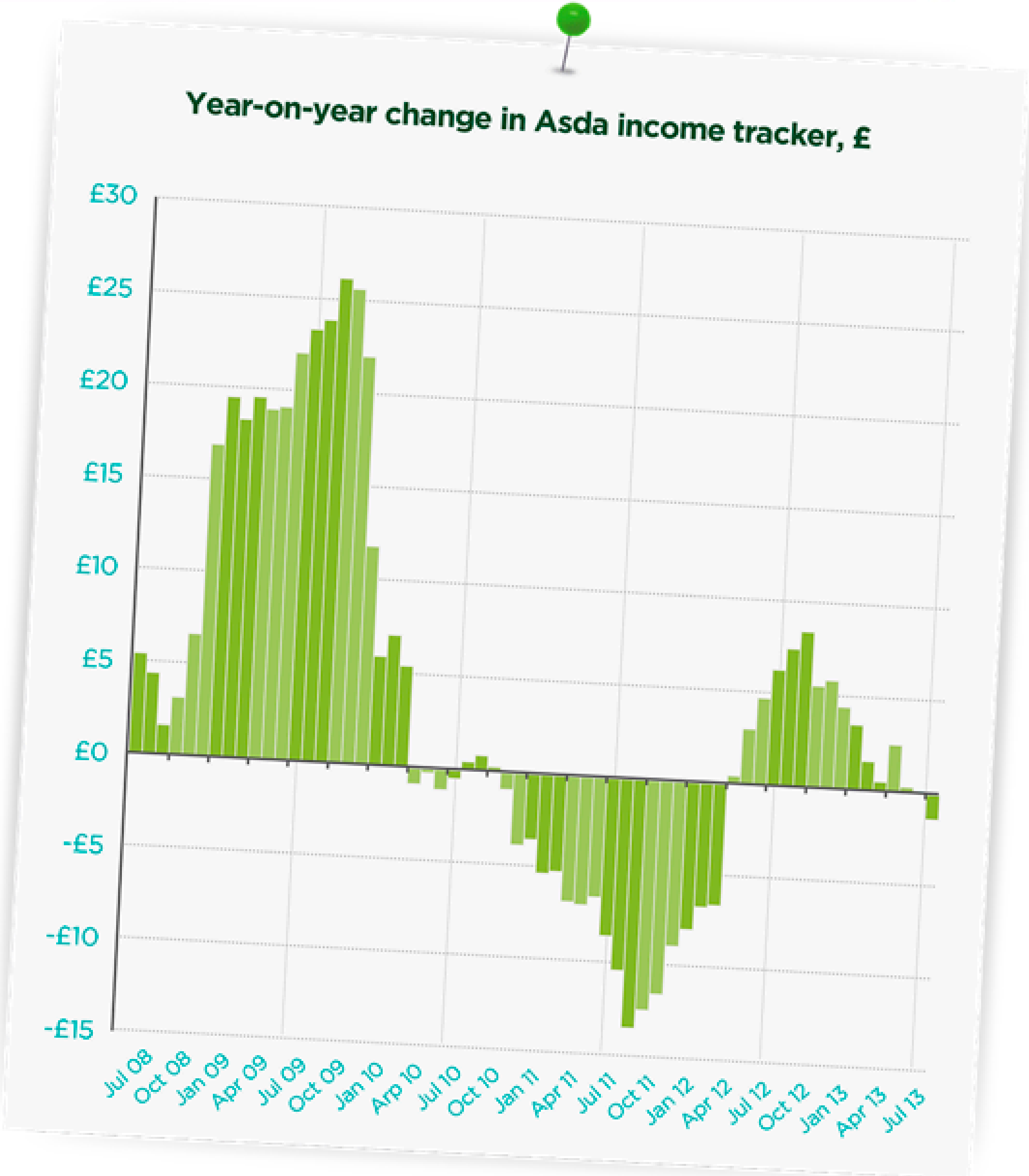
- Although discretionary incomes as measured by the Income Tracker have recently returned to negative year-on-year territory, the past five years has seen some strong gains made at times.

- The base rate cuts in 2009 helped to significantly reduce mortgage interest payments, leading to much higher discretionary income.

- However, this boom period was followed by the effects of the 2008-09 deep recession. Total pay was cut as benefits slumped, regular pay growth weakened and the pace of increases in the cost of living started to rise.

- This marked the start of a two and a half year decline in spending power.

- Growth returned in 2012 thanks to the effects of an increase in the income tax free allowance and the hefty uplift in benefits payments in April that year due to a high inflation rate in 2011.



Discretionary incomes remain beneath their all time high in early 2010

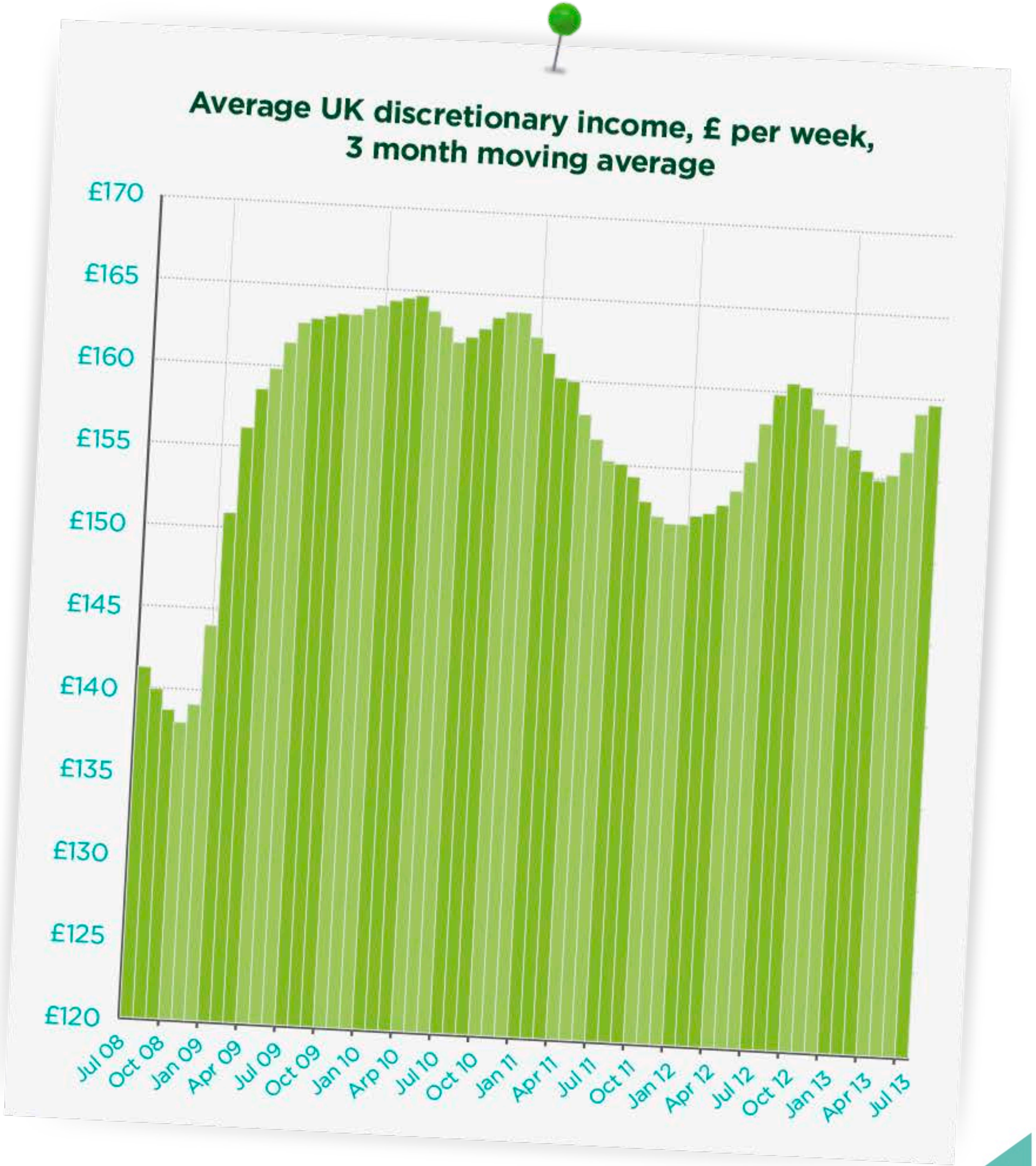
Although the level still stands above that seen before the financial crisis

- In the three months to July 2013 the level of discretionary income at the average UK household stood at **£**160 a week.

- This is marginally down on the level a year before and remains well below the peak of **£**165.

- The sharp rise in the level of discretionary incomes in early 2009 is due to the sharp reductions in the Bank of England's base rate, the December 2008 reduction in the VAT rate and a steep drop in inflation as commodity prices fell back as the global economy fell into recession, helping to boost spending power to all time highs.

- However the squeeze on real incomes over the subsequent three years means that discretionary spending power remains subdued.



Labour market has held back increases to discretionary spending power

Unemployment has been kept from rising further amid weak economic conditions due to erosions in real wages

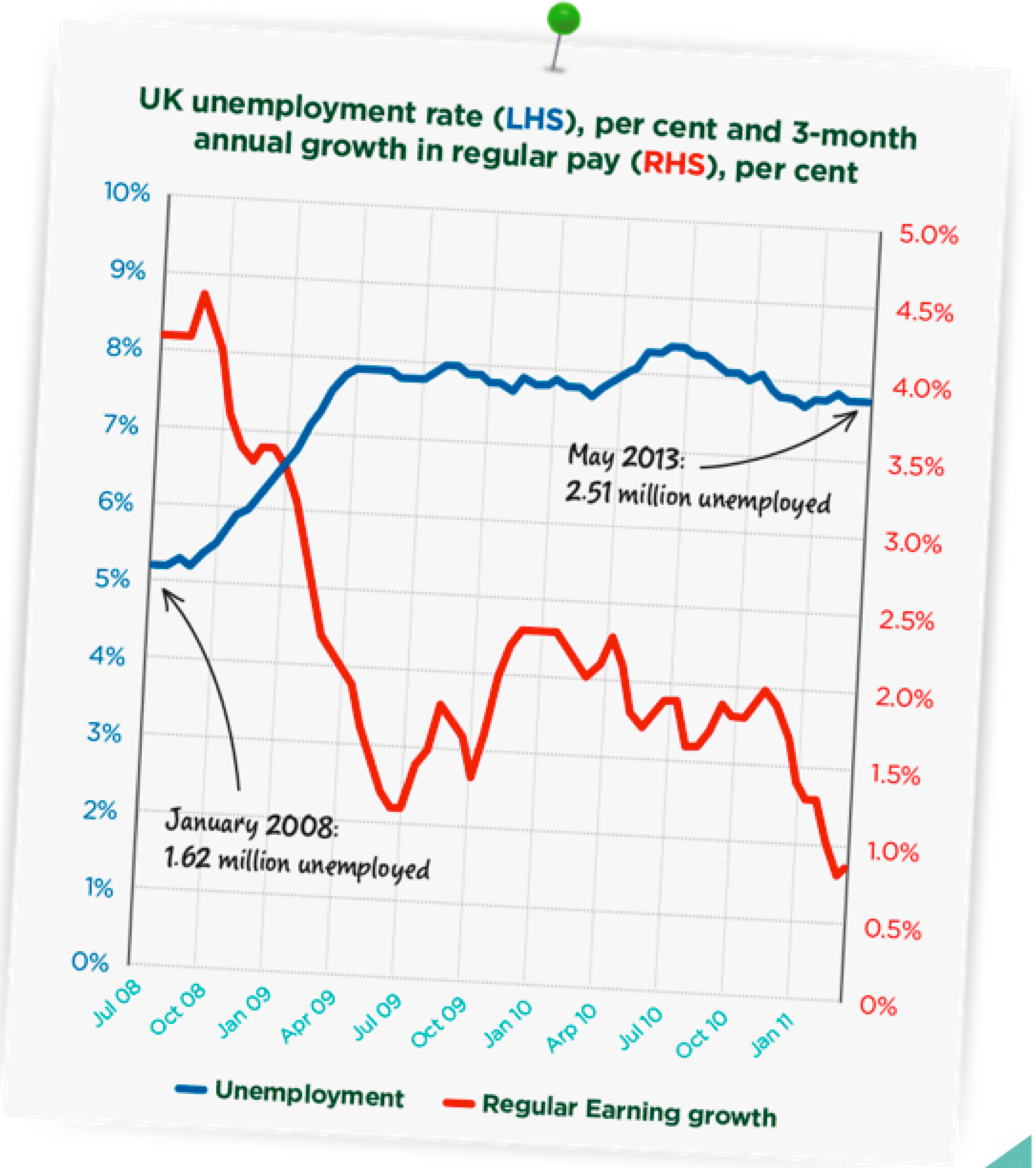
- The unemployment rate climbed significantly during and after the recession of 2008-09, rising from just over the 5% mark to around the 8% level.

- This shift in the labour market weighed down on spending power growth, as employees lost their jobs.

- Over the same time period, growth in regular wages dropped off, falling away from the pre financial crisis average of over 4.0% to less than 20% by 2010.

- Unemployment has remained remarkably flat since 2010, despite further periods of economic contraction, remaining well below the levels reached following the 1990s recession of near 11 per cent.

- As a result of this, productivity has fallen back significantly and real wages taking the hit from weak economic conditions instead.



Employment prospects for young people worsened sharply in past five years

More than one in five jobseekers aged under 24 are unable to find work

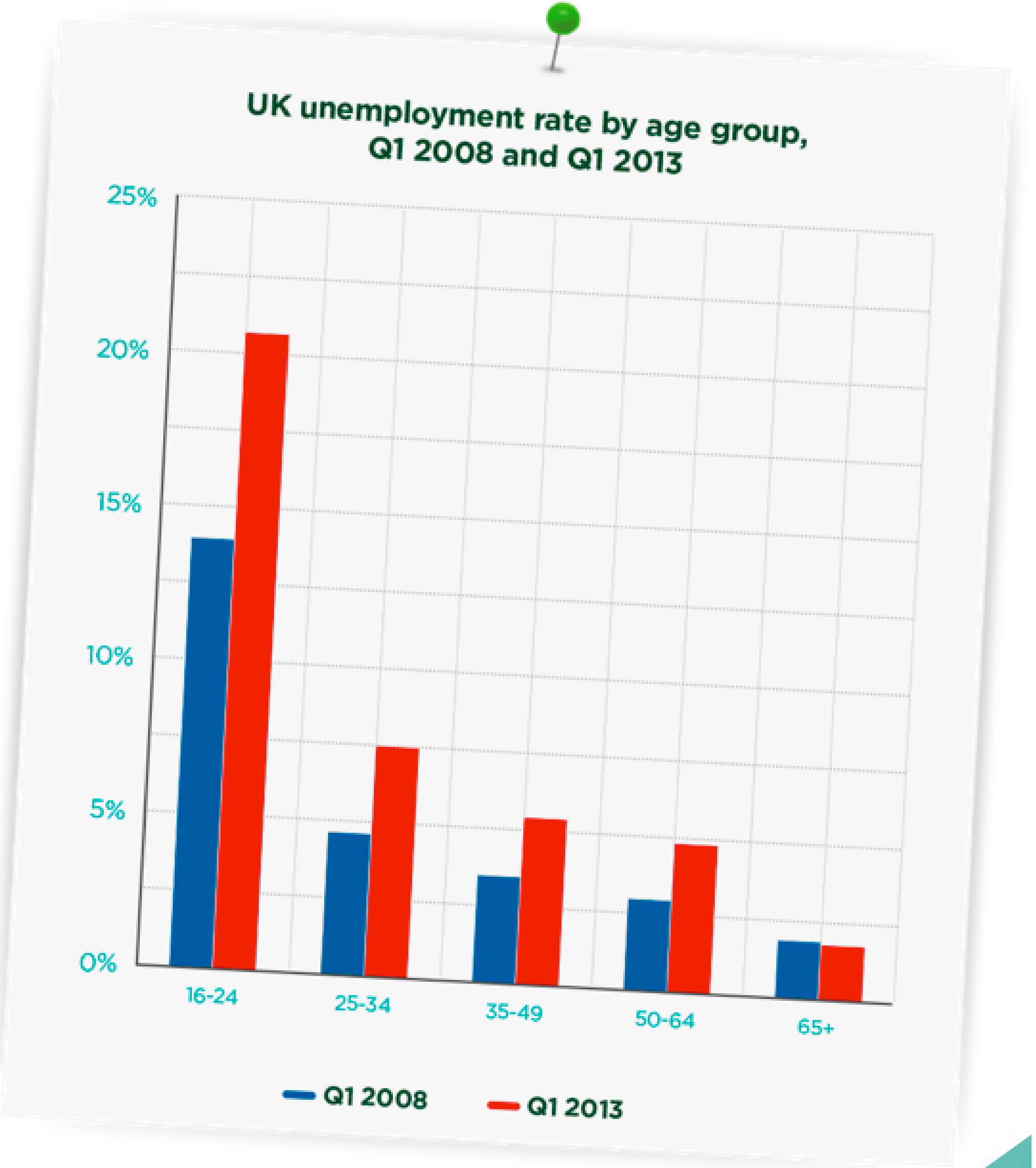
• The unemployment rate for those aged 16 to 24 stood at 20.7% in Q1 2013, up from 14.0% five years before.

• This is equivalent to almost one million young Britons out of work, up from just under 700,000 in Q1 2008.

• For the youngest jobseekers – those aged 16 or 17 – the unemployment rate climbed to 37.3% in Q1 2013, up from 24.4% five years before.

• At the same time, unemployment for those aged 25-34 stands at 7.5%, up from 4.7% five years before and equivalent to a total of 550,000 jobseekers.

• The unemployment rate for those aged 35-64 stands at around the 5% mark, equivalent to another million out of work Britons.



Manufacturing and construction jobs hit hard since start of financial crisis

Construction employment fell by 13% between Q1 2008 and Q1 2013

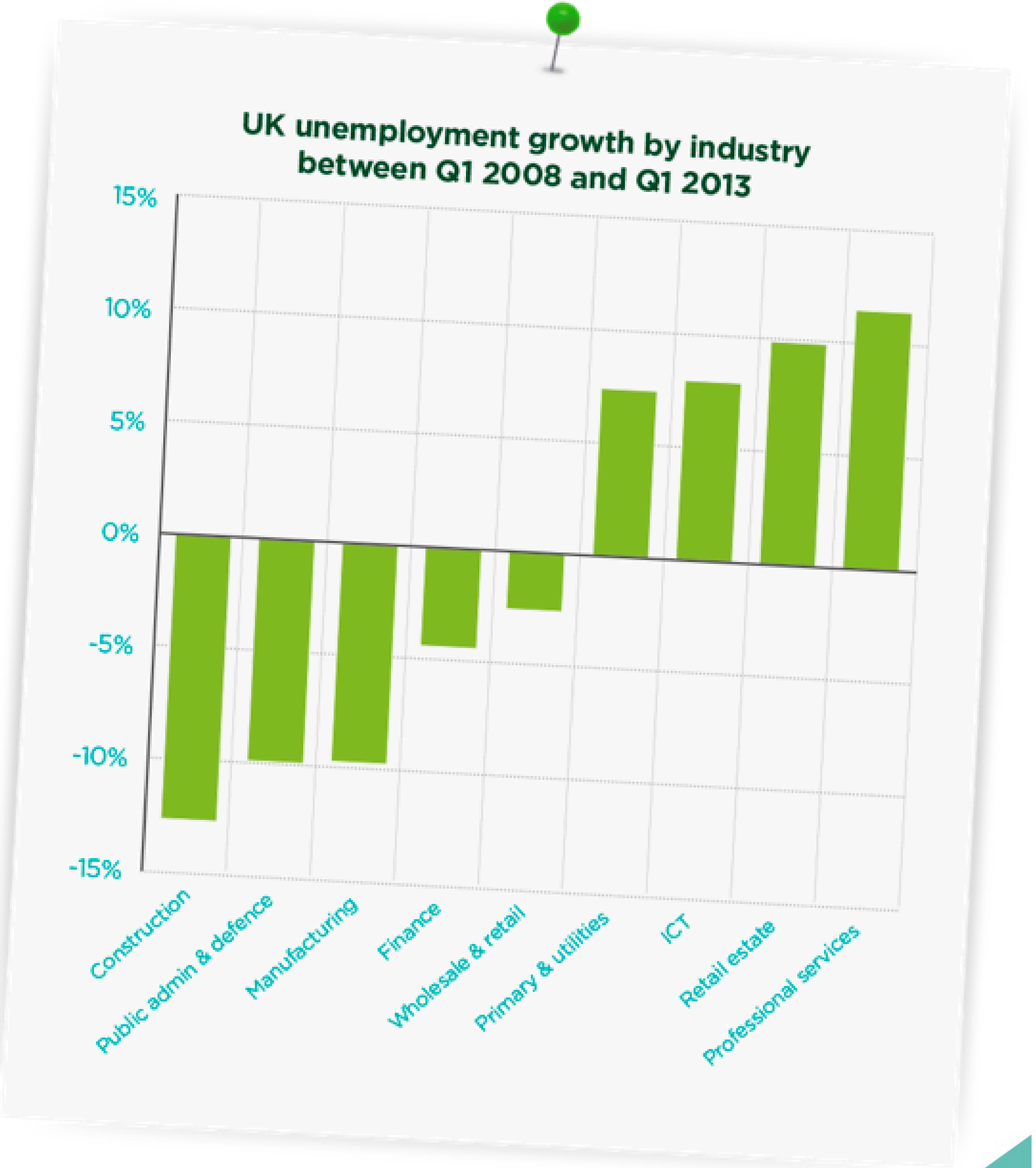
- This is equivalent to 290,000 people being laid off, taking the total employed in the sector to less than two million.

- The manufacturing sector also saw sharp declines in its workforce, also losing almost 290,000 jobs over the period – a decline of 10%.

- Meanwhile, public sector cutbacks brought down the level of employment in the public administration and defence sector by 10%.

- However, at the other end of the scale, much of the services sector has been seeing gains to employment over the past five years.

- ICT, real estate, professional services and transport all see their workforces expand between Q1 2008 and Q1 2013.



Change in tax policy has helped to boost net incomes since 2008

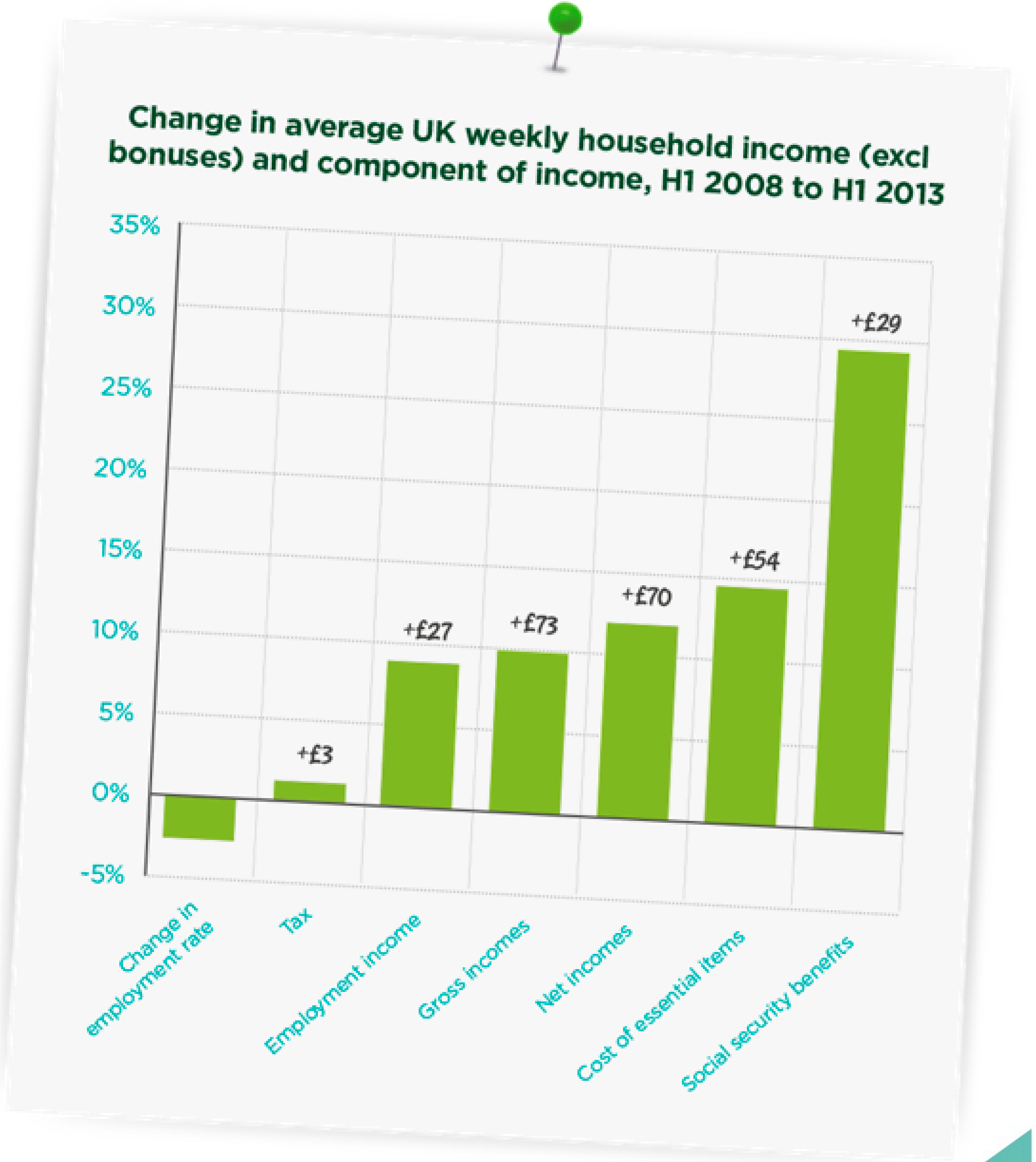
Net incomes grew over past five years by 11.9% compared to gross income growth of 9.9%

- Average UK household incomes have risen over the past five years in nominal terms, with growth coming from wages, self employment income, pensions and social security benefits.

- Although worsening conditions in the labour market, including rising unemployment, have weighed down on growth in income from wages, a stabilising effect was felt from social security benefits.

- Gross incomes rose between Q1 2008 and Q1 2013 by £73 a week – from £629 to £702.

- Thanks to reductions in the income tax free personal allowance, net incomes rose over the same period by almost the same amount, increasing between Q1 2008 and Q1 2013 by £70 a week.



Growth in the cost of essential items remains high, outpacing income growth

Although down on recent highs, the rate continues to stand higher than the Bank of England's target

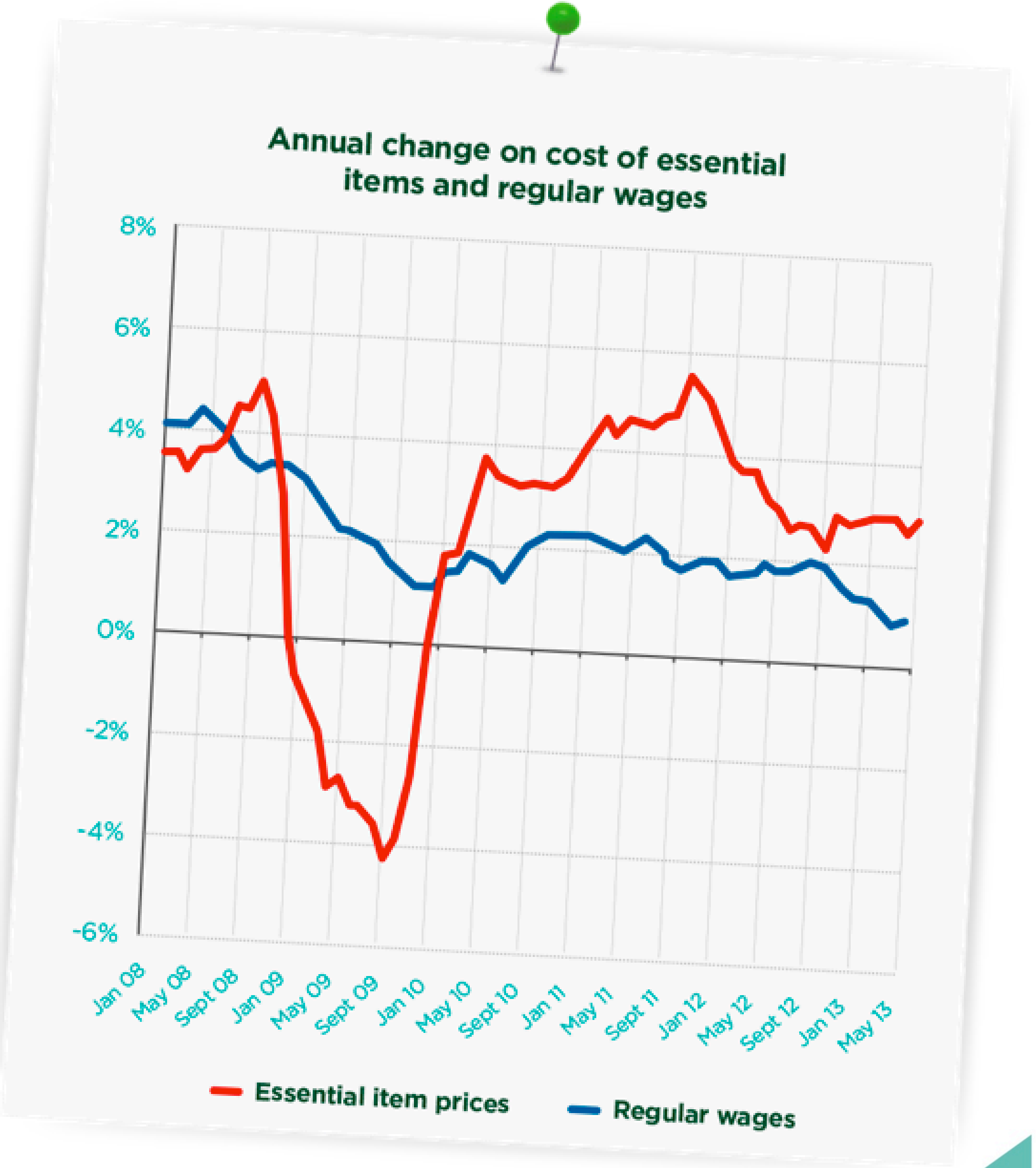
• Growth in the cost of living fell back sharply into negative year on year territory in 2009, as the Bank of England slashed its base rate to record lows and the rate of VAT was cut to 15%, down from 17.5%.

• However, once the base rate effect fell out of the year on year comparison, the cost of living started to rise at a faster pace – compounded by VAT returning to 17.5% in January 2010.

• The price of a barrel of oil stood well above the $100 mark for much of 2011, causing substantial price inflation for petrol and home utilities. In addition, VAT was increased again to 20% in January 2011.

• Inflation in the cost of living slowed through 2012 however, as the price of oil stopped climbing.

• The past five years have seen a lot of volatility in inflation – exacerbated by changes to the VAT rate.



Food, housing and transport costs have put a lot of pressure on household finances

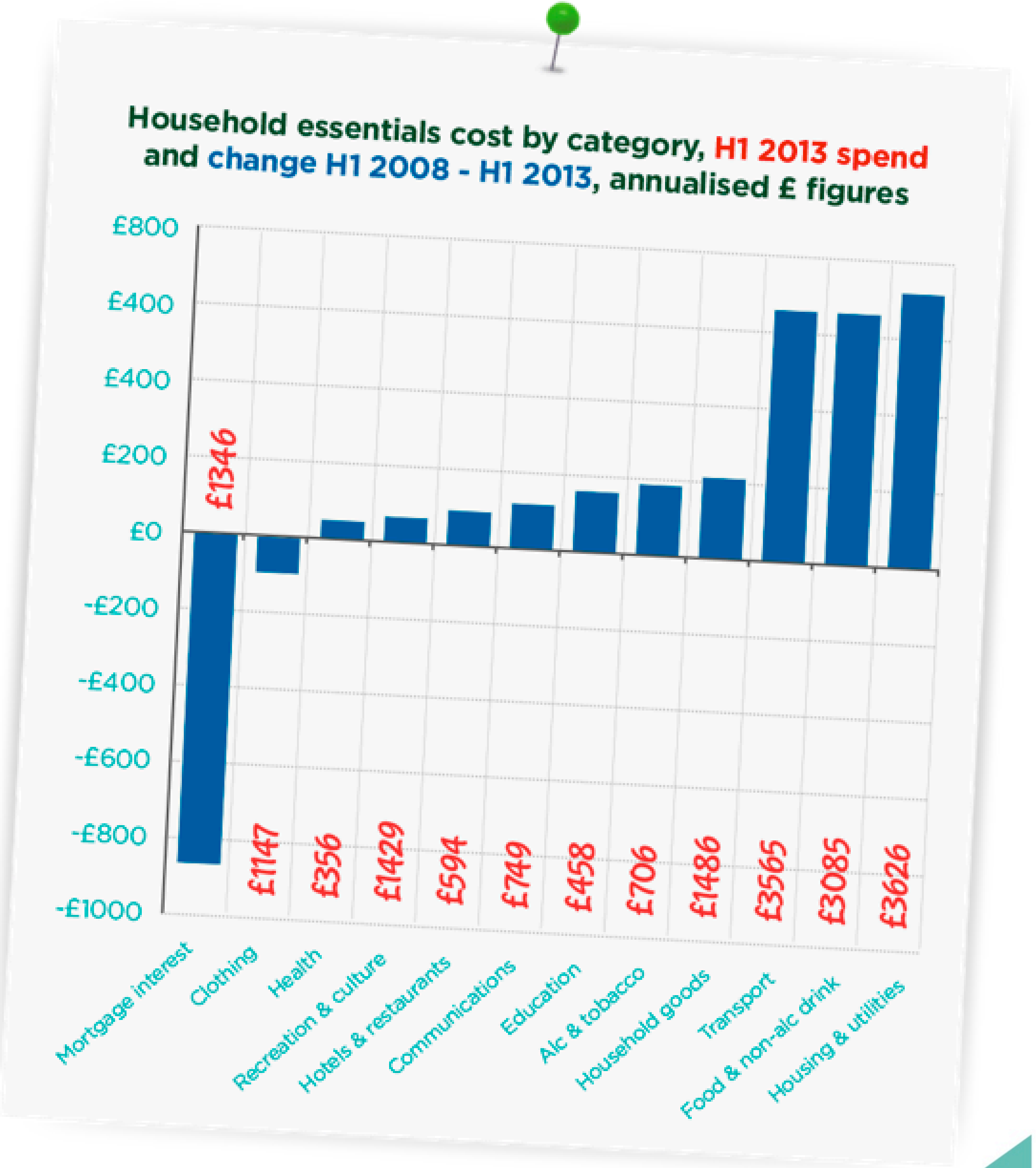
Costs of these items pushed up due to changes in the global economic environment

- In the first half of 2013, the cost for average UK households for housing and utilities increased by more than **£**700 compared to the first half of 2008.

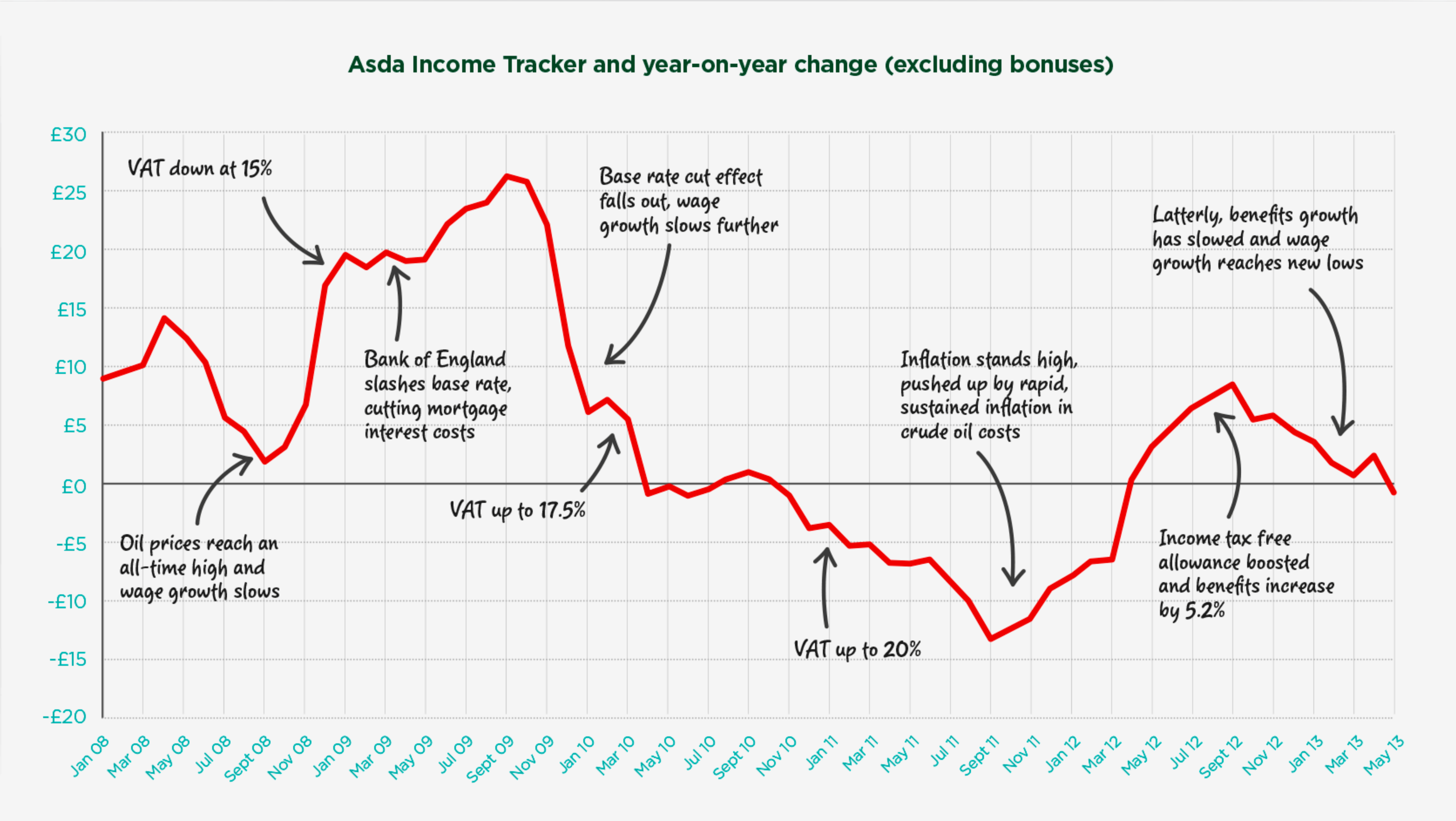
- Over the same period, the cost for average UK households for both foodstuffs and transport costs increased by more than **£**640.

- The cost of these essential items have been pushed up due to international factors. For example, the price of a barrel of brent crude oil was 22% higher in H1 2013 than in H1 2008, pushed up by a rebound in global economic demand and greater instability in the Middle East.

- At the other end of the scale, the cost of spending on clothing and mortgage interest have both fallen back. Clothing prices fell back for much of the twenty years up to 2010, due to cheaper labour in the Far East, while mortgage interest fell back in line with Bank of England base rate cuts.



Visualising the effect of these economic changes



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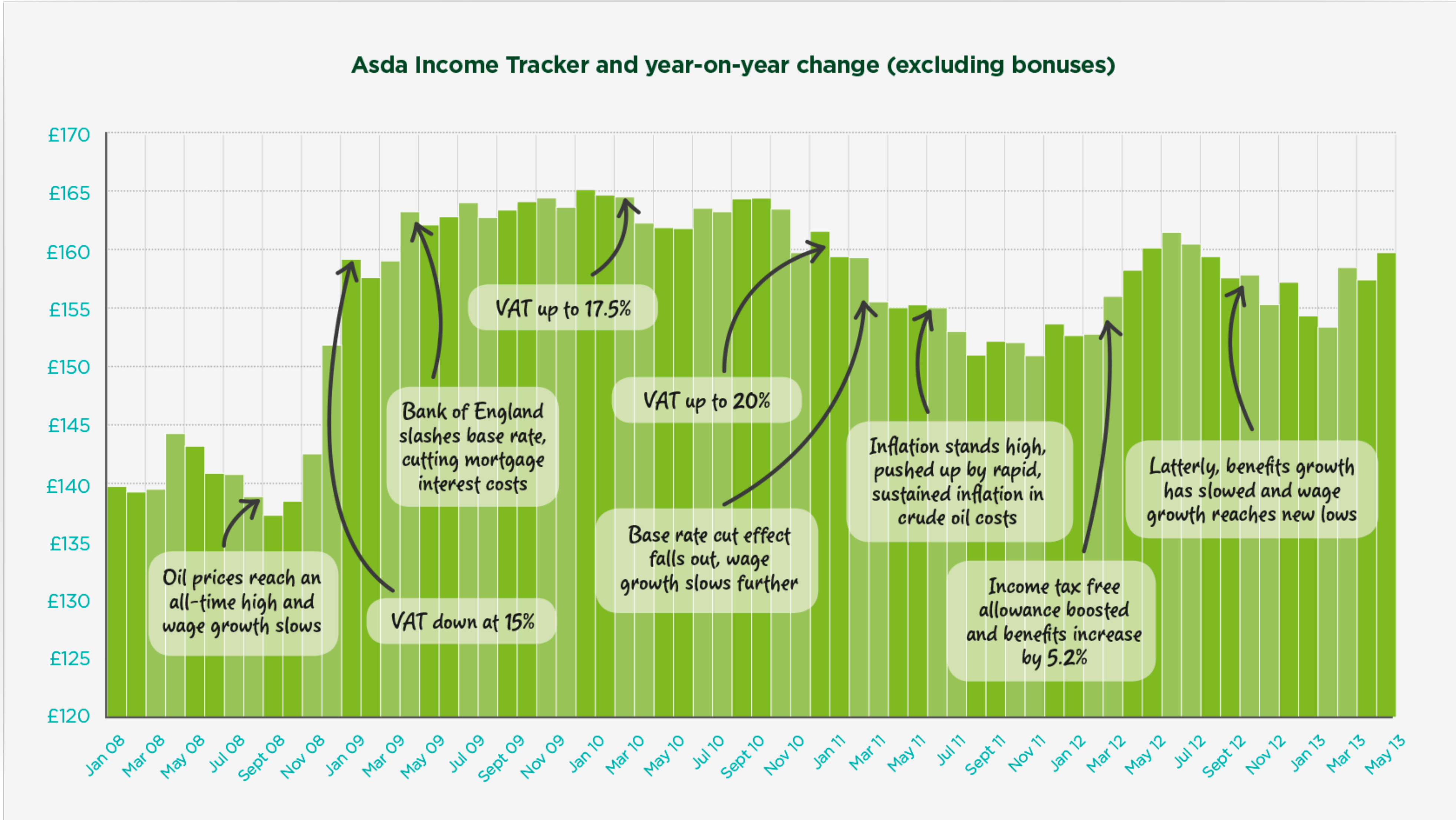

Constructing the Asda Income Tracker

Total household income
H1 2008: £629 per week
H1 2013: £702 per week

e.g. wages, investment income, pensions, social security, self employment earnings

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e.g. national insurance contributions, income tax

Taxes
H1 2008: £116 per week
H1 2013: £119 per week

=

Net income
H1 2008: £513 per week
H1 2013: £583 per week

i.e. take home pay

Net income
H1 2008: £513 per week
H1 2013: £583 per week

i.e. take home pay

–

e.g. food, clothing, housing costs, bills, transport, communication costs, health, children's schooling, house maintenance and repair

Cost of living
H1 2008: £372 per week
H1 2013: £426 per week

=

Family spending power
H1 2008: £141 per week
H1 2013: £157 per week

e.g. holidays, cinema, theatre, eating out, toys, sports, savings, jewellery, national lottery and other gambling payments, computer software and games


ASDA

Overall inflation is expected to remain above the Bank of England's target rate

Consumer price inflation expected to stand around the 2.5% mark in medium term

- Inflation is currently being kept elevated by increases in the cost of food, home utilities, university education and public transport.

- These effects are likely to lessen later in 2013, falling out of the year on year comparison.

- However, in 2014 and beyond, the inflation rate is expected to be kept elevated by rising global demand growth, as the world economy gathers pace and emerging economies grow faster.

- This economic growth is expected to place upward pressure on the prices of many commodities, such as energy inputs, metals and soft commodities such as food stuffs and fabrics.

- Rising global commodity prices will feed through to the UK consumer, keeping growth in the cost of living from slowing significantly.

Wage growth to remain weak but start to pick up in the outer years

Low productivity growth continues to hold back wage growth

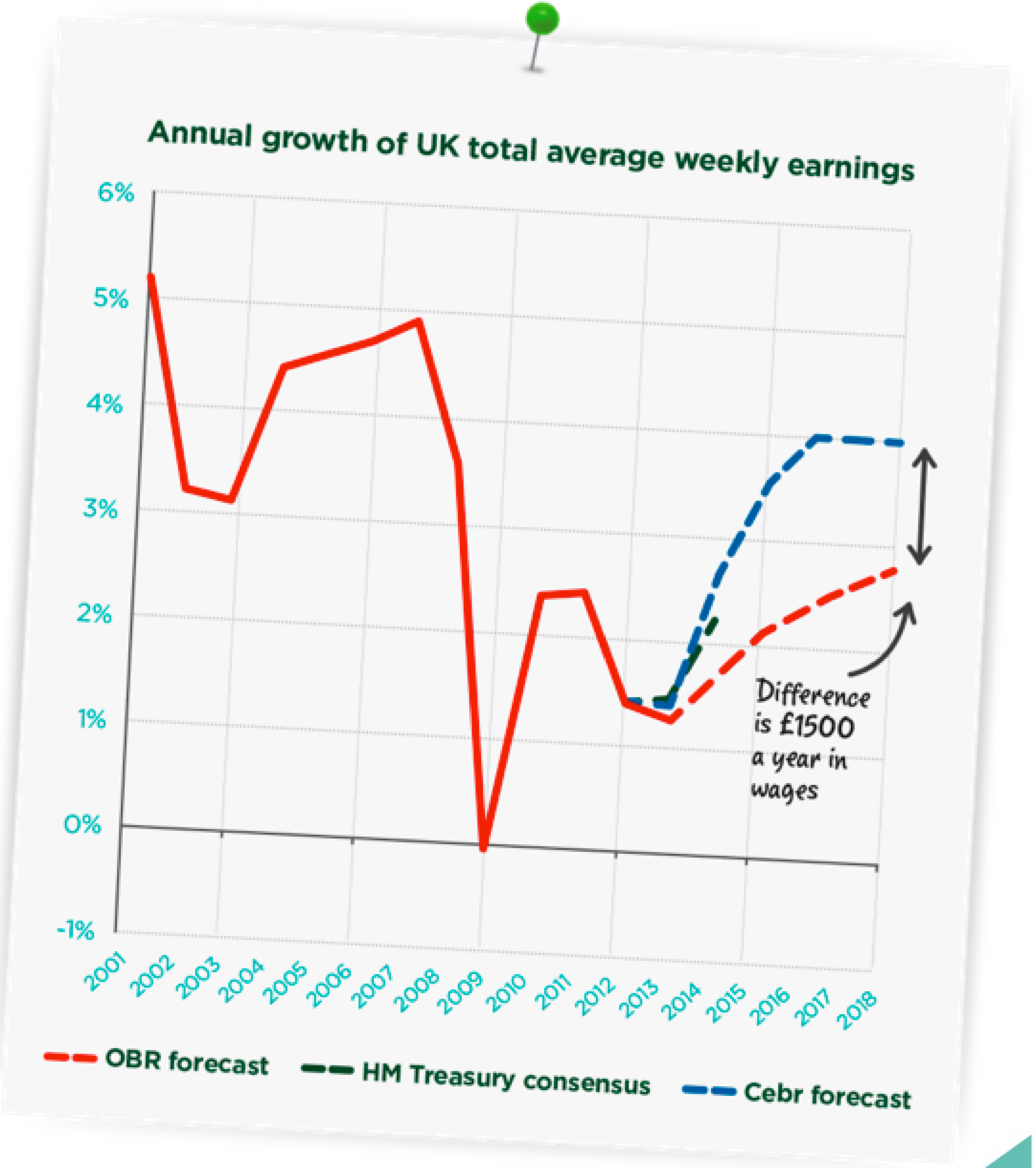
• In 2013, economic growth is still only slow and a lot of people remain out of work. In fact, many of those in work are underemployed, working fewer hours than they'd like to.

• The resulting competition for vacancies alongside slow productivity growth means that annual pay settlements are stuck at record lows.

• The macroeconomic outlook is for growth to gradually return over the coming years, and wages are expected to start to rise faster alongside this pick up.

• However, a 'new normal' climate of lower wage growth than before the financial crisis is likely to persist – wages are unlikely to reach growth rates of over 4.0% in the next five years.

• However, the Office for Budget Responsibility predicts a rosier outlook, with wage growth of 4% by 2016.



Public sector job cuts to keep unemployment rate elevated

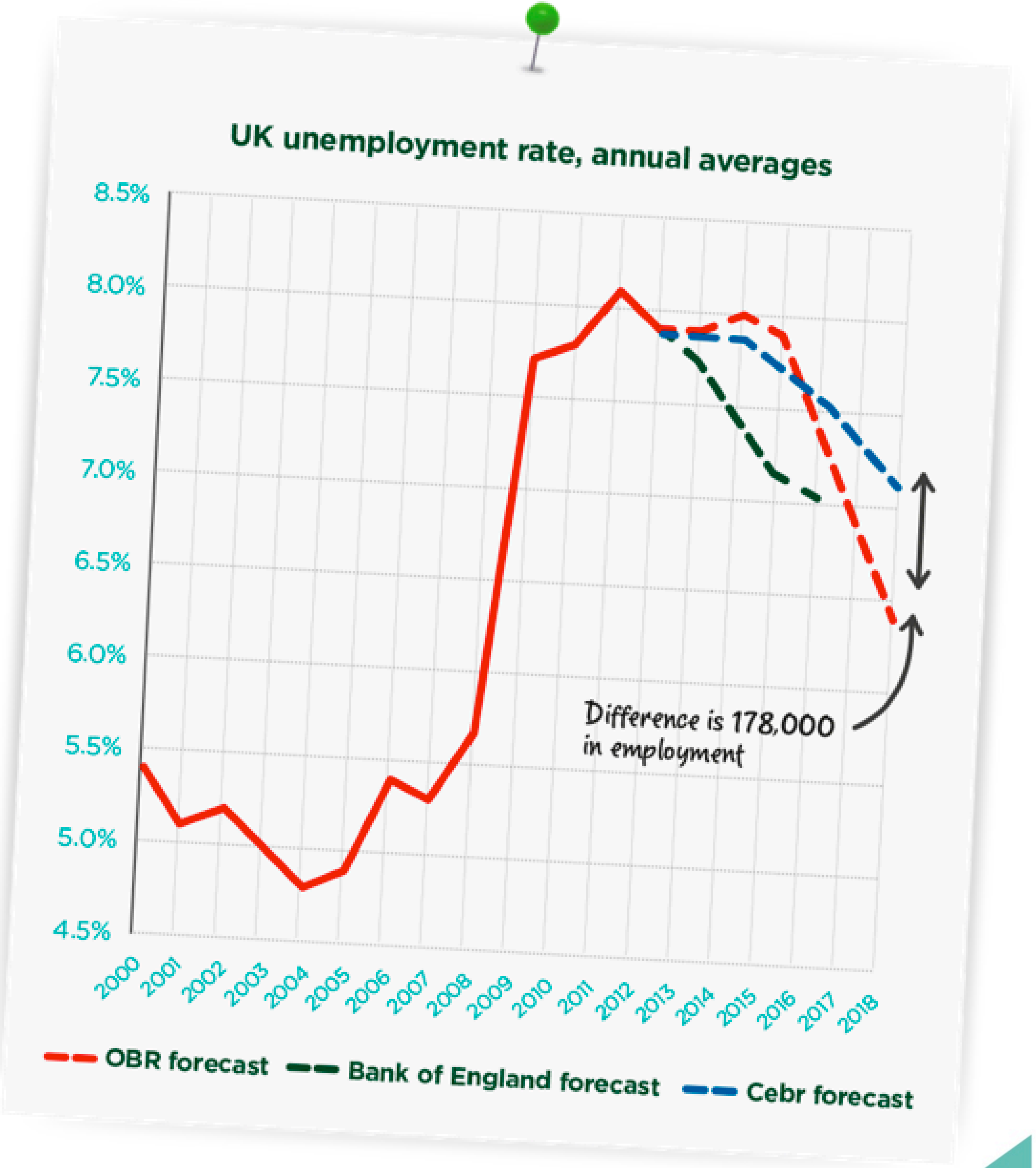
Although the private sector is creating jobs, overall unemployment to fall only slowly

- Although the economy is now slowly expanding again, the budget deficit remains very high – at £83 billion in 2012/13. As such, after the 2015 election, many more government cuts will be required.

- The Office for Budget Responsibility expects significant further losses to public sector employment over the years to 2018, with cuts of around 800.000 jobs expected.

- Although the private sector is expected to create jobs, particularly as economic growth picks up speed, this fiscal drag from the public sector means that the unemployment rate is likely to stay elevated.

- The unemployment rate is not projected to reach anything like its pre financial crisis levels before 2018 – a further factor weighing down on the potential levels of wage growth.



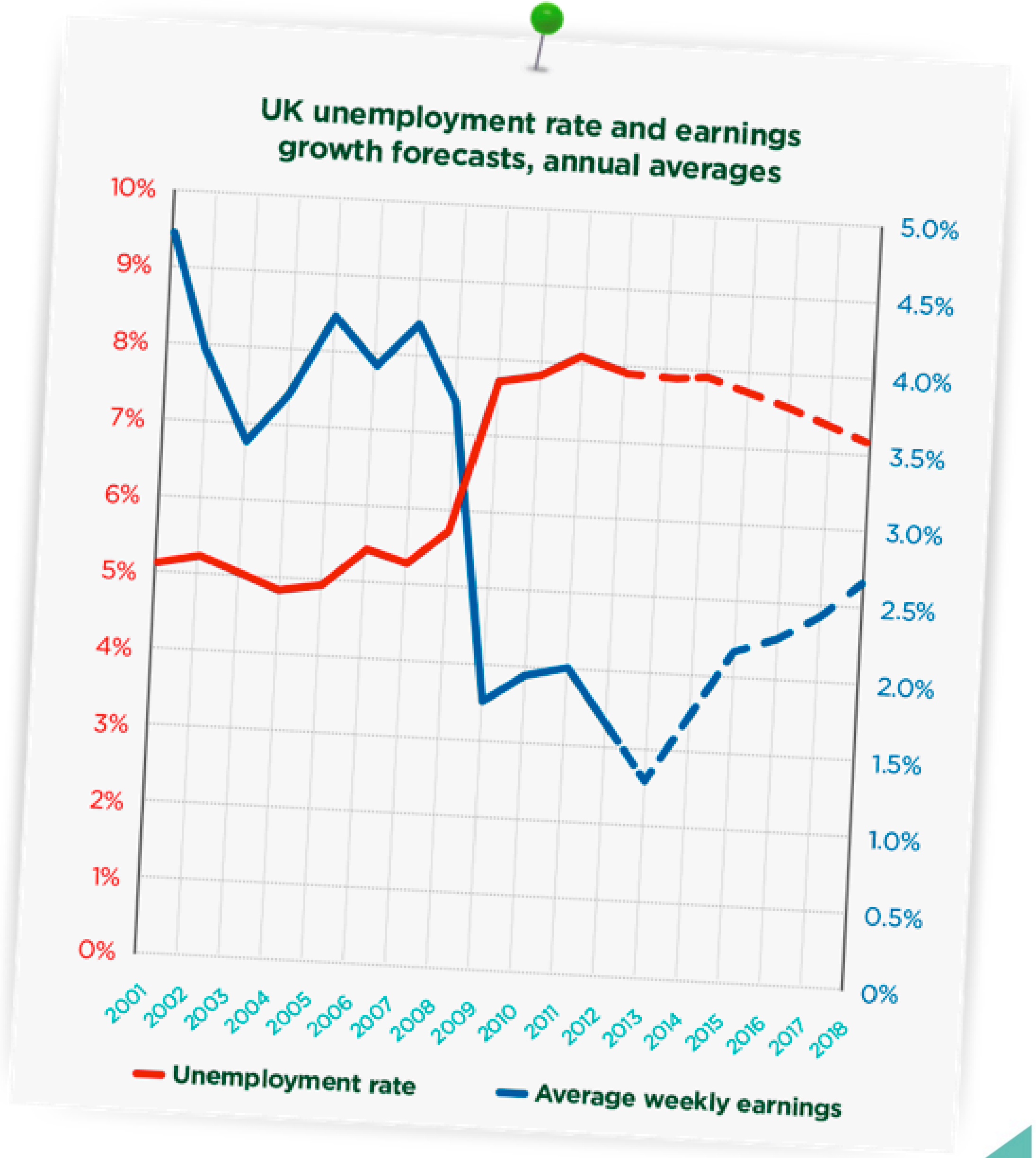
Overall, UK employment conditions expected to remain tougher than pre financial crisis

Unemployment to remain higher and wage growth to continue lower than in years to 2008

- Although labour market conditions will gradually ease in the years to 2018, it is expected to take longer than our forecast period for conditions to return to those seen before the financial crisis.

- Although private sector net job creation is expected to help bring down joblessness, public sector job cuts will prevent the unemployment rate from falling further.

- With the unemployment rate remaining elevated, wage bargaining power for those in work is reduced. This effect, in combination with relatively weak economic growth, will prevent earnings growth from returning to pre financial crisis levels during our forecast period.



Bank of England keeping rates on hold for now as economic growth remains weak

However, a rate increase is likely once the recovery starts to build up steam

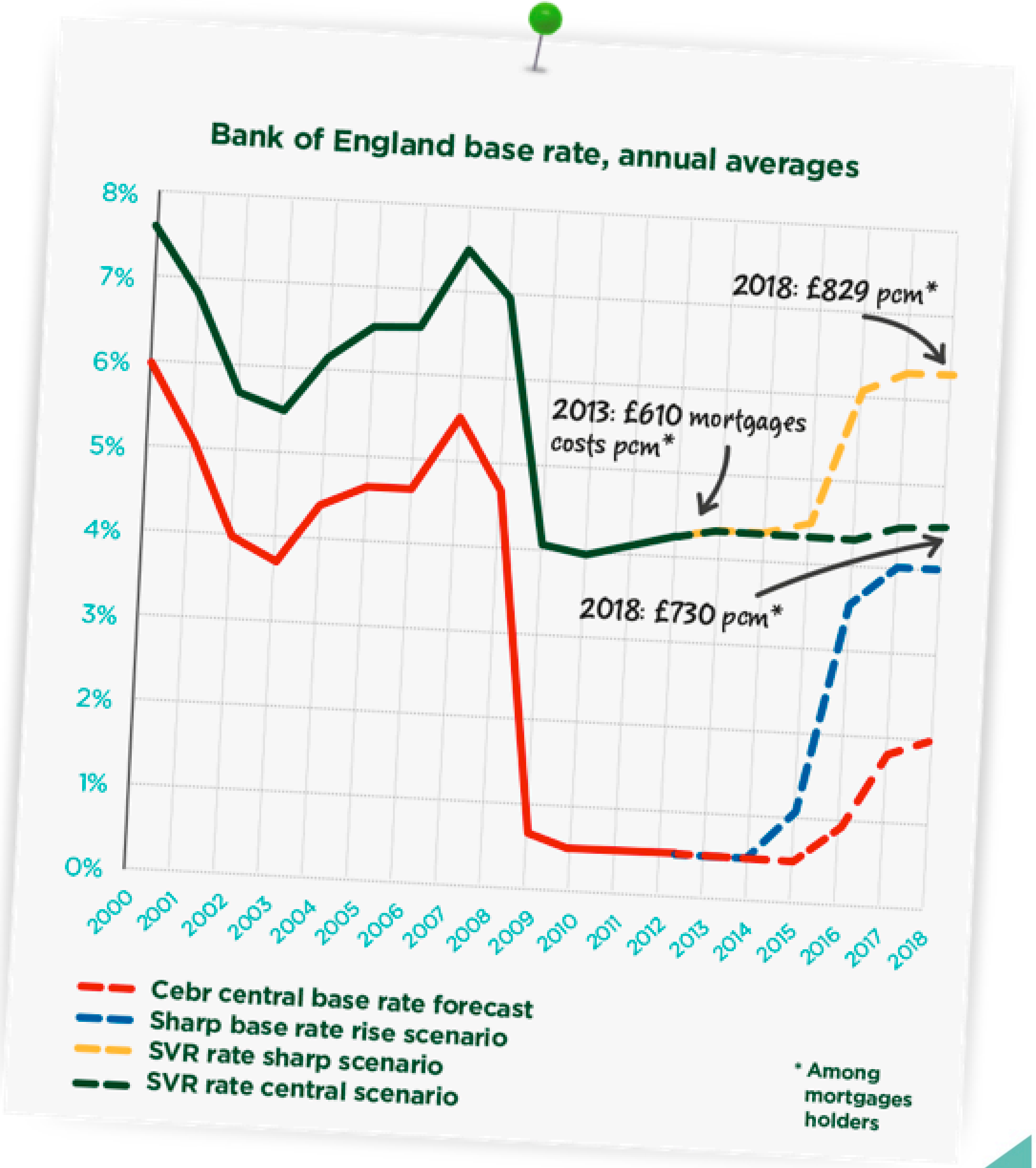
- The Bank of England cut rates sharply as a result of the financial crisis and recession of 2008-09.

- The Bank announced forward guidance, that it will start to consider raising the base rate if unemployment falls to 7.0%, which it expects to happen in 2016.

- However, there are 'knockout' clauses specified in the August *Inflation Report* – notably, if CPI inflation is expected at 2.5% or higher 18-24 months ahead.

- Although Cebr's central forecast has unemployment reaching 7.0% after 2018, we expect inflation to remain around 2.5% and as such, the Bank will invoke their knockout clause. We expect rates to start rising in 2016, ultimately reaching 2.0%.

- An alternative modelled scenario looks at a sharp rate rise following the 2015 UK election, to defend sterling as markets react to a loss of credibility on deficit reduction – in this case, rates increase swiftly to 4.0%.



Cost of mortgage interest to increase significantly over next five years

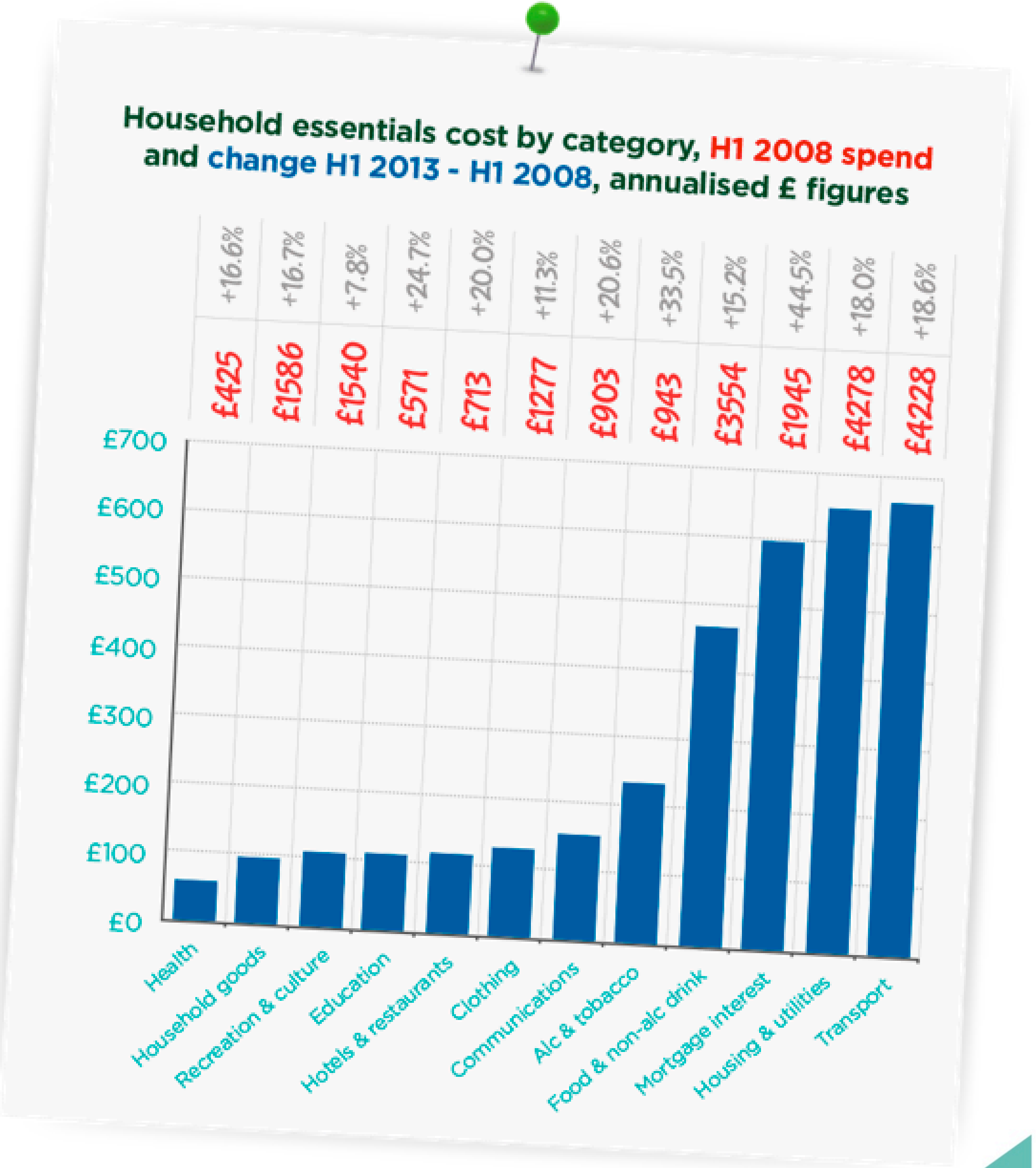
Housing and transport costs also likely to place further pressure on household finances

- The key drivers of increases in the cost of essential spending over the next five years are expected to be transport, housing & utilities and mortgage interest payments.

- The expected increase in the Bank of England's base rate is projected to increase the cost of mortgage interest payments by £540 on an annual basis between the first half of 2013 and the first half of 2018.

- Further increases in the cost of crude oil as global demand strengthens are expected to push up the cost of vehicle fuel and utility prices, while a relative scarcity of housing stock is likely to keep rent prices growing.

- Food costs are also likely to be a key contributor to increases in the cost of living, with the cost expected to rise by an annualised figure of £340 over the next five years, as world demand for food increases, pushing up prices.



Our central scenario implies four years of stagnation on income tracker ahead

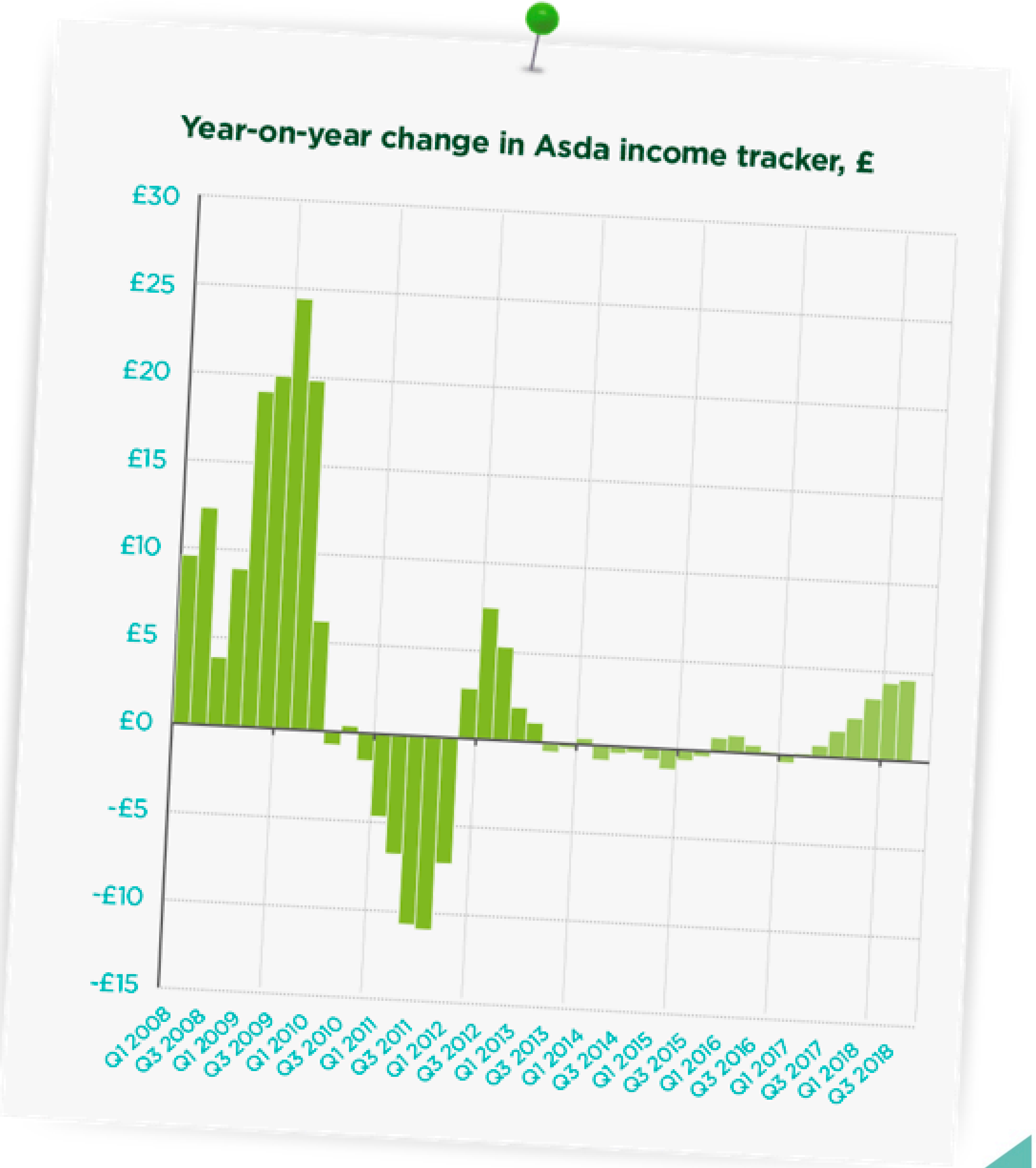
Taken together, these factors mean that discretionary income growth will be held back

- Although the recent declines in the Income Tracker are not expected to deteriorate much further, very little year on year growth is projected for much of the years out to the end of 2017.

- This is due to the effect of continued weakness in wage and employment growth, sustained elevated increases in the cost of living, and the effects of fiscal policy and monetary policy.

- The coalition government has rapidly increased the tax free allowance to £10,000 – but future increases are expected to be slower, in line with wage growth. In addition, benefits cuts are limited to 1.0% year on year until 2016.

- Furthermore, the Bank of England is expected to start increasing base rates in 2016, ultimately reaching 2.0% in 2017.



Discretionary income to remain below 2009 peak until at least 2018

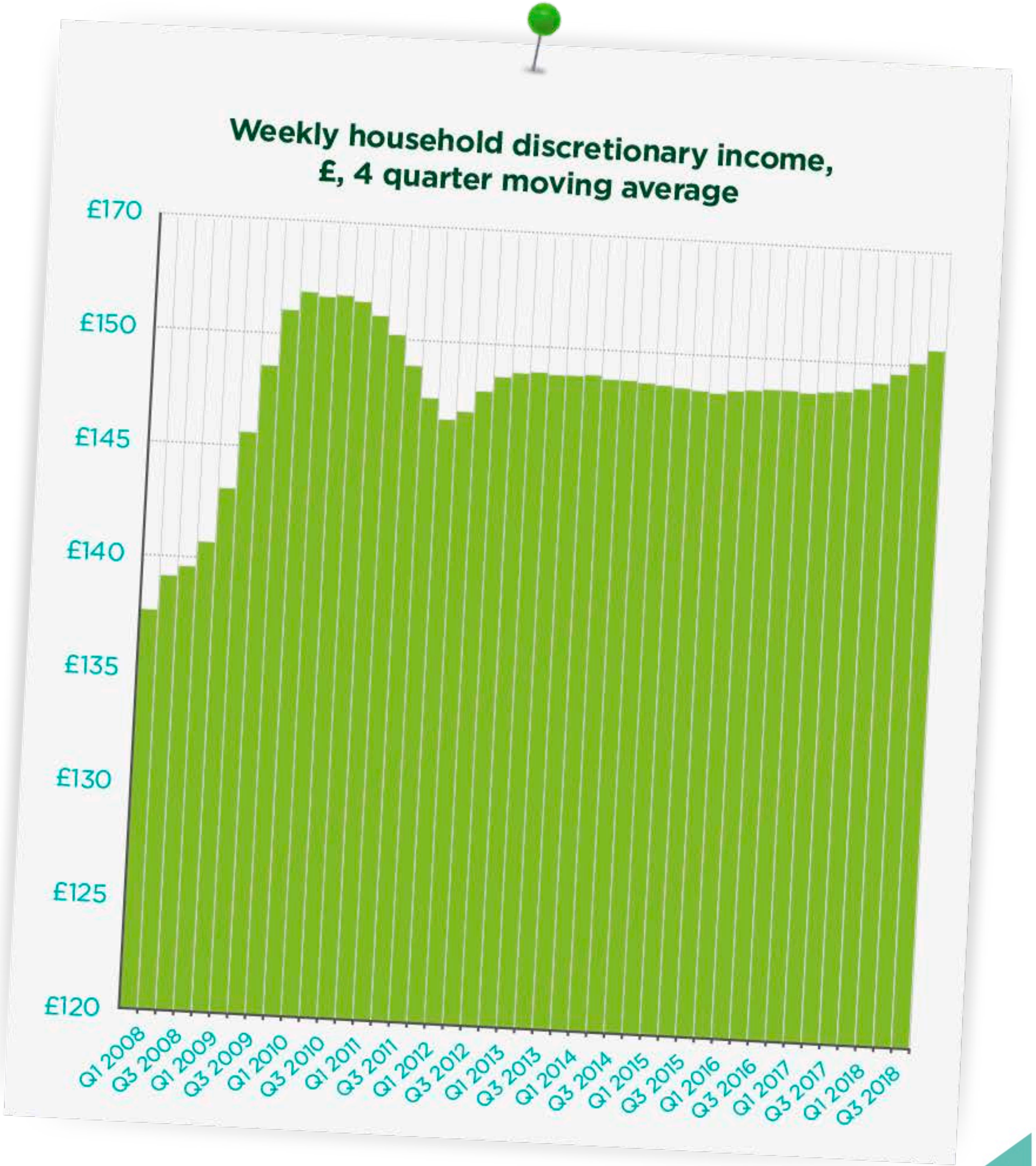
No significant change on the Income Tracker for the next three years

• The result of this stagnation in the Income Tracker is that the pre financial crisis peak in discretionary incomes seen in 2009 is unlikely to be reached for the next few years.

• As it is likely to be 2018 before incomes start to rise significantly again, the level of household discretionary income is projected to remain at or below the £160 a week mark for the next four years.

• In 2018, the level of discretionary income is projected to start rising further above this level, but still remain below the quarterly maximum level of £165.

• When the effects of price rises in non-essential items is considered, the spending power of the average UK household will be falling further – this £160 a week will buy less each year.



Constructing the Asda Income Tracker

Total household income
H1 2013: £702 per week
H1 2018: £785 per week

e.g. wages, investment income, pensions, social security, self employment earnings

–

e.g. national insurance contributions, income tax

Taxes
H1 2013: £119 per week
H1 2018: £125 per week

=

Net income
H1 2013: £583 per week
H1 2018: £660 per week

i.e. take home pay

Net income
H1 2013: £583 per week
H1 2018: £660 per week

i.e. take home pay

–

e.g. food, clothing, housing costs, bills, transport, communication costs, health, children's schooling, house maintenance and repair

Cost of living
H1 2013: £426 per week
H1 2018: £501 per week

=

Family spending power
H1 2013: £157 per week
H1 2018: £159 per week

e.g. holidays, cinema, theatre, eating out, toys, sports, savings, jewellery, national lottery and other gambling payments, computer software and games

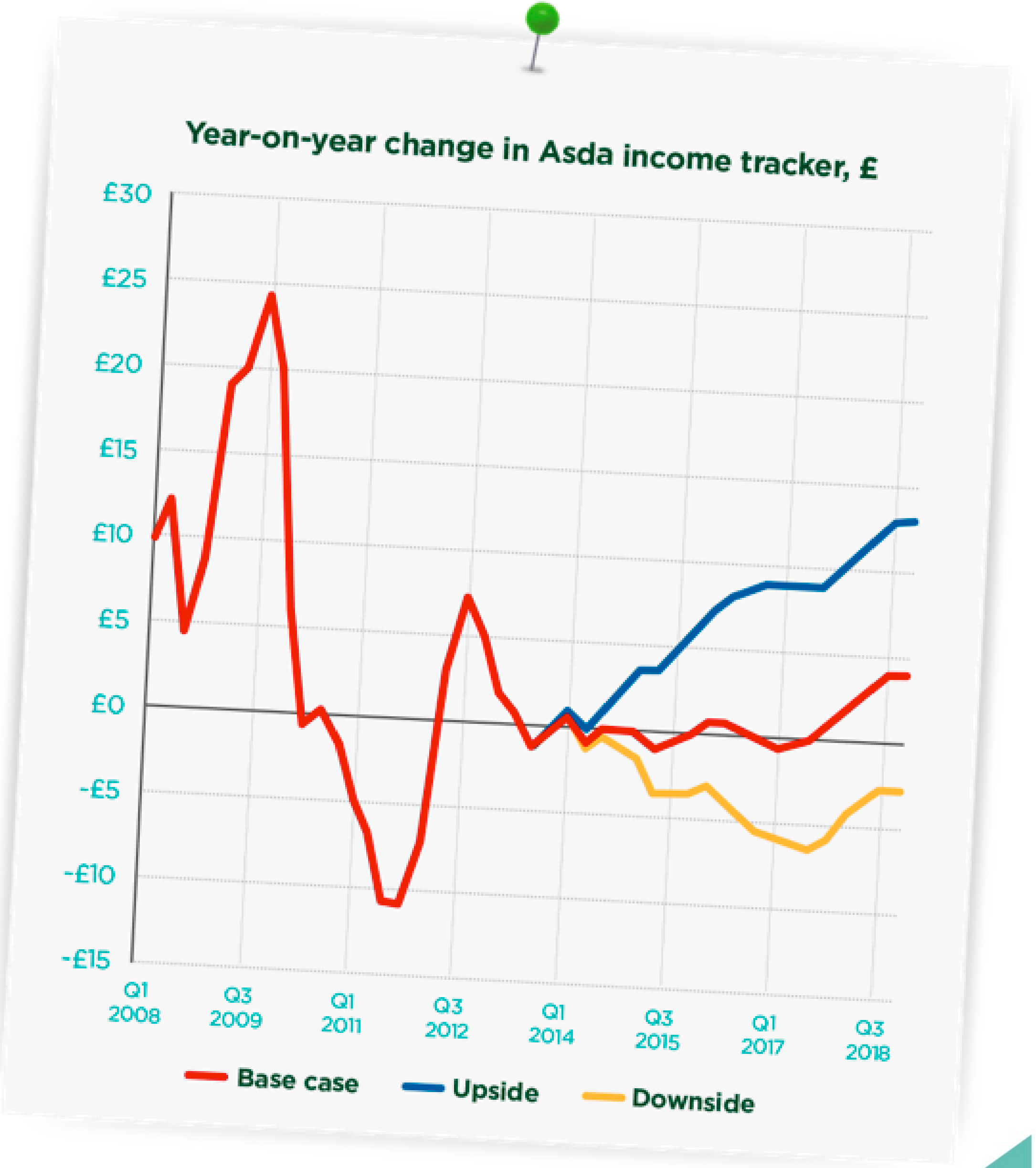
Discretionary incomes return to growth in 2014 under rosier OBR scenario

The OBR's central scenario is for a much faster return to growth than in Cebr's central forecast

- The forecast for the Income Tracker is based on the central forecast from Cebr's UK economic model. However, there are risks around this forecast and here we look at two alternative scenarios.

- The Office for Budget Responsibility (OBR) predicts a much faster return to economic growth, with resulting faster increases in wage growth and reductions in unemployment. Under this scenario, discretionary incomes would start rising year on year by 2014, with much faster annual growth appearing towards the end of the forecast period.

- There are also downside risks. If the Eurozone sovereign debt crisis flared up again, slowing UK and global growth, discretionary incomes could fall further – particularly if further fiscal austerity measures are required. While we attach a relatively low possibility to this, another worsening of the Euro crisis cannot be ruled out.



Keeping the base rate on hold would significantly boost spending power

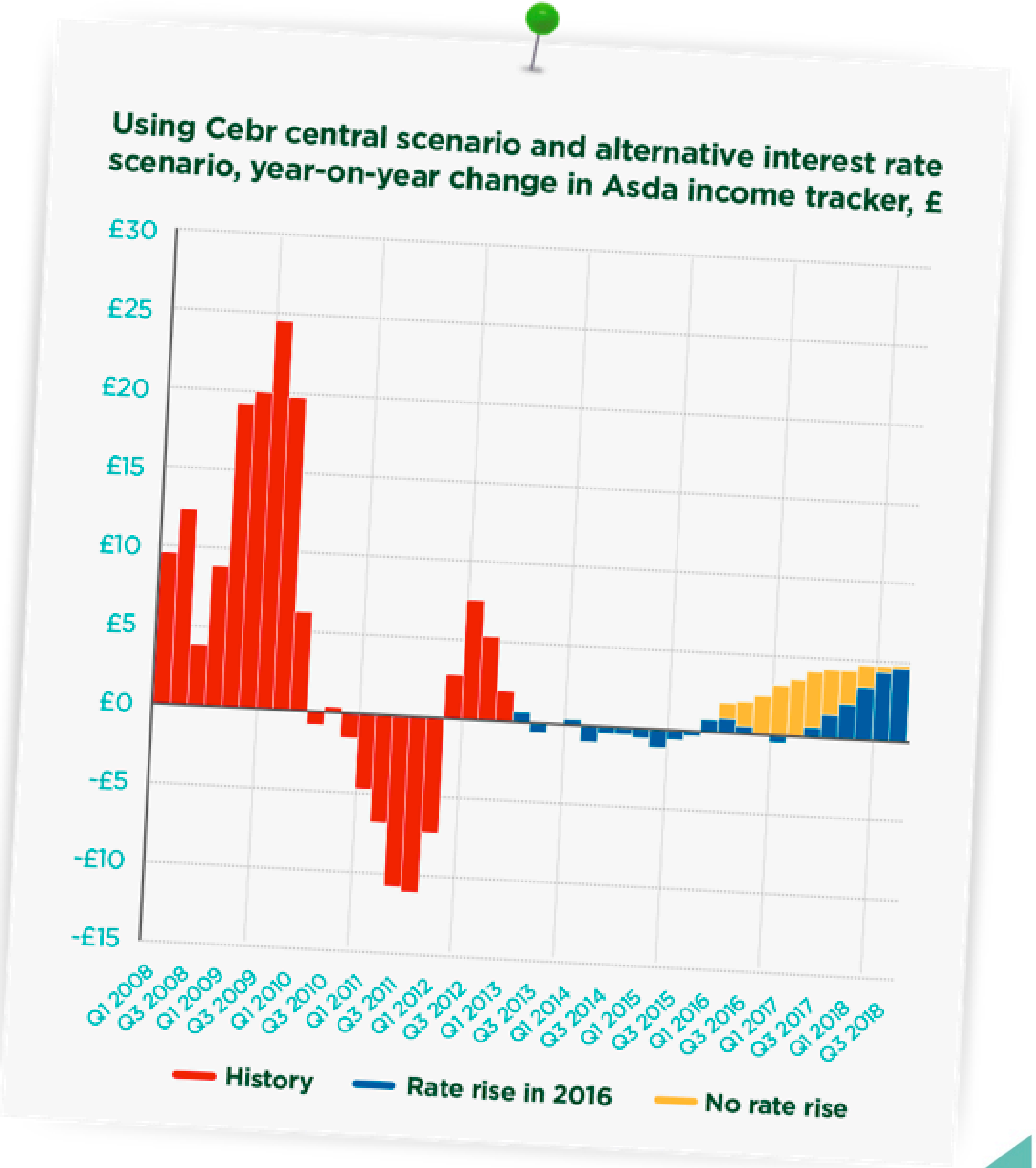
Holding off a rate rise could boost discretionary incomes by more than £4 a week much sooner

- The central forecast assumes the Bank of England gradually increasing the base rate in 2016 as economic growth picks up, reaching 2.0% in 2017 from its current level of 0.5%.

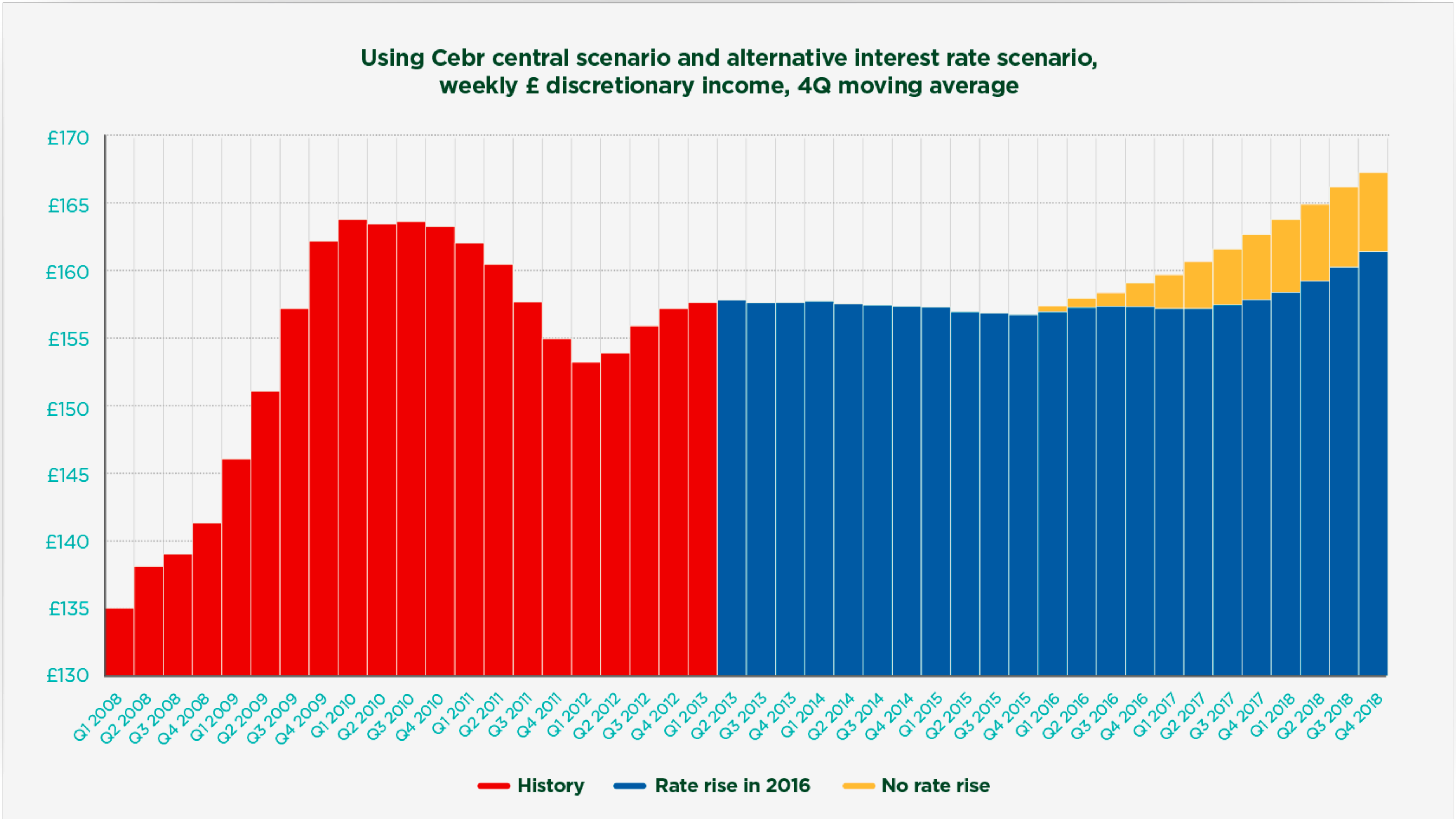
- However, if under the central scenario, the Monetary Policy Committee don't invoke the inflation knockout clause and wait for unemployment to reach 7.0%, rates could stay on hold until 2018.

- As such, discretionary incomes would start rising faster much sooner, reaching £4 a week year on year increases (or over £200 in annualised terms) in 2017 instead of 2018.

- Of course the income squeeze from raising rates will come at some point, but if it is held off until incomes are rising more robustly then it may not result in further declines to discretionary spending power.



Keeping the base rate on hold would significantly boost spending power



An aggressive monetary tightening post-election would sharply reduce spending power

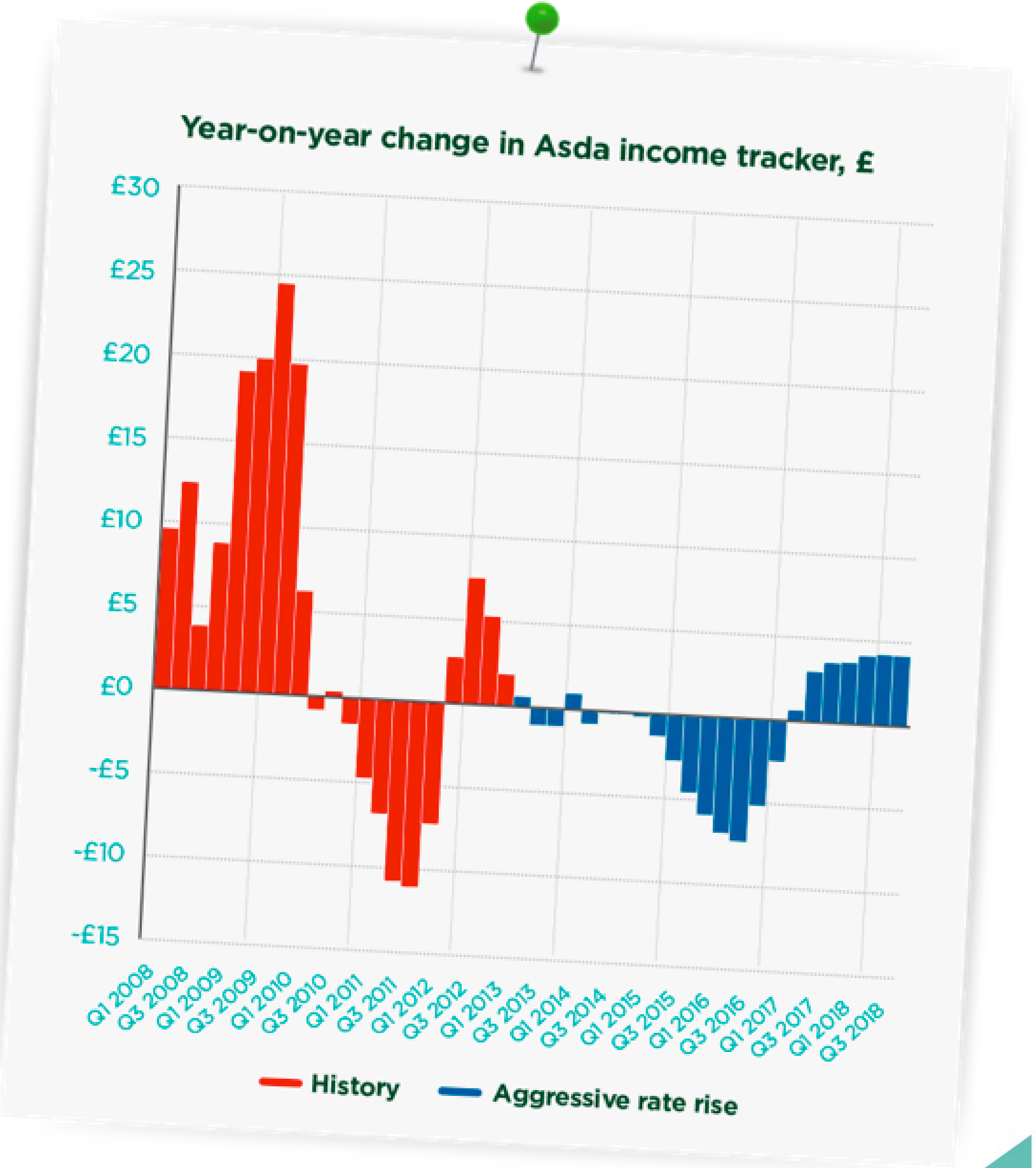
A significant and sudden increase in the base rate would cut deep into spending power

- An alternative modelled scenario to gradually raising rates in 2016 is a sharp increase following the next government election in 2015.

- Failure to take tough policy decisions could lead to a loss of credibility on deficit reduction and investors taking flight from sterling under this scenario – the Bank of England may be forced to raise rates to defend the value of UK currency.

- Although this is a more extreme scenario than our central assumption, it highlights the extent to which discretionary incomes are at risk from changes to the base rate, even if Governor Mark Carney has been at pains to reassure households and businesses that a rate rise remains a way off for now.

- Here we assume the Bank raising rates to 4.0% from the current level of 0.5%. The result is a year on year decline in spending power of more than £7 a week (4.8%) or £390 in annualised terms, before recovery comes in late 2017.



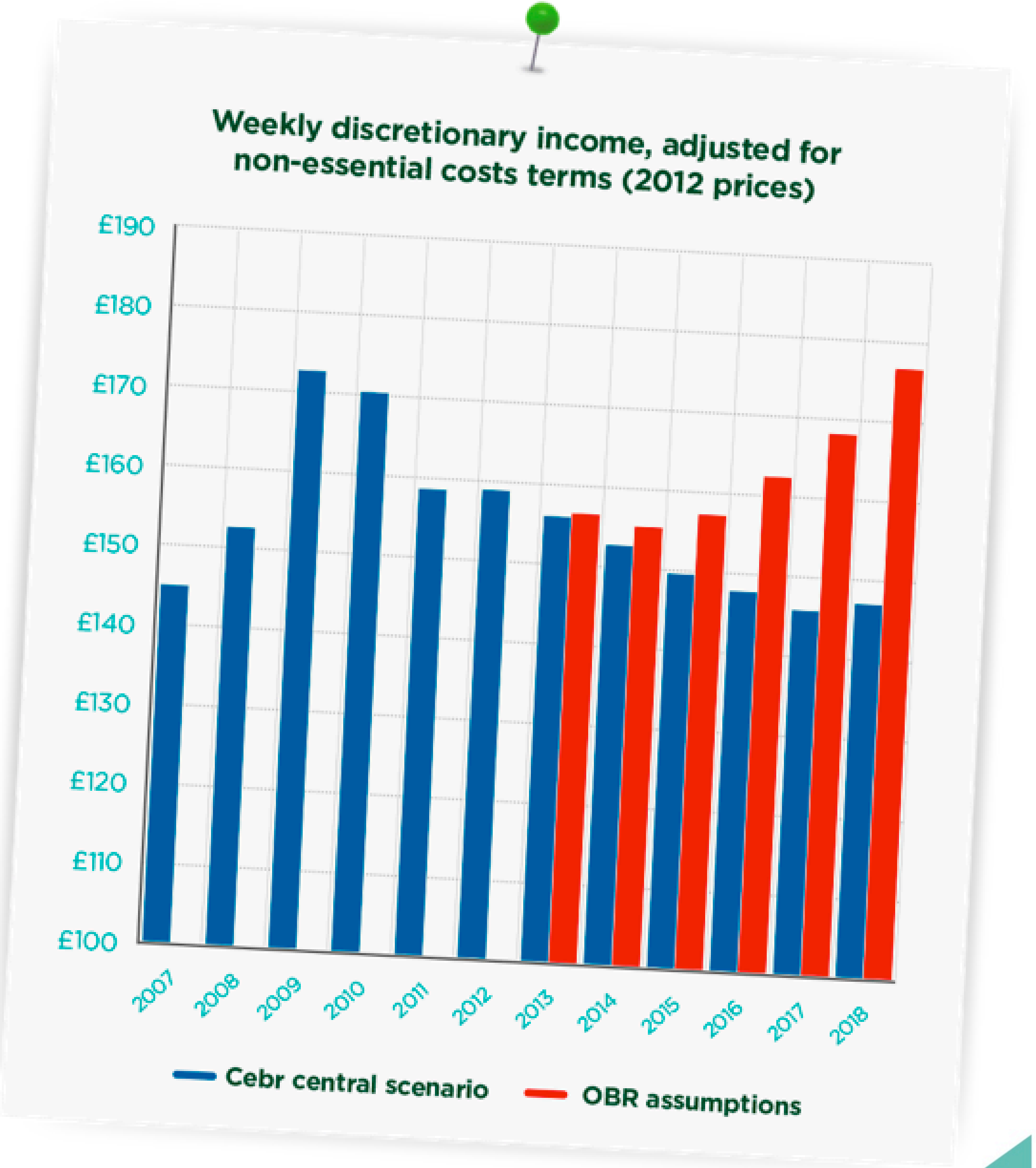
However, adjusting for inflation, spending power faces further erosions

The rising cost of non-essential items means that households can afford less in real terms

- In Cebr's central scenario, discretionary incomes are held back in nominal terms by a combination of weak wage and employment growth and continued increases in the cost of living.

- Once the effect of increases in the cost of non-essential items is taken into account however, discretionary incomes are expected to see further declines in real terms – only starting to recover by 2018.

- However, even using the assumptions from the Office for Budget Responsibility's forecasts, discretionary spending power is expected to remain below its 2009 peak in real terms until 2018 – effectively nine years before household financial positions reach regain where they once were.



Analysing the effects on lower and higher income groups

- In this section we consider different types of household, focussing on the different pressures being faced by both higher and lower income households.

- For our lower income household, we consider those in the second income quintile – that is, the fifth richer than the poorest fifth, but with lower income than all other households. For the higher income household, we consider those towards the top of the income distribution – the ninth decile, just below the very highest earners.

- The table below indicates some of the characteristics of these household types.

Household type Figures for 2011 (latest *base* data from ONS)	Average annual gross income	Average annual total spending	Average annual spend on mortgage interest	Average income earned through employment	Average income from social security benefits
Lower income household - second income quintile	£17,800	£14,400	£350	34%	46%
Higher income household – ninth income decile	£60,000	£31,500	£2,700	87%	4%

Strong increases in benefits have boosted incomes of poorer households

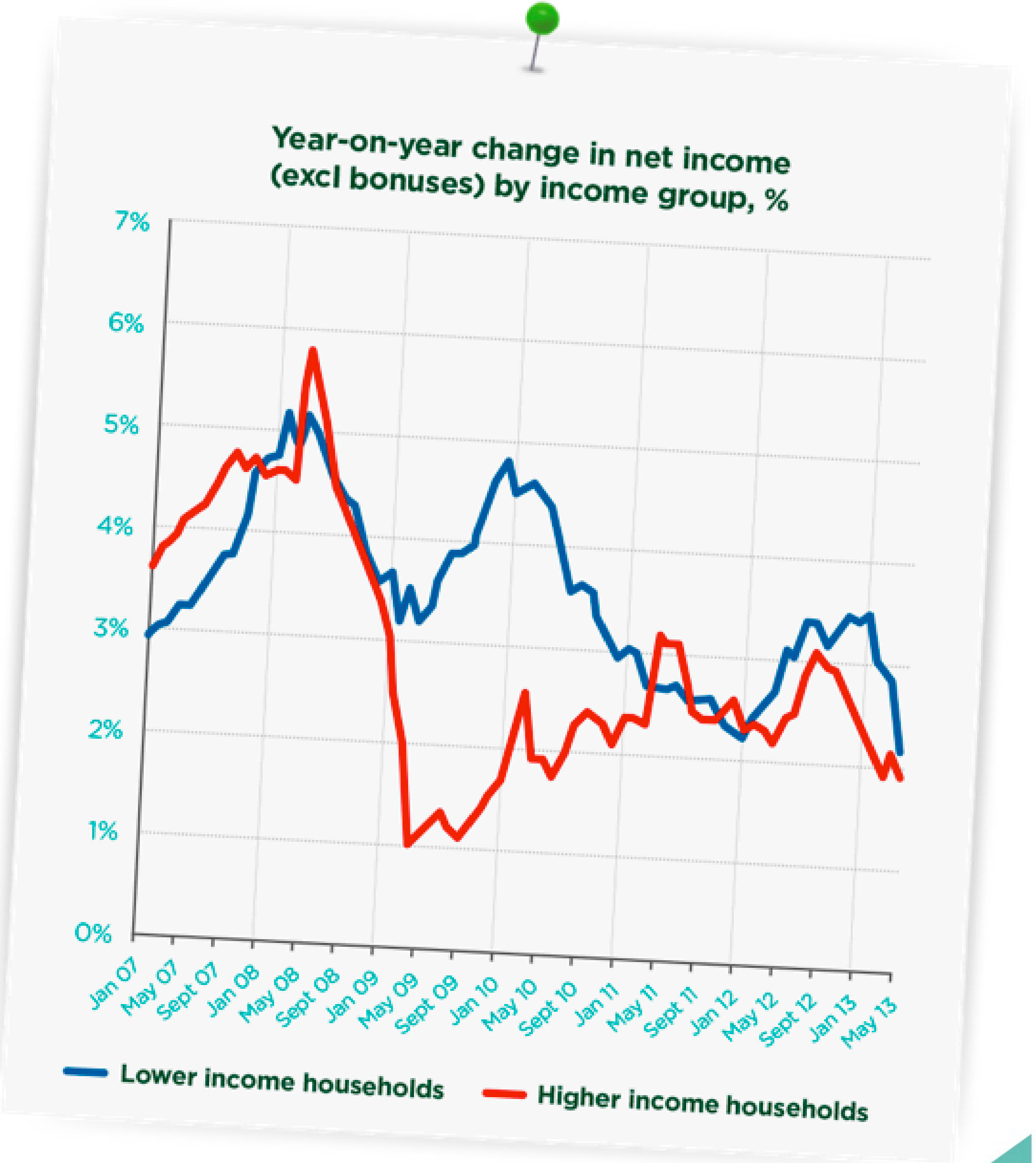
Income growth is slowing for those on both higher and lower incomes

- Income growth for poorer households, which include many retired people, has been supported over the years since the financial crisis by strong increases in social security benefits, which were increased in line with inflation, also running high.

- Conversely, higher-income households have seen their income growth slow significantly since the financial crisis, as weak economic performance has dragged down the pace of wage increases.

- Income for these richer households slowed to near zero growth in 2009 as employment dropped, regular wage increases fell back to just 1.0% and self employment income declined.

- Although employment growth and a slight recovery in wage growth helped to boost income increases in 2011 and earlier in 2012, these effects have been falling back in 2013 and very weak wage growth has persisted.



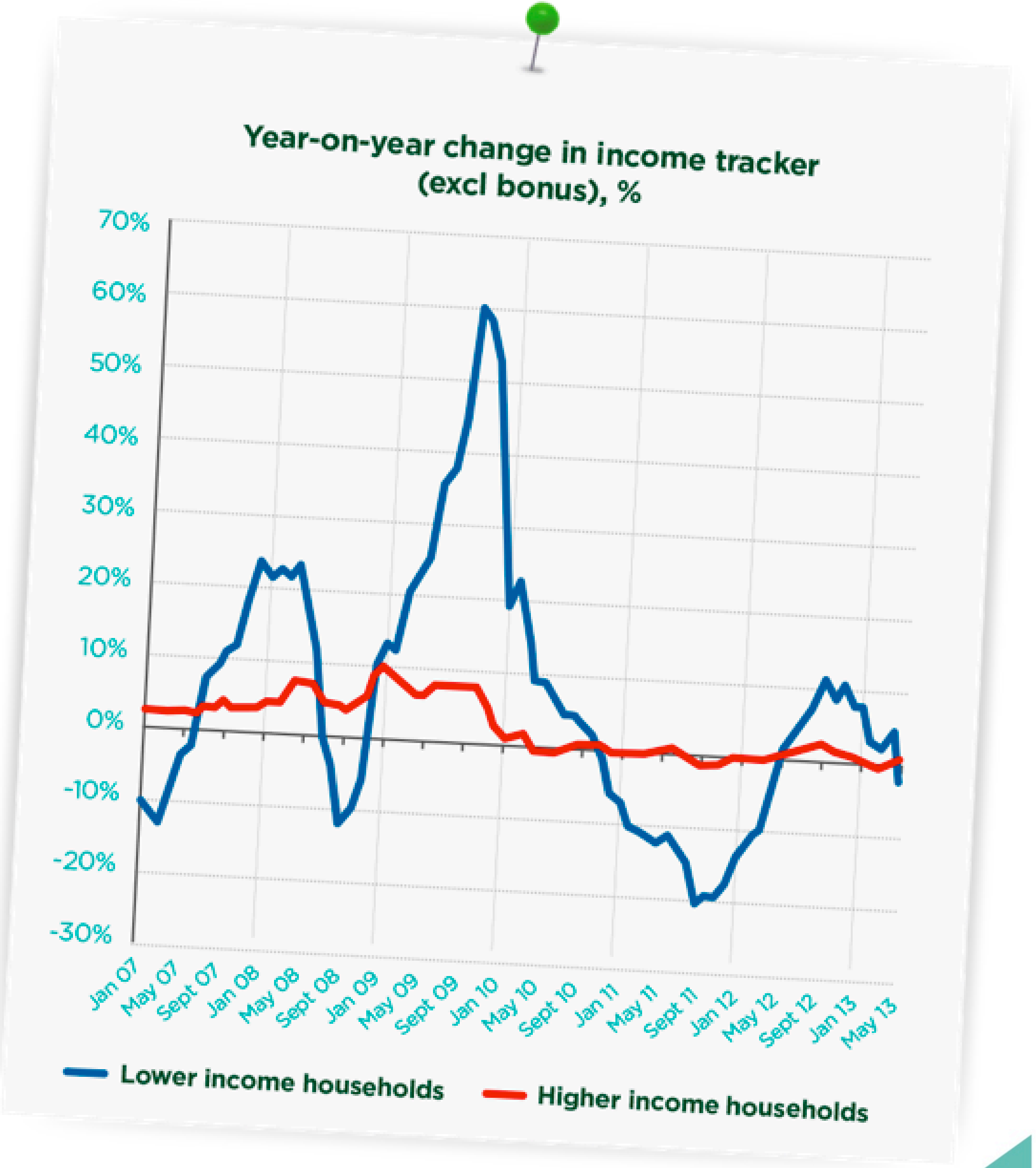
Current economic conditions holding back spending power for both better and worse off

Income Tracker returning to decline for those on higher and lower incomes

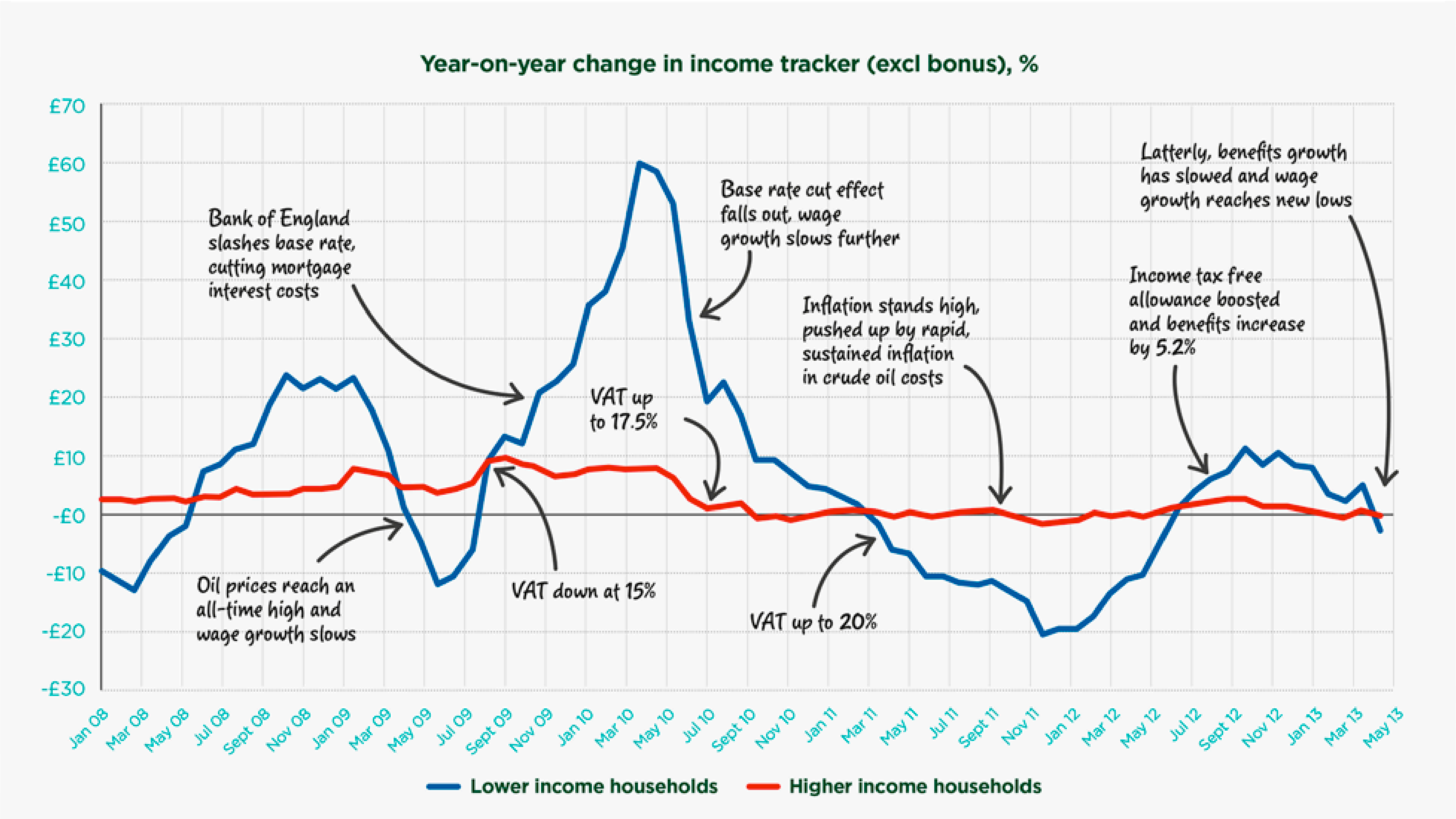
• Poorer households saw their incomes boosted in 2012 by the 5.2% uprating to social security benefits from the previous year. This, combined with cooling inflationary pressures in 2012 and the significant increase to the income tax free personal allowance helped discretionary incomes to show year on year growth through much of 2012 and early 2013.

• However, discretionary spending power started to fall back again for those on lower incomes in April 2013, as despite further increases to the tax free personal allowance, the pace of growth in the cost of living is once again outpacing income increases.

• For those on higher incomes, the very slow pace of wage increases has weighed down on spending power – for these households too, discretionary spending power is in year-on-year decline from May 2013.



Visualising the effects on discretionary income



Austerity measures to hold back income growth among lower income households

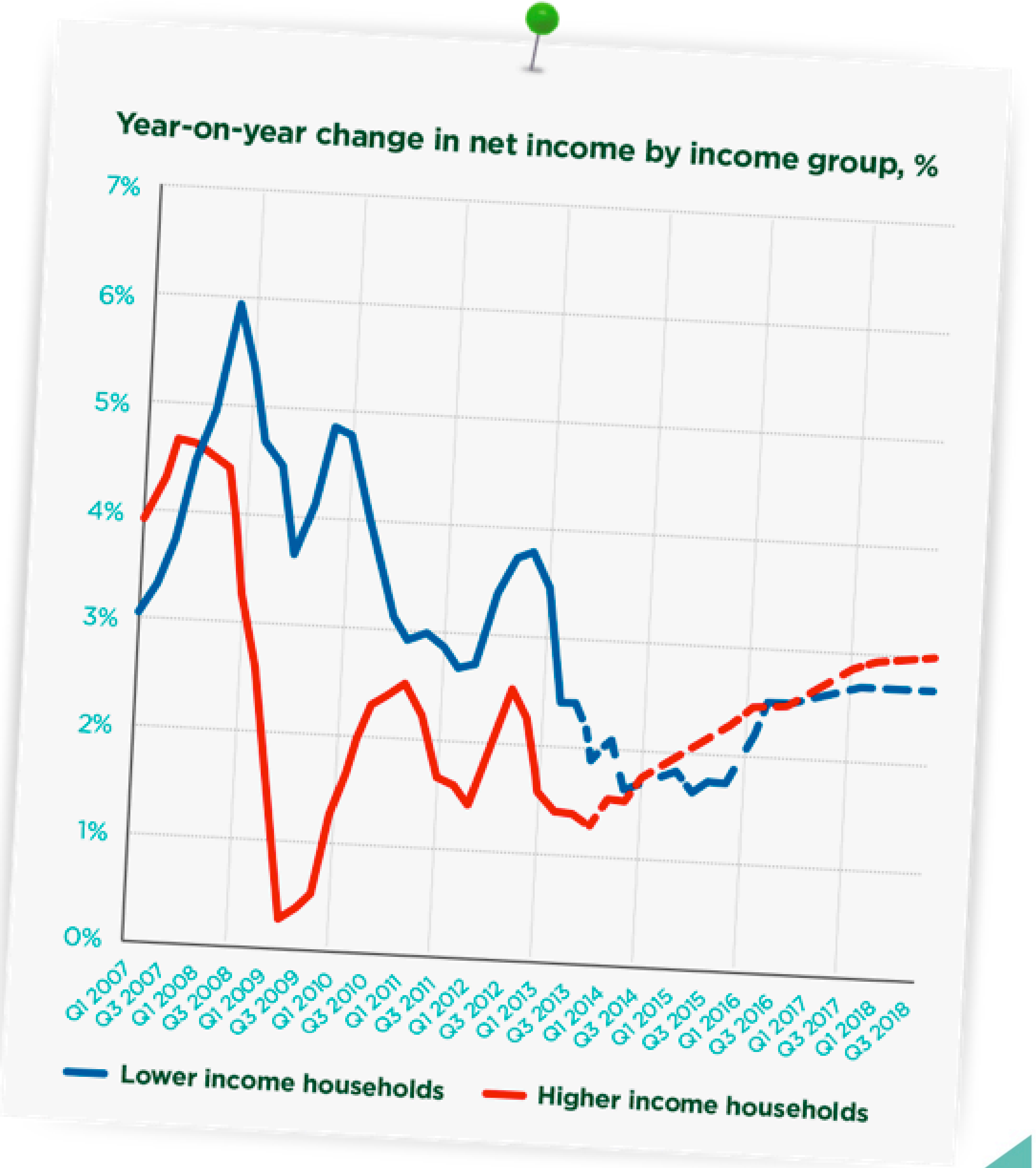
But accelerating wage growth will help boost those on higher incomes

- The 1% uprating cap in many benefits is to continue until 2016, significantly holding back income growth for those on lower incomes.

- However, once this cap expires and benefits are again upweighted by inflation, stronger household income growth is expected to return for poorer households.

- Households on higher incomes, who are much less dependent upon social security benefits, are expected to see their income growth boosted from 2014 by rising employment levels and accelerating wage growth.

- However despite the upturn in the outer years of our forecast period, income growth is projected to remain well below that seen before the financial crisis.



Further spending power erosions likely ahead for poorer households

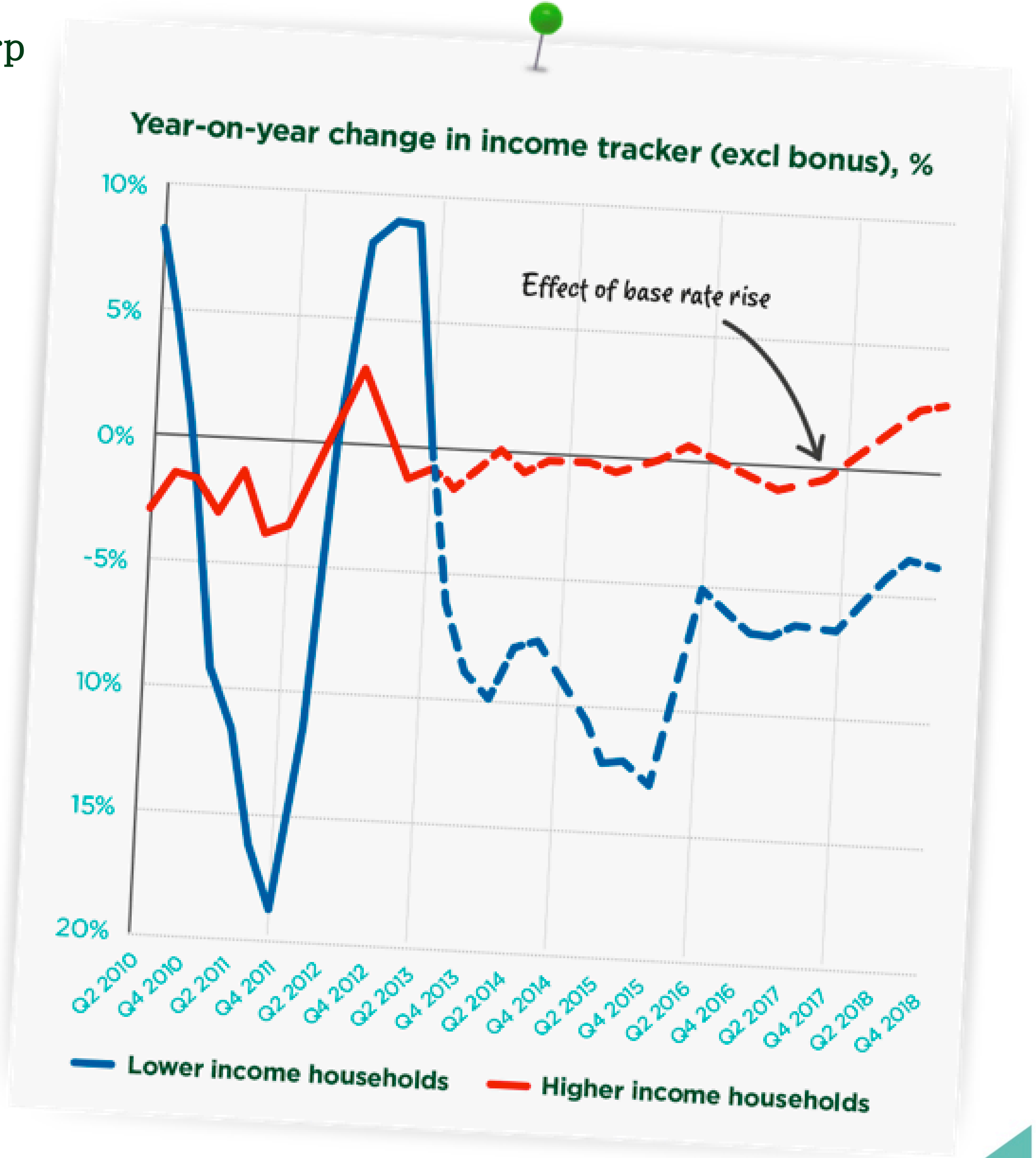
Although annual declines will become less sharp in 2016, they're likely to continue past 2018

• For households on lower incomes, spending power is projected to face further erosions until at least 2018, held back by relatively slow income growth and continued above-trend growth in the cost of essential items.

• However, the year on year decline in weekly discretionary income is projected to become less sharp from April 2016, as the 1% cap in social security benefits upweighting comes to an end.

• Despite this, households on lower incomes are set to have their spending power constrained by weak income increases and elevated cost growth for essentials.

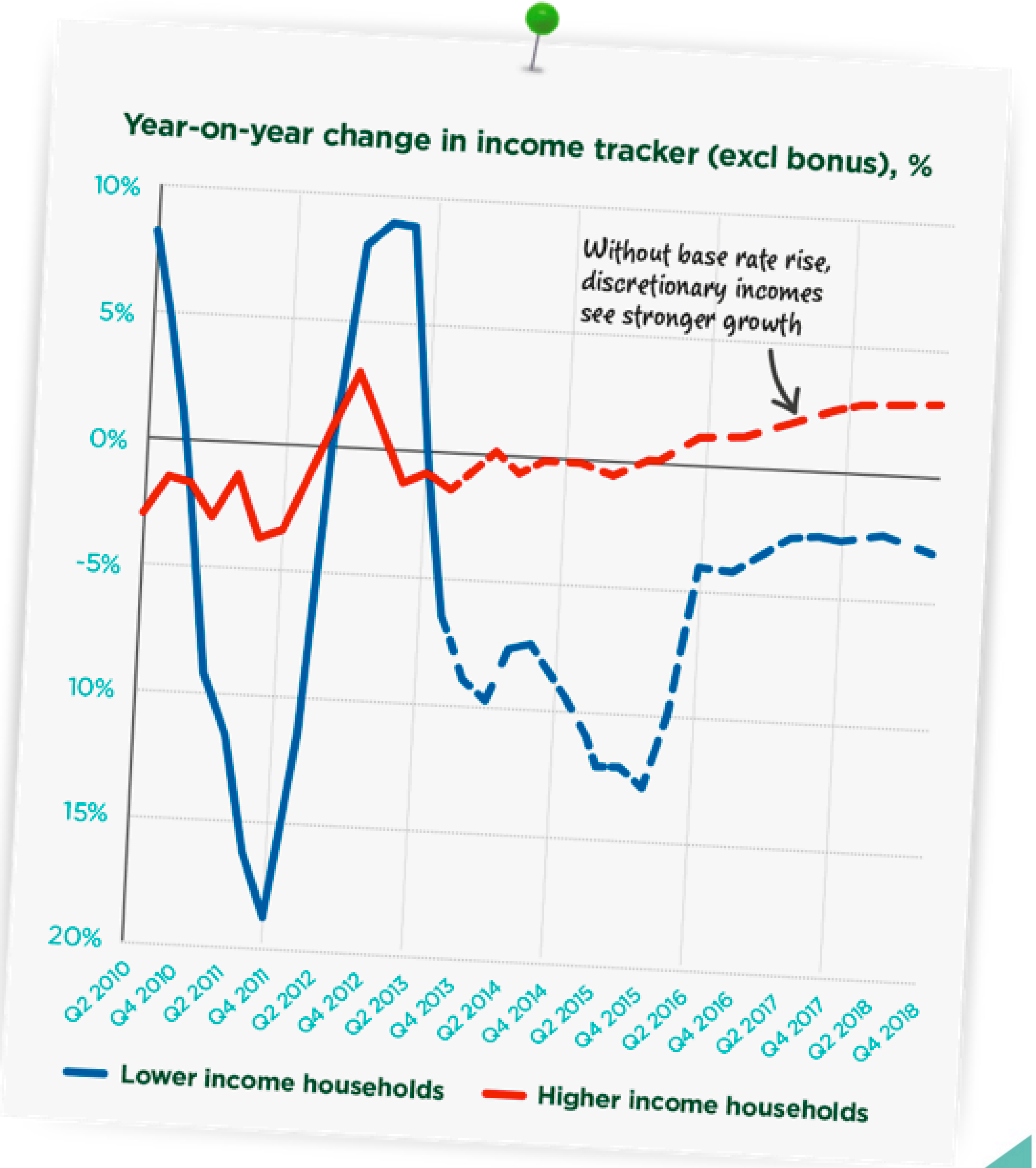
• At the same time, higher income households, relatively unconstrained by the cap on benefits growth, are expected to see slow but steady growth in discretionary spending power over the years to 2018.



Delaying a rate rise would soften the declines to spending power for lower income households

However, higher income households spend a greater share on mortgage interest

- Holding off on increasing the Bank of England's base rate in 2016 would stop the spending power of those on lower incomes from declining as sharply.
- If the rate rise was pushed back to beyond 2018 then discretionary incomes could be falling in 2016 and 2017 by around 3% year on year instead of closer to 7%.
- Delaying the rate rise would also push up the discretionary incomes of richer households. Those on higher incomes spend 3.5% of their weekly incomes on mortgage interest payments, versus 2.1% for those on lower incomes.
- Without the rate rise, discretionary incomes for richer households could be rising by 2.5% year on year instead of closer to 1%.



The lower income group is much more focussed toward older age groups – more than half of households are aged 60 or over

	Second quintile	9th decile
15-34	16%	20%
35-54	24%	55%
55-64	15%	18%
65+	44%	7%

Income group breakdown statistics in detail

Annualised figures	Net Incomes			Cost of Living			Discretionary Incomes		
	2008	**2013**	**2018**	**2008**	**2013**	**2018**	**2008**	**2013**	**2018**
Lower income households	£14,600	£17,200	£19,300	£13,200	£15,400	£18,100	£1,400	£1,700	£1,200
Higher income households	£44,700	£49,900	£56,600	£31,700	£35,500	£42,000	£13,100	£14,400	£14,700

Splitting the UK household population into five groups

- In this section we split households into five different age groups, to examine the effects of recent and forecast economic conditions.

- Households headed by someone aged between 30 and 49 have the highest gross annual income, as well as the greatest spending on mortgages – and hence greatest exposure to interest rate changes. The oldest households spend very little on mortgages, leaving them relatively unexposed to mortgage interest rate changes, although savings income growth will continue to be hit by low interest rates.

- The table below indicates some of the characteristics of these different household types.

Households by age of head of household Figures for 2011 (latest *base* data from ONS)	Average annual gross income	Average annual total spending	Average annual spend on mortgage interest	Average income earned through employment	Average income from social security benefits
Aged under 30	£30,400	£19,500	£970	83%	11%
Age 30 to 49	£46,500	£24,600	£2,300	90%	8%
Age 50 to 64	£41,500	£21,600	£1,100	77%	9%
Age 65 to 74	£25,900	£16,100	£130	22%	39%
Age 75 or over	£19,400	£11,800	£10	5%	50%

Income growth for older households held up well over past five years

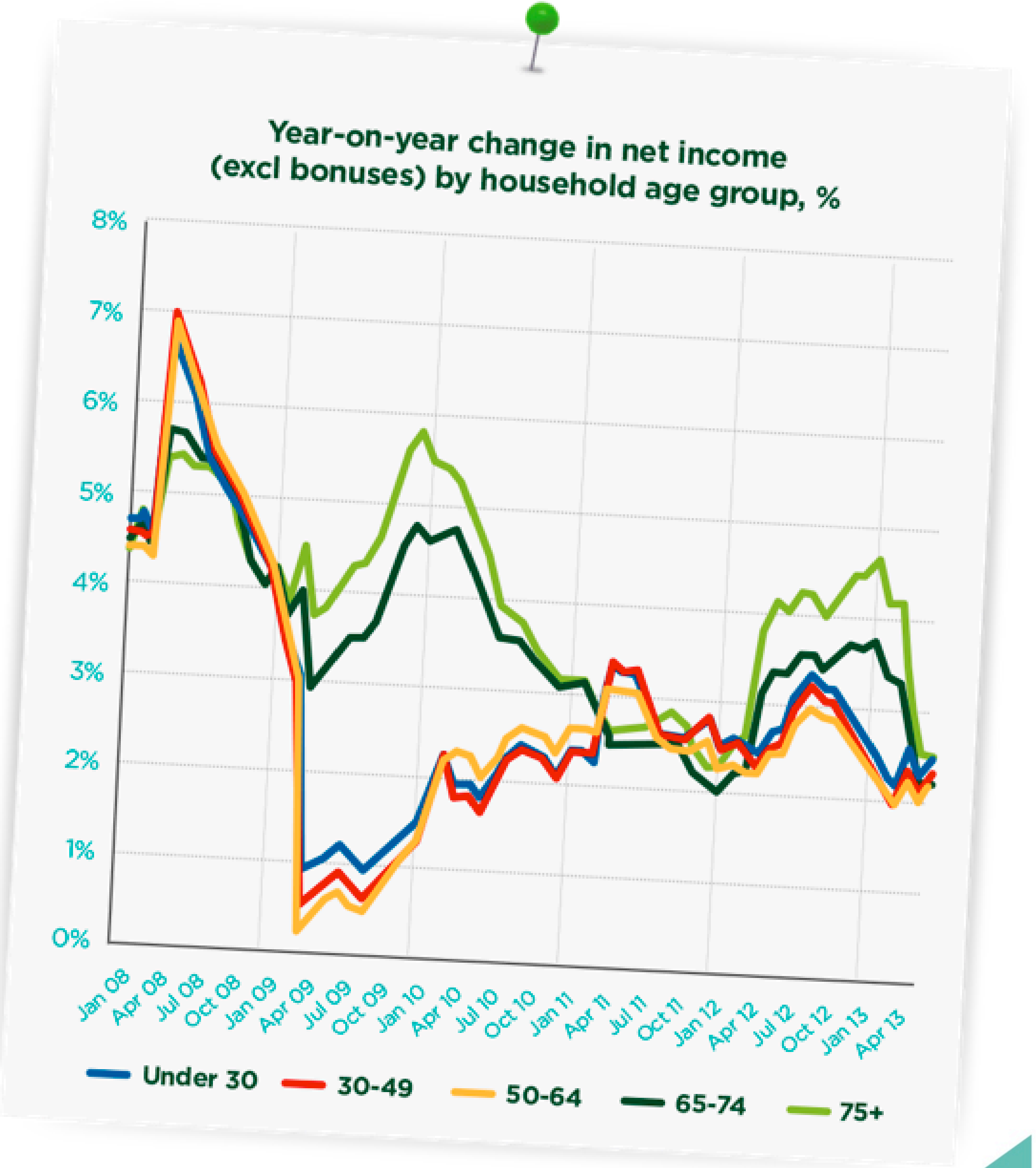
However income growth for all age groups has slowed in recent months

- Net income growth for households where the household head is over the state pension age was boosted over the years between 2009 and 2011 by social security benefits being increased in line with the previous year's inflation level.

- Over the same period, income growth among working age households was held back significantly by sharp reductions in wage growth and an increase in unemployment.

- In 2012, net income growth across age groups was pushed up by increases in the personal income tax free allowance. This had a proportionally larger effect on older households, who typically have a lower overall income.

- However, income growth has been slowing in recent months due to the much lower uprating of benefits in 2013 compared to 2012.



Pension 'triple lock' to support income growth of older households

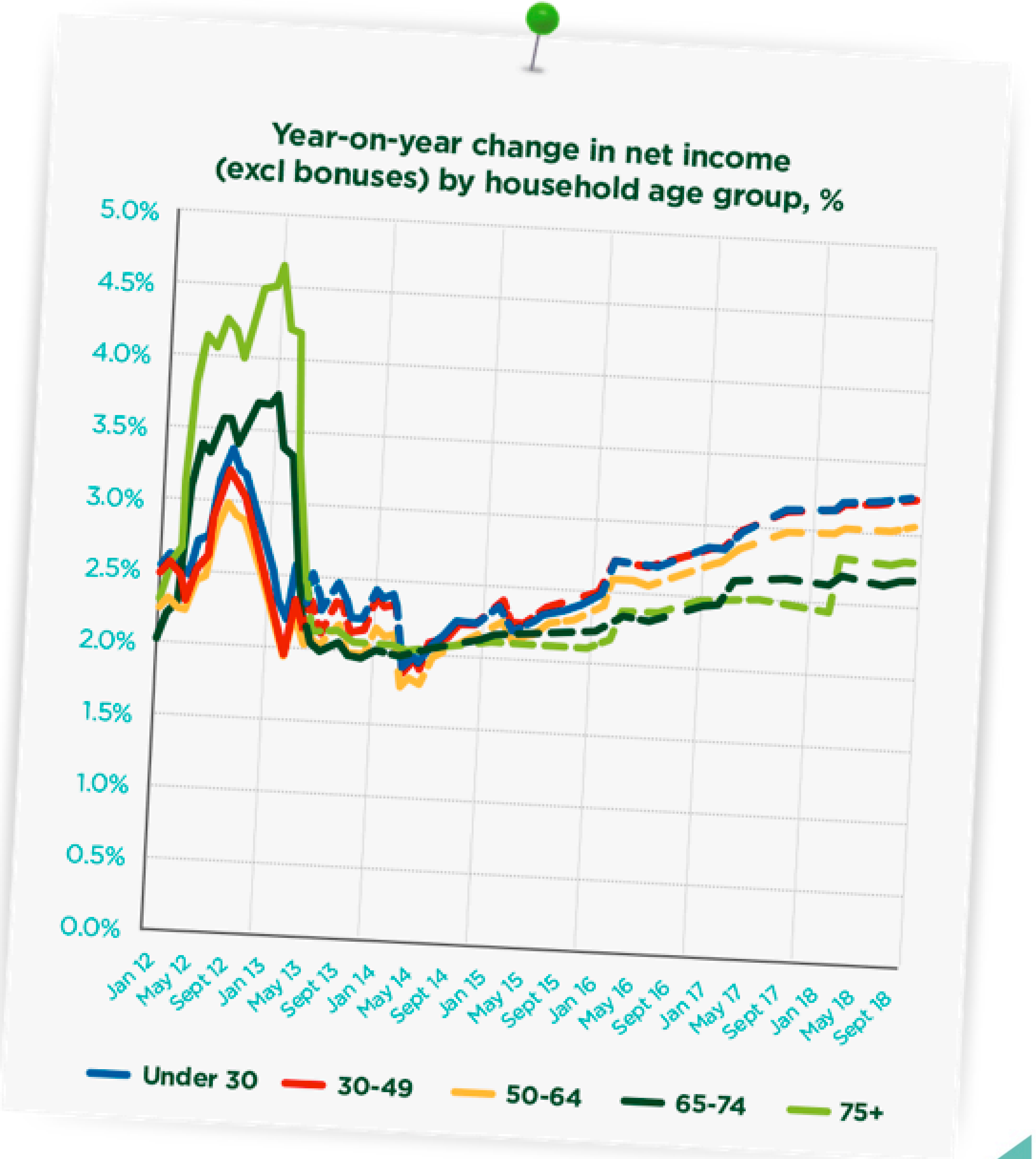
However by 2018, income growth at younger households will be growing the fastest

• State pensions are being safeguarded over the next few years by the 'triple lock' – where pension income rises by wages, CPI inflation or 2.5%, whichever is highest.

• This guarantee will support growth in net incomes for older households over the coming few years, while households more dependent on working age benefits and earned income continue to see subdued income growth.

• However, the decision to simplify age-related income taxes means that the income tax free personal allowance for those aged over 65 will be left on hold until the working-age allowance catches up.

• Once wage growth starts to pick up and the 1% growth cap in working age benefits comes to an end, income growth among younger households is set to outpace that of retired households.



Youngest households have faced the largest declines in discretionary income

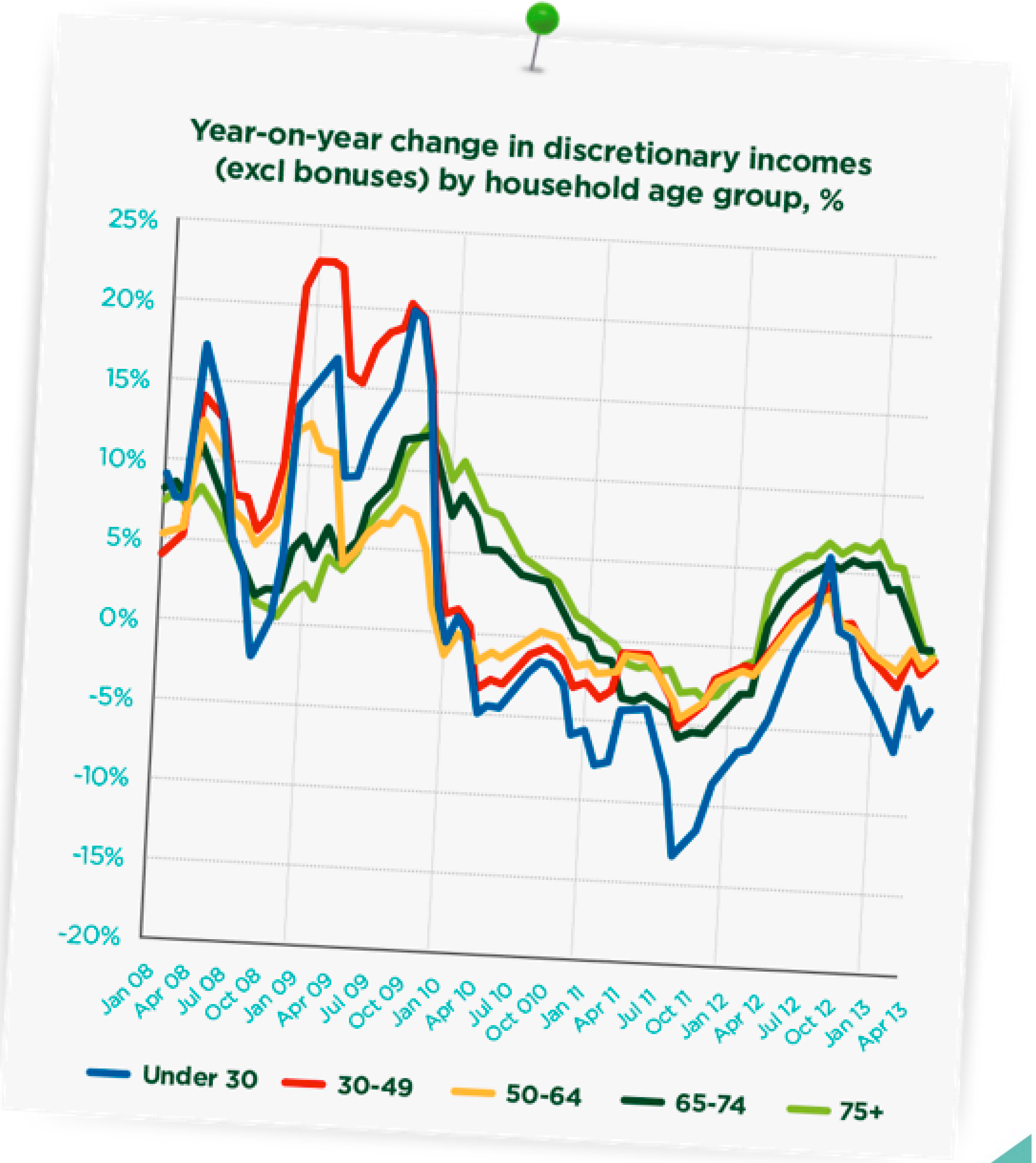
Spending power for retirement age households has been more resilient

• Households where the head is aged under 30 have seen the fastest increases in the cost of living of any working age household over the past five years, with an average annual inflation rate of 3.3%, compared to 2.5% for 30-49 year olds and 3.1% for 50-64 year olds.

• These younger households spend a greater share of their budgets on transport, rent and utilities and as such were the most affected by the sharp increases in the cost of energy over the past five years. Rapid growth in the cost of crude oil sent petrol and home electricity and gas prices soaring in 2011.

• In addition, households with heads aged under 30 faced less of a mortgage burden compared to those aged 30-49 and as such, were able to benefit less from the cut in mortgage interest.

• Labour market conditions for the UK's youngest are particularly tough, with unemployment rates of 38.1% in Q2 2013 for those aged 16-17, and 19.2% for those aged 18-24.



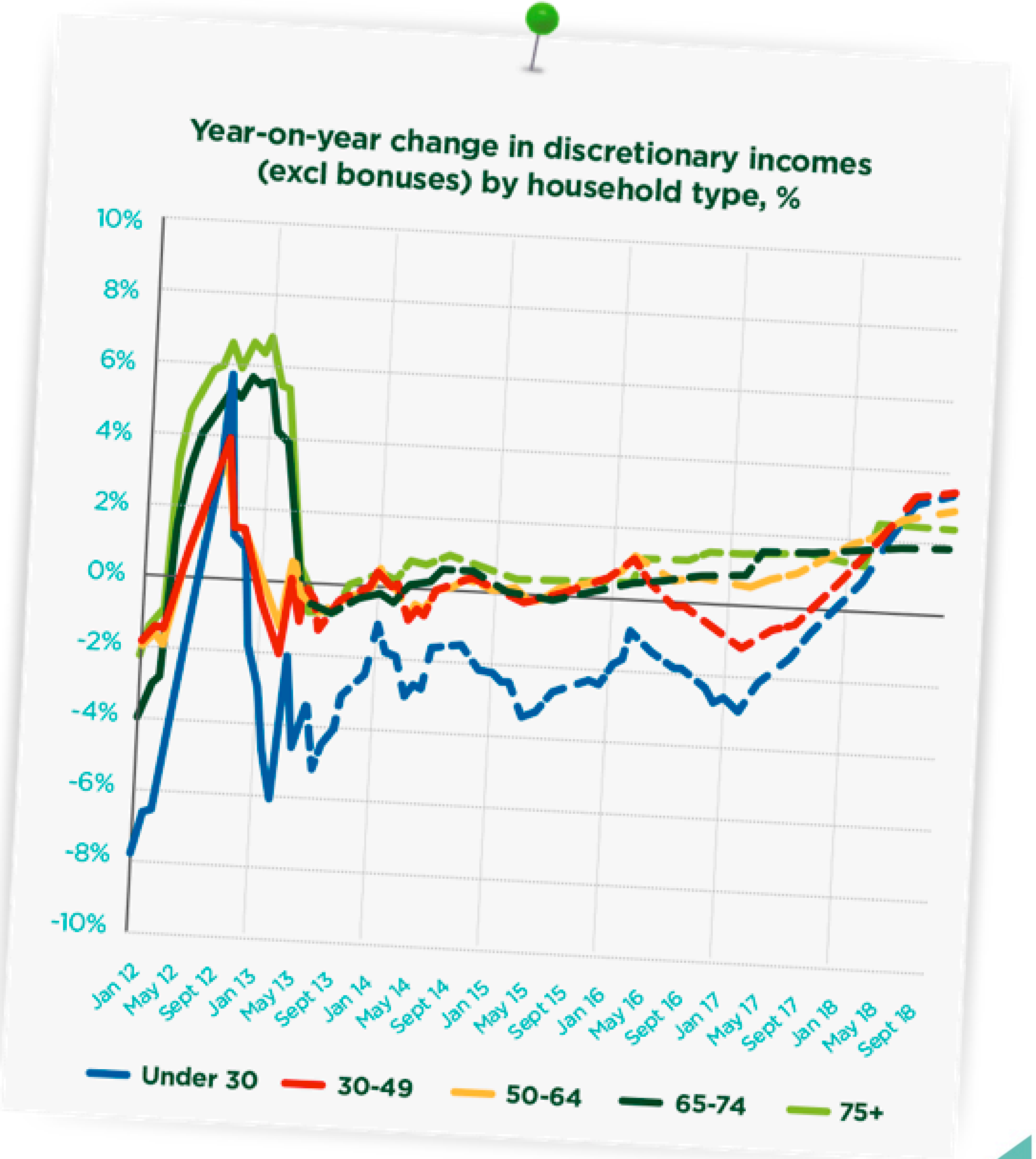
Further spending power losses likely ahead for younger households

However, all households expected to see growth in discretionary incomes by 2018

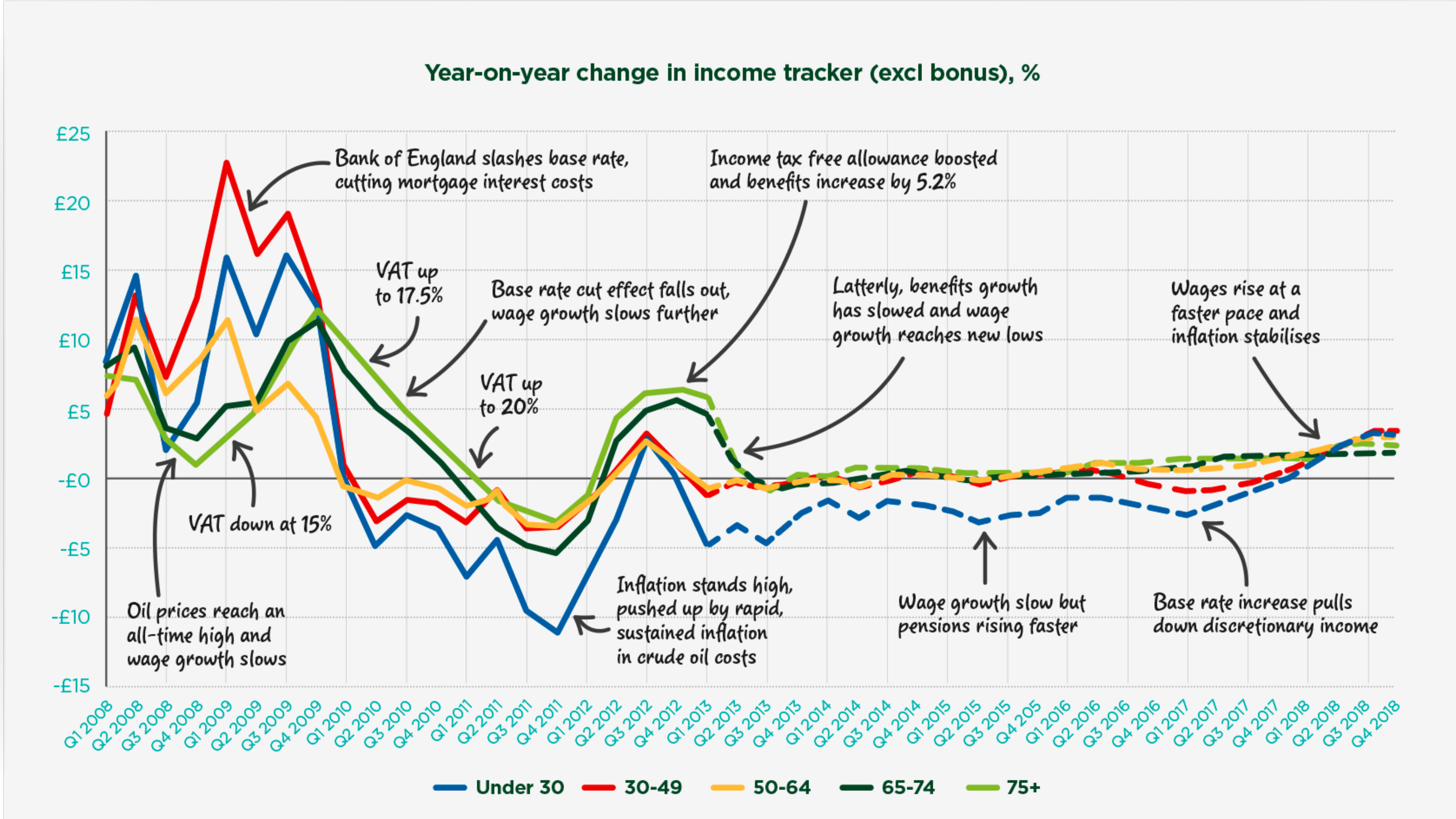
- Driven by the triple lock on pensioner incomes, older households are expected to slow but steady growth in discretionary spending power over the coming five years.

- For those over aged over 75, annual growth of just over 1% is expected until April 2018, when the income tax free personal allowance is expected to start rising again. For those aged 65-74, growth of just over zero is expected until April 2017, again when the tax free allowance for the age group starts rising.

- However, for those aged under 30, further declines in discretionary incomes are projected ahead. A heavy reliance on slow-growing wages combined with the impact of the base rate rise is expected to keep discretionary income growth in negative territory until 2018.



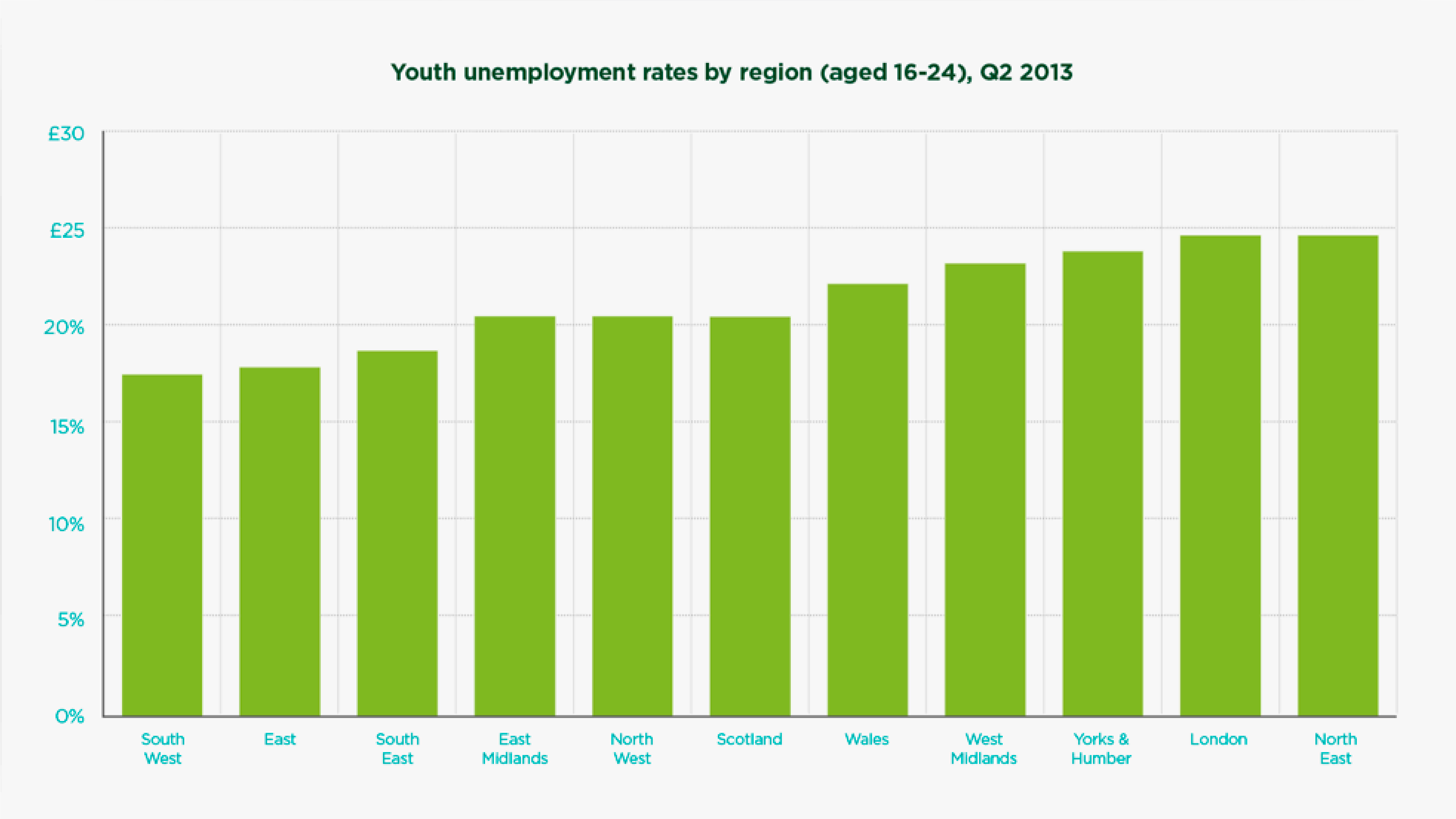
Visualising the effects on discretionary income



Age breakdown statistics in detail

Annualised figures	Net Incomes			Cost of Living			Discretionary Incomes		
	2008	**2013**	**2018**	**2008**	**2013**	**2018**	**2008**	**2013**	**2018**
Under 30	£22,400	£25,100	£28,700	£18,100	£21,100	£24,900	£4,200	£4,000	£3,800
30-49	£32,800	£36,700	£41,800	£23,800	£26,600	£31,400	£9,000	£10,200	£10,400
50-64	£30,200	£33,800	£38,200	£20,200	£23,400	£27,300	£10,100	£10,400	£10,900
65-74	£20,400	£24,000	£26,800	£14,500	£17,400	£19,900	£5,900	£6,600	£6,900
75+	£16,000	£19,300	£21,500	£10,600	£12,900	£14,700	£5,400	£6,400	£6,700

Youth unemployment is highest now in London and across the North of England



Examining different household types

- In this section we look at different specific household types, to examine the effects of economic conditions on households that are easier to identify with.
- Of those that we examine, families with two parents and two children typically have the highest gross income, while single parents have the least gross income.
- The table below indicates some of the characteristics of these household types.

Households by composition type Figures for 2011 (latest *base* data from ONS)	Average annual gross income	Average annual total spending	Average annual spend on mortgage interest	Average income earned through employment	Average income from social security benefits
Two parent, two child	£55,700	£29,500	£2,700	90%	8%
Single adult, working age	£22,700	£13,400	£940	80%	10%
Retired couple	£27,600	£17,400	£60	5%	45%
Single parent	£18,900	£14,000	£800	43%	42%

Income growth for two-parent families and single adults dropped sharply in 2009

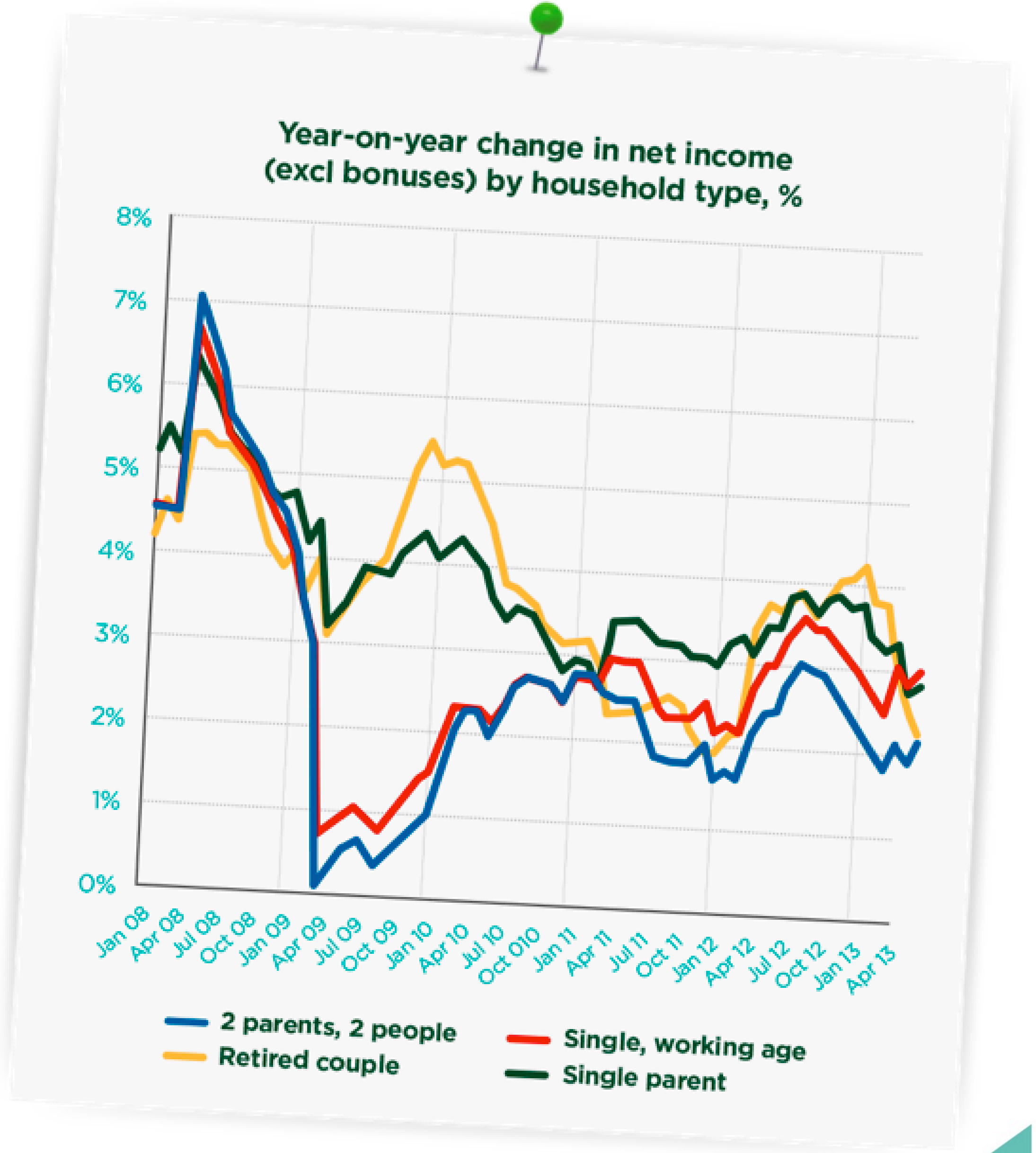
While households more dependent on employment saw sharp growth slowdown

- For families with two parents and two children and those with a single working age adult, net income growth declined sharply during the recession in 2009, as wage growth slumped and employment fell back.

- During this period, single parents – more dependent on social security benefits – and retired couples – who rely on pensions – saw income growth supported due to payments being up weighted in line with inflation.

- However, in recent months, net income growth has fallen back for each age group.

- This is due to wage growth reaching an all time low, employment growth falling back, a slowdown in the unweighting of working-age benefits and the income tax free personal allowance for retired persons being put on hold.



Single parents to see income growth constrained until 2016

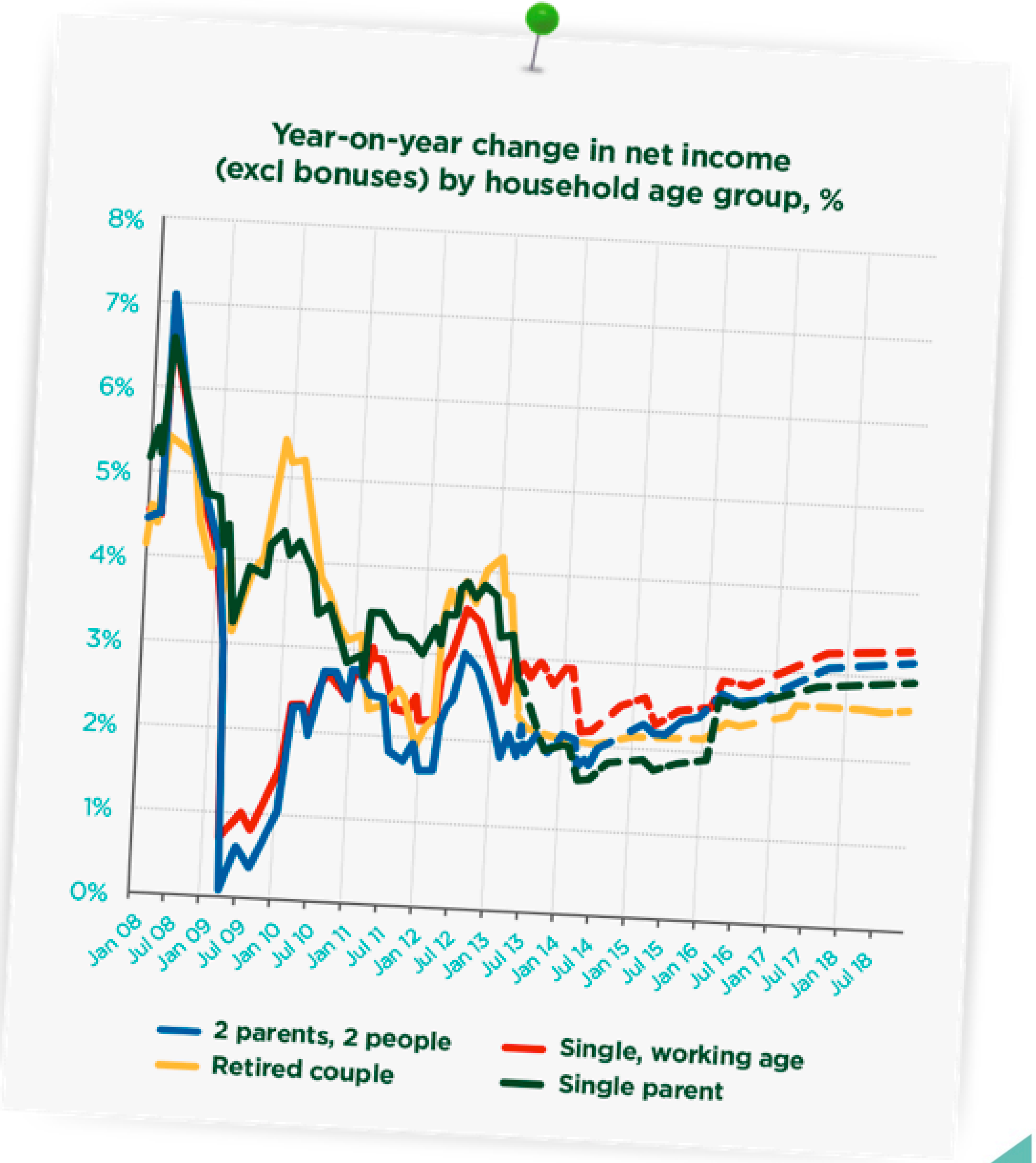
The end of the 1% cap in benefits growth will help to push up income growth

- Single parents depend on social security benefits for roughly two fifths of their income and as such, the current cap on growth in working age benefits at 1% is holding back their net income growth.

- From 2016, this policy comes to an end, and single parents are expected to see their net income growth jump as a result.

- This effect will also help to boost income growth for two parent families and single working age adults, although it will be less pronounced as much less of their income comes from the state.

- Retired couples will have their income growth supported by the triple lock on pensions over the coming years.



Single adult households experienced some of the sharpest declines in spending power

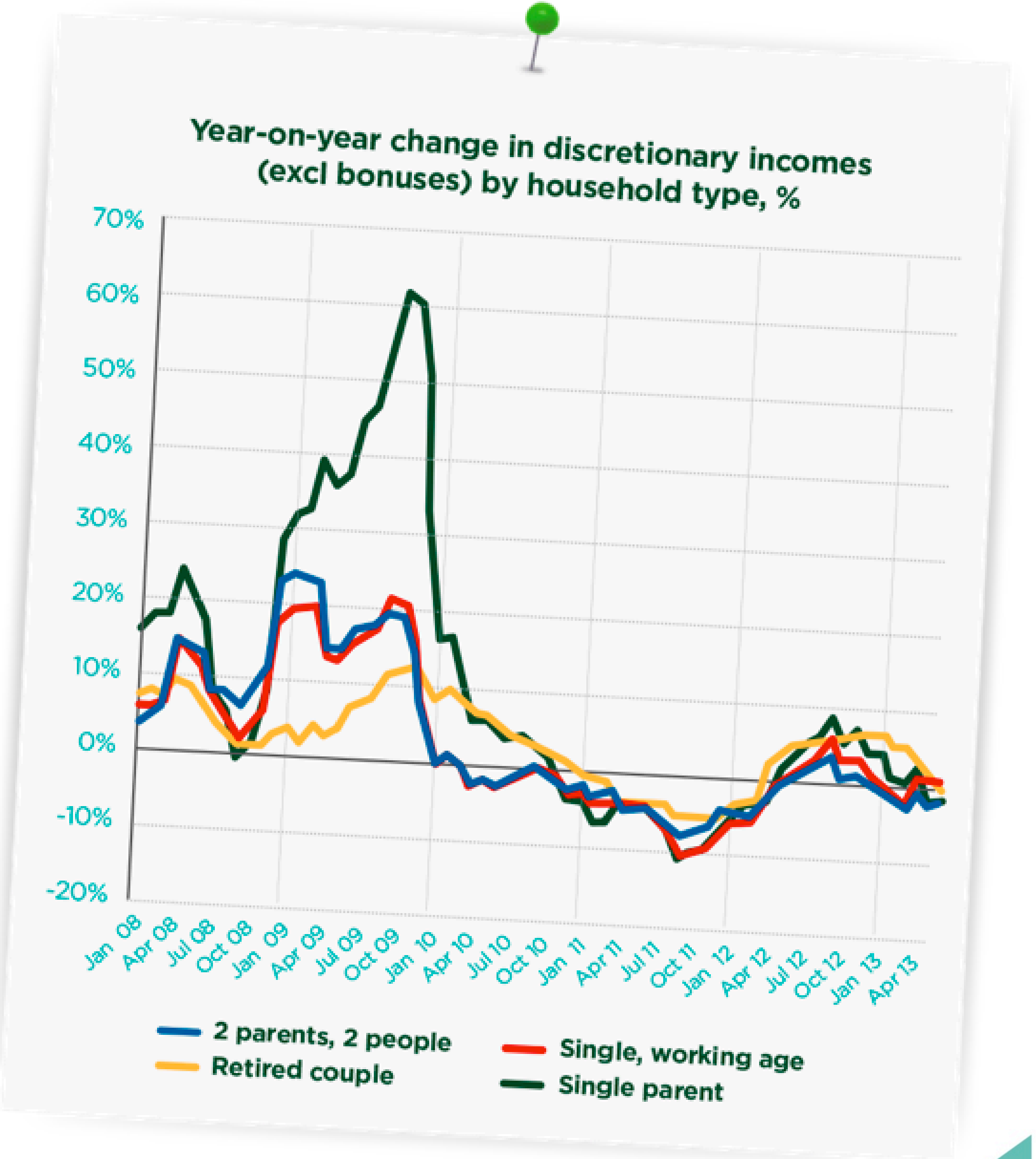
Meanwhile, spending power for retired couples faced less acute declines over the past few years

• Single parent households have been the most exposed to sharp housing cost increases over the past five years, with 16% of their gross weekly income spent on rent and utilities, more than any of the other household types.

• Rapidly rising costs for rent payments and home electricity and gas helped to erode the spending power of single parents through 2011.

• Single working age households, spending 13% of their gross incomes on housing costs, also sharply felt the squeeze over much of the past three years.

• Retired couples have been less acutely affected, thanks to more rapidly rising net incomes and lower spend on essentials such as housing.



Discretionary income growth to return across the board by 2018

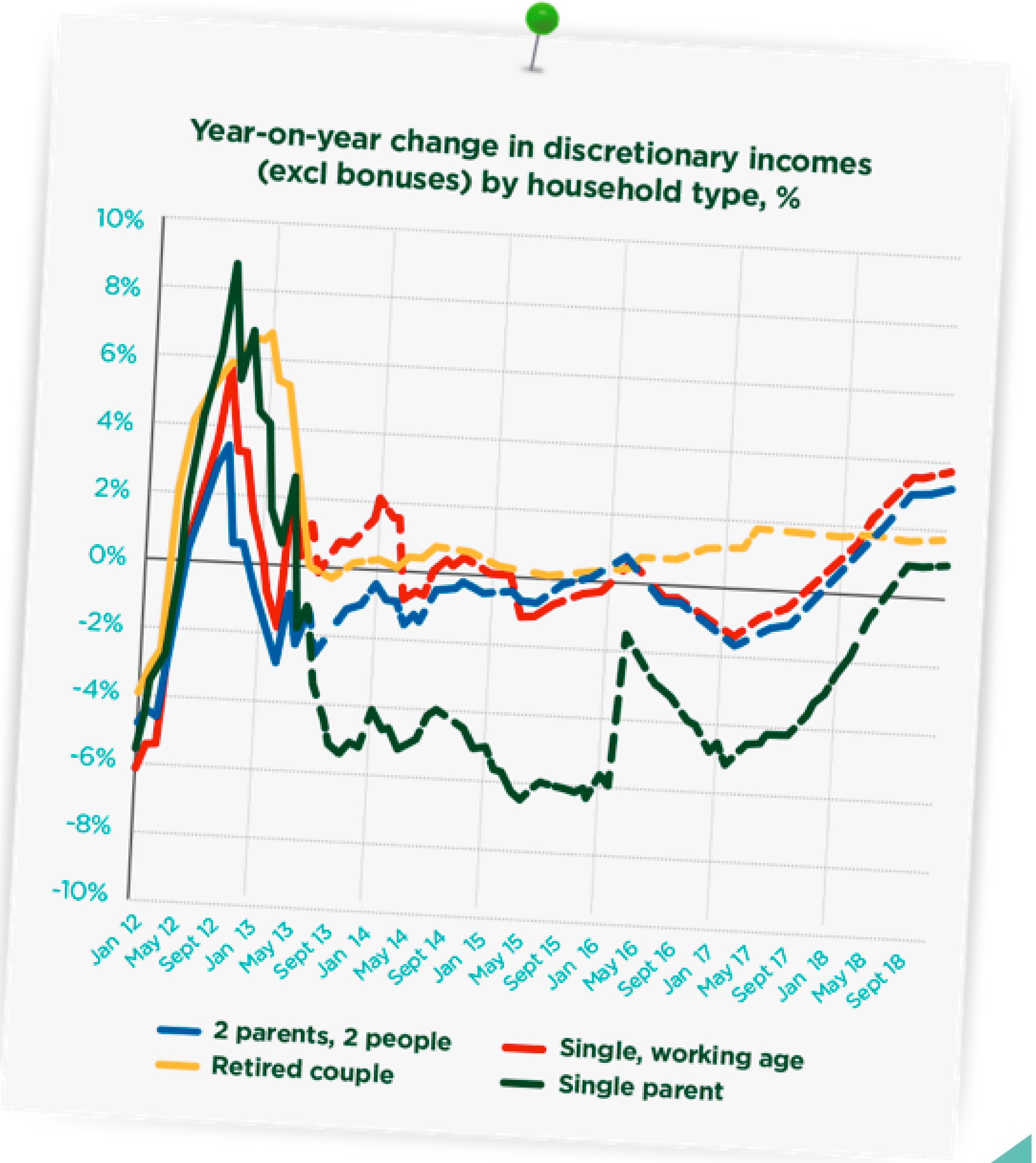
Although this return will be slower for single parent households than others

• Although discretionary income growth for two parent families and single working age households is projected to avoid facing sharp declines until 2016, an increase in the base rate would send spending power back down.

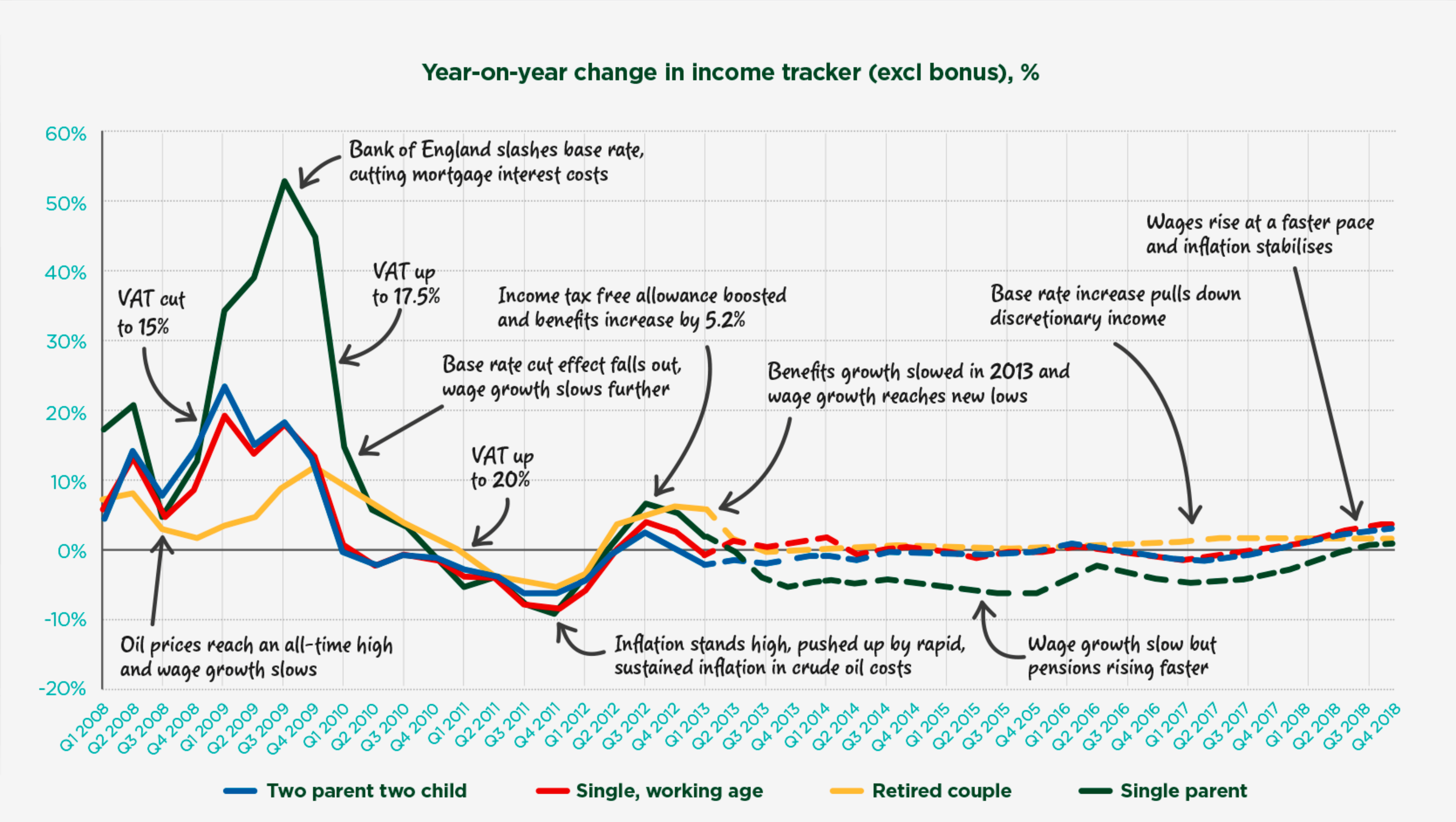
• Following the end of effect of this base rate rise, discretionary incomes would start to increase again in late 2017 and 2018.

• Retired couples are projected to see modest discretionary income growth over the next five years, protected by the pension triple lock and the lack of exposure to mortgage interest rate changes.

• Single parents, however, are expected to face the consecutive blows of the 1% cap in benefits growth, which comes to an end in 2016 but is swiftly followed by the rise in mortgage costs.



Visualising the effects on discretionary income



Demographic breakdown statistics in detail

Annualised figures	Net Incomes			Cost of Living			Discretionary Incomes		
	2008	**2013**	**2018**	**2008**	**2013**	**2018**	**2008**	**2013**	**2018**
Two parent, two child	£38,800	£42,900	£48,700	£28,500	£31,700	£37,500	£10,300	£11,200	£11,200
Single, working age	£16,300	£18,400	£21,100	£12,700	£14,500	£17,100	£3,600	£3,900	£4,000
Retired couple	£22,300	£26,500	£29,600	£15,600	£18,800	£21,500	£6,800	£7,700	£8,100
Single parent	£15,100	£17,900	£20,000	£13,100	£15,200	£17,700	£1,900	£2,700	£2,300


British
Isles
Irish Sea
Ireland
Snowdon
1085m
Pennines
Trent
Britain
Severn
St. George's
Channel

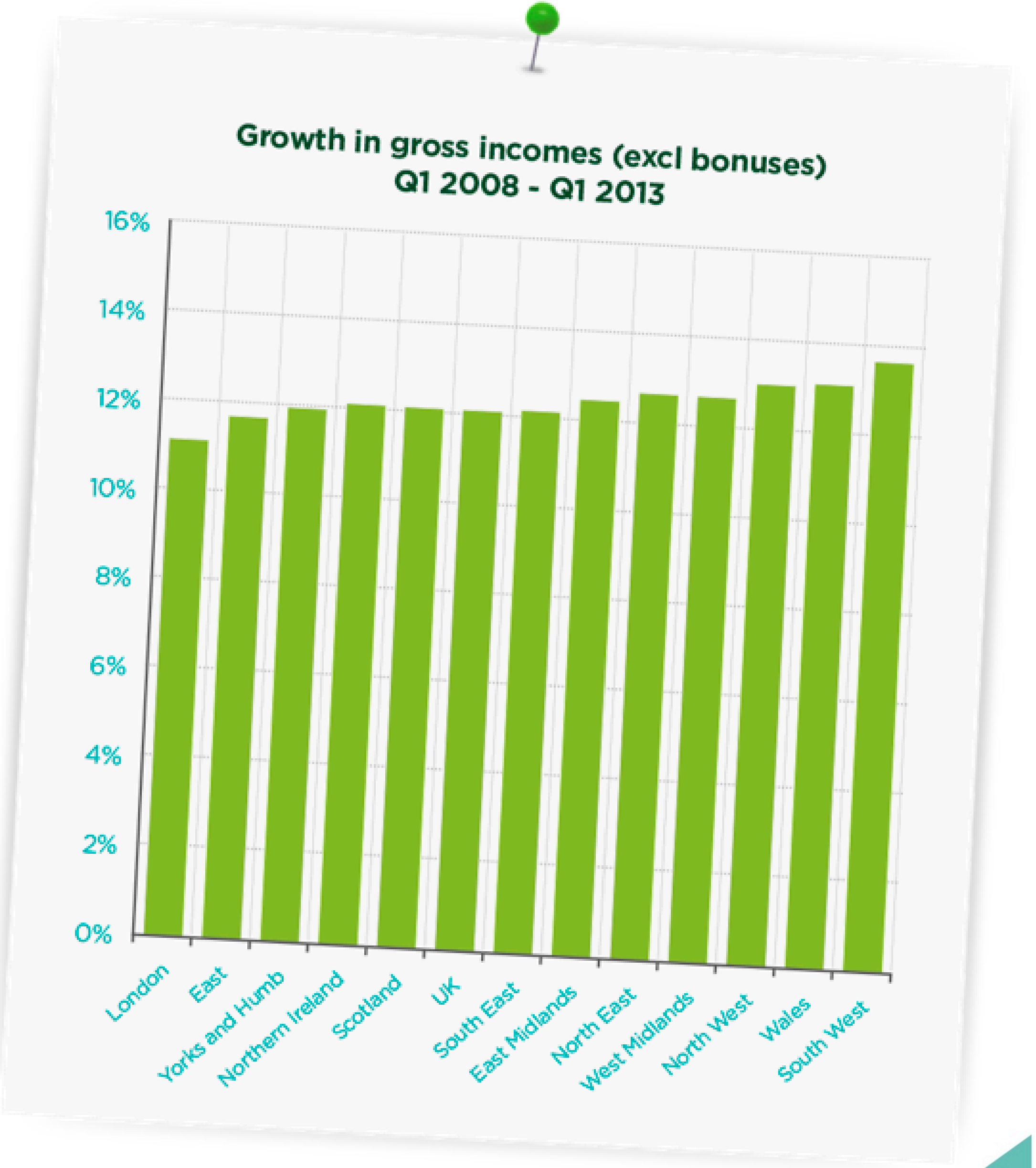
London has experienced the slowest income growth over the past five years

High dependency upon wages & salaries in London has depressed income growth

• With 82% of income in London coming from wages & salaries and self-employment income, the very weak productivity growth and hence pay increases over the past five years have heavily weighed down on the income growth of London households.

• The East of England comes close behind London with the slowest income growth, as 78% of total income is from wages & salaries and self-employment.

• At the other end of the scale, the South West has the lowest dependency on income earned through work, with just 68% coming from wages & salaries and self-employment. Instead, social security benefits and pensions make up a greater proportion of income – both income streams that are typically uprated in line with inflation and as such, have recently grown faster than wages.



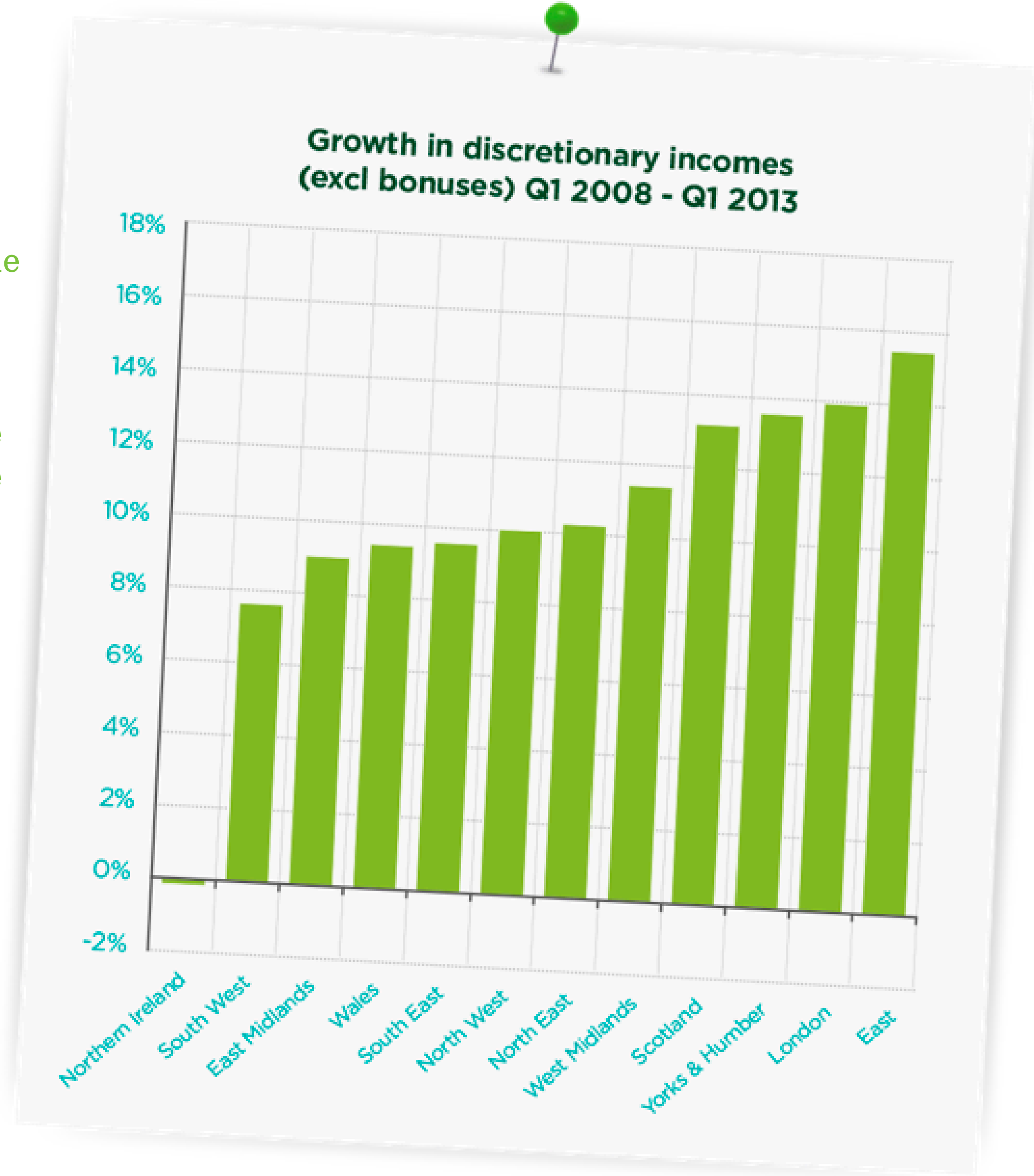
But spending power in Northern Ireland has been hit the hardest

Slow income growth and rapid inflation have eroded spending power in Northern Ireland

- Households in Northern Ireland have had the lowest levels of discretionary income of anywhere else in the UK over the past five years.

- Northern Irish households have also faced some of the slowest income growth and fastest increase in the cost of living in the UK. This was largely due to the relatively low share of spending on mortgages – as such, households benefitted proportionally less from the cut in base rates. The cost of essentials rose between Q1 2008 and Q1 2013 by 16.6%, while gross incomes rose by only 12.0% over the same period.

- At the other end of the scale, discretionary spending power in the North East has been supported over the past five years by some of the slowest increases in the cost of living as well as income levels buoyed relatively well by increases in benefits.



Further income growth restraint for regions dependent on public sector

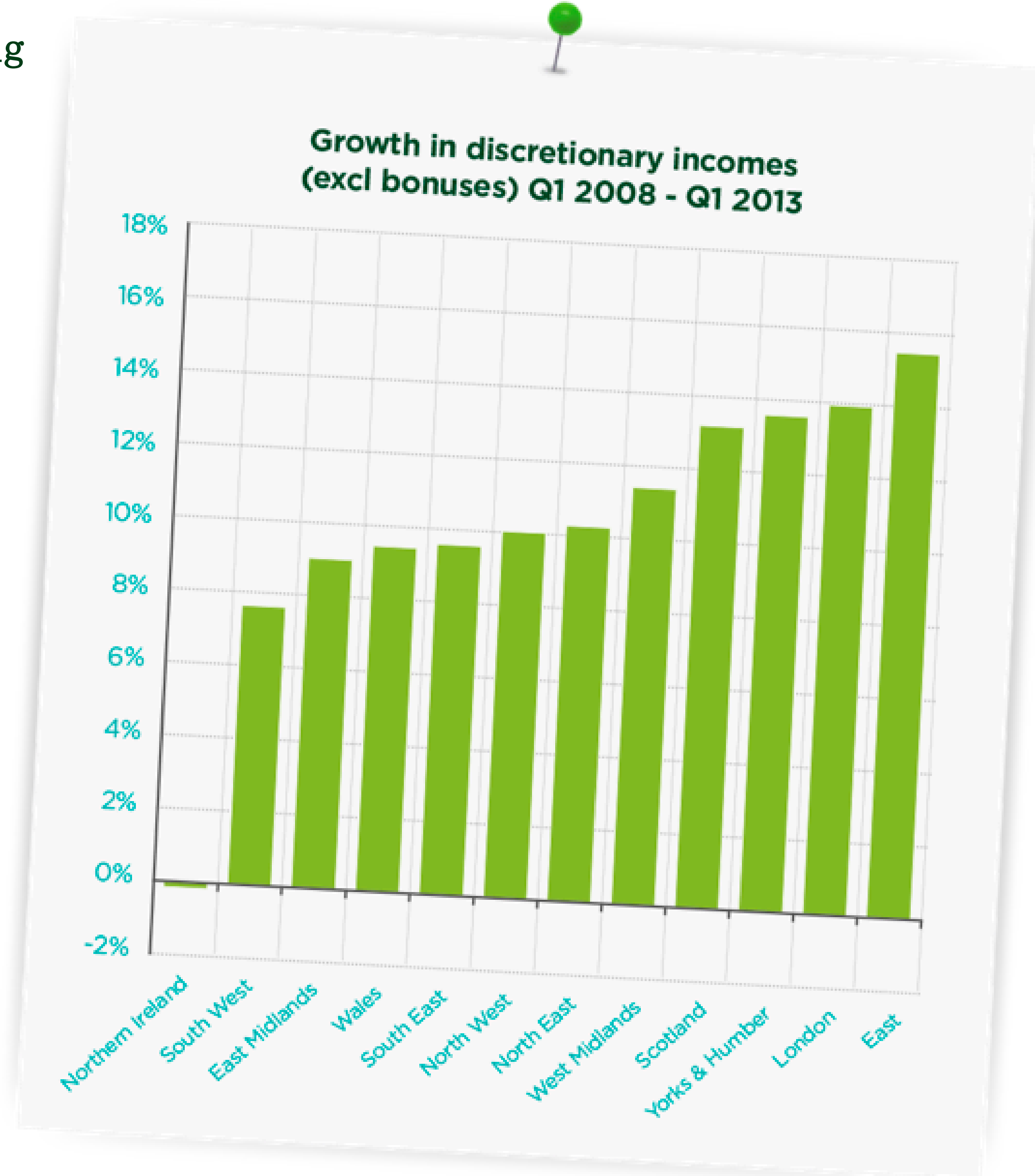
Public sector job cuts to hold back spending power growth in devolved nations of the UK

- Regions of the UK most dependent upon the public sector face the slowest income growth over the coming five years due to a combination of government employment cuts and the cap on benefit upweighting.

- This is expected to be particularly the case for Northern Ireland, where in Q1 2013 almost three in ten (28.1%) workers were employed by the state.

- At the other end of the scale, regions such as London and the East of England are expected to see faster income growth.

- A higher share of income comes from wages & salaries and self-employment in these regions, reducing the effect of the cap on benefits.



Northern Ireland to take further blows to discretionary spending power

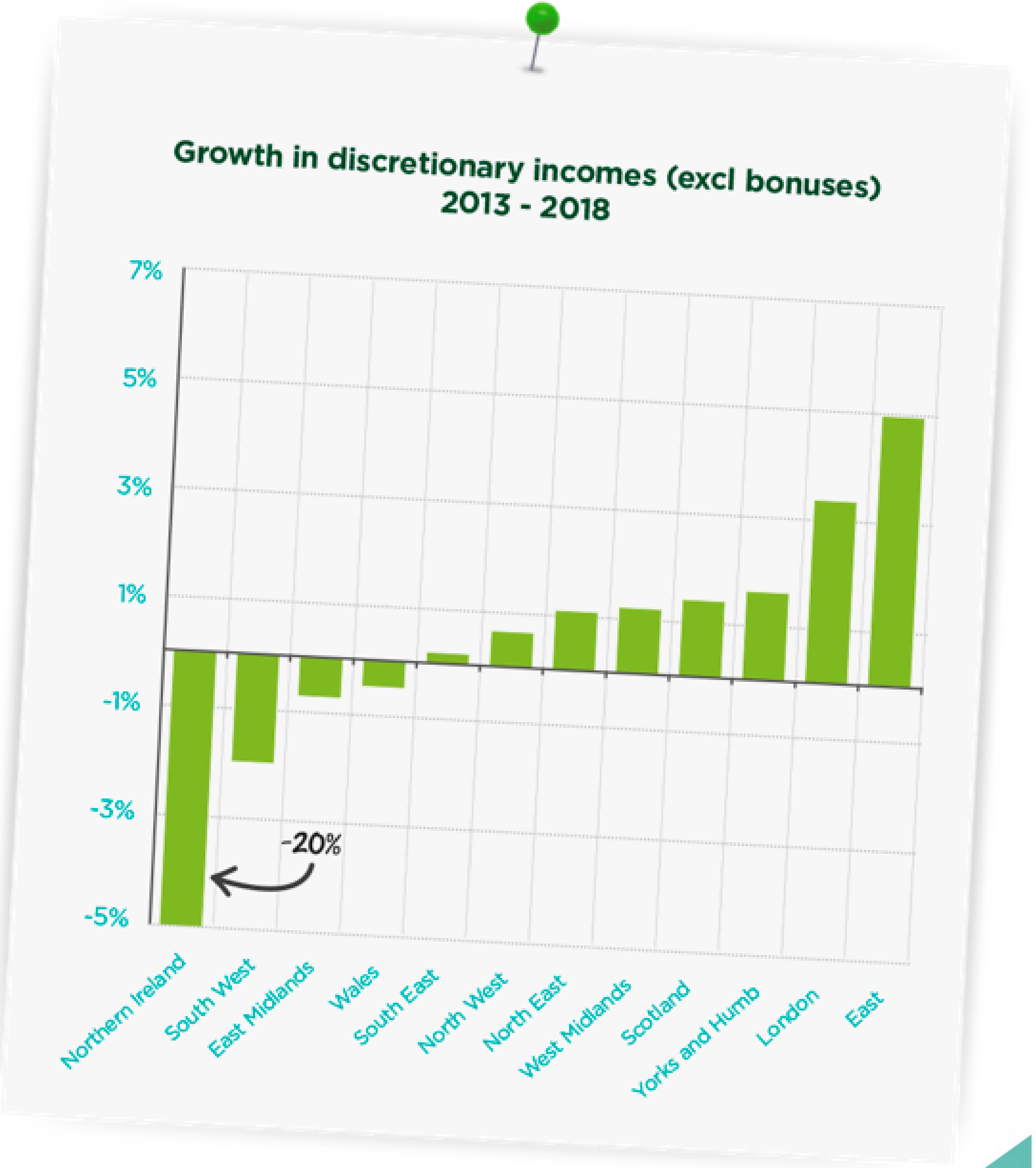
Households in Northern Ireland to continue to face tough economic conditions

- Households in Northern Ireland are projected to face a further 20% decline in their discretionary incomes over the next five years.

- Slow income growth due to high dependency on the public sector is likely to be outpaced by increases in the cost of living over the period.

- At the other end of the scale, strengthening labour markets in London and the East of England are expected to help push up growth in discretionary spending power in the years to 2018.

- Although income growth for households in the South East is expected to be relatively strong over the coming five years, the region is more exposed than others to the effects of interest rate increases, weighing down on spending power over the period.



Regional statistics in detail

Annualised figures	Net Incomes			Cost of Living			Discretionary Incomes		
	2008	**2013**	**2018**	**2008**	**2013**	**2018**	**2008**	**2013**	**2018**
North East	£22,400	£25,700	£29,100	£16,500	£19,000	£22,300	£5,900	£6,700	£6,800
North West	£25,200	£28,900	£32,700	£18,900	£21,900	£25,600	£6,200	£7,000	£7,100
Yorkshire & Humber	£23,500	£26,800	£30,300	£17,500	£20,300	£23,700	£6,000	£6,500	£6,600
East Midlands	£26,000	£29,700	£33,500	£19,300	£22,500	£26,300	£6,700	£7,200	£7,200
West Midlands	£24,900	£28,500	£32,200	£18,300	£21,400	£25,100	£6,600	£7,000	£7,100
East	£29,900	£33,900	£38,600	£21,300	£24,500	£28,700	£8,600	£9,400	£9,900
London	£36,000	£40,600	£46,000	£24,700	£28,400	£33,400	£11,400	£12,200	£12,600
South East	£30,600	£34,900	£39,600	£22,900	£26,300	£30,900	£7,700	£8,600	£8,600
South West	£27,300	£31,300	£35,300	£20,700	£24,000	£28,100	£6,600	£7,300	£7,200
Wales	£24,400	£28,000	£31,500	£17,600	£20,500	£24,000	£6,800	£7,500	£7,500
Scotland	£26,700	£30,200	£34,000	£18,800	£21,900	£25,600	£8,000	£8,300	£8,500
Northern Ireland	£23,700	£27,000	£30,400	£20,600	£24,100	£28,000	£3,100	£3,000	£2,400

ASDA

Appendices, Data Sources and Method

Please find attached method notes and the tabulated date. Asda produces a monthly income tracker report with a more comprehensive report every quarter.

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Method

The Asda income tracker is calculated from the following equations:

- Total household income minus taxes equals net income
- Net income minus basic spend equals Asda income tracker

Total household income for the United Kingdom is derived from the Living Costs and Food Survey 2011 (released December 2012). This is updated on a monthly basis using official statistics on average earnings, unemployment, social security payments, interest rates and pension income. Earnings data from the Office for National Statistics that is released in the month of the report refers to the previous month. We forecast earnings data for the month of the report.

Taxes are subtracted from total household income to estimate the actual amount that can be spent on goods and services, i.e. net income or disposable income. The average amount of tax paid is calculated using the latest version of the Living Costs and Food Survey. This is updated on a monthly basis using Office for National Statistics data and Cebr modelling.

Method

These components are based on official statistics and Cebr calculations.

Net income is calculated by deducting our tax estimate from our total household income estimate.

Basic spend (cost of living) figures are updated using monthly consumer price data and the trend growth rate in the volume of essential goods and services purchased over the most recent ten year period. A full list of items constituting basic (or 'essential') spending was created in collaboration between Asda and Cebr when the income tracker concept was originally formed in 2008. This list is available on request.

The *Asda income tracker* is a measure of 'discretionary income', reflecting the amount remaining after the average UK household has had taxes subtracted from their income and bought essential items such as: groceries, electricity, gas, transport costs and mortgage interest payments or rent. The income tracker measures the amount left over to spend on discretionary purchases such as leisure and recreation goods and services.

Method

Forecasting method

All the components of the Asda Income Tracker are forecast using the central scenario from Cebr's in-house UK economy model.

This provides figures out to 2018 for all the key components of the Income Tracker model, including inflation by category, unemployment and wage growth.

Disclaimer

This report was produced by the Centre for Economics and Business Research (Cebr), an independent economics and business research consultancy established in 1993 providing forecasts and advice to City institutions, government departments, local authorities and numerous blue-chip companies throughout Europe. The main contributors to this report are Cebr economists Rob Harbron, Scott Corfe and Charles Davis.

Whilst every effort has been made to ensure the accuracy of the material in this report, the authors and Cebr will not be liable for any loss or damages incurred through the use of this report.

London, September 2013