COMMERCIAL BANKING

UK Consumer Outlook: Prepare for lift-off

Does the UK consumer have the power to ramp up spending in 2021?

By the side of business

LLOYDS BANK

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Introduction

Living through the biggest decline of consumer spending ever recorded in the second quarter of 2020, we find ourselves in a race between infections and injections (of the vaccination kind).

Less than 18 months ago, we published a report titled 'Don't underestimate the UK consumer' where we called out consumers resilience in the face of elevated economic and political uncertainty. We concluded that little could derail this optimism. Even the threat of a hard Brexit did not impact our positive forecast. Fast forward to today and we face an uncertainty of an entirely different kind.

The case for UK economic optimism yet again rests on a rapid turnaround in consumer spending. In this report, we take a closer look at the household sector and the changes in spending patterns that occurred since the start of 2020, both voluntary and involuntary.

Despite the initial shock, the data suggests households have a strong appetite to spend and we can see considerable pent-up demand. Interestingly, 2020 saw household savings rates not only hit record highs but stay elevated throughout the year. The resultant "excess savings" are estimated to be around 5% of UK GDP with the bulk of these having been built up "involuntarily".

We also note that some of this resilience reflects households' efforts to improve their overall debt positions. Households made the largest net repayments of unsecured borrowing since records began, with repayments of secured borrowing also picking up in 2020.

Undoubtedly, the increases in savings and repayment of debt are not likely to be even across the economy. Many jobs lost during the pandemic were in the lower paid sectors of the economy. Those workers are likely to spend more rather than save and more likely to have been furloughed. The subject of equality in economic recovery is likely to be an important feature in post Covid-19 government policies. However, on aggregate, household balance sheets are stronger now than before the crisis. We thus believe this leaves the UK consumer in a strong position to resume spending.

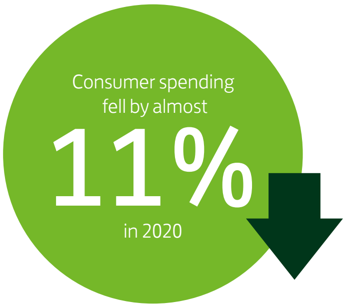
This does not change the need for retail and consumer facing businesses to transform themselves and innovate, as they adapt to the trends accelerated or brought about by the Covid-19 pandemic. Positively however, the consumer environment into which this transformation needs to be delivered is supportive.

Are we too optimistic? By the end of January 2021, there were almost 5 million furloughed workers. With the scheme's deadline on the horizon, what will be the impact on UK unemployment? Are these increases in household savings therefore "precautionary"?

Given Chancellor Sunak's near-term priority of supporting jobs, we don't believe so. However, government policy and lingering health concerns will ultimately decide how long the recovery in consumer spending will last.

2021 will be a crucial year to test that UK consumer resilience.

"The case for UK economic optimism yet again rests on a rapid turnaround in consumer spending"



> In Q2 of last year alone... consumer spending in the UK fell by 21%, it's largest decline on record and over five times larger than the previous biggest quarterly fall of 4.2%, seen in the third quarter of 1979

A look back at 2020

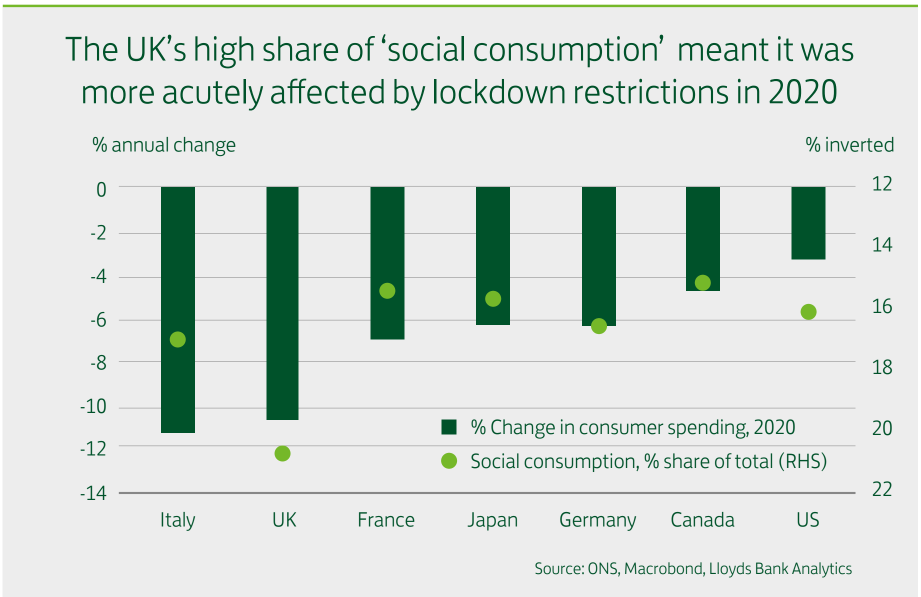
The Covid-19 pandemic has delivered a devastating shock to the world economy. Not only from a macro perspective, where the global population remains in the midst of a health crisis on a scale not seen in over 100 years. But also at a micro level, whereby attempts to contain the virus have changed the way businesses and individuals operate on a day-to-day basis.

UK consumer spending acutely affected by lockdown restrictions

From a UK economic standpoint, the impact has been particularly evident across the consumer sector. According to the Office for National Statistics (ONS), the level of UK consumer spending fell by almost 11% in 2020, with reduced 'social consumption', accounting for over half of that fall. Social consumption includes attending live sports events, cinemas, restaurants and other service sector activities where the risks of infection were perceived to be high.

Among G7 nations, the UK has typically had the highest share of social consumption as a proportion of total consumer spending (chart 1) and has unsurprisingly therefore, been one of the worst affected nations during lockdowns.

Chart 1:



In Q2 of last year alone, when government mandatory restrictions were at their most stringent, consumer spending in the UK fell by 21%, its largest decline on record and over five times larger than the previous biggest quarterly fall of 4.2%, seen in the third quarter of 1979. Admittedly, a record recovery ensued during Q3 as mandatory restrictions were eased temporarily and the 'Eat Out to Help Out' (EOHO) scheme bolstered demand. Nevertheless, with restrictions re-imposed towards the end of the year, UK consumer spending fell back in Q4 to end the year down by more than the c.10% fall in GDP seen across the whole of 2020, and, the largest drop recorded in over 100 years.

2020 saw the largest year-on-year drop in spending for over

100 years

> The behaviour of UK consumers will play a pivotal role in the recovery. The conditions appear prime for a significant rebound in consumer spending this year

A tough start but optimism is building

High Covid-19 infection rates around the turn of the year, and the associated extension of restrictions on activity and mobility, mean that the UK economy has entered 2021 on a weak footing. However, significant improvements in some key Covid metrics and a quicker-than-expected rollout of the vaccination programme has boosted hopes of a swifter and more sustainable recovery.

The easing of public health restrictions in line with Prime Minister Johnson's roadmap announcement on the 22nd February, aided by the additional support measures announced by Chancellor Sunak in his recent budget, should help facilitate a significant rebound in economic activity over the course of the year, particularly across the consumer sector.

Bank of England (BoE) officials have expressed greater optimism over the economic outlook. Governor Andrew Bailey said he now thinks a "pronounced recovery" is likely. Meanwhile, BoE Chief Economist, Andy Haldane said the UK economy was "poised like a coiled spring".

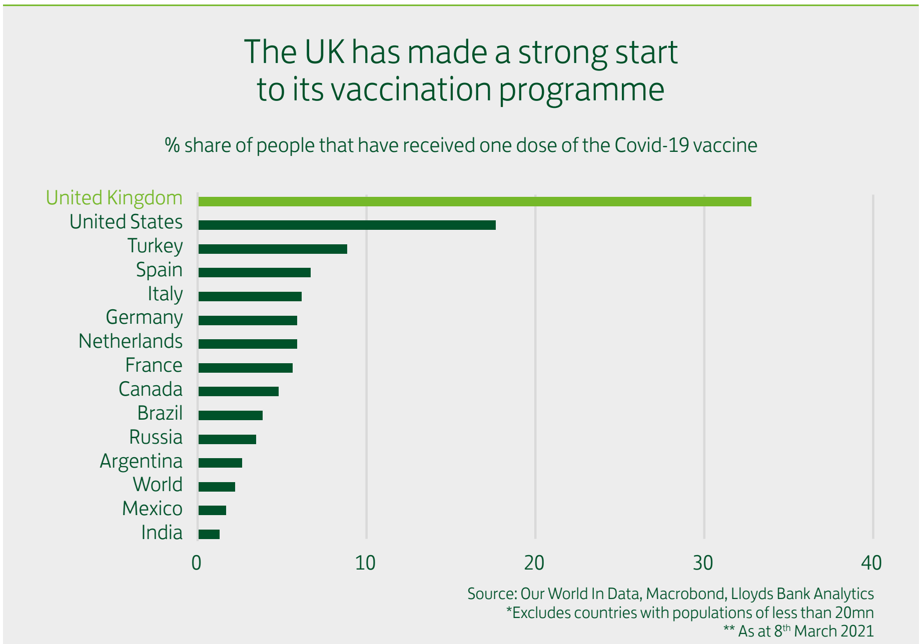
The behaviour of UK consumers will play a pivotal role in the recovery. Conditions appear prime for a significant rebound in consumer spending this year. However, given the nature and sheer scale of the decline in activity last year, how consumers will react to the reopening of the economy and lifting of restrictions remains highly unclear.

In this report, we look at four key considerations that will ultimately determine how UK consumer spending will perform in 2021.

1. A successful vaccination programme

First and foremost, the extent to which lockdown restrictions are eased and limitations on the various forms of spending are lifted, will have a key bearing on how quickly consumer spending rebounds in 2021. The exceptional start made to the vaccination rollout program in the UK (chart 2), led the government to announce its 'roadmap' out of lockdown on the 22nd February.

Chart 2:



Under the plan, the easing of restrictions will take place in four stages linked to the success of the vaccination deployment programme. This means effective progress being made in reducing rates of infection, hospitalisations and fatalities.

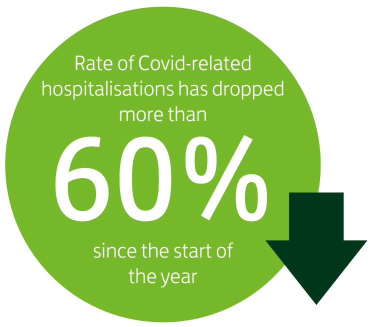
The first stage, the reopening of schools and other education facilities from 8th March, has started on time. This is a positive start as further restrictions could be lifted incrementally every 5 weeks. Non-essential retail and some areas of hospitality may open up in April, followed by a broader opening of the sector in May, including indoor service at pubs and restaurants. Followed by the proposed lifting of all legal limits on social contact by 21st June.

Prime Minister Johnson has reiterated that the government's roadmap represents the earliest that restrictions would be lifted, and that the reopening of the economy would be "cautious but irreversible". Progress on key metrics that will guide the government in their decision making have so far been encouraging:

- New infections in the UK have fallen by over 85% since the start of the year.
- More than one in three people have received their first vaccination.
- The rate of Covid-related hospitalisation has dropped by more than 60%.

Moreover, data from Public Health England recently reported that a single shot of the Pfizer vaccine reduced infection rates by around 70% and c.85% after a second dose. Correspondingly, Public Health Scotland found that the risk of hospital admissions fell by 85% and 94% respectively four weeks after receiving the initial dose of the Pfizer and Oxford vaccines. That would suggest that the government's roadmap remains broadly on track to see most legal social restrictions eased by the middle of the year albeit we are still in the early phases.

> "More than one in three people have received their first vaccination"



Spending in restaurants and hotels fell by around
90%
in the first half of 2020

Spending at hotels and restaurants rose by
500%
once the economy was partially reopened

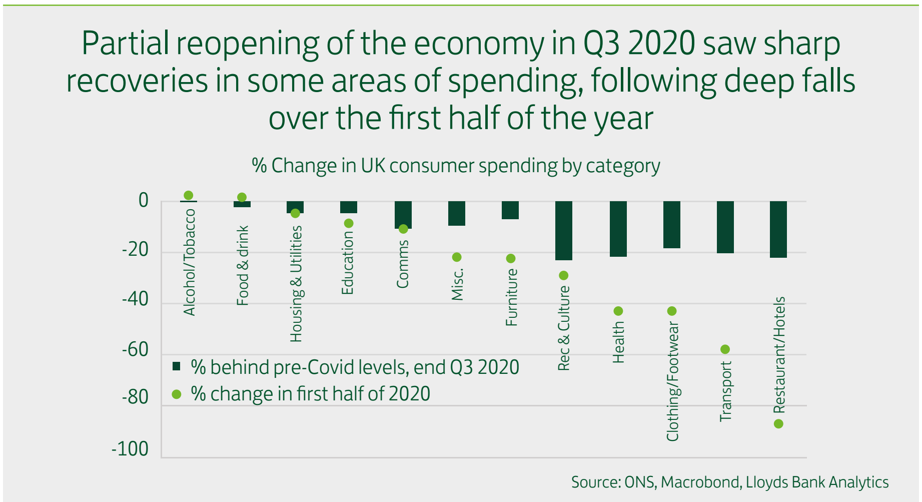
Consumption at hotels and restaurants fell by around
20%
by Q3, relative to the end of 2019

2. Households response

As and when various parts of the economy reopen and opportunities to spend increase, the degree to which households respond will be another crucial element behind how quickly UK consumer spending recovers, particularly in areas of 'social consumption'. Looking at how households responded last year offers some potentially informative observations to gauge how they may react to the easing of restrictions and reduced fears of catching Covid.

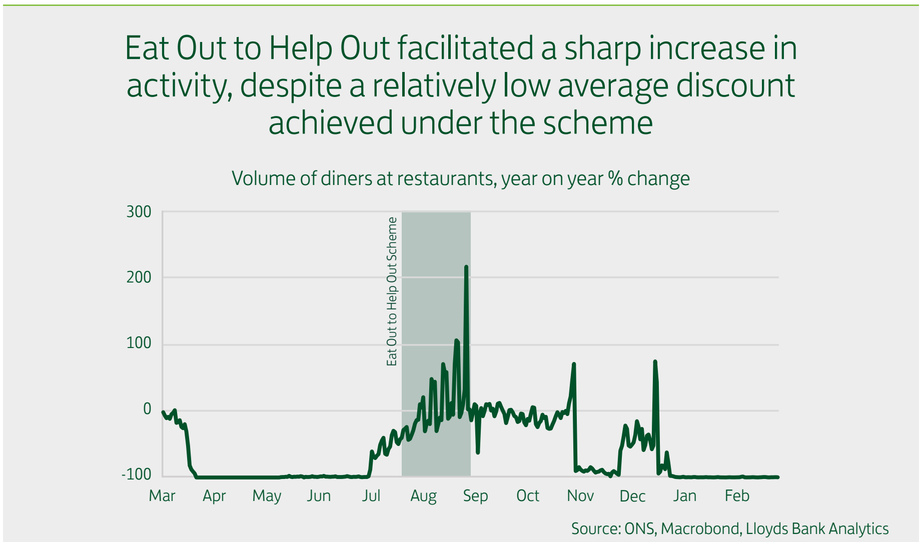
In the first half of 2020, spending in restaurants and hotels, an area of the economy heavily impacted by mandatory restrictions as establishments closed for large parts of this period, fell by around 90%. Very large drops in spending were also seen in recreation and culture (-31%), transport (-57%) and at clothing and footwear stores (-44%) as individuals sought to minimise their risk of contracting the virus, while also adapting to store closures and new ways of working (chart 3).

Chart 3:



However, the partial reopening of the economy in the third quarter saw a sharp turnaround in those areas most impacted by the initial lockdown measures. Most notably, spending at hotels and restaurants rose by over 500% leaving spending in this category 'only' down by around 20% by Q3, relative to the end of 2019.

Chart 4:



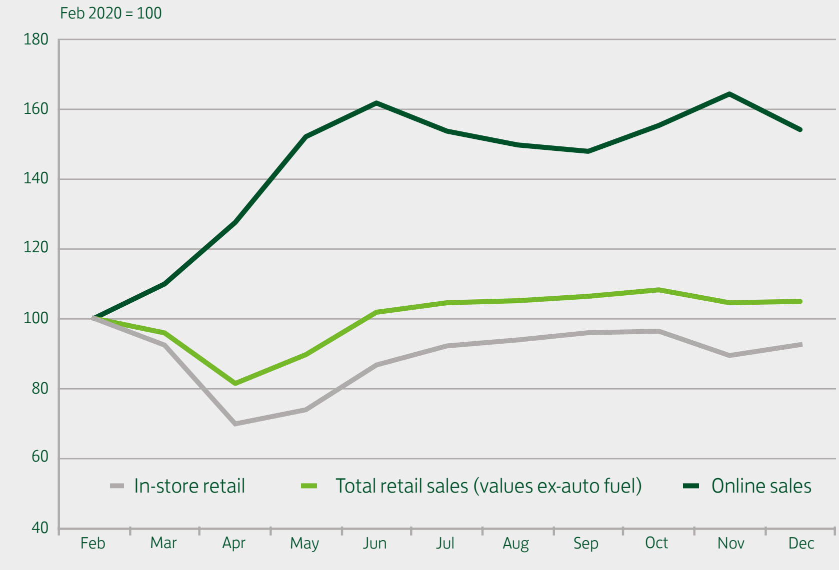
Admittedly, a large part of this rebound was due to the government's Eat Out to Help Out (EOHO) scheme. However, it still provides some useful insights into how UK consumers may react to future reductions in restrictions and highlights the strong role targeted government policy measures could play in the recovery. As restaurants reopened last July, the initial pick up in spending was slow as consumers initially reported feeling uncomfortable about eating out. However, as chart 4 above shows, activity picked up sharply from August, as the scheme, alongside the temporary reduction in VAT for the hospitality sector, took effect.

At its peak in late-August, restaurant bookings were over 200% higher on a year-on-year basis. In a speech last September, the Bank of England's Chief Economist, Andy Haldane, noted that based on the actual average discount achieved under the scheme, the "price people put on overcoming their caution about visiting a restaurant was at £5.22, strikingly low". So while the EOHO scheme played a strong part in promoting a return to restaurants and cafes, the low incentives households required to do so suggests that the price for overcoming fears of catching the virus was also small.

It also points to a high degree of pent-up demand for some items, which alongside the resilience of retail sales activity last year suggests that households' appetite to spend has remained strong during the pandemic. Compared to its pre-pandemic level last February, the 'value' of UK retail sales (ex-auto fuel) ended the year around 5% higher, despite in-store sales being down nearly 8%. That reflected a sharp shift towards online sales, which saw a 50% increase on the year (chart 5).

Chart 5:

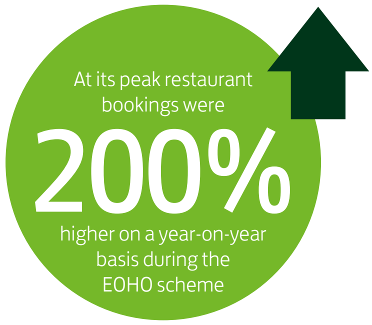
A large share of retail sales shifted online last year, in response to closure of 'physical' stores and social distancing measures



Source: ONS, Macrobond, Lloyds Bank Analytics

Admittedly, retail sales is a far from perfect measure of overall consumer activity given that it only accounts for around 40% of overall consumer spending. Nevertheless, it does suggest that where consumers' ability to shop has been less affected – either because certain stores have remained open and/or individuals have been able to switch to other methods of purchasing and towards substitute items – spending patterns have proved more resilient.

This bodes well for how quickly spending could pick-up for certain items where consumption has been constrained, as and when restrictions are eased. In particular, those items that have shown the greatest sensitivity to changes in lockdown restrictions, for example areas of social consumption, could benefit to a greater degree.



> The price people put on overcoming their caution about visiting a restaurant was at £5.22, strikingly low

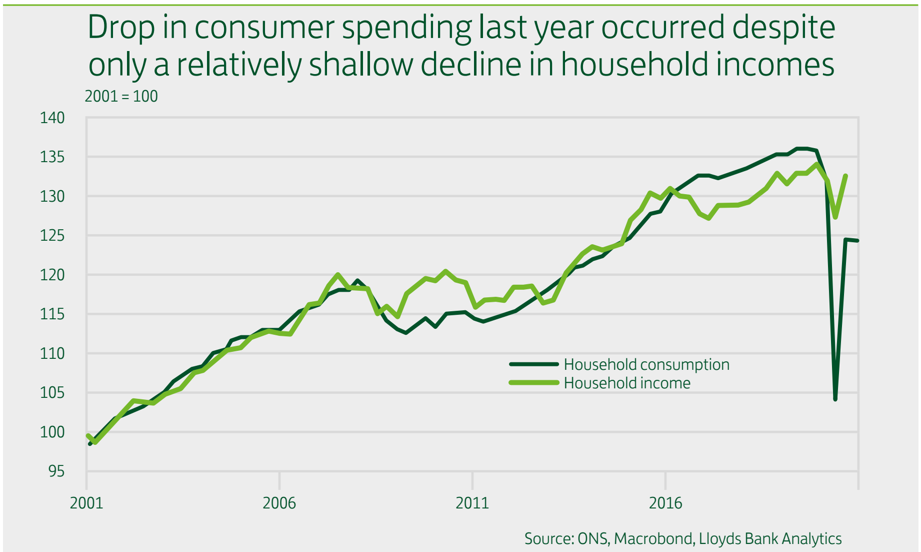
ANDY HALDANE

Bank of England Chief Economist

3. Higher savings

A striking feature of the fall in consumer spending last year is that it occurred despite only a relatively shallow decline in aggregate household incomes (chart 6). This was largely due to the unprecedented support provided by the government's job retention and other income support schemes. The sharp rise in household savings over the past year suggests that (on aggregate) households are well placed to support a sizeable increase in consumer spending.

Chart 6:



This was particularly evident in the second quarter of 2020 with the household saving ratio soaring to 27.4% from 9.5% in the previous quarter. This was also far above the long-term average of 8.5%. This meant that just over £1 out of every £4 earned by households was saved in Q2 last year, more than three times the average saving rate of £1 out of every £14 in the previous five years (2015-2019).

Savings balances aside, however, even a reduction in the rate at which households saved last year would itself imply a significantly greater amount of consumer spending (assuming household incomes remained broadly steady). We estimate that a one-percentage point reduction in the saving ratio, would lead to a rise in consumer spending of around £3.8bn, or just under 0.2% of GDP.

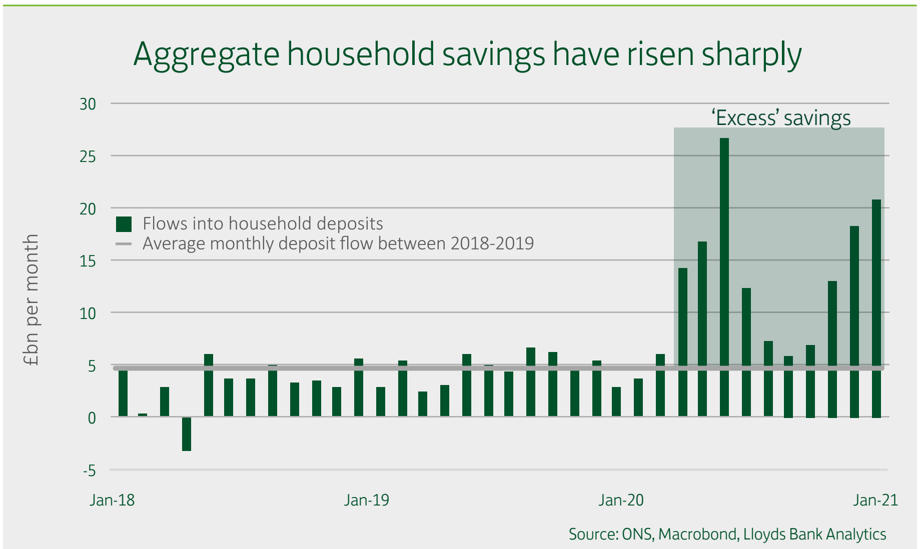
To put that into context, if the household saving ratio were to instantaneously drop back from the average rate of 18% recorded between Q1 and Q3 of 2020, and in line with its long-term average of around 8.5%, that alone would point to spending by households being around £40bn higher per quarter.

"Just over £1 out of every £4 earned by households was saved in Q2, more than three times the average saving rate"

A one-percentage point reduction in the saving ratio could lead to a **£3.8 billion** rise in consumer spending

Over the course of 2020, household deposits with banks increased by around £152bn. The bulk of these savings are likely to have built up 'involuntarily', from households not being able to spend in their usual way. Based on an average monthly flow of around £4.5bn seen across 2019, that would suggest that close to £100bn of the increase could be classed as 'excess' – i.e. above that which may have occurred in more normal circumstances (chart 7). The Bank of England's Chief Economist believes that 'accidental savings' may reach £250bn by the middle of the year, equivalent to around 20% of annual household spending. This takes into account deposit flows into other products such as National Savings, investment accounts and retail investment funds as well as further accumulation over the first half of 2021.

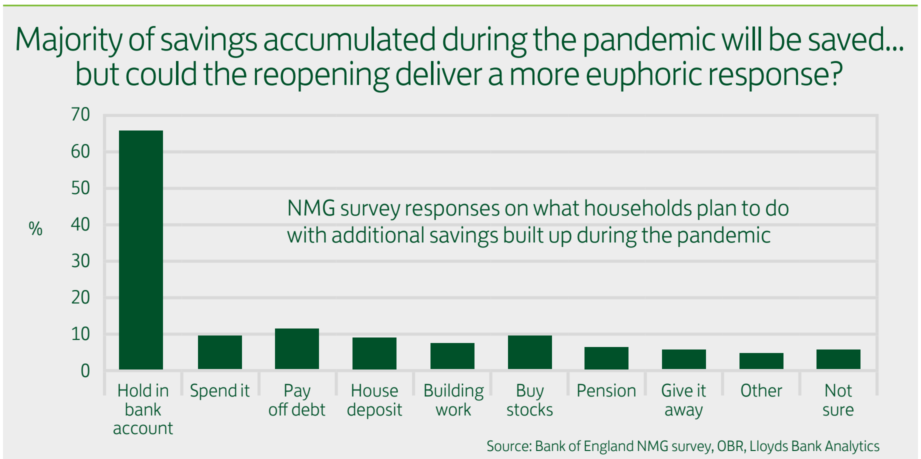
Chart 7:



Modern consumption theory would suggest that rather than immediately spending all of the extra savings accumulated during the pandemic, households would be more likely to hold on to most of it in order to allow for higher consumption in the future. While a survey conducted by the Bank of England last autumn also supports this notion (chart 8), given the unprecedented nature of the downturn last year, the potential for a more euphoric response – as and when various restrictions have been lifted – should not be ignored.

However, the increase in savings is uneven across the household sector, particularly as most jobs lost during the pandemic have been concentrated in the lowest-paid sectors of the economy. This will have implications for the extent to which savings balances may be drawn down. Lower-paid workers tend to spend a higher share of their income but are also more likely to have seen a reduction in pay resulting from jobs in consumer service industries being furloughed.

Chart 8:

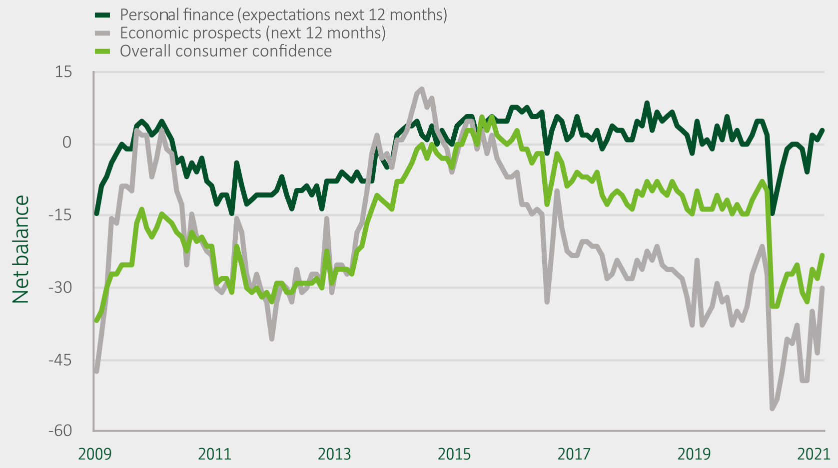


4. Government policy and personal finances

Undoubtedly, government policy has played a critical role in supporting household finances during the pandemic. According to the GfK consumer confidence survey, households' expectations for their personal finances have remained remarkably resilient during the pandemic, despite overall consumer confidence being dragged down by persistent concerns around the economic outlook (chart 9).

Chart 9:

Personal finance expectations have remained remarkably resilient despite wider concerns persisting around the economy



Source: GfK, Macrobond, Lloyds Bank Analytics

In particular, the impact of the furlough and other income support schemes has been instrumental in staving off a sharp decline in household incomes, than may have otherwise been the case had the UK unemployment rate matched the double-digit highs seen in some other countries. At its peak, almost 9 million jobs were furloughed under the Coronavirus Job Retention Scheme (CJRS), equivalent to around 1 in 3 employee jobs. By the end of 2020, around 3.9 million people were still furloughed with the number rising to almost 5 million at the end of January 2021.

The Chancellor's recent decision to extend the scheme by 5 months until the end of September, should alleviate some of the near-term pressure on firms to make tough decisions around headcount. The extension means the scheme will remain in operation well beyond the point that most of the mandatory government restrictions are removed. That points to firms potentially retaining more workers than would otherwise have been the case, particularly across those sectors that are expected to see the slowest pick up demand due to the relatively later easing in lockdown restrictions.

At its extreme, in the absence of an extension and if all those jobs currently supported by the furlough scheme were lost, that would potentially lead to unemployment rising sharply, to around 16% of the workforce from 5.1% at the end of 2020, posing a significant restraint on the UK consumer recovery. The Office for Budget Responsibility (OBR) still expects unemployment to rise, but the peak in the jobless rate is expected to be somewhat lower (c.6.5%) than envisaged previously (7.5-8.0%) by both the Bank

At the peak of the Coronavirus Job Retention Scheme around

1 in 3

jobs were furloughed

By the end of January 2021, almost

5 million

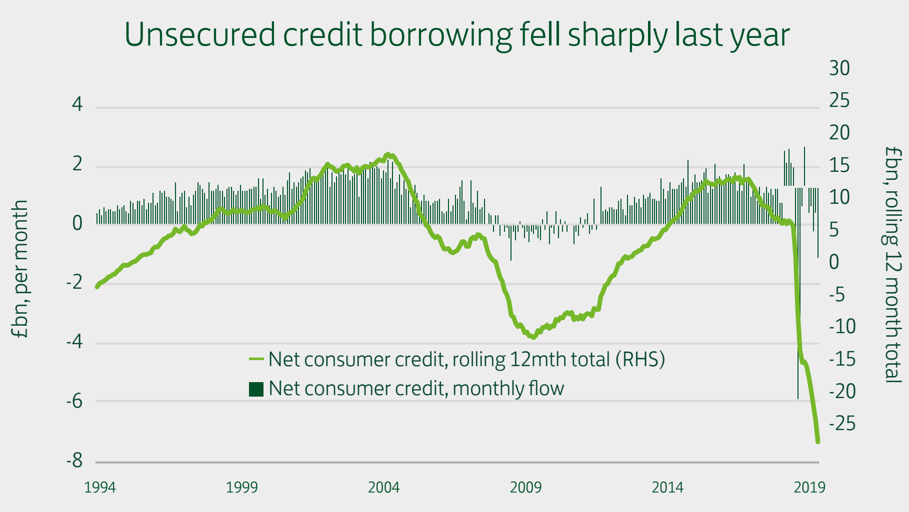
jobs were still furloughed

> "The impact of the furlough scheme has been instrumental in staving off a sharp decline in household incomes"

of England and the OBR. That should allow for some of the increase in 'precautionary' savings generated over the past year, associated with a higher risk of unemployment, to be reduced, adding further impetus to the recovery in household spending.

Positively, efforts made by households to improve their overall debt positions also contributes to the resilience in households' personal finance expectations. Admittedly, some of this happened 'involuntarily' due to the limited opportunities to spend during successive lockdowns. Households made a net repayment of £16.6bn of unsecured borrowing (credit cards, loans, car finance etc.) in 2020, the first annual net reduction since 2011 and the largest since comparable records began in 1993 shown in chart 10.

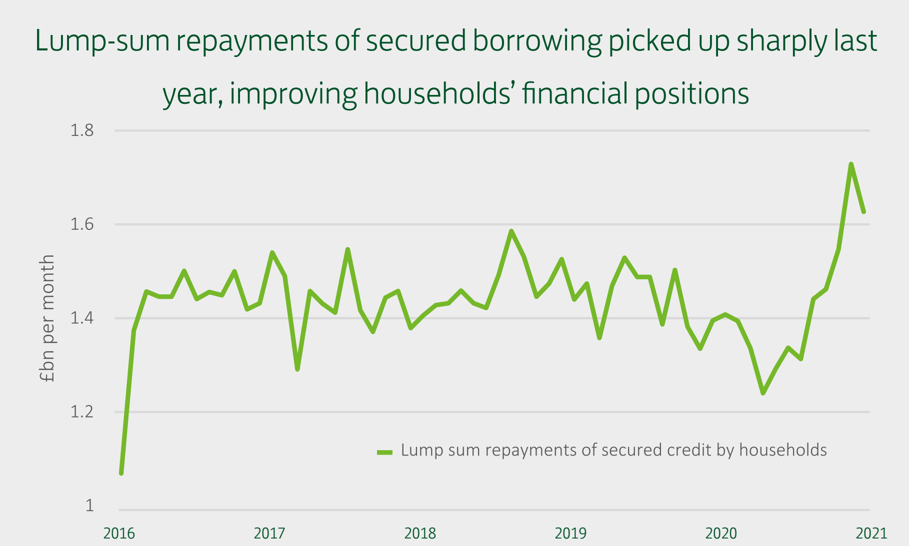
Chart 10:



Source: Bank of England, Macrobond, Lloyds Bank Analytics

It is also noteworthy that even lump sum repayments of secured borrowing (outside of regular monthly payments and redemptions) picked up sharply in the second half of 2020, as demonstrated by chart 11. This suggests that a greater share of unspent income was intentionally directed towards improving households' financial positions. Overall, that should leave households in a strong position to spend once lockdown restrictions are lifted.

Chart 11:



Source: Bank of England, Macrobond, Lloyds Bank Analytics

> Positively, efforts made by households to improve their overall debt positions also contributes to the resilience in households' personal finance expectations

> That should leave households in a strong position to spend once lockdown restrictions are lifted

> The outlook for a sizeable rebound in consumer spending looks strong

Conclusion

The rapid rollout of the vaccine programme is underpinning hopes of a sustainable easing in mandatory restrictions, in line with the government's roadmap. This has boosted hopes of a swift rebound in UK economic activity after a likely contraction in the first quarter. In particular, those parts of the economy that have been subject to the most stringent conditions are expected to see the sharpest recoveries. The need to adapt quickly to an ever evolving situation last year, means the pandemic has led to changes in spending behaviours. Some of which are likely to prove temporary, while others have accelerated longer-term structural changes. How these spending patterns evolve, as and when restrictions are rolled back, will play a key role in the overall recovery in consumer spending.

On the basis that the rolling back in restrictions removes a key impediment for households to go out and spend, especially for those services where consumption has been most restricted or discouraged, a relatively strong recovery in spending should ensue. In particular, with aggregate household balance sheets looking stronger than before the crisis, and supported by the potential drawdown of some of the additional savings accumulated over the past year, the outlook for a sizeable rebound in consumer spending looks strong.

However, how enduring and broad based the recovery in consumer spending proves to be, will depend on the extent to which wider health concerns linger and also how government policy evolves.

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