

Viewpoint

Quarterly

Issue 6. July 2022

Economic woes worsen (fast)

Economics from **IGD**



What's in it for you?

The Benefits: how this issue will help you

The consequences of the war in Ukraine continue to unfold – the outlook for many developed markets now seems bleaker than it did at the start of the year, with inflation choking-off economic recovery from COVID-19.

In the UK, inflation is running far ahead of previous expectations and is likely to go further still. The financial and psychological impact on consumers is severe and volume food sales are contracting.

At present, there is little prospect of material improvement. If anything, a long period of economic stagnation seems likely – even if recession is avoided.

In this report, we provide IGD's view of recent events, seen through the lens of the food and consumer goods industry, highlighting possible implications for your business.

We connect you to original sources and to IGD's wider research, to help you build a fuller picture of what is happening now and what might come next.

What's in it for you?

The Aim: about this series of reports

Our experts track and monitor multiple sources of information. Combined with our knowledge of the industry and shopper insights, this shapes our "Viewpoint".

We provide this analysis as part of IGD's Social Impact activity because we believe it supports better planning and decision-making, to the benefit of the shoppers we serve and society as a whole.

We will continue to monitor closely the longer-term impact of global events, price inflation, government policy and other major themes, keeping you up-to-date in future issues of this series.



IGD Viewpoint in summary

Economic woes worsen (fast)

The cost of living crisis dominates the business landscape in 2022. The food and consumer goods industry is seeing the strongest inflation in decades and there is likely much further to go before prices begin to stabilise.

Many shoppers are in severe financial distress and they are being forced into difficult spending decisions. IGD's ShopperVista research shows that some have fallen suddenly into material hardship.

In the short-term, businesses will remain focused on inflation pressures and supply issues, however longer-term strategic risks should also be considered.

UK economy facing recession

Annual "all items" CPI inflation reached 9.4% in June 2022, with food and drink at 9.8%. IGD anticipates that [food and drink inflation](#) will peak at 14 to 16% in late summer or early autumn, averaging between 10% and 12% over the full year.

Economic growth faltered in the first half of the year. Performance in May was stronger, but it is clear that the consumer-facing part of the economy is not doing well. Multiple indicators suggest that recession is now highly likely.

Paradoxically, the labour market remains strong for now, with low unemployment and many unfilled vacancies. The Bank of England has warned against high pay awards, for fear of triggering a wage-price spiral. However, trade unions are becoming increasingly assertive.

Household incomes in decline

Pay is rising fairly quickly, but is not keeping pace with inflation, leaving most workers facing a fall in real wages, after adjusting for the impact of inflation.

The cost of living support package provided by the Treasury, worth around £1,200 for the most vulnerable households, will go some way in shielding them from the impact of energy price increases. Unfortunately, energy is only one part of the inflation problem, and households will remain under pressure from food and petrol prices too.

Persistent availability concerns and cost of travel will limit the ability of the most vulnerable households to mitigate food price inflation by shopping around and accessing the best prices.

Shopper sentiment remains bleak

IGD expects shopper confidence to dip further in the coming months as shoppers contend with increased financial pressures.

Faced with further increases in the cost of food, petrol and energy, expect more shoppers to cut back their spending, particularly those on the lowest incomes. Businesses have a key role to play in ensuring continued food supply at affordable prices.

The changing policy landscape

The UK suffers from a number of strategic economic weaknesses, making it especially vulnerable to global events.

The government has announced plans to address this, but it is not clear how successful it will be – even in the best case, major improvements will not be delivered quickly.

IGD forecasts suggest an extended period of low growth for both [food retail](#) and [eating out](#), but this does not mean that these markets will stay static – major structural change and evolution is still expected.

Government also continues to develop policy for food and consumer goods – businesses leaders must remain alert and adapt accordingly.



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UK economy faces recession

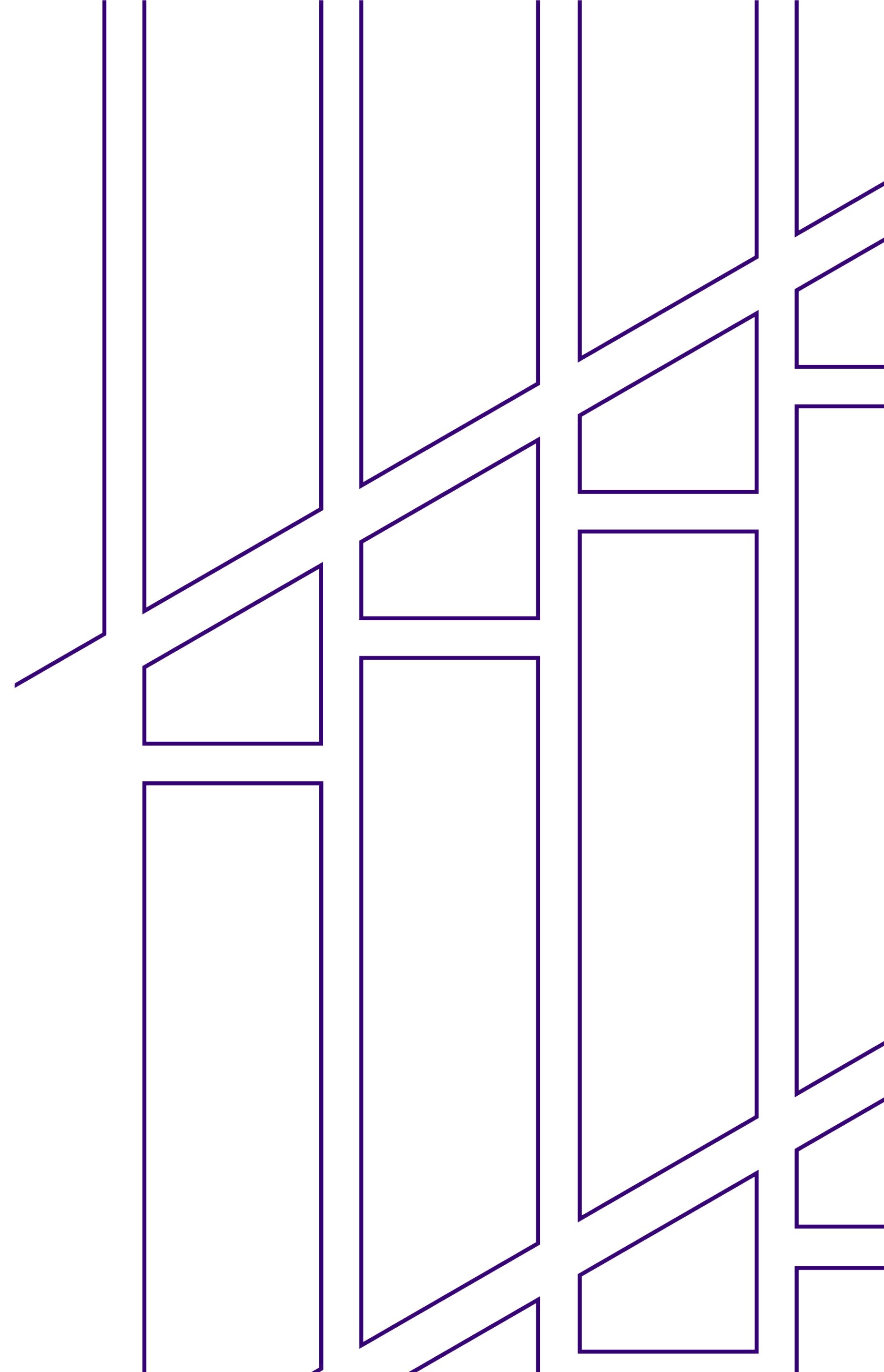
Viewpoint from **IGD**

A recession is expected to materialise in the short to medium term as the cost of living crisis weakens consumer demand, whilst businesses face continued supply disruption and labour shortages.

The Bank of England now expects annual “all items” CPI inflation to peak at 11% in autumn, before falling back to its target of 2% within 2 years.

IGD [believes](#) that food price inflation will average between 10% and 12% over 2022, with a peak value of 14% to 16% reached in late summer or early autumn.

Household incomes will remain under severe strain over the coming months. Without significant pay increases, living standards will continue to fall sharply.



What's happening?

Energy, petrol and now food prices have driven inflation to its highest level in 40 years, reaching 9.4% on the CPI measure in June. The RPI measure, the broadest measure of household inflation, is accelerating faster, hitting 11.8%

Unfortunately, inflation shows no sign of subsiding. The Bank of England has forecast that [CPI inflation will top 11%](#) in autumn 2022 once the energy price cap rises in October. Pressure on household income is expected to continue, [Ofgem has confirmed](#) that the energy price cap will be higher than its previous prediction of £2,800 for the annual average household bill in October.

Food price inflation is accelerating, increasing to 9.8% in June, up a further 1.1% on the last month. In our Viewpoint special [report](#), IGD forecast that food inflation will average between 10% and 12% over 2022, peaking at 14% to 16% in the summer.

Monetary policy is the traditional response to high inflation, through the raising of interest rates. Since 2021 the Bank of England has been [increasing interest rates](#), with the rate currently at 1.25%. It expects rates to continue to rise and [reach 2.5%](#) by mid-2023.

Raising interest rates is an effective means of dampening demand when demand is forcing prices higher. Unfortunately, the current inflationary event is primarily down to supply side shocks and the potential for interest rates to control inflation seems limited.

Leading indicators of economic performance make concerning reading. Consumer confidence hit record lows in June, with consumers cutting back on big ticket items. The business community is also feeling the impact, with investment [down 0.5%](#) between January and March 2022.

The labour market remains tight. Vacancies outnumber those who are unemployed, with staff shortages disrupting supply chains and constraining economic activity.

The current labour market shortages have been driven by two key factors:

- The pandemic reversed the long-term trend of falling economic inactivity*. This is principally a result of over 250,000 people between the ages of 50 and 64 leaving the workforce since January 2020. The main reasons to leave the workforce are retirement and long-term illness. For businesses, it is unlikely these people will return in considerable numbers to solve the labour shortages.

*Economic inactivity is defined by ONS as "people who are not in work, who have not sought work in the last 4 weeks and / or are unable to start work in the next 2 weeks".

- Since EU Exit, there has been a c.200,000 fall in the number of EU migrants employed. This has been partially replaced by non-EU migration, however, the current migration policy favours high-skilled workers. This has led to shortages for lower-skilled workers.

Other implications of EU Exit are beginning to become clearer. Overall trade has fallen as a share of GDP by around 8%. This is considerably higher than comparable countries and further weakens UK economic competitiveness.

Why it matters

Inflation, a tight labour market and weakening confidence caused economic recovery from COVID-19 to falter in H1 2022.

However, provisional data for May 2022 showed surprisingly strong month-on-month performance, with economic activity up 0.5%.

Services grew most strongly, but much of this was accounted for by government spending, especially healthcare.

On the consumer side, expenditure is falling.

Demand for retail, recreation, gambling and eating out weakened month-on-month, probably due to softening confidence and falling spending power.

Risk of recession remains high – the economy cannot do well unless consumers are feeling financially secure and assured.

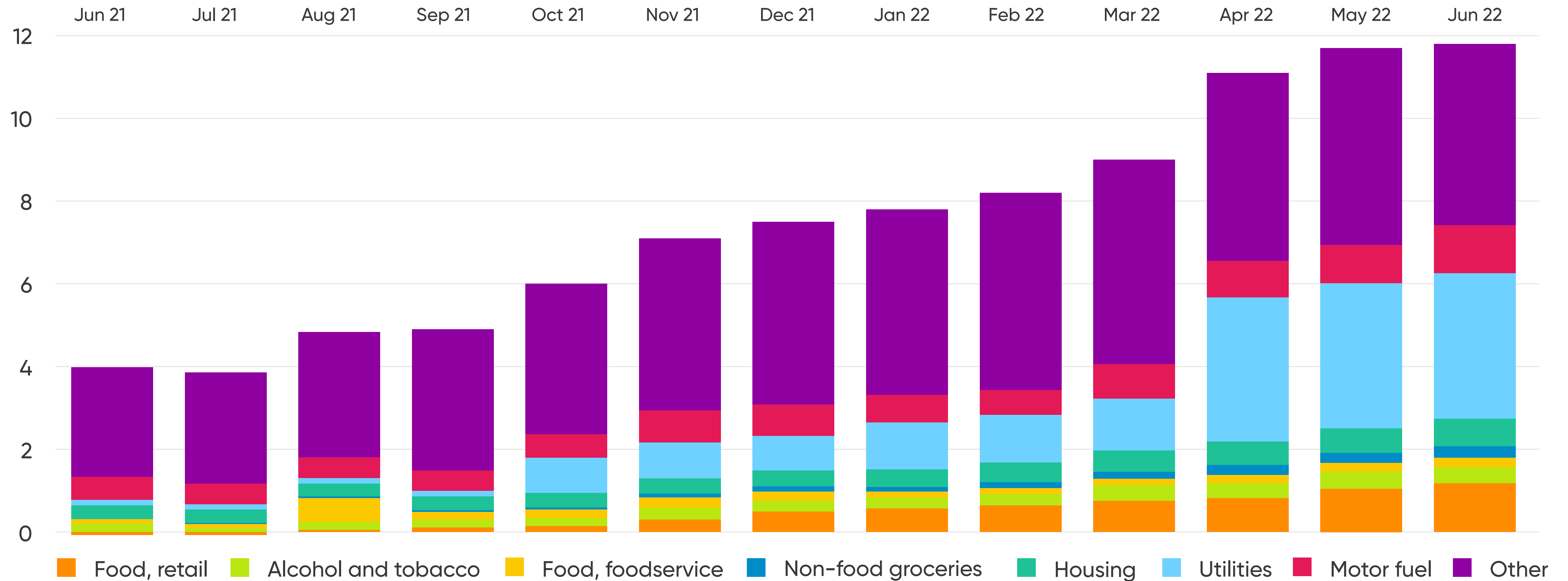
If recession comes, recovery may be difficult. A combination of economic mismanagement, EU Exit and weak Sterling have left the UK economy exposed in a competitive global environment.

Data at a glance

Contributions to RPI

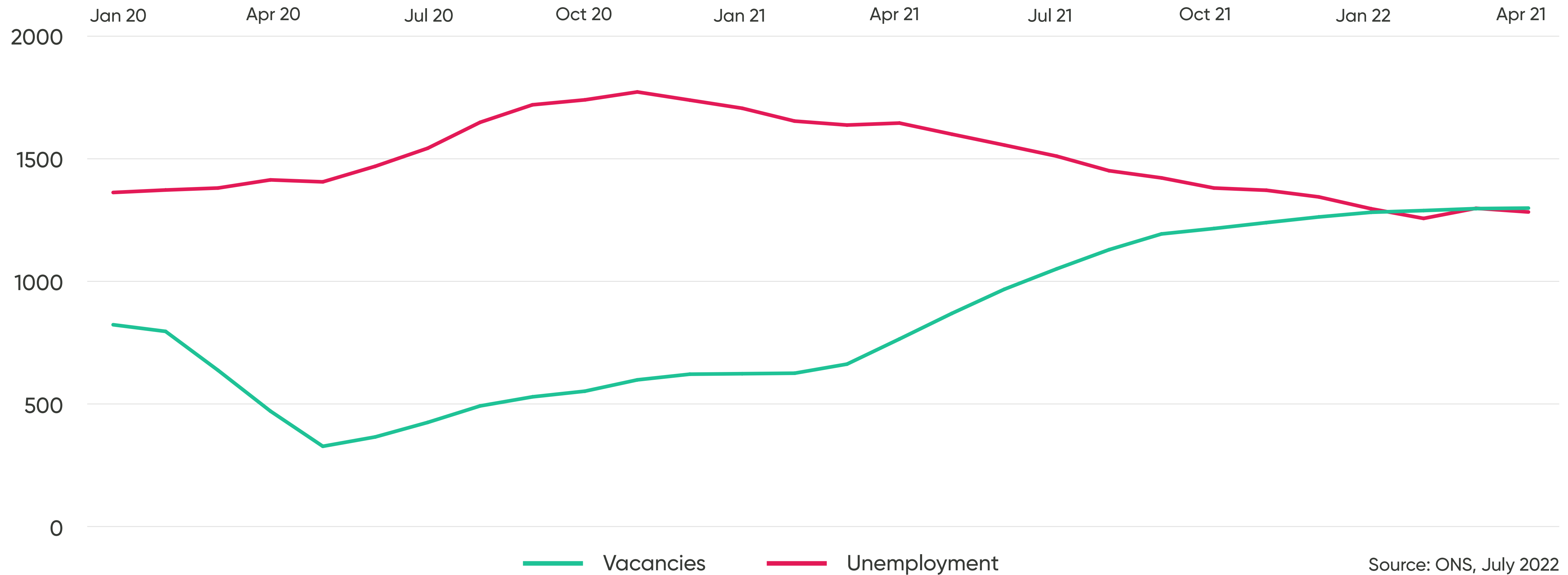
Estimated contribution to annual RPI

Source: ONS and IGD calculations, July 2022



Data at a glance

Number of vacancies and those unemployed no. of people (000's)



Source: ONS, July 2022

Implications for your business

▲ Supply chain risks remain high

As global commodity markets remain volatile, expect supply shortages to remain. Protectionist decisions by key producers of goods could cause sudden shocks to markets.

▲ High tax burden to remain

With poor economic growth forecast, the government will have to maintain its pressure on tax revenues to afford public services that will also be seeing cost increases.

▲ Labour shortages to curtail growth

Unemployment may rise slightly as the economy enters recession, however, expect continued labour market tightness. Recruitment and retention will continue to be challenging, with labour shortages likely to have commercial implications.

▲ Interest rates creeping up

The Bank of England is now raising interest rates regularly to curb inflation. The expectation is that this will continue to rise to above 2%. This will prove costly for new business investment and will create challenges for heavily indebted businesses.

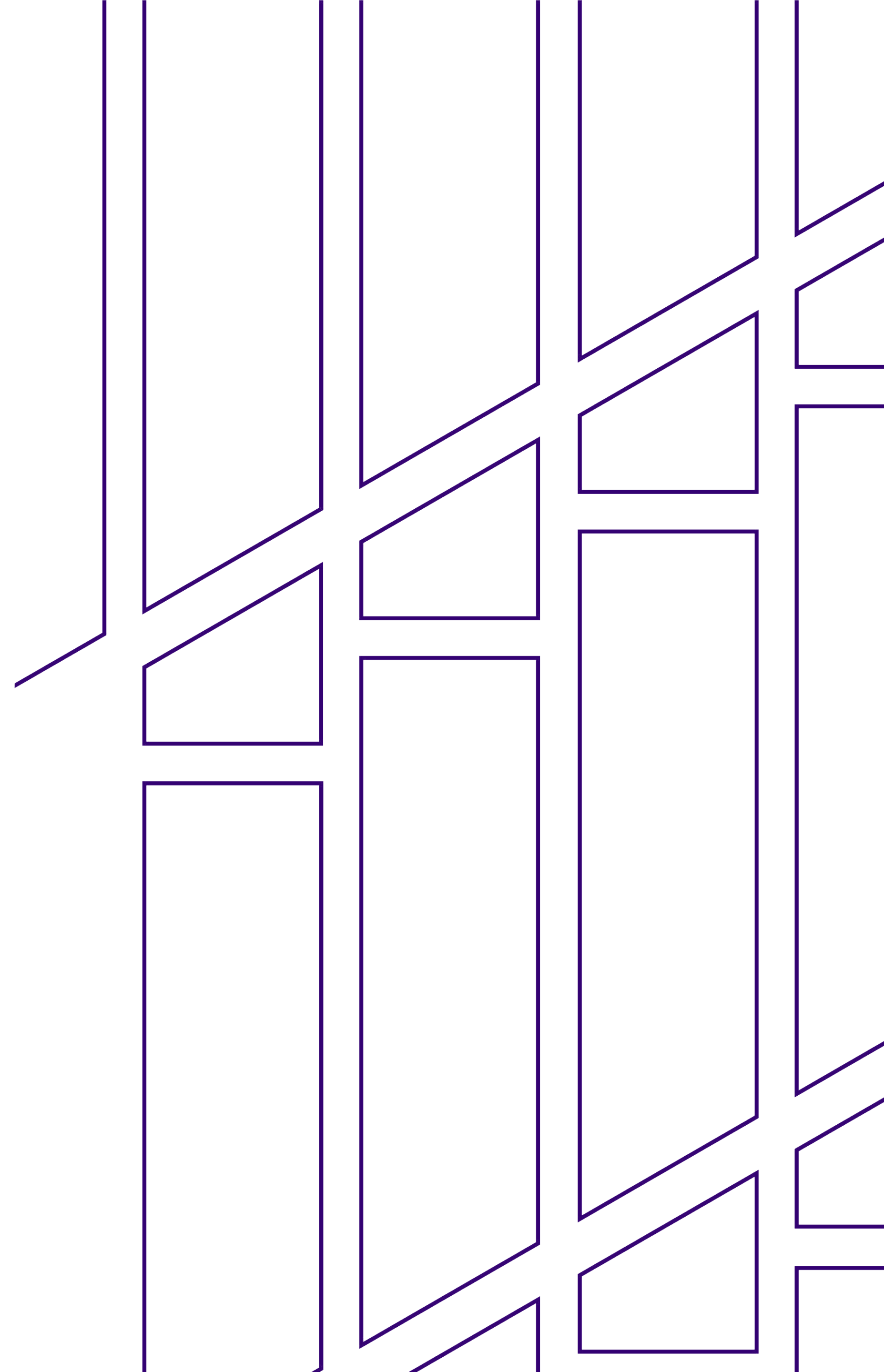
Household incomes in decline



As is the case in any inflationary period, the poorest in society are the hardest hit. More of their budget is spent on essentials such as food, fuel and energy, and so the increases in these bills will affect them disproportionately.

The support package from the Treasury will go some way to shield the most vulnerable households from the impact of rising energy bills, however, the Government will be unable to protect everyone from all price increases. Access to, and availability of, the most affordable food will be critical in allowing households to manage inflation.

Around a quarter of UK households have no access to savings at all and so are more likely to use food banks, skip meals or go into debt, raising severe welfare concerns. It is likely that UK household debt will increase in the coming months.



What's happening?

Households across the UK are seeing a significant reduction in living standards. Average wages, after adjusting for the impact of inflation, are falling. Using the RPI measure of inflation, the broadest measure of household inflation, workers were 4.1% worse off than a year ago in May 2022.

UK households have seen real wages flatline since 2008, leaving households vulnerable to inflation spikes. Large real wage contractions over 2022 are an exacerbation of the long-term trend post financial crisis.

Wage growth in 2022 is mainly being supported by strong bonus growth, which tends to favour higher earners (eg: the financial services sector, sales professionals). Stripping out the impact of bonuses, regular pay has fallen in real terms by 6.2% compared to the last year. This is a severe contraction for lower and middle income workers.

The Government has announced a [targeted support package](#) to help vulnerable households pay for higher energy bills. The most vulnerable households will receive £1,200 in 2022, which will cover around 70% of the expected price cap rise.

The support will only cover price increases through to March 2023, but with prices expected to remain high into early 2024 this may have severe welfare implications going forward – support will likely run out before prices fall.

Those in low paid employment and not receiving Universal Credit, will only receive around half of the £1,200 support.

The group most likely to see the largest fall in living standards from energy price rises will be the “squeezed middle” – too poor to accommodate price change, but not poor enough to qualify for maximum support.

Unfortunately, domestic energy is only one part of the inflation picture for households. The average petrol price across the UK has risen by 30% in 2022, whilst IGD forecast that the average family of four will have to pay £516 more a year for food by December 2022. The Government is currently not providing support for households for these price rises.

Why it matters

Households will develop techniques to manage inflation. Within food retail this is likely to be by trading down to lower cost items, visiting discount stores and purchasing less.

Last month, [ONS revealed](#) that the prices of the lowest cost food items are rising in line with other food and drink inflation. However, this ignores availability of, and access to, these items. For those who rely on the lowest cost food, it is important that this food is available reliably, in stores they can access.

The ONS data suggests that for two-thirds of

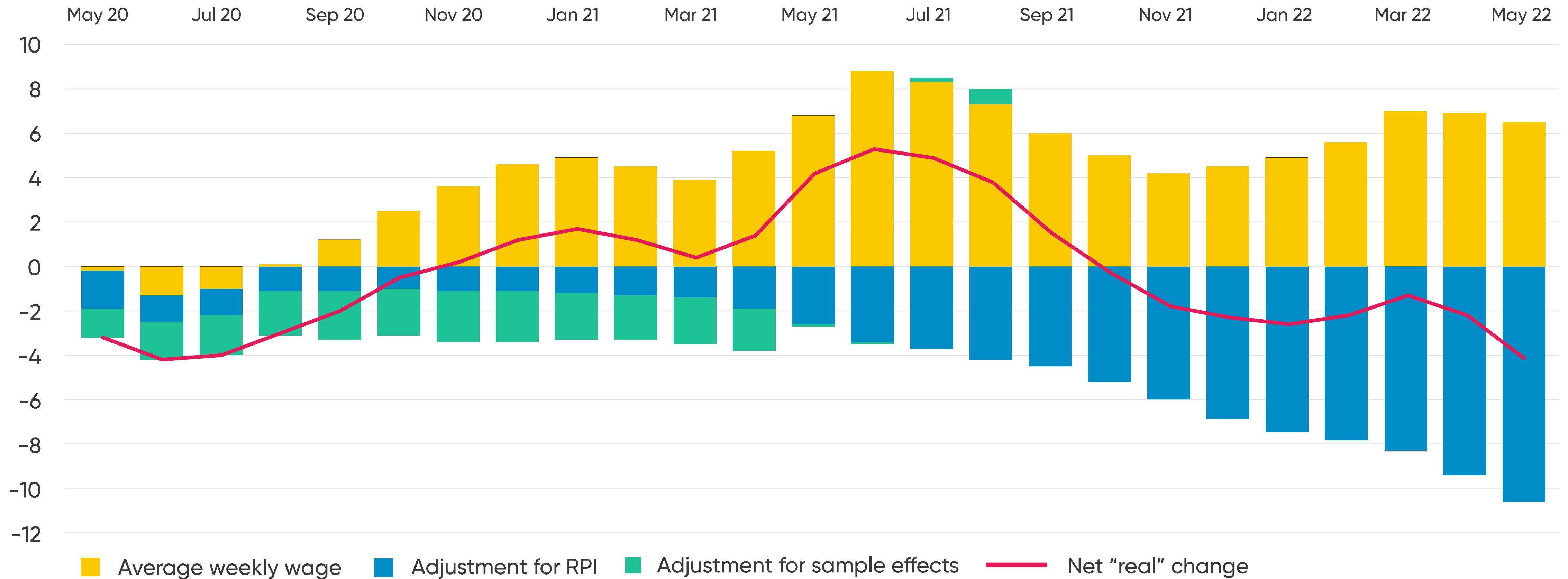
the items sampled, if a substitute is necessary due to a lack of availability the price would increase by at least 20%. This will have a significant impact on the price of a weekly shop for vulnerable households.

Record high petrol prices, and tighter travel budgets will limit the ability for households to shop around and access the lowest cost food, restricting their ability to manage inflation.



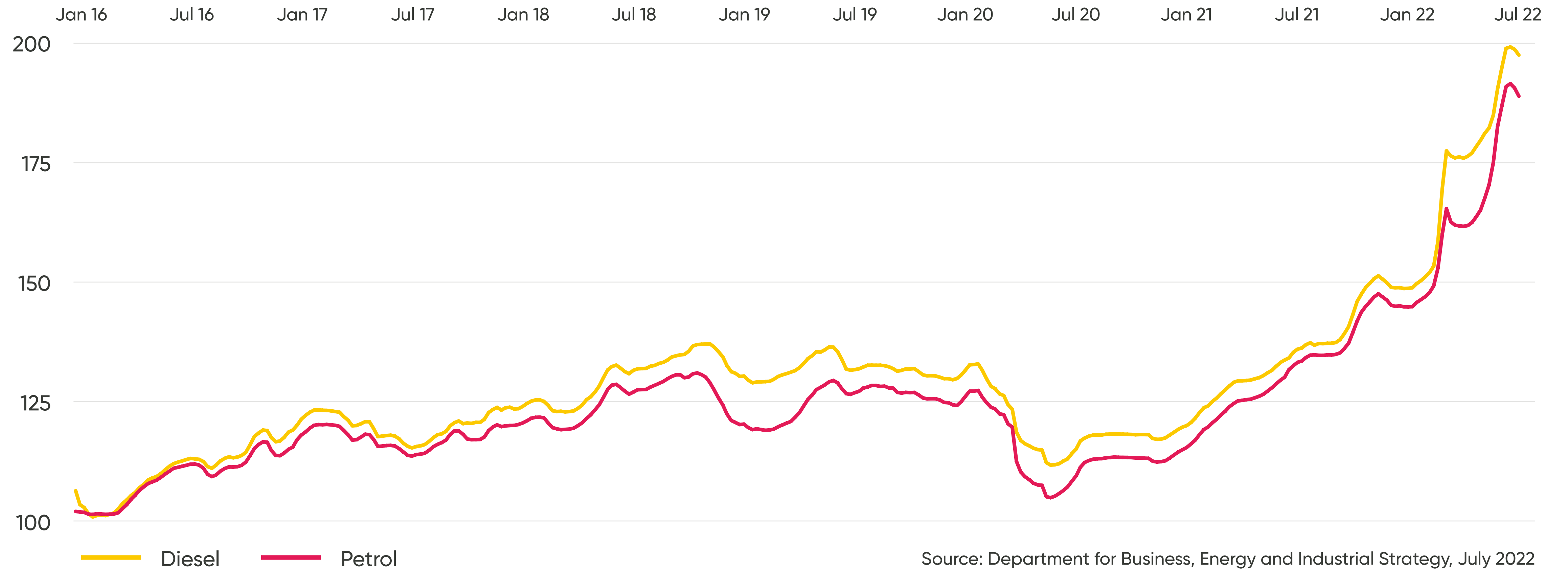
Data at a glance

Change in average real weekly wage, all workers Year-on-year change (%)



Data at a glance

Weekly road fuel prices pence per litre (£)



Source: Department for Business, Energy and Industrial Strategy, July 2022

Implications for your business

▲ Availability to play a crucial role in household budgets

The cost of living crisis and the experience of vulnerable shoppers has put a spotlight on the availability of the lowest cost items.

Prioritisation of these items across the supply chain will ensure the most vulnerable households have the best opportunity to manage food inflation. Availability issues impacting the lowest cost items are likely to lead to more meals being skipped.

▲ A proactive union movement

Many businesses have made significant investment in wages in recent months, but maintaining real pay at a time of surging inflation is challenging.

Trade unions will inevitably be keen to negotiate further pay increases.

▲ Expect more labour churn

Given inflationary pressure on consumers and a tight labour market the motivation for lower paid workers in particular to seek other employment opportunities may increase in the months ahead – employers will need to work hard to hold on to current employees. These employees will be a challenge to replace.

Retaining existing staff and encouraging people into the industry will be crucial to ensure supply chains can run as efficiently as possible.

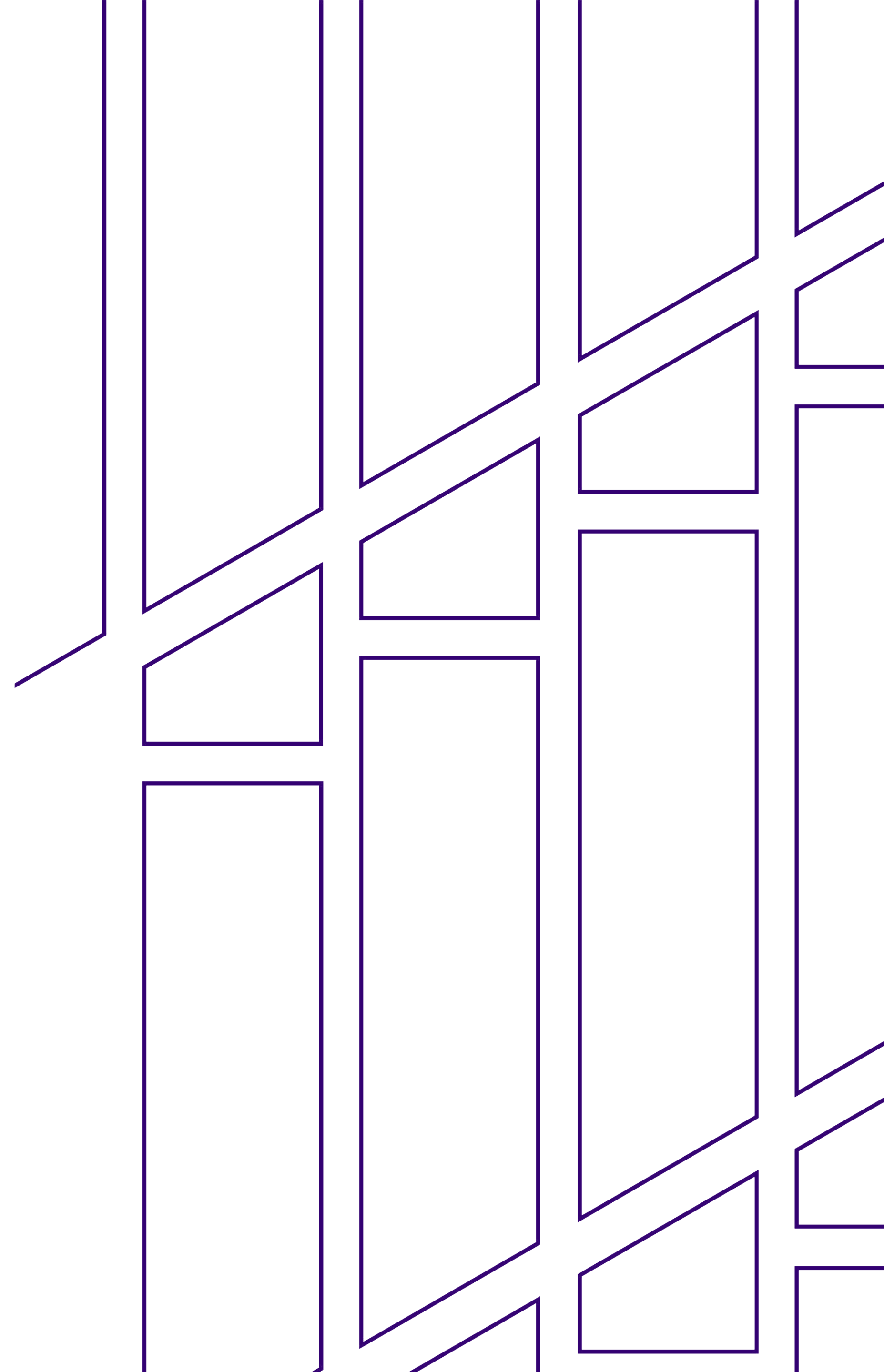
Shopper sentiment remains bleak

Viewpoint from **IGD**

With IGD predicting that food price inflation will nearly double from its' current level by later summer, shopper sentiment will remain bleak with confidence dipping further in the coming months. As shoppers contend with further increases in the cost of food, petrol and energy, expect them to cut back on their spending.

Managing household budgets is set to become even more difficult for a significant proportion of shoppers, particularly those on lower and fixed incomes. Food stress will become a real issue for some of these households.

Expect shoppers to be increasingly divided in the methods they use to cope with rising inflation. Businesses will need to be agile to align their offer with changing shopper preferences. Shoppers will be looking for government and business to provide further support to help them contend with these cost of living pressures.



What's happening?

Shopper confidence has declined once again and reached a new all time low* of -24 in June, according to [IGD's Shopper Confidence Index](#) (for ShopperVista subscribers). This compares with a score of -3 in June 2021.

As the war in Ukraine continues to disrupt supply chains and global energy markets, prices for food, fuel and energy continue to rise, denting shopper confidence.

With inflation reaching a 40 year high in May, shoppers are becoming increasingly pessimistic about the future. 91% expect food prices to rise in the next year, with 50% expecting prices to get much more expensive compared to just 14% in June 2021. This is the highest level since January 2016.

*All-time low – since this was first measured in August 2013.

As [wage growth lags inflation](#), financial confidence has declined sharply, with 56% of shoppers expecting to be worse off financially in the year ahead, the highest level to date. This compares to just 21% expecting to be worse off in June 2021. Just 15% expect to be better off.

Faced with greater financial pressures, shoppers are increasingly shifting their focus to saving money. 41% are prioritising saving money over quality, compared to 15% in June last year.

While all consumers are being affected by the worsening cost of living crisis, lower income groups are being impacted the most.



- ▲ 62% of lower income consumers (DEs) expect to be financially worse off in the year ahead compared to just 45% of higher income consumers (ABs)
- ▲ 47% of lower income consumers (DEs) expect to focus more on saving money rather than quality this year compared to 39% of higher income consumers (ABs)

This is resulting in further changes in shopping behaviour including more shopping around, increased shopping frequency and lower levels of product loyalty, particularly to well-known brands.

Shoppers are divided in the way they are coping with rising food price inflation. Lower income shoppers are more likely to be doing the following:

- ▲ Skipping a meal more often
- ▲ Reducing usage of convenience stores and online grocery

Higher income shoppers are more likely to be doing the following:

- ▲ Planning more of their meals
- ▲ Cooking more using leftovers
- ▲ Making more packed lunches

Why it matters

With shopper sentiment very bleak, there is a real risk that shoppers will cut back their spending further, thereby leading to further [volume loss](#) for food retail.

Food stress may increase with more of those on the lowest incomes forced to miss more meals and turn to food banks for support. This will undoubtedly leave many households – and the businesses serving them – looking to the future with considerable anxiety.

With saving money becoming more important, there is the potential for fewer shoppers to focus on [healthy and sustainable diets](#).

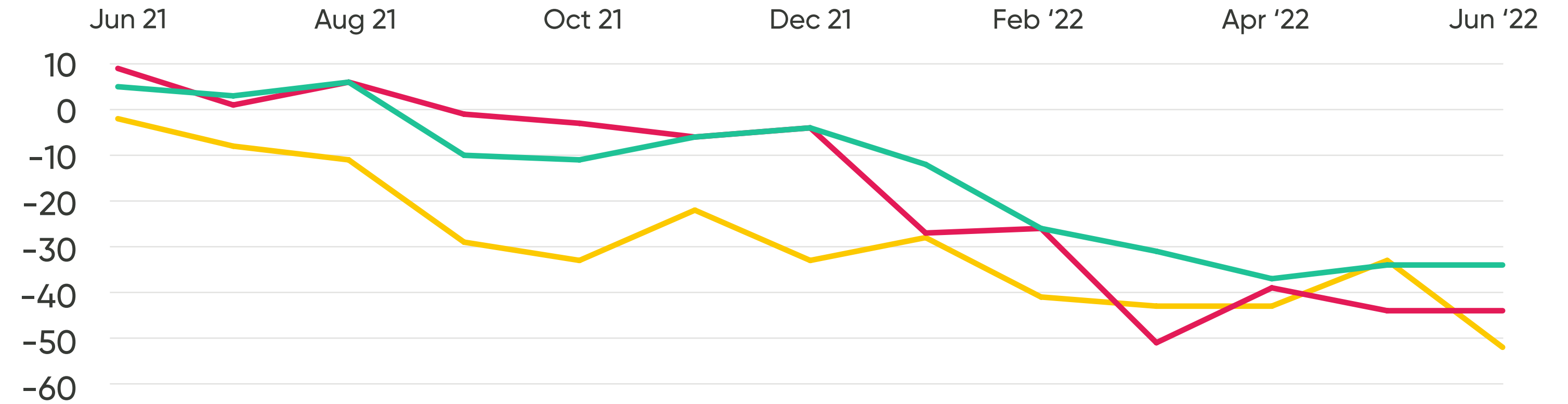
Source: IGD ShopperVista; Base: 1,000+ ALL shoppers, June 2022

Data at a glance

- DE
- C2
- ABC1

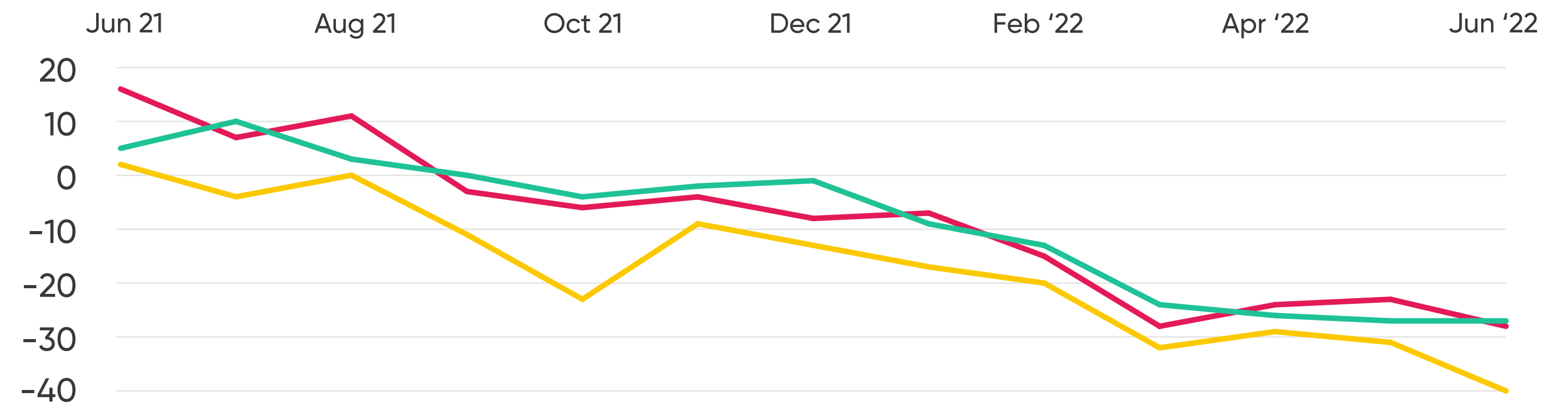
Financial confidence in year ahead by income group

Net confidence – better off minus worse off (%)



Focus more on quality vs saving money in year ahead by income group

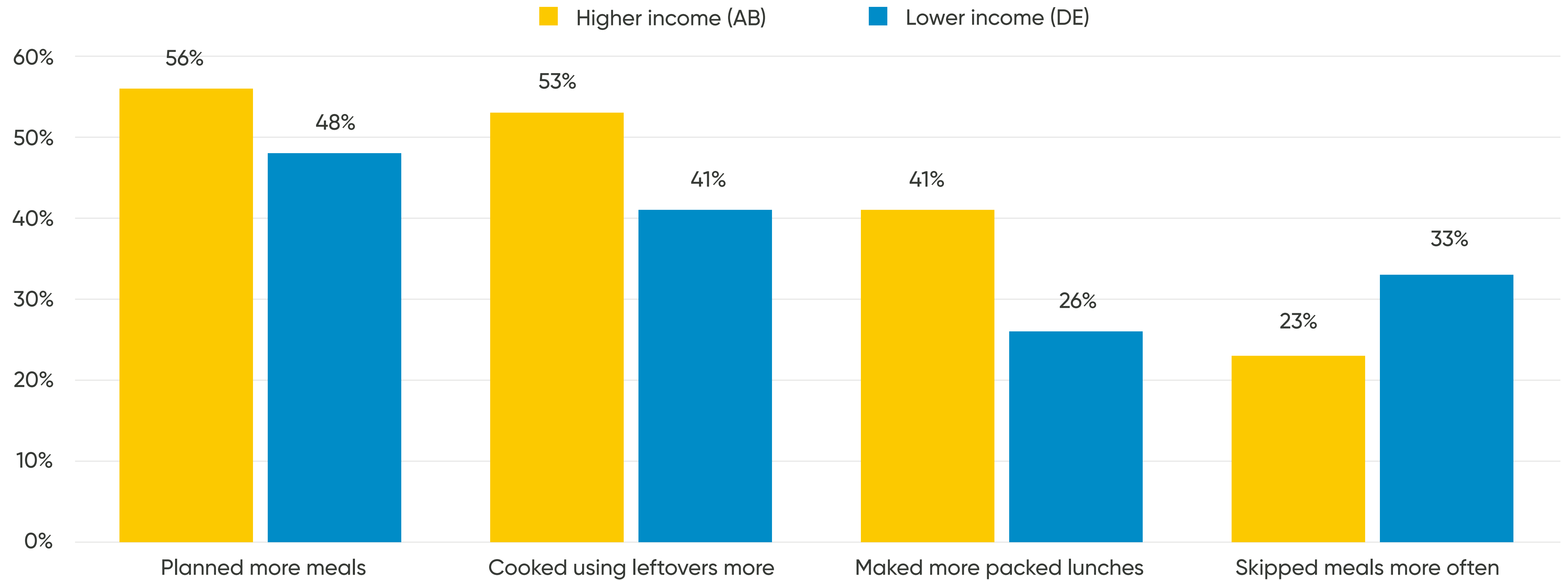
Net Quality minus saving money focus in next year (%)



Data at a glance

Saving money tactics

Source: IGD ShopperVista; Base: 1,000+ ALL shoppers, May 2022



Implications for your business

▲ Increased price sensitivity

Expect shoppers to focus more on price comparison when choosing food and grocery products and stores. Businesses will need to provide products at affordable prices. Minimise the impact of rising input prices for shoppers.

▲ Loyalty under pressure

IGD ShopperVista research has revealed that fewer shoppers are remaining loyal to well-known brands. Branded suppliers will need to showcase value and quality messages to avoid more shoppers switching to private label alternatives.

▲ Lead on sustainability

This is undoubtedly a moment of disruption. But it's also the time for industry to lead on sustainability. IGD is [working collaboratively](#) with the whole industry to drive tangible change in several areas including food waste, packaging, net zero, environmental labelling and healthy and sustainable diets. Join us in these programmes to ensure shoppers don't have to choose between cost and sustainability.

The changing policy landscape



The resignation of the Prime Minister and changes in the Cabinet will inevitably delay some policy initiatives. The outcome of the Conservative leadership election will define the future direction of Government policy. Government and businesses are understandably focused on managing the cost of living crisis, but those in leadership roles must also consider longer-term strategic challenges.

Government must deliver a credible plan for economic development in the post-EU era – improving productivity and competitiveness should be the central objective.

Better productivity would allow the government to manage national finances more sustainably and also, hopefully, improve prosperity for citizens after an extended period of stagnating real incomes.

The Government has set out some elements of its strategy to deliver these goals in its recent [levelling up](#) and [food strategy](#) policy papers.

The Food Strategy does not adopt all the recommendations made by Henry Dimbleby in his [independent review](#) of the food system, and there are questions as to whether it will deliver sufficient change required to address the most significant challenges we face.

However, IGD welcomes the move towards a more transparent, data-driven food system, which will allow better decision-making for all participants, including shoppers.

With government resources limited, it is likely that food and consumer goods businesses will need to take the initiative in tackling issues such as climate change and obesity.

IGD believes there is a real desire from businesses to find a clear way forward and to help deliver a long-term positive change to Britain's food system. IGD stands ready to play our part using our unique ability to bring stakeholders together from across the whole food and consumer goods industry.

What's happening?

Historic weaknesses biting

As outlined in Chapters One and Two, consumers in the UK – and other countries – are seeing their spending power eroded rapidly, as strong inflation eclipses income growth.

Consumers in the UK may be more exposed to the inflation threat than their counterparts in other developed economies, due to long-standing strategic weaknesses:

- ▲ Depreciation of Sterling, making imports more expensive
- ▲ A large, long-standing trade deficit in goods and energy, increasing UK vulnerability to global events
- ▲ Persistently low real wage growth, likely due to weak productivity performance

- ▲ Lack of savings in many households, meaning that resilience to financial shock is low

The UK government is also in a weak position, due to:

- ▲ Difficulties delivering the anticipated benefits of EU Exit (eg: expanded global trade, reduced red tape)
- ▲ Exceptionally high sovereign debt, raising concern over future borrowing costs
- ▲ Limited scope for further monetary measures to support the economy
- ▲ Unfunded health and pension liabilities, a major problem as the population ages

In spite of this, the Government continues to develop legislation and regulation across several areas that impact food and consumer good businesses.

Northern Ireland

Talks between the UK and the EU on reform of the Northern Ireland Protocol (“the Protocol”) remain deadlocked.

The UK government continues to favour a negotiated settlement, but it has introduced [legislation](#) allowing it to act unilaterally. The Bill has now passed a second reading on the House of Commons, but it has faced broad opposition both within and beyond the UK – the EU has threatened legal action if the government persists.

Government has [set out](#) its high level thinking, but detailed plans remain unavailable, as consultation is ongoing.

Any change to border arrangements in Northern Ireland remains some way off – in the meantime, “standstill” arrangements continue to apply.

Government Food Strategy

In June 2022, the government published its [food strategy](#) in response to recommendations made by Henry Dimbleby in his independent review, outlining plans for further development of the food system, with three broad strategic objectives:

- ▲ A prosperous, resilient agri-food system
 - ▲ Improve farm productivity, maintain current levels of local food production
 - ▲ Support innovation across the agri-food system
 - ▲ Expand the Seasonal Agricultural Workers Scheme and conduct an independent review of labour
 - ▲ Review existing skills programmes
- ▲ A sustainable, affordable food system, with better health outcomes
 - ▲ A Food Data Transparency Partnership, with mandatory reporting initially for health metrics

- ▲ A land use framework to be published in 2023
 - ▲ Trials on interventions to encourage healthier, more sustainable diets
 - ▲ Measures to improve school food provisions and drive health via the school system.
- ▲ Grow agri-food trade
 - ▲ Harness the benefits of EU Exit through free trade agreements
 - ▲ Driving agri-food exports via embassies

Note that agriculture and food are devolved policy areas, with responsibility distributed across national governments. The strategy announced in June 2022 covers England only, although government has stressed its intention to work closely with the Devolved Administrations, reflecting that the food system operates on a UK-wide basis.

Other government activity

- ▲ EU Borders – The Government has [elected](#) to further delay implementation of some changes affecting movement of agri-food goods from the EU to the UK. It is also likely that the final form of border administration will be somewhat different to what was initially envisaged.
- ▲ HFSS – In June, the Government [announced](#) a change in timelines for implementing some new rules on promotion and marketing of food high in fat, salt and sugar (HFSS). Rules on product placement in stores will be implemented as planned in October 2022.
- ▲ Queen's Speech – [The Queen's Speech](#) of 10 May 2022 includes reference to several measures of interest to food and consumer goods businesses, including Bills on rating for business property, genetic technology and animal welfare.

Why it matters

The Government has indicated that delays to implementation of border measures and HFSS rules were a direct response to rising inflation. This indicates that government recognises the difficulties faced by businesses and consumers, and is keen not to aggravate them.

However, these changes will still be implemented within the foreseeable future and almost all businesses in the food and consumer goods space will be affected to some degree. The future shape of the industry will be determined in part by these rules.

Looking further ahead, the promised land use framework, aimed at maximising biodiversity and mitigating climate change could have the greatest impact on food production in the UK.



Implications for your business

▲ Maintain strategic awareness of border plans

Many food and consumer goods businesses are reliant on goods imported from the EU and will therefore be impacted to some degree by planned changes to UK border arrangements.

The government is still developing plans to be introduced in 2023 (now called the Target Operating Model, or "TOM").

Business leaders should look for opportunities to participate in this process and be ready to implement procedural change as needed – timescales may be short.

▲ Progress on Northern Ireland is critical

Talks between the UK and the EU remain deadlocked but this cannot continue indefinitely.

With the EU threatening legal action and the UK moving to bypass its partners, it is easy to envisage a negative outcome.

Many food and consumer goods businesses have supply chains that extend from GB to NI and these could be affected by change, whether it is agreed or contested.

It may be time to consider possible outcomes and to plan accordingly. Flexible supply arrangements may be needed (eg: it may be easier in future to supply stores in NI from Ireland than from GB).

▲ Expect delays to government business

The resignation of the Prime Minister is likely to delay key policy initiatives such as those to tackle obesity (due to be set out in a Health Disparities White Paper), as well as future fiscal policy.

Businesses should remain agile to upcoming policy changes.

Next steps

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1

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to get in touch with us for further help and support