HARGREAVES LANSDOWN

A SAVINGS AND RESILIENCE BAROMETER FOR GREAT BRITAIN

A landmark study by Oxford Economics

July 2022

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FOREWORD

CHRIS HILL
CEO, HARGREAVES LANSDOWN

When we launched HL's Savings and Resilience Barometer in January, we were hopeful that the turbulence of recent years might finally be behind us and that all of us would be able to look forward to a less stressful time when it came to our finances.

We knew that 2022 would bring its fair share of challenges, and that inflation was likely to erode some of the strong foundations of financial resilience that many people had managed to build during the pandemic. However, as the year started there were few signs of the scale of the cost-of-living crisis that millions of people now have to face on a daily basis.

The invasion of Ukraine, and the subsequent economic fallout from key parts of the global community coming together to deploy economic sanctions against Russia, has dramatically intensified the inflation we were already seeing from supply chain pressures post Covid. The cost of everything - from food to fuel – has hit people's finances where it hurts the most: everyday essential spending.

Oxford Economics has updated the Barometer to look at where people stand right now. It has also modelled what the next twelve months holds in store, to help us all understand how these continued strains -from higher interest rates to continued high inflation – will impact households' financial resilience.

This work helps provide practical and constructive insight and analysis that we hope will show people how economic shocks will impact them personally, both in the months ahead, and over the longer-term. It will also inform policymakers about some of the priority areas for them to make suitable interventions. Finally, it gives firms such as Hargreaves Lansdown the understanding to enable us to best support our clients throughout this period we face

This report gives the headline analysis, which shows just how challenging the current circumstances are. Real disposable income has fallen and will remain stagnant, even with the significant policy interventions from Government. We expect to see 41% of households dipping into reserves or debt simply to stand still. The cumulative impact of this is that any gains in resilience during lockdown have been wiped out with resilience inequalities between the rich and the poor, being compounded further.

Ahead of these findings, in May, we held an invaluable discussion with members of our broader Sounding Board to ensure that the work we are doing, the data we are collecting and the value we hope to bring from this research – for policy makers and for individuals and their families – is as relevant as it can be. I want to say thank you to the representatives from StepChange, Nationwide Building Society, Legal & General, The Money and Pensions Service, HM Treasury, Department for Work and Pensions, the Financial Conduct Authority, the Personal Finance Research Centre at the University of Bristol, the Resolution Foundation and Nest Insight. I am grateful to those who took the time to share their ideas, provide essential feedback and suggest practical solutions that will continue to improve the work of the Barometer.

What was clear from the discussion at the Barometer Sounding Board, is that understanding more granular data will remain vitally important when planning the essential support needed for households in the current volatile situation. We will also use the Barometer to work through the impact of different policy choices. Our first supplement considers pensions, and how the changes proposed in the 2017 review of automatic enrolment of employees into workplace pensions would impact people if it was implemented today. Through exploring these questions, we hope the barometer provides a useful framework for considering how and when to bring in these changes.

At Hargreaves Lansdown, we will continue to support our clients with their decisions, weighing up short-term spending requirements, and longer-term financial planning. To this end we have developed a Savings and Resilience tool based on the barometer's data, so that people can see how they compare to others of a similar age group, income profile or region.

As we update and maintain this Barometer in the years ahead, we will be able to see how the various economic shocks today will impact longer term financial resilience. This will inform the actions we put in place to help build the nation's financial resilience. I know I am not alone in hoping that together we can continue to track – and improve – this resilience.

For further information on the Barometer please contact:

ANNE FAIRWEATHER
Head of Government Affairs and Public Policy
anne.fairweather@hl.co.uk
07971 073 374

NATHAN LONG
Senior Analyst
nathan.long@hl.co.uk
07527 384 753

SUMMARY FINDINGS

In January this year, Hargreaves Lansdown, in partnership with Oxford Economics, launched the first edition of the Savings and Financial Resilience Barometer (hereafter 'the Barometer'), a tool designed to provide a **holistic view** of the **state of the nation's finances**. Over the subsequent six months the macroeconomic outlook has substantially deteriorated with rapid increases in the prices of energy and commodities contributing to a **'cost of living crisis'**. The severity of the situation can be gauged from the fact that the Government has felt it necessary to intervene via three separate support packages since February.

Much analysis and commentary to-date has centred on the impact of these developments on the nation's current standard of living. In this sense, the launch of our biannual update adds to the debate, providing an insight into the **squeeze's structural impact**, essentially how various measures working-age households take to adapt to a lower income today will affect their capacity to mitigate future shocks and adequately prepare for retirement. The main insights are as follows:

Real disposable income has fallen and will remain stagnant

- The combined impact of higher inflation and the recent increase in national insurance contributions has caused a significant shock to households' purchasing power. We estimate that real disposable income fell by almost 3% in the past three months and will remain broadly stagnant over the next year despite generous policy support.

41% of households are dipping into reserves or debt to tread water

- The squeeze will force many households into the red. Indeed, our modelling suggests that in the past three months 41% of households had a negative savings rate and, therefore, will have either drawn down on savings or borrowed to fund spending.

Lockdown resilience gains are wiped out

- Overall, the projected fall in the Barometer (-3 points) over the next 12 months is sufficient to almost offset the aggregate gains made during the pandemic, a period during which stay-at-home behaviour drove a general improvement in financial resilience.

Resilience hit on the poorest is 3 times greater than of the rich

- Despite the progressive nature of fiscal policy this year, we expect lower income households to suffer steeper falls in resilience. On average, the Barometer score of households in the lowest two income quintiles (bottom 40%) is projected to fall by 4.1 points by 2023 Q2, three times greater than the average fall suffered by households in the top income quintile (-1.4 points).

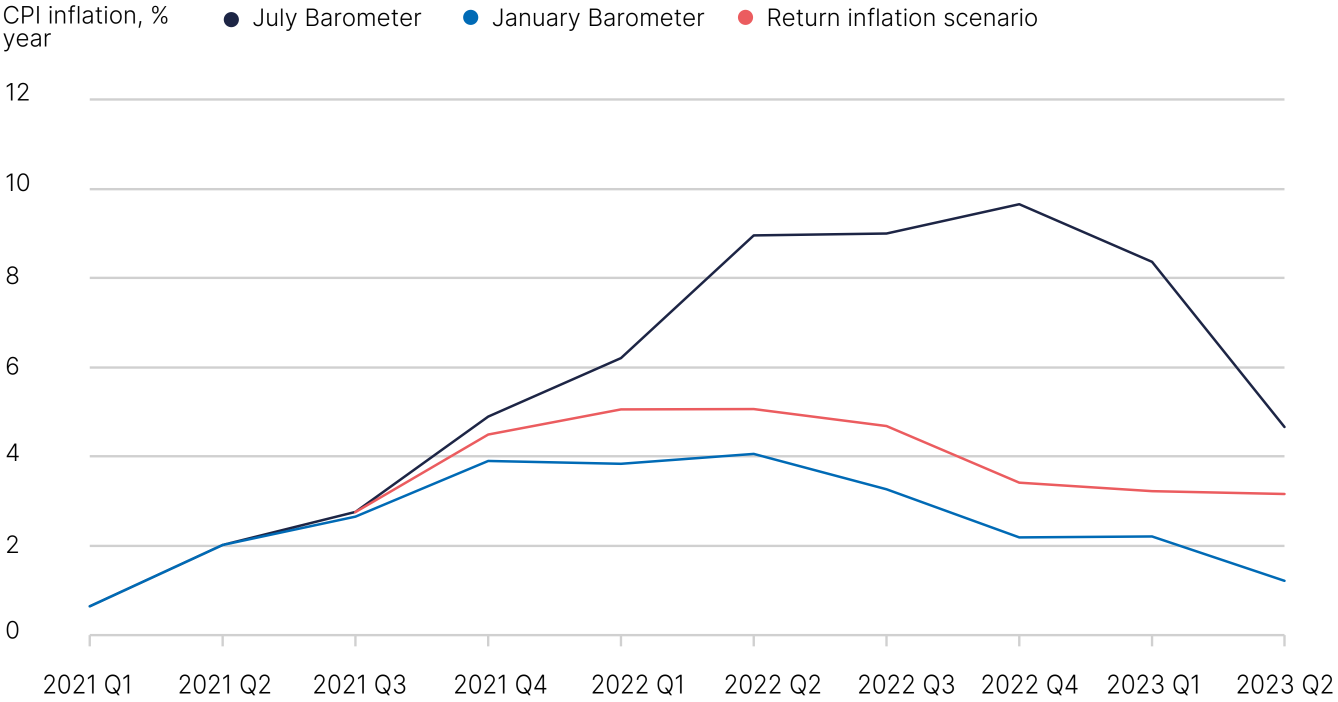
Cost of living crisis compounds lockdown inequalities

- Moreover, as shown previously, the aggregate benefits from the pandemic were unevenly shared with poorer households less able to reduce their spending. The combined effect of these two periods, therefore, will be to worsen inequality of financial resilience across the nation.

Rocketing inflation drives a 'cost of living crisis' in the UK...

Inflation is back and everyone is talking about it. In the launch edition of the Barometer, we commented upon and, indeed, quantitatively assessed the implications of a stronger bout of inflation but what has occurred this year has made our pessimistic case look optimistic (Fig. 1). Beyond the pressures created by a pandemic-related supply chain disruptions, inflation this year have been fuelled by dramatic increases in global energy and commodity prices. The resulting steep rises in the price of essentials including food, fuel and utility bills has created what has been popularly described as a 'cost of living crisis'.

FIG. 1. UK INFLATION IN 2022 HAS BEEN MUCH HIGHER THAN EVEN OUR WORST CASE FORECAST IN JANUARY



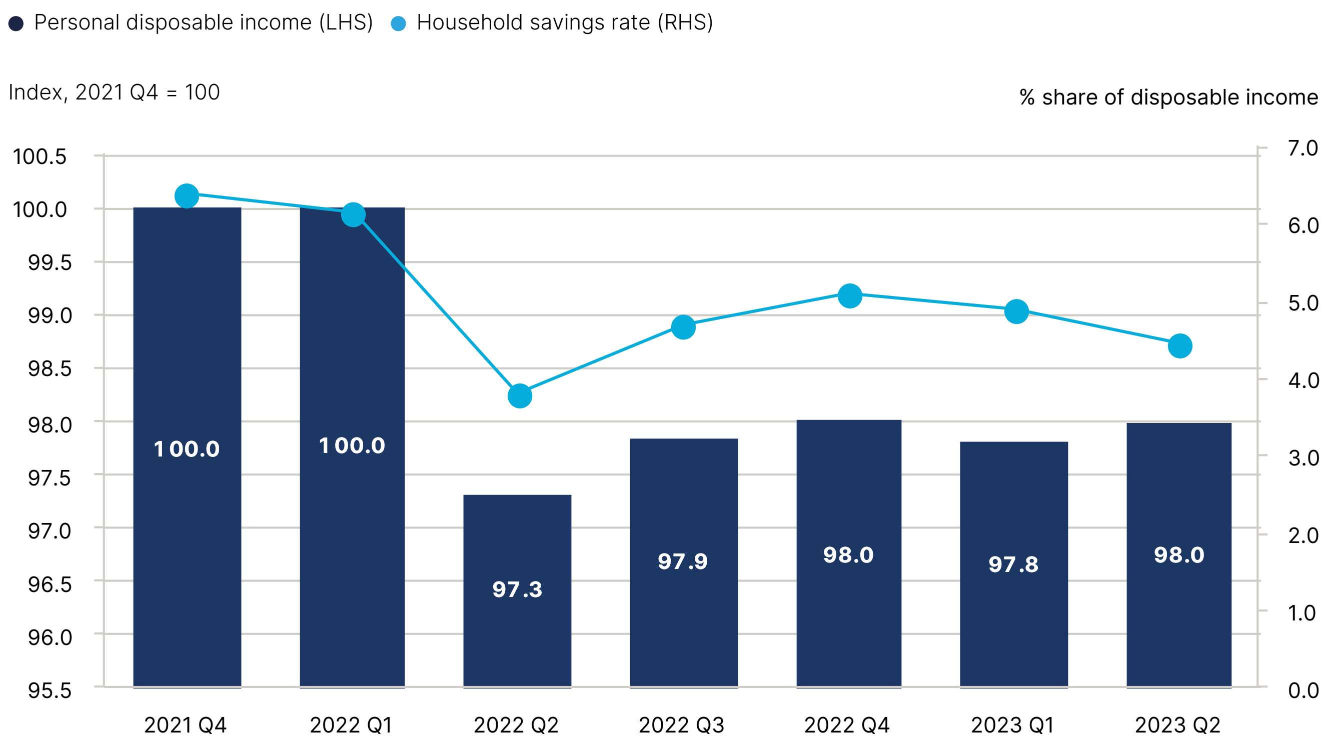
Source: ONS data, Oxford Economics forecast and scenario

...Forcing households to draw down on savings...

The shock has forced the Government into action, with three support packages announced in quick succession already this year[1]. Each has been ostensibly designed to mitigate the impact of the soaring cost of energy price rises, with recent analysis suggesting that the cumulative support on offer should broadly offset the increases in the energy price cap recorded to date and expected in the remainder of this year[2].

Nevertheless, our macroeconomic forecast suggests that average living standards will take a considerable hit this year. Inflation-adjusted disposable income is projected to have fallen back sharply in 2022 Q2 and we expect it to broadly stabilize at this level in the second half of the year. Individual consumers will react to the squeeze in many and varied ways but, in aggregate, we forecast that households will cut down on saving (Fig. 2).

FIG. 2. AS DISPOSABLE INCOME IS SQUEEZED HOUSEHOLDS WILL FIND IT HARDER TO SAVE



Source: ONS data, Oxford Economics forecast

[1] Specifically, the Chancellor announced fiscal packages in February, March and May 2022 worth £9.1 billion, £8.7 billion and £15 billion respectively.

[2] Bell, T, Brewer, M, Handscomb, K, Marshall, J and Try, L, "Back on Target: analysis of the Government's additional cost of living support", Resolution Foundation research report, May 27 2022.

41%

Share of households we predict will eat into savings or build debts in 2022 Q2 – the peak of the 'cost of living crisis'.

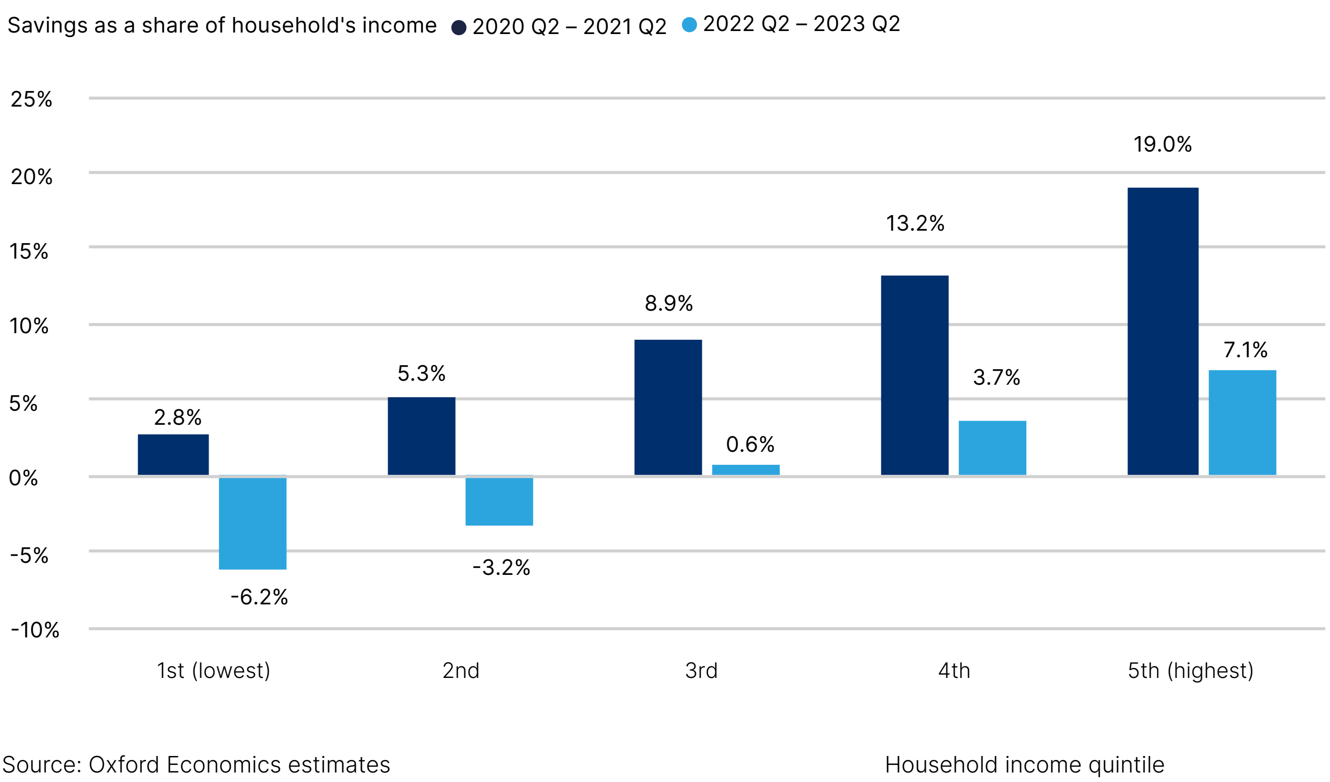
...Which will push many households into the red

The aggregate savings ratio displayed in Fig. 2 remains positive which, on the face of it, might be taken as a sign of reassurance — households are still saving, just less than previously. This, however, is misleading when trying to assess the typical experience of working-age households — the focus of the Barometer.

To provide a clearer sense of how this affects people differently we have used the model to predict the typical (median) savings ratio for households across different groups. Fig. 3 displays the results comparing the pandemic period (2020 Q2 – 2021 Q2 when households generally built-up savings) and the cost of living crisis period (2022 Q2 – 2023 Q2).

The disparity between the two periods is evident but so is the gap between households in different income bands. The predicted savings rate of working-age households in both of the lowest two income quintiles is negative. This implies that most of this group will be forced to draw down on any savings or assets they hold, or borrow more to fund their spending -a significantly increased share of which will now be diverted towards day-to-day essentials. Moreover, as highlighted in our launch publication, the increase in savings rates during the pandemic was highly uneven across society, with those on lower incomes, notably parents, less able to reduce spending.

FIG. 3. MEDIAN WORKING-AGE HOUSEHOLD SAVINGS RATIO BY INCOME QUINTILE: PANDEMIC VS COST OF LIVING CRISIS

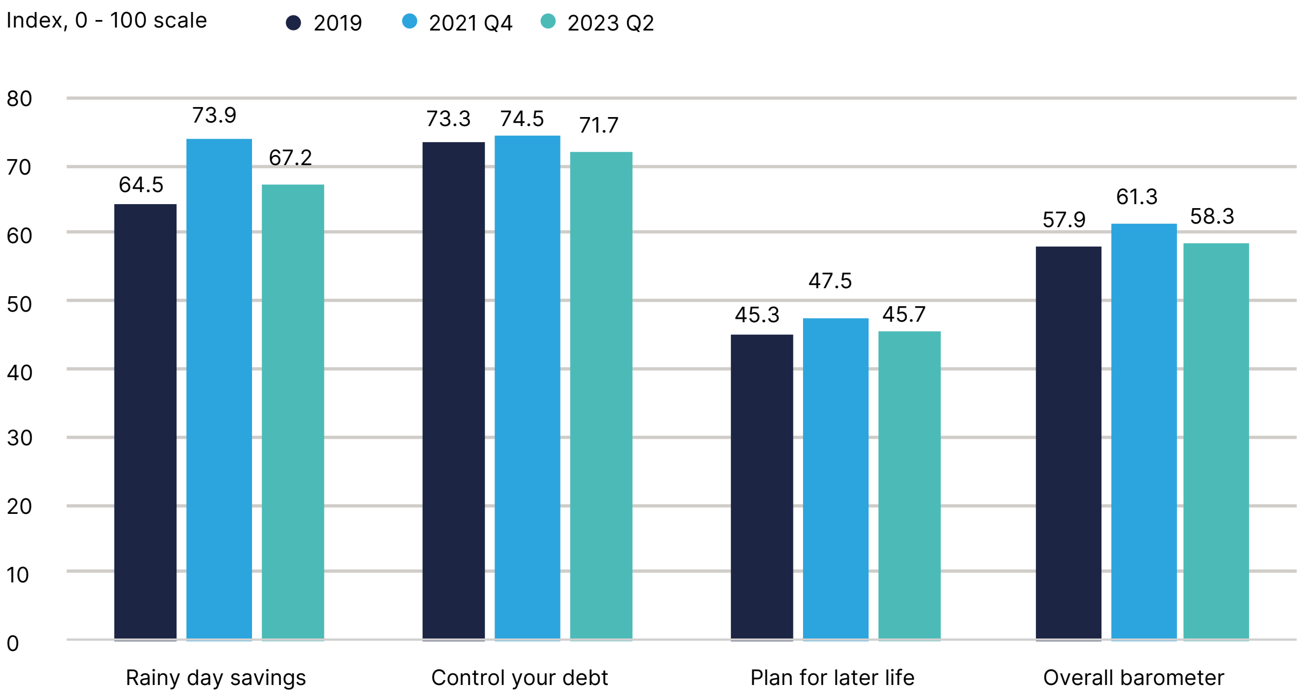


Source: Oxford Economics estimates

Trends in the barometer suggest that the squeeze will erode any extra resilience households built during the pandemic

The barometer tool provides a holistic lens, which helps us understand the structural implications of these trends and the impact on the capacity of households to weather financial shocks ('Rainy day savings' pillar), manage their credit ('Control your debt' pillar) and adequately prepare for retirement ('Plan for later life' pillar). In our launch report, we described how the state of the nation's finances improved, across all of these measures, through the course of the pandemic, but highlighted that we expected roughly half of this benefit to be eroded in 2022 due to a more challenging economic environment. As a result of the adverse developments this year, we now expect these gains to be almost fully reversed over the next 12 months.

FIG. 4. NATIONAL BAROMETER SCORES BY PILLAR: 2019 VS 2021 Q4 VS 2023 Q2

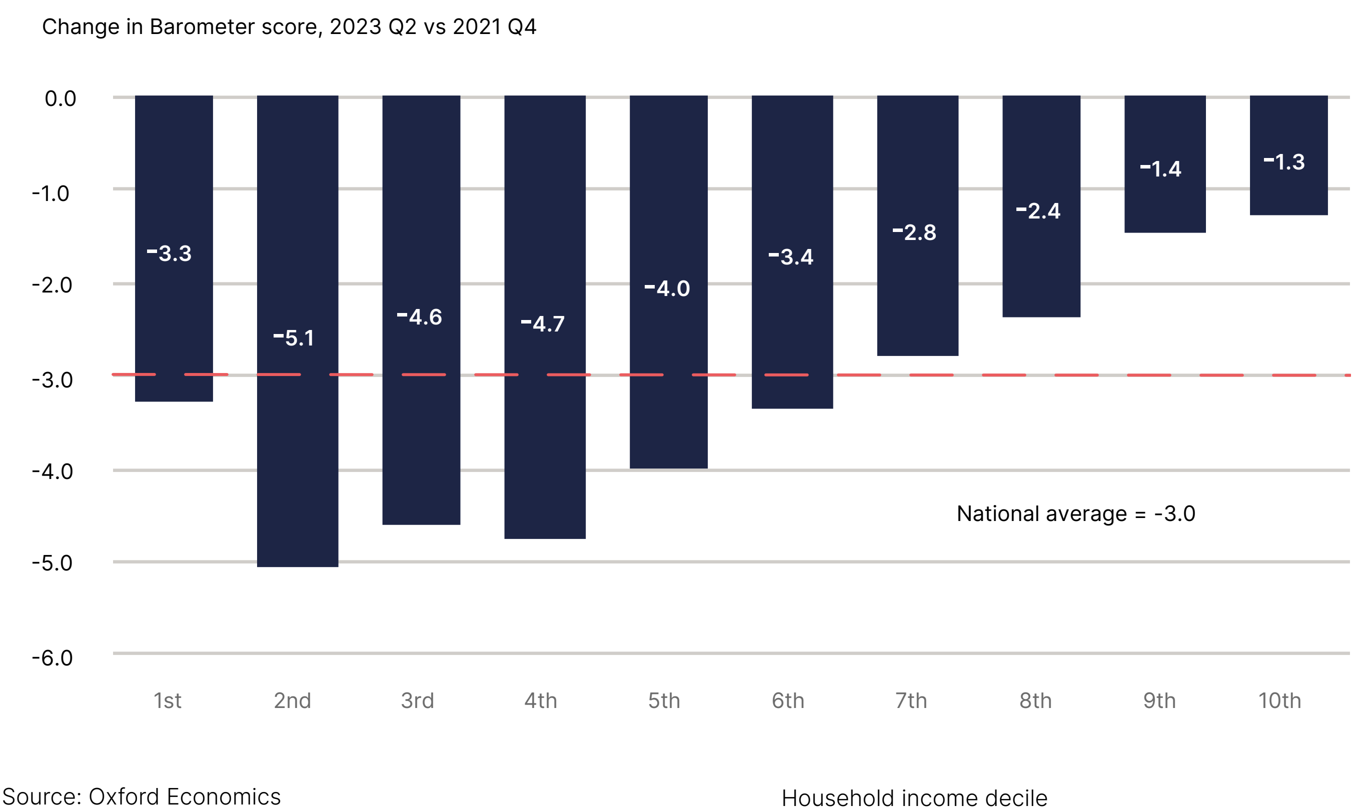


Source: Oxford Economics

Despite efforts of policymakers, trends this year will widen existing inequalities in financial resilience

Fiscal policy measures taken this year have, overall, been highly progressive. Despite this, as shown in Fig. 5, the projected decline in the average barometer score between 2023 Q2 and 2021 Q4 is highest for low and lower-middle income households, with the scores of those on high incomes declining significantly less-than-average. This trend can be linked back to the pattern visible in Fig. 3—essentially, these households are better placed to react by saving less rather than needing to resort to drawing down on their assets or taking on more credit.

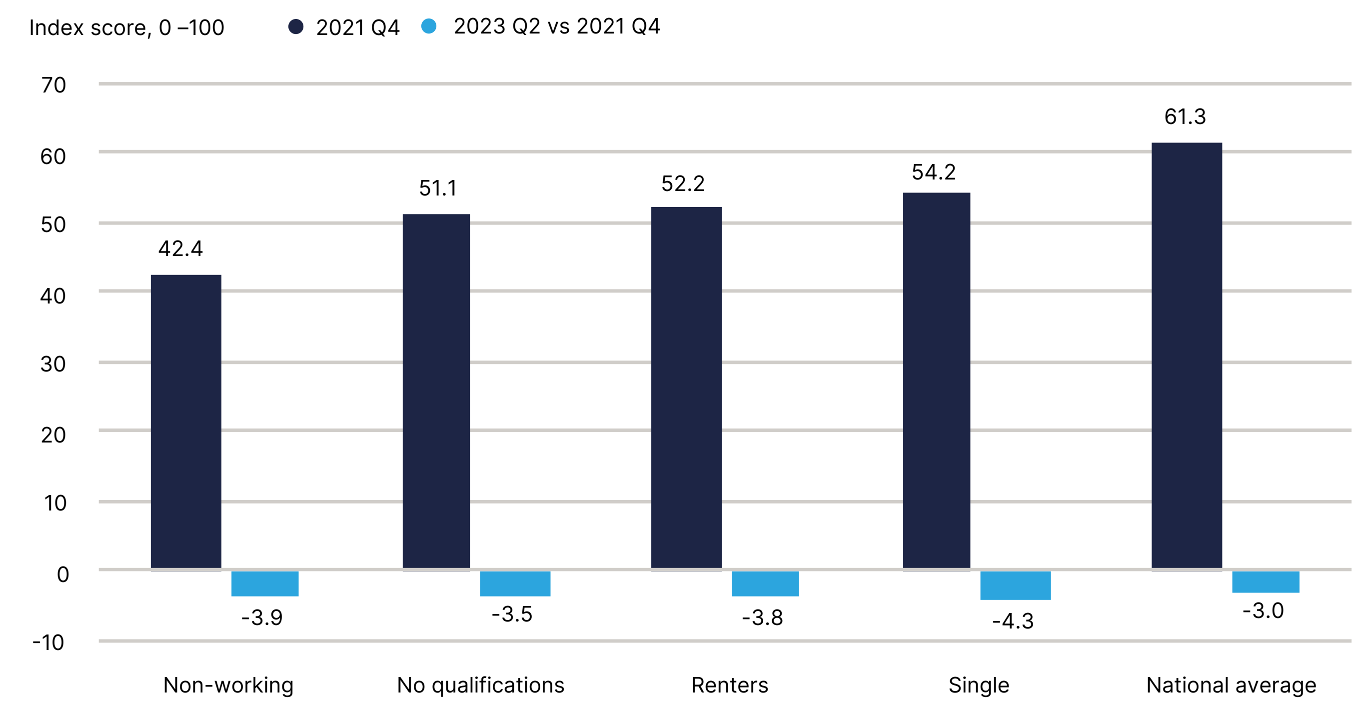
FIG. 5. CHANGE IN BAROMETER SCORE BETWEEN 2023 Q2 AND 2021 Q4 AMONG HOUSEHOLDS BY INCOME DECILE



Source: Oxford Economics

Consistent with this trend, we expect the next 12 months to see a widening of the inequality in short- and long-term financial security, as measured by the Barometer. Overall, the projected decline in households' Barometer scores is larger for those which started from a lower base. Fig. 6 exemplifies this trend of widening inequality through the lens of selected groups. Their identity will be of no surprise to readers: renters, singletons, non-working households and those without qualifications - all characteristics associated with lower incomes. One of the practical implications of these larger gaps within society is that greater levels of future government support will be required in the face of any future economic downturn or to ensure a designated minimum standard of living for adults through their retirement.

FIG. 6. BAROMETER SCORE IN 2021 Q4 AND FORECAST CHANGE BY 2023 Q2 FOR SELECTED SOCIOECONOMIC GROUPS



Source: Oxford Economics

THE UNDERLYING PICTURE

Key findings by barometer pillar

1. **Control your debt – Higher income households feeling the pinch.** The nation's debt resilience improved during the pandemic (73.3 to 74.5) but is projected to fall to 71.7 by Q2 2023. This is almost entirely explained by the servicing of household debt becoming less affordable in the wake of the cost of living crisis, with increasing interest rates hiking the repayments on variable rate debt and households taking on more debt. Higher income households are more impacted as they tend to have higher levels of debt to begin with.

2. **Protect you and your family – Less than half have sufficient protection** – 43% of households have sufficient cover should they pass away, but this falls to only 12% of single parent families. This lack of cover is concerning and is an area that we plan to give greater focus to as the Barometer develops.

3. **Save a penny for a rainy day – Pandemic stores of cash wiped out for poorer households** – the accumulation of savings through lockdown was one of the key reasons that overall financial resilience had risen. This improvement was not equally distributed, with higher income households managing to enhance their rainy-day savings more than lower income households. However, the combination of a lifting of lockdown and rising prices means the barometer's projections show most of the financial resilience gains in this area have been given up by Q2 2023. The lowest income households (bottom 20%) are projected to be below their pre-pandemic starting point whereas the top 60% of households are expected to have more cash set aside for a rainy day.

4. **Plan for later life – Long term resilience is broadly flat but inflation is eroding pensions savings** – long term resilience remains broadly flat from the pre-pandemic position to our projections for Q2 2023. The paying down of debt through the pandemic has meant the indicators of additional assets (+2.8 points) and housing wealth (+2.3 points) that can be used to fund retirement have been fortified, but the surge in prices (ahead of investment returns and wage growth) means that the amount in pensions is generally not keeping up with what is required for a moderate income in retirement (-1.9 points).

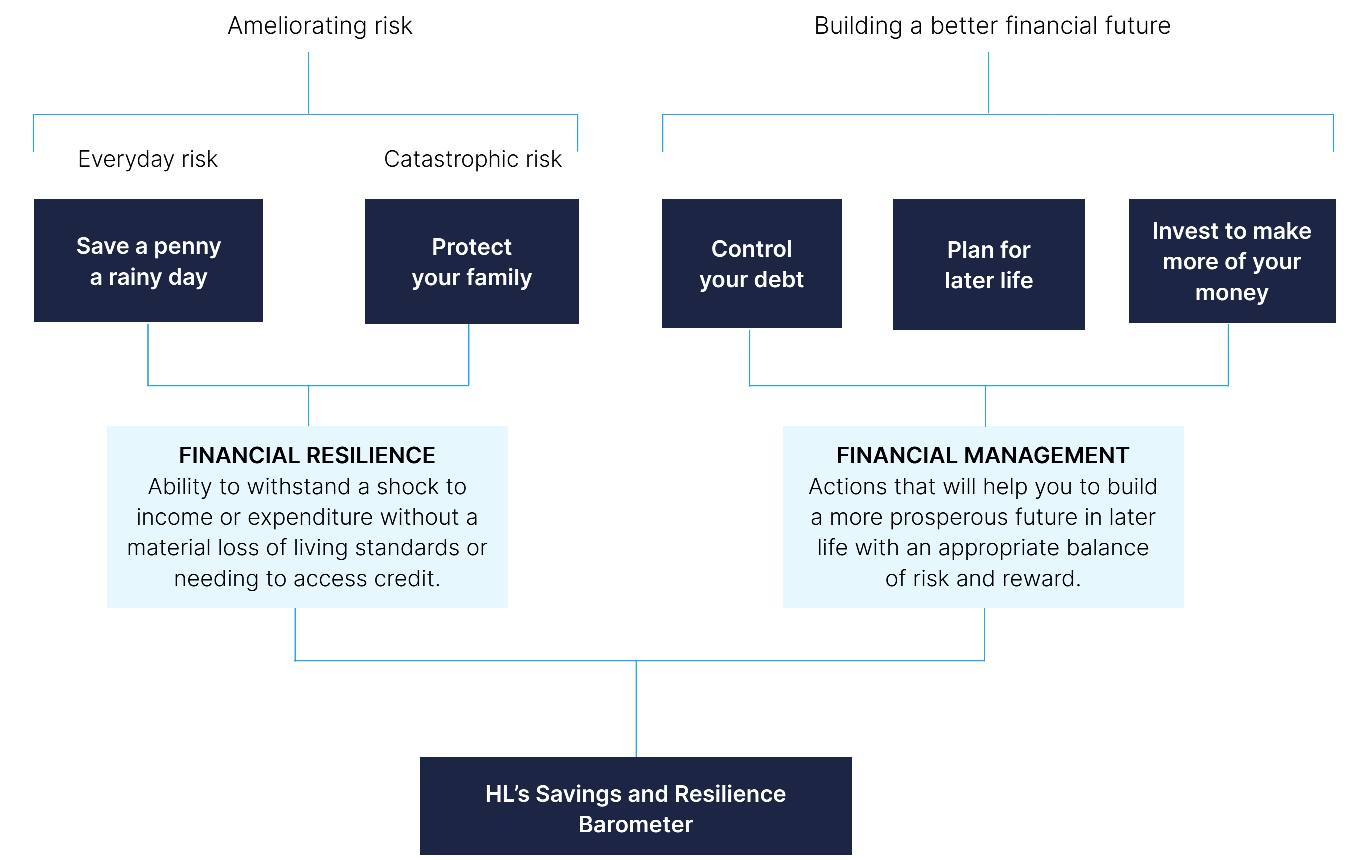
5. **Invest to make more of your money – Scope for more investment for long term returns** – 35.9% of households have more than 6 months' worth of essential expenditure, of which half have gone on to invest to make more of their money. The Barometer measures the investment intensity of household wealth. Overall, 22.8% of household wealth is invested to make it work harder. The youngest are least invested with 13.2% of Gen Z households investing their excess income compared to 28.8% for the Baby Boomers.

We've also picked up that households where one of the adults had a parent who was self-employed are likely to invest a greater proportion of their wealth. This is area that we plan to look into further in the coming months.

ABOUT THE BAROMETER

The HL Savings and Resilience Barometer is an index measure designed and produced by Oxford Economics. It is based around Hargreaves Lansdown's five building blocks for financial resilience depicted in Fig. 7. The aim of the Barometer is to provide a holistic measure of the state of the nation's finances, monitoring to what extent households are prudently balancing current and future demands whilst guarding against risks.

FIG. 7. SAVINGS AND RESILIENCE BAROMETER: CONCEPTUAL STRUCTURE



In collaboration with Hargreaves Lansdown, Oxford Economics mapped each of these pillars to a list of 17 individual indicators (Fig. 9). The list was chosen to ensure that the information captured in each category is conceptually distinct and designed to recognise the inherent trade-offs that are associated with financial planning.

The data underpinning the indicators is sourced using a household panel dataset for a representative group of British households, developed by linking together official datasets. The Wealth and Assets Survey (WAS), published by the ONS, has been used as the core dataset due to the breadth of financial data available in the survey. This source does not include every variable required to measure the factors and the latest survey only extends as far as 2020 Q1. Therefore, we have used a range of methods including econometric analysis to build on the core dataset using data from the Financial Lives Survey (FLS), Living Costs and Food Survey (LCFS) and the Labour Force Survey (LFS).

For each indicator, the data was used to create an index value on a scale of between zero and 100 for households in the panel. In each case, a score of 100 was assigned to households who had reached a specified resilience threshold e.g., holding liquid assets equivalent to at least three months of essential expenditure. Households whose savings are sufficient to cover more than three months of spending are, therefore, not rewarded for this additional level of security.

Such a design is appropriate to capture the concept of resilience and the intrinsic trade-offs involved in financial management. Threshold values are defined with reference to benchmark recommendations where available and, where not, using the statistical distribution of values within the dataset and the judgement of the research working group.

To bring the dataset up to date, values have been extrapolated through to 2021 Q4 using a wide range of macroeconomic and survey data and different modelling techniques. A much more detailed description of the approach can be found in the methodology report available on the project's landing page[3]. Finally, current and future values are projected based on Oxford Economics' baseline forecast for the UK economy from its Global Economic Model (GEM).

Barometer Update
We have spoken with many interested stakeholders about our method of measuring household resilience and received valuable feedback for which we're incredibly grateful. This has led to a tweak to the methodology for pillar 5 'Invest to make more of your money.' The investment intensity of households is now measured only for those with more than 3 months of essential spending and only on the monies that they have after accounting for 3 months of essential expenditure.

FIG. 8. SAVINGS AND RESILIENCE BAROMETER: BAROMETER INDICATORS

Save a penny a rainy day	Protect your family	Control your debt	Plan for later life	Invest to make more of your money
Adequacy of liquid assets	Adequacy of life insurance protection	Affordability of future repayments	Value of pension	Investment intensity
Surplus income	Income protection coverage	Use debt	Home ownership in retirement	
Eligibility for and generosity of sick pay	Critical illness coverage	Uncertainty of future repayments	Net financial assets	
Eligibility for and generosity of redundancy package	Balance of earnings	Existence and severity of arrears		
		Subjective evaluation of debt position		

[3] https://www.hl.co.uk/features/5-to-thrive/savings-and-resilience-comparison-tool

ABOUT OXFORD ECONOMICS

Oxford Economics was founded in 1981 as a commercial venture with Oxford University's business college to provide economic forecasting and modelling to UK companies and financial institutions expanding abroad. Since then, we have become one of the world's foremost independent global advisory firms, providing reports, forecasts and analytical tools on more than 200 countries, 100 industries, and 7,000 cities and regions. Our best-in-class global economic and industry models and analytical tools give us an unparalleled ability to forecast external market trends and assess their economic, social and business impact.

Headquartered in Oxford, England, with regional centres in New York, London, Frankfurt, and Singapore, Oxford Economics has offices across the globe in Belfast, Boston, Cape Town, Chicago, Dubai, Dublin, Hong Kong, Los Angeles, Melbourne, Mexico City, Milan, Paris, Philadelphia, Stockholm, Sydney, Tokyo, and Toronto. We employ 450 staff, including more than 300 professional economists, industry experts, and business editors—one of the largest teams of macroeconomists and thought leadership specialists. Our global team is highly skilled in a full range of research techniques and thought leadership capabilities from econometric modelling, scenario framing, and economic impact analysis to market surveys, case studies, expert panels, and web analytics.

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The modelling and results presented here are based on information provided by third parties, upon which Oxford Economics has relied in producing its report and forecasts in good faith. Any subsequent revision or update of those data will affect the assessments and projections shown.

To discuss the report further please contact:

Henry Worthington: **hworthington@oxfordeconomics.com**

Oxford Economics
4 Millbank, London SW1P 3JA, UK
Tel: +44 203 910 8061

HARGREAVES LANSDOWN

Hargreaves Lansdown, One College Square South,
Anchor Road Bristol BS1 5HL

Tel: 0117 900 9000
Registered number: 02122142
www.hl.co.uk

0622