Rewarding Learning

General Certificate of Secondary Education
2015

Economics

Case Study
for use with Paper 1
Consumer spending, savings and debt in the UK

[G9271]
MONDAY 1 JUNE, AFTERNOON

G9271

You must use **this** clean copy of the Case Study in the examination and not your own annotated copy.

Case Study: Consumer spending, savings and debt in the UK

Introduction

Consumers face many challenges when trying to manage their personal finances. As well as budgeting for their everyday needs, they have to think about the future and how to finance their retirement.

Traditionally, people saved money until they could afford to buy the goods and services they wanted. Now we live in an age where consumers can use credit to finance their consumer spending. This means they can have immediate enjoyment of a wide range of goods and services without having to wait until they save enough to pay for them. Consumers may be paying off a variety of loans linked with their purchases. The repayment period could be up to five years for consumer durables such as sofas or cars. The largest loan that most people are likely to have in their lifetime is a mortgage with a repayment period of approximately twenty-five years. This means that in total, consumers may owe considerable sums of money to banks and other financial institutions that they are paying back with interest over agreed periods of time.

Changes in consumer spending, savings and debt have important consequences for individuals and for the economy as a whole. Interest rates have been at historically low levels and any increase could have serious economic implications.

Source 1: Financial products used by adults in the UK

Consumers have a wide choice when it comes to selecting financial products that will help them to manage their everyday finances and plan for the future. People use different financial products at different stages of their lives.

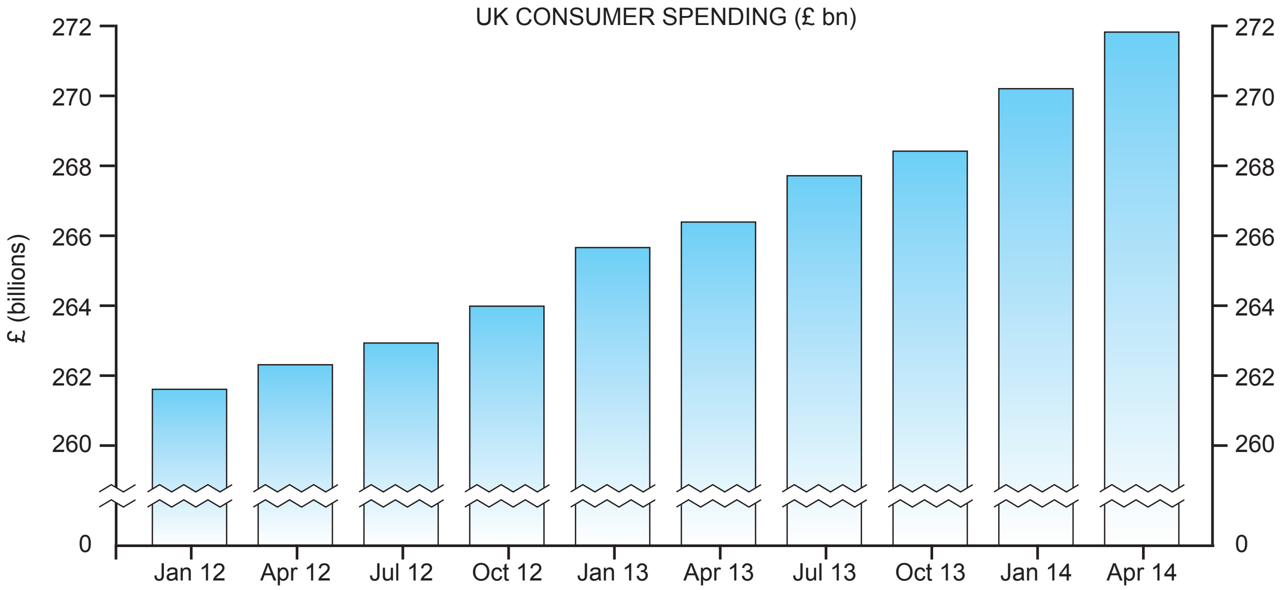
Ownership of Financial Product by Age in 2012 (% of adults in each age group)

Examples of financial products (2012)	Age								
	16-24	25-34	35-44	45-54	55-59	60-64	65-74	75+	All
Current Account	78	86	87	85	79	83	78	76	82
Individual Savings Account (ISA)	3	13	13	13	16	15	20	16	13
Other Bank Accounts e.g. Savings	8	16	17	16	17	19	20	23	16
Stocks and shares/Member of Share Club	1	3	4	4	9	8	6	6	4
Premium Bond	0	2	3	3	3	3	4	7	3
Credit Union Account	4	11	9	8	7	10	6	2	8

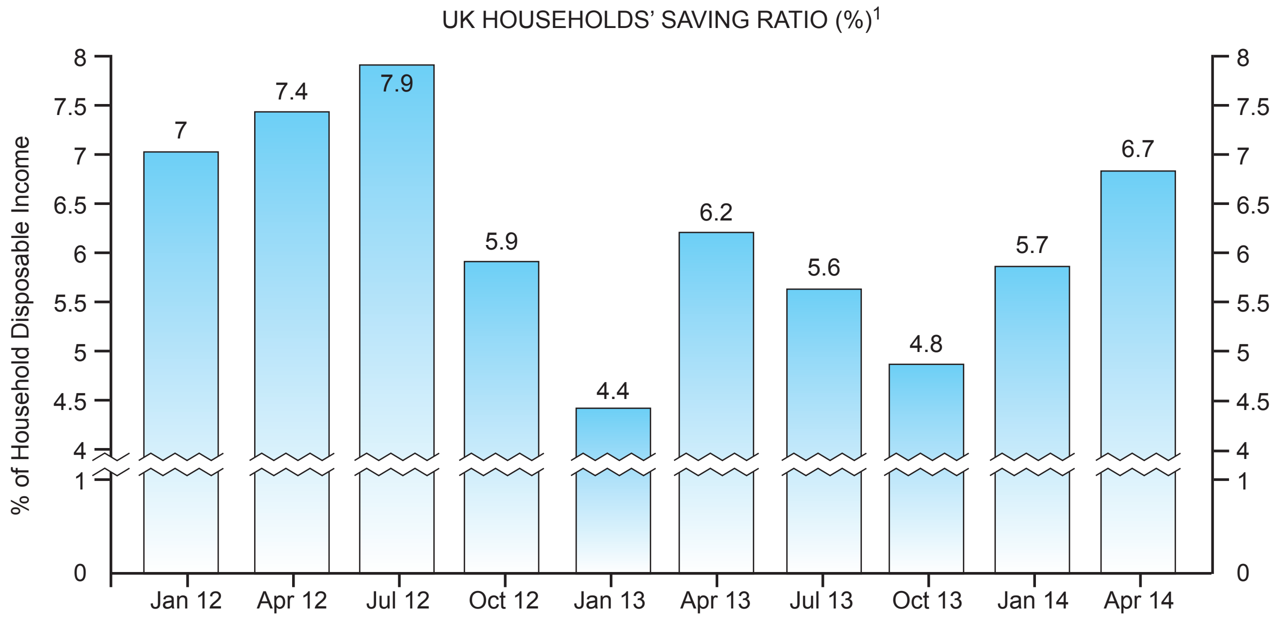
Source 2: Consumer spending and savings

Consumer spending is important for the economy and in 2013, it accounted for 66% of Gross Domestic Product (GDP).

In the final months of 2013, consumers appeared to be on a shopping spree as their spending increased. Wages were not rising as fast as inflation so the increase in spending was mainly caused by households dipping into their savings or taking out new loans, including the controversial payday loans.



© Trading Economics www.tradingeconomics.com/united-kingdom/personal-savings and www.tradingeconomics.com/united-kingdom/consumer-spending



© Trading Economics www.tradingeconomics.com/united-kingdom/personal-savings and www.tradingeconomics.com/united-kingdom/consumer-spending

Building up a reserve of savings is vitally important for people at different stages of their lives. When people are setting up home, whether renting or buying, they need a deposit and funds to buy essential household goods. Throughout their lives they will probably need to draw on savings to pay for unforeseen events, luxuries and expensive purchases that are not regular occurrences. When people decide to stop working, they need to have planned their finances so that they have a source of income on which to live. The state pension, when people eventually receive it, is unlikely to be enough to maintain the standard of living that many people have enjoyed during their working lives.

[1] The Savings Ratio is the proportion of household disposable income that goes into savings.

Source 3: Concerns about the lack of financial education

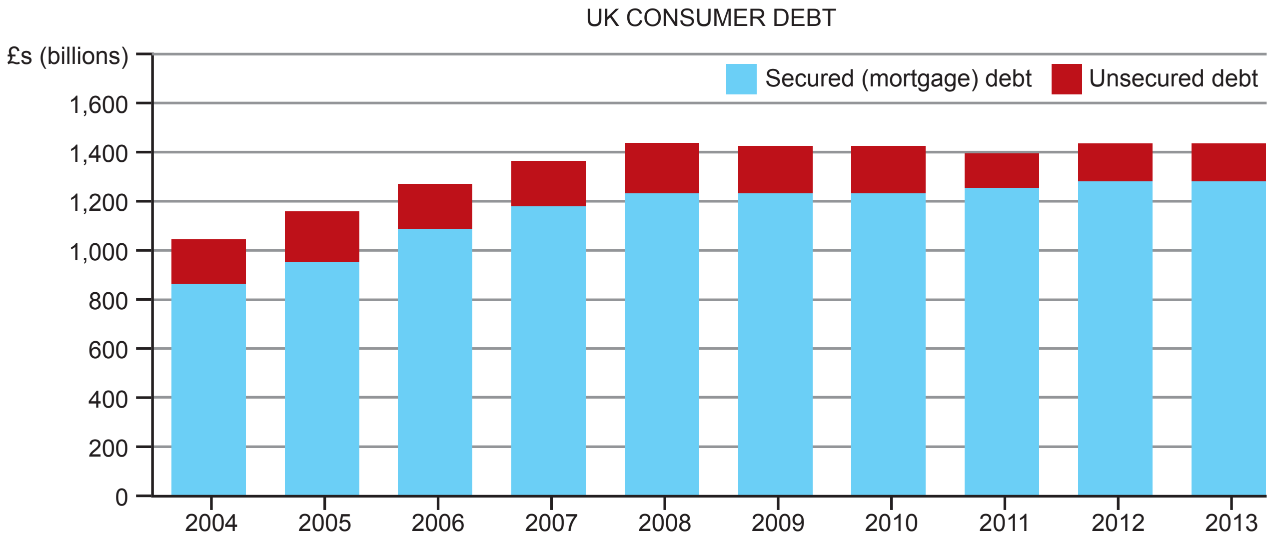
Borrowing money and using credit to purchase goods and services has become a normal way of life for many. This relatively new credit-funded lifestyle of consumers makes a vital contribution to the health of the UK economy. However, concerns have been expressed that many people do not have sufficient financial knowledge and skill to make informed financial decisions.

As part of the campaign to make financial education compulsory in the curriculum, Justin Tomlinson MP, chair of the All Party Parliamentary Group on Financial Education for Young People, said: *"Young people are entering an increasingly complex financial world of store cards, mobile phone tariffs, credit agreements and financial marketing. It is vital that we equip them with the skills they need to be savvy consumers. … These (financial) skills are then with them for a lifetime, helping them to avoid unmanageable debt, helping them through their working lives and encouraging them to save for their future".*

© Adapted from: Lack of financial education costs UK £3.4 billion a year, 13 December 2012 from www.moneysavingexpert.com

Source 4: Consumer debt in the UK

Consumer debt has been rising for several years and many organisations and the government are concerned about this situation.



© Adapted from The Money Charity, Debt Statistics, October 2013 Edition. http://themoneycharity.org.uk/media/Debt-Stats-Full-October-2013.pdf

A major new study compiled by the Money Advice Service highlights how 8.8 million people in the UK live with serious debt problems, but only one in five of this group is currently accessing advice to help with it.

It reveals that over four million people have been struggling to pay their bills for more than a year and admit their debt repayments prevent them from buying the basics. The report describes eight categories of people who are in serious debt with families accounting for half of these.

Money Advice Service – Categories of people with Debt Problems (2012)		
Category	Number of people (million)	% of the total
1. Struggling students	1	11.3
2. First time workers	0.9	9.8
3. Optimistic Young workers	1.1	12.5
4. Low wage families	0.8	9.3
5. Stretched families	1.4	16.3
6. Worried working families	1.7	19.4
7. Benefit dependent families	1.8	20.2
8. Uncomfortable retirees	0.1	1.1
Total	8.8	100

© Segmenting the over-indebted population of the Uk report, August 2013. By The Money Advice Service.

Unsurprisingly, the majority of people who are struggling with debt said it has a negative impact on their life and three out of four admitted they are unhappy. But repaying debts is very important to four in five of the 8.8 million who said they would like to pay off their debt as soon as possible. The other one in five did not admit to being in serious debt.

Sources: Adapted from http://themoneycharity.org.uk/media/Debt-Stats-Full-October-2013.pdf and The Money Advice Centre
"Maxed out", a policy report by CSJ Working Group November 2013
The Centre for Social Justice

Source 5: Households face "unprecedented" squeeze on living standards

A new report shows that the prices of essential goods and services have increased by an average of 25% over the past five years. Over the same period, the Consumer Prices Index (CPI) increased by 17%. The research found that living standards had fallen as families struggled to cope with the rising cost of living at a time when real wage rates had been falling.

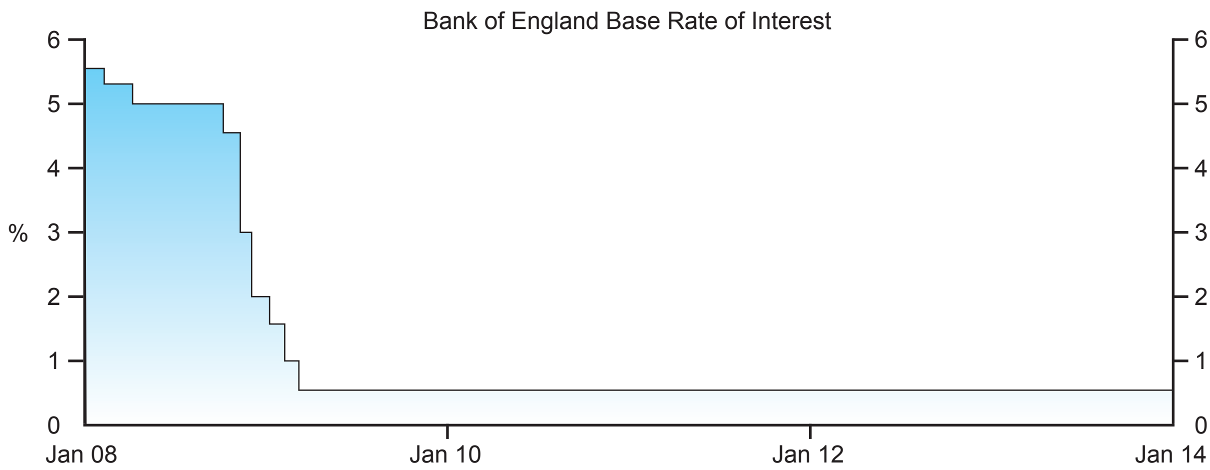
The report highlighted the price rises that had contributed most to the financial pressure on families. Energy prices had increased by approximately 40%, childcare costs by 37%, public transport by 30%, social housing costs by 26% and food by 24%.

Government policies, such as the increase in the personal tax allowance, had eased the strain on families but the report concluded that this was being overshadowed by the effects of public spending cuts, cuts to benefits and tax credits, and the rising cost of essentials. It seemed that the effects of government policies aimed at helping families were being cancelled out because workers had received little or no increase in wages over the same period.

In June 2013, official government statistics showed that household real disposable income fell by approximately 2%, the biggest annual drop in 25 years. To make ends meet, households dipped into their savings. In the last quarter of 2012, the proportion of total disposable income saved in the UK was 5.9% but this fell to 4.4% by the first quarter of 2013. Some economists expressed concern for the UK economy because they had expected the UK household sector to be stronger.

Source: Adapted from Household savings plunges to 5 year low, Richard Dyson www.telegraph.co.uk 27June 2013

Source 6: Record low UK interest rates



© Trading Economics http://www.tradingeconomics.com/united-kingdom/interest-rate

Since 2009, the Bank of England has held the base rate of interest at a record low of 0.5%. With returns on savings as low as 0.1% after tax, and CPI running at 2.8%, why should anyone bother to save? Many savers feel victimised by low interest rates and for those who rely on the income that their savings generate, this is a real problem.

In theory, people could be better off just spending their money and it seems to many that this is exactly what the government wants – more consumer spending now. However, one consequence of the credit crunch is that people are nervous about leaving themselves short of money for the future.

For those who are in a position to save, economic policies are having a serious impact. The government is also stressing the need for people to save so that they can be more self-sufficient in their old age. With life expectancy increasing, people may need to save now to make adequate preparation for the future.

Adapted from: BBC News 11 May 2013

Source 7: Retirement just seems so far away

The state pension age is rising. For many years, the age at which people could claim the state pension was 65 for men and 60 for women. As a result of the steady increases in life expectancy and the increasing burden on the "public purse", the government currently plans to increase the state pension age to 68 for both men and women.

Some critics argue that the state pension age should be more closely related to increasing life expectancy. If this happens, today's 33 year-olds may not get a state pension until they are 73 and for those just finishing their A levels, they could be 77 before they are eligible for a state pension. Furthermore, the government has been concerned for some time that people are not making adequate financial preparation for their retirement by contributing to a private pension scheme.

Percentage of working-age men and women (16–64) contributing to private pensions in 2011–12		
Age	**Men**	**Women**
16–19	2%	3%
20–29	21%	19%
30–39	41%	44%
40–49	47%	55%
50–65	43%	47%
All	37%	40%

Amid concerns that fewer people were saving into work pension schemes, the government has changed the law so that by 2018, workers will automatically enrol in a work pension scheme.

Source 8: Consumer debt, compensation windfalls and rising house prices drive the economic recovery

The latest economic statistics showing that GDP increased by 0.7% in the second quarter of 2013 have raised hopes that the economic recovery, if slow, can be sustained. The Chancellor tweeted: “This shows that Britain’s hard work is paying off and the country is on the path to prosperity”.

The construction sector seems to be improving after a volatile performance in 2012. House builders and first time buyers have been helped by the government’s Help to Buy Scheme. Rising house prices, particularly in London and the South-East of England, have improved consumer confidence.

One critic commented that for millions of people across the country there is little sign of recovery as they still face prices rising faster than wages. While the economic recovery appears to be gaining pace, it seems to be dependent on consumer borrowing and expectations of rising house prices rather than on the export-led growth that the Chancellor had hoped for. Households appear to have increased their spending in spite of falling real take-home pay by cutting their savings and increasing their reliance on credit. Between 2011 and 2013, consumer spending power was also boosted by a total of £12 billion from compensation payments made by banks for the mis-selling of payment protection insurance (PPI).

In the longer term, low levels of saving could have a negative impact on investment and this will affect the growth of the economy. However, if people suddenly decide to save more, this could damage consumer spending and reduce economic growth in the short-term.

Source: Adapted from:www.deloitte.co.uk/mondaybriefing, 28 October 2013; Debt-fuelled consumers and expensive houses drive British recovery, http://uk.reuters.com, 5 August 2013 and UK GDP: Fastest growth for 3 years, BBC News 25 October 2013