The Global CEO Advisory Firm

Cost of living crisis

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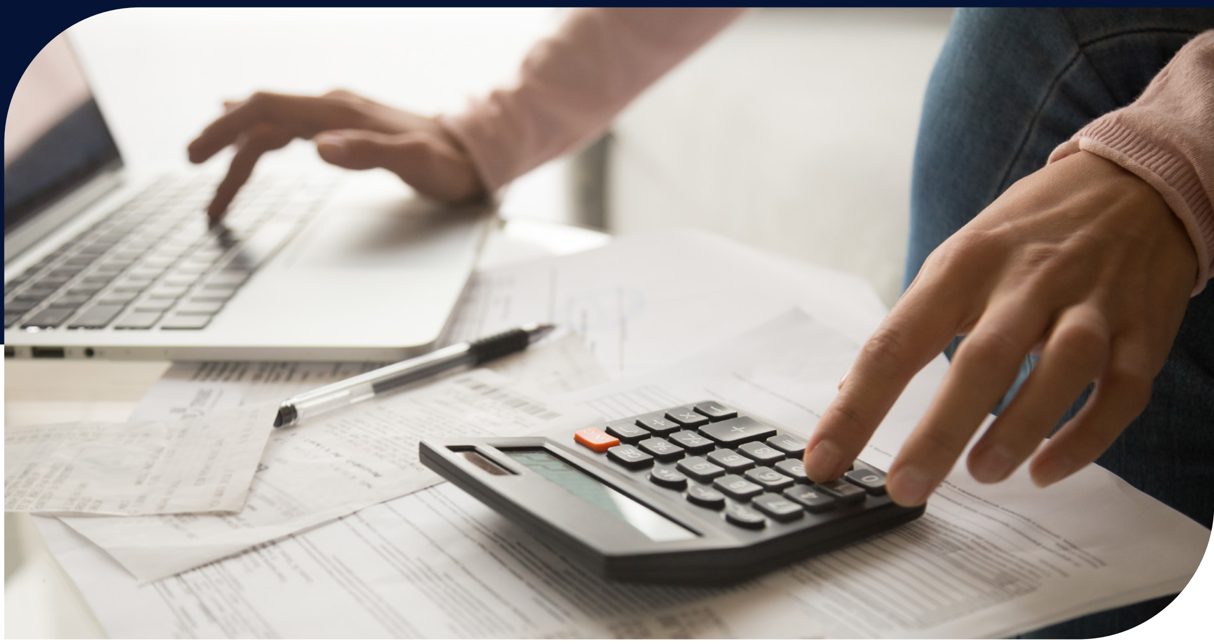


The UK is experiencing its highest level of inflation in c. 40 years, driven by the aftermath of the Covid-19 pandemic, ongoing issues related to Brexit and the emerging impacts of the Russia-Ukraine conflict.

Comparatively limited wage growth has resulted in a "cost of living crisis," with energy and transport costs in particular contributing to squeezed disposable incomes. Whilst the Bank of England has responded by raising interest rates, it is constrained in the extent of its response by low growth rates and fear of an impending recession, with consumer confidence remaining low despite government support measures.

This poses a challenge to consumer products suppliers, both in the short-term (with lower discretionary spend reducing demand for non-essential items), and longer-term changes to consumer purchasing attitudes and behaviours.

Key drivers of the cost of living crisis

Energy

Typical household energy bill rising £693 p.a. (54%) following price cap increase in April 2022[1].

High wholesale prices may drive a further increase in the cap of potentially over 70%[2] in October 2022, leading to fears of an "eat or heat" choice for lower-income households.

> **"Falling disposable incomes and consumer confidence leads to a reprioritisation of spending towards essential spend."**

Transport

Average forecourt prices for unleaded petrol rose from 146.6p to 191.4p between 1 February 2022 and 1 July 2022[3], driven by sanctions and supply disruption resulting from the Russia-Ukraine conflict.

The cost of a car itself (exc. fuel) has risen 20% since 2020.

Macro

Food inflation (9.8% in the year to June 2022)[4] reduces the level of disposable income available for non-essential items.

Disruption in supply (e.g., Ukrainian grain) has driven inflation in staples such as beef, chicken, eggs and milk.

Real wages between March 2022 and May 2022 fell by a record 2.8% versus the prior year[5].

Expected changes in consumer behaviour in response

Reprioritisation of spending

Consumers feel they have to make decisions on which items are essential to them and which are not.

Holiday spend is being protected post-Covid, at the expense of other non-essential items such as media subscriptions and high-value homeware.

Reduction in car usage

Consumers will increasingly turn to other modes of transport as the cost of car usage increases.

Reduction in discretionary movement

Changing patterns of footfall will have major implications for traditional retail locations, and businesses in these areas will need to adjust their strategies.

Search for value

As consumers have less income in real terms, they may spend more time "trading down" shopping for better deals, leading to them being more price sensitive and more susceptible to brands offering greater value.

1. Ofgem https://www.ofgem.gov.uk/publications/price-cap-increase-ps693-april
2. Sky News https://news.sky.com/story/cost-of-living-energy-price-cap-expected-to-double-in-january-experts-say-12660095
3. RAC https://www.rac.co.uk/drive/advice/fuel-watch/
4. ONS https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/june2022
5. ONS https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/averageweeklyearningsingreatbritain/july2022

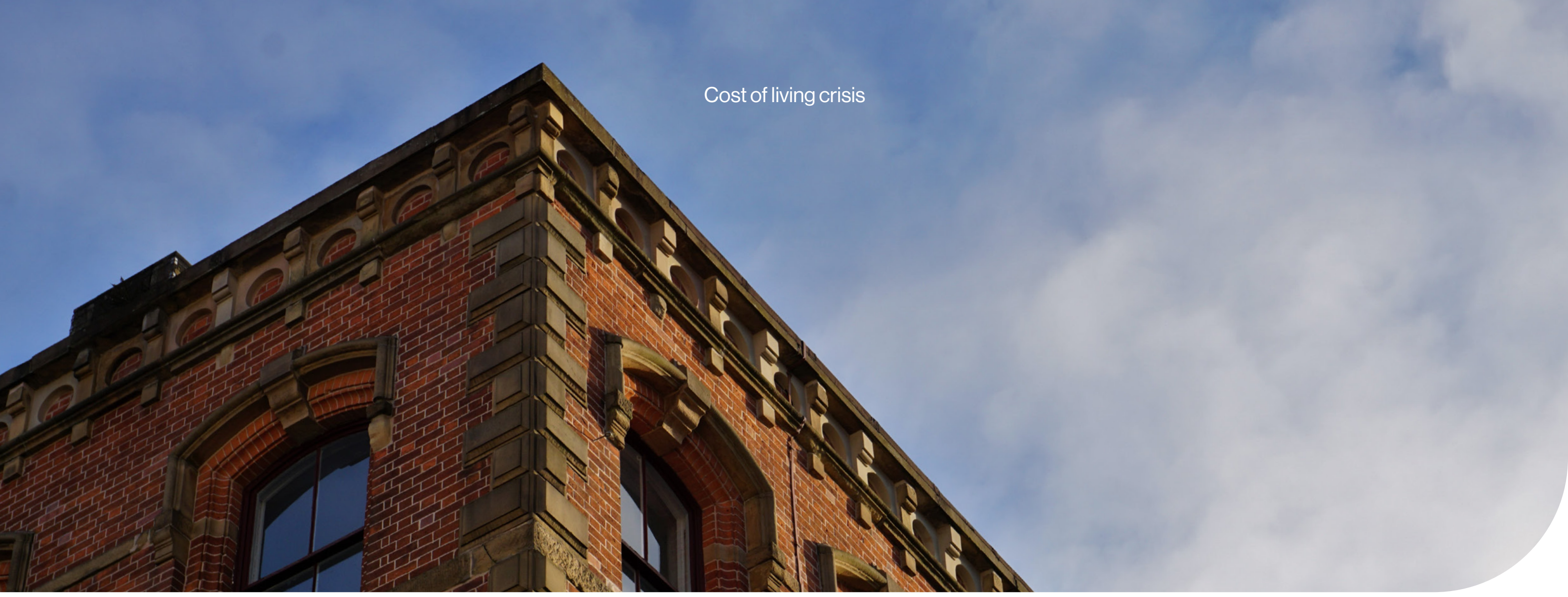
Cost pressures

- Commodity prices remain volatile following Covid-19 and the Russia-Ukraine conflict
- Energy price rises impact manufacturing and shipping costs
- Value of sterling decreasing versus the dollar year on year, making imports more expensive
- Financing implications as cost inflation puts pressure on ABL funding limits, even where trading volumes are stable
- Increased wages in response to staff shortages (driven by falling migration, changes to working patterns post-Covid and changing demographics)

Squeezed profits

Demand pressures

- Consumers dropping out of certain markets for non-essential items (e.g., luxury homeware) or reducing frequency of purchases
- Consumers trading down, choosing cheaper, lower-margin products and/or switching to discount suppliers
- Greater market segmentation has increased competition in many markets compared with previous economic shocks
- Retailers (often being direct customers for consumer products) may refuse/delay passing on price rises to their own customers



Conclusion

After a period where supply chain challenges have seen production inefficiencies, reduced margins and an inability to achieve desired volumes, demand for consumer goods is now being affected as well. This is only likely to intensify if a recession occurs and the pressures lead to a cooling of the labour market and increased unemployment, and/or a further reduction in real wages, coupled with increased interest rates in efforts to dampen inflation.

This may leave many consumer products suppliers facing a challenging short- to medium-term outlook. This is particularly likely to impact suppliers of high-end or luxury goods, as falling disposable incomes and consumer confidence leads to a reprioritisation of spending towards essential spend and a "trading down" effect.

Suppliers adversely impacted by Covid-19 restrictions and with consequently weakened balance sheets can ill-afford a further period of poor performance which, combined with the withdrawal of government protections and repayment of Covid loans, may trigger a cash-flow crisis.

Suppliers should consider different demand scenarios in their business plans and actively engage early in funding discussions. For companies with strong balance sheets, opportunities may arise to grow market share either through acquisition or organically as competitors leave markets.

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