Economic Outlook Briefing

2022/2023

CFG INSPIRING FINANCIAL LEADERSHIP

PRO BONO ECONOMICS

Contents

Introduction

2022 is set to be a difficult year for many charities and their finances. The charity sector is still dealing with the mounting financial, operational and governance pressures from Covid-19 and its aftermath, and this is now coupled with an escalating cost of living crisis and the outbreak of war in Ukraine.

Recent polling indicated that 58% of charity leaders believe that financial sustainability is their main challenge.[1] So, as the Chief Executive of the Charity Commission pointed out in her annual speech at the end of last year, for charities "the most difficult times may lie ahead".

Unfortunately, charities will not remain unscathed from rising inflation and the accompanying cost of living crisis.

On the one hand, the cost of operating is set to increase quite significantly, with an increase in labour costs and the purchase of goods and services. In addition, many will see an increase in demand for their services, while also seeing the value of donations and grants decline.

With this in mind, it would be prudent for all charities to consider the potential impact that these conditions will have on their finances, and what, if anything they might be able to do to help mitigate this.

We hope this briefing provides a useful overview of the key economic issues and trends to be aware of, providing a useful resource for trustees and charity boards to make strategic decisions about their finances.

1. Charity Landscape Report 2022 | Charities Aid Foundation | https://www.cafonline.org/docs/default-source/about-us-research/charity_landscape_report_2022.pdf
2. Gross Domestic Product (GDP) | Office for National Statistics (ons.gov.uk); United Kingdom Economic Snapshot | OECD; Home | Bank of England; Average weekly earnings in Great Britain | Office for National Statistics (ons.gov.uk); Labour market overview, UK | Office for National Statistics (ons.gov.uk)

Key economic statistics[2]

After two years of the pandemic, we now see signs of economic recovery in the UK, particularly when we look to economic growth and employment. However, this has been overshadowed by a worsening cost of living crisis, as the UK experiences a rise in inflation not seen in 30 years. With Covid-19 still affecting our lives and the recent outbreak of war in Ukraine, what can we expect of the economy in 2022, and how might this affect the charity sector?

GDP Growth 2021	7.5%
Growth forecast for 2022	4.7%
Unemployment	4.1%
Regular wage growth	3.7%
Interest rate	0.5%
Inflation	5.5%

Notes:

Growth

We are now seeing GDP back to pre-pandemic levels. Over 2021 economic output grew 7.5%[3] – a welcome sign of recovery. This has mainly been driven by household spending on goods and services and is likely to continue this year, with the OECD forecasting a strong but relatively moderate growth of 4.7%.[4] However, given the uncertainty around Covid-19, energy prices and the impacts of Brexit and the Ukraine conflict on the supply chain, GDP (and other metric) forecasts vary considerably.

Labour market

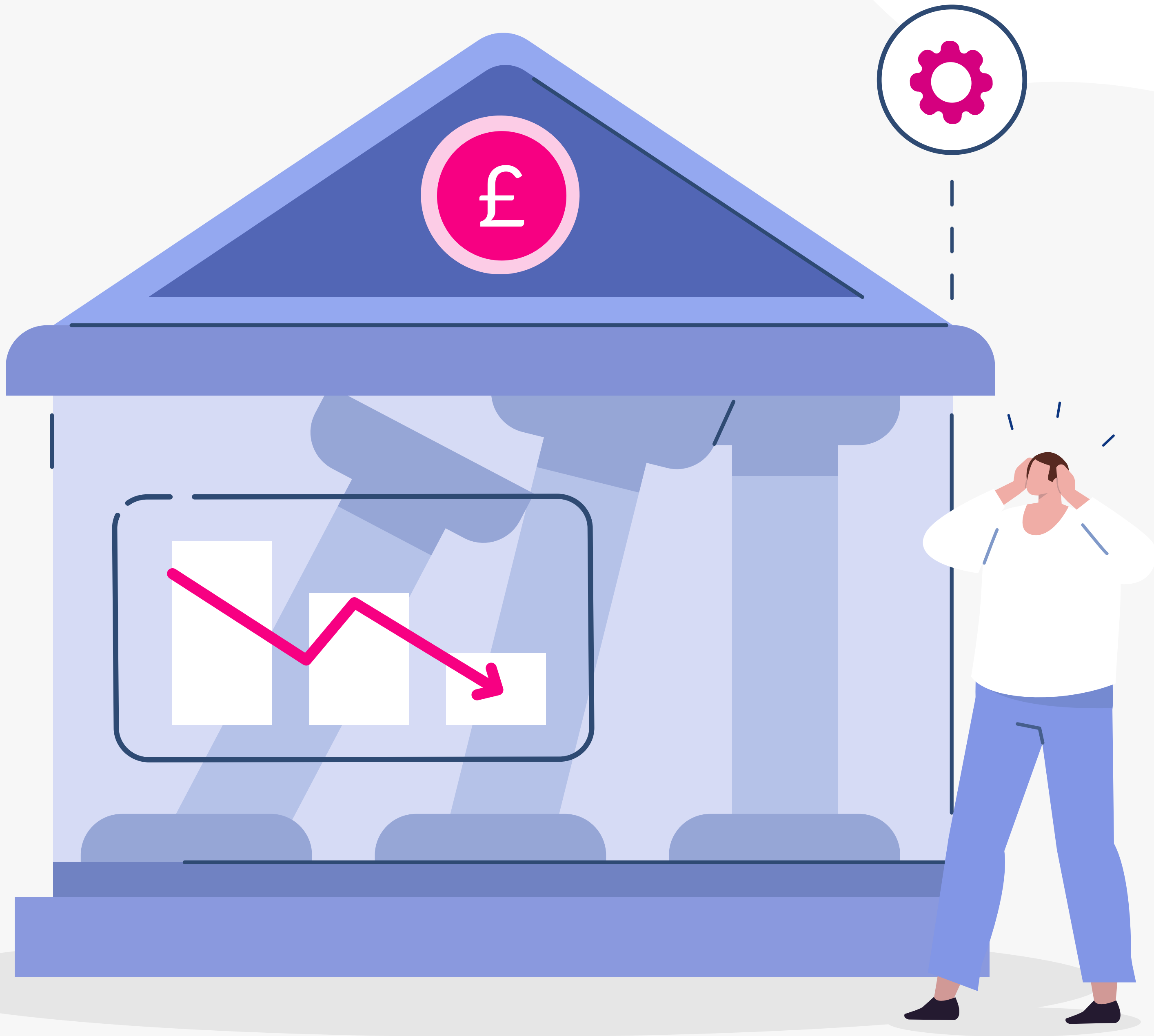
The labour market has been experiencing some recovery, with unemployment declining in recent months to pre-pandemic levels at 4.1% and increasing numbers on payroll.[5] However, inactivity rates have been growing since the end of 2021, now up to 21.2%, driven by more people living with long-term ill-health and/or disabilities, particularly due to mental ill-health. This suggests that low inactivity may persist over the next few months or years, requiring targeted health and employment support from the third sector to help people re-engage with the labour market.

Inflation

Due to the combined global trends of rising energy costs, Covid-19 related supply chain disruption and a surge in demand as pandemic restrictions ease, as well as the additional impact of Brexit impacts on the UK's supply chains, price levels have increased by 5.5% in the last year.[6] As the main drivers of this inflationary pressure still persist, economists expect inflation will continue to rise. Forecasts for the next year vary, reflecting the level of uncertainty, but the Bank of England predicts that annual CPI will rise to a peak of 7.25% in April this year. However, the war in Ukraine has substantially increased energy prices, putting further upward pressure on inflation.[7] The latest Bank of England forecasts were made just before the war broke out, and are therefore likely to underestimate the scale and duration of high inflation.[8] This means that prices will rise in the shops, bills will increase and the real value of wages will be reduced. This will reduce living standards overall and exacerbate the cost of living crisis, particularly for those on low incomes who spend a larger portion of their income on essentials, are less likely to have savings and are more likely to experience increasing hardship and debt.

3. Gross Domestic Product (GDP) | Office for National Statistics (ons.gov.uk)
4. United Kingdom Economic Snapshot | OECD
5. Labour market overview, UK | Office for National Statistics (ons.gov.uk)
6. Consumer price inflation tables | Office for National Statistics
7. The Living Standards Outlook 2022 | The Resolution Foundation | http://www.resolutionfoundation.org/publications/the-living-standards-outlook-2022/
8. Bank of England Monetary Policy Report February 2022

For more information on inflation and the charity sector, see the Inflation chapter.



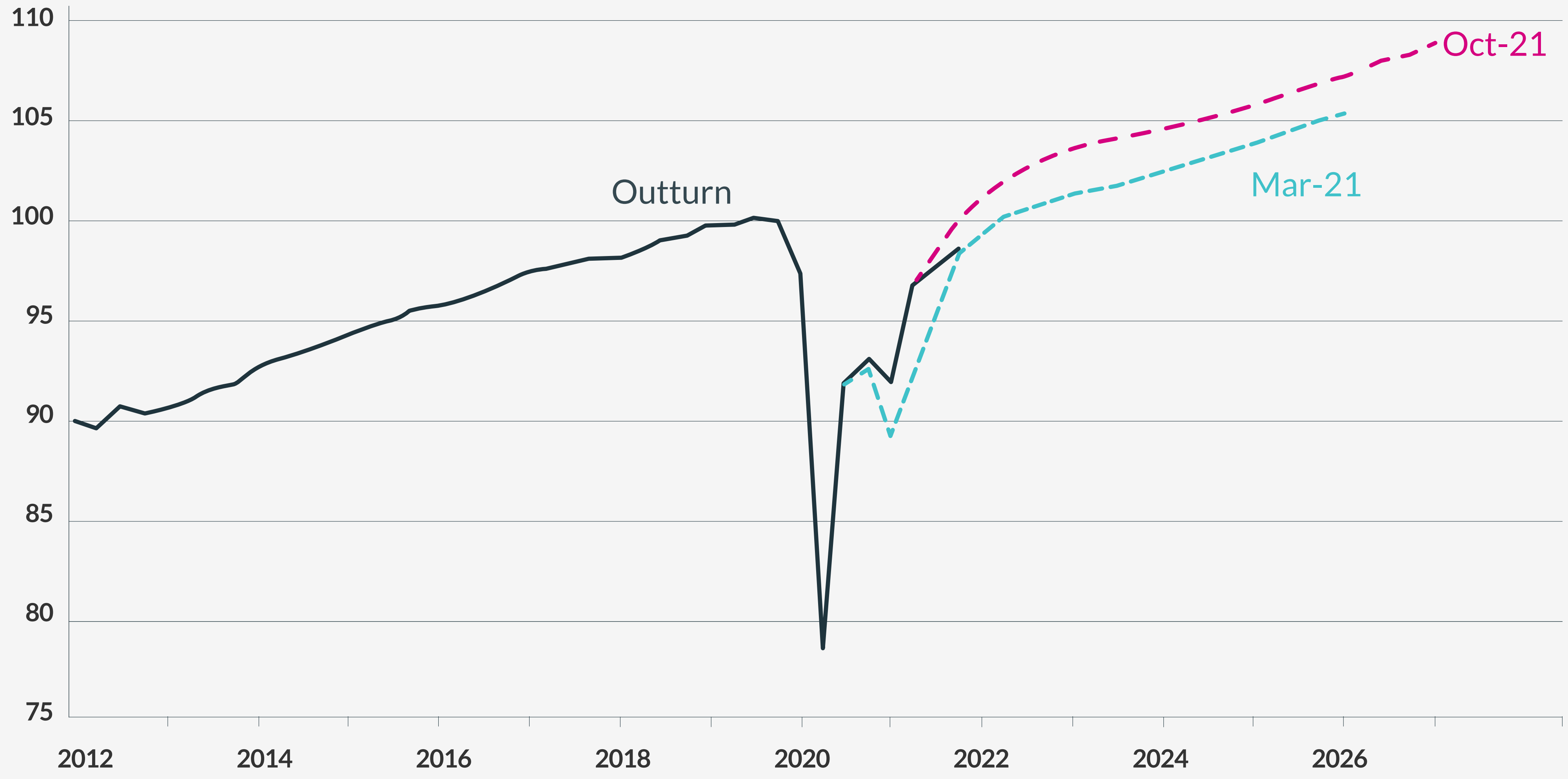
Interest rates

The Bank of England raised interest rates from 0.25% to 0.5% this February, in response to high inflation. This is bittersweet for the charity sector.

On the one hand, the sector is a net saver, not borrower, so this interest rate rise may help to offset some of the erosion of the value of their income due to inflation.

On the other hand, households with debts and mortgage repayments may struggle with larger repayments compounded by inflationary pressures; this would squeeze the cost of living even further and may result in more people turning to charity support.

Indices of real-terms GDP per capita, outturn and selected OBR projections: Q4 2019 = 100



Source: PBE analysis of OBR, Economic and Fiscal Outlook, various

9. Consumer price inflation tables | Office for National Statistics
10. Will inflation in the UK keep rising? | Bank of England
11. Rising inflation: What do charities need to know? | Pro Bono Economics

Inflation

Across the board, economists forecast that inflation will increase from the already high 5.5% experienced in the last 12 months.[9] The Bank of England suggests price rises will spike at 7.25% in April, as the causes of high inflation so far (namely high energy prices, supply chain blockages, and easing Covid-19 restrictions encouraging buying) are likely to continue through this year.[10] The war in Ukraine is expected to exacerbate the situation. Before the war broke out, it was expected that inflation rates would slowly fall after spring this year and over 2023 due to the temporary nature of the inflationary pressures. Economists now estimate that the conflict may push inflation above pre-war forecasts, and extend the period of high inflation further than expected.

Charitable donations

Rising price levels may reduce the volume and value of charity income. As donors experience higher prices, and a squeeze on the value of their salaries, they are likely to reduce their spending on goods and services (i.e. consumption). Previous PBE analysis evidenced a relationship between real consumption and charitable income. If the association between consumption and charitable income continues to hold, charity income will likely fall alongside consumption due to rising prices.

Charity expenses

Along with the rest of the economy, charities will find goods and services more expensive. Across the sector, the largest element of charity spending is on staff salaries. With fears of staff burnout growing, demand for jobs in the sector falling and large numbers of staff on low pay, the charity sector has a strong incentive to offer fair salaries to attract and retain staff. However, for wages to keep up with inflation, we estimate that total staff expenditure in the sector would need to be £2bn in 2024, an increase of 9% from 2021.[11] In common with other sectors of the economy, few charities will be able to afford such a big increase, meaning that their staff will see the value of their wages fall in real terms.

It is also important to note that the increase in price of one good or service may be greater than that of another, and that the impact of inflation on a charity's expenses depends on the mix of what they buy. Transport and housing prices have seen the strongest increase due to energy price rises, followed by hospitality, furniture and education.

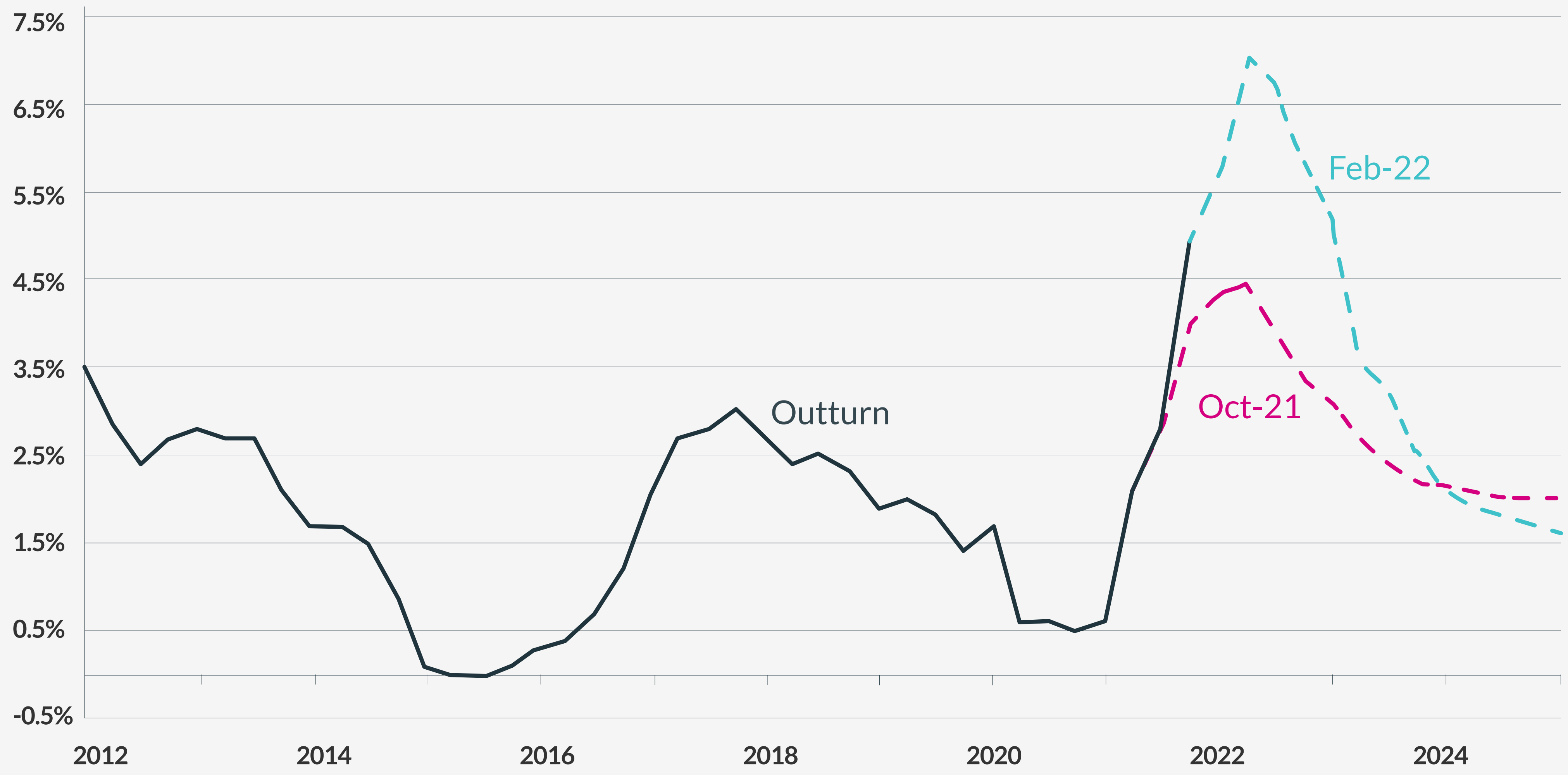
Demand for services

The cost of living crisis is worsening, and the impact on people across society is highly likely to result in rising demand for charity services. Already homelessness, food bank and debt charities have seen surges in demand as people struggle to cover costs of food and other essentials on top of soaring utility costs.[12] In January alone the price of food rose by 2.7%,[13] the highest increase since October 2013, and shop price inflation doubled from 0.8% in December to 1.5% in January. Kantar expects that annual food bills could rise by £180 on last year.[14] The energy price cap (the maximum price that energy suppliers can charge) is set to increase by 54% in April, meaning a £693 jump in the average annual household energy bill.[15] While the government is offering energy bill discounts up to £350, this will not stop the hit to living standards, especially with another price cap increase expected in October.

The cost of living squeeze will hit the most vulnerable and lowest income households the most, as a larger share of their expenditure is on essentials including energy bills, transport and food, leaving little room for cutting back on spending. Combined with an erosion of wages, a relatively low level of accumulated savings and a real cut in benefits (which will only rise by 3%) we are likely to see more people in poverty and seeking support from charities.

12. Poor face choice to 'heat or eat' as British energy price surge looms | Financial Times (ft.com)
13. Shop price inflation soars (brc.org.uk)
14. Pre-pandemic shopping routines return to UK... but price rises spell battle for consumer spend (kantar.com)
15. Price cap to increase by £693 from April | Ofgem

CPI annual rate (by quarter), outturn, October 21 and February forecasts



Source: PBE analysis of OBR Economic and Fiscal Outlook (Oct 2021), Bank of England Monetary Policy Report (Feb 2022)

Tax

There have been relatively few big changes to taxes that solely affect charities in recent years. Minor administrative changes have been made to Gift Aid, including changes to the donor benefit rules and new *de minimis* limits for year end letters, but there has been little appetite for fundamental reform. While charity infrastructure bodies have been pushing for reductions to the overall charity tax burden, given the state of the public finances and uncertain times ahead for the economy, it is unlikely that there will be sizeable changes to key charity taxes in the near future. However, with tax increases scheduled for this year, the tax burden for charities – and many of their beneficiaries – is set to increase.

Health and social care levy

From April this year national insurance contributions (NICs) will increase by 1.25 percentage points (the main rate for employees is due to rise from 12% to 13.25%) with this new transitional increase to the main and additional rates of NICs taking effect until April 2023. From then onwards, the new 1.25% health and social care levy will be in place, with the money being ringfenced for health and social care. This will place additional costs on all employers, including charities, as they will be required to contribute an additional 1.25%, through increased ERNICs in 2022/23 and through the separate HSC levy from April 2023. Alongside paying the new rate, there will likely be additional one-off costs of updating software and systems to reflect this.

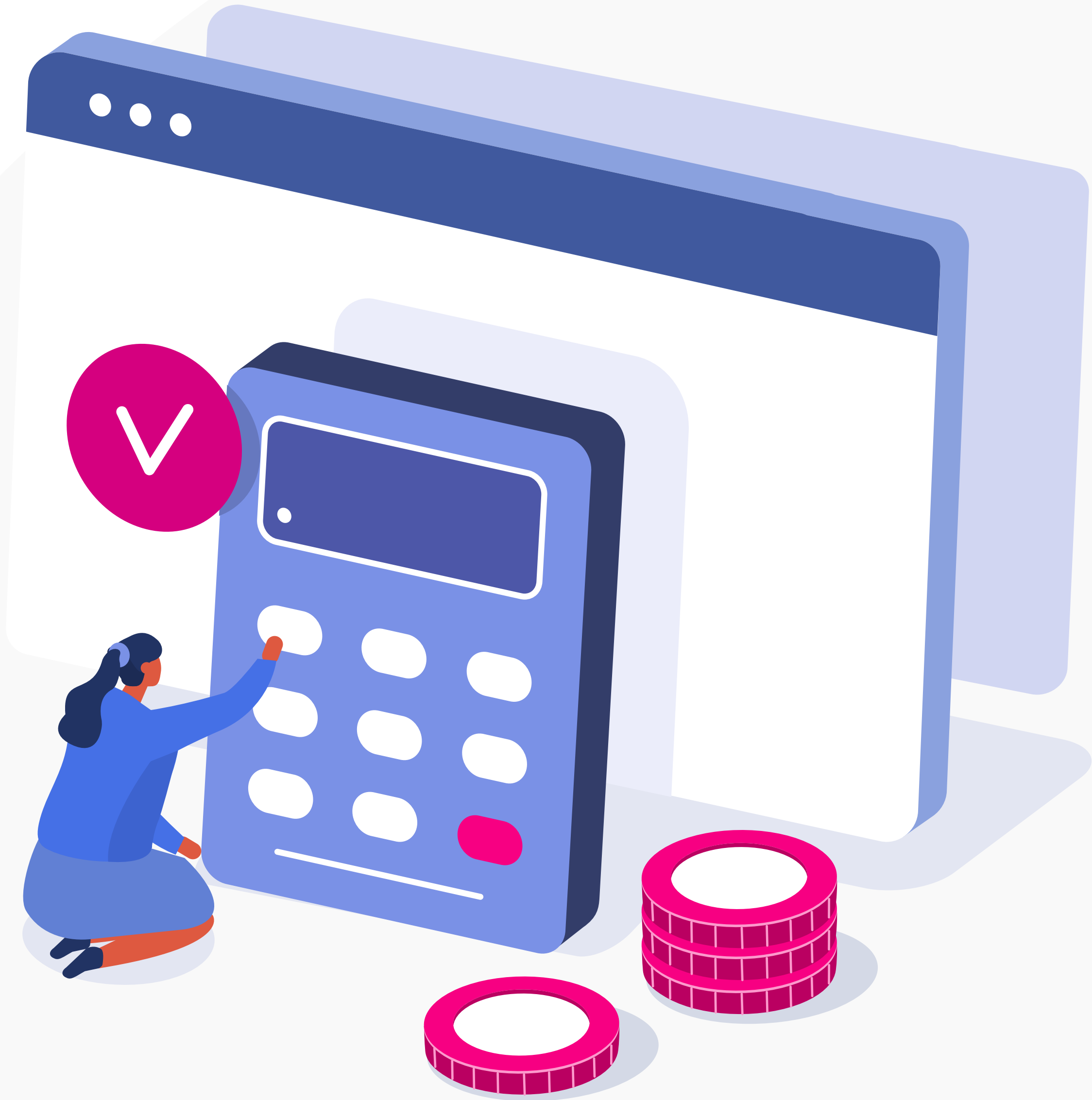
Business rates

Business rates relief has not been changed at all in recent years. Charities retain 80% mandatory relief, with a further 20% discretionary relief potentially available from the local authority.

The government published its response to the 'Future of Business Rates' consultation in October last year, with many fearing this could see amendments, or even a plan to remove entirely, charitable rate relief. So it was positive news that the government committed to retain charitable rate relief for the foreseeable future.[16]

In relation to existing reliefs (including charitable rate relief) they stated that "The government does not intend to remove any of the existing reliefs at this time." While this is positive, this does not preclude them from doing so in the future. As a sector we should continue to monitor any changes to business rates and reliefs that many occur and be prepared to advocate for charitable rate relief if any fundamental changes are proposed.

In response to the pandemic, the government introduced the expanded retail discount scheme providing 100% business rates relief to charity shops, museums, galleries and theatres amongst other select charity buildings. This relief was followed by a 66% relief for the period 1 July 2021 to 31 March 2022. But this, alongside a number of other minor tax changes that occurred at the most recent Budget (Theatre Tax Relief, Orchestra Tax Relief and Museums and Galleries Exhibition Tax Relief[17]) does not materially reduce the amount of tax that most charities will need to pay in the year ahead.



16. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1028478/BRR_final.pdf
17. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1028478/BRR_final.pdf

Income from Individuals

NCVO Almanac data indicates that for some time the largest single source of charity income is from individuals. The most recent analysis found that, although pre-pandemic voluntary sector income and expenditure were growing, they were doing so at a rate of only 1%, with almost half of voluntary sector income coming from the public.[18]

It is worth bearing in mind that the data from the most recent Almanac is for the year 2018/19, with a supplement of some more recent financial information to provide a little context on charities' finances as a result of the pandemic. These findings are indicative but not necessarily a full or wholly accurate of the current financial position of charities in 2022. However, it is important to note that income from the public was the only source of income which increased from 2017/18 to 2018/19, with all others declining. Future years' analysis will determine whether this is an aberration or a trend which continued throughout the pandemic.

Impact of Covid-19 on charity finances

A survey from the Charity Commission on the impact of Covid-19 on charities from October 2021 found that 72% of charities had seen their financial position negatively impacted by Covid-19,[19] with the majority having lost income from charitable activities as a result. Linked to this, the survey found that many charities (40%) used some or all of their financial reserves. These findings are also supported by a number of other surveys of the sector through the pandemic.[20]

The bad news doesn't end there, as more than a third of all charities surveyed expected to generate less revenue from fundraising and donations in 2022. This follows a longstanding trend that prior to Covid-19 the rate of return on money spent on fundraising has been declining since 2010. This means that charities will need to spend more on their fundraising activity to gain the same returns.[21]

18. Sector finances - Financials | UK Civil Society Almanac 2021 | NCVO
19. Covid-19 Survey 2021 | GOV.UK (www.gov.uk)
20. Covid-19 Charity Tracker Survey | Pro Bono Economics
21. charity-benchmarks-iof-members-(2).pdf (ciof.org.uk)
22. https://www.gov.uk/government/news/government-sets-out-conditions-for-returning-to-07-aid-target

Income from government

Income from government made up about a quarter of all charity income in 2018/19, with this figure having continued to decline since 2000. Nonetheless, many charities still rely on funding from government, local government and other public services as a key source of income, and even more beneficiaries are affected by the amount of funding that related government departments receive.

International development

Departmental spending across government has been subject to austerity since 2010, but not all departments have been affected equally. Charities which deliver overseas aid (international non-governmental organisations or INGOs) have been some of the hardest hit in recent years. In 2021, the government ended the longstanding commitment to spend 0.7% of GNI on Official Development Assistance (ODA) and reduced its commitment (temporarily) to 0.5% of GNI. With a significant reduction in the size of the overall economy, GNI is also smaller than it would have been previously.

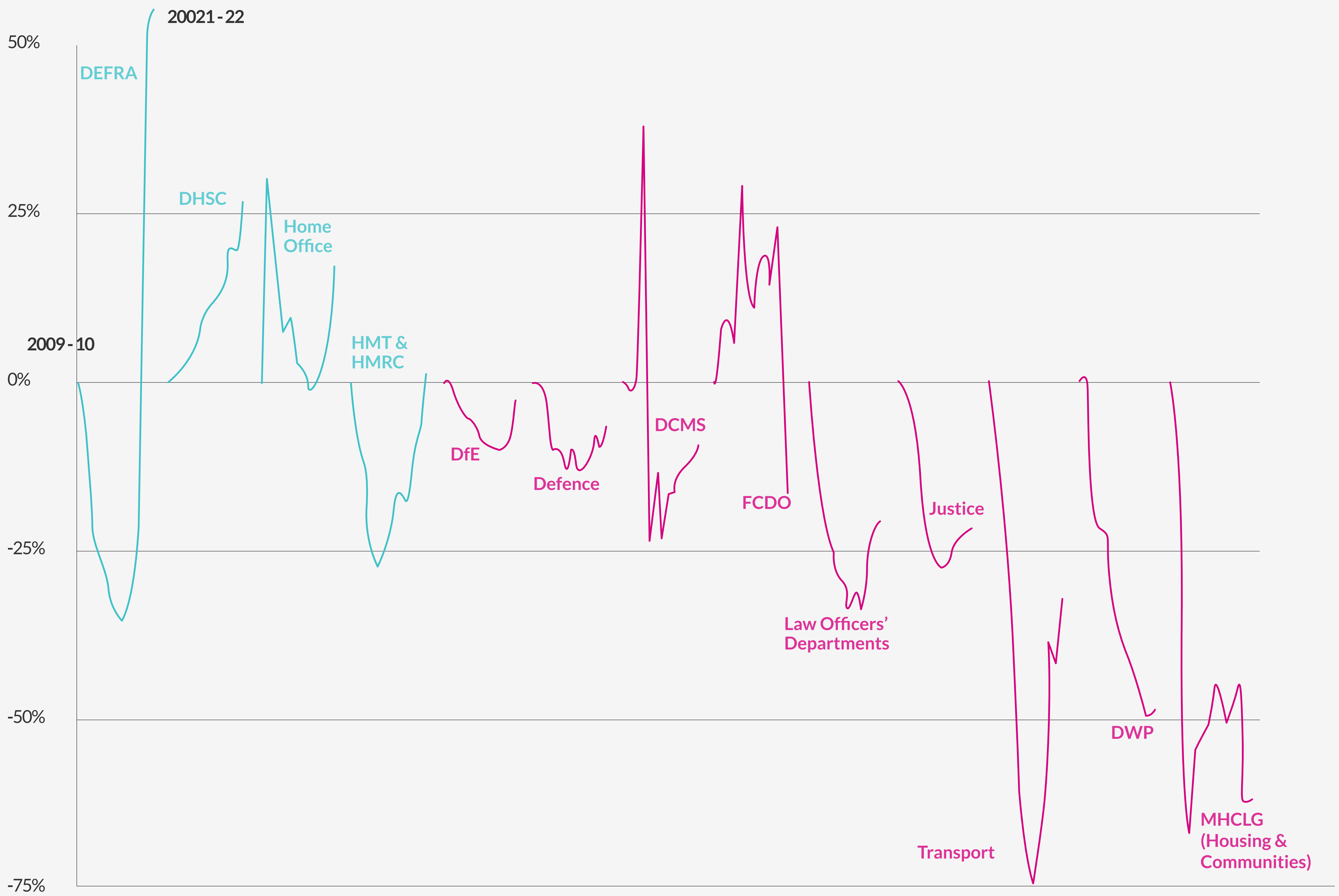
The conditions for spending on international development to return to 0.7% are not predicted to be met until 2024/25, and as a result spending on aid is unlikely to increase any time soon.[22] Conditions for charities who work overseas will be challenging for some time.

Local government

The most recent spending review saw core spending power for local authorities increase by 3% in real terms each year until 2024/25. However, these increases do not make up for many years of under-investment.

The Institute of Fiscal Studies has demonstrated that local authorities have seen sizeable cuts since 2010, even after the recent increase. The increase also does not put local government finances on a sustainable footing for the long term. So charities, and their beneficiaries, that rely on local government funding, will likely find things challenging for the foreseeable future.

Change in real-terms resource DEL since 2009-10



Source: Institute for Fiscal Studies

Levelling Up white paper

The recent Levelling Up white paper laid a welcome emphasis on increasing wellbeing across the UK, focusing on social capital alongside economic capital. However, there was little in the way of funding commitments or concrete policies to match the ambitions which the paper lays out, and a lack of clarity on how far civil society organisations will be able to shape future policies. It is therefore difficult to determine at this stage how the plans will affect charity finances.

It is fair to say that in the very short term it is unlikely to make much difference for most charities, despite a number of initial funding commitments. These include small pots of money from dormant assets such as £44m to the Youth Futures Foundation, £20m to Access (the Foundation for Social Investment) and £4m for Fair4all Finance. However, they will not benefit the vast majority of the sector.

UK Shared Prosperity Fund

We have known since the 2021 Spending Review and Budget that the amount of money provided through the fund (£2.6bn by 2025) will not match the amount previously provided by the EU and accompanying funding. In addition to this, the guidance currently published says that the Shared Prosperity Fund will focus on 'communities and place and local business interventions to boost pride in place' in it's first two years, with funding for 'people and skills' not anticipated until 2024/25.

This means that charities previously reliant on European Structural Investment Funds (ESIF) funding to help those furthest from the labour market to develop skills and re-enter the workforce will miss out until then. The only exception to this was the commitment to 'maintain the flexibility to fund voluntary sector organisations delivering locally important people and skills provision where this is at risk due to the tail off of EU funds'.

However, there is no indication of the scale of this or how widely it will be used, and it may be too late to support many projects affected by ESIF running out.

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About Pro Bono Economics

Pro Bono Economnics (PBE) uses economics to support the social sector and to increase wellbeing across the UK. The charity combines project work for individual not-for-profits and social enterprises with policy research that can drive systemic change.

About Charity Finance Group

Charity Finance Group (CFG) is the charity that inspires a financially confident, dynamic and trustworthy charity sector. CFG does this by championing best practice, nurturing leadership and influencing policy makers.