How to look after your money

Understand and manage a budget including needs vs wants, payslips and why prices keep going up

KEY TERMS

Needs vs wants: things you can't live without versus things you can live without.

Essentials: things that are absolutely necessary.

Luxuries: things that are pleasant to have or experience but not absolutely necessary.

Conscious spending: thinking carefully about buying things and what the effect might be on your budget. Conscious spending habits include shopping around for the best option, saving things to your online basket, asking for a second opinion, and waiting 48 hours before buying.

Impulse spending: when you buy things without carefully thinking about them or the consequences for your budget, often driven by emotion.

WAGES, TAX AND SAVINGS

Taxman: this is a short name for the organisation that collects tax: **HMRC**, which stands for Her Majesty's Revenue and Customs.

Net income: the money you actually get on payday after deductions such as income tax, National Insurance and health benefits.

Income tax: tax paid directly on your personal income.

National Insurance: tax you pay directly on your personal income; your employer also pays some. It goes towards state benefits such as sick pay, the state pension and maternity allowance.

Student loans: sums of money lent to students to help them pay for education; you only repay them from your wages if you earn over a certain amount.

WAGES, TAX AND SAVINGS continued

Pensions planning: setting aside part of your earnings with money from your employer each month, going towards a future pot of cash that can be accessed on retirement.

Payslip: this document is given by an employer to an employee each payday. It shows total wages earned for a set period of time as well as deductions including taxes and personal deductions such as pension contributions or health benefits.

Savings: the portion of income set aside for future use and not spent.

50:30:20 rule: a budgeting method where the rule of thumb is to divide your monthly net income into three spending groups: 50% for needs, 30% for wants and 20% for savings, investment or towards a rainy day fund.

GENERAL

Cost of living: the cost of living is the amount of money needed to cover basic expenses such as housing, food, taxes and healthcare in a certain place and time period.

Inflation: the overall rate of increase in prices over a given period of time, usually a year. But it can also be more narrowly calculated for certain goods such as fuel, food or services.

Basket of goods: the basket of goods and services is used to represent a typical family's spending so inflation can be calculated. The items included in the basket change so that the commonly bought items are up to date and representative of consumer spending patterns.

Consumer Prices Index: the CPI is published by the Office for National Statistics. It measures the average change over time in the prices of goods and services bought by most households in the UK.

Shrinkflation: a form of inflation, most common in food and drinks, that consists of reducing a product's size while keeping its retail price the same.

Debt: money borrowed by one party from another which has to be repaid, normally with interest. Many people take on debt as a way of making large purchases that they could not afford under normal circumstances. Debt can be in the form of credit cards, loans or mortgages among other things.

Progressive taxation: the more you earn, the more tax you pay.

Bank of England: the Bank of England is the central bank of the United Kingdom, responsible for setting interest rates, financial stability and issuing banknotes.

FAQS

BUDGETING QUESTIONS

I've never run out of money, why do I need to budget? A budget helps create financial stability and reduce stress. Your budget creates a plan for your income and spending and allows you to track it so that you can reach your financial goals- which can be anything you want. It ensures you have enough money for your needs and wants and don't overspend, which may lead into getting into debt.

How can automation help me budget? When you automate your finances through things like standing orders or direct debits you are setting up your bill payments and savings accounts to be paid automatically from your main bank account (can be done online or through your banking app) - most commonly monthly. You're putting your money on autopilot. By automating your finances, you're making sure you pay your bills on time and avoid costly late payment fees.

What should you do if you don't stick to your budget? If you don't stick to your budget for one month, it's best not to ignore the problem: it's better to reflect on what and why you've been spending. Ask yourself: "Is there anything I can cut back on for the next month? Have I changed my expenditures or have prices gone up?" This should reduce the feeling of panic and help you reset for the following month. That may mean cutting down on some expenditures or finding ways of increasing income, like working extra shifts. If concerned, you can also seek guidance. There are recommended organisations to speak to below.

PAYSLIP QUESTIONS

What does my tax get spent on and by who? Your taxes get pooled together and are then used to help fund public services. These include the NHS, education, the welfare and defence systems, as well as investment in public infrastructure such as transport and housing.

Does everyone have to pay the same amount of income tax? Income tax rates are progressive in the UK, meaning the more you earn, the more you'll need to pay. If you earn less than £12,571 this year, you will not pay any income tax. Above that, how much you pay depends on three "tax bands", or ranges of income. Earners in these bands pay 20% on the lowest incomes, then 40% and, for the highest earners, 45%. When you go up a band, you only pay the higher level on your higher earnings, not your whole salary.

Why is my net (take home) pay important? It is the amount that gets paid into your account after deductions are taken away, so it's the amount that matters most when you plan your spending and calculate your budget.

PAYSLIP QUESTIONS continued

How does a pension work? A pension is a type of retirement plan that you and your employer can pay into, which is treated favourably by the tax system. This provides monthly income on your retirement. A percentage of your pay is put into the pension scheme automatically every payday by you and your employer. Currently, you can access your pension at 55 years old (which may increase in future). When you pay into a pension, you are giving up current income in exchange for money in the future (in the form of pension income). This is something to be considered when budgeting as it will come out of your pay cheque. There are three types of pension: state pension, workplace pensions and personal pensions. To learn more, please see MoneySavingExpert.

Why should I care about my pension now? Pensions provide the cash to live off when you retire. The more money you put away into a pension and the sooner you start, the more money you will have to live off when you leave the world of work.

How do I know my boss is saving my pension money? It is the law that your employer pays any pensions deductions from your pay, plus their own contribution, into a pension scheme on your behalf. Most employees will receive evidence of this from their pension scheme provider.
If you suspect that an employer is not doing this, you can contact the Pensions Regulator.

INFLATION QUESTIONS

What is the Bank of England (BoE) and what is its role in inflation? The Bank of England is the central bank of the UK and is independent of the government. It has national responsibilities such as issuing currency and setting interest rates (known as monetary policy). It also regulates banks and insurance companies and is the government's bank and the lender of last resort. The BoE holds gold and currency reserves.

The BoE has the job of keeping inflation low and stable. The main way it does this is through changing interest rates. The BoE's "base rate" of interest is what your bank uses for setting the interest rate you earn on savings or on you pay for a loan or mortgage. The BoE will increase or decrease interest rates to try and keep prices at a target rate of 2%.

What does an interest rate mean for me? Interest rates tell you how high the cost of borrowing is, or how high the rewards are for saving.
As a borrower, the interest rate is the amount you are charged for borrowing money, shown as a percentage of the total amount of the loan. The higher the percentage, the more you have to pay back on top of your original loan amount. If you're a saver, the interest rate tells you how much money will be paid into your account as a percentage of your savings. The higher the interest rate, the more will be paid into your account for a given amount.

Generally, when interest rates are low, more people are willing to borrow money to make bigger purchases on items such as a house or car, and it is cheaper for businesses to expand. Even small changes in interest rates can have a big impact. So it's worth staying tuned in to see whether they rise, fall or stay the same.

INFLATION QUESTIONS continued

Why can't the Bank of England fix the inflation problem? The cause of inflation is important. Prices rise when there isn't enough of the things people want. In economics jargon, this is when demand (for goods or services) is high and supply is low. High inflation rates in the UK towards the end of 2021 and into 2022 have been mainly caused by global price increases in oil, gas and food, which have been in short supply.

Consumer spending can be encouraged or discouraged by changing interest rates, which is the main tool available to the BoE. But this does not change the global factors so the BoE can't simply "fix" the problem. Also, higher interest rates may lead to consumers spending less, as mortgage and borrowing costs increase, leading to slower economic growth. By making people buy less, this could reduce inflation. But when the economy is already weak, the BoE will be careful not to make decisions that could slow the economy too much.

Can anyone control inflation? On an individual level, there is not much we can do to control inflation when it gets very high. Collectively, inflation is affected by how businesses price their goods and services or how much they agree to pay their workers. The Bank of England is the main organisation whose role it is to control inflation through interest rate increases. The government can also increase spending and reduce taxes - known as fiscal policy - to support consumers- or do the opposite to reduce spending in the economy. All of these decisions have to be made carefully and are aimed at maintaining slow and steady economic growth, keeping business confidence strong and without shocks which may send the economy into a slowdown or even recession (when the economy shrinks for six months in a row).

When does inflation become a problem? Inflation isn't always bad news. A little bit, around 2%, is actually quite healthy for an economy. There is no exact cut-off for when inflation becomes a problem but it can become a worry when it significantly rises or falls below the 2% mark. If it's much higher than 2%, the cost of living increases faster and wages don't keep up. For example, with inflation reaching 9% in June 2022 in the UK, people experienced higher costs of things like food, energy and heating, eating into their budget. High inflation can also be bad for savers, investors and lenders, because when they get their saved money back, it will buy them less than they thought.

If prices fall, known as deflation, the worry is that the public will spend less. This is because deflation makes it harder to pay off debt (money is now worth less so the loan or mortgage a person has to pay back is relatively more expensive). Businesses may also sack employees when this happens.

What is the point of saving money when inflation eats into my savings? It is important to keep some savings for what's known as a rainy day (or emergency) fund. If prices go up or your job disappears, it may be that your budget gets squeezed and you need to access some of these savings.

GENERAL QUESTIONS

Who can I talk to if I'm worried about money?

1. Citizens Advice – 'Debt and Money' service advises on a number of topics including financial difficulties, cost of living and communications with creditors
2. MoneyHelper – Help if you're struggling with debt provides a guide for individuals who are having issues keeping up with their debts.
3. NSPCC Helpline: 0808 800 5000
4. CHILDLINE: 0800 1111
5. You can contact The Pension Tracing Service to help you find pensions you've paid into but lost track of.

What questions do you still have about money?

Send your questions to FLIC at info@ftflic.com