

UK CONSUMER MONTHLY

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A monthly review of the recent developments in the consumer sector

Editor: Roger Bootle

High street resilient, but weakness persists elsewhere

- **Total consumer spending – page 2**

Retail sales have continued to hold up better than expected, rising by 0.9% in Q1. However, spending off the high street remains weaker. Overall consumer spending probably still fell in Q1.

- **Retail spending – page 3**

The main measures of annual sales growth picked up in March, despite the fact that the Easter boost didn't come until April this year. General retail share prices are now up 40% on the start of the year.

- **Economic drivers of spending – pages 4 & 5**

Lower bonuses have pulled average earnings growth into negative territory, while the Budget contained only a paltry net giveaway for this year. The household saving rate shot up at the end of last year, as households saved rather than spent the rise in income resulting from falling interest payments.

- **Prices & costs – page 6**

Retailers have continued to have some success in passing on higher import prices to consumers. Further announcements on VAT were conspicuous by their absence in the Budget.

- **Outlook**

Retail sales have lost some of their shine, but are still performing rather better than might be expected given the economic backdrop. However, spending off the high street is certainly still suffering. And we continue to think that the high street faces a renewed period of weakness before long. Disposable incomes have been boosted by falling interest payments and inflation. But slowing pay growth and rising unemployment will increasingly offset this boost. In addition, rising job insecurity and concerns about future tax rises means that any extra income is likely to be saved. We still think that consumer spending will fall by around 3.5% in real terms this year, although the drop in retail sales now looks set to be slightly smaller than this.

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Total consumer spending

Some signs of stabilisation

- High street spending has continued to perform rather better than expected, but other parts of spending are still suffering heavily.
- Retail sales rose by 0.9% in the first quarter, with the latest trading statements retaining the more positive tone seen since the end of last year.
- The rise was broadly in line with Q4's 0.7% increase. However, the robust rise in retail sales in Q4 did not prevent overall spending falling by 1%. (See Chart 1.)
- Indeed, spending *off* the high street appears to have remained much weaker than retail sales, suggesting that overall spending probably fell again in Q1. We do not yet have any official figures on non-retail spending in Q1. However, output in the retail, hotels, pubs and restaurants sector fell by 1.2% in Q1, despite the rise in retail sales. (See Chart 2.)
- Meanwhile, the Bank of England's agents' score of consumer services turnover is still drifting downwards, albeit at a more modest pace than before. (See Chart 3.)
- And the number of private new car registrations started to fall at a faster pace again in March. The annual growth rate was -28.6%, down from -21.7% in February. (See Chart 4.)
- That said, according to the latest report by the Bank of England's regional agents, the rate of decline in spending on *used* cars has eased. The agents also reported that demand for some other consumer services had stabilised or even picked up – most notably with reports of increased spending on domestic holidays. The impact of the lower pound has no doubt played a role in this shift in expenditure.

Chart 1: Real Household Spending & Retail Sales (% q/q)

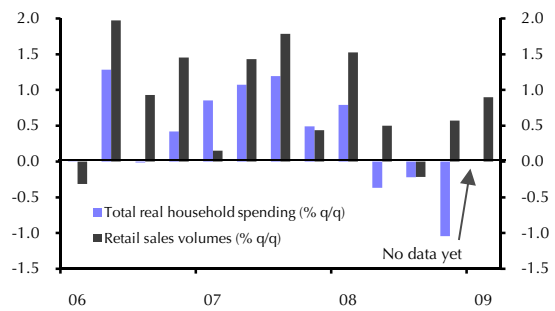


Chart 2: Retail Sales & Output in Consumer Sectors (% q/q)

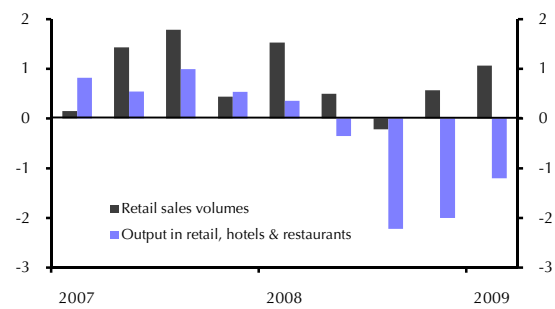
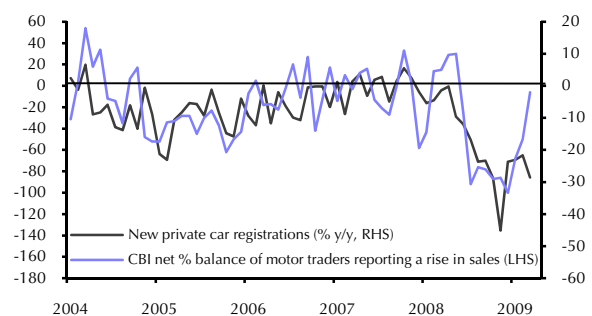


Chart 3: Bank of England Agents' Scores



Chart 4: New Car Registrations



Source – Thomson Datastream, Bank of England & SMMT

Retail Spending

Sales still holding up

- Retail sales are still holding up better than might have been expected given the economic backdrop and the later timing of Easter.
- Admittedly, the CBI's reported sales balance fell from -27 to -44 in March. However, the survey only covers part of the month. The BRC's measure of like-for-like sales growth (which covers the whole month) rose from -1.8% to -1.2%.
- Clearly demand is weak if like-for-like sales are still falling. But the -1.2% growth rate was better than the rates seen at the end of last year. (See Chart 1.)
- What's more, the BRC survey was expected to suffer from the later timing of Easter this year compared to last. This should depress annual comparisons in March, but boost them in April. Indeed, John Lewis reported an annual sales decline of "only" 1.5% in the week ending 11th April, reflecting this Easter boost.
- The Office of National Statistics figures (which *do* adjust for the timing of Easter) also showed a rise in the annual growth rate of sales volumes in March, from 0.4% to 1.5%. (See Chart 2.)
- Sales rose by 0.3% m/m. But non-food sales *fell* by 0.2% m/m. The drop would have been even bigger but for a weather-related 1.5% increase in clothing sales. (See Chart 3.)
- The FTSE 350 index of general retailers has continued its upward march, outpacing the overall stockmarket spectacularly. (See Chart 4.) It now stands 40% above its level at the start of the year, although there is disagreement about whether this recent rally will be sustained.

Chart 1: CBI & BRC Measures of Retail Sales Growth

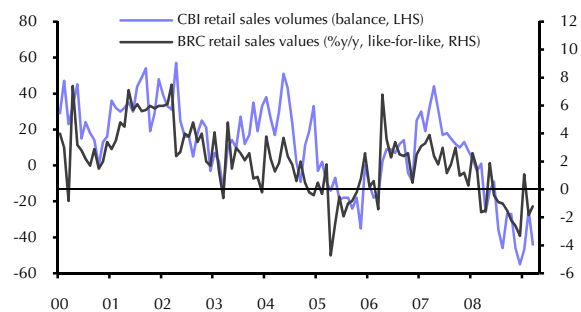


Chart 2: Official Measure of Retail Sales (% y/y)

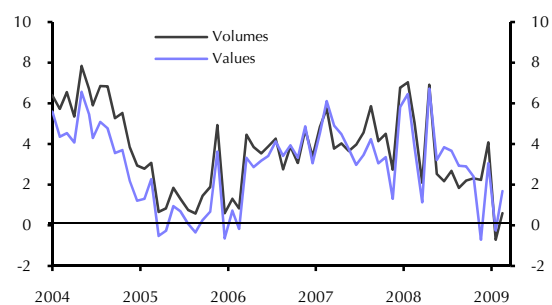


Chart 3: Retail Sales Volumes in March (% m/m)

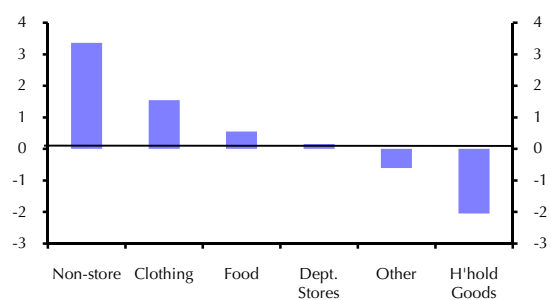
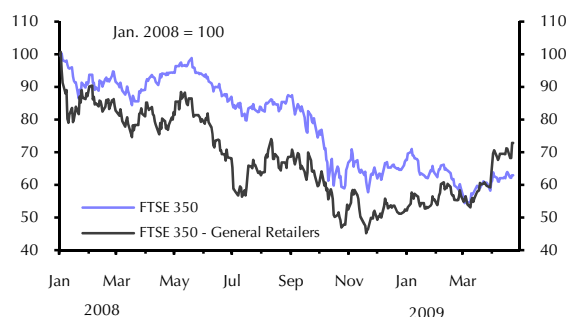


Chart 4: Stockmarket Indices



Sources –Thomson Datastream, CBI, BRC, John Lewis

Economic Drivers of Spending

Disposable income saved rather than spent...

- News on the labour market remains grim and the Budget gave little money away. But there are some signs of life in the housing market.
- Households actually saw a strong £5.8bn or 2.5% quarterly rise in their real disposable incomes in Q4 of last year. (See Chart 1.) This reflected an even bigger £6.8bn drop in debt interest payments, itself a result of the 300 basis points drop in interest rates in Q4.
- In response, income gearing – interest payments as a share of income – fell below 4%, the lowest level for at least 20 years. (See Chart 2.)
- However, with interest rates now at a floor, this boost to income will fade. The Monetary Policy Committee left interest rates at 0.5% in April and instead voted to continue with their quantitative easing programme of £75bn of asset purchases.
- The labour market is also becoming an increasing drag on income growth. Average annual earnings growth including bonuses fell to -2.1% in February. This was primarily a result of lower bonuses, although regular pay growth slowed too. (See Chart 3.) Claimant count unemployment rose by 73,700 in March.
- The Budget contained only a modest net giveaway of £5.2bn in 2009/10. The measures aimed directly at households amounted to £2.4bn, equivalent to just 0.3% of disposable income. What's more, the giveaway turns into a fiscal tightening in future years, with households earning over £150,000 bearing the brunt of the tax rises announced so far.
- In any case, households are saving, rather than spending, their increases in disposable income. As Chart 4 shows, household saving as a proportion of income jumped from 1.7% to 4.8% in Q4.

Chart 1: Real Household Disposable Income Growth

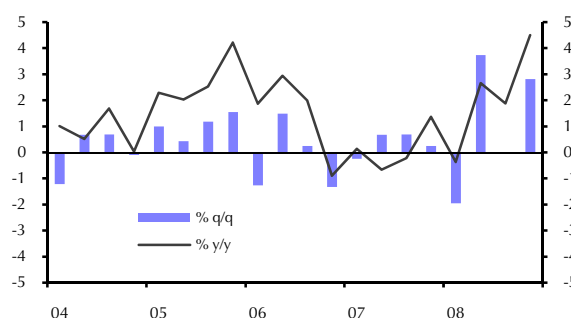


Chart 2: Income Gearing (Interest Payments as a % of Income)

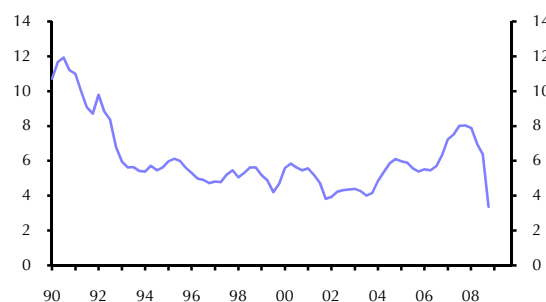


Chart 3: Average Earnings (% y/y)

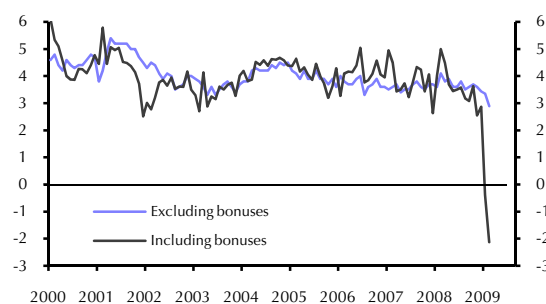
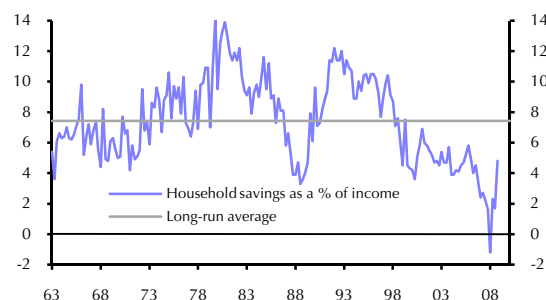


Chart 4: Household Saving Rate (%)



Sources – Thomson Datastream

Economic Drivers of Spending (continued)

...largely due to falling wealth and low confidence

- The weakness of the housing market continues to suggest that the saving rate will rise further.
- At least housing market activity appears to have found a floor. Mortgage approvals rose by 6,000 to 38,000 in February. Meanwhile, the Bank of England's Credit Conditions Survey showed that a positive net balance of lenders expected to increase the availability of mortgages in the next 3 months. (See Chart 5.)
- However, at their current levels, approvals are still consistent with large falls in house prices. The Halifax index fell by 1.9% m/m in March. The Nationwide index rose by 0.9%, but monthly volatility is not unusual; a rise in the Halifax index in January was subsequently reversed. (See Chart 6.)
- The 20% peak-to-present fall in house prices has left around 1 million households in negative equity. If the peak-to-trough fall in house prices totals 40%, as we forecast, negative equity could affect 3.75 million households or almost one-in-three mortgages.
- Meanwhile, housing equity withdrawal fell even more sharply in Q4 than Q3. The £8bn drop reflected households paying more into the housing market (e.g. through mortgage repayments) than the money they took out (e.g. through withdrawing equity when remortgaging). (See Chart 7.)
- Despite this backdrop, consumer confidence picked up in March. (See Chart 8.) The MORI measure of consumers' confidence in the economy rose from -40 in February to -29 in March. Meanwhile, the GfK/NOP composite index rose from -35 to -30. Nevertheless, the latter measure remains exceptionally low.

Chart 5: Credit Conditions Survey – Availability of Credit

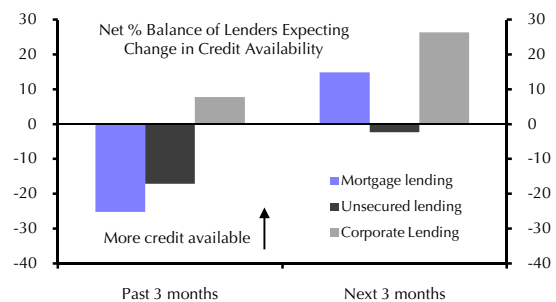


Chart 6: House Prices (% m/m)

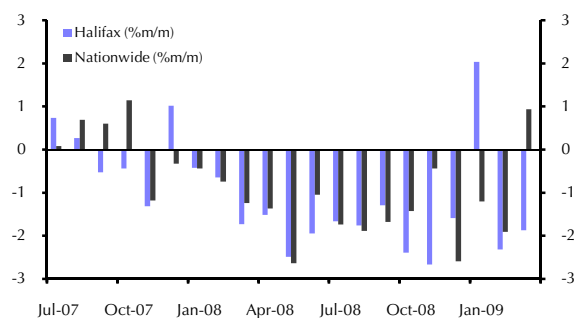


Chart 7: Housing Equity Withdrawal (£bn)

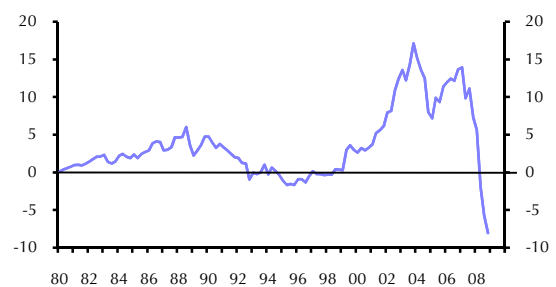
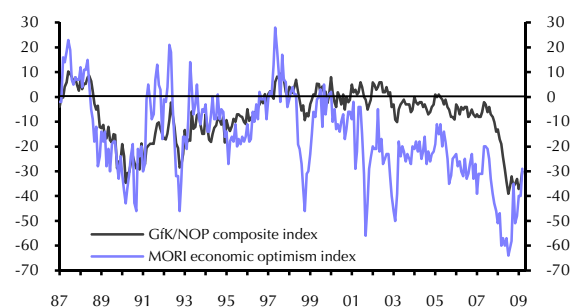


Chart 8: Consumer Confidence Indices

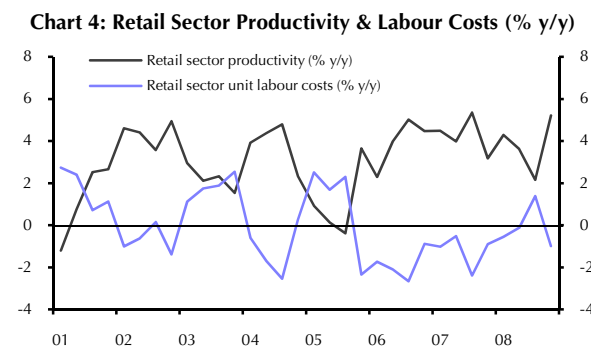
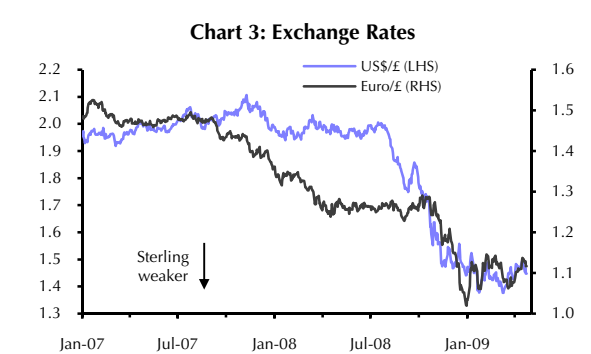
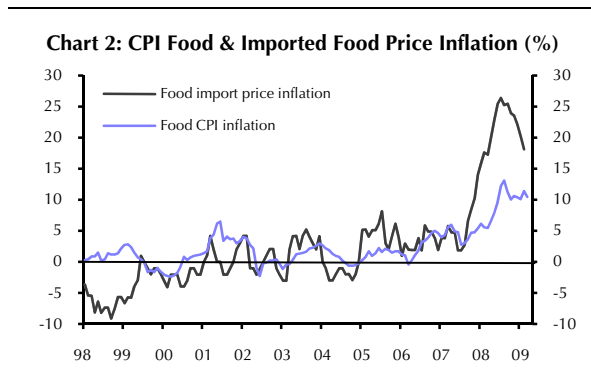
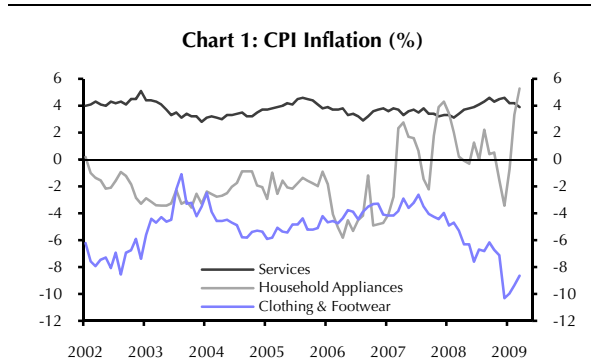


Source – Thomson Datastream, Bank of England, GfK/NOP, MORI

Prices & Costs

Rising import prices pushing up core inflation

- Retailers are continuing to have some success in raising their prices in response to soaring import costs.
- Core CPI inflation (which excludes food and energy) rose for the third month in a row in March, from 1.6% to 1.7%. Again, the rise was driven by import-intensive sectors. Services inflation actually eased. (See Chart 1.)
- The lower pound wasn't the only factor at play, however. Many retailers have now restored prices to the prices that prevailed before December's cut in the VAT rate.
- Meanwhile, food and drink CPI inflation has finally begun to ease, dropping from 11.4% to 10.5%. Further falls are likely if the recent slowdown in food import price inflation is anything to go by. (See Chart 2.)
- Annual price inflation of imported consumer goods also fell in February, but remains high at 12.9% (down from 14% in January). The pound remained at around \$1.45 over the past month. It rose slightly against the euro, but this just reversed the previous month's drop. (See Chart 3.)
- There were no VAT announcements in the Budget; the current plans therefore remain for the cut in VAT from 17.5% to 15% to be reversed at the end of this year.
- The Budget did contain a £5bn supply chain insurance scheme. However, the scheme will only top up cover for companies whose credit insurance has been reduced. Those whose insurance has been withdrawn entirely will not benefit.
- On a more positive note, retailers have managed to keep their unit labour costs under control, primarily by keeping a lid on headcounts. (See Chart 4.)



Sources – Thomson Datastream

Economic Indicators & the Month Ahead

ECONOMIC INDICATORS

	2008 Q3	2008 Q4	2009 Q1	2008	2009 (forecast)	2010 (forecast)
GDP (% y/y)	0.4	-2.0	-4.1	0.7	-4.0	-1.0
Nominal household spending (% y/y)	3.7	0.9	-	3.6	-2.1	-0.7
Real household spending (% y/y)	0.7	-0.8	-	1.4	-3.5	-1.5
Nominal disposable income (% y/y)	5.2	6.6	-	4.6	2.4	1.8
Real disposable income (% y/y)	1.9	4.5	-	2.2	1.0	1.0
Saving ratio (%)	1.7	4.8	-	1.9	5.4	7.7
Total debt to income ratio (%)	170	169	-	171	162	159
Housing equity withdrawal (% of disp. income)	-2.5	-3.4	-	-1.0	-1.9	-1.5
Interest payments (% income)	6.4	3.4	-	6.1	2.6	2.5
All interest & debt repayments (% of disp. income)	18.8	15.6	-	18.9	15.3	15.5

	Feb 2009	Mar 2009	Apr 2009	2008	2009 (forecast)	2010 (forecast)
CBI reported sales balance	-25	-44	-	-24	-	-
BRC Retail Sales Monitor (like for like sales, % y/y)	-1.8	-1.2	-	-0.8	-	-
Retail sales volumes (% y/y)	0.4	1.5	-	3.6	-2.5	-2.0
Average earnings (including bonuses, headline rate)	0.1	-	-	3.6	0.1	0.6
LFS Employment (% y/y)	-0.8	-	-	0.9	-2.7	-2.7
Claimant count unemployment rate (%)	4.3	4.5	-	2.8	5.8	7.5
Nationwide house prices (% y/y, forecast for end-year)	-17.6	-15.8	-	-15.9	-20.0	-10.0
Mortgage approvals (000s)	37.9	-	-	43	-	-
Consumer credit (£bn)	-0.2	-	-	0.9	-	-
Consumer confidence (GfK composite balance, nsa)	-35	-30	-	-29	-	-
CIPS/Markit services sector PMI	43.2	45.5	-	47.6	-	-
CPI inflation (% y/y)	3.2	2.9	-	3.6	1.4	0.8
Bank of England repo rate (% , forecast for end year)	1.00	0.50	0.50	2.00	0.50	0.50

Source – Thomson Datastream/National Statistics/Capital Economics

THE MONTH AHEAD

	Latest number	Period covered	Next release date	Period covered
National Accounts: GDP %q/q(%y/y)	-1.9(-4.1)	Q1 (Prov.)	22 nd May	Q1 (2 nd Est.)
CBI reported sales balance	-44	Feb	28 th Apr	Mar
BRC Retail Sales Monitor (like for like sales % y/y)	-1.2	Mar	12 th May	Apr
Retail sales volumes (% y/y)	1.5	Mar	21 st May	Apr
Average earnings (inc. bonuses, headline)	0.1	Feb	13 th May	Mar
LFS Employment (% y/y)	-0.8	Feb	13 th May	Mar
Claimant count unemployment rate (%)	4.5	Mar	13 th May	Apr
Nationwide house prices (% y/y)	-15.7	Mar	27 th – 30 th Apr	Apr
CIPS/Markit services sector PMI	45.5	Mar	6 th May	Apr
CPI inflation (% y/y)	2.9	Mar	19 th May	Apr
Bank of England repo rate (%)	0.50	Apr	7 th May	May
MPC Minutes (No change - change)	(9-0)	Apr	20 th May	May

Source – Thomson Datastream/National Statistics