

UK CONSUMER ANALYST

Q3 2011



Squeeze on real pay to worsen:
Special topic – How will the euro-zone crisis affect consumers?



- Real spending to fall both this year and next.
- But some – such as clothing – to do worse.
- Inflation to fall below pay growth late next year.

- Some sectors – such as cars – to do better than in recession.
- London not as immune as is widely assumed.
- But spending may take longer than incomes to recover.



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Design by Bobby Gunthorpe

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UK CONSUMER ANALYST

2nd Aug. 2011



Economic analysis of the UK consumer sector

Editors: Roger Bootle and Vicky Redwood

Third quarter 2011

Squeeze on real pay to worsen

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Executive summary

- With the economic recovery still struggling to regain momentum, we have lowered our forecasts for consumer spending and GDP growth this year. We now expect a 1.5% drop in real spending (compared to our previous forecast for a 1% fall). We still expect spending to drop further next year.
- The struggling recovery could prompt the Government to rethink its austerity plans. But we think that the troubles in Greece will just strengthen its resolve to get a grip on the UK's own debt problems.
- In any case, rising commodity prices have been a bigger problem for consumers so far than the fiscal squeeze, and the forthcoming rise in utility prices is the latest blow to consumers' spending power.
- By the end of 2012, pay growth should be outpacing inflation again.
- However, consumers may use the increase in real pay to reduce their debt and increase their saving. Accordingly, spending may be slower to recover than incomes.
- Retail sales are doing slightly better than overall spending – as occurred during the recession. But we doubt that this will last.
- A further rise in food price inflation will support food sales in value terms, but will encourage consumers to further reduce the quantity they buy.
- We expect clothing sales to suffer from the drop in disposable incomes – meaning that the sector will fare worse over the next couple of years than during the recession.
- Sectors such as household goods and car sales will see real spending fall, but less severely than during the recession.

The key economic issues for the consumer spending outlook

- **Commodity prices.** Rising food and energy prices are primarily responsible for the squeeze on real pay. We think that commodity prices will fall back as global demand slows, allowing inflation to fall sharply next year.
- **Interest rates.** Rate expectations have fallen but markets still expect some policy tightening next year. We think that interest rates could remain unchanged until 2014.
- **The euro-zone crisis.** An escalation of the debt crisis could threaten the stability of the European banking system and cause credit conditions in the UK to tighten. We doubt the euro-zone will survive in its current form.
- **Plan B.** Consumers would get some relief if the Government eased back on its austerity plans in order to aid the struggling economic recovery. However, we think that a Plan B is only likely if the economy slows significantly further. And it might not be targeted at consumers anyway.
- **Employment.** The employment outlook hinges on whether the private sector can continue to offset the public sector job cuts. If the economic recovery continues to struggle as we expect, we doubt that firms will keep hiring at their recent rate. They may even shed staff.

Key macro & household forecasts

Average over year unless otherwise stated	2010	2011f	2012f	2013f	2014f*	2015f*
Key macro variables						
GDP (% y/y)	1.4	1.0	1.5	2.0	3.0	3.0
Consumer Price Inflation (% y/y)	3.3	4.7	2.8	1.2	1.7	2.0
Interest rates (% end-year)	0.5	0.5	0.5	0.5	1.5	3.0
Unemployment Rate (% ILO definition)	7.9	8.0	8.7	9.3	8.8	8.1
Household spending						
Nominal household spending (% y/y)	5.1	3.6	1.8	1.7	3.2	4.0
Real household spending (% y/y)	0.9	-1.5	-1.0	0.5	1.5	2.0
Nominal retail spending (% y/y)**	4.4	3.0	0.8	-0.4	1.5	2.0
Real retail spending (% y/y)**	0.9	-1.0	-0.5	0.5	1.5	2.0
Nominal non-food retail spending (% y/y)	4.2	1.5	-2.1	-1.2	0.8	2.0
Real non-food retail spending (% y/y)	0.7	-1.2	-0.6	0.4	1.7	2.3
Household income						
Average earnings (% y/y)	2.3	2.3	2.6	2.8	3.5	3.8
Employment (% y/y)	0.1	0.9	-0.7	-0.6	0.5	0.8
Nominal disposable income (% y/y)	3.4	3.0	1.8	2.2	4.2	5.5
Real disposable income (% y/y)	-0.8	-2.0	-1.0	1.0	2.5	3.5
Saving ratio (%)	5.3	4.8	4.8	5.5	6.5	8.0
Household debt						
Total debt (% y/y)	0.7	-1.0	-0.8	0.2	2.2	3.5
Total debt to income ratio (%)	159	153	149	146	144	142
Interest payments (as a % of income)	7.3	6.9	6.7	6.6	7.4	8.7

* In the current environment, our forecasts for 2014 and 2015 are particularly uncertain and subject to change.

** We forecast quarterly spending on retail goods, rather than the monthly retail sales figures. (See page 10.)

Short & medium-term outlook for key sub sectors (see pages 14-18)

Sector	Outlook
Food & Drink	A further rise in food price inflation should boost value growth. However, consumers are likely to continue to economise by "trading down".
Alcohol & Tobacco	The downward trend in real spending on alcohol and tobacco would be exacerbated by a renewed downturn in overall consumer spending.
Clothing & Footwear	Clothing appears to have lost some of its sensitivity to the economic cycle. However, historically it has been one of the most income-sensitive sectors. And rising prices could depress demand.
Household & DIY Goods	A sluggish recovery in housing market activity, combined with house price falls, is likely to prompt further falls in sales of household and DIY goods. However, the falls are likely to be much smaller than during the recession.
Recreation & Culture	We remain optimistic that the continued development of new products will stimulate demand. Historically, however, recreational goods (which include items such as televisions and iPods) have been one of the most income-sensitive sectors.
Pubs & Restaurants	With consumers already having cut spending in pubs and restaurants sharply, the sector may be less vulnerable than others to further falls. Equally, though, this sector may simply have become more sensitive to the wider economic environment.
Hotels	The lower exchange rate should continue to attract tourists to the UK. However, the relatively poor outlook for the euro-zone economy could offset some of the boost to the tourism sector from the lower pound.
Transport	Car sales are likely to remain sluggish given that confidence is weak and unsecured credit will remain hard to get. But they should hold up better than in the recession.

Special Topic – How will the euro-zone crisis affect consumers?

Consumers at risk from higher borrowing rates

- It might seem as though the euro-zone crisis has little direct bearing on UK consumers. The contribution of the UK Government - and therefore UK taxpayers - to the bail-outs of peripheral European countries has been small. And UK exporters are the most exposed to a downturn in euro-zone demand.
- There may even be some benefits from the crisis for consumers. If investors shun the euro, the consequent rise in the pound should make it cheaper for UK consumers to go abroad - although so far the euro has been holding up surprisingly well. (See Chart 1.)
- However, the euro-zone crisis could adversely affect households in a number of ways. For a start, consumers will still end up suffering if a slowdown in the euro-zone hits UK exports. Hopes rest on the external sector to keep the recovery going during the fiscal squeeze. Without strong export growth, GDP growth – and hence employment and household income growth – will be weaker.
- Second, the euro-zone crisis could reinforce the Government’s resolve to adhere to its current austerity plans - or “Plan A” - in order to reassure the markets that the UK can reduce its own high level of debt. As Chart 2 shows, this means that the most severe government spending cuts are yet to come.
- The third risk for consumers is the potential effects of the sovereign debt crisis on the banking system. UK banks have relatively small holdings of government debt of countries such as Greece, but France and Germany have much bigger exposures. A loss of confidence in the European banking system could prompt the interbank lending market to seize up, as it did during the Lehman Brothers crisis, leading to tighter credit conditions for consumers.
- Indeed, funding costs for banks have already been rising (as proxied by the spread between interbank lending rates and riskless interest rates shown in Chart 3). So far borrowing rates to households have remained steady but they could soon start to rise. (See Chart 4.)
- In addition, some peripheral euro-zone countries play a significant role in providing credit *directly* to the UK. Mainly through Santander, for example, Spain provides some 14% of loans to UK households; Ireland also lends a significant amount. (See Chart 5.) Troubles at home could force these banks to rein in their lending.
- Meanwhile, a general rise in risk aversion resulting from the euro-zone crisis could hit risky assets. This could have adverse effects on household wealth and consumer confidence. Events in Europe have already weighed on equity markets both in the UK and abroad since the start of the year. (See Chart 6.)
- Finally, UK consumer-facing firms will suffer if tourism from Europe dries up as economic growth there slows. We expect GDP growth in the euro-zone to slow to almost zero next year. (See Chart 7.) Almost three quarters of overseas visitors to the UK are from Europe. (See Chart 8.) Indeed, the number of visits to the UK from Spanish and Italian residents last year was as big as the total number from the US and Canada.

How will the euro-zone crisis affect consumers?

Chart 1: Euro/Pound (2010 – July 2011)

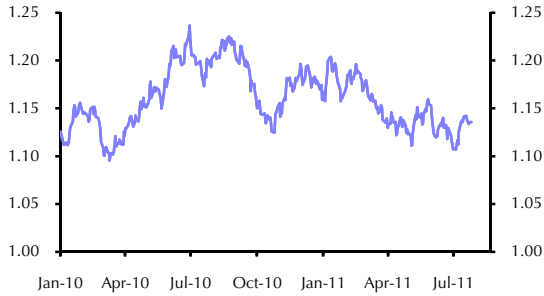


Chart 2: Real Government Spending (% y/y) (2008/09 – 2014/15)

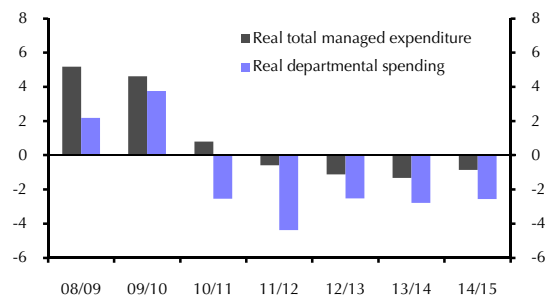


Chart 3: 12m LIBOR Minus 12m OIS Rates (bps) (2008 – July 2011)

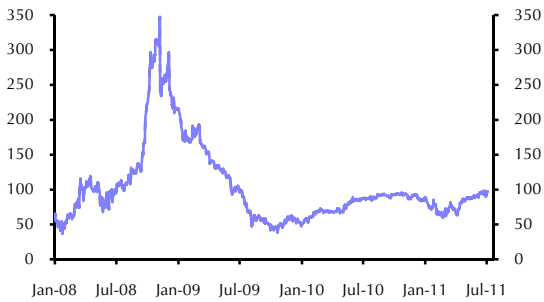


Chart 4: Quoted Interest Rates on New Borrowing (%) (2007 – May 2011)

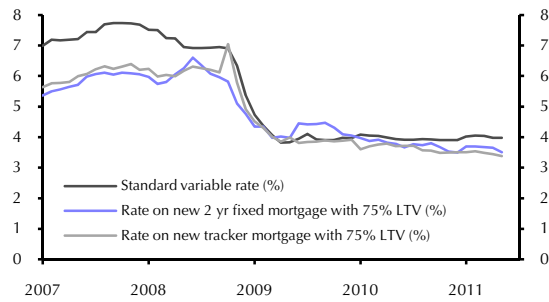


Chart 5: Outstanding Loans Provided to UK By Selected Foreign-Owned Banks (% of All UK Loans, 2010)

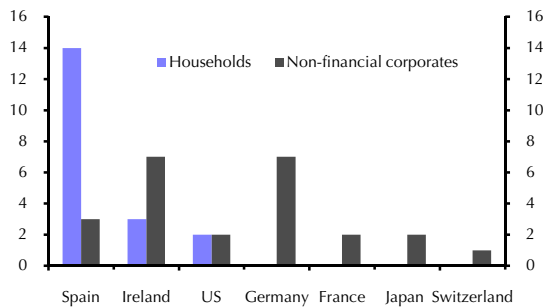


Chart 6: Equity Markets (Jan. 2011 = 100) (January – July 2011)

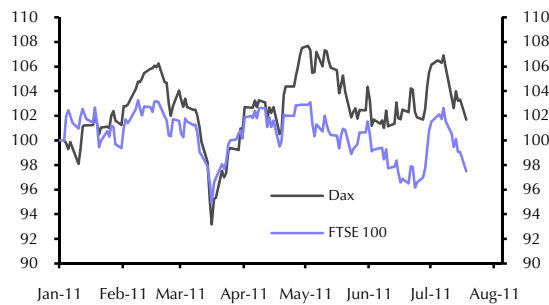


Chart 7: Euro-Zone Real GDP (% y/y) (2005 - 2013)

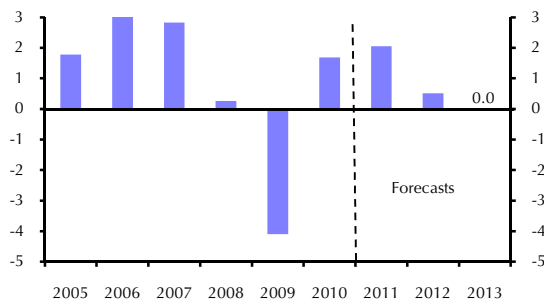
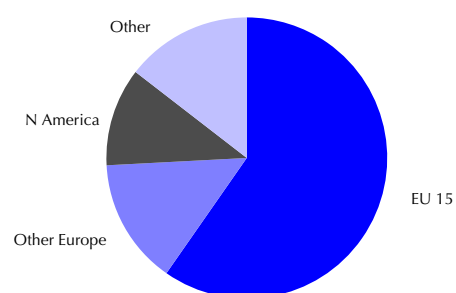


Chart 8: Visits to the UK By Country of Origin (As a % of Total, 2010)



Sources – Thomson Datastream, Bank of England, ONS, HM Treasury

Outlook for consumer spending

Real incomes to fall by 2% this year

- With the squeeze on real pay even worse than we anticipated, we have recently reduced our forecasts for consumer spending. We now expect real spending to drop by 1.5% this year and by a further 1% in 2012 (compared to our previous forecasts for falls of 1% and 0.5% respectively).
- We expect the large amount of slack in the labour market to keep nominal pay growth at close to 2%. With inflation now heading above 5% that means further big falls in real pay.
- The latest blow for consumers is a rise in utility prices to take effect from August or September. Essential areas of spending make up just a fifth of an average household's overall spending, but they will eat up more than half of its rise in take-home pay this year. (See Chart 1.)
- Households could reduce their saving to compensate for the further falls in their real pay. Indeed, the saving rate dropped in the first quarter of this year (from 5.1% to 4.6%) and fell to 3% during the recession. But we doubt that saving will fall much further when consumer confidence is still so weak – and at a level consistent with further falls in real spending. (See Chart 2.)
- At least a near-term interest rate rise has fallen off the agenda. Markets now expect only a negligible tightening of monetary policy during the next year. And we think that rates will be unchanged until 2013 or even 2014.
- In addition, the private sector is still managing to offset the public sector job cuts. (See Chart 3.) But the employment recovery seems to be fading, with the number of job vacancies still low. We still think that unemployment will rise to near 3 million, although perhaps not until 2013.
- What could bring relief for consumers? The Government could scale back its austerity measures as part of a “Plan B”. There have been calls for it to introduce a temporary VAT cut. However, a Plan B does not seem imminent. Even if it were, it might be focused on boosting investment rather than consumer spending. Even a VAT cut might not help much, if the experience of the one in late 2008 is anything to go by. (See Chart 4 & Page 20.)
- More helpful would be a sharp fall in commodity prices, bringing the squeeze on real pay to a quick end.
- If we are right in expecting inflation to fall sharply next year, real pay should be rising again by the end of 2012. (See Chart 5.)
- However, households may use the extra money to repair their balance sheets rather than spend it. The process of deleveraging is still only part way through. Mortgage repayments have not really risen and the level of household debt is yet to fall (although it has been dropping as a share of incomes). (See Chart 6.)
- We therefore expect the recovery in spending to lag behind the pick-up in real incomes. (See Chart 7.) We expect spending to rise in 2013, but only by about 0.5%. Even by the start of 2014, spending will still be about 5% below its pre-recession peak. (See Chart 8.)

Outlook for consumer spending

Chart 1: Rise In Post-tax Pay & Essential Spending Over Next 12m For An Average Household (£)

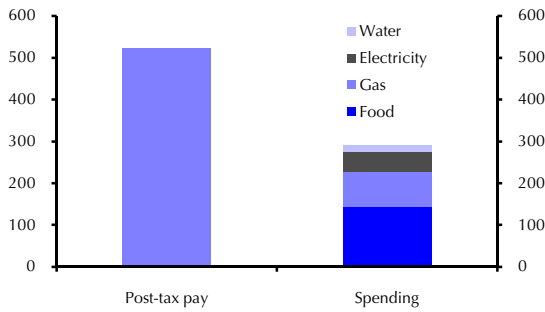


Chart 2: Consumer Confidence & Household Spending (1985 – July 2011)

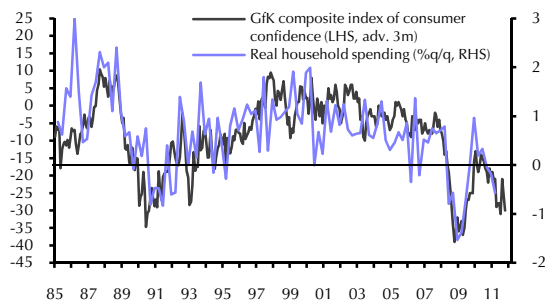


Chart 3: Employment (000s, q/q) (2007 – Q1 2011)

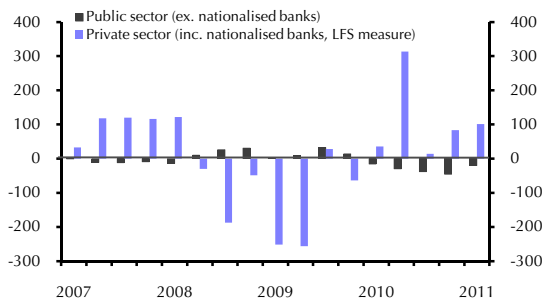


Chart 4: VAT Rate & Retail Sales Growth (2005 – June 2011)

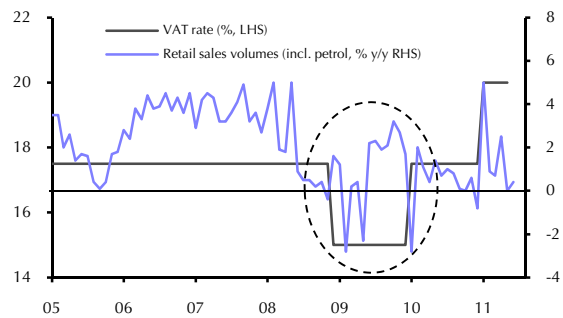


Chart 5: CPI Inflation & Average Earnings Growth (2007 – 2013)

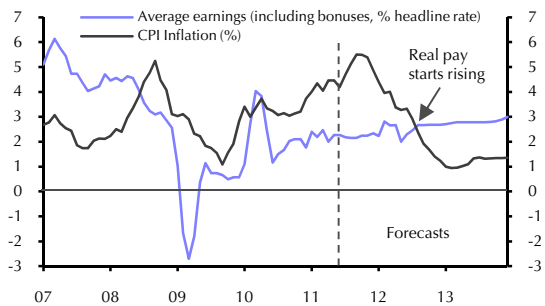


Chart 6: Mortgage Repayments & Household Debt (1987 – Q1 2011)

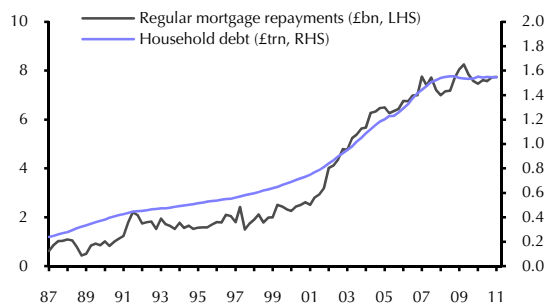


Chart 7: Real Household Income & Spending (% y/y) (2000 – 2013)

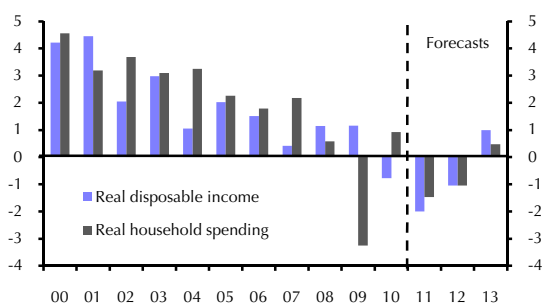
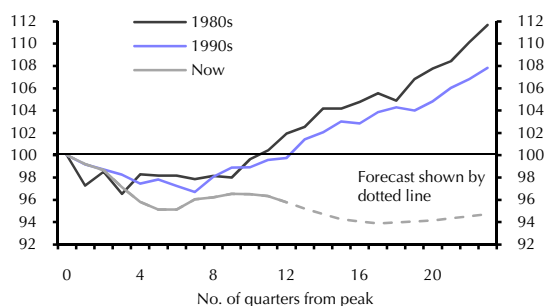


Chart 8: Real Household Spending (Level, Peak = 100)



Sources – Thomson Datastream, Bank of England, GfK/NOP

Outlook for costs, prices and margins

More discounting likely

- Pricing power is likely to weaken significantly as consumer spending falls further.
- Firms already seem to be responding to the slowdown in consumer demand by increasing their price discounting. Core goods and service inflation fell in June as summer sales began earlier than usual. (See Chart 1.) We expect core inflation to fall further.
- Admittedly food price inflation looks likely to rise further as retailers pass on previous rises in commodity prices. (See Chart 2.) But with consumers responding to higher food prices by reducing how much they spend, retailers may be reluctant to let food price inflation rise too much further. So suppliers look likely to be squeezed even more.
- Cost pressures may ease a bit but will remain intense. So as pricing power weakens, margins are likely to suffer.
- Price inflation of goods produced by UK manufacturers looks likely to rise further in the next month or two, but at least surveys of manufacturers' price expectations have begun to fall. (See Chart 3.)
- Meanwhile, the combination of stable or falling commodity prices and a fairly steady exchange rate should keep import price inflation close to recent rates. (See Chart 4.) Although the pound may rise a bit against the euro due to the continued troubles in the euro-zone, we think that it could drop slightly against the dollar. (See Chart 5.)
- Agricultural prices are likely to remain volatile but below their peaks. Recent reassuring developments include Russia's lifting of its export ban on cereals and the stabilisation of oil prices (which affects the costs of food production). Indeed, we think that oil prices could fall to about \$85 pb by the end of the year as the risk premium added by the unrest in the Middle East diminishes. (See Chart 6.)
- Operating costs are unlikely to pose much of a problem. The minimum wage is due to rise in October, but the 2.5% rise to £6.08 is in line with the sluggish growth rate of overall earnings. (See Chart 7.) And we expect overall average earnings growth to remain at just 2.5% or so for the foreseeable future.
- Utility prices are rising, but some firms will have hedged against this and fuel prices should fall if oil prices drop as we expect.
- Meanwhile, the recovery in rental growth has run out of steam since the start of the year. (See Chart 8.) And the drop in vacancy rates at the national level has been flattered by the strength of the central London market.
- We still expect all-retail rents to decline by about 1% in 2011 as a whole before starting to rise modestly from perhaps the second half of 2012. The potential for rental values to begin to rise again within a one- to two-year horizon is greatest in retail warehouses, thanks to planning restrictions on development activity.
- Firms will probably also continue to look more actively for further cost savings. For example, consumer-facing firms are likely to play some part in the reduction in overall private sector employment that we expect.

Outlook for costs, prices & margins

Chart 1: Services & Core Goods CPI Inflation (%) (2005 – June 2011)

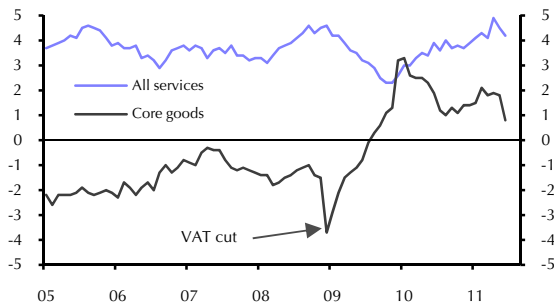


Chart 2: Agricultural Prices & Food Inflation (2000 – June 2011)

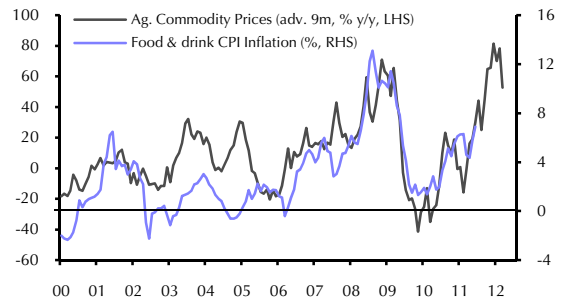


Chart 3: Manufacturers' Output Prices (1995 – July 2011)

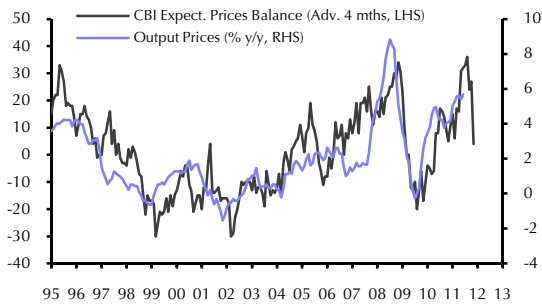


Chart 4: Import Prices & Sterling (2005 – 2012)

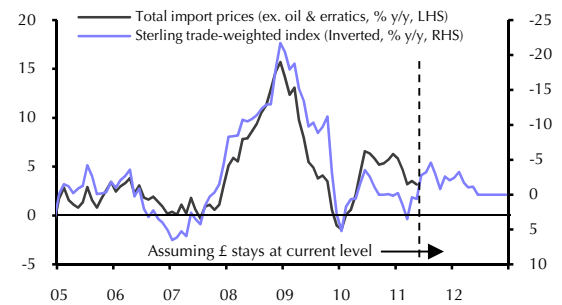


Chart 5: Exchange Rates (2005 - 2012)

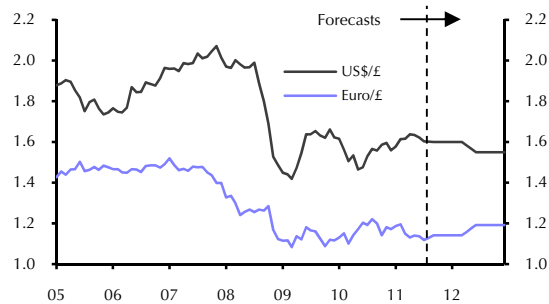


Chart 6: Oil & Grain Prices (1990 – 2012)

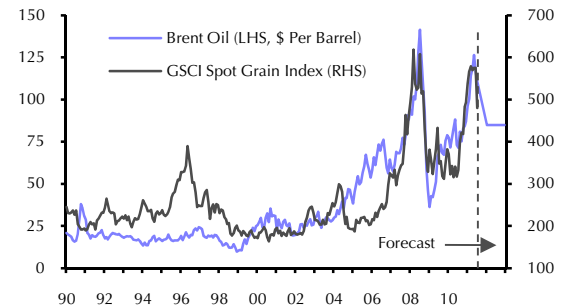


Chart 7: Average Earnings Growth & Minimum Wage Increases (% y/y) (2002 – 2011)

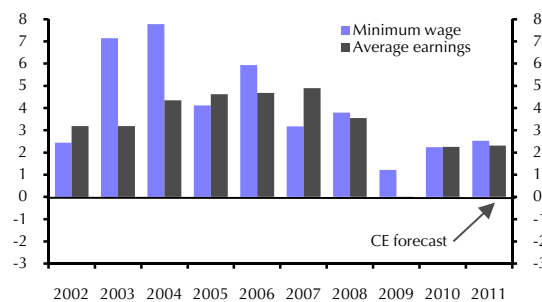
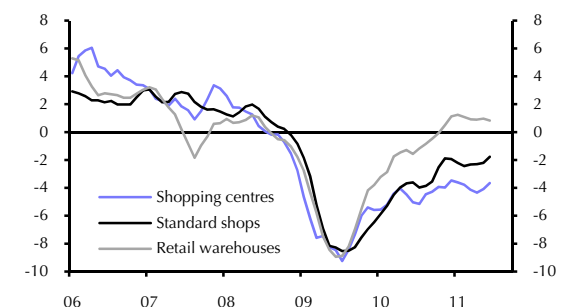


Chart 8: Retail Rental Values (% 3m/3m annualised) (2006 - June 2011)



Sources – Thomson Datastream, Bloomberg

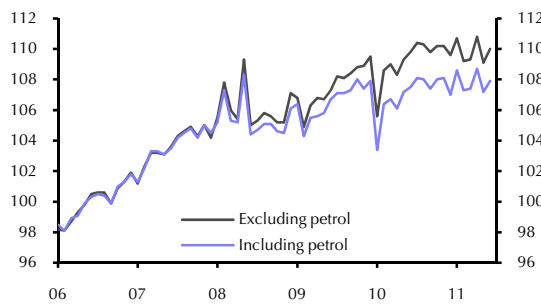
Overview of recent spending by sub-sector

Rising food prices denting volume growth

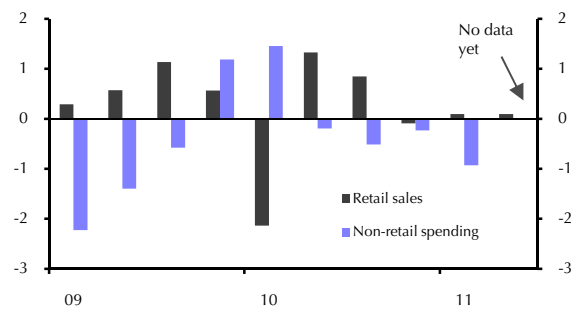
- The high street is holding up a little better than overall household spending, but most sectors have seen spending growth slow.
- Good weather, the extra bank holiday and the Royal Wedding boosted high street spending in April. But this quickly reversed and the underlying trend still looks broadly flat. (See Chart 1.)
- Spending off the high street has been faring even worse, falling sharply in the first quarter. (See Chart 2.) This echoes the pattern seen during the recession, when non-retail spending suffered the most.
- Looking at retail sales more closely, food sales have been doing surprisingly badly in volume terms. According to the ONS data, volume sales in the food sector were falling at an annual rate of 4% in June.
- This partly reflects the fact that these figures include the large amount of *non-food* now sold by supermarkets. Indeed, smaller food stores have – rather unusually - been doing better than larger food outlets. And as Chart 3 shows, the more detailed quarterly breakdown shows that real spending on food specifically is still rising.
- Nonetheless, consumers may also be reacting to rising food prices by reducing the amount they buy. Supermarkets have reported an increase in people trading down to their own-label ranges.
- Sales of household goods are still falling. Given the moribund state of the housing market, this is unsurprising. Neither housing market activity nor house prices have moved much since the start of the year.
- Meanwhile, the growth of clothing sales still looks lacklustre. Sales volumes are faring better than during the spring, when annual growth turned negative. But this period aside, volume growth is at its slowest rate in more than a decade. (See Chart 4.)
- Firms have reported increased budgeting by consumers. This has dented spending on large purchases. Indeed, the number of new car registrations in the private sector has fallen back to almost the pre-scrappage scheme level. (See Chart 5.)
- But economising has also benefited some areas of spending, such as package holidays, which allow consumers to keep better control of costs.
- Central London has continued to benefit from spending by overseas visitors, although visitor numbers are still well below pre-recession levels. (See Chart 6.). And premium travel and hotel accommodation has apparently continued to sell well.
- Of course, increasing inflation means that sales values are rising in some sectors even if volumes are dropping. Food inflation, for example, is running at more than 5%. So in value terms, food store sales are still growing faster than non-food sales. (See Chart 7.) Meanwhile, nominal spending in pubs and restaurants rose at an annual rate of 3% in the first quarter, even though volumes fell outright. (See Chart 8.)

Overview of recent spending by sub-sector

**Chart 1: Retail Sales Volumes (2006 = 100)
(2006 – June 2011)**



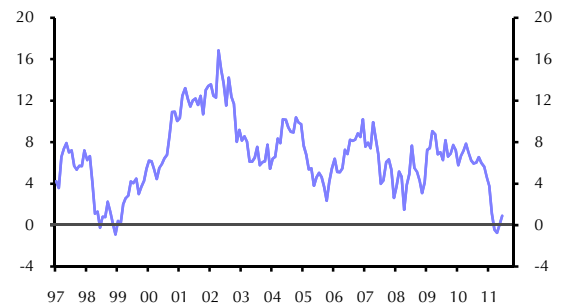
**Chart 2: Real Retail Sales & Non-Retail Spending (% q/q)
(2009 – Q2 2011)**



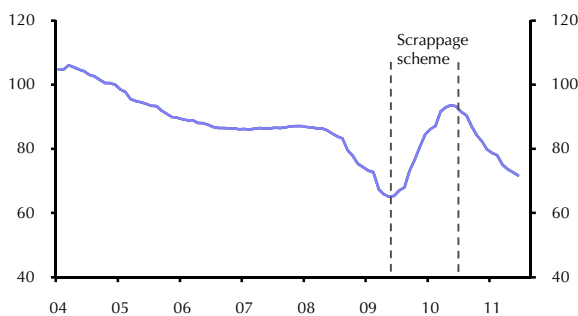
**Chart 3: Measures of Real Food Spending (% y/y)
(2005 – Q2 2011)**



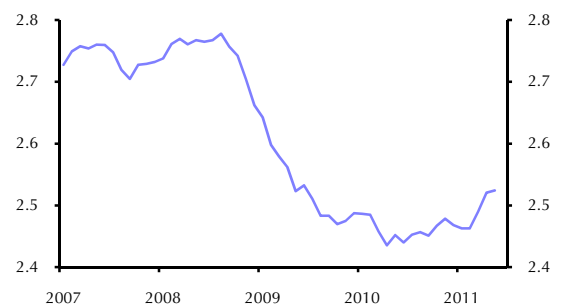
**Chart 4: Sales Volumes – Clothing Stores (% y/y)
(1997 – June 2011)**



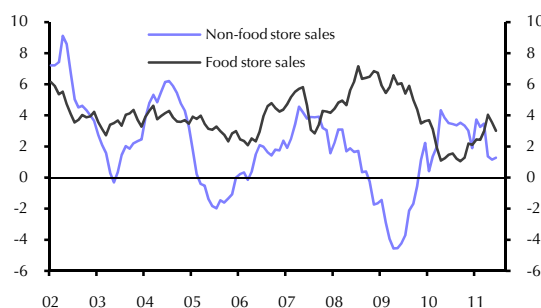
**Chart 5: Private New Car Registrations (12m rolling average)
(2004 – June 2011)**



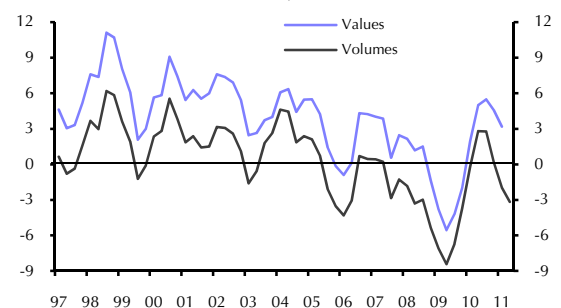
**Chart 6: Overseas Visits to the UK (12m. average, mns)
(2007 – May 2011)**



**Chart 7: Retail Sales Values (3m. av. of % y/y)
(2002 – June 2011)**



**Chart 8: Spending in Pubs & Restaurants (% y/y)
(1997 – Q1 2011)**



Sources – Thomson Datastream, SMMT, Bank of England

Sub-sector outlook

Clothing to fare worse than during the recession

- We think that spending both on and off the high street will fall both this year and next. (See Chart 1.)
- Admittedly, retail sales volumes avoided falling during the recession. But some sectors – such as food and clothing – are already doing worse than in the recession. (See Chart 2.) Accordingly, we think that retail is likely to revert to its long-term pattern of moving closely in line with overall spending.
- As food price inflation continues to rise, we expect consumers to economise. Chart 3 shows that when food price inflation has risen in the past, volume growth of food sales has tended to slow.
- Food is therefore unlikely to hold up as well as during past spending downturns. Previously we expected sales volumes to increase slightly this year. Now we expect a 1% drop, similar to the fall seen during 2009, the worst year of the recession.
- Other sectors, however, will hold up better than during the recession. Household goods and car sales were hit particularly hard by the credit crunch. While far from back to normal, credit conditions now are much looser. In addition, the second leg of the housing market adjustment is shaping up to be more gradual than the first. While we expect sales of both household goods and cars to fall both this year and next, the declines should not be as severe as during 2009. (See Chart 4.)
- Income-sensitive areas of spending continue to look very vulnerable. We expect real household disposable incomes to fall by 2% this year. We have long doubted that clothing sales can remain so resilient against this backdrop and growth is already slowing. (See Page 10.)
- That said, modest falls in clothing sales would still leave clothing as a share of overall real consumer spending very high by historical standards. (See Chart 5.)
- Spending in pubs and restaurants has already fallen by almost 3% since last October and has reversed the increases seen over the previous year or so. Further falls over the next couple of years are therefore likely to leave the level of spending in this sector well below the trough seen in the recession. (See Chart 6.)
- Spending abroad is a particularly cyclical part of consumer spending, suggesting that firms selling overseas holidays will be badly affected as consumers cut back. Chart 7 suggests that for every 1% change in overall consumer spending, spending abroad changes by 4%. The flipside is that domestic tourism should benefit. When the UK was in recession in 2009, the number of holidays taken within Britain rose by 12%.
- It is assumed that London is relatively immune from the fiscal squeeze, given that a relatively low proportion of employment in the capital is in the public sector. However, London has already been hardest hit by the tax changes for high earners and will also be worst affected by some of the benefit cuts. For example, London is a region with one of the highest proportions of households on housing benefit. (See Chart 8.)

Sub-sector outlook

Chart 1: Real Total Retail & Spending (% y/y) (2002 – 2013)

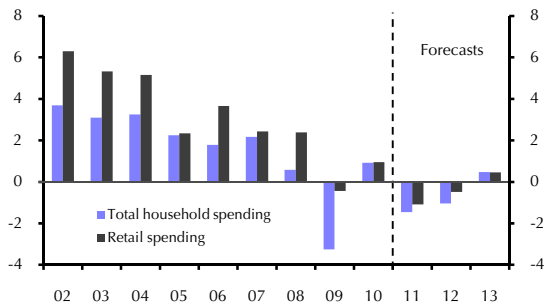


Chart 2: Food & Clothing Retail Sales Volumes (% y/y) (2005 – June 2011)

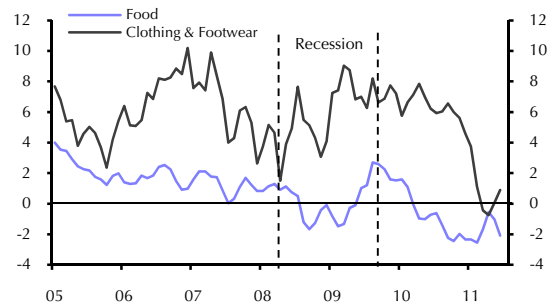


Chart 3: Food Inflation & Sales Volumes (1997 – June 2011)

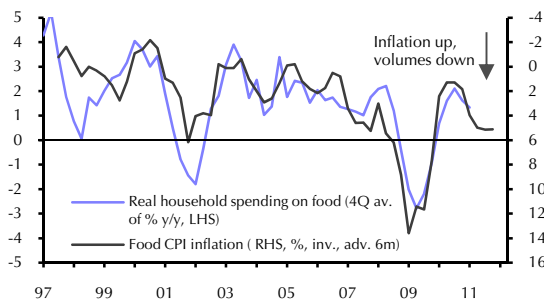


Chart 4: Real Spending on Cars & Household Goods (% y/y) (2005 – 2013)

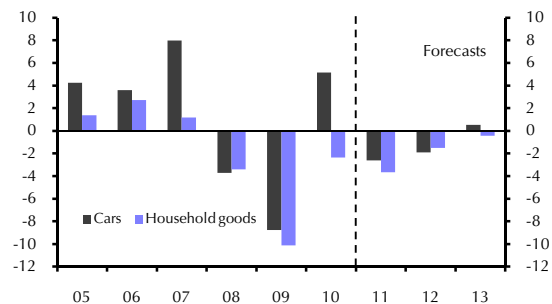


Chart 5: Real Clothing Spending As a % of Total Spending (1970 – 2015)

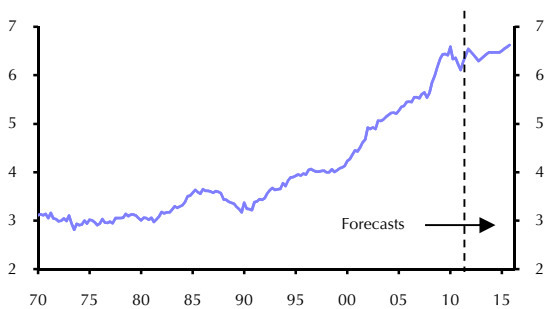


Chart 6: Spending in Pubs & Restaurants (£bn) (2000 – 2013)

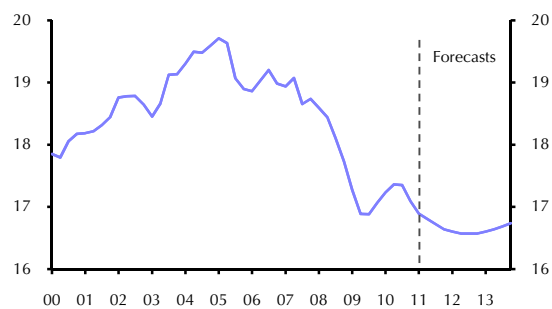


Chart 7: Spending By UK Consumers Overseas & Total Real Consumer Spending (1970 – Q1 2011)

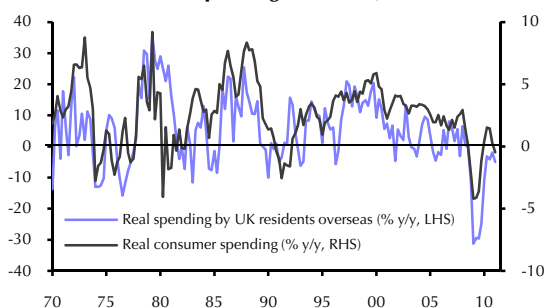
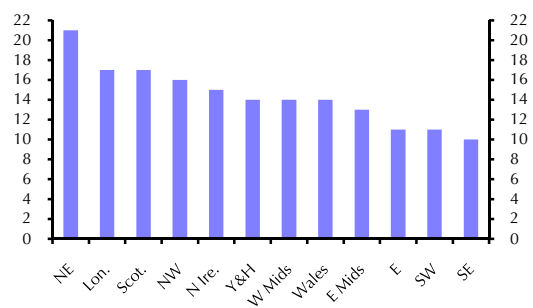
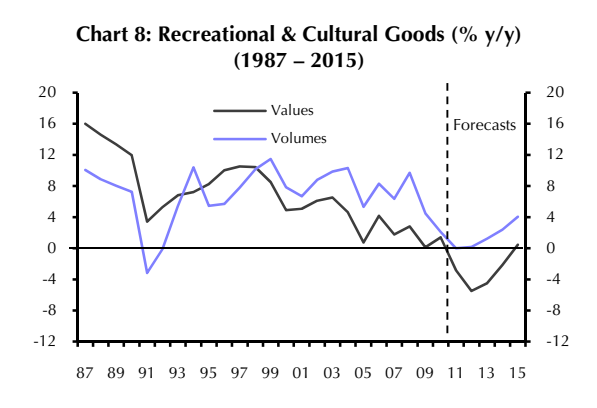
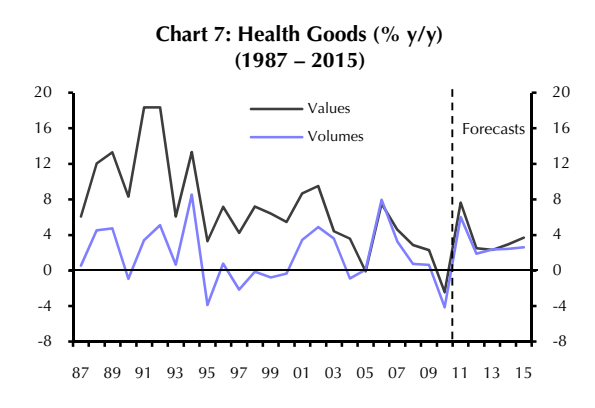
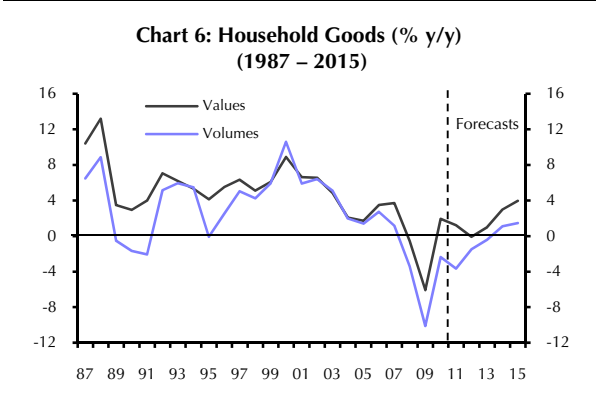
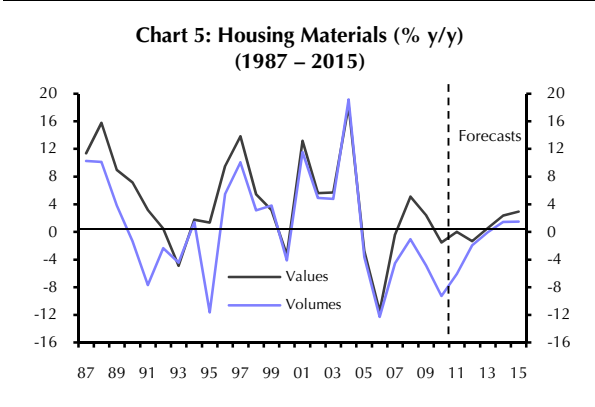
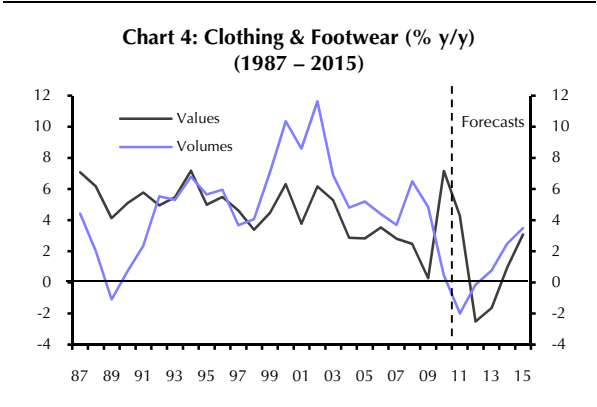
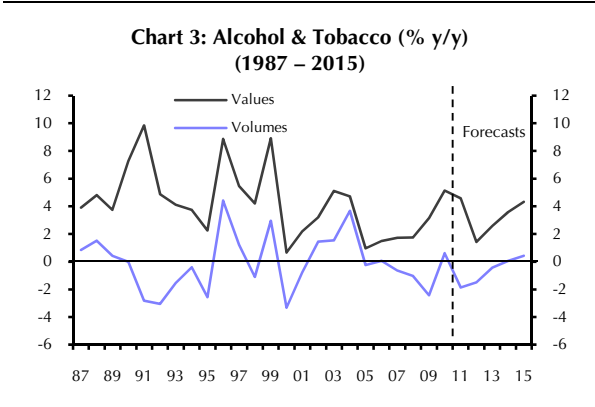
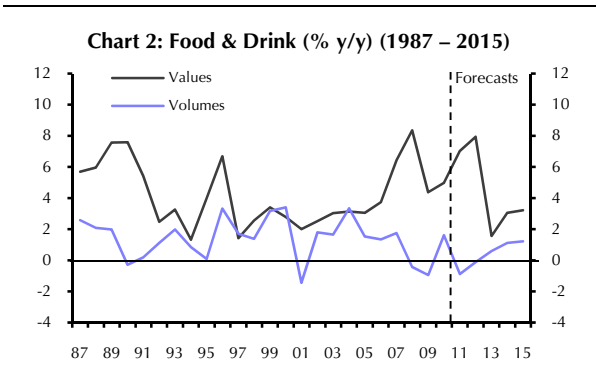
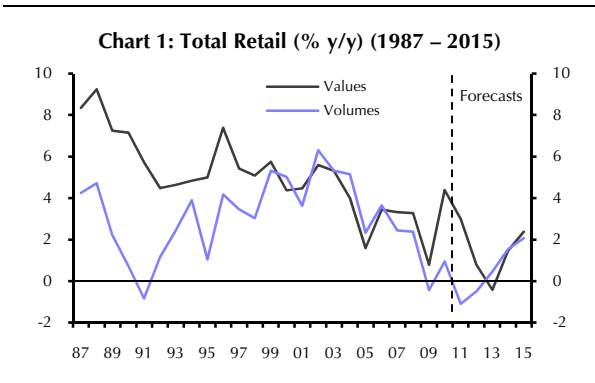


Chart 8: % Of Households On Housing Benefit (2010)



Sources – Thomson Datastream, Capital Economics, ONS

Retail sector forecasts



Sources – Thomson Datastream/Capital Economics

Non-retail sector forecasts

Chart 1: Total Non-Retail (% y/y)
(1987 – 2015)

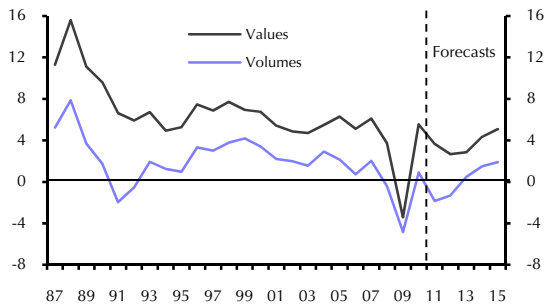


Chart 2: Housing (Rent & Bills) (% y/y)
(1987 – 2015)

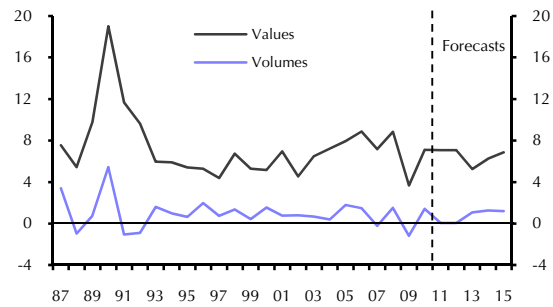


Chart 3: Car Sales (% y/y)
(1987 – 2015)

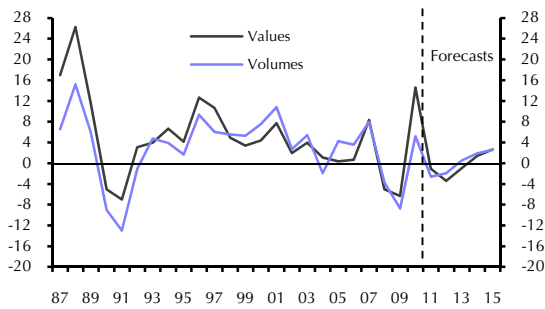


Chart 4: Transport Services (% y/y)
(1987 – 2015)

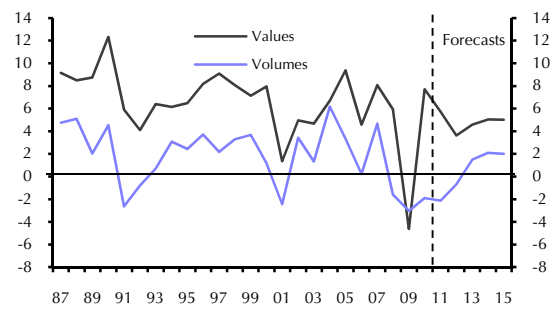


Chart 5: Communications Services (% y/y)
(1987 – 2015)

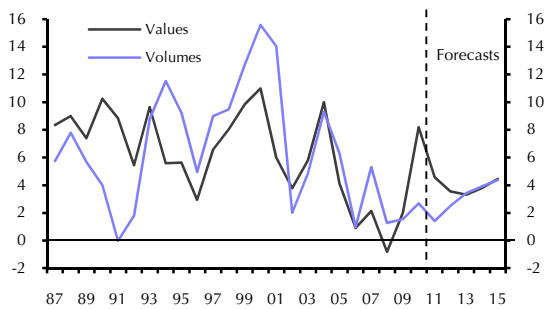


Chart 6: Rec. & Cultural Services (% y/y)
(1987 – 2015)

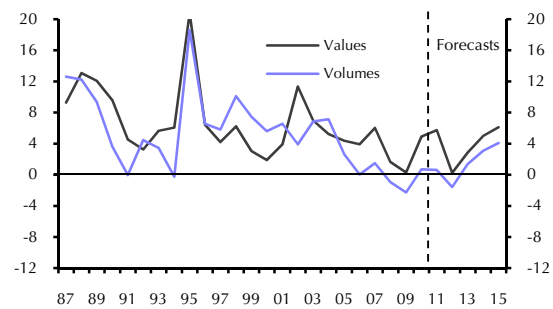


Chart 7: Restaurants & Hotels (% y/y)
(1987 – 2015)

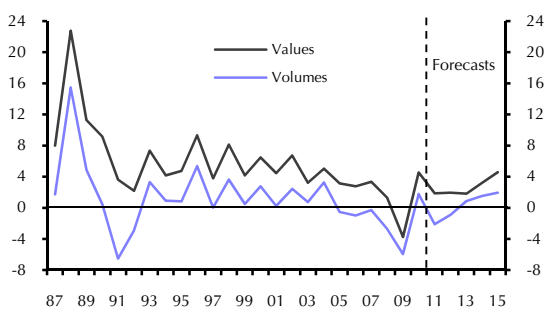
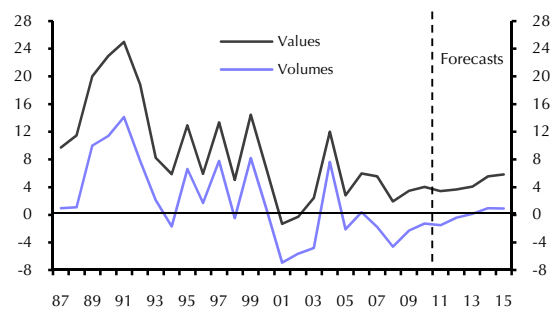


Chart 8: Education (% y/y)
(1987 – 2015)



Sources – Thomson Datastream/Capital Economics

Sub-sector* forecasts - values

%y/y Current Prices	Av. 2000-2009	2010	2011f	2012f	2013f	2014f	2015f
Total nominal consumer spending	4.2	5.1	3.6	1.8	1.7	3.2	4.0
<u>Total retail (37% of total nominal spending)</u>	3.6	4.4	3.0	0.8	-0.4	1.5	2.0
Food and drink	4.0	5.0	7.0	8.0	1.5	3.2	3.2
Alcohol and Tobacco	2.5	5.1	4.5	1.5	2.5	3.5	4.5
Clothing and Footwear	3.6	7.4	4.5	-2.5	-1.5	1.0	3.0
Housing materials (i.e. DIY)	3.3	-1.5	0.5	-1.5	0.5	2.5	3.0
Household goods	3.1	1.9	1.5	0.0	1.0	3.0	4.0
Health goods	4.9	-2.4	7.5	2.5	2.5	3.0	3.5
Communication goods	7.7	-10.2	0.5	1.5	1.0	2.5	3.5
Recreation & Culture	3.7	1.4	-2.8	-5.3	-4.5	-2.0	0.5
<u>Total non-retail (63%)</u>	4.5	5.5	3.8	2.7	2.9	4.3	5.1
Housing	6.7	7.1	7.0	7.0	5.0	6.2	6.8
Household services	1.9	25.7	2.0	2.0	2.5	5.0	6.0
Health services	5.4	3.1	1.0	2.5	3.5	6.5	6.5
Transport							
Of which: Car sales	1.7	14.5	-1.0	-3.5	-1.0	1.5	2.5
Maintenance & other transport services	4.9	7.7	6.0	4.0	4.5	5.0	5.0
Communications	4.5	8.2	4.6	3.5	3.5	4.0	4.5
Recreation & Culture	4.6	4.9	5.5	0.5	3.0	4.7	6.0
Education	3.9	4.0	3.5	3.7	4.0	5.5	6.0
Hotels & Restaurants	3.3	4.5	2.0	2.0	2.0	3.0	4.5

* See Vol.3 2005, Page 17 for a breakdown of the goods and services components of each sub-sector and the share of each sub-sector in total spending.

Sub-sector forecasts - volumes

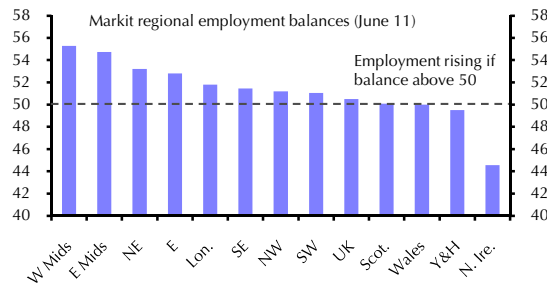
%y/y Constant Prices	Av. 2000-2009	2010	2011f	2012f	2013f	2014f	2015f
Total real consumer spending	2.1	0.9	-1.5	-1.0	0.5	1.5	2.0
<u>Total retail (37% of total real spending)</u>	3.6	0.9	-1.0	-0.5	0.5	1.5	2.0
Food and drink	1.2	1.6	-1.0	0.0	0.5	1.2	1.2
Alcohol and Tobacco	-0.2	0.6	-2.0	-1.5	-0.5	0.0	0.5
Clothing and Footwear	6.8	0.6	-2.0	0.0	1.0	2.5	3.5
Housing materials (i.e. DIY)	1.1	-9.3	-6.0	-2.0	0.0	1.5	1.5
Household goods	2.2	-2.3	-3.5	-1.5	-0.5	1.0	1.5
Health goods	2.4	-4.1	6.0	2.0	2.5	2.5	2.5
Communication goods	15.7	-3.6	8.5	10.0	11.0	12.0	12.5
Recreation & Culture	7.8	2.1	0.0	0.2	1.2	2.5	4.0
<u>Total non-retail (63%)</u>	1.2	0.9	-1.8	-1.3	0.5	1.5	2.0
Housing	0.8	1.4	0.0	0.0	1.0	1.3	1.3
Household services	-2.3	23.0	0.0	0.5	1.0	2.0	2.0
Health services	2.5	-0.5	-1.0	1.0	2.0	3.5	3.5
Transport							
Of which: Car sales	3.0	6.3	-2.5	-2.0	0.5	2.0	2.5
Maintenance & other transport services	1.4	-1.9	-2.0	-0.5	1.5	2.0	2.0
Communications	6.1	2.7	1.5	2.5	3.5	4.0	4.5
Recreation & Culture	3.1	0.7	0.5	-1.5	1.5	3.0	4.0
Education	-1.9	-1.3	-1.5	-0.5	0.0	1.0	1.0
Hotels & Restaurants	-0.1	1.8	-2.0	-1.0	1.0	1.5	2.0

Sub-sector forecasts - prices

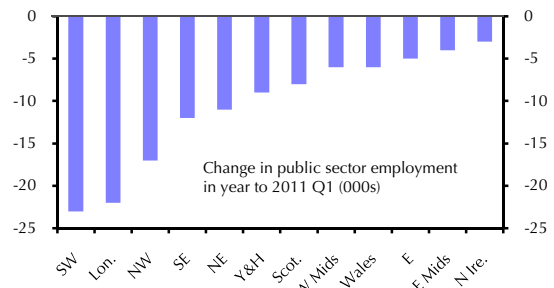
	Av. 2000-2009	2010	2011f	2012f	2013f	2014f	2015f
Total consumer spending	2.0	4.2	5.1	2.8	1.2	1.7	2.0
<u>Total retail (37%)</u>	0.0	3.4	4.1	1.3	-0.9	-0.1	-0.1
Food and drink	2.8	3.3	8.0	8.0	1.0	2.0	2.0
Alcohol and Tobacco	2.7	4.5	6.5	3.0	3.0	3.5	4.0
Clothing and Footwear	-3.0	6.9	6.5	-2.5	-2.5	-1.5	-0.5
Housing materials (i.e. DIY)	2.3	8.6	6.6	0.5	0.5	1.0	1.5
Household goods	1.0	4.4	5.0	1.5	1.5	2.0	2.5
Health goods	2.4	1.7	1.5	0.5	0.0	0.5	1.0
Communication goods	-6.5	-6.7	-7.0	-7.5	-9.0	-8.5	-8.0
Recreation & Culture	-3.8	-0.6	-2.9	-5.5	-5.7	-4.5	-3.5
<u>Total non-retail (63%)</u>	3.3	4.6	5.6	4.0	2.4	2.8	3.1
Housing	5.9	5.6	7.0	7.0	4.0	5.0	5.5
Household services	4.5	2.2	2.0	1.5	1.5	3.0	4.0
Health services	2.9	3.6	2.0	1.5	1.5	3.0	3.0
Transport							
Of which: Car sales	-1.3	7.3	1.5	-1.5	-1.5	-0.5	0.0
Maintenance & other transport services	3.5	9.8	8.0	4.5	3.0	3.0	3.0
Communications	-1.5	5.3	3.1	1.0	0.0	0.0	0.0
Recreation & Culture	1.5	4.2	5.0	2.0	1.5	1.7	2.0
Education	6.0	5.3	5.0	4.1	4.0	4.5	5.0
Hotels & Restaurants	3.4	2.7	4.0	3.0	1.0	1.5	2.5

Charts: How are regional labour markets faring?

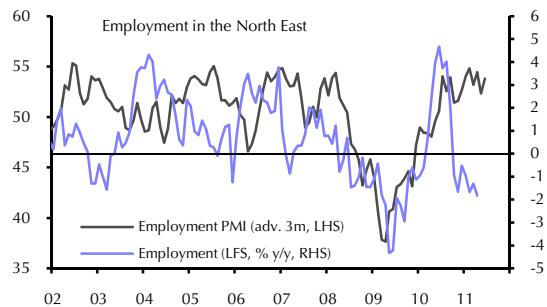
1. Business surveys suggest that employment is rising in all regions other than Yorkshire and Northern Ireland.



2. But the surveys only cover private sector firms and so will not capture the falls in public sector employment.



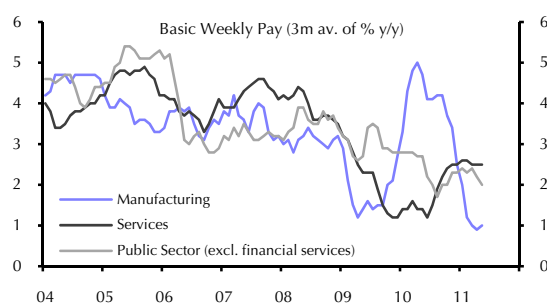
3. This may explain why, in regions such as the North East, employment growth has not kept pace with the surveys.



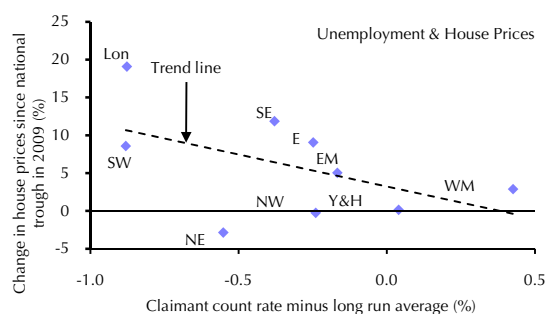
4. In fact, the North East still has the highest unemployment rate. The South East has the lowest.



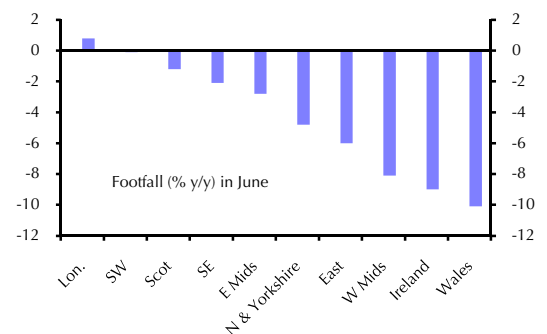
5. The North also has a relatively high share of workers in manufacturing, a sector with relatively weak pay growth.



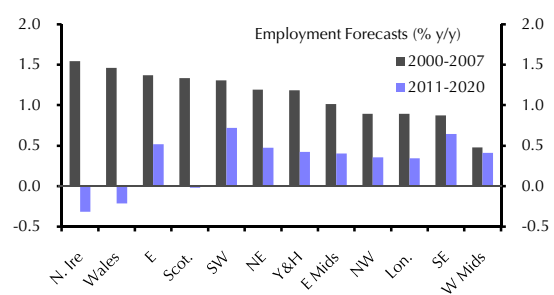
6. Weak jobs growth in the North appears to be taking its toll on the housing market.



7. This may explain why shopper numbers are falling more outside of London and the South.



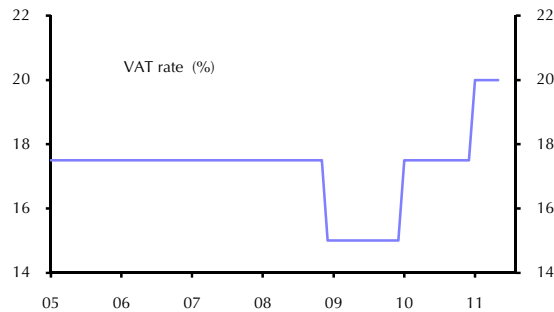
8. Looking ahead, we expect jobs growth in all regions to be weaker than before the recession.



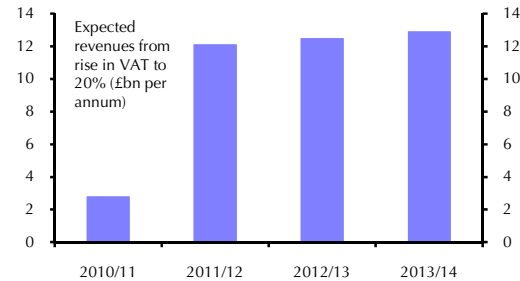
Sources – Thomson Datastream, Capital Economics, CIPS/Markit

Charts: Would a VAT cut be of much help?

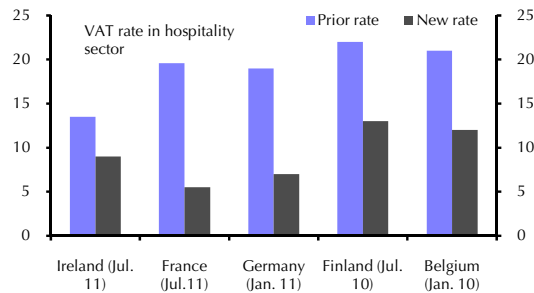
1. There are calls for the Government temporarily to return VAT to the 17.5% rate seen before January's rise to 20%.



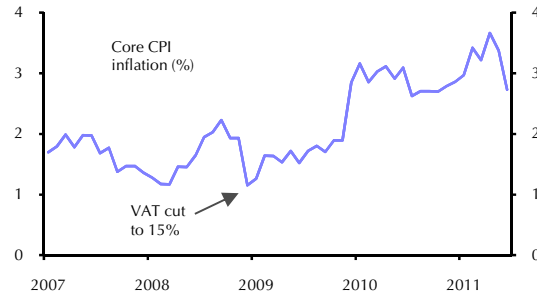
2. This rise raised about £12bn a year in revenues. Cutting it could potentially return a similar amount to consumers.



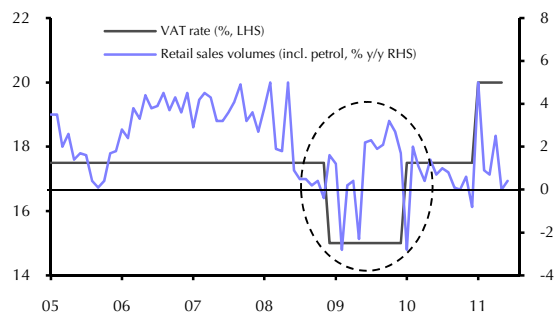
3. Or cuts could be restricted to certain sectors. Other countries have cut VAT for hospitality companies.



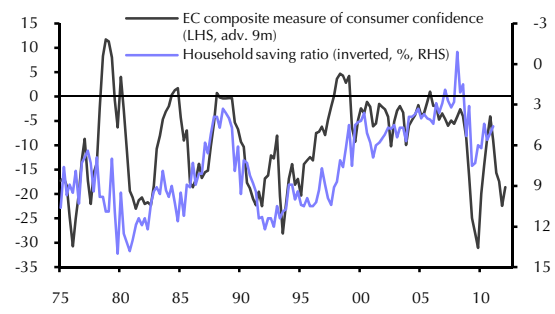
4. But retailers might not pass on the cut to consumers. When VAT was cut in 2008, core inflation fell, but soon rose again.



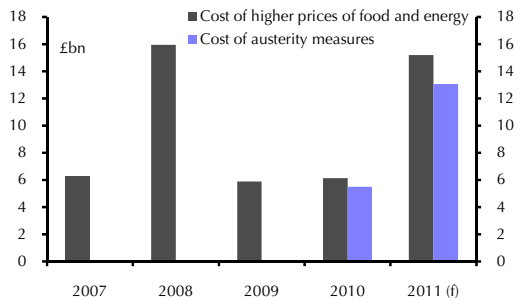
5. In any case, consumers might save, rather than spend, the money. Sales growth did not pick up after the previous cut.



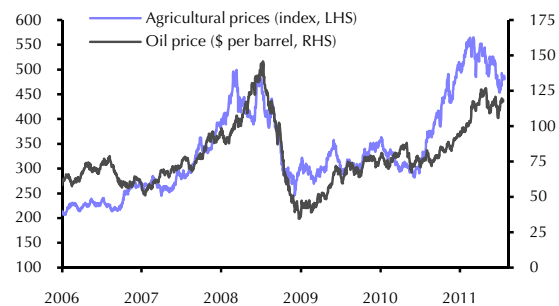
6. And the current low level of confidence is consistent with a rise in the household saving rate.



7. In any case, the VAT rise has not been the main problem for consumers. Commodity price rises have been more costly.



8. Accordingly, the main hope lies in a drop in commodity prices from their current high levels.



Sources – Thomson Datastream, Capital Economics

Capital Economics Ltd

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If you would like more information about Capital Economics and what we could do for you, then please contact us at the addresses given overleaf.

About Roger Bootle, Managing Director

Roger Bootle is one of the City of London's best known economists. As well as being Managing Director of Capital Economics, he is also Economic Adviser to Deloitte, a Specialist Adviser to the House of Commons Treasury Committee and an Honorary Fellow of the Institute of Actuaries. He was formerly Group Chief Economist of HSBC and, under the previous Conservative government, he was appointed one of the Chancellor's panel of Independent Economic Advisers, the so-called "Wise Men".

He has written many articles and several books on monetary economics. Roger's latest book, *The Trouble with Markets*, analyses the deep causes of the recent financial crisis and discusses the threats to capitalism arising from it. His previous book, *Money for Nothing*, correctly anticipated the financial crisis and has been widely acclaimed. This followed the success of *The Death of Inflation*, published in 1996, which became a best-seller and was subsequently translated into nine languages. Initially dismissed as extreme, *The Death of Inflation* is now widely recognised as prophetic. Roger is also joint author of the book *Theory of Money*, and author of *Index-Linked Gilts*.

Roger is a regular columnist for *The Daily Telegraph* and appears frequently on television and radio.





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