

# UK CONSUMER MONTHLY

Nov. 2011



## *A monthly review of the recent developments in the consumer sector*

Editor: Roger Bootle

## Labour market downturn worsens

- **Total consumer spending – page 2**

Real household spending probably fell again in the third quarter of the year.

- **Retail spending – page 3**

The 0.6% monthly rise in the official measure of retail sales in October suggested that the high street is still holding up well. But the CBI and BRC measures have been more downbeat.

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

The downturn in the labour market has worsened. Inflation appears to have passed its peak, but remains about 3% above nominal pay growth.

- **Prices & costs – page 6**

Increased supermarket competition pushed down food price inflation in October.

- **Outlook**

The consumer sector remains in a poor state. Consumer spending probably fell in the third quarter for the fifth quarter in a row. And although high street spending is holding up better than might be expected, this seems to be coming at the expense of spending off the high street. The outlook remains bleak. The deterioration in the labour market is getting worse and the escalation of the euro-zone crisis heightens the risk of a renewed credit crunch in the UK. At least inflation should hopefully now have peaked. But it will be at least a year before it falls back below pay growth. We continue to expect real household spending to fall by about 3% over the next two years.

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## Total consumer spending

### Spending still falling

- Real household spending probably fell again in the third quarter.
- The expenditure breakdown of Q3 GDP is released on 24<sup>th</sup> November. We already know that GDP posted a 0.5% quarterly rise in Q3. But we expect this to have been driven by investment and stockbuilding. In contrast, we expect consumer spending to have fallen for the fifth quarter in a row. (See Chart 1.)
- We already know that retail sales volumes, which account for around 40% of overall spending, fell by 0.2% q/q in Q3. (See Page 3.)
- Spending off the high street – i.e. on consumer services – will therefore need to have risen in order to prevent overall spending from falling. However, non-retail spending fell sharply in the first half of the year.
- Admittedly, output growth in the pubs, restaurants and hotels sector accelerated in July and August. (See Chart 2.) But spending in this sector accounts for just 10% of overall spending.
- Measures of consumer confidence point to a further sharp fall in overall household spending in Q3. (See Chart 3.) We have therefore pencilled in a 0.2% or so fall, but could easily see a bigger drop.
- Meanwhile, the little evidence we have on consumer spending in Q4 suggests that consumers have continued to cut back. Private new car registrations, for example, were 4.3% down on their level a year ago in October. (See Chart 3.)
- And while the official measure of retail sales posted a solid rise in October, other measures have been more downbeat. (See Page 3.)

Chart 1: Real Household Spending

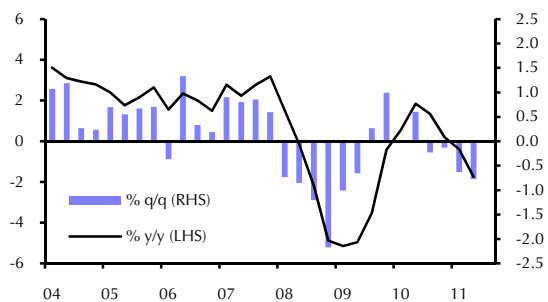


Chart 2: Output in Pubs, Restaurants & Hotels (% 3m/3m)

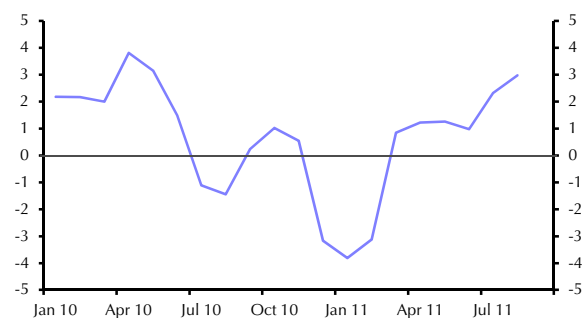


Chart 3: Consumer Confidence & Household Spending

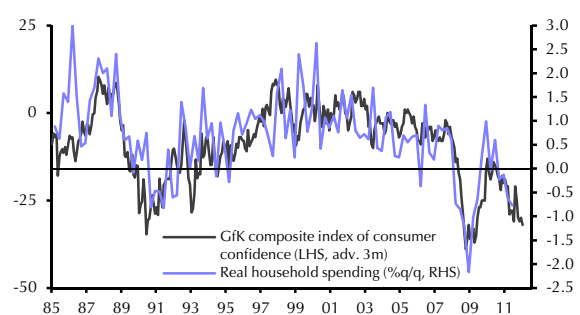
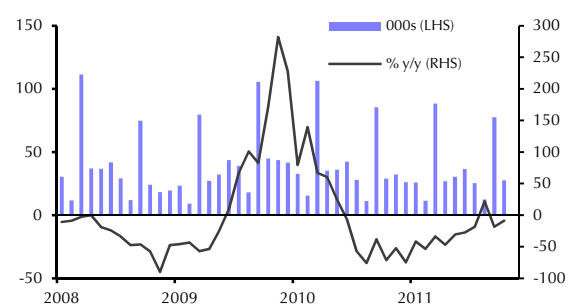


Chart 4: Private New Car Registrations

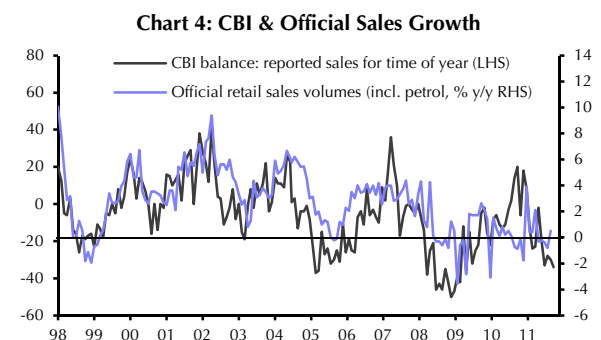
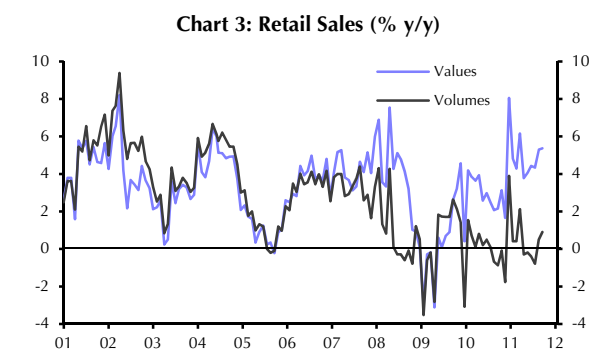
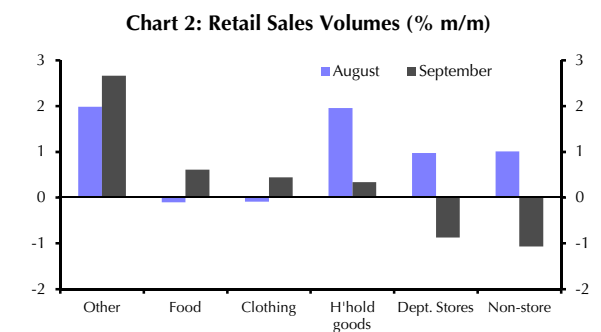
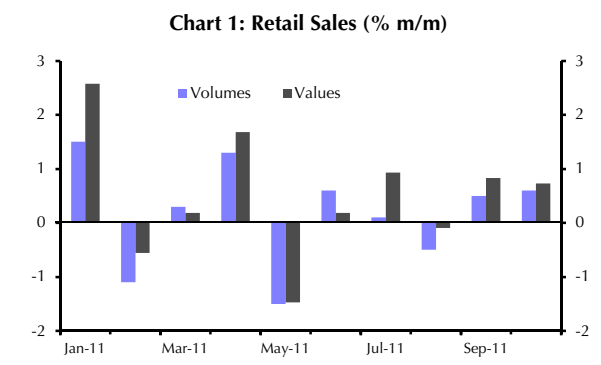


Sources – Thomson Datastream, Bank of England, CBI, SMMT

## Retail Spending

### Official measure holds up better than surveys

- The official measure of retail sales is still holding up well, but other measures have been more downbeat.
- Sales volumes rose by a monthly 0.6% in October, building on September's 0.5% increase.
- Retailers had to discount more aggressively to achieve this. (See Page 6.) Nonetheless, sales *values* also posted a strong monthly rise of 0.7%. (See Chart 1.)
- Sales volumes rose both on and off the high street. The 0.6% monthly rise in food sales was the first increase since July. Meanwhile, the 0.9% rise in non-food sales was driven by the "other" store category, which the ONS said included computers, jewellery and toys. (See Chart 2.)
- Sales volumes are still barely higher than a year ago, for both food and non-food. But of course high inflation is continuing to boost the annual growth rate of sales *values*. (See Chart 3.)
- The CBI and BRC surveys paint a weaker picture of sales growth. The CBI's balance measuring sales for the time of year fell from -30 to -34 in October and is at its lowest level since 2009. (See Chart 4.)
- Meanwhile, the BRC's measure of annual growth of like-for-like sales values fell in October from 0.3% to -0.5%. Given that this measures *nominal* spending, it implies that sales volumes are falling sharply.
- More recently, John Lewis department store sales for much of November have been falling slightly compared to last year.



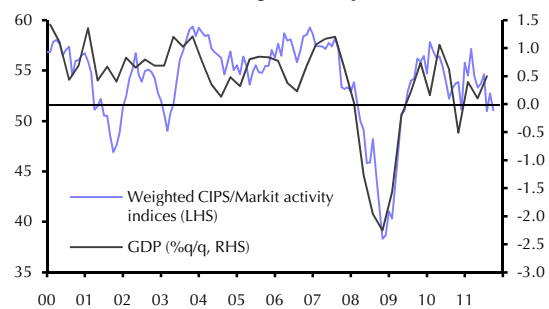
Source – Thomson Datastream

## Economic Drivers of Spending

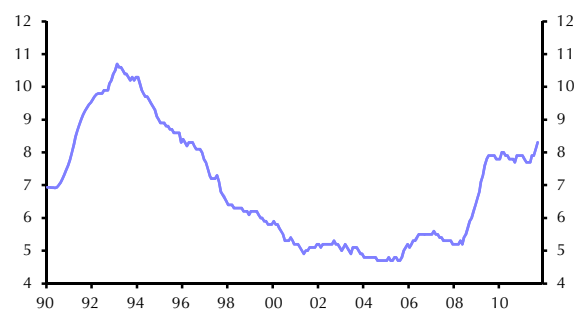
### *Unemployment at its highest rate for 17 years...*

- The economy is close to a renewed recession and job losses have continued to mount. Meanwhile, the euro-zone debt crisis threatens to push up the cost, and restrict the supply, of credit to households.
- The economy has made a weak start to Q4. As Chart 1 shows, the CIPS/Markit activity surveys suggest that it might have contracted in October.
- Conditions in the labour market have also continued to deteriorate rapidly. Employment fell by 197,000 in the three months to September. This caused the ILO unemployment rate to leap from 8.1% to 8.3%, its highest since January 1996. (See Chart 2.)
- At least the timelier claimant count measure of unemployment rose by “only” 5,300 in October. September’s rise was also revised smaller, from 17,500 to 13,400.
- However, the smaller rise in the claimant count may just reflect delays in people signing on. Moreover, there is little to suggest that the economy will be strong enough to stop joblessness rising further. Job vacancies have been on a flat to downward trend in recent months, while surveys point to further falls in private sector employment. (See Chart 3.)
- Meanwhile, the squeeze on real incomes has remained intense. The annual rate of average earnings growth including bonuses fell from 2.3% to 1.9% in September. At least inflation appears to have peaked, having fallen from 5.2% to 5% in October.
- But the Chancellor’s Autumn Statement is unlikely to contain any major measures to help households. The best that can be hoped for is that the Government scraps or delays the planned 3p rise in fuel duty in January.

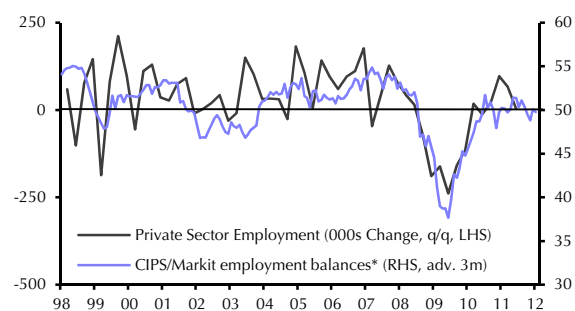
**Chart 1: CIPS/Markit Weighted Output Balance & GDP**



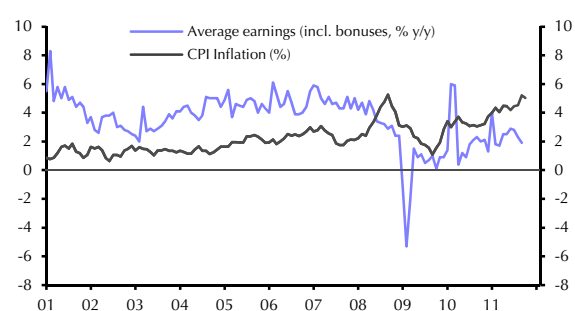
**Chart 2: ILO Unemployment Rate (%)**



**Chart 3: Measures Of Private Sector Employment**



**Chart 4: Inflation & Average Earnings Growth**



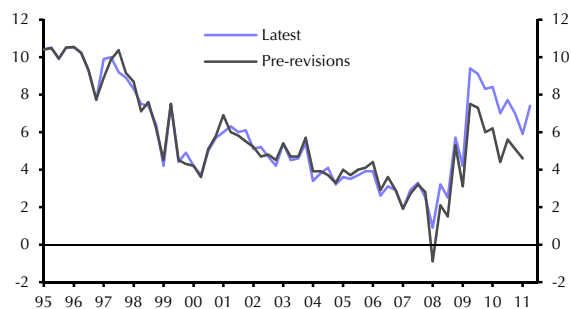
Sources – Thomson Datastream, CIPS/Markit

## Economic Drivers of Spending (continued)

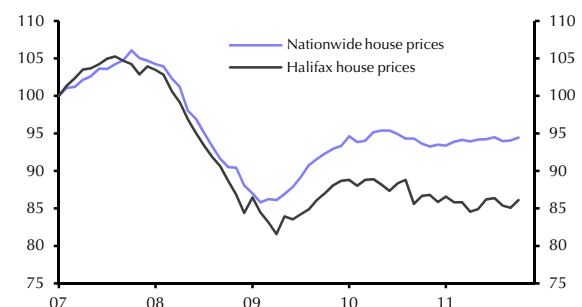
... but saving rate looking healthier

- At least the latest data on households' balance sheets suggested that their financial position is a bit stronger than previously thought.
- In particular, the household saving ratio over the past couple of years has been revised up and shows that households in Q2 saved 7.4% of their income - approximately its long-run average level. (See Chart 5.) This might suggest that households are better placed to support spending by reducing their saving rate in the coming quarters.
- What's more, both the Nationwide and Halifax measures of house prices increased in October, by 0.4% and 1.2% m/m respectively.
- Nonetheless, house prices are still on a broadly flat trend – both measures in October were still below their peaks seen this year. (See Chart 6.)
- In addition, indicators suggest that housing demand is likely to fade soon. For a start, provisional data suggest that fixed interest rates offered on new mortgages rose a touch in October. Moreover, recent rises in banks' funding costs as a result of their exposures to euro-zone sovereign debt suggest that the interest rates offered on new mortgages will rise further soon. (See Chart 7.)
- Meanwhile, the weakness of consumer confidence suggests that a pick-up in housing market activity – or consumer spending more generally – is unlikely. The GfK consumer confidence index edged down in October. Its measure of whether consumers think now is a good time to make large purchases has continued to deteriorate in recent months, consistent on the basis of past form with further falls in mortgage approvals. (See Chart 8.)

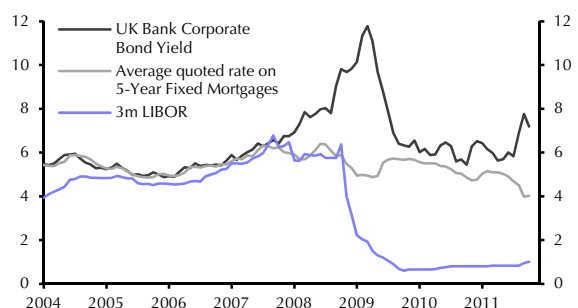
**Chart 5: Household Saving Ratio (Saving as a % of Income)**



**Chart 6: House Prices (Jan. 2007 = 100)**



**Chart 7: Mortgage Rates & Banks' Funding Costs (%)**



**Chart 8: Mortgage Approvals and Balance of Households Who Believe it is a Good Time to Make a Major Purchase**



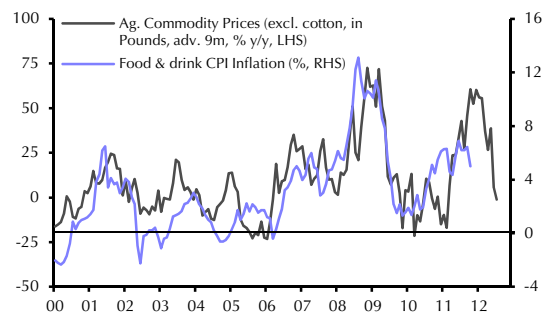
Sources – Thomson Datastream, GfK/NOP

## Prices & Costs

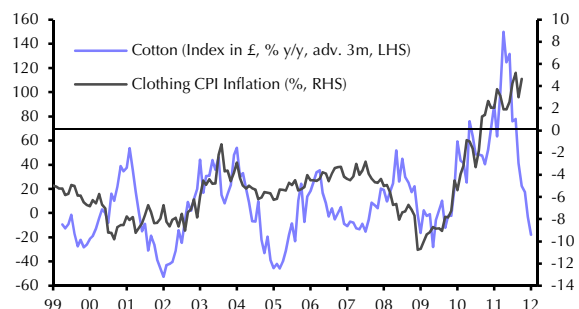
### Food inflation falls

- Weak consumer demand has spurred intense competition among the supermarkets.
- Food and drink price inflation fell from 6.4% to 5% in October, suggesting that supermarkets are struggling to pass on to consumers past rises in agricultural prices. (See Chart 1.)
- According to Nielsen, about 40% of grocery sales are on promotion. And Marks and Spencer spoke of “an increasingly promotional environment” in its recent half year results.
- Admittedly, core inflation (which excludes food and energy) edged up further in October from 3.3% to 3.4%. This reflected rises in clothing and household goods inflation.
- But the recent falls in cotton prices suggest that clothing inflation should come down soon. (See Chart 2.) Commodity prices were generally stable over the past month, but therefore remained below the levels seen at the start of the year. (See Chart 3.) The oil price has continued to hover at just above \$110 per barrel.
- The euro has remained surprisingly resilient, especially given that there are now serious concerns about Italy’s future. Nonetheless, sterling nudged up a touch from €1.15 to €1.17. The pound held broadly steady against the dollar at just below \$1.60.
- Meanwhile, retailers should be benefiting from slower growth of operating costs. Growth of retail rents has continued to weaken. (See Chart 4.) The latest RICS survey for Q3 reported a material decline in occupier demand for retail space. And annual average earnings growth in the retail, hotels and restaurants sector slowed even further in October to just 0.7%.

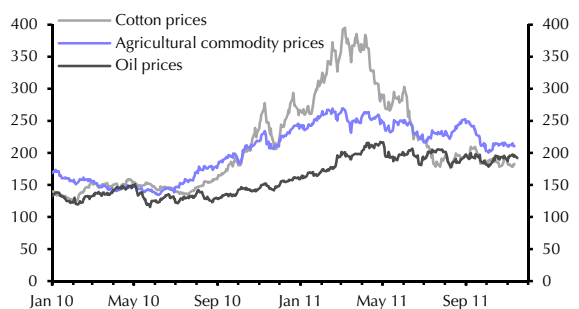
**Chart 1: Agricultural Prices & Food Inflation**



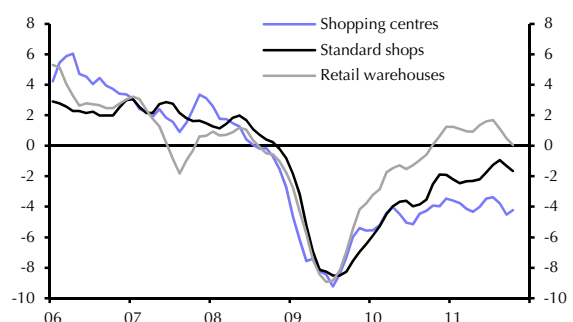
**Chart 2: Cotton & Clothing Prices**



**Chart 3: Commodity Prices (2006 = 100)**



**Chart 4: Retail Rents (% 3m/3m Annualised)**



Sources – Thomson Datastream, Bloomberg

## Economic Indicators & the Month Ahead

### ECONOMIC INDICATORS

	2011 Q1	2011 Q2	2011 Q3	2010	2011 (forecast)	2012 (forecast)
GDP (% y/y)	1.6	0.6	0.5	1.8	0.8	0.0
Nominal household spending (% y/y)	4.5	2.8	-	4.9	3.3	1.3
Real household spending (% y/y)	-0.4	-1.7	-	1.0	-1.5	-1.5
			-			
Nominal disposable income (% y/y)	1.1	3.1	-	3.9	2.5	0.8
Real disposable income (% y/y)	-3.4	-1.2	-	0.1	-2.0	-2.0
Saving ratio (%)	5.9	7.4	-	7.5	7.0	6.5
			-			
Total debt to income ratio (%)	157	156	-	158	154	150
Interest payments (% income)	6.4	6.3	-	6.6	6.3	6.1

	Sep 2011	Oct 2011	Nov 2011	2010	2011 (forecast)	2012 (forecast)
CBI reported sales balance	-15	-11	-	23	-	-
BRC retail sales monitor (like for like sales, % y/y)	0.3	-0.6	-	0.7	-	-
Retail sales volumes (including auto fuels, % y/y)	0.6	0.9	-	-0.2	-0.5	-1.0
Average earnings (including bonuses, headline rate)	2.3	-	-	2.3	2.2	1.5
LFS Employment (% y/y)	-0.4	-	-	0.1	0.3	-1.5
Claimant count unemployment rate (%)	5.0	5.0	-	4.7	4.9	5.8
Nationwide house prices (% y/y, forecast for end-year)	-0.3	-0.8	-	0.0	-2.0	-5.0
Mortgage approvals (000s)	51.0	-	-	47.7	-	-
Consumer credit (£bn)	0.6	-	-	0.2	-	-
Consumer confidence (GfK composite balance, nsa)	-30	-32	-	-18	-	-
CIPS/Markit services sector PMI	52.9	51.3	-	54.0	-	-
CPI inflation (%)	5.2	5.0	-	3.3	4.6	2.8
Bank of England repo rate (% , forecast for end year)	0.50	0.50	0.50	0.50	0.50	0.50

Sources – Thomson Datastream/National Statistics/Bank of England/Capital Economics

### THE MONTH AHEAD

	Latest number	Period covered	Next release date	Period covered
National Accounts: GDP % q/q (% y/y)	+0.5(+0.5)	Q3 1 <sup>st</sup> Est.	24 <sup>th</sup> Nov	Q3 2 <sup>nd</sup> Est.
CBI reported sales balance	-11	Oct	28 <sup>th</sup> Nov	Nov
BRC Retail Sales Monitor (like for like sales % y/y)	-0.6	Oct	6 <sup>th</sup> Dec	Nov
Retail sales volumes (including petrol, % y/y)	0.9	Oct	15 <sup>th</sup> Dec	Nov
Average earnings (inc. bonuses, headline)	2.3	Sep	14 <sup>th</sup> Dec	Oct
LFS Employment (% y/y)	-0.4	Sep	14 <sup>th</sup> Dec	Oct
Claimant count unemployment rate (%)	5.0	Oct	14 <sup>th</sup> Dec	Nov
Nationwide house prices (% y/y)	0.8	Oct	28 <sup>th</sup> – 30 <sup>th</sup> Nov	Nov
CIPS/Markit services sector PMI	51.3	Oct	5 <sup>th</sup> Dec	Nov
CPI inflation (%)	5.0	Oct	13 <sup>th</sup> Dec	Nov
Bank of England repo rate (%)	0.50	Nov	8 <sup>th</sup> Dec	Dec
MPC Minutes (More QE – No More QE)	9-0	Oct	23 <sup>rd</sup> Nov	Nov

Sources – Thomson Datastream/National Statistics