

## Novus Capital Markets Research

### Retail sales – down in January?

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The forecast that I released last week suggested that 2011 would be a reasonable year for the UK economy with GDP rising 2%. For most of us it won't feel like that. The growth will be focused on export-oriented manufacturing and services and business investment. Government spending and employment will fall. Household incomes, which were falling in real terms for much of 2010, will be down again this year as wage increases lag behind prices. As the Governor has acknowledged, it promises to be a miserable year for the UK consumer and for household living standards.

Yet, if there is one thing that we know, it is that the UK consumer is a true survivor, one that we write off at our peril. Spending rose 2% in the year to 10q3 even though real household disposable income was down 1.5% in the same period. Retail sales continued to rise in the fourth quarter and, despite December's difficult weather, rose 0.2% in the quarter as a whole. And, according to the CBI and the BRC, 2011 did not start too badly.

Unfortunately, because they report annual changes, neither the CBI nor the BRC survey is telling us anything about January in isolation (only about this January relative to last). Since sales volumes (ex-petrol) fell 3% in January 2010, the annual rate would need to rise by at least 3pp for January 2011 to be up on December 2010 – which, ultimately, is what we are interested in. **If, for example, the ONS cash spend rose at the same rate as the BRC, and if inflation rises as seems likely, then retail sales volumes would still be down by somewhere between ½% and 1% in January.** Or, put another way, without a sharp fall in inflation, growth in the cash spend will need to jump to about 6% (which seems unlikely given that wages are up by less than half that amount) simply to get a positive outcome on volumes.

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### **UK consumer – still standing (after all this time)**

Retail sales volumes fell 0.8% in December, which largely reversed the gains of Oct-Nov. Excluding petrol, which dropped 5.9% as motorists stayed at home in the snow, volumes were down 0.3%. Compared with the whole economy, which I estimate contracted nearly 2% in December, retailing held up reasonably well. Similarly, for Q4 as a whole, retail sales outperformed the whole economy, rising 0.2% in total, 0.3% ex-petrol against the ONS preliminary estimate of a 0.5% drop in GDP.

The relative resilience appears to have continued into January. The BRC reported that sales values rose 4.2% y/y, up from a snow-affected 1.5% in December and 2.8% in November. By contrast, the CBI Distributive Trades Survey showed a net balance of +37% of retailers reporting higher sales volumes in January down from +56% in December and +55% in November.

I say *appears* in the previous paragraph because both measures are on a y/y basis so what happened a year ago is just as important as what was happening this year. (The official ONS data are based on an index and do not suffer from this problem.) And where the snow came in December 2010 and January 2011 was very mild, it was the other way round a year ago with heavy snow starting just before Christmas and intensifying in January.

On this basis the CBI survey is somewhat counter-intuitive, though this might be due to its timing. The survey is conducted over a two-week period around the turn of the month. The January survey for example ran from 4-18 January while the December survey ran from 25 November to 8 December (and as such is not going to tell us a great deal about retail sales in December).

In commenting on their surveys both the BRC and the CBI acknowledged January's relative strength. For the CBI "the lure of seasonal sales and price discounting may have helped mitigate some of the impact of the VAT increase on volumes". For the BRC it was "pent-up demand after December's snow, pre-VAT rise purchases and clearance bargains" that boosted sales. Both, however, remained resolutely downbeat for the coming months. The CBI argued, quite reasonably, that household spending will be "hit by a combination of sharply rising prices and weak wage growth". The BRC, whose survey apparently provides a remarkable insight into consumer psychology, argued that spending slowed

towards the end of January “as the reality of worries about jobs and personal finances returned to customers' minds”.

Surveys of consumer confidence are also downbeat. The GfK NOP index dropped 8 points in January to -29, its lowest level in nearly two years and the biggest one-month drop since 1994. All five components of the survey fell with the question on major purchases down a massive 22 points to -29 on the rise in VAT to 20%.

The official ONS data for January are released at the end of next week. They will provide a better insight into how well (or badly) the High Street is doing at the start of what promises to be a difficult year for the consumer. There will be a weather-related bounce in petrol sales, though the relentless rise in pump prices is likely to hold back underlying demand. Of more interest will be the measure ex-petrol, which should benefit from the milder weather and a boost in the first three days ahead of the 4 January VAT hike. Despite this, the underlying picture could be quite weak.

The ONS data estimate that on the cash measure excluding petrol (which is closest to the BRC survey) retail sales rose 1% in December 2009 and fell 2.6% in January 2010. So on weather effects alone we should expect annual sales growth to be stronger in January 2011 than in December 2010. If, for example, the BRC survey contained the same 2.6% decline in January 2010 as the ONS (though we shall never know since they do not publish the data in index form), then the 2.7pp increase in the annual rate in January (from 1.5% to 4.2%) would leave the cash spend in January only 0.1% higher than in December.

We can apply a similar calculation to the ONS data. In December 2010 the ONS cash spend ex-petrol was up 2.3% in y/y terms (versus 1.5% on the BRC). If the ONS measure increases in line with the BRC in January, the y/y rate will rise to 5%; the index will be unchanged from December implying no change in the cash spend in the month. Inflation (as measured by the seasonally adjusted retail sales deflator) was running at 1.2% in December. In January 2010 prices on this measure rose 0.4% as the re-instatement of the 17.5% rate of VAT outweighed the effects of the January sales. This year there is another 2½pp rise in VAT. That should be inflation neutral except that, according to the survey conducted for the MPC by the Bank's regional agents, retailers are passing on more of the hike this year than they did last (84% of

the survey said they intended to pass on the increase in full against less than 50% a year ago). If, for example, the annual inflation rate were to rise to 1.5%, that would mean prices rising 0.7% in the month. For an unchanged cash spend, that would imply a 0.7% fall in volumes (Table 1). Alternatively, depending on the rate of inflation in January, the annual rate of growth of the cash spend might have to increase to about 6% (which seems unlikely) to get a positive outturn on volumes.

**Table 1: Retail sales**

		Volume	Value	Price
2009	Dec	109.4	111.5	101.9
2010	Jan	106.1	108.6	102.4
	% m/m	-3.0	-2.6	0.4
2010	Dec	110.6	114.1	103.2
2011	Jan	109.8	114.1	103.9
	Dec % y/y	1.1	2.3	1.2
	Jan % y/y	3.5	5.0	1.5
	Jan % m/m	-0.7	0.0	0.7

Source: ONS, Novus

This sort of calculation should be taken with a pinch of salt, though it does illustrate one important fact about this month's retail sales data – since sales fell a long way in the severe winter conditions of January 2010, the annual rate of growth can seemingly bounce very strongly this year while at the same time volumes will be down on December. The weakness of the CBI and BRC surveys is that they tell us nothing about January 2011 in isolation; only the ONS can do that.

### **Inflation – 4 and 5?**

The only other hope for retail sales is if Tuesday's data produce a sharp fall in inflation – which seems unlikely.

CPI inflation bottomed out at 3.1% over the summer and has risen steadily since then, reaching 3.7% in December. RPI inflation is running well above the CPI, mainly because the housing components

(mortgage interest payments and house price depreciation) were rising for most of 2010, but also because of the quirks of the so-called formula effect. RPI inflation picked up to 4.8% in December.

In January prices on both measures usually fall because of the New Year sales. Until last year the m/m decline was averaging 0.6-0.7% on the CPI and the CPIY measures. In January 2010, when the rate of VAT returned to 17.5%, CPI prices fell only 0.2% while CPIY prices were down 1.7% – a clear indication that not all of the VAT hike was passed through to the consumer. Petrol prices rose 2.2% in January 2010 and food was down 0.3%.

This year we have another 2½pp rise in VAT which will result in a significant difference between the headline CPI and the ex-indirect taxes CPIY measure. As we have already noted, a survey by the Bank's Agents suggested that retailers were intending to pass more of the VAT hike through to consumers immediately, which implies that the fall in CPIY prices will be less than last year's exceptional 1.7%. There will be a further boost from petrol prices which rose around 4½% this year, double last year's increase and enough to add nearly 0.1pp to the annual rate. Food prices rose 1.6% in December, partly because of the effect of the weather on the availability of some fruit and vegetables. Some of this should unwind in January.

Where the data come in next Tuesday depends critically on whether retailers are able to pass on the VAT hike as they intend. Competition on the High Street restricted the pass-through last year and the same could happen again. If it does not then CPI inflation will rise to 4% and RPI inflation to 5%. For those of us who have pensions linked to the RPI, the news is not wholly bad.

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