

## *Novus Capital Markets Research*

### **No seasonal spring**

**2 June 2011**

**The global economy:** this week's manufacturing PMIs were distinctly soggy, the weakest since Sep09 in the US and the UK. Some slowdown in the global economy is to be expected since monetary policy has been tightened in many economies (though not the US or the UK) in response to rising inflation, which hit 2.9% in the OECD in April, the highest since Oct08. For the UK, where all the growth in Q1 came from net exports, the last thing we need at this point in the cycle is an extended global soft patch.

**UK housing:** the housing market usually perks up in the spring. But in a year where household incomes are under severe pressure, the normal seasonal pick-up is absent. RICS report the usual increase in vendor instructions but a marked absence of new buyer enquiries. On the official BoE data new mortgage approvals fell in April to their lowest level since Mar09 (apart from December when the snow was the major factor). House prices are falling, according to RICS and the Halifax index, flat on the Nationwide and still edging higher according to Acadametrics. Whether you believe (as some economists do) that the housing market is a key determinant of consumer spending, or whether you look at more fundamental factors such as real incomes and interest rates (as I do), you reach the same conclusion: the outlook for consumer spending is distinctly sub-par.

**UK High Street:** the outlook may be weak but a combination of Easter, the Royal Wedding and sunshine brought the UK consumer out in force in April. Retail sales rose 1.1% in volume and 6.2% y/y in cash terms. The CBI distributive trades survey slowed from +21 in April to +18 in May, suggesting that the High Street remained reasonably buoyant last month.

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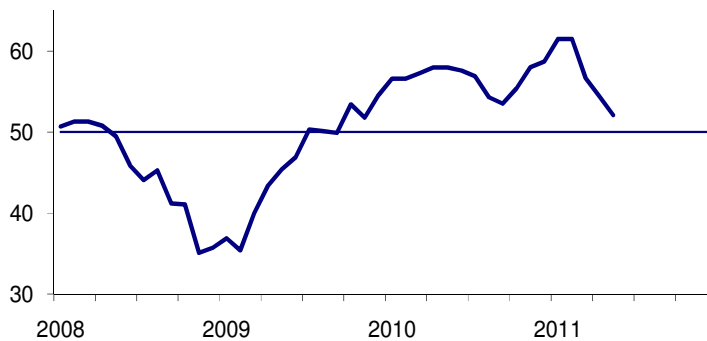
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### No seasonal spring – the global economy

The early-June surveys suggest the global economy has hit a soft patch. The manufacturing PMIs for May were uniformly on the weak side. The US ISM dropped far more than expected to its lowest level since Sep09; the euro area PMI was at a seven-month low and the Chinese PMI was at its lowest level for nine months. The UK PMI came in at its lowest level in nearly two years (52.1), having been as high as 61.5 only three months ago (Chart 1 and Table 1). As a result, the global PMI for manufacturing calculated by JPMorgan fell from 55.0 in April to 52.9, its lowest level since Sep10.

**Chart 1: UK manufacturing PMI**



**Table 1: PMI (manufacturing)**

	Apr	May
US	60.4	53.5
Euro area	58.0	54.6
China	52.9	52.0
UK	54.4	52.1

Source: CIPS, Markit

The sharp drop in the UK manufacturing PMI is due in part to the timing of the Bank holidays and to disruptions to the supply chain following the Japanese tsunami. It is not mirrored in the May CBI survey which reported a balance of +20 expecting to increase output in the next three months. The balance is down from a peak of +27 in March but still well above the long-run average. The same is true of order books which improved in May both in aggregate and for exports.

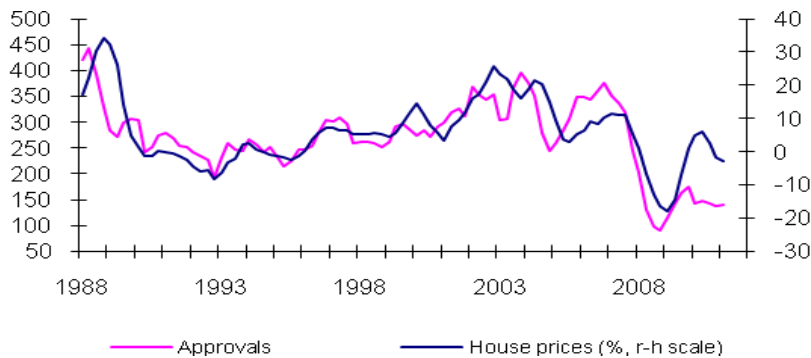
The last thing the UK needs at this stage in the recovery is a soft patch in the global economy. As I noted last week, all the growth in Q1 came from net exports with both consumer spending and investment falling back. Some slowdown in the global economy might be expected since many economies have been raising rates to restrict inflation which, in the OECD area, has reached 2.9%, an increase of 1pp in

just six months and the highest rate since Oct08. Even so, the weakness that we saw in yesterday's manufacturing PMIs was disconcerting.

### No seasonal spring – the housing market

The housing market usually perks up in the spring. The period from Easter to the summer holidays normally sees a pick-up in activity as new buyer enquiries and new vendor instructions rise in tandem. This year, with most household budgets under severe pressure from rapidly rising prices, it does not appear to be happening. The RICS survey reports that new instructions did pick up in April but buyer enquiries were unchanged, having fallen steadily since June. The official data show new mortgage approvals for house purchase at 45.2k in April. Dec10 apart, when the snow was the major factor, approvals are at their lowest level since Mar09 (Chart 2). The construction PMI by contrast with other housing market data as well as the manufacturing PMI was a little bit stronger, rising to 54 in May from 53.3 in April.

**Chart 2: Mortgage approvals and Halifax house price inflation (qtrly data)**

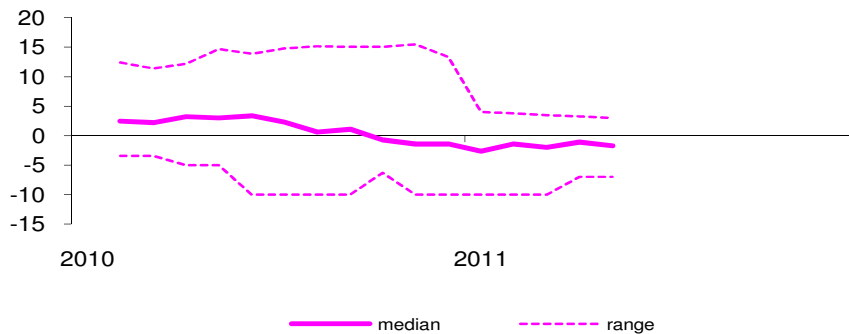


Source: BoE, Halifax

As Chart 2 shows, mortgage approvals are a reasonable lead indicator of house prices. Does this mean that house prices are in for another difficult period? A report this week from the CEBR, which forecasts a 1.4% fall in prices this year followed by a four-year rise worth 16% in total, suggests that any weakness will be temporary.

House prices started falling in 2007 on Halifax and Nationwide data (which are based on asking prices) and fell by around 20% in total. The fall started later (early 2008) and was rather less (13.6%) according to Acadametrics (which is based on Land Registry, ie realised price, data). Prices staged a modest recovery in the second half of 2009 but have been flattish for the last 12 months. The RICS survey has been in negative territory since August, though the trend is upwards. On the Halifax measure prices are falling; according to Nationwide they are flat; on the Acadametrics data they are still edging upwards. Forecasts for house prices in 2011 (Q4/Q4), were for a modest gain this time last year but are now for a small fall (Chart 3).

**Chart 3: House price forecasts for 2011**



Source: HMT

House prices have fallen sharply on two occasions in recent history. In the early 1990s demand collapsed as interest rates were raised to 15% to head off rising inflation. That was the era of the forced seller. The second was in the 2008-09, the product of a supply shock (credit crunch) as the mortgage banks just turned off the tap. Outside major shocks, either to demand or to supply, house prices do not collapse. Activity may be weak but that does not automatically produce falling prices since home-owners always have the option of staying put. At a time when household incomes are under huge pressure, I would expect activity in the housing market to remain weak and prices to move sideways or edge lower. The consensus forecast looks about right at this stage.

For those economists who believe the housing market is the be-all and end-all of household spending, the latest data are unhelpful. Consumer spending, which has fallen in each of the last two quarters, is likely to fall further if housing market activity and house prices are going nowhere. For those of us who believe that both the housing market and consumer spending are driven by fundamental factors (real incomes and interest rates), the news from the housing market is of marginal significance. If we are not moving house, spending on those items associated with house purchase (furniture and furnishings) will suffer but spending on other items may well be stronger. In any case, the outlook for RHD and hence consumer spending this year is already bleak; any softness in the housing market won't change the big picture – the current consensus is that household consumption will rise 0.5% this year following 0.8% in 2010.

### **Seasonal spring – the High Street**

In April at least the High Street appears to have defied the gloomy trend. There are (always) some special factors, the timing of Easter, the Royal Wedding and sunny weather, but the data were impressive. On the ONS measure sales volumes rose 1.1% (1.3% ex-petrol) from March and 6.2% y/y in cash terms. The BRC reported sales growth of 6.9% y/y and the CBI distributive trades survey balance was +21. The BRC has not yet reported for May but the CBI came in at +18, down from April but still signalling reasonable growth.

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