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UK: STRONG REBOUND IN RETAIL SALES IN FEBRUARY, RISKS FROM INFLATION ARE EXAGGERATED

Berenberg Macro Flash

UK retail sales (ex. auto fuel), February, in %

	yoy	mom
Actual	**4.1**	**1.3**
Previous	2.1	-0.3
Consensus	3.2	0.3
Berenberg	-	0.5

The oil and employment boost is fading: The 4.4% average annual growth in retail sales ex. autos during 2015 and 2016, and the surge to 5.8% yoy in H2 2016, was totally unsustainable. Now that the boost from cheap oil is over and employment gains slow as the labour market reaches full employment, household spending will return to more normal patterns. But it looks like households aren't ready to end the party just yet. In February, retail sales ex. autos surprised on the upside, growing 1.3% - versus estimates of 0.3% - on a monthly basis after the little over-correction in Dec and Jan. Sales ex. autos increased by 4.1% on an annual basis. All major components of retail sales expanded on the month, with discretionary spending on household goods (3.7%) and clothing and footwear (1.0%) growing at healthy rates. After rising by 1.6% qoq in Q4, well above the long-term trend of 0.7% 3M/3M, retail sales will face a little payback for the quarter overall. Comparing the Jan-Feb average to Q4 2016, retail sales ex. autos declined by 1.2%. In Q1 retail sales will likely decline on a quarterly basis for the first time since 2013. Over the medium-term, retail sales growth will likely converge towards the 20 year trend of 2.9% yoy, maybe even a little slower in H2 2016 as households adjust to rising import costs.

The risks to real household spending from rising inflation are grossly overstated. We expect inflation to average 2.7% in 2017 and 2.6% in 2018 (in line with the BoE) as the c12% fall in trade-weighted sterling since the Brexit vote pushes up import costs. At this mid-stage of the cycle, growth is entrenched, unemployment low and households feel confident enough to save a little less and borrow a little more. 2.7% annual inflation is not enough to spoil the party. Suppose sterling took another 10-15% leg down and inflation hit 5%, then households would face some real problems. That, however, seems unlikely. The rise in inflation will squeeze household incomes in 2017 and 2018 even as tight labour market conditions cause a modest rise in nominal wage growth. But it is unlikely to fully pass through into real consumption growth. Instead, real household spending growth will likely ease to a little below the 20 year average rate of 2.4% yoy after above-trend growth last year. We expect real consumption growth to ease from 3.0% in 2016, to 2.3% in 2017 and 1.9% in 2018. Our outlook is broadly in line with the BoE's survey data published yesterday – see chart. Remember, household balance sheets have strengthened since the Lehman-crisis, debt-to-income has fallen and household wealth has risen. By increasing borrowing and saving less to target a desired level of consumption, households can smooth spending over the medium-term to compensate for the modest squeezes on real incomes.

Bank of England Agents' survey of consumer demand

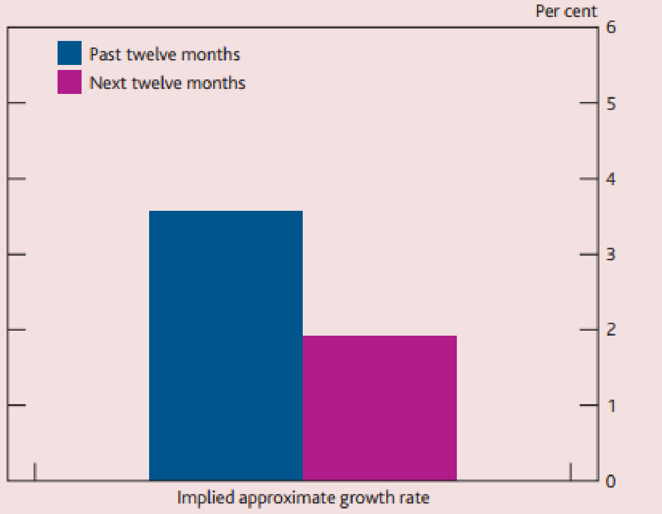

Chart A Estimated sales volumes growth,[a] past three months versus a year ago and expectations for next twelve months

(a) Implied growth rates are calculated from broad response buckets, rather than point estimates of growth, so are broad approximations only.

Source: BoE Agents' summary of business conditions, 2017 Q1, page 5, chart A.

UK retail sales (ex. auto fuel), in %

%		FEB	JAN	DEC	NOV	OCT	SEP
UK retail sales (ex. auto fuel), yoy	Change	4.1	2.1	4.9	6.4	7.6	4.0
UK retail sales (ex. auto fuel), mom	Change	1.3	-0.3	-2.2	0.1	2.3	-0.1

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