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UK: HOUSEHOLD APPETITES FOR MAJOR PURCHASES HIGH DESPITE EXPECTED RISE IN INFLATION

Berenberg Macro Flash

The risks to real household spending from rising inflation are grossly overstated. The latest GfK survey for March chimes with our key view, that rising inflation will not do too much damage to household spending appetites over the medium-term.

We expect inflation to average 2.8% in 2017 and 2.6% in 2018 (a little above consensus according to Bloomberg – 2.6% in 2017 and 2.4% in 2018) as the c13% 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. 2.8% 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 slow from 3.0% in 2016, to 2.1% in 2017 and 1.9% in 2018.

Household balance sheets have strengthened since the Lehman-crisis; debt-to-income is lower, household wealth has risen, and thanks to low oil prices, households have enjoyed three years of solid real wage gains. Feeling confident after seven years of economic growth, the UK consumer started to gear up again last year. By increasing borrowing and saving less to target a desired level of consumption, we expect households to smooth spending over the medium-term as rising inflation squeezes real incomes.

The following are the key charts from the latest monthly (March) and quarterly (Q1) surveys. Key observations are as follows:

- Consumer confidence (-6) remains elevated relative to the ten year average (-15)
- Households anticipate a sharp rise in inflation during the next 12 months
- The current financial situation of households (27) is strong relative to the ten year trend (19)
- Households expect their financial situations to remain resilient in the next 12 months
- Unemployment expectations are low and falling
- Household plans to buy a new car, buy a new home, or spend large sums on home improvement remain at high levels relative to the ten year trend



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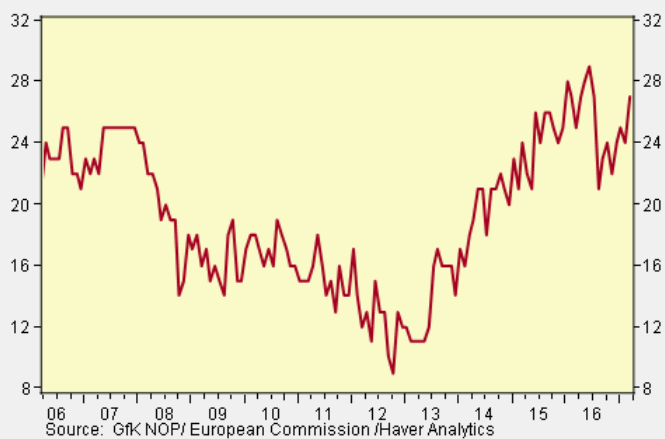
UK: GfK Consumer Confidence Barometer
NSA, % Bal



UK: GfK Consumer Survey: Consumer Prices: Next 12 Months
NSA, % Bal



UK: GfK Consumer Survey: Current Financial Situation of Households
NSA, % Bal





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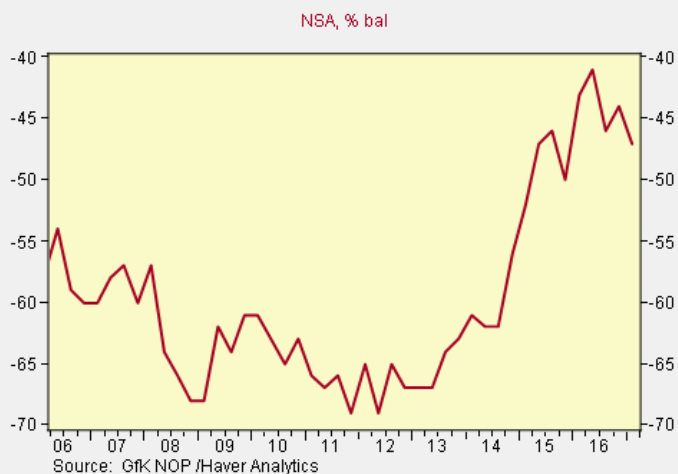
UK: GfK Consumer Survey: HH Financial Situation: Next 12 Mos



UK: GfK Consumer Survey: Unemployment Expectations: Next 12 Months



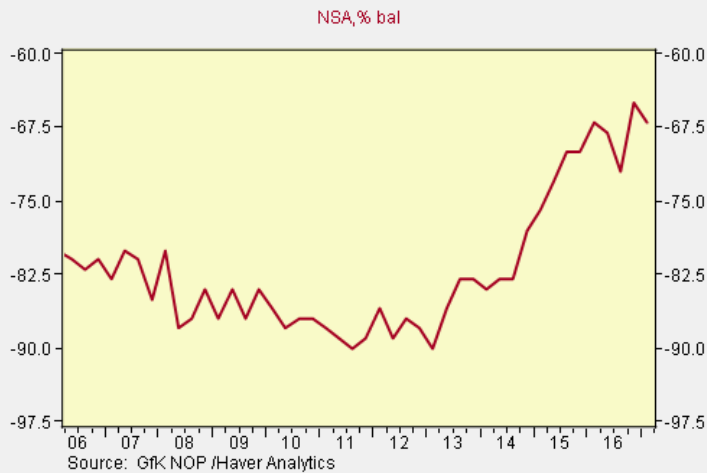
UK: GfK Consumer Survey: Plans to Buy a New Car, Next 12 Months



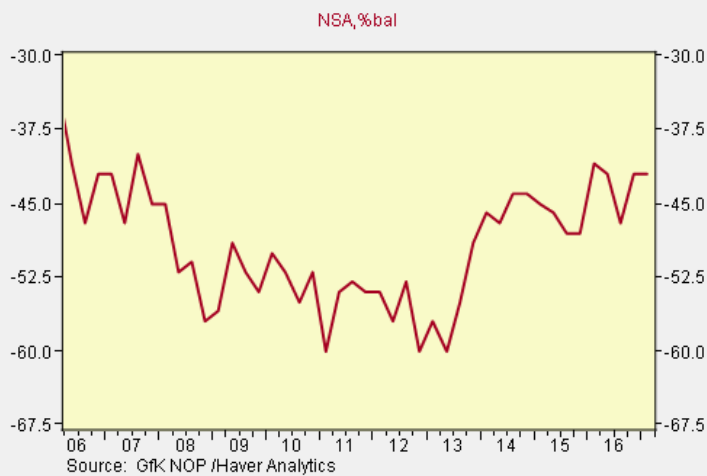


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UK: GfK Consumer Survey: Plans to Buy or Build a Home, Next 12 Months



UK: GfK Srv: Plans to Spend Large Sums on Home Improvemnt, Next...



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