

8G: EXPENDITURE PER HEAD  
FORECASTS: RETAIL PLANNER  
BRIEFING NOTE 81: EXPERIAN  
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### Economic context

#### Recent trends and near-term outlook

The UK economy is recovering from the severe recession of 2008/09, but growth is patchy and risks of a relapse persist. Domestic demand is constrained by high unemployment and rising under-employment, a lacklustre outlook for investment, pressure on public finances and the weight of household debt. The impact of deep cuts in spending and tax rises is weighing on sentiment. Growth in the three quarters since recovery began has been strongest in manufacturing, helped by the weak pound and global recovery, the service sector has also expanded. Construction rebounded in 2010q2 with its strongest quarterly gain in 50 years.

**Household spending**, after falling for six consecutive quarters with a cumulative decline of 5.2%, stabilised in 2009q3 and grew by 0.6% in the final quarter of the year. However, a combination of icy weather, higher unemployment and slow growth in real disposable incomes hit spending in the first three months of 2010, resulting in a marginal contraction of 0.1%. We believe this was a temporary relapse, with growth resuming in 2010q2.

Expenditure on **retail goods** has been more resilient than total consumer spending. Latest data (for 2010q1) show household spending 0.2% lower in real terms than a year earlier, while official retail sales data show spending volumes (excluding automotive fuel) up 2.3% in the same period. We believe this divergence between total consumer spending and retail expenditure reflects three major factors:

- consumers have cut back on big ticket items such as expensive holidays, and on expenditure on transport, recreation and culture, but continue to spend on other items;
- discounting has kept retail spending volumes up; and
- there has been a transfer of spending from services (hospitality, personal care and entertainment) to retail spending on similar items for use in the home.

Pressure on retailers' margins from discounting and weak sales for some high street names have resulted in a further rise over the past year in the number of vacant shops. However, the increase to a vacancy rate of 13.5% in July 2010 according to Experian data was much less sharp than the surge from a

vacancy rate of 7% to 12% in the year to mid-2009. During that period, the bulky goods sector suffered from the downturn in the housing market and lack of working capital as a result of the credit crunch also played a key role.

The revised official estimate of the economy's performance in 2010q2 showed an acceleration of quarterly growth to 1.2%. This encouraging outcome was boosted by a rebound in construction, manufacturing's response to the weak pound and healthy global growth, and robust expansion in financial & business services. However, it occurred before any major impact was felt from the tax increases and public spending cuts announced in the March and June budgets. These measures are bound to affect growth in the next few quarters and intensify fears about the recovery's sustainability.

Despite the acceleration in the second quarter therefore, we expect GDP growth to revert to a slower path in the next few quarters. Consumer spending will be constrained by subdued incomes and a weak labour market featuring high unemployment and under-employment. At the same time, export growth is likely to be modest in the face of lacklustre eurozone growth and a stronger pound, especially against the US\$. However, persistently low interest rates and a revival in fixed investment should provide some support. On balance, we expect GDP growth of 0.5% in 2010q3 and 0.4% in q4, producing year-on-year growth for 2010 of 1.5%.

Further out, as tax increases and spending cuts become a reality, pressure on household spending will intensify. But with fixed investment picking up and international demand remaining solid, underpinning exports, GDP growth should rebalance, depending more on these factors than on consumer spending. We forecast GDP growth at 1.6% in 2011 and 1.8% in 2012.

The implication of these forecasts for households is that **consumer spending will increase very modestly over the remainder of this year (0.2% q-on-q in q3 and 0.3% in q4) and rise by little over 1% in 2011. This will be followed by stronger though still moderate growth of 1.7% in 2012.**

### Medium-term outlook

**The medium-term outlook** is for much slower economic growth than was seen during the 12 years prior to the recession of 2008/09. We expect GDP growth to average near 2.2% a year in the five years 2013-17 and consumer

spending to average 2.3%. These rates compare with an annual average of near 3% in 1995-2007 for GDP and 3.2% for consumer spending.

The key reasons for this marked deceleration are:

- **Government finances are tightening.** Public finances deteriorated sharply during the 2008/09 crisis and require urgent and massive correction. Pressure is exacerbated as an increasing number move into retirement, raising government payments and reducing tax and National Insurance receipts. Fiscal stringency will be a feature of economic policy throughout the medium term and maybe beyond. The June 2010 budget addressed the deficit reduction issue, announcing (in addition to the £73bn consolidation by 2014/15 inherited from the previous administration) £40bn of spending cuts and higher taxes. In combination, the proposed consolidation amounts to £83bn of spending cuts by 2014/15 and £29bn of tax increases. This will subdue consumer spending throughout the medium term. In addition, public sector cuts involving considerable redundancies will boost unemployment numbers.
- **Sharp reduction in investment** (down 15% in 2009) and cancellation or postponement of plans will inevitably depress medium-term growth prospects in many parts of the UK economy.
- **Weight of household debt:** There will be no boost as in the past decade from consumer credit. The banking sector will be more cautious and households' appetite for credit will be reduced as they seek to control debts which are at historically high levels in relation to incomes. Moreover, savings are likely to be higher than in the past decade as job insecurity continues against a backdrop of high unemployment and weak growth.
- **The main engines of growth in the past decade – financial and business services and the housing market - will be less buoyant.** London's financial services sector will be more tightly regulated; it may come under increasing pressure from emerging centres in the Middle and Far East; a more subdued housing market than in the 12 years to 2007 when house price rises averaged 10% a year will curb lending and real estate activity; and the now mature business services sector will not be able to repeat its 7.9% annual rate of expansion of 1995-2007.

### Long-term outlook

While the economy is likely to improve on the 2.2% annual average growth rate forecast for 2013-17 in the second half of the coming decade, we believe that the exceptional performance of the period 1995-2007 will not be regained.

Pressures from an ageing population will reinforce the need for ongoing fiscal restraint, precluding the large-scale public sector job creation that boosted economic growth in the first few years of the present century. Environmental factors including much higher energy costs will also constrain growth. We forecast GDP growth between 2017 and 2027 to average 2.4% a year.

In conjunction with our medium-term projection for growth at 2.2% a year in 2013-17, this implies an annual average growth rate in the period to 2027 of 2.3%. This will be rather slower than the UK's previous long-term trend growth, but slightly faster than the rate forecast for the eurozone.

### Alternative long-term scenarios

We attach a 65% probability to the central scenario projection of annual growth in GDP averaging 2.4% to 2027. We present one upside and two downside scenarios, with our projections of annual expansion on retail spending under each alternative case.

#### **Optimistic scenario (20% probability)**

UK GDP growth to 2027 matches the previous long-term trend of 2.5% a year as the fiscal problems which depress consumer spending in the medium term are offset by buoyant exports and reviving fixed investment. This rebalancing towards exports and investment underpins annual average growth of 2.4% in the period 2013-17, and supports growth at 2.5% a year from 2018-27. Key features of this scenario are:

- Global trade maintains a vigorous growth path and the UK largely retains its market share
- Service sector growth approaches the 1995-2007 rate for most of the period to 2027.

### Pessimistic scenario (15% probability)

1. **Deflation scenario (5% probability).** In this worst case scenario, the UK economic recovery is derailed by a combination of depressed household spending and faltering global growth, notably in the key EU market. Weak consumer and business sentiment weigh on investment and household spending. Deflation resurfaces and takes a firm hold from which it is difficult to escape. GDP growth in the period to 2017 averages a meagre 1%, followed by 2% a year to 2027, giving a long-term average of 1.7%, with annual retail sales growth per head averaging just 1.6%.
2. **Inflation scenario (10% probability).** In this case, inflationary pressures mount as a result of international commodity price movements and a weak pound. The effects of the monetary measures taken to stimulate growth during the recession are difficult to reverse and the UK suffers a prolonged period of inflation. High interest rates are required for an extended period to drive inflation out of the system. GDP growth, already depressed by the factors noted in the central scenario, averages 1.5% a year to 2017, followed by growth at 2.4% a year to 2027, an annual average for 2013-27 of little over 2%.

### Retail sales per head under alternative scenarios

| % per annum        | 2013-17 | 2018-27 | 2013-27 |
|--------------------|---------|---------|---------|
| Central case       | 2.1     | 2.3     | 2.2     |
| Optimistic case    | 2.2     | 2.5     | 2.4     |
| Deflation scenario | 0.8     | 2.0     | 1.6     |
| Inflation scenario | 1.2     | 2.0     | 1.7     |

### Retail sales volumes

The following table (figure 1) shows projected growth rates per head to 2027 for the main categories of consumer spending on various categories of retail goods, using our central forecast.

The table also contains historic growth rates for comparison over three time periods: 1969-2009 (the ultra long-term trend); 1979-2009 (the long-term trend) and 1989-2009 (the medium-term trend).

Figure 1: UK retail and leisure spend per head 2007-27

| Vol growth per head (%)   | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013-17 | 2018-27 | 1969-2009 | 1979-2009 | 1989-2009 |
|---------------------------|------|------|------|------|------|------|---------|---------|-----------|-----------|-----------|
| Retail spend              | 1.9  | 1.9  | -1.4 | 0.3  | 0.8  | 1.8  | 2.1     | 2.3     | 2.8       | 3.3       | 3.5       |
| Convenience goods         | 0.4  | -1.6 | -2.9 | 0.3  | 0.0  | 0.4  | 0.8     | 0.9     | 0.5       | 0.7       | 0.7       |
| Comparison goods          | 2.7  | 3.7  | -0.6 | 0.4  | 1.2  | 2.4  | 2.7     | 2.9     | 4.7       | 5.3       | 5.5       |
| of which bulky            | 5.0  | 6.9  | 0.5  | -0.5 | 1.3  | 2.4  | 2.8     | 3.0     | 5.6       | 6.2       | 6.3       |
| non-bulky                 | 1.4  | 1.9  | -1.2 | 0.9  | 1.1  | 2.5  | 2.6     | 2.8     | 4.3       | 4.8       | 5.1       |
| Leisure                   | 1.2  | -0.3 | -4.5 | -1.5 | 0.7  | 1.3  | 1.5     | 1.9     | 2.1       | 1.5       | 1.4       |
| Consumer spending         | 1.4  | -0.1 | -3.1 | -0.3 | 0.2  | 0.8  | 1.5     | 2.0     | 2.4       | 2.5       | 2.5       |
| Retail spend ex non-store | 1.0  | 0.2  | -3.1 | -1.3 | -0.2 | 1.2  | 1.8     | 2.3     | 2.8       | 3.3       | 3.5       |

Figure 1 includes in the final row an estimate of retail spending excluding non-store retailing<sup>1</sup> to provide an idea of growth from purely physical outlets that is the major concern of clients of this service. Non-store retailing ie e-tailing and mail order (repair of household goods was removed from retailing in February 2010) has grown rapidly in recent years, outpacing store-based trading, and we expect a continuation of this pattern over the next few years. The differences between retail sales growth rates with and without non-store sales are quite considerable in the short to medium term.

However, the initial phase of e-tailing, boosted by the take-up of new technology, is likely to be followed by a more mature phase. From 2018, we forecast that non-store retailing will grow in line with traditional shopping. Consequently, and bearing in mind that non-store retailing accounts for under 10% of total sales, it is valid in producing the long-term forecasts of growth for the various components of retail spending shown in figures 1 to 4, to focus on retail sales as a whole.

Key features of the forecast are:

<sup>1</sup> Non-store retailing is considered in detail in Appendix 3, which contains a section on internet sales and our view on their treatment in retail capacity assessments.

- **During the period 2010/11**, growth in retail spending will be much slower than in many previous recovery phases given the constraints on economic performance, notably the squeeze on public finances.
- In the **medium term (to 2017)**, growth in retail sales volumes will be much slower than during the past decade and slower than in the long and ultra long term. This reflects the constraints on overall economic growth outlined in the **Economic Context** above, a relatively high tax burden and much more modest growth in consumer lending than in the past decade.
- While growth in household spending is forecast to pick up in the **longer term (2018-27)**, it will grow broadly in line with GDP expansion, in contrast to exceeding GDP growth by about 0.3 percentage points in the ultra-long term, (the period 1969-2009). This reflects the increasing maturity of the UK economy, less expansionary consumer credit, greater emphasis on green issues, including higher energy costs and an ageing population. Moreover, according to the latest official forecasts, population growth to 2026 is expected to be faster than in the period 1969-2009, averaging 0.7% per annum against 0.2% in the past four decades. This depresses the *per capita* growth rate used in the tables. All categories of retail spending, except convenience goods, lag the ultra long-term trend in our forecast to 2027, and the gap is substantially greater than that seen in the past two decades, which encompassed the credit-fuelled booms of the late 1980s and 1995-2007.

### Summary of long-term growth prospects and a recommendation

In figure 2, the long-term growth projections are summarized. See pages 4 and 5 for the reasons underlying the long-term forecasts.

- Our projections of future spending covering the periods, 2012, 2013-17 and 2018-27 have been merged to provide a long-term forecast covering expected growth from 2011 to 2027.



Figure 2: UK retail spending (including non-store) and leisure spending

| Volume growth per head (%) Annual averages | 2012-27 | 1969-2009 | 1979-2009 | 1989-2009 |
|--|---------|-----------|-----------|-----------|
| Retail spending                            | 2.2     | 2.8       | 3.3       | 3.5       |
| Convenience goods                          | 0.9     | 0.5       | 0.7       | 0.7       |
| Comparison goods                           | 2.8     | 4.7       | 5.3       | 5.5       |
| of which bulky                             | 2.9     | 5.6       | 6.2       | 6.3       |
| non- bulky                                 | 2.7     | 4.3       | 4.8       | 5.1       |
| Leisure                                    | 1.7     | 2.1       | 1.5       | 1.4       |
| Consumer spending                          | 1.8     | 2.4       | 2.5       | 2.5       |

This table specifically excludes recent trends and individual years. It focuses on long-term trends which are key to development projects. Even so, critical choices have to be made, between on the one hand historic medium, long and ultra-long term trends and on the other the forecasts produced by Experian.

We believe that because of the significant constraints on economic activity over the next few years, outlined in the **Economic Context**, and the slower growth forecast for consumer spending in the longer term, it is appropriate to use the forecast growth rates shown in column 1 of figure 2 rather than either the long-term, medium term or ultra long-term trends.