UK retail sales: first sign of a spending squeeze

Slowing? The drop in retail sales volumes in September and slump in consumer confidence in October could be the first signs that the long-awaited squeeze on consumer spending from the Iran war is materialising. Excluding fuel, retail sales volumes fell by 0.7% mom (Bloomberg consensus: -0.1% mom). The data is very bumpy month to month, so the slowdown in three-month-on-three-month growth in sales volumes and the annual growth rate of sales from 2.8% yoy in August to 0.8% yoy in September, the slowest since March, are more meaningful – see Chart 1. Whereas online clothes retailers blamed unusually warm September weather (the fourth warmest on record) for low sales, physical clothes and sports shops reported that consumers are cutting back more broadly. The next release will help to confirm which report is more accurate.

Succumbing to renewed pressure: To date, we have been surprised by the resilience of consumer spending as households have chosen to pay higher fuel prices and increase real-terms non-fuel spending at the expense of having less left over to save at the end of the month. Higher inflation and slow pay growth will likely intensify the squeeze on household budgets over the winter – see Chart 2. With mortgage rates up since the start of September and job opportunities limited, we suspect that consumers will become more cautious too. The drop in the GfK consumer confidence from -13 in September to -24 in October, a six-month low, supports our view. After a sizeable gain in real consumer spending in Q3, we expect it to flatline in Q4 and Q1.

Weaker spending highlights the downside risk from rate hikes: As consumer spending accounts for 60% of GDP, stalling real consumption growth is a key reason for the slowdown in growth which we anticipate. That would help to prove that the four interest rate hikes the market currently prices in are more than sufficient to prevent the rise in global energy prices from turning into a domestic inflation problem. A 25bp hike on 5 November seems to be a done deal. But if consumer spending growth weakens materially, the Bank of England can signal in the new year that it will not continue to raise interest rates.

Andrew Wishart