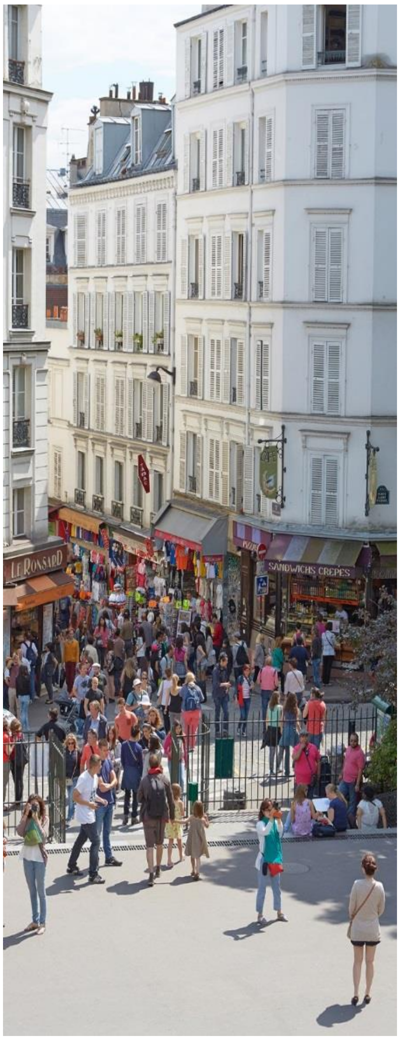
December 2015

Global Economy Watch

Consumers aren't just for Christmas – what do recent spending trends mean for your business?



Dear readers,

The Christmas period is upon us and so this month we have turned our attention to recent trends in consumer spending. For many advanced economies consumer spending accounts for around two thirds of economic activity. So how has consumer spending fared recently?

On the whole, year-on-year consumer spending growth in most Western economies is in the 2-4% range in real terms, which is a respectable figure (see Figure 1). Some of the peripheral Eurozone economies have staged a phenomenal turnaround and are at the upper end of the growth range. For example, consumers in Spain and Portugal are now spending faster than in Germany.

Our analysis shows that both the main drivers of consumer spending – disposable income and the savings ratio – have played a part in this recovery. Most of the economies we have looked at are in what we call the 'spending' quadrant where real disposable incomes have grown and savings ratios have decreased over the past three years. Greece and Italy are in the 'squeezed' quadrant as incomes have fallen and consumers have brought down their savings ratio to offset this. Germany is the one economy in the 'saving' quadrant where the savings ratio has increased, despite rising incomes, dampening consumer spending.

Going forward, we expect that the outlook for consumer spending in the Eurozone will – on the whole – be broadly positive as a cyclical upswing (further supported by the recent ECB policy action) continues to create jobs which puts upwards pressure on average earnings growth.

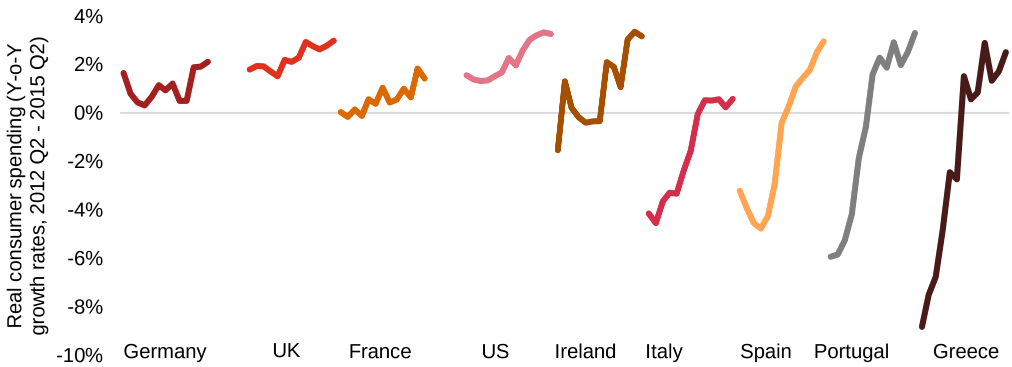
But increased consumer activity is not the only thing on the agenda this December. Policymakers from across the world are meeting in Paris to try and reach a global deal to combat climate change. We think that the major emerging economies will have a key role to play if global targets are to be met. We also think financial services businesses should keep a close eye on Paris due to the impact a deal could have on that sector.

Kind regards

Richard Boxshall

PwC | Senior Economist

Fig 1: Peripheral Eurozone consumers have staged an impressive turnaround in spending



Sources: PwC analysis, Datastream, National Statistical Agencies

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Economic update: The ECB continues to buy time for governments to press ahead with reforms

Eurozone inflation remains below target

Nine months have now passed since the European Central Bank (ECB) began its quantitative easing (QE) programme. Inflation, however, still remains below target (see Figure 2). To boost economic activity and get inflation back to target, Eurozone policymakers took further action in December by:

- Decreasing the deposit rate from -0.2% to -0.3%
- Extending the existing QE programme by six months to at least March 2017

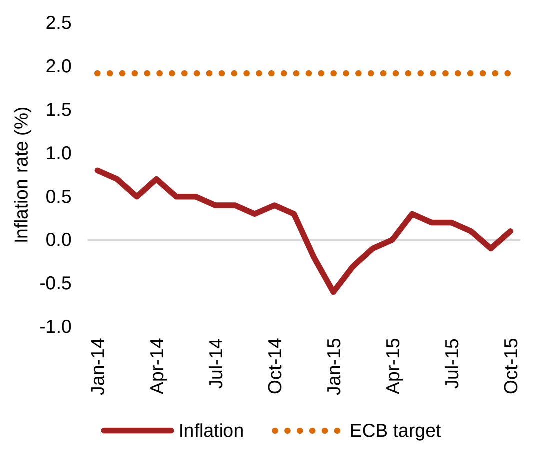
Eurozone credit is still growing at slow rates

In a recent speech, an ECB Executive Board member argued the success of its monetary policy measures hinges on household and corporations taking up cheap loans, which would then spur economic activity and inflation.

The data shows that some, but not enough, progress has been made on this front. In the Eurozone, credit growth to households and non-financial corporations (NFCs) is growing at 1.2% year-on-year, compared to 7.9% in the US and 6.8% in the UK, although the last two are at a more advanced stage of their adjustment cycle.

However, this aggregate figure for Eurozone credit growth hides the disparity of lending between various sectors of the economy. In Spain, for example, credit growth to businesses continues to contract. However, consumer credit grew by 3.8% year-on-year, which has helped fund consumer spending as we explore on page 3.

Fig 2: The Eurozone's inflation rate is significantly below target



Source: Eurostat

Paris climate summit: Deal talks driving policy and financial sector developments

The 21st annual UN led climate change conference is underway in Paris. The objective is to reach an international agreement to prevent the average global temperature rising by more than 2°C above pre-industrial levels. Ahead of the conference, over 180 countries have submitted pledges outlining national plans to reduce their greenhouse gas emissions.

These commitments require a doubling of the current rate of decarbonisation since 2000 – but it's still less than half of what is required to limit global warming to 2°C.

To address the gap, the Paris agreement seeks to include a process to review progress and increase emissions reduction in the future. There's economic potential – and implications - for both emerging and developed economies.

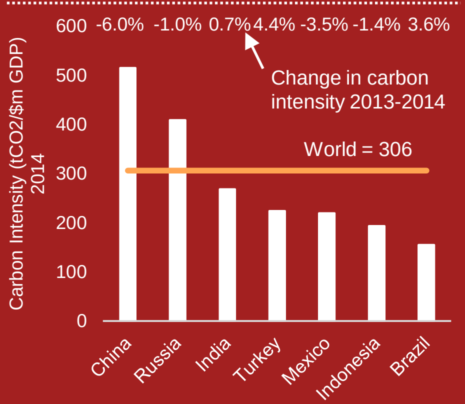
E7 critical to meeting global targets

In our Low Carbon Economy Index we track the progress of the G20 — which account for around 85% of global emissions — in decarbonising their economies. On the whole, the E7 reduced their carbon intensity at a faster rate than the G7 (in GDP-weighted average terms), but as the E7 grows economically, their need to limit emissions growth would also increase. Currently, the E7 account for 35% of global GDP in PPP terms, but our World in 2050 report projects that this could rise to around 46% by 2050.

As Figure 3 shows, China, the world's biggest emitter of greenhouse gases, achieved an impressive 6% rate of decarbonisation last year, and has pledged to reduce its carbon dioxide emissions per unit of GDP by 60-65% in 2030 compared to 2005 levels. India, the world's third biggest emitter, has pledged to reduce its emissions per unit of GDP by 33-35% in 2030. Meanwhile, Brazil has committed to an absolute reduction in its CO_2 emissions by 43% by 2030.

Post Paris, all eyes will be on national governments to create the right policy framework needed to deliver these commitments.

Fig 3: None of the E7 economies met the decarbonisation rate of 6.2% last year



Source: PwC Low Carbon Economy Index

Our analysis shows that it could channel at least $5-$10 trillion investment into low carbon sectors and create at least 20m-45m jobs around the world as a result over the next 15 years.

Financial services: fuelling green technology expansion…

Whatever the detail of a deal in Paris, it will mean more green investment will be needed. Pledges already made by each country require significant levels of private and public investment - $700bn PA in the EU and China alone – and particularly in emerging economies. For banks (and other credit allocating institutions) there will be considerable opportunities to fund these projects, and provide credit.

We have already seen this happen in India and China where companies have tapped into debt markets to fund their transitions to clean energy supplies. Additionally, a global bank pledged to invest $1bn via debt markets to boost its investments to tackle climate change

…will mean treading new ground

There is however, a limit to the amount that can be financed with bank debt, given increasingly stringent capital requirements that financial institutions face. Capital markets will need to scale up, and for that to happen, financial structures will need to be created that meet the risk-return requirement and innovative new financial models will need to be created.

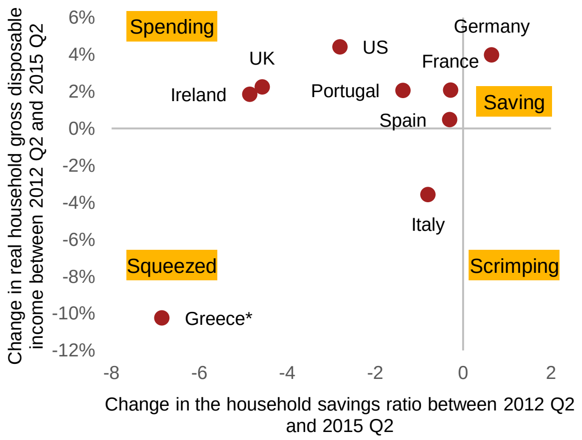
In China, whose pledges include plans to accelerate the transition from an economy based on fossil fuels to one built on clean energy, authorities have signalled that they want to explore new investment and financing mechanisms for low carbon developments (including public-private partnerships).

Looking towards the medium- to long-term, financial sector firms are beginning to incorporate the impact of climate change in their operating models. The G20 has called upon the International Financial Stability Board to open an inquiry into the systemic risks of stranded assets and financial regulators, including the Bank of England have pointed to the need to consider the risks. Climate change by its very nature is unpredictable, so the best way to prepare for unforeseen events is to put in place contingency plans. Insurers in particular are already incorporating long-term climate change assumptions in their plans to allow for the likelihood that extreme weather phenomena become more severe and/or more frequent.

Overall, for organisations in many sectors, a legally binding global deal on climate change is not the driver for action. But the regulation and incentives that could follow Paris will be. Companies are motivated by growth and new markets, and concerned about regulation and cost efficiency. Climate change will remain a risk and opportunity in all of these respects.

Will consumers behave like Santa or Scrooge during Christmas?

Fig 4: Households are relatively better off now than they were three years ago except in Italy and Greece



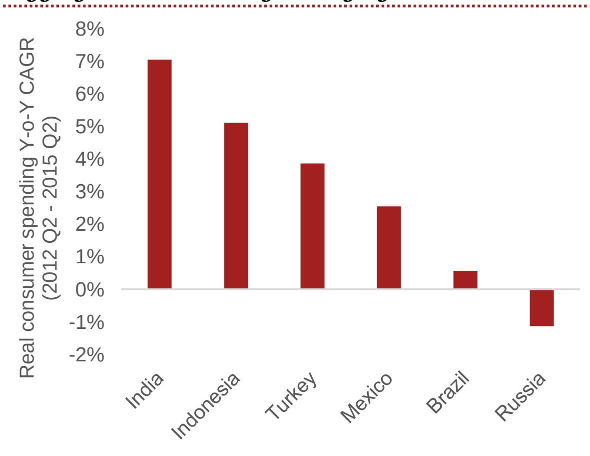
*Greece data is for 2012 Q1 to 2015 Q1
Sources: PwC analysis, Eurostat, US BEA, OECD

Table 1: Retail turnover growth is higher in all sectors than it was in the second quarter of 2012

	UK	Germany	Ireland	Spain
Food, drink and tobacco	🟡	🟡	🟡	🟡
Textiles and clothing	🟢	🟢	🟢	🟢
Health and cosmetics	🟡	🟢	🟡	🟡
Communication, household equipment and leisure	🟢	🟡	🟢	🟢
Computers and telecoms	🟡	🟡	🟢	🟡
Household appliances	🟢	🟡	🟢	🟢

Note: Based on percentage point difference in Y-o-Y growth rate between 2012 Q2 and 2015 Q2 - shrinking, below total growth, above total growth
Sources: PwC analysis, Eurostat

Fig 5: Consumer spending in Brazil and Russia is lagging behind other large emerging economies



Sources: PwC analysis, Datastream, National Statistical Agencies
We have not included China in our analysis as the authorities do not release a quarterly real consumer spending statistic.

Consumers central to turning around an economy

Consumer spending is fundamental to economic activity and to businesses. For many advanced economies consumer spending accounts for around two thirds of economic activity. As such, it is also a key driver of corporate revenues which, in turn, correlate positively with the hiring intentions of most businesses. So how have consumer spending patterns fared recently?

Some peripherals spending faster than Germany

Figure 1 shows real consumer spending trends in a range of advanced economies for the period starting in 2012. Consumer spending growth is in the 2-4% range in real year-on-year terms for most of these economies, which is a respectable figure. In some cases, such as the US and France, consumer spending is growing faster than GDP.

Figure 1 also shows that some of the peripheral Eurozone economies have staged a phenomenal turnaround in consumer spending growth since 2012 and, based on recent data, are at the upper end of the range mentioned above. For example, Portuguese and Irish consumer spending grew by more than 3% on a year-on-year basis compared to around 2% in the case of Germany. However, Italian consumer spending growth continues to lag behind that in other peripheral economies. So what has been driving these trends?

Households are savings less...

Figure 4 shows how the two key drivers of consumer spending — real disposable income growth and the savings ratio — have moved. Most of the economies in our sample are in a 'sweet spot' where real disposable incomes have grown and savings ratios have decreased, both of which boost consumer spending growth.

In the US and UK, savings ratios have declined as households have reduced their debt burden from pre-crisis levels. In addition, house prices have recovered, which has made consumers more confident. In the US, for example, the S&P Schiller House price index is at a 93-month high.

Germany seems to be the exception amongst the large advanced economies as its savings ratio has increased despite rising incomes. As a result, German real consumer spending growth has remained relatively modest at around 2%.

...but are also enjoying higher gross incomes

Gross disposable incomes have also grown as employment growth has picked up, most notably in the US, UK and Germany where around 9 million jobs have been created in total since the second quarter of 2012. Employment in Ireland and Spain is also markedly higher than in 2012 Q2, which has supported moderate income growth. Lower prices for imported food and energy have also pushed real incomes higher across the Eurozone.

Figure 4 shows that Greece and Italy are in the 'squeezed zone' of lower incomes and smaller savings ratios. In the case of Greece, Figure 1 shows that consumer spending is growing strongly, but this is driven by a large reduction in the savings ratio. This suggests that the consumer spending recovery there could be short-lived unless disposable incomes also pick up.

Where have they spent the money?

Our analysis of retail trade data across four European economies shows that the consumer spending recovery has been felt across a broad range of product categories. Table 1 shows that retail turnover volumes for income sensitive categories, for example communication, household equipment and leisure (which includes spending on recreation and culture) grew in all four European economies. However, retail turnover volumes for necessities, such as food, grew at a slower pace compared to the total (as indicated by yellow rather than green circles in Table 1). In the UK and Ireland retail turnover on household appliances grew strongly, which is associated with the recoveries seen in their housing markets in recent years.

Prospects for consumer spending

Going forward, we see a positive outlook for consumer spending in most of the advanced economies we track. If consumers continue to behave more like Santa and less like Scrooge, the retail sector as a whole should record good sales figures during the key Christmas shopping period (although competition between retailers will remain fierce).

However, the same cannot be said for some of the emerging economies. Figure 5 shows that consumer spending growth rates in the E7 (excluding China for data reasons) have grown significantly faster than in advanced economies when looking at the same three year period since 2012 Q2. However, recent geopolitical events in Russia and Turkey and economic troubles in Brazil imply that downside risks are now higher. Businesses should continue to put in place contingency plans via scenario planning to alleviate the impact of these changes on the bottom line.

Projections: December 2015

	Share of 2014 world GDP		Real GDP growth				Inflation			
	PPP	MER	2014	2015p	2016p	2017-2021p	2014	2015p	2016p	2017-2021p
Global (Market Exchange Rates)		100%	2.9	2.7	3.0	3.0	2.4	1.9	2.5	2.5
Global (PPP rates)	100%		3.5	3.2	3.5	3.5				
United States	16.1%	22.5%	2.4	2.6	2.8	2.5	1.6	0.1	1.6	1.9
China	16.3%	13.4%	7.3	6.9	6.5	5.7	2.1	1.6	1.8	3.0
Japan	4.4%	6.0%	-0.1	0.7	1.3	1.3	2.7	0.8	0.9	1.9
United Kingdom	2.4%	3.8%	2.9	2.4	2.4	2.3	1.5	0.1	1.4	2.0
Eurozone	12.2%	17.4%	0.7	1.5	1.6	1.7	0.5	0.1	1.1	1.4
France	2.4%	3.7%	0.2	1.2	1.3	1.9	0.6	0.1	1.2	1.2
Germany	3.4%	5.0%	1.6	1.5	1.7	1.6	0.8	0.2	1.3	1.7
Greece	0.3%	0.3%	0.7	-2.2	-1.4	2.5	-1.4	-0.4	0.1	1.4
Ireland	0.2%	0.3%	5.2	5.7	4.5	2.5	0.3	0.2	1.3	1.5
Italy	2.0%	2.8%	-0.4	0.7	1.3	1.3	0.2	0.2	0.7	1.4
Netherlands	0.7%	1.1%	1.0	2.0	1.8	1.9	1.0	0.3	1.2	1.3
Portugal	0.3%	0.3%	0.9	1.7	1.8	1.8	-0.2	0.7	1.2	1.5
Spain	1.5%	1.8%	0.3	3.1	2.6	2.0	-0.2	-0.6	0.8	1.2
Poland	0.9%	0.7%	3.3	3.2	3.0	3.2	0.2	-0.8	1.1	2.5
Russia	3.3%	2.4%	0.6	-3.8	-0.5	1.9	7.8	15.5	8.7	4.3
Turkey	1.4%	1.0%	2.9	2.7	2.8	3.3	8.9	7.6	7.0	6.5
Australia	1.0%	1.9%	2.7	2.0	2.9	2.9	2.6	1.7	2.5	2.5
India	6.8%	2.7%	7.0	7.3	7.7	6.1	6.7	5.0	5.2	6.0
Indonesia	2.5%	1.1%	5.0	4.4	4.7	5.4	6.4	6.8	6.1	5.1
South Korea	1.6%	1.8%	3.3	2.6	3.1	3.5	1.3	0.8	1.5	2.9
Argentina	0.9%	0.7%	0.5	2.1	1.7	2.1	-	20.0	25.0	-
Brazil	3.0%	3.0%	0.1	-2.4	-1.2	3.1	6.3	8.5	6.5	4.8
Canada	1.5%	2.3%	2.5	1.3	2.0	2.2	1.9	1.1	1.7	2.1
Mexico	2.0%	1.7%	2.3	2.5	3.0	3.9	4.0	2.7	3.2	3.1
South Africa	0.7%	0.5%	1.5	1.5	1.8	2.5	6.1	4.6	5.6	5.5
Nigeria	1.0%	0.7%	6.2	3.2	4.8	5.0	8.0	9.3	9.8	7.5
Saudi Arabia	1.5%	1.0%	3.5	2.8	2.3	3.2	2.7	2.2	2.5	3.0

Sources: *PwC analysis, National statistical authorities, Datastream and IMF. All inflation indicators relate to the Consumer Price Index (CPI). Argentina's inflation projections use the IPCNu Index. We will provide a 2017-2021 inflation projection once a longer time series of data is available. There is not a complete series of year-on-year price growth data available for 2014 so we have not provided an estimate for annual inflation in this year. Also note that the tables above form our main scenario projections and are therefore subject to considerable uncertainties. We recommend that our clients look at a range of alternative scenarios.*

Interest rate outlook of major economies

	Current rate (Last change)	Expectation	Next meeting
Federal Reserve	0-0.25% (December 2008)	Rate to rise in 2015	15-16 December
European Central Bank	0.05% (September 2014)	Rate on hold until at least 2017	21 January
Bank of England	0.5% (March 2009)	Rate rise expected in first half of 2016	14 January

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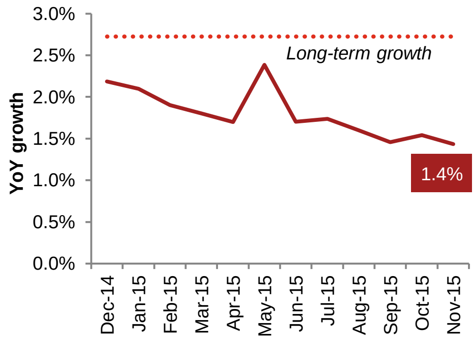
PwC's Global Consumer Index

Growth in consumer spending remained stable in November, but below its long-term growth rate. Equity market performance improved, particularly in the auto sector. However business and consumer confidence continued on a downward trajectory. Industrial production strengthened. Uncertainty over growth in emerging markets in the short-term is likely to negatively impact consumer spending.



The GCI is a monthly updated index providing an early steer on consumer spending and growth prospects in the world's 20 largest economies. For more information, please visit ***www.pwc.co.uk/globalconsumerindex***

We help you understand how big economic, demographic, social, and environmental changes affect your organisation by setting out scenarios that identify growth opportunities and risks on a global, regional, national and local level. We help make strategic and tactical operational, pricing and investment decisions to support business value creation. We work together with you to achieve sustainable growth.