

# What's happening in Australia and the rest of the world?

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## RBA cuts rates 25bp to 1.0%

The Reserve Bank of Australia (RBA) has cut rates in line with the consensus forecast - but the market seems to be backing away from earlier aggressive rate cut projections



# 1.0%

RBA Cash rate target

Cut from 1.25%

As expected

### Prospects of aggressive easing receding

Where their first rate cut seemed to provide the affirmation bias that a string of further easing was on its way, the latest rate cut does not seem to have had such an effect. At the end of last week (29 June), the probability that rates would have fallen to 0.75% by next month's meeting on 6 August, was 26.7%. Today, it is only 21.0%, and the probability does not rise to 30% until the following month. Mid-June (14th), the likelihood of rates falling as low as 0.25% was a non-negligible 6.5%, and the overall chance of rates being cut to 0.5% or lower was about 27%. Today, these implied probabilities have declined to 4% and 23.9% respectively.

## Reality check

The net result of this is that rather than depreciate on the rate cut news, the AUD has found some resilience. The AUD sell-off had already happened to a large extent. And more recently, it had been under pressure from a US Fed, that seems destined to match all the easing the RBA has now done. The main difference between these two markets is that the US money market futures still seem to be fired up with rate cut fever, whilst the Australian market is having a spell of clearer thinking.

## Statement says little

The RBA statement said that the easing "[will support employment growth and provide greater confidence that inflation will be consistent with the medium-term target](#)". And that "The central scenario for the Australian economy remains reasonable, with growth around trend expected".

There are few substantive changes to the statement that was submitted at the time of the June cut. Governor Lowe speaks later at a press briefing and may provide more for markets to digest.

Contrary to our assumption before this meeting, the RBA seems to be taking the view that with ammunition limited and ineffective, it is better to use it aggressively to have any effect at all, not to ration it out. Consequently, it seems reasonable to view another rate cut in the coming months as probable, and we are amending our forecast for a further 25bp cut to 0.75% by the year-end, with the next cut sometime in 4Q19, though more than this, and earlier, is clearly the main risk to this new forecast.

## Lessons for the Fed?

It's not clear that the Australian market can provide any lessons for US markets and the Fed, though the situations are broadly similar. One observation is in terms of market pricing, where successively more easing has been priced out of the Australian market as the RBA has actually delivered. This has prevented the AUD from taking more of a beating. A similar story could prevent a bigger USD sell-off and keep the EURUSD within the 1.10-1.15 ranges that our [FX strategists have referred to in their recent publications](#).

## Watch: Rob Carnell on the 'unremittingly bad' economic news from Asia

It would be easy to blame the US-China trade war spat for the extremely poor economic data coming out of Asia. But ING's Rob Carnell suggests there's far more to it than that



### What's to blame for the 'unremittingly bad' economic data from Asia

ING's Rob Carnell on why the economic data from Asia appears to be 'unremittingly bad'.

[Watch video](#)

## Five reasons to stay long CAD

The Canadian dollar's rally may feel the kickback from re-escalating trade tensions, but the long-term outlook is still positive. We see high potential for the Loonie to keep outperforming its G10 peers in the coming quarters



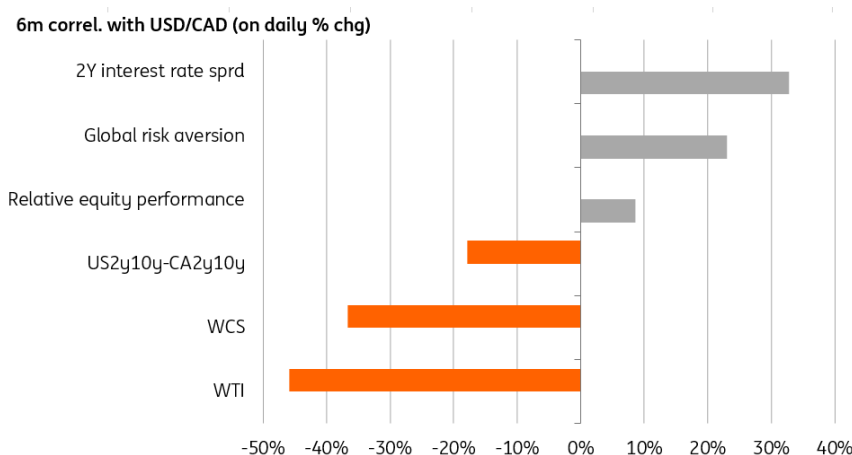
Source: Shutterstock

### A great first half for the loonie

At the time of writing, CAD is the best-performing currency in the G10 space since the start of the year (+4.09% vs USD to be precise).

We've [recently revised our USD/CAD](#) forecast profile lower and now expect 1.30 by the end of the year. Looking at the past six months, USD/CAD has been highly correlated with three market factors: crude oil prices, interest rate spreads and market risk sentiment. The shape of the yield curve and relative equities performance tend to show a less relevant correlation.

[Read our latest issue of FX Talking: The beginning of the end of the dollar's rally](#)



Source: Bloomberg, ING

In the current market environment, the largest risk to an open economy like Canada and its currency are the ongoing trade tensions. The recently-agreed trade truce and the restart of negotiations for a deal between the US and China will probably keep market risk sentiment supported for some time. Although looking ahead, our trade team is reluctant to [exclude a re-escalation of trade tensions](#), and we don't exclude the US imposing fresh tariffs on Chinese exports as early as in 3Q.

Some market attention will also be on the Canadian federal elections scheduled for October. The latest vote projections suggest the incumbent Liberal party is bound to face a defeat by Andrew Sheer's Conservative party, but for the time being, we don't see a high market-moving potential to the elections.

We think there are at least five reasons which suggest positives will more than offset most trade-related downside risks and keep the Canadian dollar on an appreciating path.

## 1 Oil prices are likely to stay supported

Our commodities team expects the ongoing OPEC meeting – and the OPEC+ meeting tomorrow – to deliberate [further supply tightening in the crude market](#).

Latest media reports indicate that members should all be in agreement to extend the current deal for 1.2MMbbls/d of output cuts. This would come as a positive at a time when oil prices have already found some support from US-Iran tensions and we expect WTI keep to edge above 60 \$/bbl.

Nonetheless, the outlook for the regional benchmark Western Canada Select is slightly gloomier after reports that the Canadian state of Alberta is planning to increase its production limits. While this may translate into a partial re-widening of the Western Texas Intermediate and Western Canadian Select (WTI-WCS) spread, the very low correlation of the spread with USD/CAD performance tends to suggest the impact on the currency pair may be quite limited.

## 2

## Inflation is strong, economy is set for a rebound

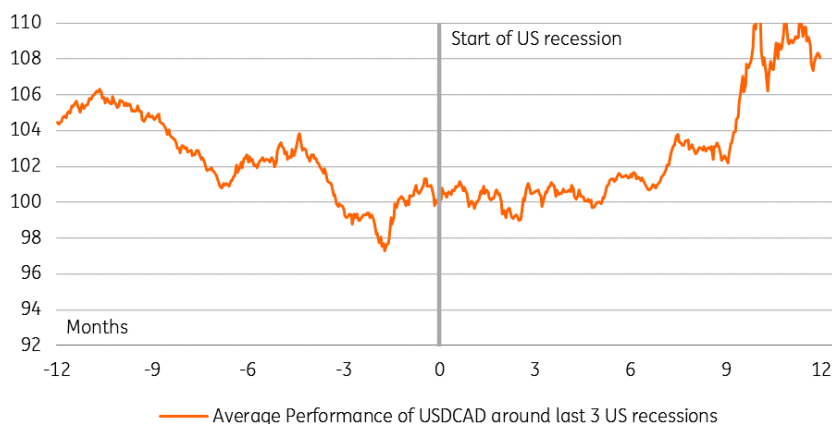
We believe a number of indicators likely back the constructive economic view expressed by the Bank of Canada in its latest statement.

- Inflation in Canada is strong. The core measure has touched 2.3% in May - a 10-year high. The headline print also surprised to the upside at 2.4%. Both measures currently fall in the upper half of the BoC inflation-target band. Looking ahead, our economists expect inflation to stay broadly in line with the 2% median target at least until the end of 2020.
- The labour market looks healthy: unemployment rate (5.8% in March) is close to historical lows, the participation rate has rebounded from late 2018 lows and wage growth (2.55% in May) has been quite robust.
- Q1 subdued GDP numbers have been negatively affected by a widening trade deficit. A recovery in the deficit has already started to benefit GDP monthly reads (April YoY read at 1.5%), suggesting that the Canadian economy likely bottomed out in Q1. We currently forecast 1.5% growth in 3Q19 and 1.7% both in 4Q19 and 1Q20.
- A further boost to exports will likely come from the ratification of the USMCA trade deal, which seems to be close to being passed by the US Congress as Democrats' oppositions have fanned.

### 3 The Fed will blink first, the BoC may not blink at all

The strong fundamentals listed above have been indeed acknowledged by Canada's central bank in its latest statement, as they reiterated an "accommodative" policy stance.

Accordingly, our economics team expects the BoC to keep rates on hold throughout 2019 and 2020. This is in contrast with markets expectations for some monetary easing ahead, with the OIS curve currently showing -25bp priced in by 2Q20. On the other side of the border, the Federal Reserve is facing increasing pressure to cut interest rates and our economists expect two rate cuts by the end of the year. Such policy divergence is likely to keep the US-Canada interest rate differential under pressure.



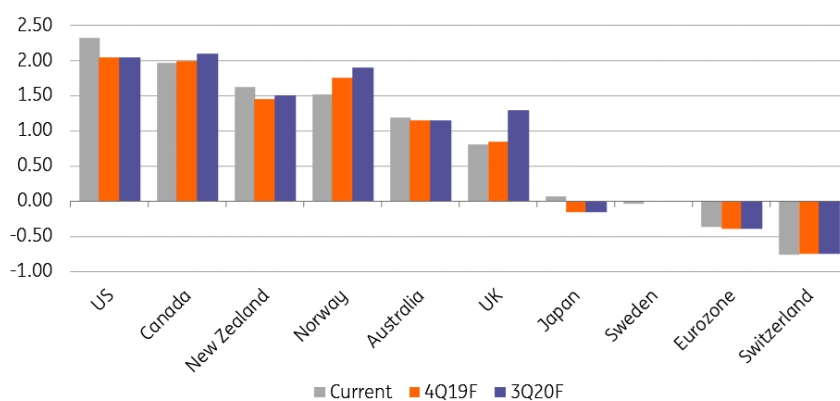
Source: Bloomberg, ING

#### 4 CAD has been historically strong before a US recession

From a different perspective, historical evidence from the three most recent US recessions suggests that the CAD has been amongst the best performers in the G10 space as USD weakened whilst approaching a US recession.

Looking ahead, investors may see in the loonie an interesting substitute to the US dollar to enter carry trades as the dollar rate advantage staggers. Indeed, CAD is currently the second-highest yielding currency (short-term rates) in the G10 space. According to our economists' forecasts, Canada will have the highest 3-month yields in 3Q20. This would keep CAD supported as investors may rush to enter carry trade positions in the coming quarters before unwinding them as increased risk of a global economic downturn threatens their profitability.

3M rates (%) - ING Forecasts



Source: Bloomberg, ING

#### 5 CAD can still benefit from short positioning

Despite the recent bullish mood on the CAD, Commodity Futures Trading Commission (CFTC) data shows that combined net speculative position on the loonie is still in short territory (-9% of open interest). This tends to suggest that there is still some room for position-squaring-related downside risk in USD/CAD, especially when considering that positioning on USD is, on the opposite, still

extensively long.

We see high potential for CAD to keep outperforming its G10 peers in the coming quarters. Nonetheless, the fall in USD/CAD may be contained around the 1.31-1.32 level until trade-tension-related downside risks dissipate. In the longer run we stick to our forecasts for 1.30 in 4Q19, 1.28 in 1Q20 and 1.26 in 2Q20.

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# Swiss-EU negotiations: A dangerous leap into the unknown

Since Friday morning, there is no more stock exchange equivalence between Switzerland and the EU. The risk is that relations between the two sour further, ultimately jeopardising the health of the Swiss economy



Source: Shutterstock

## End of stock exchange equivalence

The European Union hasn't renewed the exchange equivalence temporarily granted to Switzerland until the end of June 2019. This means that, from today, banks and financial intermediaries based in the EU can no longer deal shares listed on the Swiss stock exchanges directly in Switzerland. The problem is that these EU-based intermediaries generate more than half of the trade in Swiss equity markets and this will lead to a sharp reduction in volumes traded on the Swiss stock market. To avoid that, the Swiss Federal Department of Finance (FDF) designed new measures to protect the Swiss stock market. It has been decided that EU-based trading venues will no longer have the right to trade in securities of companies headquartered in Switzerland from today. These new measures come into effect today as well.

With these new measures, the goal of Switzerland is to exploit a legal loophole. Indeed, the European regulation requires obtaining an equivalence only when a "significant" part of the stock

market volume of a share is traded on European stock exchanges. Switzerland, therefore, wanted the volume of trade of Swiss equities on European stock exchanges not to be "significant" anymore and to become totally non-existent. If this is the case, the stock exchange equivalence is no longer necessary, according to European regulation. Then, European financial intermediaries can buy and sell shares of Swiss companies on the Swiss Stock Exchange, or on other global stock exchanges but not on European stock exchanges. In practice, it means that shares of Nestlé or Novartis, for example, may be traded via SIX (the Swiss stock exchange) or via the New York or Singapore stock exchanges, but not in Paris, London or Frankfurt.

These protective measures should make it possible to avoid a catastrophe on the Swiss stock market today. There is nevertheless a small detail that could compromise this response strategy. For the plan to work, the European authorities must recognise that trading of Swiss equities on European stock exchanges is no longer "significant". While Switzerland may be quick to point out that trade is becoming almost non-existent, nothing says that the EU will quickly recognise it. And if the procedure is dragged out by the EU, the shortfall for the Swiss stock market could be significant.

At this stage, given the uncertainty surrounding the safeguard measures, it's impossible to estimate the consequences of the non-extension of stock exchange equivalence on trading volumes and on the Swiss stock market. We will have to see how things evolve this week to get an idea of the impact.

## How did we get here?

For years, Switzerland and the EU have been negotiating an institutional agreement to replace the patchwork of treaties currently governing relations between the two entities. Because of all the problems with the UK and the Brexit agreement, the EU wanted to speed up the discussions. To exert more pressure on Switzerland, the EU decided in 2017 to link the progress of the agreement to the regulatory recognition of Swiss stock exchanges. The EU wanted to force Switzerland to move. It worked at first. A political agreement was finally reached in November 2018. But this agreement has never been ratified by the Swiss authorities. The reason is that the agreement is relatively unpopular in Switzerland, mainly because of fears that it erodes high local wages. Given that federal elections will be held in October in Switzerland, no political party wants to be perceived as yielding to EU pressure or endangering high salaries, especially as the eurosceptic party is doing well in the polls. By threatening Switzerland, the EU has become more unpopular among the Swiss, which has further contributed to the stalemate.

On the other hand, the EU believes that negotiations have dragged on long enough and it no longer sees other avenues for possible change. As in the case of Brexit, the EU believes this is the best deal possible and that it will not be renegotiated. Consequently, the situation seems completely at an impasse. The risk is that this episode triggers hostilities between the two, leading to an escalation of tensions, which ultimately has an economic impact.

## Important consequences

Tensions between Switzerland and the EU aren't good for trade, business investment, or for the funding of scientific research in Switzerland that depends on European funds.

The economic links are very strong between the two, mainly because Switzerland has access to the European common market and because Switzerland is surrounded on all sides by countries belonging to the EU. Thus, the EU is Switzerland's most important trading partner, with 53% of Swiss exports going to the EU and 71% of Swiss imports coming from the EU. As Switzerland is a small open economy relying heavily on international trade, greater difficulty in trading with neighbouring countries will be a huge problem for Switzerland. There will probably be problems in other areas as well. For example, Switzerland has access to the European electricity market, but the future of this access depends on the ratification of the framework agreement. An escalation of tensions could lead to the exclusion of Switzerland from the European electricity market, threatening the security of supply.

All in all, beyond the purely political aspect of the negotiations, a deterioration of relations between Switzerland and the EU risk jeopardising the health of the Swiss economy.

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Snap | 30 June 2019

## G20: Many bridges to cross before a US-China deal can be cut

The new cease-fire and a resumption of negotiations between the US and China keep hopes alive that a long-running trade war can be avoided. But more is needed before we can change our expectations that another round of tariffs is coming



President Donald Trump shakes hands with Chinese President Xi Jinping during a meeting on the sidelines of the G-20 summit in Osaka, Japan

Neither the US nor China reported that any of the disagreements which proved to have been deal breakers in May are closer to being resolved. So, much work needs to be done to prevent another break up of negotiations. China's promise, according to the US, to import more agricultural products from the States while the US postpones new tariff hikes, is not very different than what was already agreed upon in December last year and proved, in the end, to be insufficient for a deal.

For this round of negotiations to be a success, we need to see the difficult issues such as technology, Chinese state aid and the protection of intellectual property, to be resolved. We also need to see rules for the future enforcement of any deal. Since leaders and the American written statement did not say that concrete steps in that direction have been taken, or that the US has dropped its demands regarding these issues, much caution is warranted before anyone can cry

victory.

President Trump officially said that the Huawei case can be dealt with at the very end of trade talks. He also mentioned that US companies can sell products to Huawei if those products are not critical to national security; the definition of 'critical to national security' is very much up to US interpretation. So we believe that what President Trump has said is not impactful enough for Huawei and the other seven Chinese technology companies, which were recently included in a US entity list, to get critical components from American trading partners.

From Huawei's perspective little has been gained by the China-US sideline meeting at the G20. So, we haven't yet reached a point where we can abandon our expectations that these negotiations will break up and a subsequent round of tariffs will follow.

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## The eurozone's Japanification - more to come

With the eurozone economy stuck in a low growth, low inflation and low rates environment, it's really hard not to make 'Japanification' comparisons. If we're honest, the eurozone is probably already in the thick of it, which means rates are likely to remain lower for longer and every new crisis or recession will bring the bloc closer to more Japanification



Haruhiko Kuroda, Governor of the Bank of Japan, left, talks to Mario Draghi, President of the ECB in 2015

### A brief history of Japan's lost decades – Japan's first crisis

The roots of Japan's subdued economic performance can be traced back as far as the late 1980s.

In September 1985, following the Plaza Accord – an agreement by Japan, the United States, France, West Germany and the UK to depreciate the US dollar against the Japanese yen and the German Deutsche mark, the Japanese yen appreciated sharply. Being highly export-oriented, Japan's exports and GDP growth dropped considerably in 1986. Because of the deteriorating

economy, to stop speculative capital inflows and limit the yen's appreciation, the Bank of Japan lowered interest rates from 5% to 2.5% between January 1986 and February 1987. Furthermore, fiscal packages were compiled in September 1985 and May 1987 to support the economy. Although the economy rebounded significantly in the second quarter of 1987, the central bank kept its policy rate at 2.5% until May 1989.

Fuelled by a mixture of declining lending standards, financial regulation in the years before, low interest rates, cheap money and the belief, that the only way was up, Japanese stock and real estate prices grew at a staggering speed towards the end of 1986 and until 1990, pushing the Nikkei index from 13,000 points to an all-time high of 39,000 points in December 1989. [1]

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### *The lending standards of banks became more cautious*

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In May 1989, the central bank raised interest rates from 2.5% to 6% in just 16 months as it became concerned about asset price increases, banks' lending behaviour and upward pressure on prices. At the beginning of 1990, stock prices started to decline with the yen depreciating and long-term yields increasing. However, the BoJ kept raising rates until August 1990 – also in the wake of the Gulf war leading to an increase in oil prices. Subsequently, the lending standards of banks became more cautious, money supply growth decelerated sharply and the pace of economic growth started to slow.

When the stock market and real estate bubble started to burst in 1990 and 1991, the Japanese banking sector faced a pile of non-performing loans with Japan's corporate sector being characterised by excess debt. According to the IMF's systemic banking crises [database](#), Japan's non-performing loans (NPLs) peaked at 35% (of total loans) during the banking crisis - a level which neither Greece nor Italy reached during the European sovereign debt crisis. However, the magnitude was not immediately recognised and authorities were slow in reacting. Only in the second half of the 1990s, when large institutions started to fail, the full extent became visible. [2]

## The Bank of Japan's courageous monetary policy

Meanwhile, the Bank of Japan was quite brave with introducing new monetary policy measures beyond textbook knowledge. In October 1999, the interest rate was lowered to zero and ZIRP (zero interest rate policy) was born. Japan's central bank started to use quantitative easing policies, back in 2001, setting the outstanding balance of current accounts at the Bank as the operating target [3]. But the monetary stimulus didn't result in higher inflation as the authorities had waited too long before taking decisive action. Initially, the BoJ had raised rates during the burst instead of lowering them and it was only in 1999, a comprehensive disclosure requirement for bad loans was put in place.

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### *Japan's low inflation seems to be more structural*

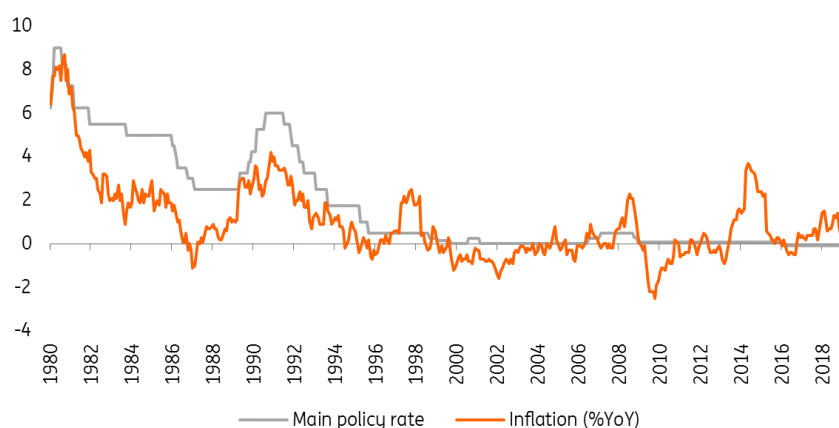
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Japan's low inflation seems to be more structural, causing low-interest rates, for which numerous

factors can be cited. Research has identified factors like the “zero-lower bound on nominal interest rates, public attitudes toward the price level, central bank communication, weaker growth expectations coupled with declining potential growth or the lower natural rate of interest, risk-averse banking behaviours, deregulation in the distribution chain and the rise of emerging economies” as possible factors depressing inflation.[4]

The Federal Reserve Bank of St. Louis (2018) adds to that technological progress, globalisation and demographic transitions [5]. Another factor weighing on inflation might actually be deleveraging. After the bursting of the bubble, the private sector deleveraged, cutting borrowing and spending.[6]

## Japan’s main policy rate and inflation (%)



Source: Refinitiv, ING Economic & Financial Analysis

## Eurozone’s lessons from Japan – the same causes or only similarities?

By now, an environment of low inflation has also reached the eurozone. It probably is structurally low inflation, driven by globalisation and digitalisation. However, the question is whether Japan-specific factors can help to explain the current low growth and low inflation situation or whether the eurozone and Japan are ‘only’ experiencing similar external factors.

Savings glut, central bank credibility, globalisation, the 1990s and 2000s saw a general decline in inflation and interest rate levels, which go beyond Japanification. But right now, the eurozone is showing similarities with Japan of the early 1990s. A financial crisis turns into an economic crisis, which then turns into a banking crisis, and finally into an existential crisis.

- **Leveraging and deleveraging:** In fact, the eurozone’s development between 2009 and 2018 has a high degree of Japanification. Government debt increased by more than 25% GDP in Japan during the bust period of the 1990s while in the eurozone, on average it increased by some 20% of GDP. Credit to households on the back of loose monetary policies increased by 7% GDP in the eurozone and by around 9% in Japan. At the same time, however, credit to the corporate sector increased more significantly in the eurozone (+20% GDP) than in Japan

(+6% GDP).

- Central bank action:** The Bank of Japan and the European central bank behaved similarly during the crisis years. The BoJ didn't only cut rates to the zero-bound in 1999, it cut interest rates by 600bp in the 1990s while the ECB cut rates by 425 bp. However, the ECB started to use its balance sheet extensively as a policy instrument earlier than the BoJ.
- Financial sector:** Both Japanese and eurozone banks accumulated a huge pile of non-performing loans during the crisis years, with Japan's NPL ratio at 8.4% in 2001 and the eurozone's NPL ratio at 8.1% during the height of the sovereign debt crisis in 2012. In both countries, the financial sector had to be supported by large capital injections.
- Demographic change:** An often-mentioned structural factor for the slowdown of Japan is ageing. In fact, Japan's working-age population (aged 15-64) has been on a declining trend since the mid-1990s, while the population as a whole started to decline from 2011 onwards. Although the eurozone still has some breathing room, the working-age population is also on a declining trend since 2009.

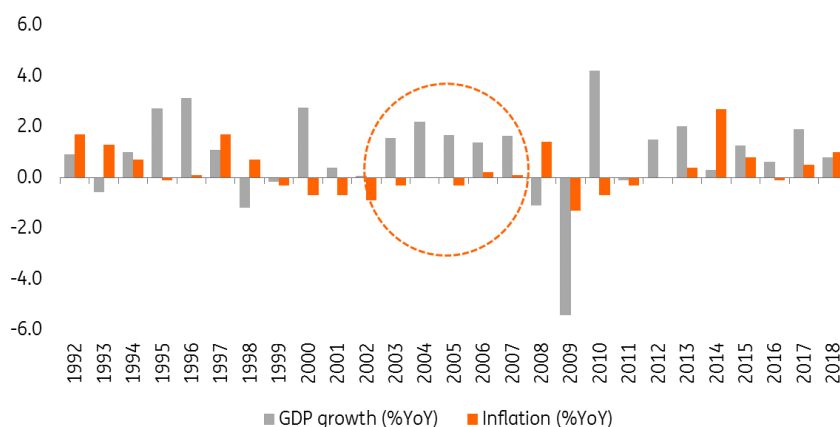
## So why should we care? Because of the next downturn...

While Japan's experiences in the 1990s were engraving, they are not enough to explain Japan's prolonged subdued economic growth environment up until today. Timing was not on its side.

The recovery of the Japanese economy was thrown back by three major events: the Asian crisis in 1997/1998, the dot-com bubble burst in 2000/2001 and finally and most importantly the global financial crisis of 2008/2009. Whenever it looked as if the Japanese economy had finally bottomed out, the next external shock came along. With the economy growing by 1.8% on average between 2003 and 2005, the Japanese central bank cautiously raised its main interest rate in July 2006 by 25 basis points to 50 basis points in September 2008.

But then, the financial crisis hit and the hiking cycle was over before it really began.

## GDP growth in Japan and inflation (%)



Source: Refinitiv, ING Economic & Financial Analysis

This is an important lesson for the Eurozone: the next crisis can always be just around the corner.

Without a strong recovery, it is difficult to escape the low growth, low inflation and subsequently low rates environment. An economic upturn could quickly be over and monetary policy might not have enough ammunition up its sleeve, with interest rates remaining stuck at the zero lower bound for years to come.

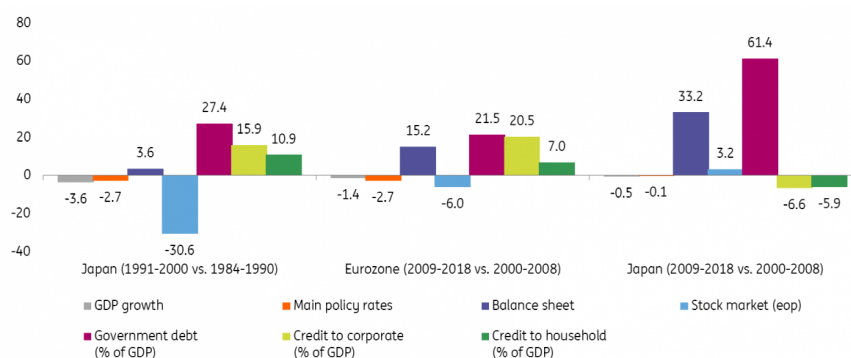
Japan's central bank hasn't raised main interest rate more than 50 basis points for over 24 years now and still has the largest central bank balance sheet measured as a percentage of GDP compared to the US and the eurozone. So, for the eurozone, the most important lesson is probably not so much the root cause of Japanification but the desperate attempts to get out it.

## What are the developments the Eurozone could be facing soon?

- **Deleveraging of the private sector:** Over the last ten years, the balance sheet problems of financial institutions and non-financial corporations have been one of the most important factors keeping the economy subdued for a long period of time, prolonging the subdued inflation environment [7]. Both credit to corporates and households have actually shrunk.
- **Ballooning of central bank balance sheet:** Over the last ten years, the balance sheet of the BoJ has increased by more than 75% of GDP. In the Eurozone, the ECB's balance sheet is currently some 18% of GDP bigger than in 2009.
- **Fiscal policy to the rescue:** Over the last ten years, Japanese government debt increased from 183% GDP in 2008 to 236% in 2018. The fiscal budget has been running deficits for 26 years, implementing countless fiscal packages to stimulate the economy.
- **Higher retirement ages:** While there has been a drop in the working age population of people aged 15 to 64, older employees and women have remained in or joined the workforce in Japan. Employment in Japan has actually been growing for seven years as the effective retirement age has moved up to close 70. Also, robotics and automation is well-advanced in Japan, keeping GDP per capita at high levels. All of this means that the expected wage-price spiral as a result of a shrinking labour force has never happened. Important lesson for the Eurozone: without these developments or measures, stagnation could easily turn into stagflation.[8]

## Economic developments in Japan and the Eurozone

(mean values over respective periods, %)



Source: Refinitiv, corporate and household credit data = BIS, government debt = Refinitiv/DG Ecfm Ameco.

## Why Japanification might be worse for the eurozone than for Japan

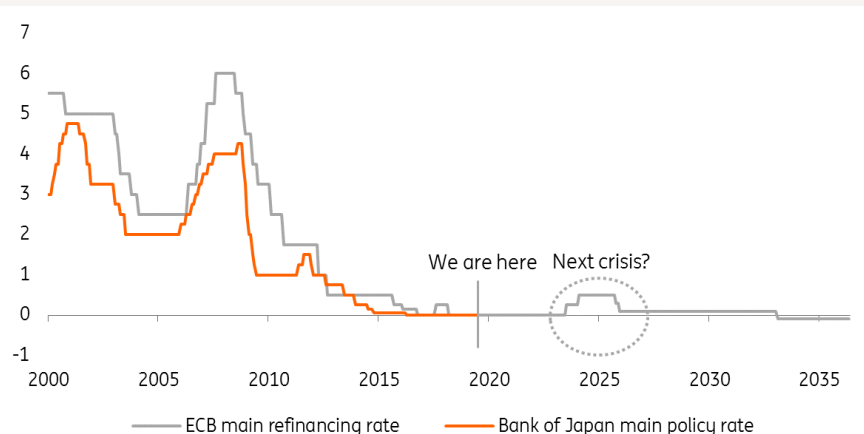
Having said all of this, Japanification doesn't have to be a bad thing, instead, it is rather a description of the state of an economy.

Despite Japan's prolonged period of subdued economic performance, the economy is still the third largest in terms of nominal GDP and is one of the most innovative and digitally conscious economies in the world and thanks to the government's fiscal packages, Japan continues to enjoy a modern and well-maintained infrastructure. At the same time, however, Japan is also a relatively homogenous society.

On the contrary, in the heterogeneous eurozone, political tensions within and between countries might rise given differing interests, economic developments and the controversial use of fiscal policies among members, making forward-looking reforms more important than ever. Particularly, the discussion about the role of fiscal policy in attempts to stabilise or kick-start the economy clearly have the potential for greater conflicts in the eurozone than in Japan.

For the eurozone, the lessons from the future from Japanification are more important than the lessons from the past. The Japanese experiences show that it will be very hard to actually escape a low growth and low inflation environment without reverting to loose fiscal policies and policies aimed at increasing productivity growth. For the ECB, this means that even looking beyond the short-term horizon with economic and trade uncertainties, the possibility of Fed rate cuts and the ECB's easing bias, there will not be much room for rate hikes in the coming years.

### Main interest rates Eurozone Japan (%)



Source: Datastream, ING

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## Retail Think Tank: What is the true state of retail spending?

There has been a general understanding that the retail sector has been proportionally losing sales, and its share of consumers' disposable income, to the leisure sector. We examine the impact and assess how far this has held back the UK retail sector



Members of the Retail Think Tank acknowledge that there are a range of different data sources available to ascertain evidence about the shift in spend away from the retail sector. However, most data does suggest that households have indeed been moving towards spending more of their incomes on services, including property rentals and accommodation/travel services. That is not to say spending on "things" has actually fallen, it is more that the relative growth rates of spending on goods versus services has been widening significantly.

A number of different structural and societal factors have contributed to this diversion of consumer spend. Firstly, the RTT notes the increased popularity of online shopping, which as a service is improving in line with technology at an almost constant rate. Without doubt, this has impacted the size of retailers' share of the available spend.

Changes within society, and the values consumers hold, also contribute to the apparent shift in spend. Members of the RTT agree that more of 'the pie' is finding its way to the leisure sector, which can provide these consumers with the more experiential, and less tangible, gratification they are looking for.

Much like the rising popularity of travel has opened up retail opportunities at travel hubs, the ever-growing use of the internet has meant retailers are seeing the store as having uses beyond just

selling. Retailers are actively looking at ways to enhance their in-store offering to provide consumers with the experiential shopping experience that they believe this generation desires. However, RTT members do question the actual benefits that retailers are reaping by this switch, and if investment in this area is actually holding the retail sector back.

It is clear though that a shift in spend away from retailers has negatively impacted the sector. However, the RTT members hold that this alone is not to blame for the fragile position that many operators find themselves in today. External economic factors, political uncertainty, rising costs, a changing consumer mindset, an increased use of technology and the rise of the discounters, alongside this shift in spend towards the leisure sector are all working together to challenge the status quo of what it takes for a retailer to succeed in 2019.

[Download the RTT's latest whitepaper on their website here](#)

**ING's Chief International Economist, James Knightley, is a member of the RTT. Here are his thoughts:**

There is a hypothesis that since the global financial crisis, households have moved away from buying “things” to buying “experiences” and this structural shift in behaviour explains some of the pain being felt by retailers.

As an economist, my first port of call when looking at the shifts in relative spending is the consumer price inflation report. Here we can see a time series of the weights of different goods and services that a “typical” person in the UK spends their money on.

Since the late 1980s there has been a notable shift in spending behaviour from goods towards services. Back in 1988, goods accounted for 71% of the basket. Today, that's down to just 52%. This largely reflects the rising proportion of spending on housing rentals (owner occupied housing is not included) and an increase in the proportion of spending on “miscellaneous services” such as personal, legal, financial and social (including retirement) services.

Still, this shift has slowed markedly since the financial crisis. In 2007, goods accounted for 54.7% versus the 51.9% today. In terms of the big components, food, alcohol and tobacco dropped from 14.6% to 14%, primarily because of tobacco. Housing and utilities have risen from 11.5% to 13% reflecting rising rents as a proportion of household spending. Transport has held steady at just over 15% (rising use, but falling prices for airfares and taxis).

In terms of the specifics of “things” versus “experiences” there are some interesting shifts. Clothing and footwear is actually up from 6.2% to 6.7%, led more by the latter than the former. However audio visual has gone from 2.9% to 2%, furniture and household equipment has edged very marginally lower to 6.5% from 6.8%. Games, toys, garden and pets have held at 3.7%.

Spending on “major durables for recreation and culture” has increased from 0.9% to 1.7%, led by spending on camper vans and boats! This looks to be part of the shift to “experiences”. Package holidays have been one of the biggest movers, going from 2.9% to 4.3% of spending while accommodation services have increased from 1.9% to 2.6%. However there has been weakness in other “experiences”. For example, “catering services” dropped from 11.9% to 9.5% with restaurants, canteens and take-aways all seeing declines in relative spending.

In general, there does appear to have been a marginal shift towards “experiences” from “things”,

but it is quite tentative and there are clearly winners and losers within both groups. Given the relatively small changes in spending behaviour and the fact that the “pie” of consumer spending has got significantly bigger (consumer spending is up 14% in real terms and 46% in nominal terms since 2007) this cannot be attributed as the major factor holding back UK retail. The problem seems to lie more generally with other structural issues such as internet/rents/taxation/car parking and management.

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## Watch: China to double fiscal stimulus

China finds itself in difficulty amid the trade war with the US. Its manufacturing sector is now weaker than during the Global Financial Crisis of 2008/09. We expect the authorities to double fiscal stimulus to maintain GDP growth of more than 6% this year



### China to double fiscal stimulus

ING's Iris Pang on what China needs to do next to ensure stability amid the trade war

[Watch video](#)

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