Shock UK retail sales plunge just a temporary setback

The UK retail sector ended the year on a dramatic low. But with consumer confidence having recovered, real wage growth positive and the mortgage squeeze being dampened by the fall in market rates, we think December's fall in retail sales will be reversed in the first quarter

We think we should see a return towards quarterly growth prints in the 0.3% area later this year.

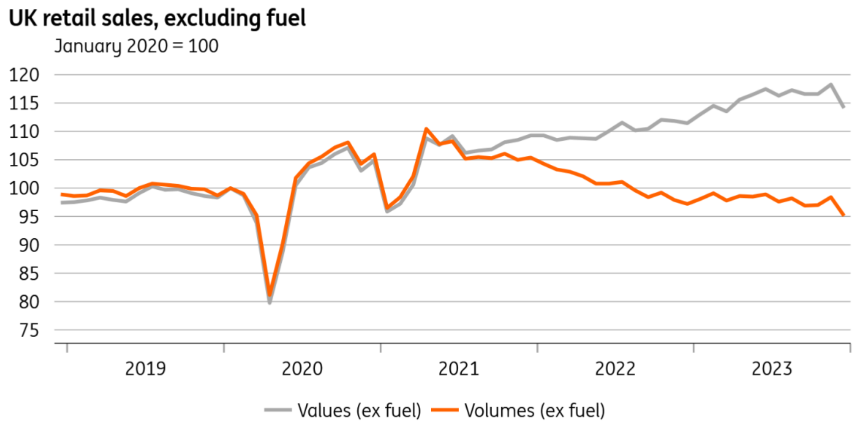
The UK retail sector seems to have had a torrid end to 2023. Retail sales fell by 3.2% on the month, which represents a huge fall – even by the volatile standards of this data. So huge, in fact, that we're a little bit sceptical.

Wet weather in December will inevitably attract some of the blame, while it does appear that the trend of pulling spending forward to November from December to benefit from Black Friday is continuing. It's hard to say, but this may be playing havoc with some of the seasonal adjustment processes.

Still, the decline in retail sales does tally with other reports, for example from the British Retail Consortium, that the Christmas trading period fell flat. And the fall in spending was broad-based.

But in reality, the consumer backdrop is starting to improve and that's hard to square with the scale of December's decline. Indeed the chart below shows that December's drop looks like a bit of an outlier. We suspect much of the loss will be recovered in January/February.

UK retail sales in level terms



Source: Macrobond

The fall in sales will bolster the chances of another small decline in fourth quarter UK GDP, and that would mean two quarters of negative growth – a technical recession, though in name only. Indeed, we've recently written how we think the UK economic outlook is starting to look brighter. The anticipation of Bank of England rate cuts and the sharp fall in market rates that has entailed will dampen the ongoing mortgage squeeze.

Roughly a fifth of mortgage holders will refinance this year, many on to higher rate products. But when we look at the average rate being paid on all outstanding home lending, we don't think that this will rise that much further. It increased from a low of 2% to 3.2% as of the fourth quarter, and we think it will rise only modestly to 3.6% by the end of this year. It's also worth remembering that only around a quarter of households have a mortgage, with considerably more owning outright.

The outlook for real wage growth also looks solid. Inflation is likely to fall below 2% in April and down to the 1.5% area in May/June, at a time when wage growth is likely to be around 4% or perhaps higher. Consumer confidence, though still below pre-Covid levels, recovered ground in 2023.

Admittedly, we shouldn't get too excited. The jobs market will continue to cool through this year, though probably not drastically. And savings levels, once adjusted for inflation, now sit below the pre-Covid trend.

Our base case is that we get modest but positive quarterly GDP growth through 2024. For the Bank of England, remember that policymakers are much more heavily focused on services inflation and wage growth as a driver of policy. It's these factors, as well as the scale of any fiscal stimulus at the March budget, that we think will determine the start date of BoE rate cuts. Our base case is currently August, though we'd bring that forward if spring tax cuts are relatively modest and/or the inflation numbers undershoot our expectations over the next couple of months.

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