The Royal Bank of Scotland Group

Spend, spend, spend

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Consumers across the world look to have splashed out in December, providing some much needed support to retailers and the wider economy.

British retailers had their best December since 2005 as total retail spending grew 6% on 2008. According to the British Retail Consortium, sales in December were strong across both food and non-food categories with the 'big freeze' failing to keep shoppers from the stores. Food sales had their best month since June, as retailers pushed premium lines and luxury items, and food price inflation filtered through to the shelves. Snowy weather looks to have given a boost to clothing and footwear, but the real winner was 'internet and mail order' sales. Up 27% y/y, online sales gave keen bargain hunters extra shopping hours without having to brave the cold.

According to the National Institute of Economic and Social Research UK GDP grew 0.3% in the last quarter of 2009. If correct, this would mean the recession officially ended in September and the economy has entered the recovery phase. We will know for sure when the official estimate is released next week. Hard data on industrial production (about 20% of the economy) provided some support to these claims. Industrial output increased 0.4% m/m in November, thanks mainly to higher oil and gas production. The manufacturing sector, however, did less well, recording no growth in either October or November.

The UK commercial property market ended 2009 in buoyant mood. Capital values rose 3% m/m in December, the largest increase in the 23-year history of the IPD index, after a peak to trough fall of 44% over the last two years. This was enough to lift the total property return for the year into positive territory (2.2%). Investor confidence has returned as relative yields look attractive, though rental conditions remain weak and the number of deals in the market is small.

In the US, it looks as if consumers got their shopping in ahead of the pre-Christmas rush. Retail sales in December were lower than those in November, marking the third consecutive year shoppers hit the stores early. Overall though, it was a much better year for retailers than 2008 as spending was up 5.4% compared with the year before. Stripping out gasoline and auto sales the picture was good, but less glossy. Core spending rose 2.3%, with the difference between headline- and core-spending largely the result of gas sales up more than a third (as oil is almost twice the price it was last year).

US consumer prices ended the year higher than they started it. Despite inflation running negative for eight months of 2009, consumer price inflation reached 2.7% in December, a result of energy prices rising 18% from their low in December 2008. But weakness in demand also weighed on price pressures: the price for services, which make up around three-quarters of the economy, saw the smallest rise since 1945. Their non-tradable nature make services a good guide to domestic inflationary pressure, which is expected to remain weak for much of this year.

Finally in the US, industrial production continued its march higher. Industrial output ticked up 0.6% m/m in December, extending the recovery which began in July. Output is now 5% above its low but still 10% off the pre-crisis high. At the current rate of expansion it would take 22 months for output to return to pre-crisis levels. A consequence of higher output is businesses sitting on fewer idle resources, evidenced by a (slowly) rising rate of capacity utilisation, up half a percentage point to 72%.

In the euro area the ECB left policy rates unchanged at 1% at its January meeting. The Governing Council is more concerned with cementing a recovery, evident in ECB President Trichet's comment that "we're doing all that is necessary to give the recovery a chance". This reinforced views that policy rates will be kept on hold for some time to come.

Recent ructions over euro member debt levels have caused waves in debt insurance markets. The cost of insuring against the combined risk of default by the 15 developed European nations (including Germany, France and the UK), is now higher than for Europe's top 125 investment grade companies. Markets no longer view developed economy sovereign debt as risk free as government bond issuance has exploded to pay for the expanding government deficits.

China's exports increased 18% y/y in December, ending a streak of 13 consecutive declines. Exports are now back to 95% of the level they were before the crisis while imports increased by a substantial 56 % over the same period, just surpassing the pre-crisis peak. China's economy is growing at a rapid pace, but there are concerns that it may be overheating. Bank lending increased to $1.4 trillion for the first 11 months of 2009, from just over $600bn for the full-year 2008. A 50bps hike in bank reserve requirements by the government last week seemed a small step to address such a vast increase in liquidity in the economy, yet it was sufficient to stall a strong commodities rally, causing metals and crude oil to trade lower.

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