BREXIT BRIEFINGS 5:

UK HOLDS UP SOLIDLY AS CONSUMERS KEEP SPENDING

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This is the fifth report in our *Brexit Briefings* series, which continues to analyze the impact of the Brexit vote on the economy, consumer health and retail sales in the UK.

1) July economic data published so far show a mixed picture, and it is difficult to get a full grasp of the vote's impact on the underlying health of the UK economy.

2) Positive data points include a boost to tourism due to the weak pound, resilient retail sales and stock market rebounds following the massive sell-offs seen immediately after the vote.

3) Negative data points include a meaningful decline in the widely observed Purchasing Managers' Index (PMI), a gauge of business sentiment in the services, construction and manufacturing sectors.

4) The Bank of England cut its benchmark interest rate by 25 basis points, to a record low level of 0.25% on August 4, following a weak PMI survey result. The bank also enacted a program of asset purchasing as another stimulus measure.

BREXIT BRIEFINGS 5: UK HOLDS UP SOLIDLY AS CONSUMERS KEEP SPENDING

The UK's vote to leave the European Union (EU) continues to dominate headlines, although too little time has passed to gauge its impact on the economy and the retail sector. It will be some time before the effect of the Brexit vote can be fully understood and digested.

UK confidence is starting to stabilize following the Brexit vote and thus far no doom or disaster scenario has materialized.

One sure fact is that Brexit negotiations will be protracted, given that newly appointed UK Prime Minister Theresa May has announced that Article 50, the clause that commences a formal exit process from the EU, will not be triggered until at least early 2017. The protracted uncertainty surrounding Brexit negotiations may discourage the business community and individuals from committing to or pursuing planned investments, further stifling much-needed economic growth.

Source: Shutterstock

We are publishing a *Brexit Briefings* series of regular reports that examine the impact of the UK's decision to exit the EU. This is the fifth report in our series, which continues to analyze the impact of the Brexit vote on the economy, consumer health and retail sales in the UK.

This report wraps up some of the latest available data points:

- UK confidence is starting to stabilize following the Brexit vote. Thus far, no doom or disaster scenario has materialized.
- There is a dearth of reliable indicators, as most of the available economic data reflect June figures. There have not been enough conclusive data points published from July or early August to enable commentators to draw any firm conclusions.
- The July economic data published so far show a mixed picture, and it is difficult to get a full grasp of the vote's impact on the underlying health

of the UK economy. Furthermore, consumer and retail sales metrics have likely been impacted by the UEFA European Championship and by volatile weather patterns.

- Positive data points include a boost to tourism due to the weak pound, resilient retail sales and stock market rebounds following the massive sell-offs seen immediately after the vote.
- Negative data points include a meaningful decline in the widely observed Purchasing Managers' Index (PMI), a gauge of business sentiment in the services, construction and manufacturing sectors.
- The Bank of England cut its benchmark interest rate by 25 basis points, to a record low level of 0.25% on August 4, following a weak PMI survey result. The bank also enacted a program of asset purchasing as another stimulus measure.
- No actual or official data have been published on how much UK GDP or economic output has changed since the June 23 Brexit referendum.

Our main impression is that consumers appear to be more confident than businesses: British consumers are continuing to grow their spending at retail and on services such as vacations. Moreover, UK businesses are set to see a boost from currency-driven inward tourism and "staycationing" by Brits.

Impact on UK Retail Sales

British Retail Consortium (BRC) and KPMG

Consumers are continuing to spend at retail. According to the BRC trade body and consultancy firm KPMG, same-store UK retail sales increased by 1.1% in July, up from a 0.5% year-over-year decline in June. July sales were driven by warmer weather and purchases of food, beverages and fashion. However, the BRC also stated that sales were mainly driven by heavy discounting activity. July total retail sales, including sales from recently opened stores, increased by 1.9% year over year, marking their strongest growth since January 2016 and showing an increase from 0.2% year-over-year growth in June.

The UK's Office for National Statistics will not publish its retail sales data for July until August 18, after we go to press.

Barclaycard

July Barclaycard data paint a mixed picture. Consumers continued to spend on everyday purchases in July, and pub and restaurant expenditure increased, but shoppers made fewer large purchases. Barclaycard reported that July sales increased by 2.6% year over year, which was lower than the 3.6% year-over-year growth seen in June.

John Lewis Retail Sales

John Lewis's reported weekly retail sales for the week ended August 6 (latest) were quite robust. Waitrose sales increased by 2.1%, driven by Olympics viewing and socializing. John Lewis department-store sales increased by 7.3% year over year. In total, John Lewis Partnership sales increased by 4% in the period.

Furthermore, John Lewis Partnership posted positive sales growth during every week in July. The company's department stores experienced only one week (ended July 23) of negative sales growth, and that was mainly due to an unprecedented heat wave, which encouraged shoppers to enjoy the outdoors.

Travel Trends

The travel and tourism sectors have benefitted since the Brexit vote due to the weaker pound.

The travel and tourism sectors have benefitted since the Brexit vote due to the weaker pound. Tourist arrival numbers were higher, hotels reported increasing bookings and search engines reported higher search traffic for flights and accommodation from foreigners in continental Europe, the Middle East and the US. High-end department stores have also reported an increase in sales in the last few weeks.

According to travel industry intelligence firm ForwardKeys, travel bookings to the UK have increased by 7.1% since the Brexit vote, compared with a decrease of 2.8% in the 28 days prior to the vote. UK arrival bookings from international visitors increased by 4.3% from June 24 through July 21. The weakened pound makes travel to the UK more attractive, and bookings from Europeans increased by 5% after the vote, while bookings by non-Europeans increased by 8.7%.

Source: Shutterstock

Industry group Tourism Alliance reported that the number of foreign visitors to the UK in July increased by 18% year over year. The organization also reported that the number of UK residents opting to stay in the UK for vacations also increased, by 11%, due to the weaker pound. Higher tourist numbers and staycationers are likely to boost retail and entertainment sales.

In its fiscal-third-quarter 2017 results, travel operator TUI Group stated that the UK continued to deliver strong performance, with revenues and bookings increasing by 6% in the summer months of 2016. Management mentioned that the company has not witnessed a slowdown in bookings as a result of the EU referendum. Bookings made by UK customers for travel abroad during the winter 2016/2017 season are up more than 20%, the company said, and the UK has also seen a good start to summer 2017 bookings, a testament to consumer health resilience.

Brexit Vote's Effect on Luxury Goods

Following the pound's devaluation, the UK has become the least expensive market for luxury goods.

Following the pound's devaluation, the UK has become the least expensive market for luxury goods. The pound has lost 10% of its value, dipping to its lowest level in 31 years. According to Exane BNP Paribas, luxury goods prices in the UK are currently 20% cheaper than the global average. Luxury goods have traditionally been more expensive in Asia, and currency fluctuations have only served to make these price differences more pronounced.

Exane BNP Paribas does not expect luxury goods companies to raise their prices in the UK in the near term, at least not until there is more visibility into and clarity on the macroeconomic implications of the Brexit vote. Furthermore, the weak British pound encourages greater tourist flows to London and the UK, which should boost luxury goods sales. London-listed Burberry, Mulberry and Jimmy Choo are mentioned by Exane BNP Paribas as luxury retailers most likely to benefit from higher tourist activity and lower relative price points.

Stock Markets

Stock markets have recovered ground from the postreferendum sell-off; the FTSE 100 and FTSE 250 indices have both regained the losses they experienced immediately following the vote. Last week, the FTSE 100 reached its highest point since June 2015. According to Citibank, most retail stocks covered by the index have recovered their postreferendum losses. However, shares of homebuilders and construction firms have still not recovered.

US markets also reached record levels last week. Record low interest rates and yields on gilts and corporate bonds—in some cases, negative yields—mean that investment flows will continue to boost equity markets.

Business Sentiment

It appears that, so far, Brexit-induced uncertainty has had a greater impact on business confidence than it has had on consumer confidence. The majority of business surveys have shown a decline in confidence. According to accounting firm BDO, business trend optimism based on growth prospects six months out, and on output measuring companies' experience of orders for the three months ahead, fell only slightly in July. Both of these business confidence readings are some way off from the level that would signal recessionary concerns. These findings are also supported by Visa UK's monthly index, which showed a 1.6% year-over-year increase in consumer spending in July.

Lloyds Bank indicated that its regional PMI survey found that businesses in England and Wales reported a decrease in output in July for the first time since 2012.

PMI Sees Negative Sentiment

The UK services industry suffered a sharp deterioration in July, with the services PMI declining to 47.4 from 52.3 in June.

The PMI is the most wide-ranging survey of British business activity, and it gauges the investment confidence of businesses in services, construction and manufacturing. The index is compiled by data provider Markit and measures companies' views on production, hiring plans, investments and general activity compared with a month earlier. The PMI is a sentiment gauge and not an actual metric of real output or activity.

The UK services industry suffered a sharp deterioration in July, with the services PMI declining to 47.4 from 52.3 in June, reaching its lowest level since March 2009. The services sector accounts for approximately 70%–80% of economic activity in the UK. Any PMI index number below 50 indicates that output and activity in that sector is declining. The UK construction PMI decreased to 45.9 in July, although the figure was higher than the 44 points that economists had forecast.

The all-sector PMI decreased to 47.3 in July from 51.9 in June, suggesting that UK business activity was contracting. It was the lowest reading since April 2009, but still much higher than the trough seen in 2008. Markit stated that the PMI survey results indicate that quarterly GDP could decline by 0.4%.

However, Markit also said it is still too early to determine if business confidence, and the corresponding PMI values, will remain at their current, low levels going forward. We further note that the extent of the negativity in this PMI survey appears to be out of kilter with the more solid metrics we cite elsewhere in this report.

Bank of England Cuts Rates to Lowest Level Ever

Following the announcement of the weak PMI survey result, the Bank of England cut its benchmark interest rate by 25 basis points on August 4, to a record low level 0.25%. Some economic policy analysts expect to see further interest rate cuts in the UK.

Source: Shutterstock

The Bank of England has also enacted a program of quantitative easing as a stimulus measure. The bank announced a six-month, £70-billion (US$90 billion) asset purchase (bond-buying) program in August that is designed to address and preempt a further economic slowdown in the UK. Policy makers are implementing the measures to push down borrowing costs for companies and individuals, and to incite banks to lend at record low rates, in order to spur investment and restart economic growth.

However, it seems that the issue is not a lack of credit, but rather reluctance by businesses and individuals to make investments and big-ticket purchases due to ongoing policy and economic uncertainty. Bank of England officials stated that the institution would be willing to use “a sledgehammer to crack a nut” in addressing weak UK economic growth.

Bank of England stimulatory measures will likely keep the pound weak versus other major currencies.

Following the implementation of quantitative-easing measures, the Bank of England now expects inflation to increase above its target of 2% in 2017. The stimulatory measures will also likely keep the pound weak versus other major currencies such as the US dollar and the Swiss franc.

Economic pundits are claiming that the government also needs to start implementing fiscal policy measures to boost economic growth and confidence. The government may introduce fiscal stimulatory measures such as tax reductions or added government spending on infrastructure projects in the autumn. However, the new Chancellor of the Exchequer, Philip Hammond, stated that he will wait until autumn before making a decision in order to have enough time and data to clearly ascertain the situation.

CBRE Sees Subdued Commercial Property Market

According to commercial real estate services firm CBRE, UK commercial rents remained stable in July, while property values declined. CBRE reported that UK commercial property values fell 4.1% in July, with offices in central London declining by 6.1%.

Demand for office property in London is likely to remain subdued as companies, in particular financial services institutions, wait to gain more visibility into both the impact of the Brexit vote and negotiations regarding the single market with the EU. Retail property values declined by 3.6% in July, while industrial property experienced a smaller, 2.2%, fall in value.

Listed-estate agency Countrywide stated that London rents on newly let homes dropped by 0.5% in July, but that rates on existing rental contract renewals in London increased by 8.4% year over year. Countrywide said that 23% more homes were available for rent in the UK in July than were available a year earlier, while a third more were available for rent in London. This may be due to the fact that sentiment in the sales market deteriorated and more owners decided to put their properties up for rent instead of for sale.

It is still too early to ascertain the effect of the Brexit vote on the housing and commercial real estate markets.

Publicly traded UK homebuilder Bovis Homes stated that new home sales rates since the Brexit vote have been lower than they were during the same period last year, but that interest from homebuyers remains resilient. Furthermore, the builder said that sales in the first three weeks following the referendum were quite negatively impacted, but that the last three weeks have shown more normal summer trading activity patterns.

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Economic analysts have been closely observing UK housing and real estate trends. Estate agents have noticed declines in sales since the vote, but sales of new homes have held up better than those of secondhand homes. Overall, it is still too early to ascertain the effect of the Brexit vote on the housing and commercial real estate markets.

Source: Shutterstock

Brexit Vote's Effect on UK Retailers' Supply Chains

Given the pound's devaluation, UK retailers have been forced to manage their supply chains even more tightly. A new Barclays study reported that 75% of retailers are seeking to build more efficient supply chains following the Brexit vote. Here are some more details from the survey:

- Some 81% of retailers surveyed said they expect a negative foreign exchange impact on their supply chain following the Brexit vote; 70% said they will be reviewing currency-hedging strategies.
- About 30% of retailers polled are considering changing suppliers, while 28% are looking at sourcing from different countries.
- About 32% of respondents predict that they will source more from the UK, while 12% expect to reduce their sourcing in the UK.
- Approximately 52% of surveyed retailers expect to increase their sourcing from India, while 43% expect to source more from China and 38% expect to source more from Africa. Approximately 43% of respondents plan to source less from Europe.

- Retailers are not overly pessimistic about the impact of the vote on their supply chains, but are still focusing on optimal sourcing and foreign exchange strategies. Approximately 59% of retailers polled expect supply chain costs to be flat or to increase slightly.
- Only 31% of retailers surveyed expect to pass on sourcing cost increases by raising product prices, and 53% plan to absorb the cost increases themselves.
- Finally, 41% of the retailers surveyed said that they expect the Brexit vote to have no impact on their operations.

Certain European retailers, including DFS, Boohoo.com and Zalando, have delivered strong trading and earnings results.

European Retailers Continue to Make Strong Gains

Despite the Brexit vote, certain European retailers, including DFS, Boohoo.com and Zalando, have delivered strong trading and earnings results. DFS reported 7% comparable sales growth for the second half of its fiscal year ended July 30, 2016. Boohoo.com recently increased its sales and profitability guidance for the full year, following very strong trading in the first five months of its fiscal 2016 year, and the company has seen impressive, strong trends continuing into August. Finally, Zalando posted very strong second-quarter sales and profitability results, with positive trends continuing at the beginning of August.

KEY TAKEAWAYS

UK confidence is starting to stabilize following the Brexit vote. Economic and business surveys conducted since the referendum have revealed a mixed picture of UK economic health, but no falling-off-the-cliff scenario.

A weakened pound appears to be a boon to the domestic UK tourism sector.

The widely observed PMI has shown that construction activity and services sector business confidence have deteriorated further following the referendum, but no actual or official data have been published on how UK GDP or economic output has changed. Consumers are continuing to spend, though, and they appear to be more confident than businesses.

Finally, and most importantly, not enough time has passed since the vote for us to analyze hard economic data points. Most surveys published so far feature June data. Thus, it will not be possible to closely examine the initial impact of the referendum for a few more months.

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