



Global Economy Watch

Do growing disposable incomes mean households have greater spending power this December?



Dear readers,

Once again this year, the outcome of a vote, this time in the US, has surprised. Donald Trump is gradually announcing his plan for the first 100 days of his presidency, which features many of his policies from the campaign trail, such as withdrawing from the Trans-Pacific Partnership (TPP) trade agreement. However, in some cases President-elect Trump is now taking a materially different stance to candidate Trump, refining many of his key pledges (e.g. for Obamacare), leaving the world wondering about the policies he will actually pursue.

November saw the release of the latest Q3 GDP growth figures for most large economies. Eurozone growth lagged behind that of the US and UK. But this masks the strong performance of the periphery Eurozone countries, such as Spain and Cyprus, which continue to outperform the core countries of Germany, France and Italy.

The UK economy grew by 0.5% quarter-on-quarter, down on Q2 but still a respectable rate of growth showing little immediate impact from the Brexit vote. Looking to next year, however, against a backdrop of continued uncertainty regarding Brexit, the Office for Budget Responsibility (OBR) has downgraded its official projections for GDP growth from 2.2% to 1.4% for

2017. Against this weaker outlook, the Chancellor's Autumn Statement focused on boosting productivity growth and investment, announcing measures to support infrastructure, housing and science and innovation.

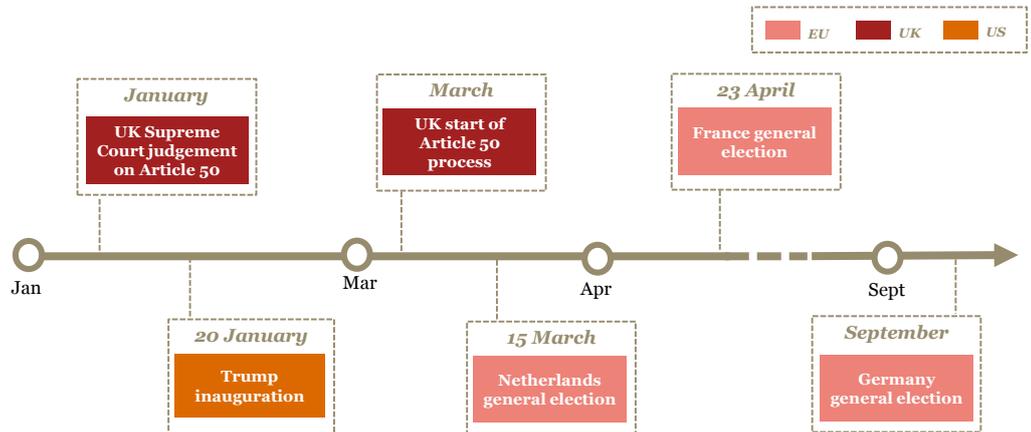
The UK government also abandoned its aim to achieve a budget surplus by the end of this Parliament, choosing to follow the path of (modest) fiscal stimulus rather than continued austerity. We have seen other large economies—Canada, Japan, and the US—adopt this approach recently, taking advantage of low interest rates on offer to try to provide a long-term boost to productivity. We discuss why now is the right time to provide a fiscal boost, at least for countries with the necessary fiscal space.

As we approach Christmas, many consumer-focused businesses will be hoping for a bumper season of household spending. In this month's GEW, we analyse the drivers of household spending and the implications for businesses in their revenue forecasting and planning. In the UK, gross disposable incomes are up and the savings ratio is down relative to this time last year, suggesting that this could be a promising Christmas period for European retail and consumer businesses, despite the Brexit vote.



Kind regards
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Fig 1: The coming year will see numerous developments in the global political sphere, generating considerable uncertainty



Sources: PwC analysis



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Economic update: Recovery in the Eurozone periphery continues

Growth in the Eurozone periphery continues to outperform that in the core

The latest GDP data revealed that the Eurozone economy grew by 0.3% in quarter-on-quarter terms in Q3 of this year, the same as in Q2. However, Eurozone growth was slower than in the US and the UK, where the economy grew by 0.8% and 0.5% respectively in Q3.

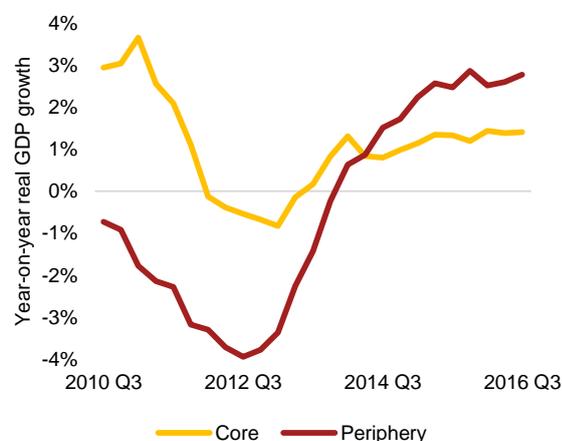
However, the overall Eurozone growth figure masks the strong performance of the peripheral Eurozone countries. Figure 2 shows that, in year-on-year terms, the periphery continued to perform better than the core, with growth of 2.8% year-on-year in Q3 compared to 1.4% year-on-year for the core economies. Spain and Cyprus, for example, are now amongst the fastest growing economies in the Eurozone.

Will political uncertainty cause the Eurozone's steady recovery to falter?

Europe as a whole could be entering a period of intense political activity, which could lead to period of uncertainty. In early December Italians cast their vote in a referendum against proposals to streamline the legislative process, prompting Prime Minister Renzi to resign. This will be followed by Dutch elections in March 2017, French presidential election in April, and German federal elections in September (see Fig 1). The potential uncertainty surrounding these political events, as well as likely ongoing lack of clarity around future trading relationships between the UK and the European Union (EU) could dampen growth at least temporarily.

In our main scenario, however, we expect the Eurozone to continue growing at broadly trend rates of around 1.5% per annum in 2017. While the growth of the periphery may taper off a little next year, strong domestic demand is expected to support the economy in the core economies, as household incomes and spending continue to grow.

Fig 2: Year-on-year growth in the periphery outstrips that in the core for the 10th quarter in a row



Core: Germany, France, Italy and the Netherlands
 Periphery: Spain, Greece and Portugal
 Sources: PwC analysis, Eurostat

Focus on: Fiscal stimulus back on the agenda in advanced economies

G7 growth is stable but anaemic

Growth in the advanced economies continues to be anaemic, despite record low interest rates: G7 GDP growth in the third quarter of this year averaged 1.4% on a year-on-year basis compared to a long term growth rate of slightly higher than 2% per annum.

Many policymakers are now re-focusing their attention on fiscal levers in a bid to stimulate growth. This year alone, we've seen most of the non-Eurozone large economies announce or extend fiscal plans:

- The Canadian government plans to invest C\$120bn, (around US\$ 90 bn) in infrastructure projects over the next ten years;
- In August this year, Japan announced a stimulus package to boost the economy worth Yen 4.6 trillion (around \$40bn) as part of a wider package which involves further funding from other quasi-government institutions;
- In the UK, as part of the Autumn Statement, the Chancellor announced a £23 bn. National Productivity Investment Fund to be spent over the next five years on housing, transport, broadband and R&D; and
- In the US, President-elect Trump plans to invest in infrastructure and make changes to the tax system in the US (though the form and scale of these policies remains to be defined).

These fiscal initiatives are likely to lead to a temporary worsening of budget balances, as Figure 3 shows, but also an increase in the contribution of government spending to growth.

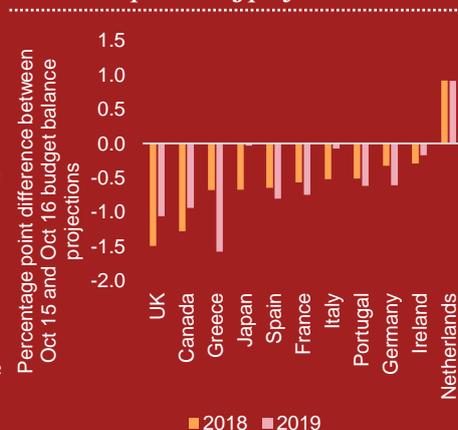
Now is the right time to provide a fiscal boost

We have identified three key reasons why fiscal stimulus may be particularly beneficial in the present economic environment:

1. Current and future government debt can be financed at cheap rates

Since the financial crisis, most governments have taken steps to tackle the liability side of their balance

Fig 3: Budget balances are expected to be worse than previously projected



Note: US omitted as the projections were made prior to the outcome of the presidential election
 Sources: PwC analysis, IMF

sheet. Even though public debt levels remain relatively high by historic standards for some of the G7, the current weighted interest expense paid on government debt is at record lows. In the US, for example, the weighted average interest rate on its government debt is expected to be 1.8% this year, compared to 3.1% a decade ago.

Future funding costs should also continue to remain relatively low, even if they show some upward trend in response to this shift in fiscal policy. For example, yields on 10-year government bonds, a measure of the cost of borrowing, are considerably below their long-term (i.e. previous 20-year) averages for all of the G7 economies we have looked at. This is despite pronounced increases in the long-term bond yield curve following the US presidential election. Governments will, however, have to be sensitive

to any further large rise in their cost of borrowing in response to fiscal easing.

2. Policy complementarities can make fiscal policy more effective

While monetary policy has been expansionary in many advanced economies since the crisis, fiscal policy has been largely contractionary. According to the IMF, government deficits in the G7 have reduced by around 6 percentage points of GDP since 2009. But, using the two policies together will increase the likelihood of influencing aggregate demand.

Present low interest rates could actually increase the fiscal multiplier and therefore the direct impact of fiscal spending on GDP, as consumers and businesses find saving relatively less attractive.

3. Fiscal stimulus can directly deliver longer-term productivity benefits

Some policies associated with fiscal expansion can have a positive long-term impact on productivity. For example, efficient infrastructure investment can improve connectivity, while government support for R&D can result in technological advances that make workers more productive.

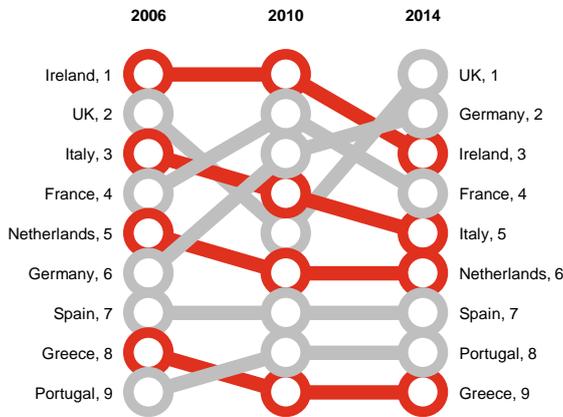
Monetary policy can also be used to try to boost productivity, but it relies on businesses taking advantage of the cheap funding on offer to spend on productivity enhancing investments instead of alternative options such as restructuring their debt or borrowing to build up inventories. Therefore, policymakers may prefer to use fiscal policy to target productivity growth more directly.

What are the main business opportunities?

Given the focus on infrastructure improvements across different economies, engineering and construction companies, in particular, could stand to benefit. Businesses in regions where these improvements are planned are also likely to gain, particularly over the longer-term. But if these plans can go some way towards raising productivity growth at a national level, then, over the longer-term, businesses across the economy stand to benefit.

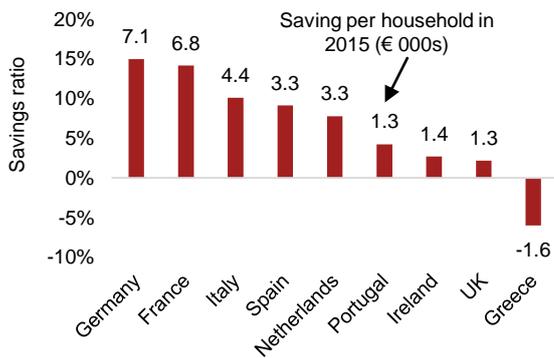
The implications of discretionary disposable income and savings for household spending

Fig 4: Germany has risen in the rankings of discretionary disposable income considerably



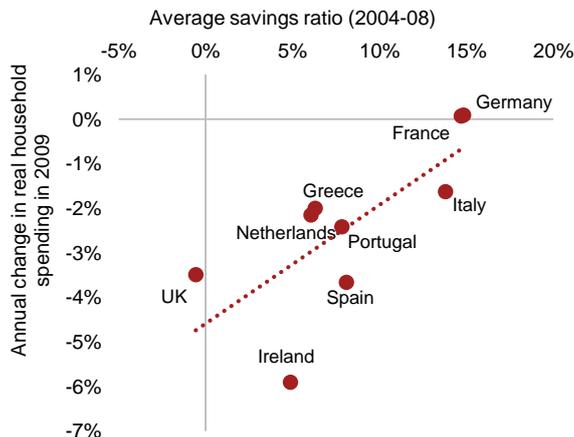
Note: grey lines represent a rise or no change in the rankings from 2006-2010, while red lines illustrate a fall
Source: PwC analysis, Eurostat

Fig 5: UK households are only saving 2% of their disposable incomes, corresponding with high spending



Note: Savings ratio is the difference between disposable household income and spending, as a proportion of disposable income.
Sources: PwC analysis, Eurostat

Fig 6: High savings in France and Germany were able to sustain spending during the 2009 crisis



Sources: PwC analysis, Eurostat

Household spending is a key driver of economic performance

In many advanced economies, household spending is the largest component of GDP. The Christmas period is traditionally a time of significantly higher consumer spending and so is particularly important for European consumer-focused businesses. Across the European countries we monitor regularly, year-on-year gross disposable household income growth¹ remains relatively strong so far this year at around 2%. But what does this suggest for household spending?

So which households are the biggest spenders in Europe?

The UK has the highest level of spending per household, leading the way by a considerable margin at around €59,000. Ireland ranks second at €49,000, followed by France at €41,000. In the UK, this strong household spending is a key driver of the economy, accounting for 65% of GDP, compared to 55% in France and Germany.

As discussed in a previous version of our [UK Economic Outlook](#), household spending is determined by disposable income and changes to savings. The spending rankings are strongly correlated with disposable income rankings – the latest data shows the UK has the highest after-tax disposable income per household at around €61,000, followed by Ireland and France at 2015 exchange rates (though the recent weakness of the pound will have narrowed the gap in 2016). But our analysis shows a more nuanced definition of disposable income can tell a more informative story.

But what happens once ‘essential spending’ is accounted for?

Not all spending is the same. Spending on housing, food and transport are, in most cases, deemed essential for households in advanced economies. This means they are likely to be prioritised by households and also that they are less responsive to changes in price. Forecasting demand in sectors like utilities is therefore subject to less uncertainty.

What really matters for households and businesses is how much of household income is left over for spending on ‘non-essentials’ such as alcohol, eating out, holidays and entertainment. Adjusting for spending on ‘essentials’² we estimated discretionary disposable income per household. Below we list out our key findings:

- Typically, over half of household spending is on ‘essentials’. At one extreme, almost 60% of French household spending goes on essentials. On the other extreme, in the UK the equivalent statistic is only around 50%. This difference lies primarily in food spend, which comprises 13% of French total household spending, but 8% for the UK.
- Housing is the largest single ‘essential’ spending category - on average it comprises around 23% of European household spending. The second largest spending category in Ireland and Spain is on restaurants and hotels, which is a non-essential category. This illustrates the differences in spending patterns and priorities across countries.
- Taking into account spending on ‘essentials’, the UK continues to top the household income rankings (around €32,000). However, using the same measure, Ireland drops to 3rd place behind Germany. This means the extent of opportunity for retail businesses in Ireland may not be as great as disposable incomes suggest.
- Over time, Germany moves from 6th spot in the discretionary income rankings in 2006 to 2nd in 2014 (the latest available data-point). In Germany, the growth of spending on necessities has increased roughly in line with the growth in disposable incomes, whereas in countries such as Italy, spending on necessities has greatly outpaced income growth.

High household savings can have positive consequences for businesses

The other main driver of household spending is the savings ratio³. Figure 5 shows that Germany has the highest savings ratio of the EU countries we analysed, with the UK and Ireland sitting towards the bottom of the list. A high savings ratio can put downward pressure on spending, and therefore revenues. However, it can also be good news for businesses, as it allows households to sustain spending during an economic downturn. Figure 6 shows that the economies which had a relatively high savings ratio in the run up to the financial crisis in 2009 made relatively smaller cut-backs in household spending during the crisis. In these countries, high savings can also increase private investment, boosting productivity.

What does all this mean for businesses this Christmas period?

Disposable household income is an important variable for providers of non-essential products when projecting revenues. But, as our analysis shows, taking a more nuanced measure of discretionary disposable income can tell a slightly different story. Changes in the savings ratio also have considerable implications for future spending meaning businesses should complement their forecasting with these additional measures. Last year, discretionary disposable incomes grew for the first time since the crisis, suggesting real household spending power has only just started to recover. Combined with the fact that adjusted savings ratios are either falling or remaining stable in all 9 countries except for the Netherlands, this suggests the Christmas period could be a prosperous one for many businesses across Europe. Santa’s elves may have a busy December ahead.

¹ Deflated using the implicit household consumption deflator

² Essentials: Housing, water, electricity and gas; food and non-alcoholic beverages; transport; health; and education

Non-essentials: Alcohol and tobacco; clothing and footwear; restaurants and hotels; recreation and culture; communications; furnishings and household equipment; and miscellaneous goods and services

³ Calculated as the difference between household disposable income and spending, as a proportion of disposable income.

Projections: November/December 2016

| | Share of 2015 world GDP | | Real GDP growth | | | | Inflation | | | |
|--------------------------------|-------------------------|-------|-----------------|-------|-------|------------|-----------|-------|-------|------------|
| | PPP | MER | 2015 | 2016p | 2017p | 2018-2022p | 2015 | 2016p | 2017p | 2018-2022p |
| Global (Market Exchange Rates) | | 100% | 3.0 | 2.5 | 2.9 | 3.0 | 1.6 | 2.2 | 2.5 | 2.5 |
| Global (PPP rates) | 100% | | 3.4 | 3.0 | 3.4 | 3.5 | | | | |
| G7 | 31.5% | 46.4% | 1.9 | 1.4 | 1.7 | 1.9 | 0.2 | 0.9 | 2.0 | 1.8 |
| E7 | 36.2% | 25.9% | 4.8 | 4.7 | 5.2 | 5.0 | 0.4 | 1.5 | 3.5 | 3.3 |
| United States | 15.8% | 24.5% | 2.6 | 1.6 | 2.2 | 2.3 | 0.1 | 1.3 | 2.3 | 2.0 |
| China | 17.3% | 15.2% | 7.1 | 6.5 | 6.5 | 5.7 | 1.5 | 1.8 | 1.8 | 2.8 |
| Japan | 4.2% | 5.6% | 0.6 | 0.6 | 0.5 | 0.8 | 0.8 | 0.1 | 1.3 | 1.5 |
| United Kingdom | 2.4% | 3.9% | 2.2 | 2.0 | 1.2 | 2.0 | 0.0 | 0.6 | 2.3 | 2.3 |
| Eurozone | 12.0% | 15.8% | 2.1 | 1.6 | 1.5 | 1.5 | 0.0 | 0.2 | 1.3 | 1.4 |
| France | 2.3% | 3.3% | 1.2 | 1.4 | 1.5 | 1.6 | 0.1 | 0.3 | 1.2 | 1.2 |
| Germany | 3.4% | 4.6% | 1.4 | 1.6 | 1.4 | 1.4 | 0.1 | 0.3 | 1.5 | 1.7 |
| Greece | 0.3% | 0.3% | -0.5 | -1.0 | 0.5 | 1.6 | -1.1 | -0.3 | 0.5 | 1.1 |
| Ireland | 0.3% | 0.4% | 26.3 | 4.0 | 3.3 | 2.6 | -0.0 | -0.1 | 0.8 | 1.5 |
| Italy | 1.9% | 2.5% | 0.6 | 0.9 | 1.0 | 1.2 | 0.1 | 0.2 | 1.1 | 1.4 |
| Netherlands | 0.7% | 1.0% | 2.0 | 1.6 | 1.6 | 1.8 | 0.2 | 0.8 | 1.5 | 1.3 |
| Portugal | 0.3% | 0.3% | 1.6 | 1.2 | 1.2 | 1.1 | 0.5 | 0.6 | 1.0 | 1.4 |
| Spain | 1.4% | 1.6% | 3.2 | 2.6 | 2.3 | 2.0 | -0.6 | -0.4 | 1.3 | 1.2 |
| Poland | 0.9% | 0.6% | 3.6 | 3.6 | 3.4 | 3.5 | -0.9 | -0.3 | 1.2 | 2.4 |
| Russia | 3.3% | 1.8% | -3.7 | -1.6 | 0.9 | 1.5 | 15.5 | 7.3 | 6.3 | 4.0 |
| Turkey | 1.4% | 1.0% | 4.0 | 3.1 | 3.2 | 3.4 | 7.7 | 8.0 | 7.8 | 7.0 |
| Australia | 1.0% | 1.7% | 2.4 | 3.1 | 2.7 | 2.7 | 1.5 | 1.5 | 2.5 | 2.5 |
| India | 7.0% | 2.8% | 6.9 | 7.3 | 7.3 | 6.5 | 4.9 | 5.1 | 5.0 | 5.0 |
| Indonesia | 2.5% | 1.2% | 4.8 | 5.0 | 5.1 | 5.4 | 6.4 | 3.6 | 4.5 | 5.1 |
| South Korea | 1.6% | 1.9% | 2.6 | 2.7 | 2.6 | 3.3 | 0.7 | 1.0 | 1.6 | 3.3 |
| Argentina | 0.8% | 0.9% | 2.4 | -0.8 | 2.1 | 2.5 | - | 30.0 | - | - |
| Brazil | 2.8% | 2.4% | -3.8 | -3.0 | 1.0 | 3.0 | 9.0 | 9.0 | 6.5 | 5.0 |
| Canada | 1.4% | 2.1% | 1.1 | 1.3 | 1.9 | 2.2 | 1.1 | 1.5 | 1.9 | 2.0 |
| Mexico | 2.0% | 1.6% | 2.5 | 1.9 | 2.1 | 3.0 | 2.7 | 2.8 | 3.4 | 3.0 |
| South Africa | 0.6% | 0.4% | 1.3 | 0.3 | 1.0 | 3.0 | 4.6 | 6.3 | 5.9 | 5.5 |
| Nigeria | 1.0% | 0.7% | 2.7 | -1.0 | 1.0 | 4.2 | 9.0 | 15.2 | 16.5 | 12.0 |
| Saudi Arabia | 1.5% | 0.9% | 3.5 | 1.2 | 1.7 | 3.5 | 2.2 | 4.0 | 3.2 | 2.5 |

Sources: PwC analysis, National statistical authorities, Datastream and IMF. All inflation indicators relate to the Consumer Price Index (CPI). Argentina has recently launched a new CPI measure, which only contains data from April 2016. We therefore do not report an inflation measure for 2015, and will provide 2017 and 2018-2022 projections once a longer series is available. Ireland's GDP growth in 2015 was boosted by some very high investment figures by subsidiaries in Ireland. 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 | 0.25-0.5% (December 2015) | A rate rise is expected this month | 13-14 December |
| European Central Bank | 0.0% (March 2016) | No rate rise for the foreseeable future | 19 January |
| Bank of England | 0.25% (August 2016) | No change in rates expected in the short-term | 15 December |



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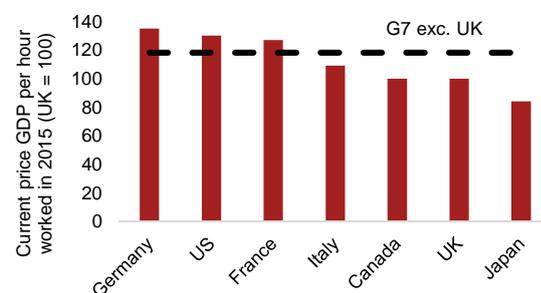
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Chart of the month

Amidst downgraded UK growth projections from the OBR, this month's Autumn statement focused on boosting productivity growth.

The Chancellor announced a new National Productivity Fund of £23 billion to support transport and housing and to enhance the UK's position as a world leader in science and innovation.

Chart of the month: The UK's productivity lags behind most of its G7 peers



Sources: PwC analysis, ONS, OECD

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