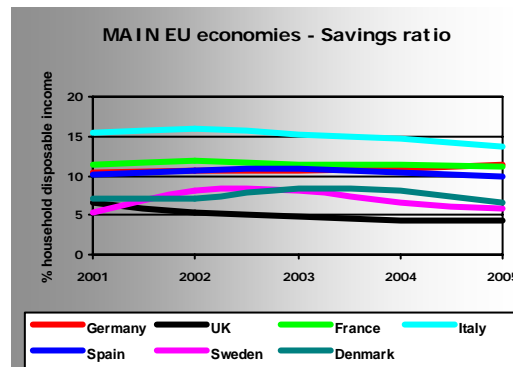


SAVE MORE – SPEND LESS

Ultimately, the health of the retail property market is underpinned by consumer spending. This is forecast to rise across the EU but high levels of consumer debt cast a long shadow

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Conceptually, it is easy to stereotype the spenders and savers within Europe however data on the savings ratios of the different countries shows a surprising result. The line between those that shop and those that do not follows the adoption of the euro.



The “outsiders” have much lower savings ratios than the Eurozone average with the UK the leading shopaholics. Mind you, the UK rates of between 4% and 5% look positively frugal by US standards.

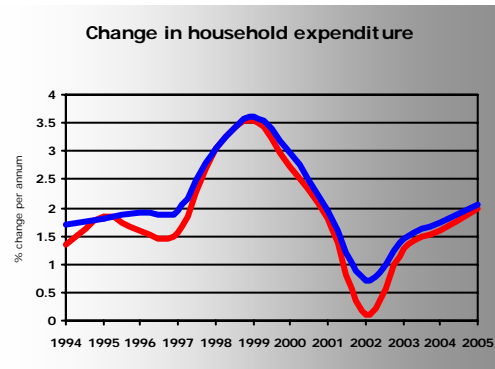
The Italians are Europe’s star savers amongst the big economies with around 15% of household disposable income salted away.

Looking forward, the OECD project some quite significant changes that could be instructive for retail demand but there remain significant differences between countries.

As a generality, savings ratios across Europe are lower now than they used to be. The EU has seen an average fall of around 40% in the savings ratio since 1970 – some countries, the UK for example, have seen a fall closer to 70%.

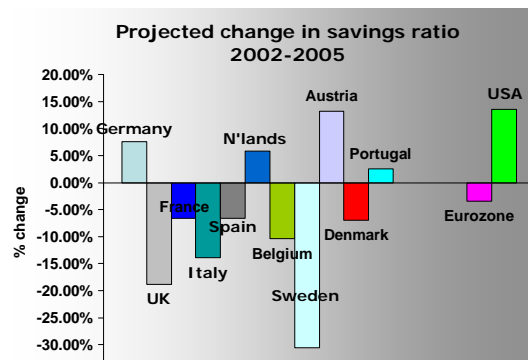
This growth in consumer spending (and borrowing) has underpinned much of the growth in retail facilities seen across the continent over the past twenty years. Additionally it has provided one of the main drivers of economic prosperity.

Data from Eurostat on household expenditure show consistent rises for both the eurozone and the EU with an acceleration in the late nineties and a barely noticeable rise in 2002.



This dataset also forecasts a return to growth in spending throughout the period 2003 – 2005, consistent with a declining savings ratio.

There are clear spatial differences here. Amongst the larger economies, Germany stands out as having a savings ratio that is projected to increase over the next few years while the UK, Italy and, to a lesser extent, France see falls.



Sweden sees the largest fall in savings ratio with a projected drop of 30% while Netherlands, Austria and Portugal see an increase. Overall, the eurozone sees a small fall. By contrast, the same OECD forecast shows the USA rising by 14% over the same period.

On the surface, this gives some clear buying signals for retail space in those locations where the savings ratio is expected to fall.

However, there are downside risks here surrounding the accumulation of consumer debt. According to Morgan Stanley Credit Research, private sector debt has risen from about 90 per cent of gross domestic product in 1987 to 165 per cent in the UK; in Germany, private sector debt is about 155 per cent of GDP, and in the US it is 150 per cent.

This could be seen as rational consumer behaviour in the face of falling nominal interest rates. Since the cost of servicing debt have dropped in line with interest rates increasing gearing is appropriate.

However, debt driven spending is heavily dependant upon consumer confidence. That which has been borrowed will, eventually, have to be repaid. The pigeons will come home to roost – the question is – when? At what stage the consumer will tire of taking on further debt?

Something will bring the borrowing spree to an end; the most likely candidates are higher interest rates or higher unemployment.

The most recent indicators of consumer confidence remained low in most of Europe but registered increases in Sweden, Finland, Austria, Portugal Spain and Italy. Since a rise in interest rates in November confidence in the UK has slid back from a peak in July and is continuing to fall.

As far as central banks are concerned this presents something of a dilemma. Debt was allowed to rise to stimulate the global economy in order that it was able to survive the dot com bust. Keeping interest rates low has encouraged consumers to keep on spending and continuing to rack up debt.

In a recovery phase, the banks would normally be expected to allow interest rates to rise. However, there is considerable concern about the effect of a regime of rate rises upon consumer confidence.

So we have an exercise in the management of expectations.

In the US, the Federal Reserve has let it be known that monetary policy will stay relaxed "for a considerable period". The European Central Bank is unlikely to raise interest rates soon, and, although the Bank of England has tightened policy, it was only by a quarter of a point.

None of this avoids the imperative for interest rates to rise, particularly in the US and the UK. In the US, where the economy appears to be growing at 8% a year, a move to realign interest rates with nominal GDP, ie returning policy to neutral, would involve a rise to around 4% from 1%

In the UK, futures markets expect the interest rate to rise to 5% by the end of 2004 – a rise of a third.

What does this say about the prospects for retail investment? The signals in the Eurostat data are mixed.

Clearly, in those economies where the savings ratio is expected to rise between 2002 and 2005 there will be a slackening of expenditure based demand. This will put pressure on retail margins and thereby onto retail property. On that basis retail in Germany, Netherlands, Austria and Portugal look more risky over that period.

Conversely, those countries where the savings ratio is projected to fall will see retail demand stimulated by more consumer spending with a corresponding stimulus for retail property. Within the Eurozone, Italy, France and Spain should see this stimulus over the next couple of years, making retail property a more attractive proposition.

Outside the Eurozone, Sweden leads the way with a projected fall in saving of 30% Although Swedish interest rates are not expected to rise any time soon. By contrast the UK is projected to see a fall in saving of nearly 20% that is hardly consistent with a rising interest rate.

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