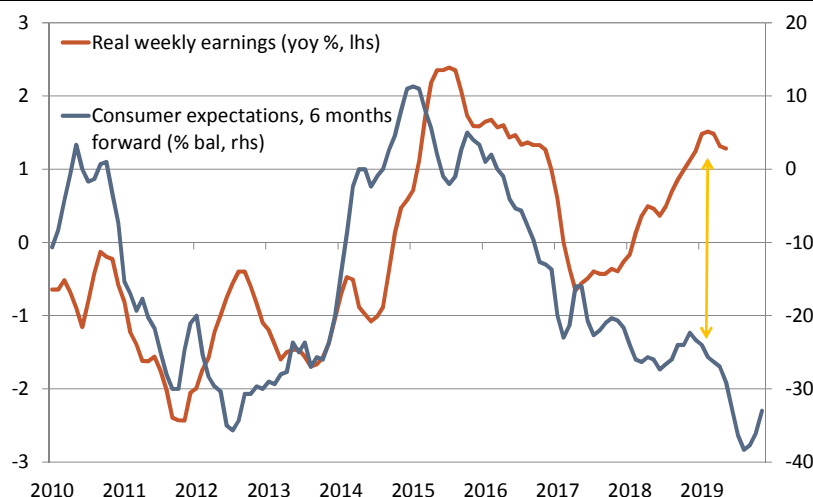


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31 May 2019

UK: mind the Brexit gap – real wages versus consumers' outlook

The Brexit effect – household expectations versus real wages



Monthly data, three-month moving averages. Consumer expectations for next 12 months. Source: Office of National Statistics, GfK.

- Mind the gap:** Changes in underlying fundamentals often show up in confidence measures before they affect lagging variables like real wages. As our chart shows, consumer expectations increased strongly from 2012 until 2014 as the UK economy rebounded from the 2010-2011 soft patch linked to the crisis in the neighbouring Eurozone. Boosted by the falling oil price in 2015, real wages continued to rise a little thereafter despite a downturn in expectations. By late 2015, both variables had started to jointly decline as global worries mounted. The UK's Brexit vote in 2016 caused further falls as uncertainty clouded the outlook and rise in inflation from the 15%-plus sterling depreciation squeezed real wages. Beginning in 2017, however, a gap has emerged. Although real wages are up, household expectations are down on the back of persisting Brexit worries.
- Households keep spending anyway:** Real domestic consumption has expanded at an average annual rate of 2.1% since the Brexit vote, compared to 2.6% in the two years before the referendum. Real retail sales growth has slowed only modestly to 3.1% yoy from 3.8% over the same period.
- Healthy consumer backdrop:** Labour demand remains strong. Employment, net wealth and job vacancies are near all-time highs. Now that the initial inflation shock following the Brexit vote has faded, households can expect real wage gains of 1.5% yoy over the medium term. The solid household fundamentals show up in other survey-based measures of household sentiment. In the latest data for May, headline consumer confidence was in line with the 20-year average of -10, while households' current financial situation was 26 (above the 20-year average of 20).
- Not all is well, of course:** Despite stable gains in headline consumption, some parts of the consumer sector are weak. Autos demand has softened badly since the Brexit vote. New car registrations declined 3.7% on an annual basis in the year to April. The outlook remains soft. This is no surprise. When consumers are uncertain about the future, they shorten their spending horizons – they maintain day-to-day spending but shy away from big purchases.
- A warning sign:** UK households have mostly managed to weather the initial Brexit shock well. However, a slide in expectations and weak demand for some big ticket items carry a clear message. A hard Brexit would raise uncertainty and, most likely, squeeze real wages via a spike in inflation due to a drop in the exchange rate. In this case, household demand could weaken badly. Consumption makes up nearly 70% of UK GDP. Where households go, the economy usually follows. [A hard Brexit](#) (35% risk) presents the single biggest risk to the outlook for domestic consumption and the broader UK economy.

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