

## Gertrude Tumpel-Gugerell: Retail sales from a euro area perspective

Speech by Ms Gertrude Tumpel-Gugerell, Member of the Executive Board of the European Central Bank, at the World Retail Congress, Berlin, 25 October 2010.

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It is a great pleasure for me to be here in Berlin today at the World Retail Congress.

Retail sales constitute about 45 percent of private consumption, which in turn amounts to a share of almost 60% of GDP. Thus, retail sales alone explain around 30 percent of aggregate demand in the euro area.

These impressive figures are enough to underline the importance of the retail sector for the overall economy. As you know, the primary objective of the ECB's monetary policy is to maintain price stability. The Governing Council of the ECB aims at keeping inflation rates below, but close to, 2% over the medium term. In order to reach this objective we must assess the inflation outlook continuously.

We form our view on future inflation by closely following and monitoring a wide range of indicators that affect inflation and the economy's output of goods and services. Retail sales is one of those indicators and certainly – as the figures above show – an important one.

In my presentation I would like to briefly touch on three questions:

1. How was the retail trade sector affected by the crisis?
2. How do – in general – financial variables and monetary policy affect private consumption and retail trade?
3. And, what is – in our view – the future outlook for the retail trade sector?

Let me turn to the first question on how sales in retail shops and stores were affected by the crisis.

**In Chart 1** you see the annual rate of change in the volume of euro area retail sales alongside with private consumption and GDP. You see that retail sales move clearly in tandem with private consumption and GDP. As GDP and consumption declined in the recent recession, so did retail sales. During the crisis, households drew back on consumption, hence private consumption growth slowed down on the basis of lower growth in incomes, reflecting mainly weak employment growth.

We can see in **Chart 2** that the low growth in real disposable income was mainly driven by the decline in overall employment. Real compensation per employee, in contrast, contributed positively in 2009 – mainly due to the low inflation rates during that time – before stagnating again in the beginning of this year. In addition, financial wealth declined in 2008, thereby further depressing consumption growth.

Another key determinant of aggregate demand are consumers' expectations. **Chart 3** gives additional evidence on how consumers' expectations and confidence declined in parallel with private consumption during the recession period. More recently, consumer confidence has increased while the indicator on major purchases, which is an indicator for durable goods consumption, has declined reaching a record low level.

Let me now turn to the second question: How do financial variables and monetary policy affect private consumption decisions and retail trade?

Loans to households, whose developments are presented in **Chart 4**, are an important indicator for the analysis of consumer spending. Hence, the ECB regularly monitors household loans as they are a key channel for the transmission of monetary policy.

Allow me to elaborate a little bit more on this point. Loan developments in the euro area can be explained by their main determinants, such as house prices, various interest rates and real income. In line with this, we saw that the annual growth rate of loans to households – after some months in negative territory – has turned positive towards the end of 2009 and since then has continued to increase steadily [ *last observation: 2.9% in August 2010*]. This positive annual growth of loans to households reflects mainly developments in lending for house purchase. Loans for consumer credit are still contributing negatively to overall loan growth. These latest developments in loans to households confirm the broad consistency with business cycle regularities, which suggest that the turning point in the growth of loans to households takes place early in the economic cycle.

The loan development needs to be seen in the context of the current low level of interest rates. Indeed, bank lending rates for loans to households for house purchase declined further in the second quarter of 2010 – still to a lesser extent than in the previous quarters. The levels of lending rates for loans to households we are currently seeing are comparable to the levels observed in 2005. For shorter-term maturities, the interest rates are even lower than in 2005. Still, at the same time, the net percentage of banks reporting a tightening of credit standards for loans to households remained unchanged in the second quarter of 2010, compared with the previous quarter. Overall, we can see that the ECB's monetary policy since the onset of the financial crisis has been very much supporting private consumption demand, and thereby retail sales, while keeping a clear orientation to preserve price stability in the medium term.

During the crisis also fiscal policy was used to stabilise consumers spending and retail sales. This raised obviously the question on whether fiscal policy in a period of recession should take a more forceful orientation to stimulate consumption or a more prudent approach to discretionary fiscal policy making. In my view, while the operation of automatic stabilisers, whose impact on activity, income distribution and the sustainability of public finances is reasonably well understood and comparatively easy to predict, discretionary changes – particularly if they are temporary – have mostly a short-living effect on demand. The car-scraping schemes implemented in several countries are a good example. Schemes geared towards car purchases certainly stimulated demand in a period of high uncertainty. But such influence has not affected the underlying trend of demand of automobiles.

In **Chart 5**, which shows the level of car registrations in the euro area, Germany and Spain illustrates that indeed car sales have benefited initially from these schemes. However, it is also visible that the increase of demand for cars was mostly an anticipation of future demand. It may however have contributed to the swift recovery of the industry.

So far I discussed the main determinants of private consumption demand on a euro area aggregate level. Let me, however, also mention that the aggregate developments in the area mask heterogeneous and even divergent changes in different member countries that have been subject to shocks of a diverse nature. **Chart 6** shows that, while the downturn of retail trade was a common feature of most euro area countries, there were significant differences across countries between the levels of retail sales in 2010Q2 compared with the time just before the financial crisis in the autumn of 2008. Although it is clear that retail sales have contracted in most countries, it is also clear that differences across countries are quite significant. [ *The volume of retail trade in Greece, for instance, stood almost 20% below its level in 2008Q2, which compares with a fall of 2.0% in the euro area as a whole.*]

Before coming to an end, let me touch on my final question on the future outlook of the overall economy and consumption and retail in particular.

[**Slide 7**] Recent statistical releases and survey evidence continue to be consistent with the picture of a positive underlying momentum of the recovery in the euro area. The global recovery is expected to continue. At the same time, private sector domestic demand should gradually strengthen further, supported by the accommodative monetary policy stance and the measures adopted to restore the functioning of the financial system. However, the

recovery in activity is expected to be dampened by the process of balance sheet adjustment in various sectors.

We expect private consumption to grow at relatively moderate rates in the coming quarters before starting to gradually strengthen again. This can be explained by:

First, still weak labour markets and moderate growth in compensation per employee are likely to continue to prevent any significant rebound of disposable income. Nevertheless, real incomes are expected to benefit somewhat from improved corporate profitability.

Second, even though the saving ratio may decline slightly more, it wouldn't surprise me if it remained above its pre-crisis level over the coming years as a result of heightened economic uncertainty.

And third, a further strengthening in the growth rate of loans to households may still be contained by continued high debt levels and subdued developments in euro area house prices. At the same time, the results of the latest bank lending survey indicate that banks expect a lower degree of net tightening of credit standards for loans to households for house purchase in the third quarter of 2010. The same holds regarding credit standards for loans to households for consumer credit and other lending, where banks still expect a net tightening but somewhat less so in the third quarter of 2010.

In conclusion, let me summarise my main points:

- The development in retail sales and hence also total demand in the economy were affected negatively the recent financial crisis.
- EU governments and the ECB have reacted to the crisis in a swift and effective manner, avoiding worse outcomes and bringing the economy back on track.
- With regard to the future, I am confident that the economy is on a good recovery track. Now is the time to ensure that recovery and to make the growth prospect sustainable for the future. For this I see three major policy challenges ahead:

First, it is important to engage in sound fiscal policies. Indeed, a number of countries have to meet major challenges, and immediate, ambitious and convincing corrective actions are required. It is crucial to strengthen public confidence in the capacity of governments to return to sustainable public finances. If such a consolidation process is pursued in a credible way, short-term effects on economic growth could be followed by the positive effect of consolidation on confidence and the expectations for future growth.

Second, the urgent implementation of far-reaching structural reforms is essential to enhance the prospects for higher sustainable growth. Major reforms are particularly needed in those countries that have experienced a loss of competitiveness in the past or that are suffering from high fiscal and external deficits. Reforms are needed in the area of labour markets in order to strengthen productivity growth. We also need increased product market competition and greater investments in education to facilitate restructuring and to foster innovation and the adoption of new technologies.

And third, we at the ECB have the responsibility to continuously ensure low and stable inflation. This will support the purchasing power of euro area households, facilitate price comparisons and lower the real cost of credits. As we have delivered on this in the past 11 years, I am confident that we will continue to do this in the future.

Thank you very much for your attention.

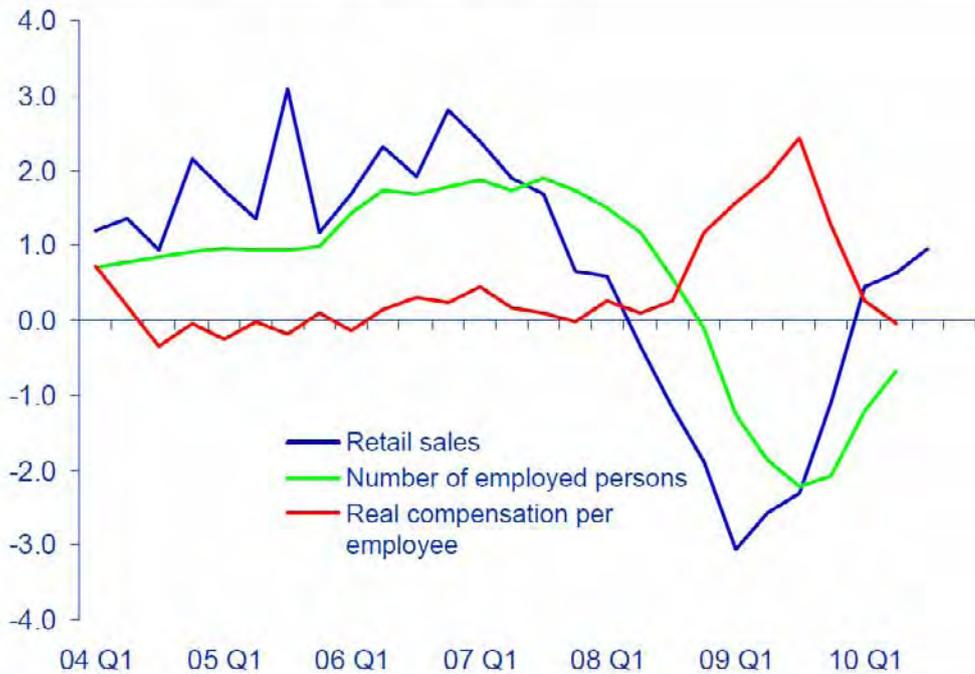
**Chart 1: Euro area GDP, private consumption and retail sales** (annual percentage change)



Source: Eurostat

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**Chart 2: Retail sales and real labour income breakdown** (year-on-year change, %)



Sources: ECB and Eurostat

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### Chart 3: Consumption and surveys

(year on year growth; standard deviations from series means)



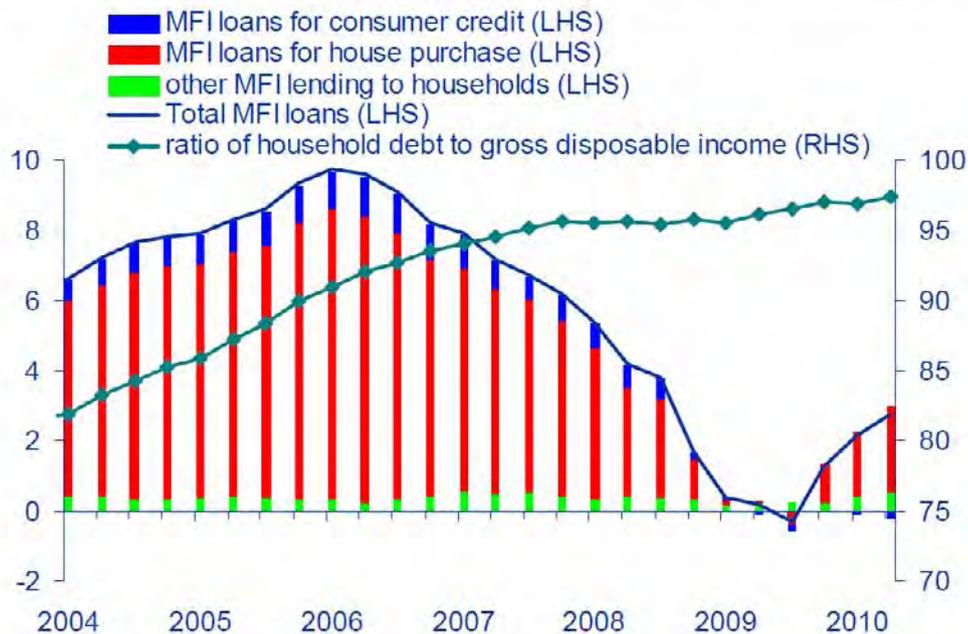
Sources: DG ECFIN, Eurostat and ECB.

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### Chart 4: Lending to households and household debt in the euro area

(annual percentage changes; pp. contributions; %)



Source: ECB.

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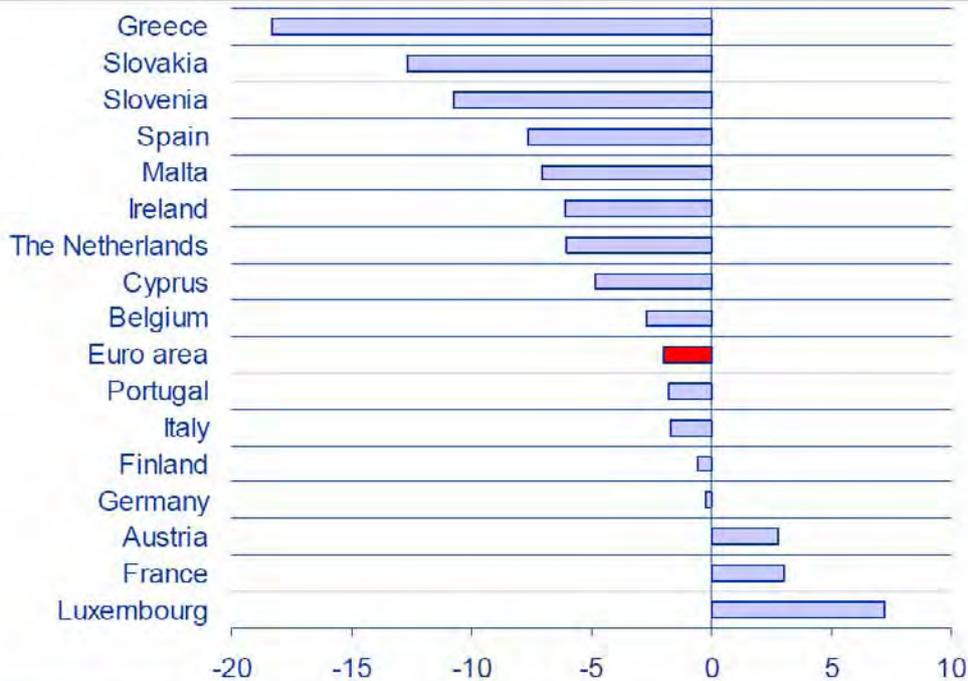
**Chart 5: New car registrations** (index: 1996 = 100)



Source: ACEA

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**Chart 6: Retail sales - percentage difference between 2008Q2 and 2010Q2**



Source: Eurostat

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## Concluding remarks and outlook

- Positive underlying momentum of the recovery in the euro area.
- Private consumption is expected to display moderate growth due to...
  - ... weak labour markets;
  - ... low growth in compensation per employee;
  - ... higher savings due to economic uncertainty; and
  - ... muted loan growth reflecting high debt levels and subdued house prices.
- Consumption should, however, benefit from...
  - ... real income developments due to higher profitability and declines in inflation; and
  - ... a lower degree of net tightening of credit standards.

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