

Regional Focus: Western European Consumer Confidence Plumbs New Depths

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Consumer confidence in Western Europe fell sharply in late 2008 and early 2009, reaching record lows in certain countries, including the UK.

Confidence is declining as a result of the global economic slowdown, rising job losses and a realisation that the downturn will be more severe than initially believed.

Although sentiment varies around the region, it is contributing to lower spending, popular dissatisfaction and negative business sentiment, which threatens more business failures and job losses throughout 2009-2010.

Key points

- Consumer confidence in Western Europe deteriorated sharply in late 2008 and early 2009, amid the global economic downturn. Western Europe was the region most negatively affected by the global financial crisis 2008 owing to its high integration in the world financial system.

According to a European Commission (EC) index in which scores above zero are positive and scores below zero are negative, confidence in the eurozone dropped from -19 in September 2008 to -31 points in January 2009, the lowest level since the survey began in 1985. Private final consumption has been a key driver of economic growth accounting for 57.3% of Western Europe's GDP in 2008;

- In January 2009, confidence was lowest in Greece and Portugal, and was the least negative in Scandinavian countries. Confidence in Germany, Western Europe's largest economy, plunged from -9 in September 2008 to -27 in January 2009;

- Key factors behind this pessimism include deteriorating economic news, continued problems in the banking sector, low levels of consumer lending, rising job losses, falling house prices and business failures. More importantly, the economic downturn in Western Europe is more severe than was initially thought;

- Falling consumer confidence is translating into lower spending. This will cause further problems particularly for the retail sector, where the number of business failures and job losses are likely to rise in 2009. More frugal spending may benefit budget retailers but will generally be damaging for most retailers and manufacturers;

- Prospects are very uncertain. Ongoing problems in the Western European financial services sector will feed through to the real economy. The eurozone is expected to shrink by -2.0% in 2009 compared to 2008 growth of 1.0%, with EC forecasts expecting the largest contraction in Ireland (-5.0% compared to -2.0% in 2008).

Confidence keeps falling

- According to the EC index, consumer confidence in the eurozone fell to -31 points in January 2009, its lowest level since 1985. The previous low of -29 points occurred in June-August 1993, during a recession which was less severe than the 2008-2009 downturn;

- The gloomiest consumers in Western Europe were in Greece (-48) and Portugal (-51), perhaps reflecting sentiment arising from the high risk of default on government debt in both countries, high unemployment rates and popular dissatisfaction with the government. Greece experienced riots in late 2008 and early 2009 and is reliant on services such as shipping and tourism, which are suffering due to lower global demand;

- Scandinavian consumers appeared the most upbeat. In Finland, the confidence index actually rose to -3 in January 2009 from -6 in December 2008, while in Sweden the index rose to -8 from -10 over the same period. Scandinavian economies are believed to be less severely affected than their regional counterparts, partly due to lower levels of debt, although all are expected to weaken in 2009;

- Perhaps the most dramatic drop in confidence took place in Germany, Western Europe's largest economy, where the index fell from -9 to -27 points between September 2008 and January 2009. This reflects rapidly deteriorating conditions, with the economy contracting -2.1% quarter-on-quarter in the final quarter of 2008 partly thanks to lower demand for German exports, which are vital to the economy.

Global and regional economic conditions take toll

Falling consumer confidence reflects belief that the global recession is more widespread and deeper than previously thought:

- The eurozone contracted by -1.5% quarter-on-quarter in the final quarter of 2008. This was the third successive quarter of contraction and means the eurozone is technically in recession (two consecutive quarters of contraction). In January 2009 the IMF revised its global GDP forecast for 2009 from 2.2% growth to 0.5% growth. With Western Europe highly integrated in the global economy, these downgrades are affecting businesses and consumers;
- Unemployment is rising across the region. In the eurozone, unemployment reached 8.0% in December 2008, its highest level since November 2006, while in the UK unemployment in the final quarter of 2008 was 1.97 million, its greatest level since 1997. Job losses have occurred across most sectors but especially the manufacturing, financial services and retail industries, where demand for Western European goods and services have dropped. This has particularly affected export-oriented economies such as Germany, where exports represented 42.6% of GDP in 2008;
- Falling property prices are depressing consumer confidence further. Several Western European countries, especially Spain and Ireland, are experiencing the end of house price bubbles, which means that consumers face losing money on their investments. The construction sector is undergoing a sharp downturn, causing the worst impact in countries such as Ireland or Spain where it accounted for 11.0% and 13.8% of GDP respectively in 2008;
- Large numbers of individual stock market investors saw the value of their assets fall in 2007-2008. With the belief that their net worth is decreasing, these consumers will generally take a more cautious approach to spending – especially on non-essentials;
- Continued problems in the financial services sectors will also depress confidence. With banks tightening credit restrictions, particularly in badly-affected markets such as the UK or Ireland, it is more difficult for consumers to obtain loans for major purchases.

Vicious circle

Lower consumer confidence is adding to problems for consumer-based businesses:

- Eurozone retail spending fell 1.6% year-on-year in December 2008, according to EU figures, while the household savings rate rose to 14.4% in the final quarter of 2008 compared to 14.0% in the third quarter. Cautious consumers are cutting back on spending to concentrate on essentials and avoid luxuries;
- More frugal spending habits will benefit lower-end retailers, for instance budget supermarkets, which have enjoyed increased revenues in 2008, but will create further difficulties for most companies and are likely to trigger more job losses. Nonetheless, currency swings should help some countries: for instance the collapse of the UK pound against the euro since mid-2008 may benefit the retail and tourism industry in the UK by offering cheaper prices than the eurozone;
- Business confidence is also falling: the EC Economic Sentiment Index (ESI), a composite of business and consumer confidence, fell in the eurozone from 88.9 in September 2008 to 67.1 in January 2009, its lowest since 1985. Depressed sentiment is likely to discourage corporate expansion and job creation;
- The risk of social unrest is increasing thanks to popular dissatisfaction with government policies, which are perceived to have had little impact on improving economic prospects. Another key issue is protectionism, especially for jobs, as evidenced by protests in the UK in early 2009 against the perceived favouring of foreign workers over UK nationals.

Prospects

The economic situation in Western Europe remains volatile. With further company failures and downgrades to growth in early 2009 it is likely that consumer confidence will remain very low. Prospects for improvement will partly depend on the impact of government stimulus plans, but also on a global recovery to raise international demand for Western European goods and services.

Government actions vary from partial nationalisation of struggling companies, as exemplified by the UK banking sector, to expansionary infrastructure spending, which is planned by France. Germany, for example, approved a €50 billion stimulus package in January 2009.

There is, however, the risk of protectionist plans, such as proposed aid to the automotive industry by the French government, which may cause divides amongst Western European countries as they are deemed to be anti-competitive.

A recovery in overall GDP growth in Western Europe is not expected before 2010. The deepest recession in 2009 is expected in Ireland at -5.0%, due to the bursting of a construction and housing bubble, high levels of consumer and government debt, the country's close relationship with the USA, and the comparative strength of the euro compared to the UK pound.

Consumer confidence in Western Europe will rebound in line with an economic upturn in 2010-2011.

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