

Retail Forecasts

Surviving the price surge

Public Executive Summary

June 2022

Retail has come out of the pandemic better off than if it never had happened! Although it wasn't easy. Spending patterns should be more consistent from here on, however there are new challenges that could put the brakes on overall spending from H2 2022. Rising inflation, higher borrowing costs and stagnant wages are weighing on the outlook. Retailers may see a pull back in overall spending and a shift to value purchases, with margins squeezed and the cost of business rising.

After a mammoth end to 2021, retail's momentum could not be slowed down even with the Omicron outbreak, flooding on the eastern coast and rising inflationary concerns. Any impact of renewed COVID safety measures in Jan-22 was trumped by consumers rushing back to stores and spending in Feb-22 and Mar-22 meaning real retail turnover rose 1.2% over the March quarter. **All this growth has seen real retail spending levels surpass the pre-COVID trend by 6.2%.** And that's just the footing retailers wanted to be on starting 2022.

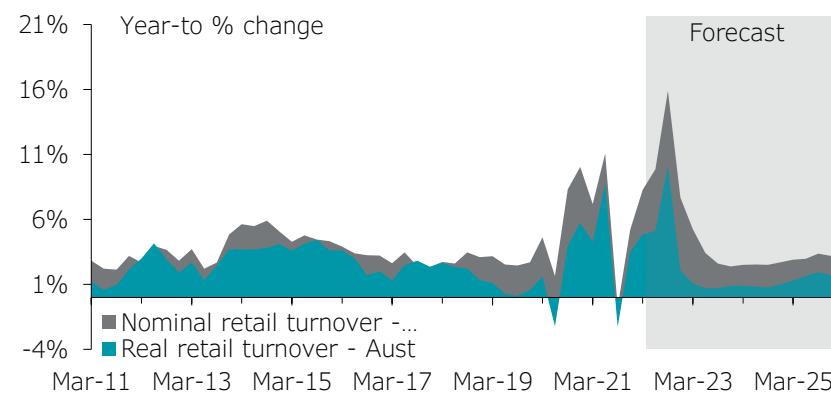
Returning mobility, record employment and pent up demand are likely to drive further gains in retail spending over the near term as the virus holds us back from very little these days. Despite most categories overtaking their pre-COVID trend, demand still remains hot for those impacted the most by lockdowns.

Hospitality is likely to benefit from pent-up demand for social interaction, with Deloitte's Global Consumer Tracker showing a big lift since early 2022 in consumers willing to visit restaurants. It is also the category that seen comparatively lower price growth as a higher proportion of costs linked to wages, which lag behind inflation.

Apparel and department stores are also expected to gain too. **The colder weather is likely to support wardrobe refreshes after consumers have spent the last two winters in lockdowns.** And as inflation pressures mount across the economy, discount department stores are likely to benefit from a 'flight to value'. Globally, sentiment is now rising for brand switching and purchasing cheaper alternatives.

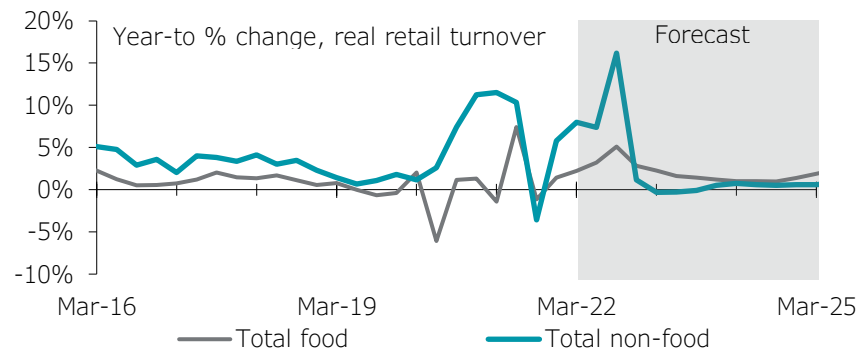
All in all, **double digit sales growth is expected for apparel, catered food and department stores over 2022** (compared with locked down 2021), driving a very healthy real retail sales performance of 5.5% growth over 2022.

Retail turnover growth (real and nominal)

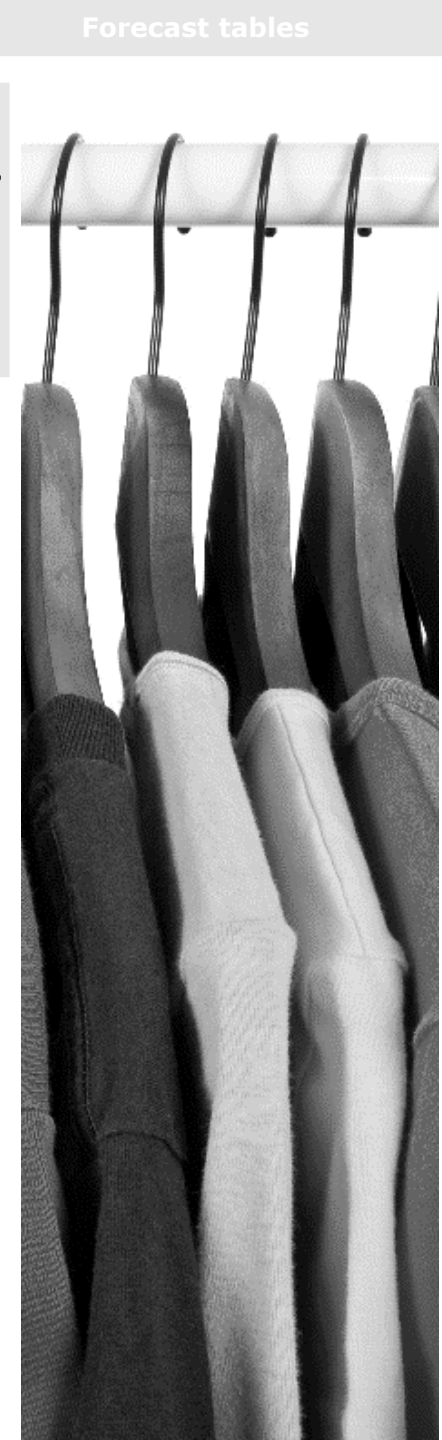


Source: ABS Cat 8501.0, Deloitte Access Economics

Real food and non-food retailing



Source: ABS Cat 8501.0, Deloitte Access Economics



The retail sector is facing strong price pressure on prices, such that the majority of turnover growth over the next few years is expected to be driven by prices rather than volumes

But over the whole retail sector the inflation challenge is now a reality. Supply chain disruptions, the Ukraine invasion and stockpiling have seen transport and commodity prices soar in Australia and globally.

For households, the price pinch is near unavoidable with CPI price growth for non-discretionary goods and services (up 6.6%) more than double that of discretionary (up 2.7%). These non-discretionary goods and services are the ones households are less likely to reduce their consumption of including food, fuel, housing and health. As the price of essentials increases, it is likely that non-essential categories are squeezed leaving retail quite exposed (both directly and indirectly) to the impact of rising prices.

The March quarter saw retail prices up by 3.2% over the year, driven by a 4.5% increase in retail food prices. And the cost of inputs is unlikely to taper anytime soon as producer prices were 16% greater than pre-pandemic levels in March. This means retailers are likely to feel the brunt of rising costs for a while. These forecasts show retail price growth peaking at 5.5% over the year to December 2022 (with food retail prices up 7.6% over the same period).

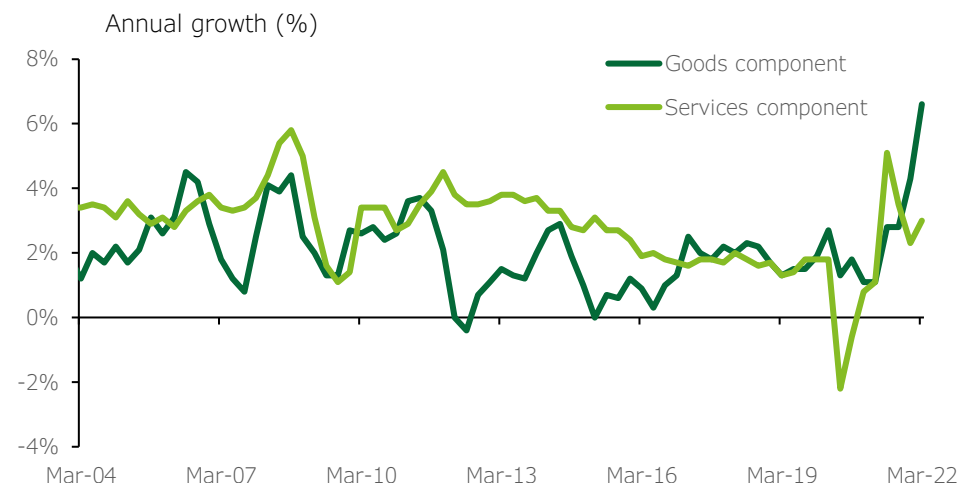
Hence the majority of retail turnover growth for H2 2022 and into 2023 and 2024 will be driven by prices rather than sales volumes. Retail sales volume growth may average only 1.1% over 2023 to 2025, compared to 1.9% per annum for retail price growth.

That forecast includes some moderation in price growth after a peak in December 2022. There are some initial signs of encouragement. Shipping costs are back to levels seen this time last year and the reopening of some Chinese cities should ease disruptions to manufacturing and trade. Most notably, the Reserve Bank is looking to actively suppress price growth through a sequence of interest rate rises.

For now though, businesses may need to look to ways to lower costs and reduce disruptions to operations to avoid losing competitiveness. This could involve diversifying and building more resilient supply chains, or shifting to a more vertically integrated structure to better control supply chain visibility. With wage pressures high, businesses may need to maximise staff retention as much as possible. The cost of replacing staff is high, and investing in systems such as training capabilities, talent pipelines and automation can help improve retention.

Overall the cost of living squeeze, higher interest rates and preference for spending on services are expected to lead to a slowdown in retail momentum through the second half of 2022, which may then result in real per capita spend on retail falling over 2023 and 2024. That means the speed of return of net migration will become a significant driver of retail's future growth prospects.

Goods and services CPI growth



Source: ABS Cat 6401.0

Managing retail inflation - The retail sector is facing broad-based pressures across the supply chain and this is seeing the largest spike in prices since the 1990s

Inflation is becoming increasingly broad-based in Australia, and that means in the retail sector. **Supermarkets are the retail category which has seen the biggest impact from price growth so far.** Sky high transport and fertiliser prices have placed pressure across the food supply chain. Some of this stems from the Ukraine invasion with oil in short supply and sanctions placed on Russian fertiliser imports. Then there are also the drivers back here at home, with flooding in agricultural areas of New South Wales and Queensland early in the year impacting crop yields and logistics. As a result of these pressures, vegetables and fruit prices for consumers have grown 6.6% and 4.9% respectively over the March quarter 2022.

But it's not just food. Consumers are also feeling the pain on non-food purchases with price growth at 2.0% over the quarter and 5.2% over the year. Imported furniture has been one of the sectors hardest hit and electronics are also hurting from the semiconductor chip shortages. **Even apparel and department stores, which has traditionally seen lower levels of price inflation than other retail sectors, are seeing price rises.**

With import prices at record levels and global drivers not easing yet, the cost of inputs may stay elevated for a while. The IMF have already revised their inflation forecasts twice this year – each time predicting inflation to remain elevated for longer than previous forecasts. And particularly for retail, this means the goods they import from manufacturers overseas are still expected to increase in price.

But it is producer prices which tell an even more concerning story. Since the beginning of the pandemic producer prices in Australia have increased 16%, and a lot of this rise came in the March 2022 quarter, increasing 4.1% over the quarter and 15.1% over the year. And the cost of inputs is unlikely to taper anytime soon as fuel and energy prices creep upwards. This means retailers are likely to feel the brunt of rising costs for a while longer from both imported and local components.

In the UK, **the Retail Price Index was up 11.1% in April compared a year earlier** – the highest retail price rise in more than a decade, while sales volumes saw the biggest annual drop since January 2021 as consumers limited their purchases in response. The picture is slightly less dire in the US, but consumers there are grappling with similar food price hikes.

For now though, **businesses may need to look to ways to lower costs and reduce disruptions to operations to avoid losing competitiveness.** This could involve diversifying and building more resilient supply chains, or shifting to a more vertically integrated structure to better control supply chain visibility. With wage pressures high, businesses may need to maximise staff retention as much as possible. The cost of replacing staff is high, and investing in systems such as training capabilities, talent pipelines and automation can help improve retention.

Source: ABS Cat 6401.0

UK Retail Price Index
Change on year earlier (%)



Source: UK Office for National Statistics

Our publications



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Business Outlook is a quarterly publication aimed at those who require depth of detail about the business environment, analysing prospects across 22 industries and each of the Australian States and Territories. It provides facts, figures and forecasts on Australian and world growth prospects, interest rates and exchange rates, wages and prices, exports and imports, jobs and unemployment, taxes and public sector spending. These forecasts strengthen and enhance your strategic planning capacity.

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Retail Forecasts

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Tourism and Hotel Market Outlook

Tourism and Hotel Market Outlook is an annual publication that provides insight into the issues facing the Australian tourism and hotel sectors, including in-depth analysis of recent trends and their underlying drivers across the domestic and international tourism markets. The *Tourism and Hotel Market Outlook* publication includes analysis of ten of the country's major hotel markets (including all capital cities) and forecasts growth in supply, occupancy, room rate and revenue per available room (RevPAR) across the ten major Australian tourism markets.

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