Retail Health Index December 2023

KPMG Australia

Contents

Introduction

Welcome to KPMG Australia's Retail Health Index© (RHI), which provides data driven insights on the future health of Australia's retail sector from the perspective of businesses operating in the sector.

In our last edition, the KPMG RHI suggested that the health of Australia's retail sector had hit bottom and begun the slow journey back towards the longer-term benchmark for sector health, with retail trading conditions not expected to normalise until well into 2025.

Our current RHI suggests a modest acceleration of trading conditions may be in play, with retail sector health predicted to return to positive territory as early as Christmas 2024. Wouldn't that be good news!

So, what has changed?

Well, let's start with what hasn't changed.

Consumer confidence remains well below its long-term average, sitting at 77.9 points in October per Roy Morgan research. Indeed, consumer confidence remains *lower* than levels recorded in the GFC and 52% of households believe they are financially worse off than a year ago, 37% believe the next 12 months' economic conditions will be *bad* and only 7% believe they will be *good*.

We also know that spending on discretionary retail remains soft (particularly household goods, clothing and footwear), and many retailers are concerned about November and December trading which often anchor the sales and margin performance for the whole year (see further comments below).

We also know that despite a pause in interest rate rises, the Reserve Bank of Australia (RBA) raised rates in early November by 25 basis points to 4.35% and has signalled more to come. The simple reality is the inflation demon remains unsustainably high at ~5.6% and the new RBA Governor, Michelle Bullock, is determined to wrestle it to the ground.

If you then consider the household savings rate has dropped below its long-term average to 3.2% and many homeowners are bailing out of their properties to avoid mortgage stress, an accelerated recovery of retail sector health seems a little hard to fathom.

So why is our RHI is suggesting a faster return to retail sector health?

The simple answer is because *despite* the anchors above, strong population growth (FY23 net population growth of ~600,000), slowing interest rises, and the wealth effect of higher property prices underpinning consumption is promising to tip the balance of the retail health drivers into positive territory, albeit we are not out of the woods yet.

What is the market saying?

Speaking with our market connections, we see some common themes.

- Retailers are worried about Christmas and the discount holiday (i.e. the *absence* of discounting) many retailers have enjoyed is well and truly over. Two years of consumers being *price takers* rather than price makers created a margin (and profit) bubble that was unsustainably good for many retailers. That bubble may not have burst yet, but it's certainly under pressure and cost out and capex constraints are the name of the game, as CEOs seek to protect their promised results for shareholders.
- Though online growth has reduced to modest levels (seasonally adjusted 2.1% in August 2023), that doesn't mean online sales are in decline. The pandemic gave online a boost globally and led to a structural shift in the mix of dollars spent online and offline. While it might be some time until Australia reaches the UK benchmark of ~38% of retail sales online (according to the KPMG BRC Retail Sales Monitor), there can be no doubt many retailers are now achieving much higher online sales penetration, and in Australia ~25% is regarded by some as the sweet spot for online and offline sales channels.
- While some supply chain costs may have reverted to normal (e.g. global container freight rates have dropped from over US$10,000 to US$1,700), these savings have been offset by strong rises in local operating costs including labour, energy and other inputs (that inflation demon again…). So, as price discounting returns to the market, this inevitably means margin squeeze, albeit off a high base for many, meaning cost out and operating efficiencies become the name of the game.
- Discretionary spending categories such as homewares, household goods and leisure equipment are hurting more than most. Stands to reason really. For some retail categories, the *pull forward* effect of the pandemic was real. Many of us bought new TVs, furniture, BBQs, surfboards, bikes and SUVs in the last two years. We simply don't need to buy more or replace what we have (yet).

We hope you enjoy reading our KPMG RHI report and if you would like to know more about how KPMG can help your business, please contact us.

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Retail Health Index

KPMG's Retail Health Index© (RHI) has risen by a faster rate than was anticipated only three months ago, suggesting retail health will return to a positive territory in the final quarter of next year as the cumulative impacts of higher population growth and moderating interest rates outweigh negative elements impacting the sector.

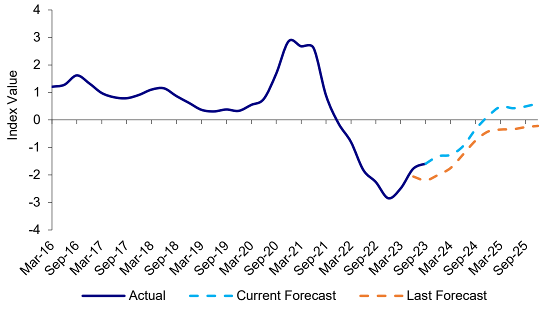
Better times are still coming, and a bit sooner…

Between the June and September quarters 2023, the KPMG RHI rose by 0.18 index points, moving from -1.77 to -1.59; an improvement over the previous quarter but one that still suggests the overall health of the retail sector remains poor.

Our revised forecasts of the components that make up the KPMG RHI also suggest the short-term outlook for the sector is improving, albeit the challenging business environment facing the sector will remain for the next 12 months.

FIGURE 1

KPMG Retail Health Index, Actual & Forecast



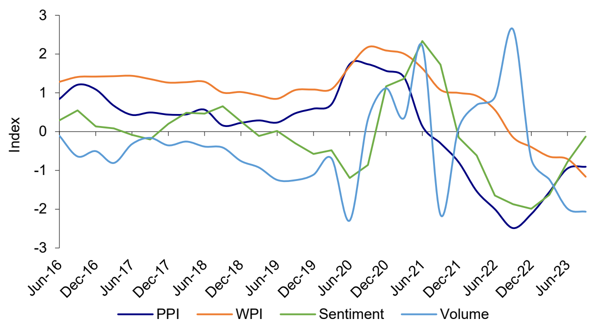
Source: BoE, ECB, FRB, RBA, Haver, KPMG

Our 2023Q3 forecasts suggest, however, the protracted downturn in the sector is now not anticipated to stretch into 2025 as previously expected. By the end of 2024 it is now anticipated that the current strong population growth will be incrementally adding to retail sector demand more consistently; the interest rate cycle will have peaked and started to contract towards more balanced monetary policy settings; and wealth effects associated with higher property prices will become accretive to aggregate consumption activity.

From an individual component perspective, retail sales volumes and producer prices have now both stabilised, consumer sentiment is lifting albeit at weak levels, and industry specific wages growth is adding pressure to the sector's performance.

FIGURE 2

KPMG RHI by Component Factors



- **PPI**: from -0.95 to -0.90 (i.e. between 2023Q2 and 2023Q3 the growth rate of PPI decreased from being 95% above its historical average to 90% above its historical average). Based on its weight of 0.64 (see Technical Appendix), PPI contributed -0.58 index points to the RHI in the September quarter 2023, down from -0.61 index points in the June quarter 2023. The deceleration in PPI growth during the three months to September positively contributed 0.03 index points to the RHI.
- **WPI**: from -0.71 to -1.16 (the growth rate of the WPI increased to 116% above its historical average from 76% above its historical average during the three months to September 2023), contributing -0.53 index points to the 2023Q3 RHI (up from -0.33 index points in 2023Q2). The recent pick-up in wages growth has contributed negatively (-0.33 index points) to the RHI between the June and September quarters.
- **Sentiment**: from -0.16 to -0.10, and contributes -0.1 index points in the 2023Q3 RHI (down from -0.45 index points in the 2023Q2 RHI).
- **Volume**: from -1.99 to -2.07, and contributes -0.39 index points in the 2023Q3 RHI (compared to -0.37 index points in the 2023Q2 RHI).

Spending indicators

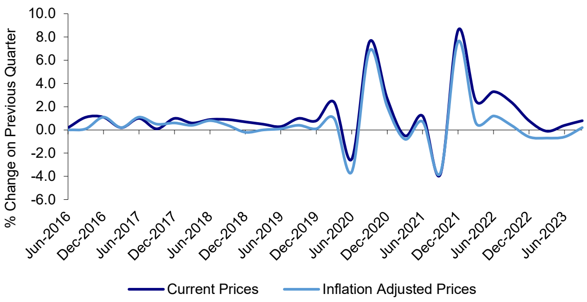
The September quarter saw consumers spending greater amounts on discretionary items, with marginally higher volumes of goods and services purchased during Q3 than Q2, although total sales activity remains below peak levels.

Retail sales

Retail turnover at current prices increased by 0.8% during the September quarter of 2023, and doubled the rate of growth achieved in the June quarter. From an inflation-adjusted perspective, retail sales volumes rose 0.2% during the quarter – the first quarter of rising activity levels since 2022Q3. Within the context of declining turnover, consumers are spending proportionally less on food and groceries, suggesting the 'nice to haves' are now being left out of the household shop.

FIGURE 3

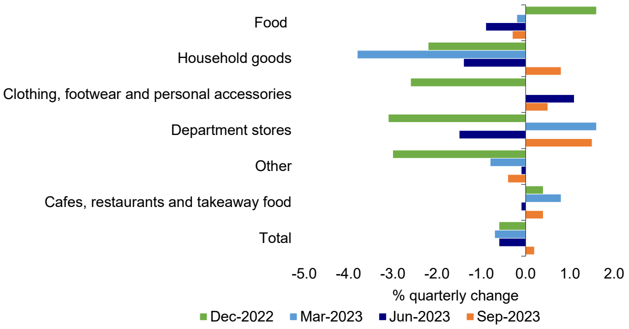
Change in Retail Turnover, Australia, Current and Inflation Adjusted, Quarterly



Other retailing (-0.4% q/q) and Food retailing (-0.3% q/q) experienced the only declines in spending activity during the quarter. There was surprising strength in Department Store retailing (1.5% q/q), Household goods retailing (0.8%) and Clothing, footwear and personal accessory retailing (0.5%) during the quarter.

FIGURE 4

Change in Quarterly Inflation Adjusted Sales by Category, Australia



End of season discounting and destocking by Department stores, combined with migration have been suggested as the driver of the positive turnaround in sales volumes during the September quarter.

Consumer sentiment

Consumer sentiment has taken another nosedive in October 2023 following several consecutive months of improvement that were most likely linked to the RBA pause in raising the cash rate.

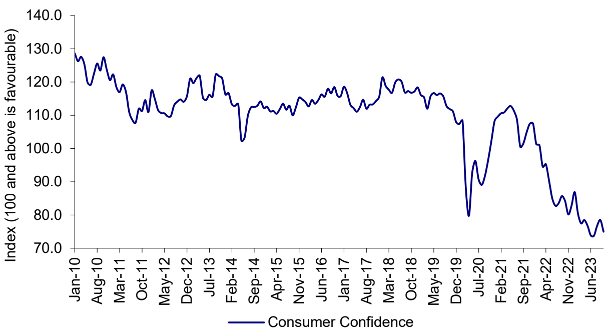
The Westpac–Melbourne Consumer Sentiment Index for Current Conditions has continued to remain below the neutral 100 mark for 22 consecutive months now – the second longest period of negative sentiment since 1974 (the longest period being 45 consecutive months between the start of 1989 and the end of 1992, coinciding with the period post the 1987 stock market crash and incorporating the 1991 recession).

The downturn in consumer sentiment is most pronounced in outlook for economic conditions over the next five years. This index has slumped to levels last seen at the height of the pandemic uncertainty, and are lower than levels recorded during the GFC.

There is a pattern in the ANZ–Roy Morgan Consumer Confidence survey question associated with *Time to Buy a Major Household Item.* Since May 2022, the survey results (generally) show a drop in the Index reading in the week following an RBA Board meeting where the cash rate was increased; however, the Index then recovers some of the fall during the subsequent weeks until the next RBA Board meeting occurs and ratchets down again if the cash rate rises.

FIGURE 5

ANZ–Roy Morgan Consumer Confidence



Cost indicators

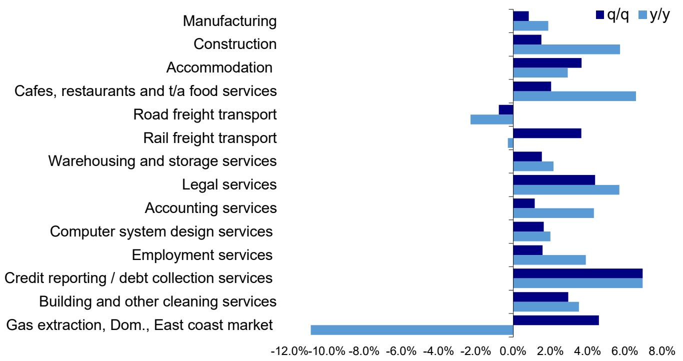
Producer Price Index

The producer price index (PPI) increased by 1.8% q/q in the third quarter of 2023; the highest rate of growth since the same quarter last year, and prior to that it was the September quarter 2008 where quarterly PPI growth was of a similar strength (1.9%). This very strong lift in PPI followed several quarters of soft growth meaning annualised PPI is running marginally lower in the September quarter at 3.8%, down from 3.9% recorded in June.

Three-quarters of the 60 categories that contribute to the PPI recorded either zero price increases or disinflation in the September quarter of 2023 – more than what occurred in the June quarter. However, of the 15 categories contributing to the increase in PPI, fuel, electricity, construction and takeaway food saw significant increases that swamped the smaller negative or flat price adjustments in the other 45 categories.

FIGURE 6

Producer Price Index, Output Price Growth by Selected Industry Sectors, June Quarter 2023



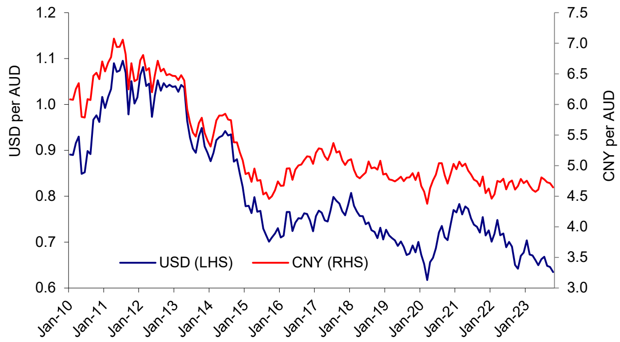
Foreign exchange

The Australian Dollar continues to trade at relatively weak levels in foreign exchange markets, falling from USD 0.664 at the start of July 2023 to be trading at around USD 0.656 at the time of writing the report (24 November 2023) – although the AUD/USD exchange rate hit a low of USD 0.628 in late October.

On a Trade Weighted Index Basis, the AUD has depreciated by 1.3% since the beginning of July 2023 compared to 24 November 2023 rates; with the AUD appreciating against the Japanese Yen (1.7%) and depreciating against the Chinese Yuan (-2.9%) – Australia's two largest trading partners – during this period.

FIGURE 7

Exchange Rate, AUD vs USD vs CNY



Wages

The national Wage Price Index (WPI) for the private sector grew by 4.2% y/y at the end of the September quarter 2023. The Accommodation and food services and Retail sectors recorded annual increases in total hourly rates of pay excluding bonuses of 5.6% and 4.4% respectively over the same time period.

Wages growth in these two sectors have been driven by the recent National Minimum Wage decision determined by the Fair Work Commission. The minimum wage set in modern awards, which covers about 60% of employees in the Accommodation and food service sector and about 30% of employees in the Retail sector, increased by 5.75% from 1 July 2023.

FIGURE 8

Annual Growth in Wage Price Index by Selected Industry

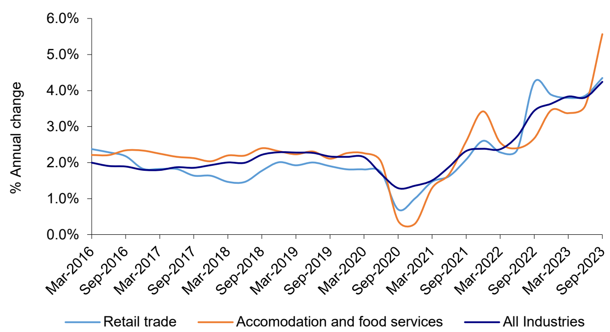
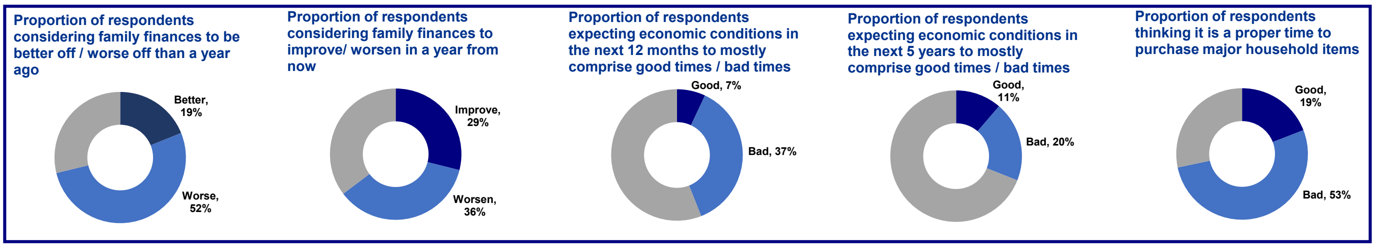


FIGURE 9

Westpac–Melbourne Institute Survey of Consumer Sentiment



Household spending

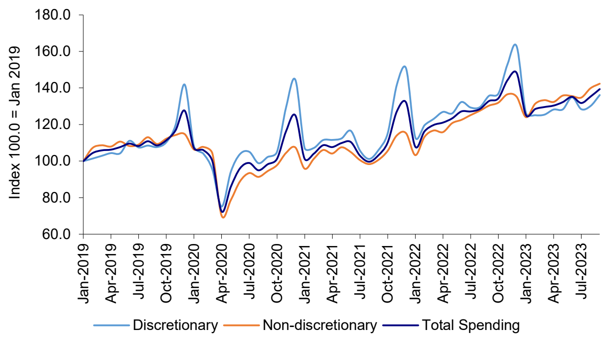
Household spending picked up during the September quarter 2023, with most of the growth coming in discretionary spending categories. Average non-discretionary spending (on a $-current, calendar-adjusted basis) grew only 0.8% over the three months from the end of June, whereas discretionary spending increased by 3.3% over the same time period. During these three months, average spending on goods decreased by -0.1%, while spending on services grew by 4.2%.

Over the three months to the end of September, for households the largest increase in (average) spending compared to the June quarter was on Transport (+6.2%), following by Health (+4.3%) and Recreation and culture (+4.1%). Conversely the categories recording the largest quarterly falls in average spending were Furnishings and household equipment (-4.3%), Clothing and footwear (-3.0%) and Alcohol and tobacco (-1.0%).

Average retail petrol prices rose 6.4% during the September quarter compared to the June quarter, and while some households enjoyed an expansion in household income via wage resets, it also appears most households needed to (further) reallocate spending away from ‘nice-to-haves’ to ‘necessary’. Despite this cost pressure, the national school holidays in September saw a material uplift in spending on Hotels, cafes and restaurants (4.6% m/m) and Recreation and culture (4.0% m/m).

FIGURE 10

Monthly Household Spending by Type, Australia



Population

At the end of June 2023, Australia’s population was around 26.5 million, a net increase of nearly 600,000 during the previous 12 months. About 20% of this population growth was via natural increases, while the remaining was the result of overseas migration.

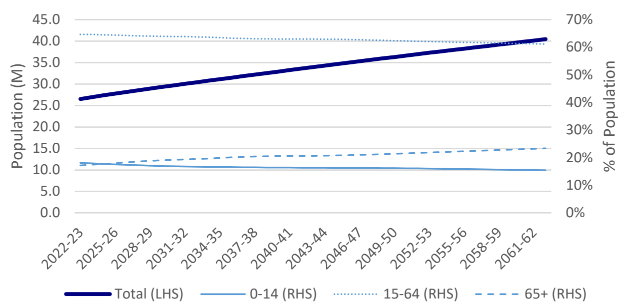
Overseas arrivals information shows about 7.7 million non-citizens landed in Australia on either a permanent or temporary basis during FY23; up from 1.8 million in FY22 and 0.3 million in FY21. Of these 7.7 million people, about 1.1 million arrived on permanent visas, 4.4 million arrived on temporary visas, 1.5 million were New Zealand citizens receiving a visa on arrival and 640,000 were international students.

There continues to be a significant return of international students to Australia. In the four months to October 2023, 266,000 international students arrived in Australia; which if this pace continues for the remainder of the financial year Australia will see annual international student arrivals of around 800,000 for FY24 – a level similar to that achieved in FY19.

Australia’s population is expected to reach 30 million around the end of this decade (or early into the next one) and then hit 40 million around 2060. Over the next 40 years we will see a greater proportion of Australia’s population aged 65 years or older (+6.1%) and a proportionally lower population aged 15 to 64 (-3.5%) and 14 years or younger (-2.6%). The implications for this on the retail sector are likely to be mixed (given older people tend to have less financial stress than working-age residents, although people also tend to reduce consumption as they age), while the implications for the government are much starker – lower working age population, lower per capita tax receipts (assuming no changes to current tax policy settings), and higher government spending on health and aged care.

FIGURE 11

Population Forecasts by Age Grouping, Australia



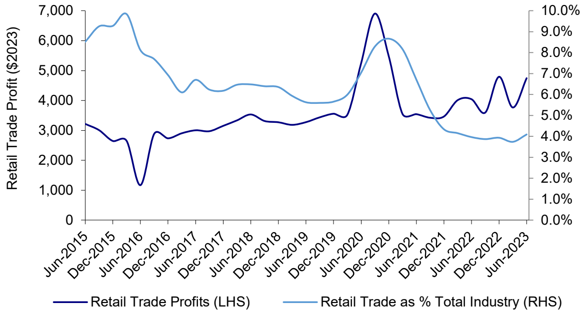
Performance indicators

Profitability

Profitability with the retail sector continues to be volatile, with the June quarter 2023 recording a near 25% uplift in profit before income tax compared to the March quarter 2023. This increase in profits for the sector was achieved against a broader challenging backdrop which saw aggregate profits fall 15% q/q. This lift in retail sector profits combined with the fall in profits nationally resulted in the retail sector lifting to now represent 4.1% of total industry profit (before tax) in Australia, which while it is an improvement, is still only around two-thirds of its long-run average of 6.4%.

FIGURE 12

Retail Sector Profit before Income Tax

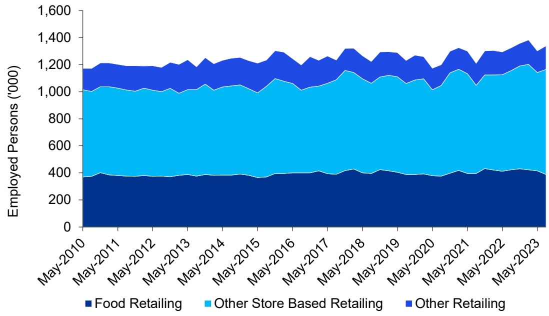


Employment

The retail sector employed 1.33 million people in Australia at the end of the September quarter of 2023. Food retailing employed around 390,000 workers, other store-based retailing around 778,000 workers, with the remaining 174,000 workers employed in other forms of retailing activities.

FIGURE 13

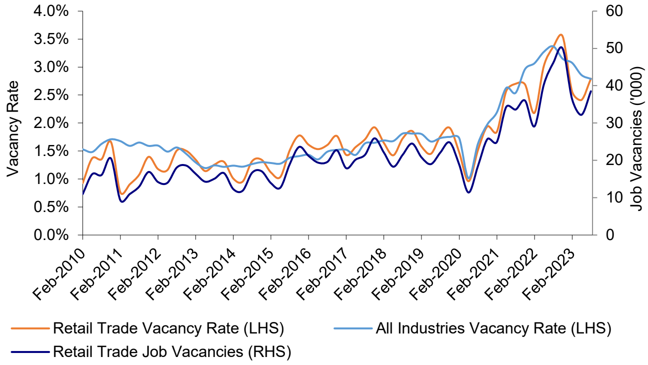
Retail Sector Employment, Australia ('000)



There has been a slight increase in the number of job vacancies within the retail industry in Australia, increasing from 32,200 unfilled jobs available within the sector in May 2023 to around 38,500 unfilled jobs in August 2023. This increase in job vacancies was proportionally larger than the increase in the number of people employed in the sector, resulting in a rise in the vacancy rate for the sector – a result opposite to the national trend which saw the aggregate vacancy rate fall over the three months to August 2023.

FIGURE 14

Job Vacancies

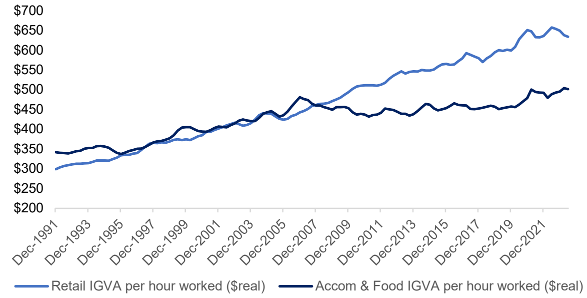


Labour productivity

KPMG has calculated a proxy labour productivity measure using real Industry Gross Value Added and hours worked. As show in Figure 14 below, the Retail sector has recorded steady productivity growth over the past two decades, growing around 2.4% per annum. In comparison the Accommodation and food services sector has seen labour productivity flatline from the late 2000s, with compound labour productivity growth of only 1.3% over the same time period.

FIGURE 15

Labour Productivity Estimates



Online indicators

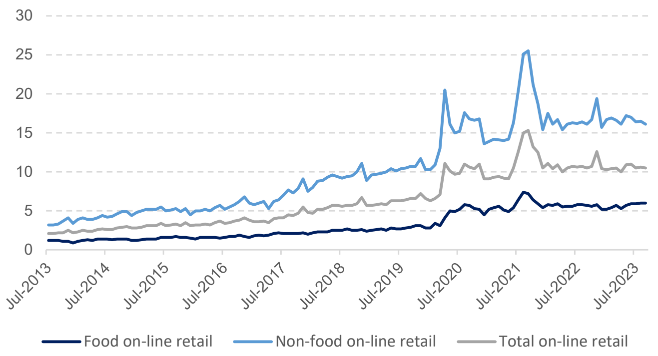
While the growth in online sales in Australia has slowed, overall online has stabilised at ~10% of total retail activity post-Covid, with online food at ~6% and non-food at ~16% of total sales. 'Click & collect' continues to be a preference for shoppers across food and liquor.

Online retail sales

Online retail sales totalled about $10.8 billion during the September quarter 2023, a drop of around 6.5% over the value of online sales recorded during the June quarter. Non-food online retail sales dropped 8.5% over the quarter, and was 1.6% lower compared to the September quarter 2022. Food online sales also fell during the September quarter by 2.5%, however compared to the same quarter last year, online food sales was 6.6% higher.

FIGURE 16

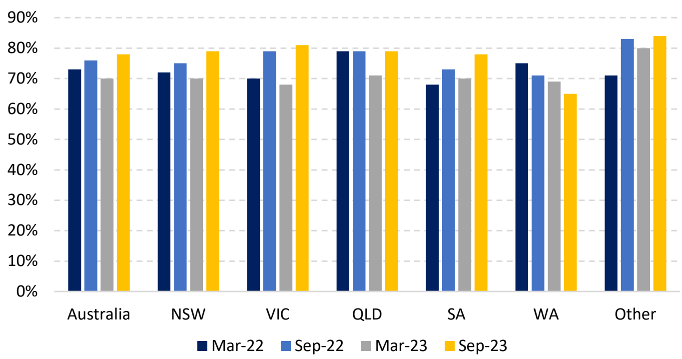
Online retail sales by type as a proportion of Total Sales



The University of Sydney Business School Transport Opinion Survey (TOPS) has shown a steady rise in the penetration of online shopping nationally, with 78% of Australians indicating they shopped online over the previous four weeks in September 2023 compared to 76% in September 2022.

FIGURE 17

Proportion of Australians who shopped online over the past four weeks

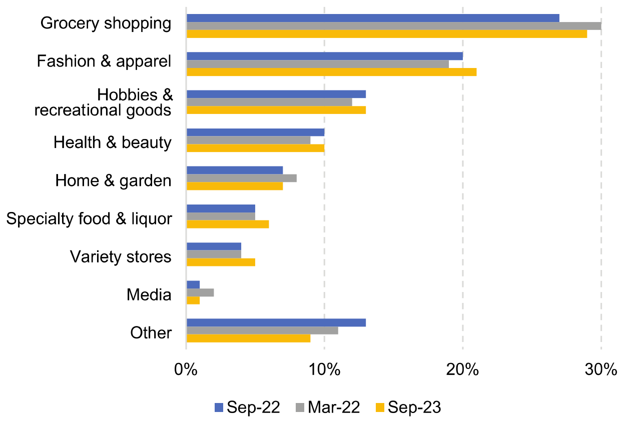


The TOPS survey also showed that the penetration of online shopping as a purchasing activity increased across all States and Territories over the 12 months to September 2023, with the exception of Queensland (which stayed constant at 79% – which is *higher than the national average*) and Western Australia (which fell from 71% in September 2022 to 65% in September 2023).

Respondents in the September 2023 survey indicated on average they spent $395 on online purchases over a nominated four-week period; an increase of $20 over the spend identified in September 2022. Of this expenditure, just under 30% was spent on Grocery shopping, 21% on Fashion and apparel and 13% on Hobbies and recreational goods.

FIGURE 18

How online expenditure was spent



The TOPS survey also questions respondents how the goods they purchased online are received by them; either as 'click & collect' purchases or delivered to a physical address. The survey shows that **40–50%** of online purchases in the categories of Grocery shopping, Variety stores, Speciality food and liquor and Home and garden products **are picked up** by the purchaser at the retailer's physical store or nominated outlet.

However, Pureplay online only retailers are more prevalent in the categories of Fashion and Apparel, Health and beauty, and Hobbies and recreational goods, where on average ~70% of online orders were delivered to the customer.

Technical appendix

The KPMG Retail Health Index (RHI) provides an assessment of the health of the Australian retail sector based on households' and producers' data available at a quarterly frequency. It represents the common component of series covering consumer behaviour and retailer's production.

A leading framework for the construction of an economic index from multiple time series is the so-called factor model. The factor model suggests the existence of a small number of unobserved series, called factors, which drive the co-movements of the observed economic time series. Leading applications of the framework includes the New York's FED Weekly Economic Activity Index.

In our application, we assume that there is a single factor, RHI_t, that drives co-movements of the retail variables, X_t

$$X_t = \Lambda RHI_t + \epsilon_t,$$

where Λ captures the factor loadings and ϵ_t refers to the idiosyncratic dynamics.

And the common method for estimating the unobserved factors is by principal components. In other words, principal component analysis is a dimensionality reduction method that is often used to reduce the dimensionality of large datasets, by transforming a large set of variables into a smaller one that still contains most of the information in the large set of variables. That is, principal components are constructed components from linear combinations of variables which best explain the variance in the data.

The RHI is computed as the first principal component of four quarterly variables: retail volume, the producer price index (PPI), the retail sector wage price index (WPI), and the Westpac–Melbourne Institute's consumer sentiment index. These data are then transformed to year-on-year growth terms. All transformed series are then standardised to have a mean of zero and a standard deviation of one. Furthermore, the growth rates of wages and prices are reversed for the purpose of interpretation, i.e. higher wages and costs mean the retail sector is not doing so well.

Table T.1 below shows the respective weights of each variable on the RHI, and the total variance explained by the RHI.

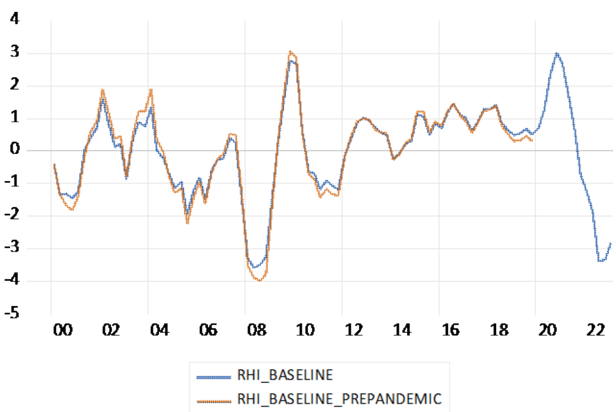
Table T.1 – RHI Weights

Variables	Weights	
	Baseline	Baseline pre-pandemic
Producer Price Index	0.64	0.64
Wage Price Index	0.46	0.47
Consumer Sentiment	0.58	0.57
Retail Sales Volumes	0.19	0.22
Total Variance Explained	0.49	0.48

Source: KPMG

The first column provides the weights using the full sample between the March quarter 1999 to the March quarter 2023. The second column shows the weights using the pre-pandemic sample for the baseline, which are little changed from the full sample weights. The pre-pandemic RHI, as a result, remains quite similar to the full sample one (Chart T.1).

Chart T.1 – RHI Baseline & Pre-pandemic Baseline



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