Retail Health Index June 2024

KPMG Australia

Contents

Introduction

Welcome to the May '24 edition of KPMG Australia's Retail Health Index© (RHI). The RHI provides data driven insights on the current and 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 overall health of the Australian retail sector remained poor and that a recovery to healthy economic conditions by the end of calendar year 2024 was looking less likely.

Unfortunately, the latest KPMG RHI shows only a minor improvement in in key indices and suggests healthy retail conditions remain on track to return in September 2025.

Between the December quarter 2023 and the March quarter 2024 the KPMG RHI moved from -1.57 to -1.48, a rise of 0.09 index points, reflecting about the same rate of improvement achieved during the final quarter of last year. While any improvement is welcome, the rate of progress over the quarter seem to stall, meaning the overall health of the sectors remains weak.

Key takeaways

- Retail sales activity remains in the doldrums with virtually no nominal growth occurring. Once inflation and immigration are considered, sales activity – especially associated with discretionary spending – remains well below levels seen 12 months ago.
- What is more concerning for the industry is the fact that this decline in volumes is occurring in a period of extremely high population growth, with 2.55m non-citizens landing in Australia in the March 2024 quarter on either a temporary or permanent basis suggesting spending on an established per household basis is (at least) down at least 5% percent on a year-on-year basis.
- The tick up in inflation has been interpreted by financial markets that the RBA may need to lift the cash rate again, or at least, keep the cash rate higher for longer. This extension or prolonging of current financial pain for many households has continued to weigh heavy on consumer confidence with the Westpac – Melbourne Institute survey reporting 51% of consumers consider their family finances to be worse than a year ago and only 31% expecting their financial situation to improve in the next year.
- The relative profitability of the retail sector is now well below its long-term average, representing 4.7% of total industry profitability compared to its long-term average of 6.4%.

What is the market saying?

- Roy Morgan research suggests that mortgage stress is now approaching peak levels seen during the GFC (31.4% in February 2024 vs 35.6% in May 2008)
- With low levels of consumer confidence driven by a cost-of-living crisis for many consumers, unsurprisingly, discretionary retail has been taking a few hits. Some of Australia's major discretionary retailers announced softer half year results driven by lower-than-expected same store sales, however our major food retailers remain robust, and history suggests they are less vulnerable to the ups and downs of consumer confidence.
- Overall insolvency numbers are now well ahead of pre pandemic levels with ASIC forecasting over 10,000 companies will enter external administration by 30 June 2024, a number not seen since 2013. These insolvency numbers have largely driven by supply and demand issues impacting the building and construction sector, with consumer and retail insolvencies remaining at relatively modest level despite difficult trading conditions.
- Many retailers are focusing on cost control and cost out campaigns to optimise operating models and shareholder returns. Those retailers with balance sheet strength are leveraging their position to invest in artificial intelligence to enhance customer experience, improve demand planning and supply chain efficiency and reduce the compliance costs across a range of operating and reporting functions.
- In response to economic conditions, the Federal Government has released a budget which includes measures (E.g. stage three interest rate cuts and $300 electricity rebates) designed to alleviate the cost-of-living crisis impacting many consumers and create some household spending breathing room. Naturally, these measures are also likely to benefit the consumer and retail sector short term.

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) shows recovery stalled in the first quarter of 2024, although we remain confident of the revival of the sector by September 2025 given the broad tax relief coming from 1 July 2024 and the $300 per household energy bill relief in the May 2024 budget. Declining wages and improved sentiment offset higher producer prices and lower volumes, resulting in a minor improvement in the March quarter 2024 RHI.

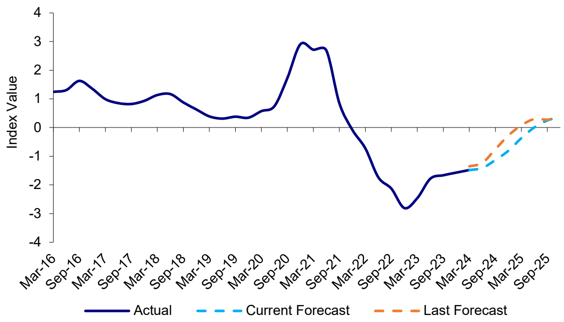
KPMG believe better times are expected in the near term once household disposable income kicks up…

Between the December quarter 2023 and the March quarter 2024 the KPMG RHI moved from -1.57 to -1.48, a rise of 0.09 index points, reflecting about the same rate of improvement achieved during the final quarter of last year. While any improvement is welcome the rate of progress over the quarter seem to stall, meaning the overall health of the sectors remains weak.

Our latest forecasts of the components that make up the KPMG RHI continue to suggest the short-term outlook for the sector should rising, albeit still operating below a 'balanced' or 'positive' setting.

FIGURE 1

KPMG Retail Health Index, Actual & Forecast



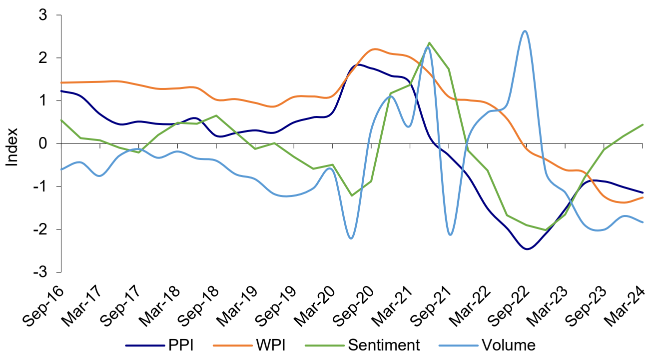
Source: BoE, ECB, FRB, RBA, Haver, KPMG

Our 2024Q1 forecasts confirm our earlier view that the recovery of the retail sector is likely to stretch into next calendar year even with the positive outlook for improving household disposable income. There remains however continued volatility within the elements of the RHI brought about from patchiness across the broader economy.

From an individual component perspective improved consumer sentiment and a softening in wages lifted the RHI, while increases in producer prices and decline in retail sales voles dragged down the RHI outcome.

FIGURE 2

KPMG RHI by Component Factors



- **PPI**: from -1.0 to -1.1 (i.e., between 2023Q4 and 2024Q1 the growth rate of PPI increased from being 100% above its historical average to 110% above its historical average). The acceleration in PPI growth during the 3 months to March 2024 negatively contributed -0.09 index points to the quarterly change in the RHI. That is, PPI contributed -0.74 index points to the RHI in the March quarter 2024, from -0.65 index points in the December quarter 2023
- **WPI**: from -1.37 to -1.26 (the growth rate of the WPI decreased to 126% above its historical average from 137% above its historical average during the 3 months to March 2024), contributing -0.58 index points to the 2024Q1 RHI (down from -0.64 index points in 2023Q4). The slowdown in wages growth in the sector contributed positively (0.05 index points) to the change in the RHI between the December and March quarter.
- **Sentiment**: from 0.17 to 0.44 and contributes 0.25 index points to the 2024Q1 RHI (up from 0.1 index points to the 2023Q4 RHI).
- **Volume**: from -1.70 to -1.83, and contributes -0.38 index points to the 2024Q1 RHI (compared to -0.35 index points to the 2023Q4 RHI).

Spending indicators

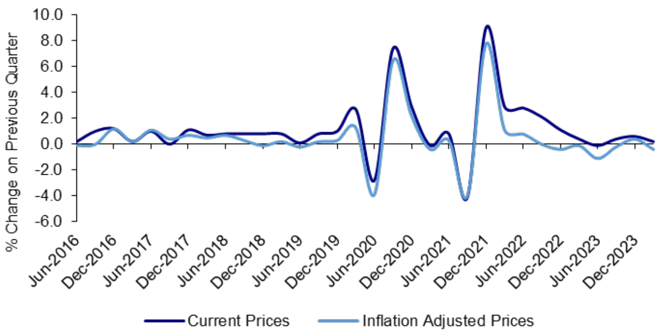
Retail sales activity remains in the doldrums with virtually no nominal growth occurring. Once inflation and immigration is considered, sales activity – especially associated with discretionary spending – remains well below levels seen 12 months ago.

Retail sales

Retail turnover at current prices increased by 0.1 percent month-on-month between March and April 2024 but recorded negative real growth of –0.4 percent over the first quarter of 2024. This outcome continues the trend, with 6 out of the past 7 quarters recording zero or negative real growth in retail turnover.

FIGURE 3

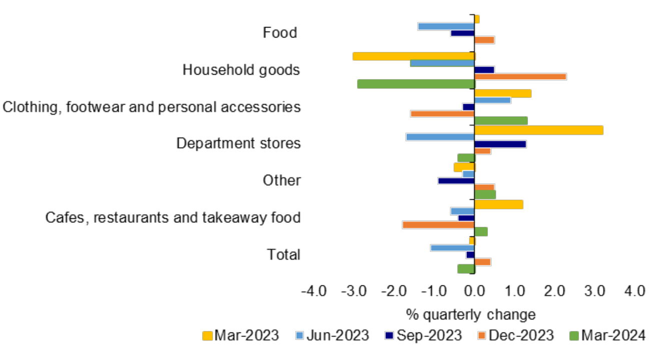
Change in Retail Turnover, Australia, Current and Inflation Adjusted, Quarterly



What is more concerning for the industry is the fact that this decline in volumes is occurring in a period of extremely high population growth, suggesting spending on an established per household basis is (at least) down by around 5 percent since the middle of 2022. The brunt of this decline in sales volumes has been borne by the Household goods sector, which has fallen by 9 percent since the start of financial year 2023.

FIGURE 4

Change in Quarterly Inflation Adjusted Series, Rolling 3-months, $Current Seasonally Adjusted



The household goods sector saw retail turnover decline by -2.9 percent for the March quarter 2024, while Department stores also saw sales volumes fall by -0.4 percent over the same time-period. Food retailing experienced flat sales volumes over the quarter, although Cafes. Restaurants and takeaway food retailing recorded small, growth of 0.3 percent suggesting households more regularly chose to 'give the kitchen the night off' during the summer holidays.

Clothing, footwear and personal accessory retailing experienced reasonable quarterly growth in sales volumes (+1.3 percent), albeit still low compared to historical March quarter growth patterns.

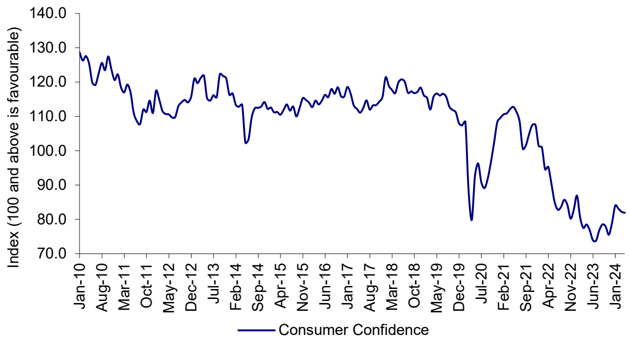
Consumer sentiment

The tick up in the inflation read has been interpreted by financial markets that the RBA may need to, at worst, lift the cash rate again, or at least, keep the cash rate higher for longer. This extension or prolonging of current financial pain for many households has continued to weigh heavy on consumer confidence.

The Westpac–Melbourne Consumer Sentiment Index for Current Conditions has continued to remain below the neutral 100 mark for 28 consecutive months now – although there has been a sharp contraction again in May 2024 with confidence falling to near record lows once more. This downturn in confidence has been mirrored in the ANZ-Roy Morgan Consumer Confidence survey question associated with *Time to Buy a Major Household Item* which fell markedly at the start of May 2024.

FIGURE 5

ANZ–Roy Morgan Consumer Confidence



Cost indicators

Cost pressures for the industry appear to be softer, helped by a slight strengthening in the AUD

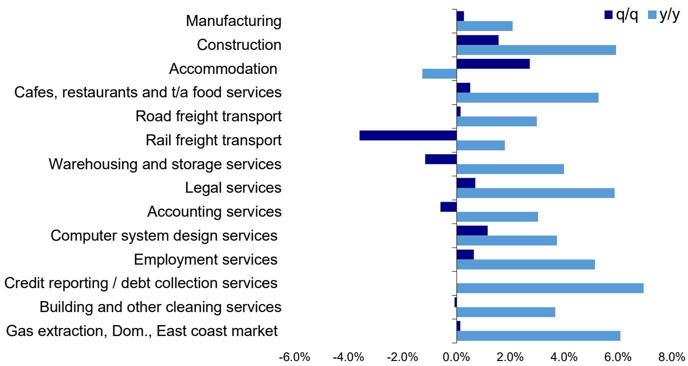
Producer Price Index

The producer price index (PPI) increased by 0.9 percent q/q in the first quarter of 2024; the same rate of growth experienced in the December quarter 2023. Despite this stabilisation during the first three months of the year annual PPI growth rose from 4.1 percent y/y to 4.3 percent y/y due to the drop-off of the lower March quarter 2023 PPI values.

Despite the recently quarterly weakening in the PPI the number of categories that recorded either zero price increases or disinflation in the first three months of 2024 increased compared to the previous quarter. The increase in the PPI was therefore highly concentrated, with only 4 sectors recording quarterly growth of 3 percent or more. Beef, sheep and wheat farming costs jumped nearly 13 percent q/q, while sugar and confectionary manufacturing rose by around 5 percent q/q.

FIGURE 6

Producer Price Index, Output Price Growth by Selected Industry Sectors, March Quarter 2024



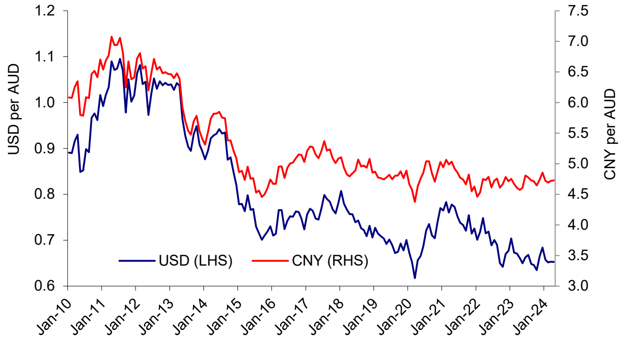
Foreign exchange

The Australian Dollar remains at relatively weak levels in foreign exchange markets, falling from USD 0.653 at the end of March 2024 to be trading at around USD 0.665 at the time of writing the report (end-May 2024) Market views regarding the timing and extent of policy rate cuts during 2024 and beyond continue to revised down given the inflation print, however given this outlook looks similar across the US and other developed economies the AUD has remained relatively stable across most currencies.

The AUD Trade Weighted Index has however appreciated by 2.6 percent since the end of the first quarter 2024; with the AUD appreciating most against the Japanese Yen (+5.7 percent), Philippines Peso (+5.7 percent) and the Vietnamese Dong (+4.4 percent).

FIGURE 7

Exchange Rate, AUD v. USD v. CNY



Wages

The annual growth rate for the national Wage Price Index (WPI) for the private sector fell slightly to 4.1 percent y/y for the second consecutive quarter. The Accommodation and food services and Retail sectors both recorded a stabilising in annual increases in total hourly rates of pay excluding bonuses, with each sector seeing annual wages growth of 4.4 percent and 4.0 percent respectively in the March quarter 2024.

The stabilising of wages growth across the two sectors continues to reflect softer labour demand, albeit that employment across the Accommodation and Food services sector and the Retail trade sectors increased by 3.5% and 1.7% respectively between November 2023 and February 2024. Despite this growth total employment in these two sectors job vacancies recorded a drop of 8,000 positions to be filled over the 3 months to February 2024, and importantly from a wage growth perspective there are still around 40,000 less people employed across the two sectors than compared to employment levels in the middle of 2023.

FIGURE 8

Annual Growth in Wage Price Index by Selected Industry

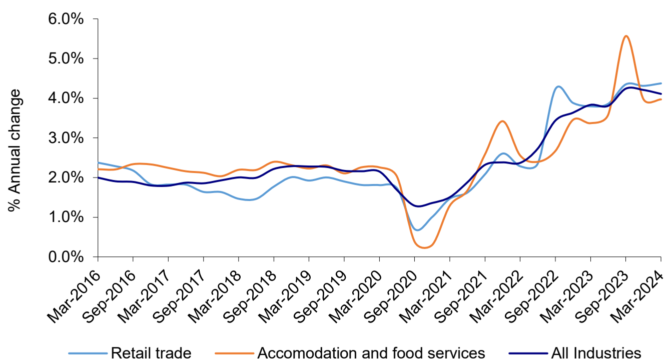
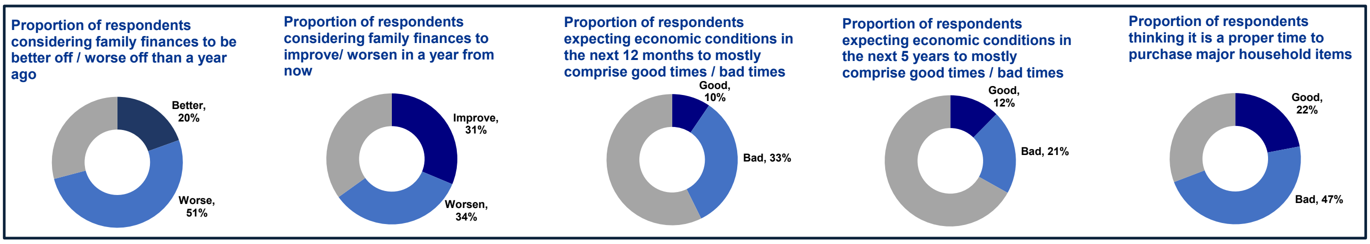


FIGURE 9

Westpac – Melbourne Institute Survey of Consumer Sentiment



Household spending

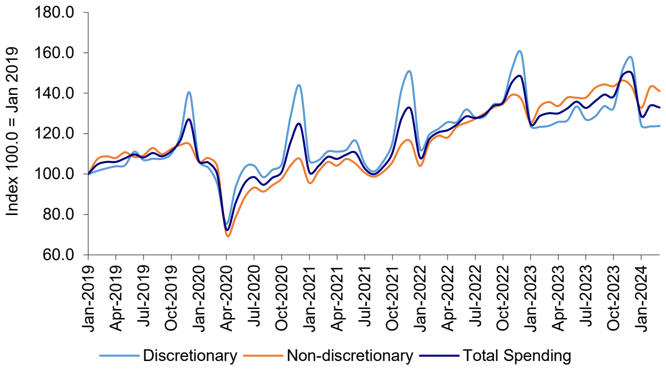
Household spending fell substantially during the March quarter 2024, with the decline largely because of the cyclical post-Christmas fall in discretionary spending (-15.8 percent on a $current, calendar adjusted basis). Average household spending fell by -9.5 percent over the first three months 2024, which compares slightly better than the -10.5 percent fall that occurred during the first three months of 2023. During the first quarter of 2024 average spending on non-discretionary goods fell by -3.6 percent.

Over the three months to the end of March 2024 households decreased their (average) spending on Clothing and footwear by -28.1 percent and Furnishings and household equipment by -19.8 percent compared to the December quarter. The pull back in spending in these two categories during the first quarter of 2024 is nearly equal to the step up in spending that occurred in these categories during the December quarter, suggesting aggregate (nominal) sales during this 6-month period is likely to have been flat.

Spending on Recreation and culture and Hotels, restaurants, and cafes – essentially holidays and leisure activities experiences – fell in the March quarter 2024 consistent with the cyclical pattern of spending in these categories; reflecting the ending of summer holidays and the return to work and school for many Australian's. However, a silver-lining to this decline is that the fall in spending was proportionally less than the same decline experienced in the first quarter of 2023.

FIGURE 10

Monthly Household Spending by Type, Australia



Population

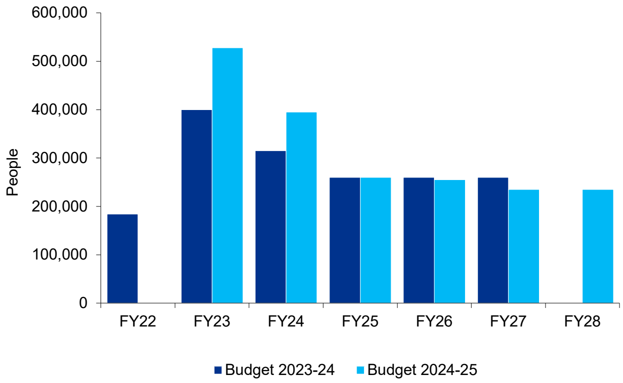
Overseas arrivals information shows about 2.55 million non-citizens landed in Australia on either a permanent or temporary basis during the first quarter of 2024; up from 2.34 million in the December quarter 2023. This increase in overseas arrivals is heavily biased towards permanent and long-term arrivals, with around 133,000 of the approximate 207,000 arrivals in the March quarter 2024 falling into these two categories.

Current public concerns around housing availability and rental affordability are also seen as areas where government policy can positively influence outcomes in the short term by adjusting the size and timing of foreign migration into Australia.

To this end the Commonwealth Government has announced in the May 2024 Budget that Net Overseas Migration would be wound down from 528,000 in FY23 to 395,000 in FY24 and 260,000 and 255,000 for FY25 and FY26 respectively, and 235,000 for each of FY27 and FY28.

FIGURE 11

Net Overseas Migration Targets by Year, Commonwealth Budget



Performance indicators

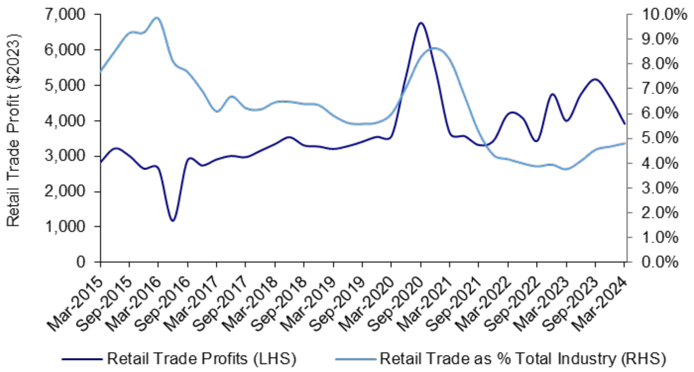
Falling profits, weak productivity and softening demand for labour confirm tough conditions

Profitability

Profitability with the retail sector has contracted now for the second quarter in a row, with the March quarter 2024 recording a 17 percent fall in profit before income tax on top of the 9 percent fall achieved in the final quarter of 2023. This decline in profits for the sector was (unfortunately) consistent with achieved against weakening backdrop of profits across the domestic economy, although the decline in profitability in the sector was at a pace double that of the economy as a whole (-8.4 percent).

FIGURE 12

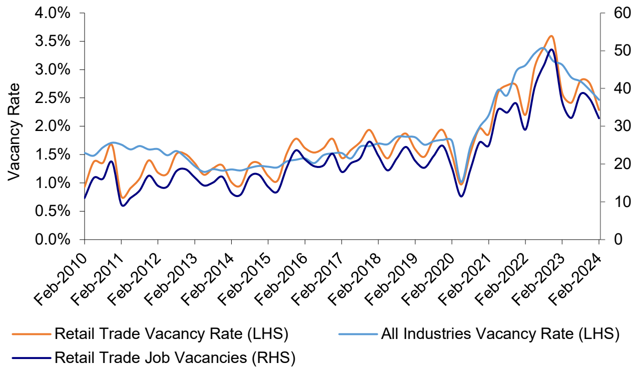
Retail Sector Profit before Income Tax



There has been a slight decrease in the number of job vacancies within the retail industry in Australia, falling from 37,200 unfilled jobs available within the sector in November 2023 to around 32,100 unfilled jobs in February 2024. This decline in job vacancies was proportionally larger than the increase in the number of people employed in the sector, resulting in a fall the vacancy rate for the sector to now be around 2.3 percent, a level not seen since the beginning of 2022, but still around 50 percent higher than the long run vacancy rate for the sector.

FIGURE 14

Job Vacancies

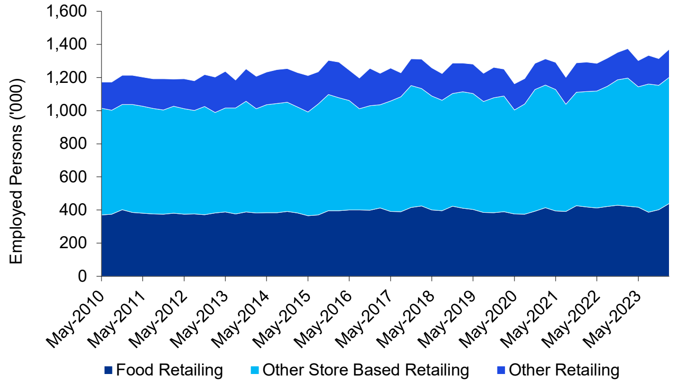


Employment

The retail sector employed 1.37 million people in Australia at the end of February 2024, about the same number of workers employed in the sector 12 months ago. There has however been a reallocation of workers within the sector, with around 17,000 more people employed in food retailing in February 2024 compared to February 2023, while other store-based retailing has seen the number of workers fall by nearly 13,000 over the same time period.

FIGURE 13

Retail Sector Employment, Australia ('000)

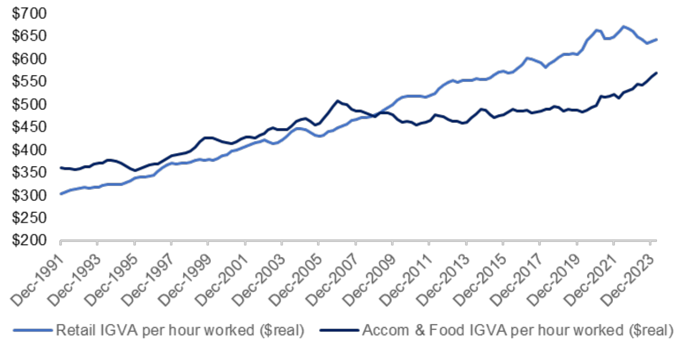


Labour Productivity

KPMG has calculated a proxy labour productivity measure using real Industry Gross Value Added and hours worked. As show in Figure 15 below the Retail sector has recorded steady productivity growth over the past two decades, growing around 2.4 percent per annum; although it has fallen backwards and stalled over the past 12 months. In comparison the Accommodation and food sectors has seen labour productivity kick up; growing at three times the rate being achieved in the retail sector since the beginning of 2019.

FIGURE 15

Labour Productivity Estimates



Online indicators

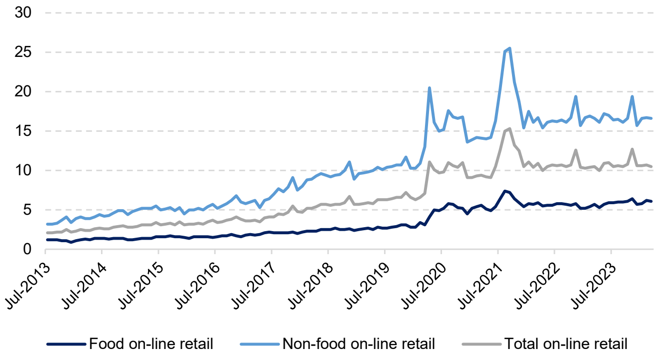
Online sales in Australia has stabilised as percentage of total retail sales post-COVID, with 77% of Australians being regular on-line retail shoppers spending over $400 a month on average. While fashion and apparel remain a strong category for online shopping, recent data suggests grocery is the *growth* category, capturing about 30% of online spend.

Online retail sales

Online retail sales totalled about $12 billion during the March quarter 2024, a rise of around 3.4 percent over the value of on-line sales recorded during the December quarter 2023. Non-food on-line retail sales grew faster than on-line food sales over the quarter, both up 4.2 percent and 1.6 percent on a seasonally adjusted basis respectively.

FIGURE 16

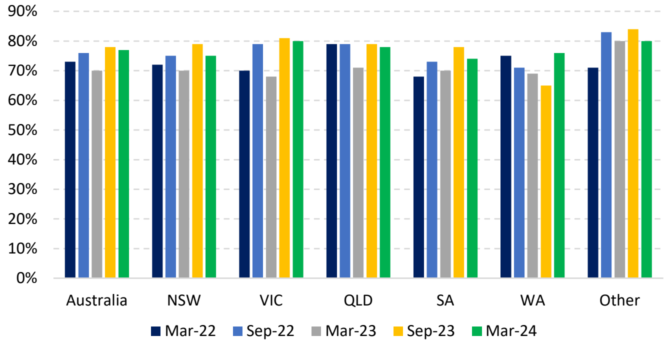
On-line retail sales by type as a proportion of Total Sales



The University of Sydney Business School Transport Opinion Survey (TOPS) has also shown a stabilisation in the penetration of on-line shopping nationally, with 77% of Australian's indicating they shopped on-line over the previous four weeks in March 2024 compared to 78% in December 2023.

FIGURE 17

Proportion of Australian's who shopped on-line over the past 4 weeks

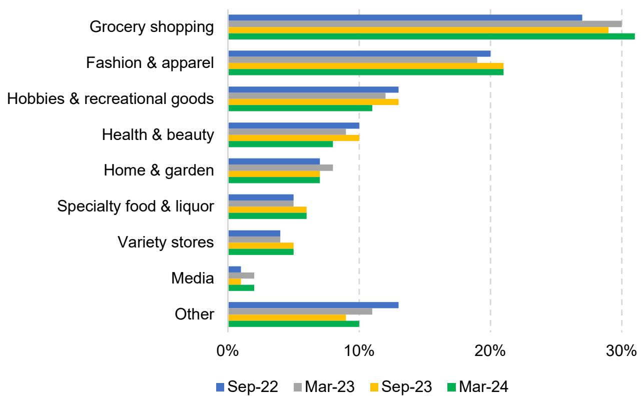


The TOPS survey also showed that the penetration of on-line shopping as a purchasing activity was maintained at near survey high levels during the first quarter of 2024. Notably Western Australia has seen a marked turn around on-line shopping activity, although this improvement has been largely a result of a step-up in non-grocery purchasing.

Respondents in the March 2024 survey indicated on average they spent $413 on on-line purchases over a nominated 4-week period; an increase of $18 over the spend identified in September 2023. Of this expenditure, just over 30 percent was spent on Grocery shopping, 21 percent on Fashion and apparel and 11 percent on Hobbies and recreational goods.

FIGURE 18

How on-line expenditure was spent



The TOPS survey also questions respondents how whether they are in paid work activities. The latest survey changed the questionnaire design from asking respondents about work patterns in recent weeks to work patterns in a typical week.

The survey found that in a typical week workers on average spend 38 hours working, of which about 27.4 hours (or 72 percent) is spent at their main workplace, 8.2 hours is spent working from home ("WFH") (22 percent) and 2.5 hours is spent working from somewhere else (7 percent). While the survey design is slightly different the latest results show that rates of WFH is about the same as it was 6 months ago; although WFH rates have increased slightly in Victoria, Queensland and South Australia, but fallen slightly in New South Wales and Western Australia.

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 data sets, 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.

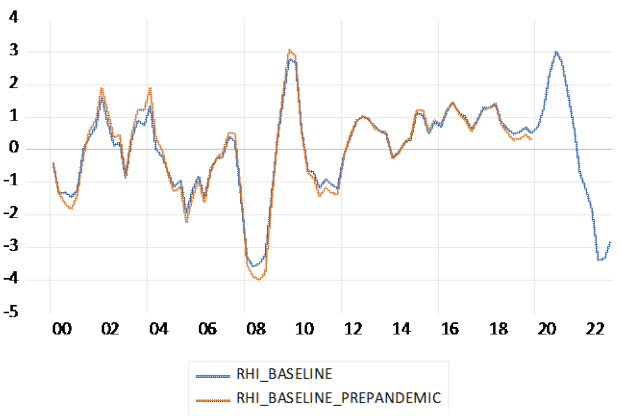
Table T.1 – RHI Weights

Variables	Weights	
	Baseline	Baseline Pre-pandemic
Producer Price Index	0.64	0.64
Wage Price Index	0.47	0.47
Consumer Sentiment	0.57	0.57
Retail Sales Volumes	0.22	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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