Retail Health Index September 2024

KPMG Australia

Contents

Introduction	03
Retail Health Index	04
Spending indicators	05
Cost indicators	08
Performance indicators	09
Online indicators	10
Technical appendix	11
Key contacts	12

Introduction

Welcome to the latest 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 showed recovery stalled in the first quarter of 2024 as discretionary retail slowed amidst the cost-of-living crisis.

Unfortunately, the latest KPMG RHI shows that the recovery has faced additional setbacks. The delay is primarily driven by the increase in producers' costs and subdued consumer sentiment, as sticky inflation has created a considerable amount of uncertainty about the cash rate outlook, resulting in consumers remaining cautious about every dollar they spend.

The latest KPMG RHI shows the KPMG RHI further fell by 0.24 index points, moving from -1.49 to -1.73 between the March quarter 2024 and the June quarter 2024; suggesting the overall health of the retail sector remains in poor condition. Nevertheless, we expect this setback to be transitionary, albeit the time frame for the return of 'healthy' retail conditions is now not likely until mid to late 2025.

Key takeaways

- The retail sector is bearing the brunt of Australia's two-speed consumer market. Renters and those struggling with mortgage payments are hit hardest by rising costs, while outright homeowners continue to spend, though not always in stores or local restaurants. Instead, the post-Covid bounce in overseas travel appears to have reset spending patterns, with 'cashed-up' consumers seemingly preferring to allocate 'big ticket' spending towards overseas holidays and leisure rather than on major household goods. In fact, the number of Australian travellers increased by 7.3% in the 12 months to June 2024.
- While it may be gradual, inflation is set to ease further, lifting the purchasing power of households as price growth abates.
- Real wage growth is anticipated to continue, which coupled with the tax cuts and other cost-of-living reliefs, is likely to further improve households' purchasing power over the coming year.
- However, the impact of the Stage 3 tax cuts, which came into effect on 1 July 2024, remain uncertain. Latest leading data from various surveys suggest households have 'banked' most of their tax savings.
- A reduction in interest rates in 2025 will also help ease retail conditions.
- The upcoming changes in immigration policies will likely concern retailers. The latest Federal Government Migration Strategy aims to return immigration back to pre-Covid levels, mainly via implementing a cap on new international student intakes.

Are we in a new age of disruption?

While the economic factors behind challenging retail conditions are top of mind, standing back, we may be seeing a perfect storm of retail disruption combined with economic headwinds.

So, what are the key themes driving a more *disrupted* retail environment?

- The boomers have all the money (at least temporarily), while Gen X, Y and Z are struggling to pay the rent, much less buy a house. A recent report from JBWere suggested that up to $5 trillion will be transferred across generations in the next 10 years or so, creating a massive shift in wealth and spending power, and reframing existing consumer dynamics in the medium term.
- The drive to social commerce continues at pace, with the number of consumers treating their favourite social media platform as their primary *discovery* channel for retail hitting 50% for the first time according to Salesforce data. Social media platforms could become *more* than just the centre of our universe for entertainment sooner than we think.
- Online marketplace platforms (think Shein, Temu and Amazon) are recalibrating the search for value for consumers, leveraging social media and supply chain models which cut out the middleman (i.e. the retailer) and all their fixed costs. These platforms enable the consumer to buy directly from (mostly) Chinese factories at price points up to 60% less than they would otherwise pay in a store environment. Shein alone is expected to generate global revenue approaching US$60 billion in 2025.
- AI – or should we say, generative AI – is threatening (or promising) to completely reframe retail supply chains, product development and customer experience within the next three to five years. Which reminds us of Amara's Law: *'We tend to overestimate the effect of a technology in the short run and underestimate the effect in the long run*'. Watch this space.

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) experienced a setback in its recovery this quarter, primarily driven by higher producer prices and worsened consumer sentiment. Retail volumes continue to decline, but at a slower rate compared to previous periods.

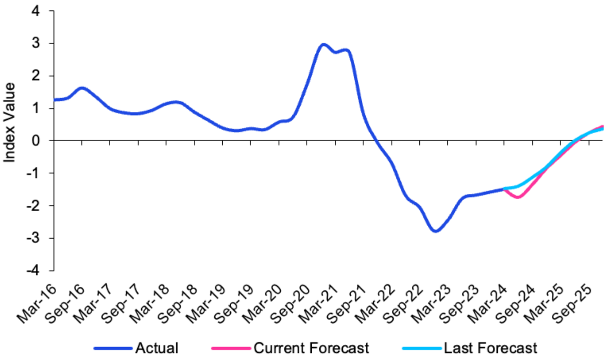
The road to recovery is proving a bumpy ride …

Between the March quarter 2024 and the June quarter 2024 the KPMG RHI further fell by 0.24 index points, moving from -1.49 to -1.73; a backwards step in the road back to healthy retail conditions.

Our latest forecasts of the components that make up the KPMG RHI suggest the medium-term outlook for the sector remains positive, however, short-term headwinds are impacting the near-term trend and creating risk to the recovery time frame.

FIGURE 1

KPMG Retail Health Index, Actual and Forecast



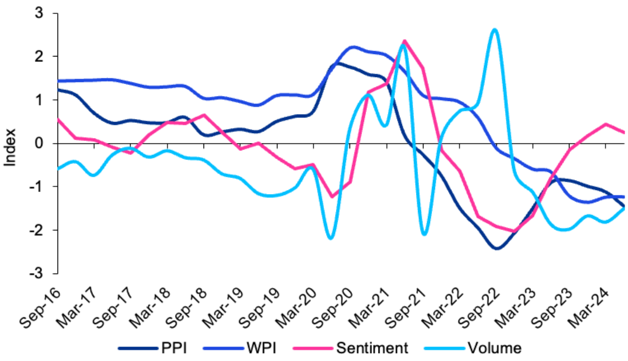
Source: KPMG's calculation, ABS, Haver

Our 2024Q2 forecast suggests the recovery of the retail sector is unlikely to occur before the end of CY25 and the recent swings amongst the four elements of the RHI reveals continued volatility amongst the key drivers of sector performance.

From an individual component perspective, strong growth in road transport costs and manufacturing material saw producer prices act as a drag on the RHI. Moreover, consumer sentiment turned down during the quarter largely because of concerns over the possibility of another rate hike or prolonged high cash rates as inflation returns to target at an uncomfortably slow pace.

FIGURE 2

KPMG RHI by Component Factors



- **PPI:** from -1.12 to -1.45 (i.e. between 2024Q1 and 2024Q2 the growth rate of PPI increased from being 112% above its historical average to 145% above its historical average). The acceleration in PPI growth during the three months to June 2024 negatively contributed -0.21 index points to the quarterly change in the RHI. That is, PPI contributed -0.93 index points to the RHI in the June quarter 2024, from -0.72 index points in the March quarter 2024.
- **WPI:** from -1.24 to -1.23. The growth rate of the WPI remained little changed over the past three months, remaining approximately 123% above its historical average in the June quarter 2024; contributing negligibly to the quarterly change in the RHI.
- **Sentiment:** sentiment fell from 0.44 to 0.24 and contributes 0.14 index points to the June quarter RHI (down from a 0.25 index point contribution to the March quarter RHI).
- **Volume:** from -1.81 to -1.50, and contributes -0.36 index points to the June quarter RHI (compared to a -0.43 index point contribution to the March quarter RHI).

Spending indicators

Overall consumer spending on discretionary items continued to weaken despite strong population growth.

Retail sales

Retail trade in July 2024 was unchanged, following rises of 0.5% in both May and June largely on the back of end of financial year sales. However, the impact of the Stage 3 tax cuts, which came into effect on 1 July 2024, remain uncertain. Latest leading data from various surveys suggest households have 'banked' most of their tax savings.

This represents the second consecutive period since the beginning of 2024 where retail trade volumes have declined on a q/q basis. While the statistic alone reveals a strong enough reason for the sector to be concerned, when real retail sales are considered on a per capita basis the story becomes even worse.

KPMG estimates real per capita retail sales have declined in the last eight quarters since 2022, with a peak-to-trough decline of approximately 6.7%.

FIGURE 3

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

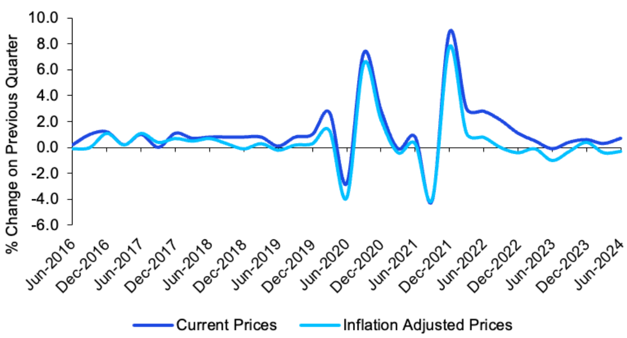
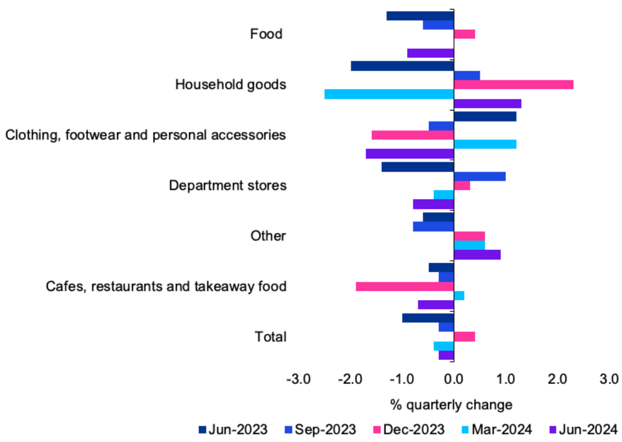


FIGURE 4

Change in Quarterly Inflation Adjusted Sales by Category, Australia



Turnover rose in most non-food-related industries in the month of June, led by Household goods retailing (+1.1%) Department stores (+1%), Other retailing (+1%), and Clothing, footwear and personal accessories retailing (+0.7%) as spending on discretionary goods rose. Food-related spending was mixed, with an increase in Food retailing (+0.2%) and no change in Cafes, restaurants and takeaway food services.

However, most sectors recorded negative growth in sales volumes in the June quarter, except for Household goods (+1.3%). Clothing, footwear and personal accessories recorded the largest fall (-1.7%), following by Food (-0.9%), Department stores (-0.8%) and Cafes, restaurants and takeaway food retailing (-0.7%).

Despite this accelerated growth in nominal retail trade, retail volumes in the June quarter fell by 0.3% following a drop of 0.4% in the March quarter.

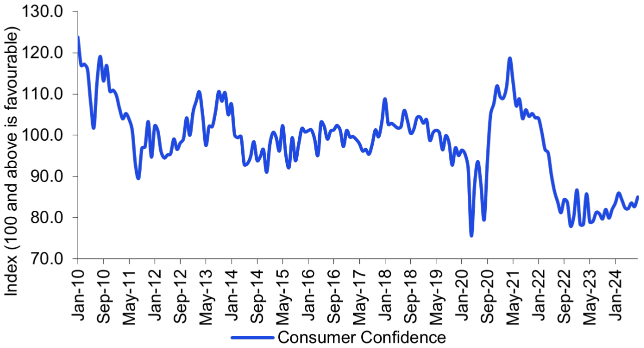
Consumer sentiment

The Westpac–Melbourne Institute Consumer Sentiment Index rose 2.8% to 85 in August from 82.7 in July. This small improvement might be partly attributed to the RBA's decision to keep the cash rate unchanged despite the strong commentary in the media by some economists arguing for further increases in the cash rate and the support coming from tax cuts and electricity rebates.

Despite that, the Westpac–Melbourne Institute Consumer Sentiment Index for Current Conditions has continued to remain below the neutral 100 mark for *31 consecutive months.* This protracted sentiment slump is second only to the early 1990s in terms of the duration and weakness of reads.

FIGURE 5

Westpac–Melbourne Institute Consumer Sentiment



The component indexes show a clear improvement over the past three months centred around family finances. The 'family finances vs a year ago' sub-index surged by 7.7 index points in August, the biggest quarterly gain in three years, lifting the sub-index to 70.9 – a two-year high. Consumer expectations for their finances also improved, with the 'family finances, next 12 months' sub-index rising 96.8. This is the highest level since the interest rate tightening cycle began in May 2022.

Other components showed much smaller, mixed shifts. Consumers are a little less pessimistic about the near-term economic outlook but a little more downbeat on the medium-term view.

The 'time to buy a major item' sub-index edged up to 82.6 but is still well below its long-run average of 124.

FIGURE 6

Westpac–Melbourne Institute Consumer Sentiment by Component, quarterly change

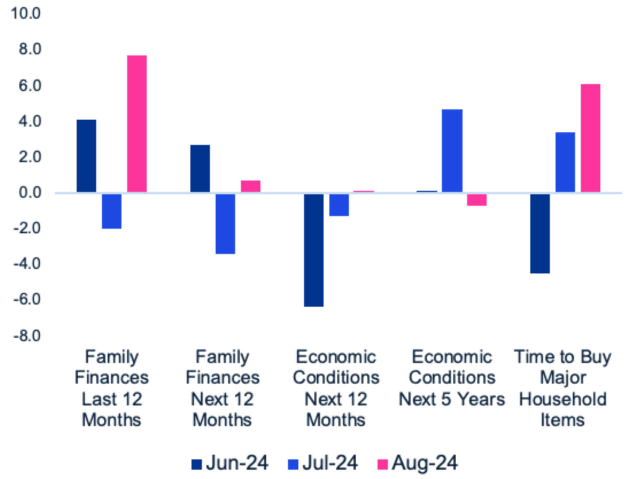
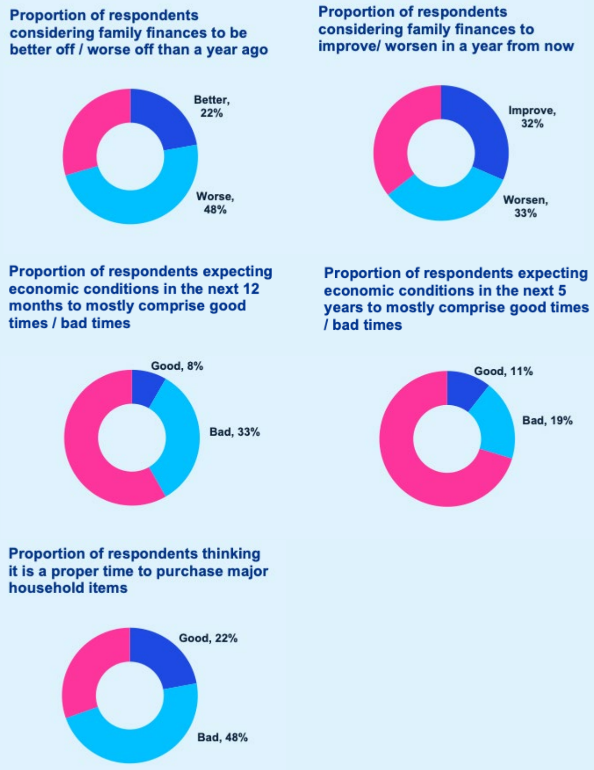


FIGURE 7

ANZ–Roy Morgan Survey of Consumer Confidence



Household spending

Quarterly household spending was little changed on a current price and seasonally adjusted basis in June 2024 compared to the March quarter 2024, after recording consecutive rises of only between 1% to 2% in the past four quarters. Their meagre increases also mean household spending has fallen in real terms.

This new data shows households spent less on Services in the June quarter, but more on Goods compared to the previous quarter. Lower spending on recreational and cultural services, hotel accommodation, and dining out contributed to the 1% drop in Services spending. The fall was partially offset by a 0.5% rise for spending on Goods, as households took advantage of end of financial year sales.

Household spending on discretionary items continued to weaken, falling by 1% over the three months to the end of the June quarter. Non-discretionary still maintained the same growth rate as the previous quarter at 0.5%, but this is noticeably weaker than the June quarter of last year. Household savings remain well below the long-term average.

FIGURE 8

Household Savings Ratio, Australia

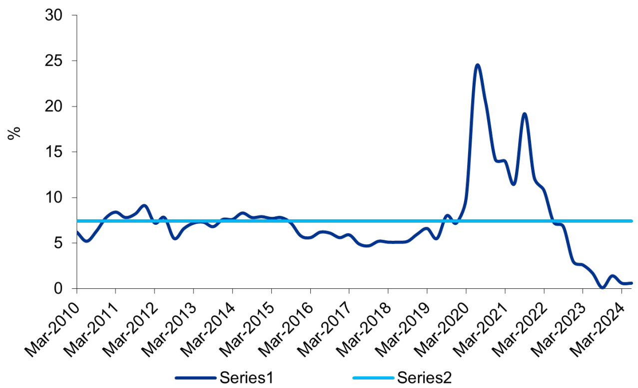
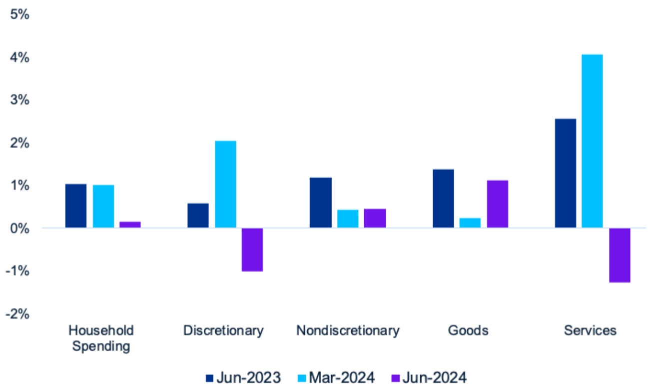


FIGURE 9

Monthly Household Spending by Type, Australia



Looking at spending on a disaggregated basis, KPMG analysis shows five out of eight consumption categories recorded positive quarterly growth albeit off a low base. Clothing & Footwear led, growing by 11%, followed by Furnishings & Household Equipment (+7.1%), Health (4.3%), Recreation & Culture (3.6%) and Hotels, Cafes & Restaurants (1%). Alcoholic Beverages & Tobacco recorded the largest decline in spending (-4.6%).

Population

Australia's population grew by 2.5% to 26.97 million people in December 2023, according to the latest figures released in June 2024 by the ABS.

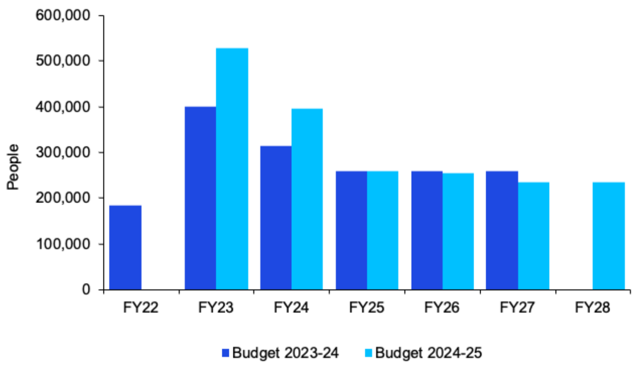
Net Overseas Migration (NOM) drove 84% of this population growth, while natural increase accounted for the other 16%. NOM was 547,300 people in 2023, or approximately 25% higher than 2022. Natural increase was 103,900 people in 2023, 6.4% less than in 2022.

Current public concerns around housing availability and rental affordability have led the government to adjust the size of foreign migration into Australia. The government will only allow 270,000 new students to enrol next year – 175,000 for public and private universities and colleges and 94,500 for vocational providers. That is around 16% less than 2023.

The adoption of these new migration targets is expected to result in NOM being 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 10

Net Overseas Migration Targets by Year, Commonwealth May 2024 Budget



Cost indicators

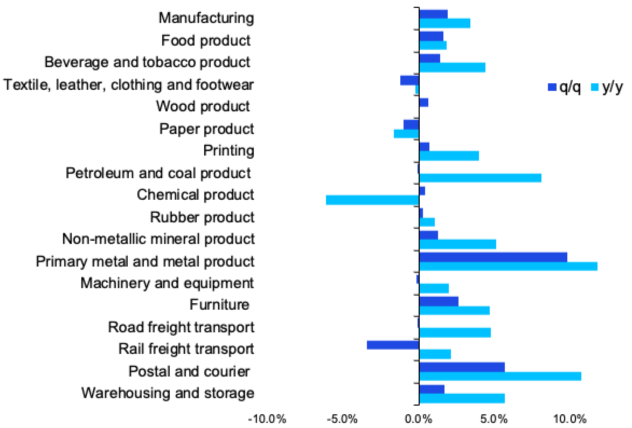
Producer Price Index

The producer price index (PPI) increased by 1% q/q in the June quarter of 2024; *about the same* as the rate of growth experienced in the March quarter 2024. Annual PPI growth rose from 4.3% y/y to 4.8% y/y, reflecting broader inflationary pressures.

Despite the easing in the supply chain, prices for manufacturing output continued to rise moderately, by 1.9% q/q and 3.4% y/y. This growth was mostly driven by the increase in metal input costs. In the transport, postal, and warehousing services sectors, prices were influenced by a combination of factors. Postal and courier pick-up and delivery services saw a significant price increase of 5.7%. Lower fuel prices helped lower rail and road freight transport services by 3.5% and 0.1% respectively.

FIGURE 11

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



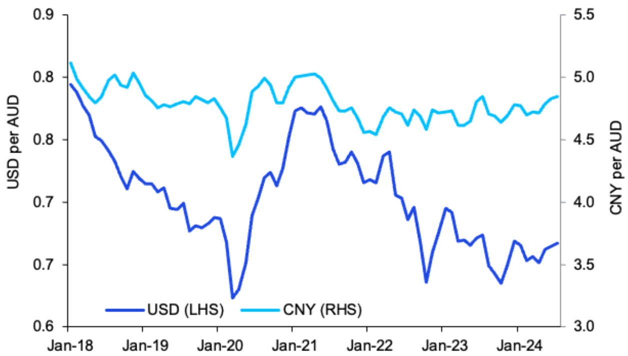
Foreign exchange

The Australian Dollar has risen from USD 0.651 at the end of April 2024 to be trading at around USD 0.667 at the time of writing this report (late August). Market views regarding the delayed timing of policy cuts in Australia compared to other advanced economies, especially the expectation that the US Fed will drop the Federal Funds Rate by at least 25bp at their next meeting in September, has resulted in a stronger AUD.

This strengthening can be seen in the AUD on a Trade Weighted Index Basis, which has appreciated by 1.6 index points since the end of April.

FIGURE 12

Exchange Rate, AUD vs USD vs CNY



Wages

The national Wage Price Index (WPI) in June 2024 maintained its annual growth rate at 4.1% y/y for the second consecutive quarter.

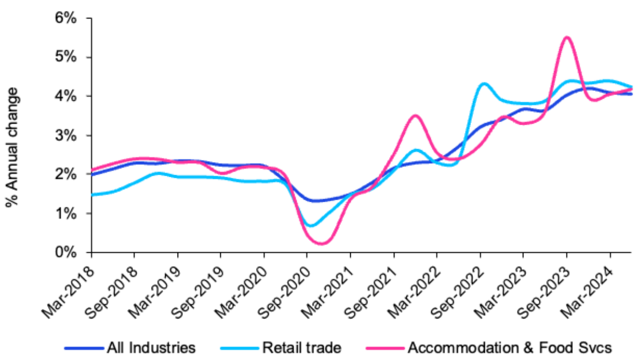
The Retail sector recorded a minor *pullback in annual increases* in total hourly rates of pay excluding bonuses, down from 4.4% in the March quarter to 4.2% in the December quarter.

The Accommodation & Food Services sector recorded a slight annual increase in wage growth, growing at 4.2% in the June quarter compared to 4.0% in the March quarter.

Nevertheless, the latest wage growth figures for both sectors are significantly higher than the number recorded a year ago, suggesting that labour demand is not yet softening, and strong wage growth is still weighing on overall retail conditions.

FIGURE 13

Annual Growth in Wage Price Index by Selected Industry



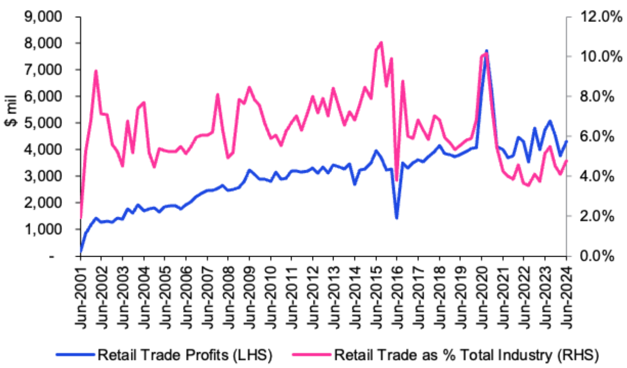
Performance indicators

Profitability

Profitability for the retail sector is continuing to get squeezed as discounting-led sales activity is leading to reduced margins given operating constraints and wages continue to escalate (albeit at slower rates than those experienced in 2022 and 2023). While the decline in profitability in the retail sector was smaller than the overall industry profit drop of 3.9%, the retail sector's contribution to total industry profit remained at just 4.7%; well below its long-term average of 6.3%.

FIGURE 14

Retail Sector Profit before Income Tax

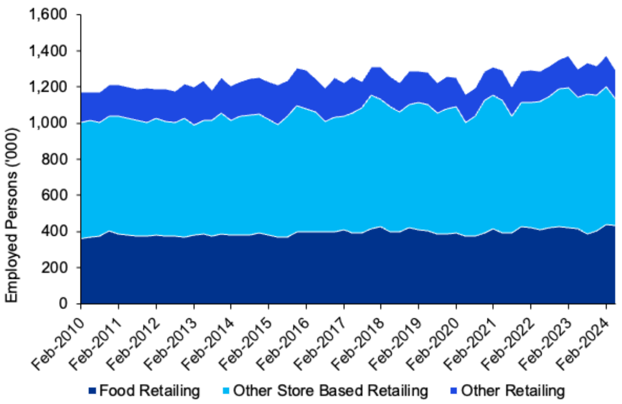


Employment

The retail sector employed 1.29 million people in Australia at the end of May 2024, slightly less than the average level of employment that occurred within the sector over the previous 12 months and roughly at a similar level as May 2023. This 'averaging down' in the retail sector workforce is most pronounced in non-food store-based retailing, which has seen total employment fall by around 10% from its peak in August 2023. Food retailing continues to employ large numbers of workers, with around 430,000 people working in this retail subsector.

FIGURE 15

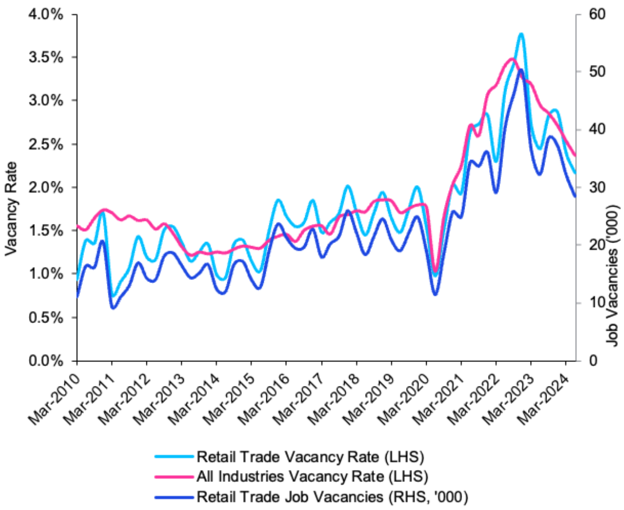
Retail Sector Employment, Australia ('000)



There has been a slight decrease in the number of job vacancies within the retail industry in Australia, falling from 32,100 unfilled jobs available within the sector in March 2024 to around 28,400 unfilled jobs in June 2024. With lower job vacancies and little changed employment in the retail sector, it results in a fall in the vacancy rate for the sector – a result similar to the national trend.

FIGURE 16

Job Vacancies

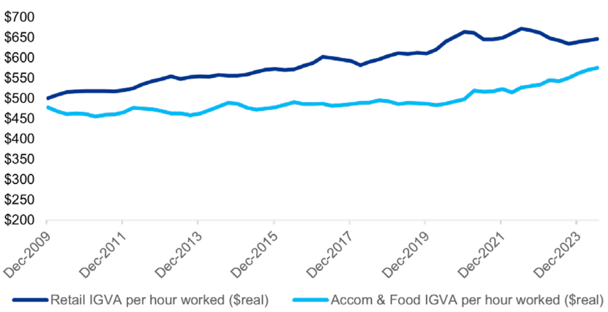


Labour productivity

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

FIGURE 17

Labour Productivity Estimates



Online indicators

Online retail sales

Latest retail spend figures show more consumers turn to online shopping for discounts.

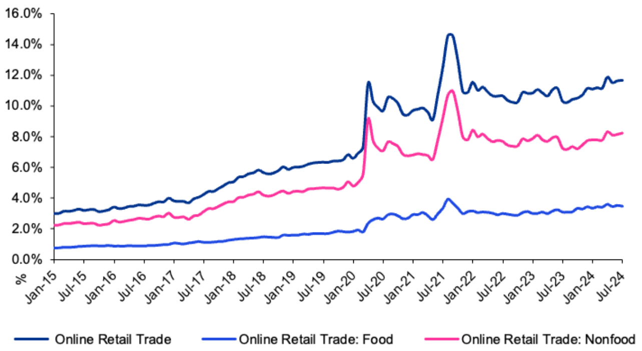
Total online retailing sales were $4,221.7 million in July 2024, in seasonally adjusted terms. Seasonally adjusted online sales rose 0.3% ($12m), following a rise of 1.5% ($61.5m) in June 2024. Seasonally adjusted through-the-year sales are up 15.9% ($579m).

The proportion of online sales to total retailing rose slightly from 11.6% to 11.7%. The proportion of online sales to total retailing was 10.5% at the same time last year.

The proportion of online food retailing sales to total food retailing fell slightly from 6.5% to 6.4%. The proportion for online non-food retailing sales to total non-food retailing rose from 17.7% to 18.3%.

FIGURE 18

Online Retail Sales by Type as a Proportion of Total Sales



Online shopping behaviour

Statista has revised its latest e-commerce revenue forecast for Australia in September 2024 upward relative to its previous forecast in March 2024. The latest forecasts expected that the revenue in the e-commerce market in Australia continuously increase between 2024 and 2029 from ~$55 billion to reach ~$85 billion in 2029, with a compound average annual growth rate (CAGR) of 9.4%. This represents a significant increase from the March 2024 forecast, which projected revenue to reach about $33 billion in 2024 and $77 billion by 2029, with a CAGR of 9.3%.

This upward revision indicates a positive outlook for the Australian e-commerce sector, driven by robust consumer spending, the ongoing expansion of online retail platforms, and growing consumer comfort with making purchases without physical inspection.

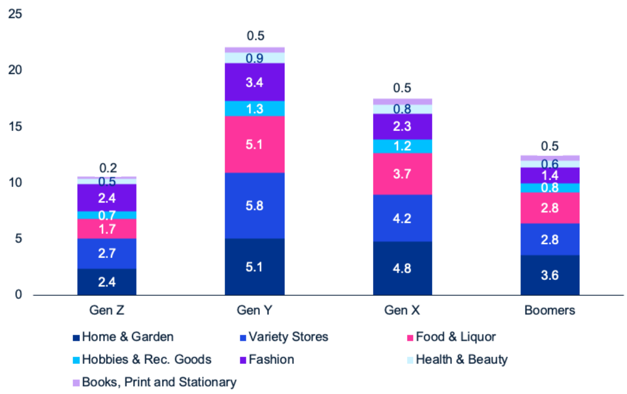
The latest Australia Post *Inside Australian Online Shopping Report* (2024 edition) reveals consumers continue to adjust their online purchasing behaviour. Over 2023, Variety Stores (especially Online Marketplaces) recorded the biggest growth in spending, overtaking Food & Liquor to become the second largest spending group after Home & Garden.

The Australia Post report also highlights a very interesting finding with respect to online shopping frequency. It seems that shoppers need to reach a minimum level of activity to be comfortable with regularly purchasing from the internet, and this minimum threshold appears to be 'once a month'. Once shoppers surpass this activity level then online purchasing continues to grow at solid rates (around 2% per annum) until they reach a threshold equal to around one internet purchase per week, after which growth in buying activity slows to around 1% per annum. This 's-curve' profile fits standard consumer behaviour theory in that once a person becomes comfortable with a new channel to market, they continue to adopt purchasing through that channel until it reaches a maximum level across the mix of other 'safe and reliable' channels. For Australia, consistent with the revised Statista analysis, the opportunity for e-commerce remains strong as there are still a high number of consumers who are purchasing in the lower-to-middle section of the e-commerce s-curve.

The Australia Post report has also highlighted different purchasing behaviour across different generations. Younger generations, including Gen Z and Gen Y are cutting back in response to challenging financial conditions and uncertain job markets, with their online spending falling by 11% and 2% respectively. Meanwhile, older generations with stable finances and less mortgage stress continue to spend more generously online, with Baby Boomers increasing their online spending the most by 7%.

FIGURE 19

Online spending categories across different generations ($b), Australia Post *Inside Australian Online Shopping Report 2024*



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.

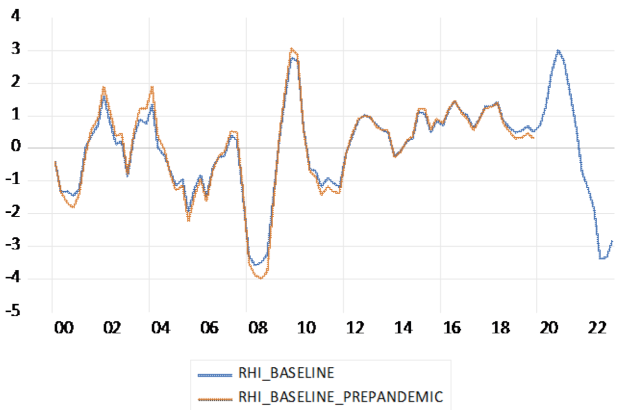
Table T.1 – RHI Weights

Variables	Weights	
	Baseline	Baseline Pre-pandemic
Producer Price Index	0.64	0.64
Wage Price Index	0.47	0.47
Consumer Sentiment	0.56	0.57
Retail Sales Volumes	0.24	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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