Retail Health Index March 2024

KPMG Australia

Contents

Introduction

Welcome to the third 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 a modest acceleration of trading conditions may be in play, with the overall recovery in health of the retail sector forecast to lift throughout calendar year 2024 such that a balanced outcome may be achieved by the end of the year.

The latest KPMG RHI shows a lift between the September and December quarters 2023 by 0.17 index points, moving from -1.65 to -1.48; an improvement over the previous quarter, but one that still suggests the overall health of the retail sector remains poor and one that suggests a balanced outcome by the end of 2024 may be at risk.

Key takeaways

- We may not see retail market conditions recover to a *healthy* level until mid 2025. While November 2023 produced good sales volumes, discretionary spending in December remained relatively weak as consumers adopted a *spend and save* approach to the traditional festive season.
- Immigration remains a tailwind for household goods, however, underlying consumer confidence remains very low and almost half of consumers believe this is a *bad time* to purchase major household items.
- Household savings rates have now dropped well below their long-term average as consumers' *dry powder* available for spending is redirected towards *needs* as opposed to *wants* in response to the drop-off in disposable income and surge in the cost of living. Despite strong H1FY24 results from some listed retailers, sector profitability remains well below its long-term average, as discretionary spend remains down and operating costs remain elevated for some retailers.

Looking forward, what are the megatrends for the sector?

While the Australian retail sector may be facing some headwinds for the time being, there was widespread optimism at the National Retail Federation *Big Show* in January 2024 in NYC that the future for the sector remains bright.

KPMG's team identified several megatrends facing the sector:

- The adoption of AI across the retail value chain, with ~70% of retail leaders indicating AI will be a game changer for retail models impacting supply chain, product development, demand planning and, of course, the customer experience.
- Acceleration of the investment in instore technology to create a *frictionless* retail experience for consumers, including *just walk out* technology and biometric payment solutions such as *Amazon Palm Pay*, and leveraging technology to combat a global retail crime epidemic.
- Continued investment in sustainable retail including the development of circular retail models (e.g. apparel brands launching peer-to-peer marketplaces to facilitate the resale of branded product in the second-hand market).

Our experience in NYC also highlighted:

- The explosion of social commerce #tiktokmademebuyit and social media's impact on the physical store environment with brands leveraging influencer strategies to drive customer engagement and product development.
- The investment brands are making in their ESG credentials and core values as a key ticket to play.
- The widespread adoption of product personalisation and collaboration across brands and with customers directly.
- The strong growth momentum for value retailers who have optimised their supply chain and product development functions, with online pureplay disruptors such as Shein and Temu having a significant market impact.

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) continues to recover from its trough at a similar speed to that experienced during the third quarter of 2023, although we had anticipated the December quarter to be a little bit stronger than it was. Higher producer prices, lower volumes, and stronger wages more than offset the positive contribution from the uplift in consumer sentiment.

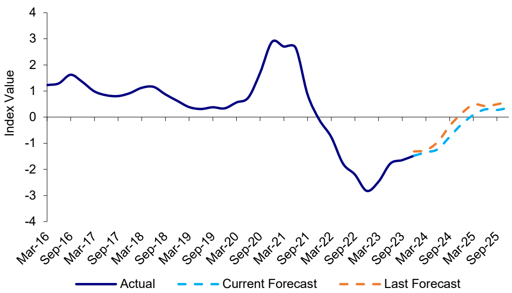
Better times are still coming, but maybe a little later than we previously thought…

Between the September and December quarters 2023 the KPMG RHI rose by 0.17 index points, moving from -1.65 to -1.48; an improvement over the previous quarter, but one that still suggests the general health of the retail sector is frail.

Our latest forecasts of the components that make up the KPMG RHI continue to suggest the short-term outlook for the sector is rallying, albeit at a slightly slower pace than our last forecast.

FIGURE 1

KPMG Retail Health Index, Actual & Forecast



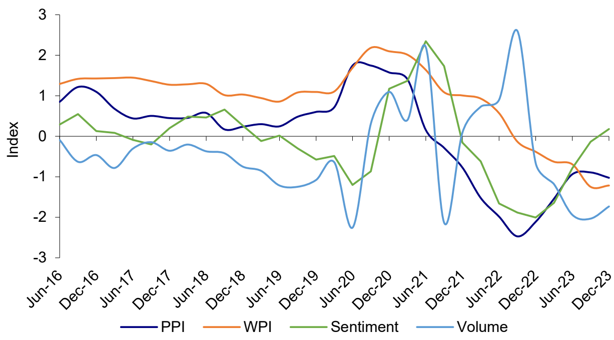
Source: BoE, ECB, FRB, RBA, Haver, KPMG

Our 2023Q4 forecast suggests the recovery of the retail sector may stretch *beyond the end of this calendar year*. The recent swings amongst the four elements of the RHI reveal continued volatility amongst the key drivers of sector performance.

From an individual component perspective, retail sales volumes, wages and consumer sentiment lifted, while strong growth in road transport costs – a significant cost component of the retail sector – saw producer prices act as a drag on the RHI.

FIGURE 2

KPMG RHI by Component Factors



- **PPI**: from -0.9 to -1.0 (i.e. between 2023Q3 and 2023Q4 the growth rate of PPI increased from being 90% above its historical average to 100% above its historical average). Based on its weight of 0.64 (see Technical Appendix), PPI contributed -0.66 index points to the RHI in the December quarter 2023, from -0.58 index points in the September quarter 2023. The acceleration in PPI growth during the three months to December negatively contributed -0.09 index points to the RHI.
- **WPI**: from -1.25 to -1.21 (the growth rate of the WPI decreased to 121% above its historical average from 125% above its historical average during the three months to December 2023), contributing -0.56 index points to the 2023Q4 RHI (down from -0.58 index points in 2023Q3). The slowdown in wages growth in the sector contributed positively (0.015 index points) to the RHI between the September and December quarter.
- **Sentiment**: from -0.13 to 0.18 and contributes 0.1 index points in the 2023Q4 RHI (up from -0.08 index points in the 2023Q3 RHI).
- **Volume**: from -2.03 to -1.73, and contributes -0.36 index points in the 2023Q4 RHI (compared to -0.42 index points in the 2023Q3 RHI).

Spending indicators

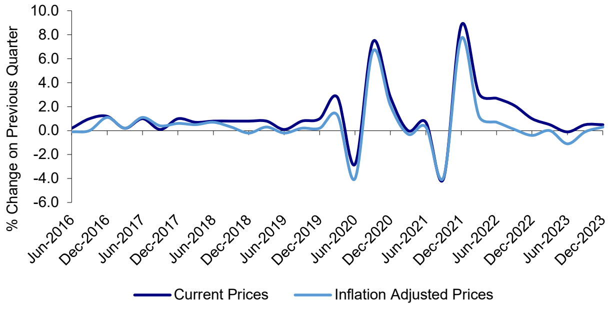
While total sales volumes lifted during the December quarter, driven by Black Friday and Cyber Monday sales events, overall consumer spending on discretionary items continued to weaken.

Retail sales

Retail turnover at current prices increased by 0.5% again during the December quarter of 2023, about *half the rate of growth* of the same quarter in the previous year. From an inflation-adjusted perspective, retail sales volumes rose 0.3% during the quarter. While still low, this represents the strongest increase since the June quarter 2022. The very strong population growth being experienced in Australia is now starting to be seen within retail spending data, with turnover on household goods growing at its fastest quarterly rate in two years.

FIGURE 3

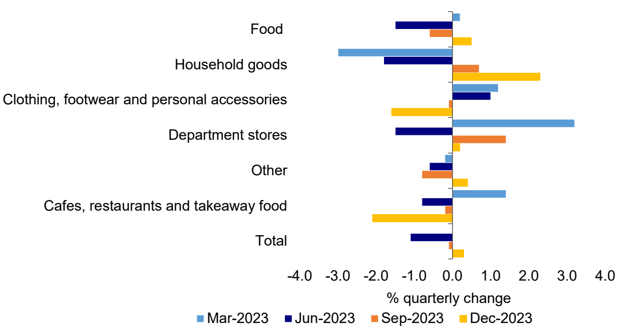
Change in Retail Turnover, Australia, Current and Inflation Adjusted, Quarterly



Despite this population growth, pure discretionary spending remains very weak as the cost-of-living surge is causing households to reallocate their spending budgets to more 'needs' and less 'wants'.

FIGURE 4

Change in Quarterly Inflation Adjusted Sales by Category, Australia



Cafes, restaurants and takeaway food services saw inflation adjusted turnover decline by -2.1% q/q, while clothing, footwear and personal accessory retailing also fell -1.6% q/q. These sectors are more likely to experience positive quarterly real growth in 'normal' conditions due to Christmas spending influences.

Food retailing (0.5% q/q), Other retailing (0.4% q/q) and Department Store retailing (0.2% q/q) experienced small but positive real spending growth during the quarter.

Consumer sentiment

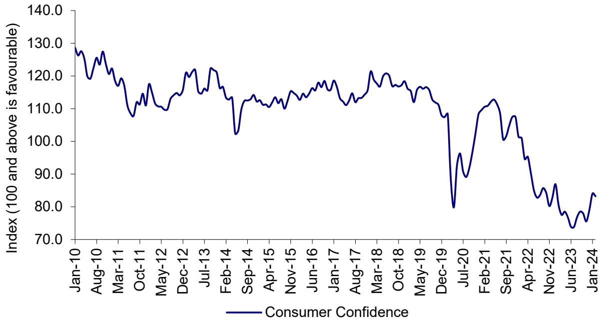
The November 2023 25 bp cash rate increase by the RBA resulted in Consumer Confidence declining again back down to near record lows.

The Westpac–Melbourne Consumer Sentiment Index for Current Conditions has continued to remain below the neutral 100 mark for *28 consecutive months,* although there has been a noticeable lift in consumer sentiment from the start of 2024 across the current, short-term and medium-term outlook.

However, this uptick in confidence may not translate to a turnaround in spending on household goods. Despite a lifting in the index reading for the ANZ–Roy Morgan Consumer Confidence survey question associated with *Time to Buy a Major Household Item,* the positivity associated with *the Santa Claus effect* felt at the start of January 2024 had fallen off by the end of the month and is back down at levels seen at the end of last year.

FIGURE 5

ANZ–Roy Morgan Consumer Confidence



Cost indicators

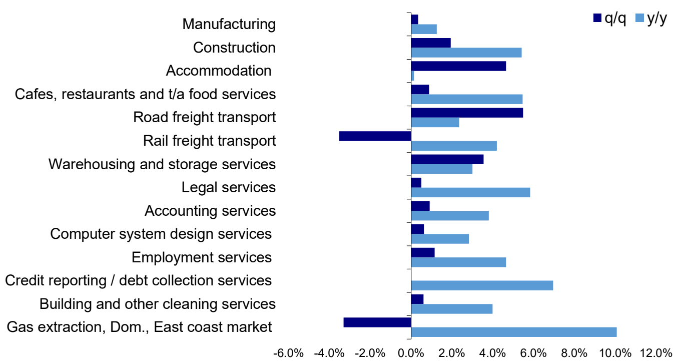
Producer Price Index

The producer price index (PPI) increased by 0.9% q/q in the final quarter of 2023; *about half* the rate of growth experienced in the September quarter 2023. Despite this weakening during the final three months of the year, annual PPI growth rose from 3.8% y/y to 4.1% y/y due to the drop-off of the (relatively) lower December quarter 2022 PPI values.

The number of PPI categories that recorded either zero price increases or disinflation in the last three months of 2023 fell slightly compared to the previous quarter. The increase in the PPI was therefore relatively concentrated, with only eight sectors recording quarterly growth of 3% or more. Road freight transport costs jumped nearly 5% q/q, while cereal and bakery goods manufacturing grew by slightly more than 4% q/q.

FIGURE 6

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



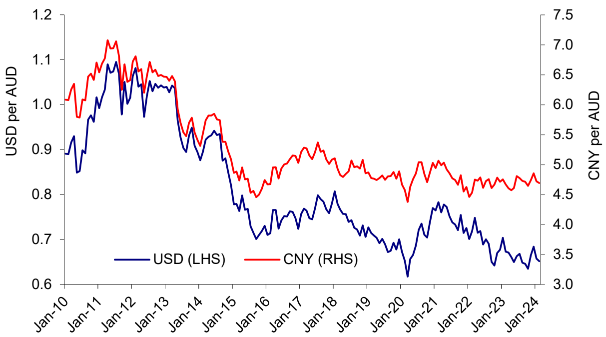
Foreign exchange

The Australian Dollar remains relatively weak, falling from USD 0.684 at the end of December 2023 to be trading at around USD 0.656 at the time of writing this report (mid-March 2024). Market views regarding the timing and extent of policy rate cuts during 2024 and beyond seem to have been revised down since the end of last year, resulting in a weakening of the AUD across most currencies.

This weakening can be seen in the AUD on a Trade Weighted Index Basis, which has depreciated by 2.4% since the beginning of the 2024; with the AUD depreciating most against the US Dollar (-4.7%), UAE Dirham (-4.7%), and the UK Pound (-4.1%) during this period.

FIGURE 7

Exchange Rate, AUD v. USD v. CNY



Wages

The national Wage Price Index (WPI) for the private sector maintained its annual growth rate at 4.2% y/y for the second consecutive quarter. The Accommodation and food services and Retail sectors both recorded a *pull-back in annual increases* in total hourly rates of pay excluding bonuses, down from 5.6% and 4.4% respectively in the September quarter to 4.0% and 4.3% respectively in the December quarter.

The decline in wages growth across the two sectors is likely to be the result of the *softening in labour demand*, with filled jobs falling -7.6% in the Accommodation and food services sector and -0.5% in the Retail trade sector between the September and December quarters. There has also been a weakening in sourcing new labour as the number of businesses recording job vacancies in both sectors fell in the latter part of 2023.

FIGURE 8

Annual Growth in Wage Price Index by Selected Industry

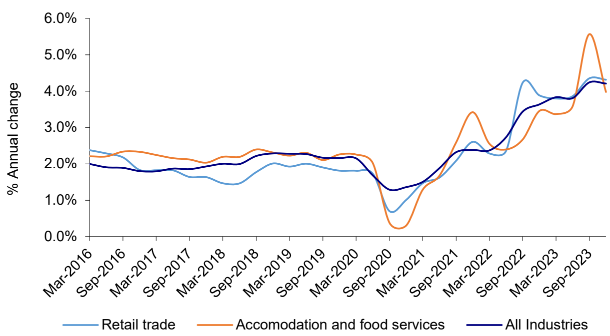
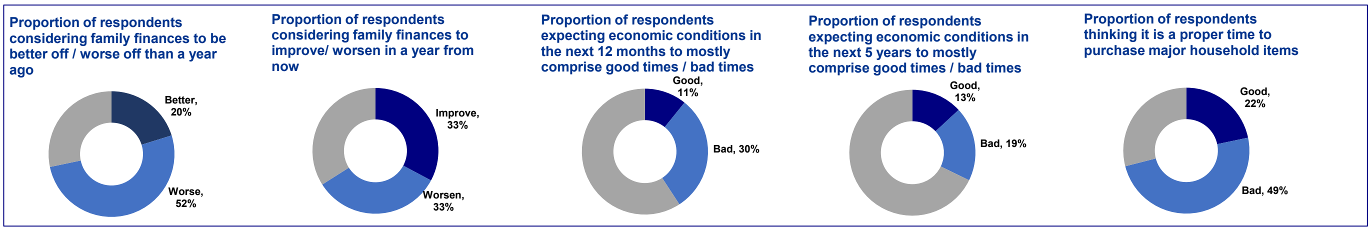


FIGURE 9

Westpac–Melbourne Institute Survey of Consumer Sentiment

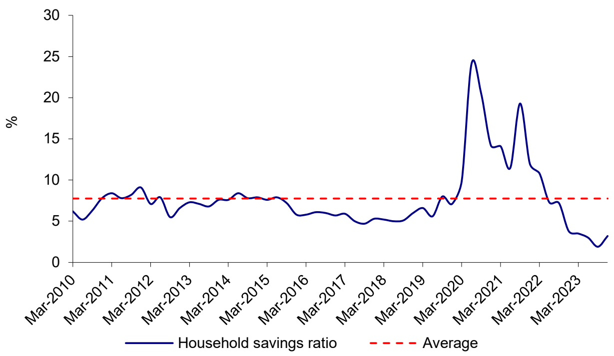


Household spending

Household spending jumped during the December quarter 2023, with most of the growth coming in discretionary spending categories. Average non-discretionary spending (on a $current, calendar adjusted basis) grew only 1.9% over the three months from the end of September 2023, whereas *discretionary spending surged by 13.4%* over the same time. During these three months, average spending on goods grew by 16.3%, while spending on services surprisingly fell by -0.6%.

FIGURE 10

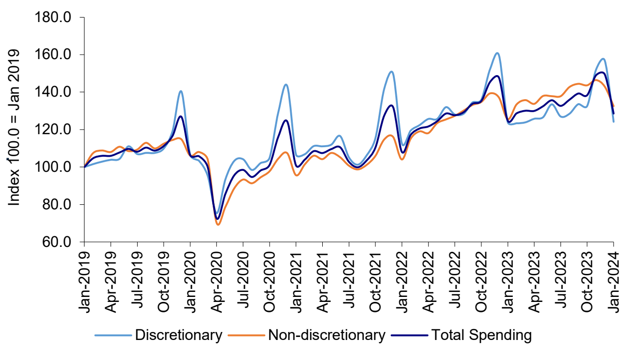
Household Savings Ratio, Australia



Over the three months to the end of December, households increased their (average) *spending on Clothing and footwear by 28.0% and Furnishings and household equipment by 19.1%* compared to the September quarter. Clearly households are adopting a *save-spend pattern* around the Black Friday sales event, with consumers looking to maximise their buying power with their available income.

FIGURE 11

Monthly Household Spending by Type, Australia



Spending by households at Hotels, cafes and restaurants fell by -1.1% over the quarter. The December quarter captures the traditional festive season, which historically has seen spending in this category jump in the month of December around 8% over November. However, consistent with the theme of high cost-of-living pressures, the kick-up in spending in 2023 was around the size of the monthly jump in spending for this category previously experienced in the four years between 2019 and 2022.

Population

Overseas arrivals information shows about 8.1 million non-citizens landed in Australia on either a permanent or temporary basis during 2023; up from 4.3 million in 2022 and 0.35 million in 2021. Of these 8.1 million people, about 1.3 million arrived on permanent visas, 5.5 million arrived on temporary visas, 1.7 million were New Zealand citizens receiving a visa on arrival and 730,000 were international students.

The latest Population Statement was released by the Centre for Population at the end of December 2023. The updated statement contains revised population forecasts that suggest Australia's population will reach (about) *27.15 million people by the end of June 2024*, an *annual increase of 510,400 people* – with roughly a quarter of this growth attributed to natural increases and the remaining associated with net overseas migration (NOM).

The statement also revealed that the two most populated states – New South Wales and Victoria – will continue to drag in a higher proportion of the national population over the coming decade; taking about 60% of the near 2.3 million population growth expected between FY23 and FY33.

While NOM is forecast to decline through the coming decade to levels considered by the government to be more sustainable, what NOM does occur is also getting pulled towards the two largest states also; albeit that Victoria is expected to take over from NSW as the destination of choice for foreign migrants by 2033.

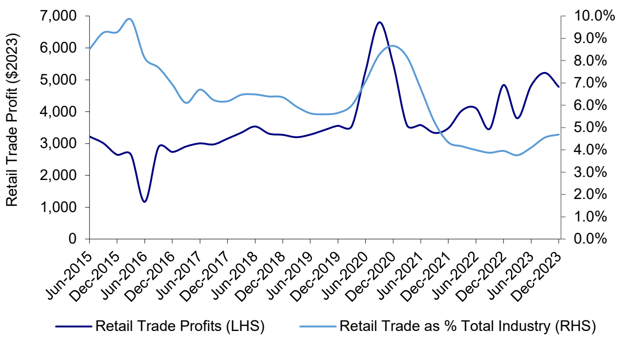
Performance indicators

Profitability

Profitability with the retail sector remains volatile, with the December quarter 2023 recording a 9% fall in profit before income tax compared to the September quarter 2023. This fall in profits for the sector was achieved against a backdrop of recovering corporate profitability, albeit still at levels well below those recorded during 2022. This fall in retail sector profits has resulted in the retail sector creeping down again to represent only 4.7% of total industry profit (before tax) in Australia; still well below its long run average of 6.4%.

FIGURE 12

Retail Sector Profit before Income Tax

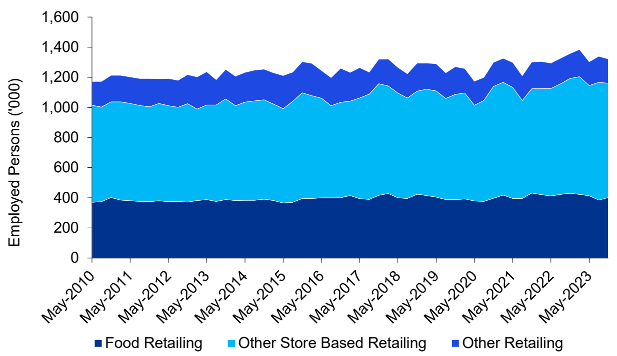


Employment

The retail sector employed 1.32 million people in Australia at the end of November 2023, slightly less than the average level of employment that occurred within the sector over the previous 12 months. This 'averaging down' in the retail sector workforce is most pronounced in the non-food store-based retailing, which has seen total employment fall by around 3% from its peak. Food retailing continues to employ large numbers of workers, with around 400,000 people working in this retail subsector.

FIGURE 13

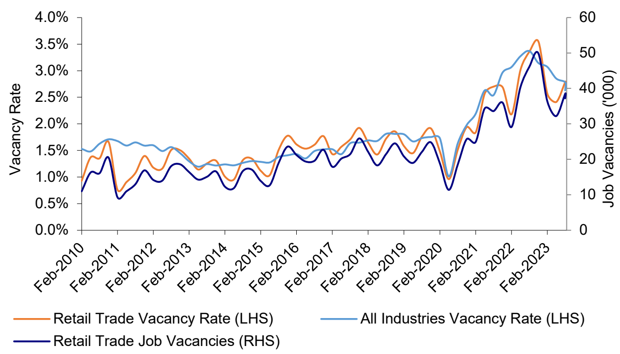
Retail Sector Employment, Australia ('000)



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

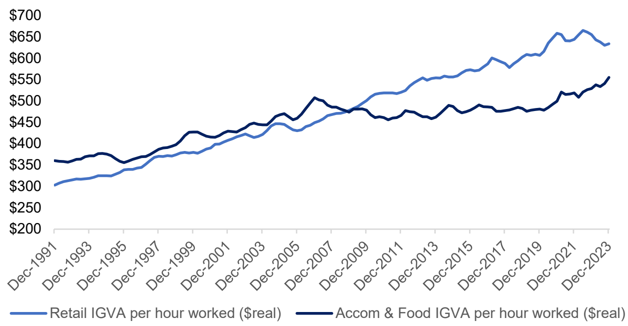


Labour Productivity

KPMG has calculated a proxy labour productivity measure using real Industry Gross Value Added and hours worked. As shown 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 1.5% over the same time period.

FIGURE 15

Labour Productivity Estimates



Online indicators

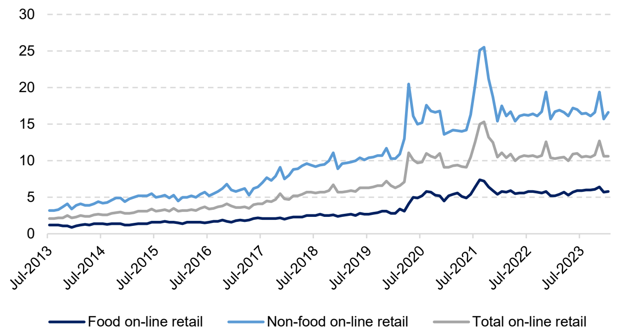
While online sales growth in Australia has moderated, KPMG's research suggests that when it comes to seamless commerce (channel agnostic), the Australian retail sector is middle of the pack compared to eight key markets, with further opportunity for improvement.

Online retail sales

Online retail sales totalled about $11.6 billion during the December quarter 2023, an increase of around 4.5% over the value of online sales recorded during the September quarter. Non-food online retail sales grew 3.7% over the quarter, but was 1.2% lower compared to the December quarter 2022. Food online sales also grew during the December quarter by 6.2%, and compared to the same quarter last year, online food sales was up strongly by 12.6%.

FIGURE 16

Online Retail Sales by Type as a Proportion of Total Sales

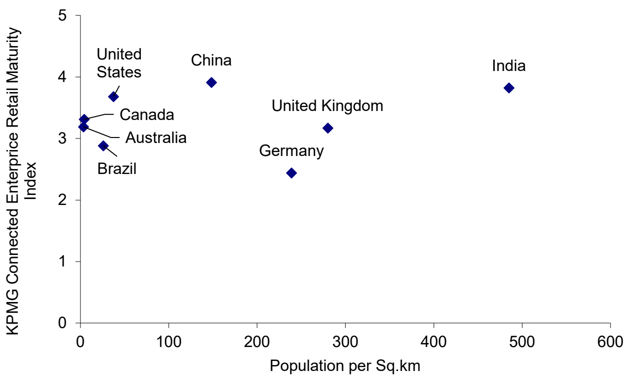


Towards seamless commerce

KPMG's recent report suggests Australia ranks in the middle of eight key major markets for seamless commerce where the consumer is channel agnostic.

FIGURE 17

KPMG Connected Enterprise Retail Maturity Index and GDP per capita (US$)



Population dispersion and last mile delivery remain structural impediments, albeit Gen Z consumers are increasingly pivoting towards social media as their primary discovery channel.

As transactional capabilities of social media platforms evolve, we expect social commerce to become embedded as a key customer interface.

The Statista eCommerce Report for Australia suggests the ecommerce market is anticipated to see:

- online revenue reach nearly $50b in 2024 and $77b by 2029 at a compound average annual growth rate (CAGR) of ~9.3%
- the number of online users expand to ~22.6m by 2029, meaning user penetration in Australia will lift from current levels of ~65% of the population to ~83% of the forecast population in five years' time
- average revenue per user (ARPU) is expected to grow to AU$2,900.

Statista[2] also provide similar analysis and forecasts for the United States which suggest:

- online revenue is projected to reach AU$1,161b in 2024 and AU$1,767b by 2029 at a CAGR of 8.8%
- the number of online users is expected to expand to around 332m by 2029, representing ~97% of the user population, up from current user penetration rates of around 84%
- average revenue per user (ARPU) is expected to amount to AU$4,300.

	2024		2029	
AUD				
Market size ($b)	$50	$1,161	$77	$1,767
Users	17	288	23	332
ARPU	$2,900	$3,400	$4,300	$5,300
Source: Statista				

Should the domestic ecommerce market develop more substantially over the next five years and come closer to that found in the US, with user penetration and ARPU growing to levels much stronger than current expectations to match those in the US at the end of that time frame, then KPMG estimates the size of the Australian ecommerce market could be as large as $140b – nearly double current Statista forecasts.

(1) https://www.statista.com/outlook/emo/ecommerce/australia?currency=AUD
(2) https://www.statista.com/outlook/emo/ecommerce/united-states?currency=AUD

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 retailers' 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.

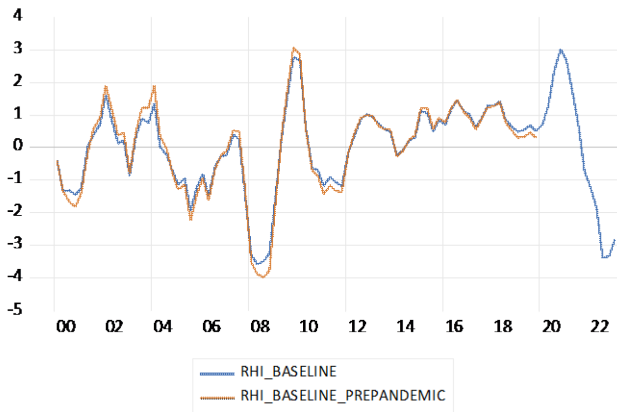
Table T.1 below shows the respective weights of each variable on the RHI, and the total variance explained by the RHI.

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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