Asian Cities - 1H 2023

SPOTLIGHT
Savills Research

Australia Retail

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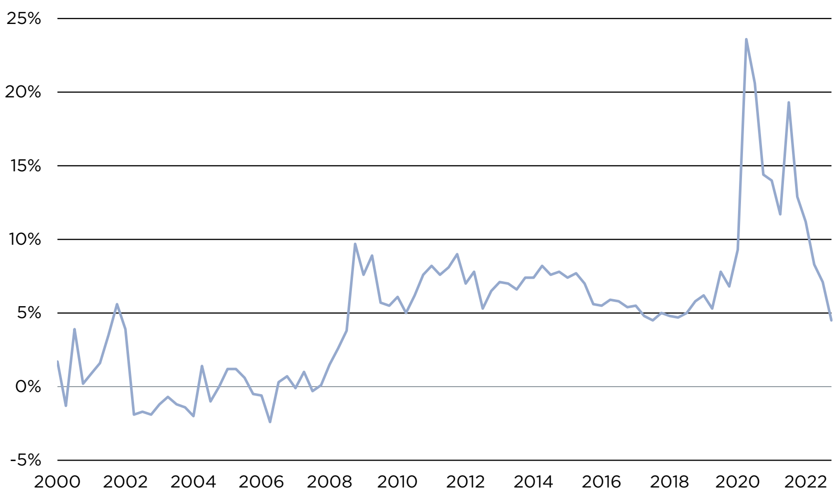
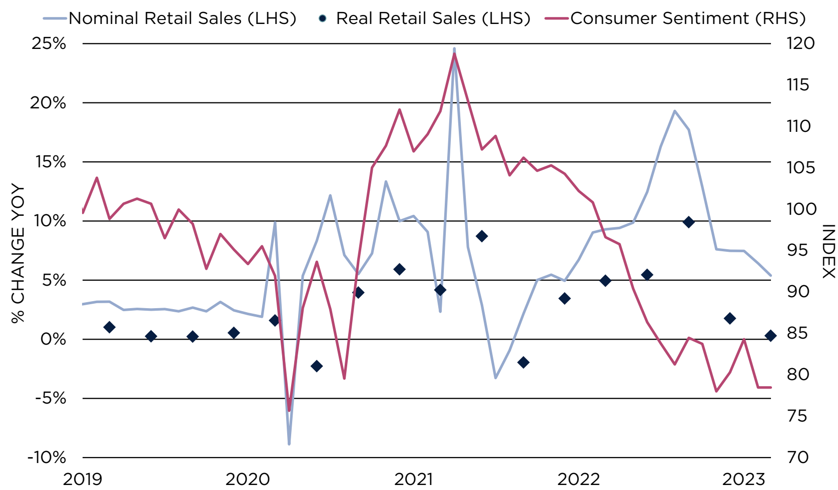
Near-term headwinds but retail sector nears turning point

GRAPH 1: Household Savings Ratio, 2000 to 2022



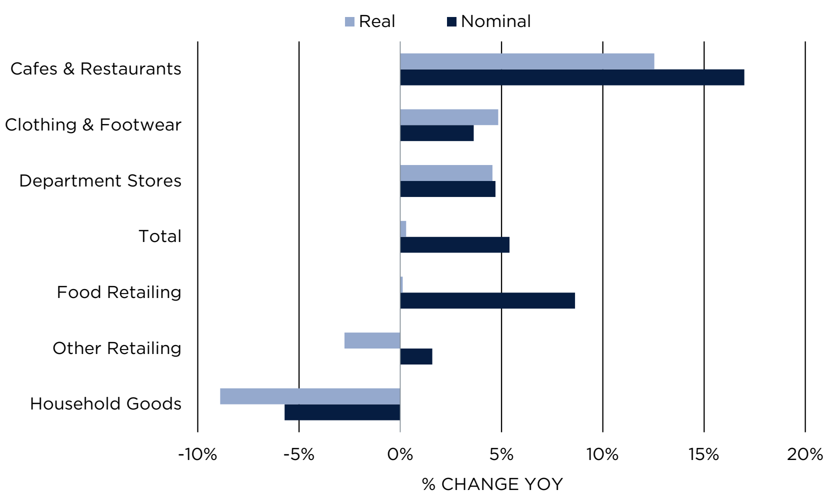
Source Savills Research, Macrobond

GRAPH 2: Nominal and Real Retail Sales and Consumer Sentiment, 2019 to March 2023



Source Savills Research, Macrobond

GRAPH 3: Nominal and Real Retail Sales by Segment



Source Savills Research, Macrobond

HIGHER INFLATION AND INTEREST RATES DRIVE SLOWDOWN IN CONSUMER SPENDING

After a period of exceptionally strong growth coming out of pandemic restrictions, consumer spending is slowing as the impact of higher interest rates and inflation begin to bite. Nominal retail sales rose by 0.4% in March, with annual growth slowing to 5.4%, down from a peak of nearly 20% in mid-2022, and the slowest growth rate in 18 months.

Driving the slowdown is the ongoing decline in the household savings rate, which has fallen back to pre-pandemic levels. Households have largely spent the income boost from pandemic stimulus, while higher inflation and interest payments have eroded household disposable income.

While the 5.4% annual growth in nominal retail sales is a little above its two-decade average growth rate (4.9%), high inflation means the growth in real retail sales has been much lower. With headline inflation rising by 7.0% over the year to Q1/2023, real retail sales have declined over the past six months to be just 0.3% higher over the year, well below the two-decade average of 3.2%.

Although overall household consumption has slowed, spending on services and smaller discretionary purchases continues to be robust. For example, real retail sales for cafes, restaurants, and takeaway food services continues to record strong growth, up by 12.5% over year, while department store (+4.6% y/y) and clothing, footwear, and personal accessory (+4.8% y/y) retailing are also seeing solid growth. By contrast, consumers are making fewer large discretionary purchases in the face of cost-of-living pressures, with real household goods sales declining by 3.7% in Q1 to be 8.9% lower over the year.

KEY MACRO DRIVERS NEARING A TURNING POINT FOR RETAIL

1) Inflation has peaked; near peak interest rates?

The Reserve Bank of Australia (RBA) surprised financial markets by lifting the cash rate by a further 25 basis points in May to 3.85%, taking the cumulative increase to 375 basis points since May 2022. Despite the May increase, financial market pricing suggests the RBA and other major central banks are close to the end of the tightening cycle. While the full impact of the interest rate increases on households and consumer spending is yet to be felt, an end to the monetary policy tightening cycle (and the potential for interest rate cuts going into 2024), coupled with moderating inflation, is beginning to boost consumer sentiment and represents a potential turning point for the retail sector.

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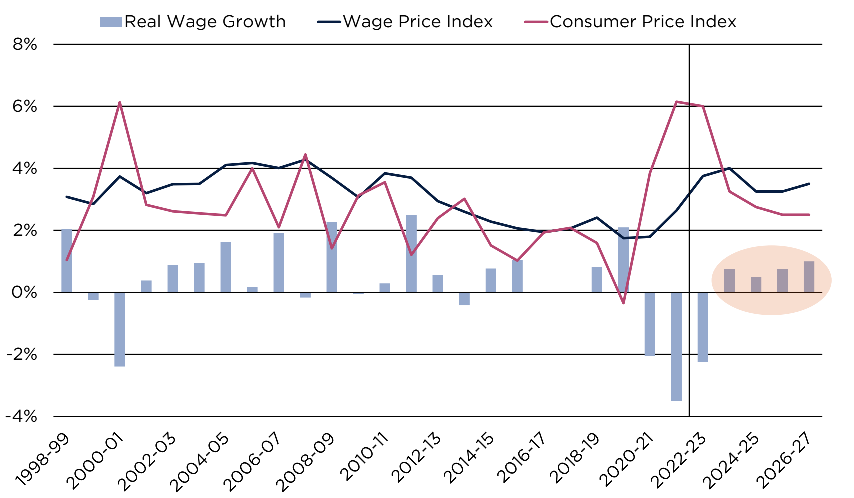
2) Real wage growth expected to turn positive from 2023-24

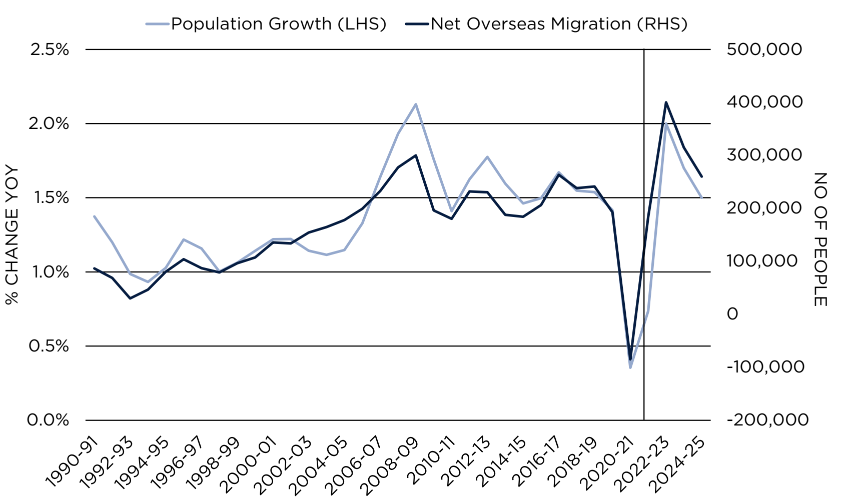
After several years of negative real wage growth, Treasury expects wage growth to outpace the rate of headline inflation from the 2023-24 financial year until at least 2026-27. Inflation is expected to moderate from its current elevated level while aggregate wage growth is predicted to continue to strengthen reflecting the lagged impact of the current tight labour market conditions. Sustained positive real wage growth would be a significant change for consumers whose capacity to spend in recent years has been hampered by negative real wage growth, with significant benefits for the retail sector.

GRAPH 4: Wage Price and Consumer Price Indices, Financial Year Basis, 1998-99 to 2026-27



Source Savills Research, Macrobond, Treasury

GRAPH 5: Total Population Growth and Change in Net Overseas Migration, Financial Year Basis, 1990-91 to 2024-25



Source Savills Research, Macrobond, Treasury

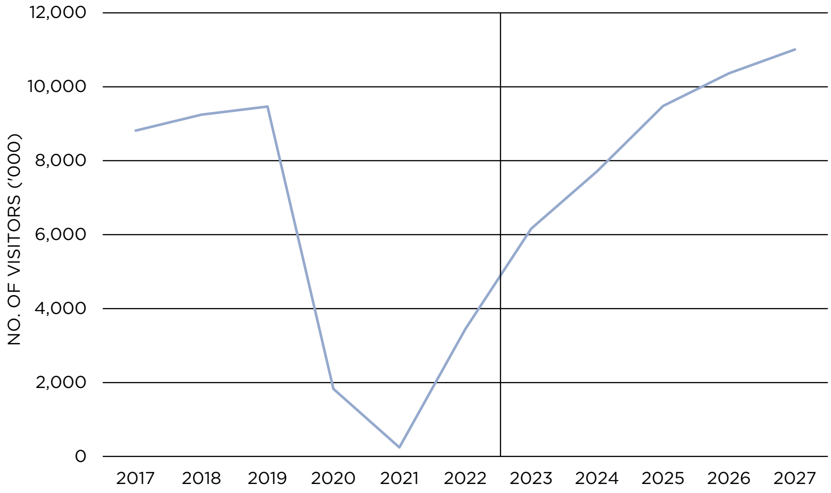
3) Recovery in migration and stronger population growth

Overseas migration is recovering at a faster rate than previously anticipated coming out of pandemic-era border restrictions. Treasury upgraded migration forecasts in the May Budget, with net overseas migration predicted to be 400,000 in 2022–23, and 315,000 in 2023-24, the highest annual intake on record and well above the long-run average of around 150,000. Population growth is also expected to be significantly higher, increasing by 2.0% in 2022–23 and 1.7% in 2023–24, the strongest annual growth rate since 2008-09, and up from the long-run average of 1.4% and 0.7% in 2021-22. Stronger population growth will add to aggregate demand in the economy and presents an ongoing tailwind for the retail sector.

4) Tourism recovery

In addition to the rebound in overseas migration, international tourism arrivals are also expected to recover following the reopening of Australia's border. Over the year to February 2023, there were around 4.5 million international tourist arrivals, an increase of over 1,000% over the year. There is plenty of potential for further growth though, with annual arrivals still only around half of pre-pandemic (2019) levels. International arrivals are expected to continue to increase a rapid rate, with more than 20% growth expected in both 2024 and 2025, to surpass the pre-pandemic high of 9.5 million by 2025.

GRAPH 6: International Visitor Arrivals Rebounding from Pandemic Border Closures, 2017 to 2027



Source Savills Research, Tourism Australia

The ongoing rebound in international tourism will provide a tailwind for the retail sector over the coming years, with CBD retailers, and services and discretionary segments set to particularly benefit. According to Tourism Australia, prior to the onset of the pandemic, international tourists spent AU$45.4 billion in 2019, equivalent to a little under 14% of total annual retail sales in Australia at that time.

MACRO TAILWINDS AND PANDEMIC RE-REPRICING DRIVE INVESTOR INTEREST IN RETAIL

Investors flocked to retail assets coming out of the pandemic, attracted by falls in capital values in 2020 and the prospect of a rebound in consumer spending (particularly on services), and population growth and tourism. Total retail investment volume in Australia was nearly AU$20 billion over the year to Q2/2022, the highest level on record.

As in other commercial property segments, retail investment activity has declined sharply since the second half of 2022, with the rapid rise in interest rates and debt costs, and uncertainty over the outlook for interest rates and consumer spending, weighing on investor sentiment. While Q1/2023 investment volume was down 69% from a very strong Q1/2022, activity in Q1 was nearly double the 5-year pre-pandemic Q1 average, pointing to ongoing investor interest in the retail sector.

This is backed up by the ANREV Asia Pacific Investment Intentions Survey, which finds that 88% of North American and European investors prefer retail assets in the APAC region as a potential investment in 2023. The appeal of retail assets is underpinned both by their perceived ability to hedge against inflation, as well as the potential for growth in the retail sector from the macro tailwinds that will increasingly exert themselves after the impact of higher interest rates fully works its way through the economy.

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