

Retail update Autumn 2022



Sector overview

The UK's cost-of-living crisis coupled with the economic consequences of the war in Ukraine has created a significant shift in consumer behaviour and has led to numerous obstacles for the retail industry to try and overcome. With such an uncertain economic outlook the prospect of a post-pandemic recovery for retailers and their supply chains has become much more challenging. Impacted by rising wages, reduced consumer spending, a need to focus on ESG, and global supply chain issues, retailers are facing significant pressure on their margins with consumer appetite weighted towards mark-downs amidst a heavily promotional environment. Data, published by GfK, revealed that the combination of falling real incomes and rising costs have pushed consumer confidence to -44 in August 2022, the lowest since records began in 1974. In September, the Bank of England increased interest rates by 50bps to 2.25% making it more expensive to borrow and service personal debt with a knock-on impact expected on consumer spending.

Consumers are already looking to tighten spending habits, buying less or downsizing in almost every category. As inflation surged to its highest level in nearly 40 years (9.9%), spend is diverted to essential goods such as food, utilities, gas, and other non-discretionary items, leaving less money available for discretionary purchases.

Although energy, import, shipping, and haulage costs have increased significantly, retailers are making every effort to keep prices low for their customers through dynamic promotional activities, discount offers for vulnerable groups, shrinkflation (reducing product sizes to maintain price) and strengthening own brand propositions.

Support measures announced by the UK Government will see energy prices for non-domestic energy customers such as businesses, charities and public sector organisations capped - protecting them from rising energy costs.

Whilst we anticipate Christmas trading to be a peak period, the challenge ahead will be the rising cost of living in the UK and how it impacts consumer confidence and therefore demand in general. Ultimately, both consumers and retailers are in for a challenging time throughout 2022 and beyond.

Retail update

Data

- > British Retail Consortium highlighted that footfall in August decreased by 12.4% as consumers reduced spending amidst the spiralling cost-of-living.
- > PwC reported that 6,147 retail stores closed in the UK during the first six months of this year with only 3,888 stores opening.
- > ONS reported that the Consumer Prices Index (CPI) rose by 9.9% in the 12 months to August 2022, down from 10.1% in July. Food and non-alcoholic beverages made the largest upward contribution to the monthly rates in August 2022, while falling prices for motor fuels resulted in a large offsetting downward contribution.
- > Bank of England raised interest rates again in September, from 1.75% to 2.25%, taking borrowing costs to their highest level since 2008.
- > Bank of England expect price rises will push inflation to ca 13% over the next few months.
- > GfK consumer confidence index hit a new record low of -44 in August, the lowest since records began in 1974. This was impacted by inflation, higher interest rates and the war in Ukraine.

Retail Trends in 2022:

- > **ESG:** Consumer behaviour has seen a greater shift in demand towards retailers who adopt a more ESG friendly approach to their practices. Ethically sourced goods and a lower carbon footprint are increasingly important for consumers.
- > **Hybrid Retail:** Retailers who can find a successful blend of having physical stores whilst also a modern e-commerce platform, will be well placed to take advantage of market movements.
- > **Demand For Same Day Delivery:** To meet the demands of customers who have become accustomed to making last-minute or urgent purchases, retailers are anticipated to expand their collaborations with delivery companies that offer same-day fulfilment.
- > **Investment:** Businesses that can reinvest in their business model will hold an advantage over their competition. Investment in supply chain models is critical to ensure a smoother running business that fulfils customer demand with a leaner cost base.

Notable insolvency events

Government covid measures during 2020 and 2021 - such as furlough schemes, business loans and the closure of UK Courts - resulted in a benign insolvency environment during this period. In recent years, this sector has however seen some high profile insolvencies such as: Missguided, McColl's Retail Group, Studio Retail, Sofa Workshop, Debenhams, Arcadia, Peacocks, M&Co, Oakfurnitureland, Benson beds, Harveys Furniture, TM Lewin, Go Outdoors, Poundstretcher, Monsoon Accessorize, Oasis and Warehouse.

The outlook for 2022/2023 is for retail insolvencies to increase as sectorial and economic challenges start to bite. According to the Insolvency Service Official Statistics, we are already seeing an uptick. The number of registered company insolvencies in August 2022 was 1,933 which was 43% higher than in the same month in the previous year (1,348 in August 2021), and 42% higher than the number registered three years previously (pre-pandemic; 1,365 in August 2019). Moreover, on the 26th of March the restriction that prevented landlords from issuing winding-up petitions against tenants ended and it is expected that this action alone will see insolvencies rise in the sector.

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Retail Sales Breakdown (Great Britain - August 2022)

- > **Online Retailers:** Sales volumes fell by 2.6% in August 2022; despite this fall, sales volumes were 24.4% above their February 2020 pre-pandemic level.
- > **Household Goods Stores:** Sales volumes fell by 1.1% in August 2022, mainly because of fall in furniture and lighting stores. Feedback from retailers suggests that consumers are cutting back on spending because of increased prices and affordability concerns.
- > **Clothing Stores:** Sales volumes fell by 0.6% in August 2022 and were 5.7% below their February 2020 pre-pandemic level.
- > **Non-Food Stores:** Sales volumes fell by 1.9% over the month and were 2.0% below their pre-coronavirus February 2020 pre-pandemic level.

Underwriting approach

- > **Information is key:** We remain in regular dialogue with a variety of businesses across the retail sector. We seek to obtain updated management accounts to fully understand the trading performance in the current environment and the funding facilities that are being made available to support working capital.
- > **A case-by-case underwriting stance in Retail:** QBE continue to review each business on their own financial merits.

Figure 3: Sales volumes fall across all sub-sectors of non-food stores

Volume sales, seasonally adjusted, Great Britain, August 2019 to August 2022



Source: Office for National Statistics - Monthly Business Survey - Retail

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