BIZCOMMUNITY

Inflation pass-through still to come for retail

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With little relief on the horizon to buoy spending, the consumer confidence outlook for the remainder of the year is anything but optimistic.

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There is little to support expenditure as inflation and living costs continue to rise, putting strain on disposable income.

The curbing of credit, including unsecured lending, poor job prospects and a moderation in income growth are worsening the slowdown in consumer activity.

Late last month, the financial results from the country's retail stalwarts confirmed margin pressure. They also entrenched a foreboding gloom over the sector.

"Things are bad," says equity analyst at 36ONE Asset Management Daniel Isaacs.

"There is nothing to show alleviation of the situation. In effect they (retailers) might be coming under more pressure because they haven't actually started passing through the full inflation effect of the weaker rand."

Absorbing costs

Retailers have been absorbing a sizeable portion of the uptick in food prices to retain customers. This is unlikely to continue, with economists predicting that official food inflation will reach a peak of just under 10% by year end, as rand weakness seems set to continue and droughts in certain regions reduce a poor maize harvest.

Shoprite reported a lower than expected sales gain of 7.6% in its South African supermarket operation for the half year.

Internal food inflation during the period averaged 3.8%, compared with estimated official food inflation of 5.6%, indicating prices have been subsidised to grow volume.

"The full price pass-through hasn't happened yet but the consumer is already feeling the strain, ... there is still more strain to come," Isaacs says.

Truworths says product price inflation arising from the devaluation of the rand is likely to be higher than 10% for the balance of the 2014 financial period.

With a similarly dour view, Stanlib retail analyst Theresa Heath says consumers will continue to digest high debt levels, swallow rising food, fuel and imported goods inflation and become more accustomed to smaller real wage increases.

"A slowdown in sales has been seen pretty much across the board after the last wave of results, and we see no reason for this to improve this year," she says.

Employment not promising

The most important drivers for vibrancy in consumer spending - employment and income growth - offer no promise.

From the perspective of employment, South Africa has recovered to similar levels of employment achieved before the 2008 global financial crisis - mostly due to growth in the public sector - but the outlook from here on is challenging, says Kagiso Asset Management investment analyst Simon Anderssen.

"Companies and government are no longer offering above-inflation wage increases and this limits consumers' ability to buy more goods and services. The strikes in the platinum sector will have a meaningful impact on retailers in the Rustenburg area."

Furthermore, there is little evidence that the weak rand is helping South Africa's exporters in the manufacturing sector, and mining companies are increasingly exploring mechanisation options to reduce dependency on labour.

Other dynamics unfolding are the disparity in growth rates between living standard measures (LSMs) and the strength of various categories. Portfolio manager at Gryphon Asset Management Reuben Beelders says the pressure at this point appears to be particularly acute at the lower end of the market, but should interest rates rise further, this pressure is likely to also be felt at the upper end.

Sheltered from the slowdown seen by its peers, Woolworths emerged the top performer as its wealthier customers kept tills ringing, especially at the upmarket player's food business. However, CEO Ian Moir acknowledges that interest-rate rises are the "real risk" to the upper-end customer.

Though upper-income customers appear to be in a better position, if the Reserve Bank embarks on a cycle of raising interest rates, analysts say the party may come to an end for the well-heeled. The repo rate was hiked by 50 basis points in January.

Middle-income feeling the pinch

Isaacs says middle-income consumers are suffering the most. "Those exposed to the middle-income consumer, like Truworths, and especially retailers with exposure to credit, are going to take strain. Consumers have less of a propensity to borrow and companies have less willingness to lend," he says. Walmart-owned Massmart has felt the pain acutely with Game SA, where comparable sales show a decline of 2.6% for the 53-week period to December 29.

"Game sells durables to middle-income SA, and unsurprisingly it's pretty tough there... sales are hard to come by, everyone is discounting to try to get the volume and customers," Massmart chief operations officer Guy Hayward says.

Within the retail sector, sales of nondurable goods such as food seem to be holding up better than semidurable and durable offerings.

Stanlib's Heath says while food sales are expected to be resilient, consumer volumes will remain under pressure.

Consumers are also expected to "shop down" into smaller pack sizes or into house-branded products, which offer better value.

"Within the clothing space, we think the lower-priced cash retailers will do relatively better than their competitors, especially those with a credible and compelling fashion offer," Heath adds.

According to Anderssen at Kagiso, the furniture sector faces structural issues. "There are too many furniture stores for our market and none of the listed furniture retailers have articulated a compelling strategy on how to overcome this. At the same time, credit losses from past sales are likely to have a significant impact on profits over the next 12 months."