Retail Think Tank: A defining time for UK retail

With all the uncertainties building around Brexit, and the UK's trade agreements, the months ahead will be defining times for the retail industry, challenging the acumen of even the very best leadership teams in retailing. So says Tim Denison, co-chair of the Retail Think Tank as it launches its annual review

Shoppers in Liverpool, UK

2018 marked yet another troublesome year for the retail industry, which had already been facing strong macroeconomic and geopolitical headwinds, along with the barrage of longstanding structural upheaval, driven by ever-changing and varied consumer behaviour. The troubles began right from the year's starting blocks, with the KPMG/Ipsos Retail Think Tank's (RTT) health assessment in the first quarter recording the lowest score (79) in five years. This followed disappointing Christmas trading and marked the second consecutive deterioration in retail health – a reality many retailers were understandably reluctant to digest.

Download the RTT's Annual Review on their website here

ING's Chief International Economist, James Knightley, is a member of the RTT. Here are his thoughts:

2018 has been a tough year for the UK economy and the retail sector in particular. The main direct effect from the June 2016 Brexit vote so far has been the collapse in the pound, which pushed up import prices and lead to broad rises in inflation. Unfortunately, wages have barely kept pace meaning a squeeze on spending power. At the same time, business continues to face an uncertain period due to a lack of clarity on what is going to happen. Consequently, the UK has been one of the worst performing major economies, likely expanding around 1.3% in 2018 versus 1.9% in the Eurozone and 2.9% in the US. 2019 is unlikely to get any easier.

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We are approaching crunch time in the Brexit process and this is increasingly weighing on both business and consumer sentiment. Fears of a potential "hard Brexit" linger – one in which trade is heavily impacted to due customs and regulatory checks that result in long port delays. This implies a risk of a lack of fresh food, medicine, manufacturing components and consumer goods. In a worst case scenario, it could mean empty shelves, factory shutdowns and rampant inflation.

Recent scenario analysis produced by the Bank of England also talked of a deep recession, surging unemployment and collapsing asset prices in such a situation. However, there is little appetite for such an extreme form of Brexit within the House of Commons, aside from a handful of Brexit "purists". Moreover, recent parliamentary votes and proposed amendments suggest a "softer" form of Brexit remains the most likely outcome. Indeed, there is growing talk of a "Norway plus" model, which would leave things relatively unchanged (Customs Union + single market, but without any say on the rules) while betting markets continue to see the odds of a second referendum slashed – 18 months ago it was priced at 20/1, today it is as low as 6/5.

This broad range of possibilities in an environment of political flux means no-one can have much confidence in their forecasts for 2019. I for one think a hard, severe Brexit will be avoided, but things are likely to get worse before they get better in terms of both market moves and economic data – politicians often need a nudge. Indeed, there are strong parallels when US Congress initially didn't back the proposals to deal with the sub-prime crisis in 2008. A steep equity market sell-off and a realisation that action needed to be taken now led to a swift reappraisal of what to do.

As such the first half of 2019 is likely to be very challenging, but as the Brexit crescendo gradually subsides confidence should start to return with consumers increasingly willing to open their wallets. With the Bank of England signalling a desire to see higher interest rates should conditions allow it, we could see borrowing costs rise. However, a likely rebound in sterling may help margin pressures for retailers.

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