2016 was a particularly turbulent year for the UK, both politically and economically and this in turn has had implications for the retail sector. The most positive trend to emerge from 2016 was the resilience of the UK consumer in the wake of the EU Referendum. It was expected that consumer confidence and spending would be hit, and whilst confidence did fall immediately after the event, it has since returned to a level which is still above the long run average for the series. This confidence has also been shared by retailers who have continued to expand across the UK in the months following the vote.

The most worrying news for the sector was the return of some high profile administrations, the likes of which the sector had not seen over the past couple of years. Fortunately however, these administrations were the result of retailers such as BHS and Austin Reed not keeping pace with changing consumer preferences as opposed to toxic economic conditions.

Christmas 2016 was a confirmation of the positivity remaining in the market with the volume of sales increasing by 4.3% in December compared to a year earlier. Many retailers reported very robust sales over the period, though many of the trends from Christmas 2015 were repeated

Christmas 2016 proved to be a lot more successful than perhaps anticipated. The out performance of the grocery sector was the most welcome news which emerged from the Christmas trading period. According to Kantar, UK consumers spent an extra £480m on groceries in the run up to Christmas compared to 2015, increasing total supermarket sales by 1.8% Whilst Aldi and Lidl both posted record breaking Christmas sales, it was the stellar results posted by both Morrisons and Tesco which grabbed the headlines. Both retailers have been through quite turbulent times over the past years, but it now appears that their respective turnaround plans have started to pay dividends.

Results from non-food retailers were slightly less unanimous, though generally still positive. Retailers such as M&S, Supergroup, Ann Summers, Shop Direct and Reiss all reported solid sales. Next were the only notable disappointment of Christmas 2016, with full price sales falling by 0.4%. The retailer also warned that rising inflation in 2017 could further erode sales.

One issue which continues to stand out is the outperformance of online. Although this point is somewhat overused, the sales successes of retailers such as Asos and Boohoo allude to the fact that the consumer continues to be increasingly drawn to shopping online rather than in shops.

2017 RETAIL OUTLOOK
JANUARY 2017

Summary

Christmas 2016: Key Trends

Christmas 2016: Sales

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Outlook: 2017 Retail

Article 50. Theresa May has stated that she plans to invoke Article 50 by the end of March 2017, which will formally begin the UK's withdrawal from the European Union. Assuming the recent legal judgement doesn't overly affect the trajectory of the process, as this begins to occur, the true extent to which Brexit will affect the UK economy and subsequently the retail market will become clearer. For the retail sector, a new set of trade agreements will be the main area of concern going into the negotiations. One of the other main areas where confusion is present within the Brexit negotiations is the status of immigration rights for EU nationals currently working in the UK. With a large chunk of the workforce in UK retail having a European background, this aspect of the negotiations will be very significant for the sector.

Inflation. The beginning of a new inflationary environment reared its head at the tail end of 2016. However, with the bulk of major retailers having currency hedging arrangements in place until the end of Q1 2017, there has been a very limited amount of pain passed through to the UK consumer yet. With the value of the pound against the dollar falling by over 10%, price increases across the UK retail market are inevitable. A recent KPMG/Ipsos Retail Think Tank found that they anticipated price increases of between 5-8% in 2017. Whilst this won't overly affect consumption of inelastic goods, discretionary spending on big ticket items could fall away if price increases are significant.

Consumer confidence and its effect on spending. Consumer confidence finished the year at -7, slightly up on November and 5 points up on its July 2016 low point. Whilst this marked a decline on the levels of confidence witnessed in 2015, confidence has not been as adversely affected as was initially anticipated in the wake of the Brexit vote. Confidence is expected to stay negative in 2017 as uncertainty still hangs over the UK. As one of the primary leading indicators for consumer spending, it will be of paramount importance that confidence does not fall too far.

Labour market and the National Living Wage. The labour market will be an area of concern for the retail sector going into 2017. Employment levels are unlikely to increase much further, already standing at a record high. Following the outcome of the EU Referendum, hiring has stalled in many sectors, with employers waiting for the uncertainty surrounding the Brexit vote to recede even slightly. With a period of inflationary environment, it's likely that we will see growth of real household incomes slowing sharply, which could clearly have a detrimental effect on UK retail sales. Another factor affecting the labour market was the introduction of the National Living Wage (NLW) in April 2016, with the next increase to be implemented in April 2017. There was originally speculation that increasing the NLW would trigger job losses. Fortunately, this didn't materialise, with retailers instead improving productivity and increasing prices. However, with another round of wage rises approaching, increasing total costs, it remains to be seen how retailers will deal with this issue in 2017.

Further European uncertainty. The rise of populism and right wing politics will remain an area of concern for European economies in 2017. With major elections approaching in both France and Germany and with populist parties attracting significant chunks of the electorate in the polls, this could cause further EU political instability. Whilst the direct implications for UK retail are limited, indirectly the sector could be hit, with spending across the whole of the EU beginning to stall.

Occupational conditions. Retail vacancy rates across the UK continued to fall across 2016 in the majority of regions. Whilst there are no obvious candidates to go bust this year, it's possible that occupational conditions could be more challenging going into 2017. Despite occupational demand remaining strong in some regions, vacancy stats from the Local Data Company showed that take up slowed in the second half of 2016. We anticipate that demand will remain polarised, with strong towns or retail destinations continuing to attract robust tenant interest, whilst high vacancy rates in weak locations will persist. The exit of American retailers Banana Republic and American Apparel illustrates both the high level of competition and the challenging occupier conditions within the UK retail space.

Outlook: 2017 Investment

Following a fairly strong finish to the year, 2016’s total retail investment volume of £10.6bn was 20% down on 2015, a stronger relative performance than All Property which saw volumes fall by 28%. With BNP Paribas Real Estate forecasting a total volume of £38bn, we estimate that retail volumes will fall to around £8.5-9bn in 2017.

In a continuation of the trend witnessed in the latter part of 2016, we anticipate that prime high streets, will remain the focus of many investors. This will especially be the case in Central London where overseas money will remain attracted to the currency play resulting from sterling's depreciation. This increased level of demand will sharpen pricing, driving a modest capital return over the year.

In the shopping sector segment, we expect pricing to remain flat or indeed harden slightly for prime/ regional stock. At the secondary end of the market, yields will ease on an average basis, and with very little rental growth forecast for the segment, returns will fall just shy of high street stock over the course of 2017.

Retail warehousing will remain attractive in 2017, due to an above average income return combined with relatively strong occupier demand which is still present at the lifestyle/ furniture end of the market. We forecast that yields will remain flat on an average basis, but that pricing on smaller lot size (£1-£10m) solus units or small schemes will sharpen further, with private investors attracted to the sector following the increase in stamp duty land tax on second homes in 2016.