Brexit: Implications for the UK Retail Market

Briefing Note | 06 July 2016

The vote to leave the EU brings a new dawn for retail and leisure in Britain and Europe, along with short-term uncertainty. The full implications will take time to manifest, but any medium to longer term negative impact on consumer spend is unlikely to be as severe as during the Global Financial Crisis (GFC) in 2007/8. To an extent, the impact of the GFC has kicked the industry into better shape, and significant structural change has already been largely absorbed by much of the retail market; the sector is arguably better positioned than in 2007.

The Consumer

- The short-term impact of the vote has been uncertainty, which will inevitably impact on consumer confidence.
- This uncertainty will persist until next steps are clarified, political parties recover from recent fallout, and Scotland's intentions become clear.
- Consumer spending will be linked to job certainty and consumer confidence. Big ticket items are more susceptible to a slowdown in consumer spending; leisure, including F&B, is likely to remain relatively resilient.
- The UK population has become familiar with austerity since the 2008 recession, so a change in consumer behaviour is not anticipated to be extreme.
- It is the uncertain political backdrop, rather than a weak underlying UK economy, that is the catalyst driving uncertainty - underlying UK economic fundamentals are solid.
- Over the long-term, retail spend has increasingly represented a diminishing proportion of disposable income, as a result of price deflation in the sector and rising overall consumer wealth.
- Retail sales have consequently become more resilient to economic shock; this was demonstrated during the GFC, as retail held up in relative terms, while other elements of discretionary spend were harder hit.
- Lack of job certainty and inflationary pressures will provide headwinds to retail, although a short-term reduction in interest rates and a fall in the cost of mortgage debt financing will provide some respite to UK shoppers.

The Retailer

- Workforce concerns - uncertainty around migrant labour will remain, however the impact of any increased controls around migration are unlikely to be as significant as perhaps feared.
- Currency - in the short-term, the majority of retailers will be well-hedged against a fall in the value of sterling, and will be able to maintain current sourcing costs and pricing strategies.
- Longer term, if sterling remains weak for a sustained period, this will impact retailers' overseas sourcing costs, as a significant amount of merchandise buying is done in US dollars.
- This will put pressure on retailers' margins, which are already thin (for some), and will inevitably lead to rising consumer prices - competitive pressure may limit the amount of price inflation in some sectors.
- The currency movement does, however, make UK retail more attractively priced, and will reduce the costs of exports, benefitting some domestic retailers with international operations, start-ups and online operators.
- The weak pound could boost tourism numbers to the UK in the short term, from the US, European and Asian markets. This will be of clear benefit to Central London and other UK tourist destinations.
- While mainstream retailers are likely to be assessing the current situation and some will defer decision-making for a period, for some this is a good opportunity to secure space on attractive terms. Either way, retailer strategies will change.

The Investor

- Occupational demand is likely to be patchy, and weaker locations are susceptible to rental declines; this trend was well underway prior to the EU Referendum.
- Investors are likely to sit on income streams unless forced to sell; prime yields may remain fairly resilient, however the gap between prime and secondary is likely to widen.
- Brexit will not necessarily be responsible for the re-pricing of some weaker secondary assets, which have become increasingly impacted by underlying structural change in the retail industry.
- Assuming occupational demand remains in better shape compared to previous downturns and favourable currency movements support overseas investor demand, the impact on values for relevant retail assets will be contained.
- As we have seen over the last eight years, resilience prevails across the country. The right assets with core success attributes will continue to remain relevant, will compete for our time and spend and will become increasingly resilient to change. There is still sustainable value in relevant retail property, located in the right locations.

One thing is certain; there is no way that the UK retail market will remain unaffected by the decision to leave the EU, either positively or negatively, and a period of reflection is guaranteed. Change leads to uncertainty, it also leads to opportunity here and elsewhere in the EU; new pockets of resilience will emerge across the retail spectrum. Winners and losers existed in retail before the EU Referendum – in that respect nothing has changed.

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