Consumers are under pressure

SA retailers as a group have revelled in a decade of remarkable growth, and the high ratings of their shares may suggest there's more to come. But there are warning signals too.

The growth has come from a combination of wages rising faster than inflation, generous consumer credit, low interest rates and social grants on a grand scale.

"Things are about as good as they get for retailers," says Investec Asset Management fund manager John Biccard.

But can these conditions last?

Nedbank Capital retail analyst Syd Vianello believes cracks are already showing, and retailer sentiment seems to support his view. In their third-quarter 2011 survey of retailers, Ernst & Young (E&Y) and the Bureau for Economic Research found that only 48% were satisfied with business conditions, down from 58% in the first quarter.

"The latest trading updates from most retailers show that these are not boom times," says Vianello. Among general retailers, he adds, there were only two exceptions, Foschini and Mr Price "Both traded extremely well."

Foschini reported sales in the three months to December up 17% compared with the same period in 2010, a strong showing that flowed from a set of initiatives, including aggressive credit extension. Foschini grew its credit book 10% in 2010 and aimed for a similar rise in 2011.

Mr Price went into Christmas 2011 with its stock level R228m up on a year earlier and reaped the benefit in the form of a 16% rise in sales. "Mr Price's strength is that it's a fashion value retailer that appeals to all income groups," says Coronation Fund Managers analyst Quinton Ivan.

Supporting the subdued outlook of most retailers are signs that consumers are taking strain. Research firm Nielsen reported a 0,4% fall in the sales volume of fast-moving consumer goods in the 12 months to September. And Tiger Brands chairman André Parker told the FM recently (Money & Investing January 27) that the food manufacturer faces a "slump" in demand.

At first glance this appears inconsistent with Shoprite's 13% rise in sales in the six months to December. E&Y retail and consumer products sector leader Derek Engelbrecht says the answer seems to lie in part in a higher contribution from general merchandise. Shoprite noted "healthy growth" in this segment.

"People are cutting back spending on nondurables but still want fashionable clothes and the latest ego-boosting electronic products," says economist Mike Schüssler This is also seen in strong car sales, particularly entry-level models. "People can't afford houses but they can afford to buy a car," Schüssler says.

On the rise in car sales, Engelbrecht notes that creative financing by vehicle manufacturers is a big factor. Indeed, a big portion of consumer spending in general depends heavily on retailer credit. The odds are also better than even that banks' aggressive extension of unsecured consumer credit supports a substantial proportion of cash sales. "It's just difficult to say how much of a tailwind this has been for retailers," says Ivan. (See Economic Viewpoint page 12.)

Whatever the case, many consumers are heavily overindebted, a reality that must eventually tell on overall consumer spending. "Over the past 10 years consumer debt to disposable income has gone from around 40% to almost 80%," Biccard says. "It can't go much higher."

Just over a third (39%) of the 19m credit-active consumers were fully up to date with their repayments at the end of June 2011, reports the National Credit Regulator. Three years earlier 45% of credit-active consumers had a completely clean payment slate.

The ability to keep up regular repayments has declined despite most wage and salary earners receiving increases well above inflation. For instance, nonfarm average wages rose by about 10% in 2011, double the monthly average inflation rate of 5%.

Wage increases well above inflation could continue in 2012 and even longer but there is a limit to SA's ability to sustain this trend and remain competitive, says Biccard. Already facing a sharply rising budget deficit, government will find it difficult to sustain what has been a huge rise in its wage bill. "With new appointments and wage increases, government's wage bill rose almost 25% last year," says Biccard.

That also means there is likely to be little relief for taxpayers in the upcoming budget. Ivan notes that tax rates paid by higher income earners are likely to rise.

It is not only consumers under pressure that threaten SA retailers. Absa Capital analyst Christopher Gilmour believes competition in the retail sector will rise sharply once the Walmart machine gets into top gear through recently acquired Massmart. "The discount offers we have seen so far from Massmart are just a foretaste of what's to come," says Gilmour.

How long can the retail party go on? No-one can say for sure. "It could go on for another year," says Ivan. But he warns: "When sentiment turns it will turn fast."

The current high ratings of most retail shares leave little room for error. This was seen in the reaction to Clicks' recent trading update, which fell short of analysts' expectations. Within 10 days of the update's release Clicks' share price had slumped by 13%.

The same fate no doubt awaits any retailer that fails to match investors' high expectations.

Source: *Financial Mail*