

Commentary

Global 2023 Holiday Retail Outlook: No Festive Cheer For Some Retailers

DBRS Morningstar

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Key Highlights

- In the UK, U.S., EU, and OECD countries, consumer confidence has remained below 100, indicative of consumers' pessimistic attitude to future developments in the economy.
- In tandem with consumer confidence, many retailers have observed shoppers continuing to curb their discretionary spending.
- This holiday season we believe that consumers will continue to curb their overall spending, particularly for discretionary products, trade down to more affordable product offerings, show greater preference for private labels, search for promotional discounts, and prioritize online over in-store purchases.
- We anticipate that the evolving consumer behaviour to increasingly favour grocers and discount retailers, will have a varied impact on general retailers and negatively affect some more niche, discretionary retailers.

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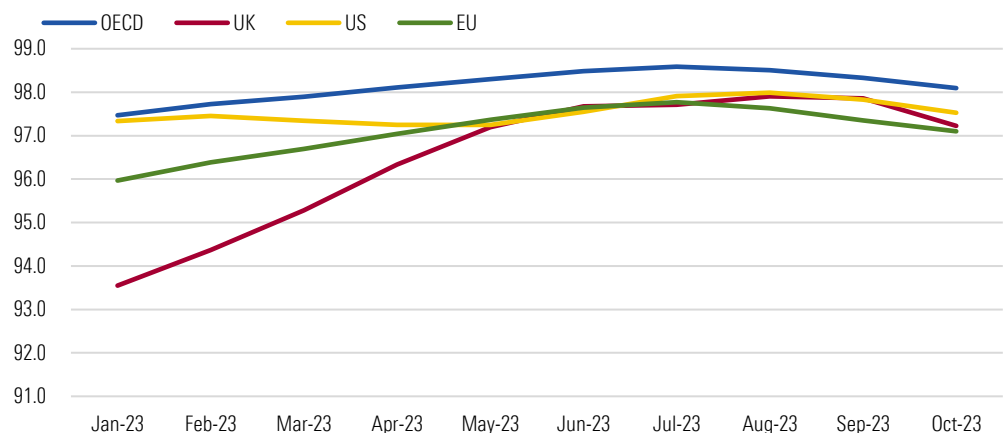
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Around the world, the holiday season — the months of November and December — is marked by major shopping events, including U.S. Thanksgiving, Hanukkah, Christmas, and New Year, and is generally the most important time of the year for retailers. While we anticipate holiday sales will grow in 2023, we expect this to be at a slower rate compared with 2022.

This holiday season, amid weak consumer purchasing power and bleak consumer confidence, we believe that consumers will (1) continue to curb their overall spending, particularly for discretionary products; (2) trade down to more affordable product offerings; (3) show greater preference for private labels; (4) search widely for promotional discounts; and (5) prioritize online over in-store purchases. Consequently, we anticipate that these changes in consumer behaviour will (1) have less of an impact on grocers, given their relatively inelastic product offering; (2) benefit discount retailers because of their generally broad assortment of value-based products, discounts, and promotional offerings; (3) have a varied impact on general retailers depending on where they are on the discretionary to non-discretionary spectrum, their product assortment across different pricing tiers, and branded versus private label offering; and (4) likely pressure the operating performance and free cash flow (FCF) of some more discretionary retailers. Across the retail sector, although the profitability of multinational retailers may be pressured more in some countries than in others, depending on the extent of consumer purchasing power and consumer sentiment, we believe their geographic diversification will somewhat insulate them compared with their smaller, regional peers.

Bleak Consumer Confidence Globally Driven By The Challenging Macroeconomic Backdrop

Exhibit 1 Consumer Confidence Index – 2023



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In the UK, U.S., EU, and OECD countries, consumer confidence—an indicator of future developments in household consumption and spending—has remained below 100 (see Exhibit 1). Values below 100 indicate a pessimistic attitude toward future developments in the economy, possibly resulting in a tendency to save more and consume less. In tandem with consumer confidence, many retailers, including Walmart Inc. (Walmart, rated AA with a Stable trend), Costco Wholesale Corporation (rated AA (low) with a Stable trend), Target Corporation, and Canadian Tire Corporation, Limited (Canadian Tire, rated BBB with a Stable trend), in their most recent quarterly earnings have observed that shoppers, pressured by persistent but easing inflation and high interest rates, continue to curb their discretionary spending, choosing instead to spend on essentials. This pattern of consumer behaviour was amplified by additional pressure from the October 2023 resumption of student loan repayments in the U.S.; spiking energy prices, particularly in Europe; the depletion of excess savings; and more stringent borrowing conditions globally.

Evolving Consumer Behaviour Against a Challenging Macroeconomic Backdrop

Given their weak purchasing power and bleak consumer confidence, we believe that what consumers shop for and how they shop this holiday season could be markedly different from prior years. Consequently, and in addition to curbs already on their overall spending particularly for discretionary products, this holiday season we expect consumers to:

(1) Trade Down To More Affordable Product Offerings

We believe that groceries and gifts will continue to top consumers' shopping lists this holiday season. However, as the challenging global macroeconomic environment maintains its grip on consumer wallets, we expect shoppers to continue to look for value for money by trading down to cheaper alternatives from premium products.

(2) Show Greater Preference for Private Label Products

As highlighted in our commentary, *Battle of the Brands: Private Labels Filling Grocery Carts... For Now*, we expect consumers to remain brand agnostic about essentials as they prepare for holiday season festivities, at least in the near term. Retailers like Canadian Tire, Macy's, Marks and Spencer, and Walmart have increasingly invested in private-label offerings of more discretionary products, ranging from kitchenware and homeware to clothing, footwear, and accessories, which we expect to become more popular with consumers this holiday season as these present a more affordable alternative to their branded counterparts.

(3) Search Widely For Promotional Discounts

Shopping for the holiday season typically begins to surge with the approach of Black Friday globally and Cyber Monday in North America and Europe. This year, however, as purse strings have been tightened, we anticipate that consumers have instead pulled forward their holiday shopping as they search widely and for a longer time for promotional discounts and deals like free shipping or buy-now pay-later. According to the National Retail Federation (NRF),¹ in the U.S. an average of 55% of Thanksgiving purchases were specifically driven by sales and promotions compared with 52% in 2022. The NRF¹ also observed that more than half of consumers took advantage of early holiday sales and promotions, and approximately 35% shopped specifically in the week leading up to Thanksgiving (November 16 to 22) in the U.S.

(4) Favour Online Over In-Store Purchases

We believe that the increasing popularity of online sales will persist over the holiday season, as shoppers can peruse a wider assortment of gifting ideas from different retailers, compare prices, make the most of exclusive online offers, and arrange for delivery or collection from the comfort of their homes. We expect e-commerce sales growth to outpace bricks and mortar growth. Indeed, according to Adobe Analytics, Black Friday 2023 generated \$9.8 billion in U.S. online sales, up 7.5% from 2022 levels.² In the U.S., e-commerce spending on Cyber Monday was \$12.4 billion, up 9.6% on the same period last year, while Cyber Week increased by 7.8% year-over-year to \$38 billion.³

Not the Most Wonderful Time of the Year for (Some) Retailers

Based on the anticipated change in consumer behaviour, we expect:

(1) More Festive Cheer for Grocers

Given their relatively inelastic product offering, we expect the operating performance and FCF of grocers such as Loblaw Companies Limited (Loblaw, rated BBB (high) with a Stable trend), METRO INC. (Metro, rated BBB (high) with a Stable trend), and Sobeys Inc. (Sobeys, rated BBB with a Stable trend) to remain largely insulated from the worst effects of the challenging macroeconomic environment on consumer spending this holiday season. According to the NRF¹, grocery stores and supermarkets were amongst the top destinations for Thanksgiving weekend shopping in the U.S. That said, we expect consumer dynamics to particularly favour discount grocers such as Aldi and Lidl, as well as Loblaw's No Frills, Metro's Food Basics, and Sobeys' FreshCo.

¹ National Retail Federation. Thanksgiving Holiday Weekend Sees Record Number of Shoppers. Nov. 28, 2023.

² CNBC.com. Black Friday shoppers spent a record \$9.8 billion in U.S. online sales, up 7.5% from last year. Nov. 25, 2023.

³ Adobe Analytics. Media Alert: Adobe: Cyber Monday Surges to \$12.4 Billion in Online Spending, Breaking E-Commerce Record. Nov. 28, 2023.

(2) Happier Holidays for Discount Retailers

As consumers continue to curb their discretionary spending and seek cheaper alternatives, we expect them to increasingly favour discount retailers like Dollarama Inc (rated BBB with a Stable trend) this holiday season, given their typically broad assortment of value-based products. This should hold the operating performance and FCF of such discount retailers in good stead.

(3) A Mixed Bag for General Retailers

This holiday season, we anticipate that the effect of changing consumer behaviour on the operating performance and FCF of general retailers will largely depend on where they are on the discretionary to non-discretionary spectrum. Retailers that have a diversified offering of essential and discretionary products, like Walmart and Costco, are typically more resilient to the effects of changing consumer behaviour than peers like Target, whose discretionary products contribute more than 50% of its topline.⁴ Furthermore, large general retailers typically have a wide offering of discretionary products across a spectrum of prices, such as Canadian Tire's 'Good, Better, Best' product offering, as well as an established portfolio of private label discretionary products like that of Macy's, Marks and Spencer, and Walmart, which should position them to benefit from consumers trading down to more affordable gifts, and switching to higher-margin store-branded presents.

(4) Lumps of Coal for Some More Niche, Discretionary Retailers

As consumers remain cash strapped, we anticipate the softness in demand experienced by discretionary retailers during the year, including the likes of Nordstrom, Inc. (rated BB with a Stable trend) and [Mastermind Toys](#) to persist this holiday season. We also expect retailers with a high-ticket discretionary product offering, such as Best Buy Co Inc., to continue to experience demand pressure as consumers shy away from large purchases on credit given the high interest rates and more stringent borrowing conditions globally. Consequently, we expect the operating performance and FCF of some more niche, discretionary retailers to decline compared with the surge that they enjoyed during previous holiday seasons.

⁴ CBS News Minnesota. Target tops third quarter profit expectations, but inflation weighs on shoppers. November 16, 2023.

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