Geomarketing

ACROSS
THE EUROPEAN RETAIL REAL ESTATE MAGAZINE

GfK

EUROPEAN RETAIL IN 2018

GfK study on key retail indicators: 2017 review and 2018 forecast

EDITORIAL

Dear readers,

"No man is an island," wrote the English poet John Donne in 1624. What is true for individuals is also true for economies.

The European economy faces major changes due to Brexit in addition to various economic and political challenges. The potential impact of Donald Trump's "America First" policy is one example. Existing international trade agreements are threatened by the USA's announcement to impose punitive tariffs on aluminum and steel in response to national security concerns. This situation is creating anxiety about a trade war, which would have a significant economic impact on both sides of the Atlantic.

Despite these uncertainties, all European countries experienced economic growth in 2017.

This robust increase in private consumption contributed to a positive development of the macro economic conditions, which allowed stationary retail to compensate for market share losses to online trade. Adjusted for inflation, most EU-28 countries experienced an increase in retail turnover.

As in previous years, central and eastern European countries topped the rankings. A case in point is Hungary, which is our focus country this year. In the chapter devoted to this country, we assess how regulatory conditions affect retail development in Hungary's dynamic market.

Our study also examines the development of key retail indicators for 32 European countries. For the first time, we include a section on Europe's fashion retail segment, which faces threats from e-commerce, among other things.

We invite you to use our study as support for your strategic retail decisions, whether as an investor, retailer or project developer.

Kind regards,

Dr. Johannes Schamel
Study lead
Geomarketing, GfK

Contents

PURCHASING POWER IN 2017

Slight increase in nominal purchasing power*

+1.9%

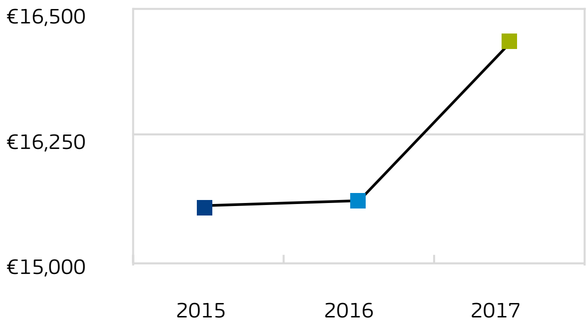
more per-capita purchasing power in the EU-28

From an economic perspective, the past year was relatively calm. Despite the Brexit negotiations, the European economy experienced an upturn, which was due in part to moderate increases in private consumption. In 2017, each citizen of the EU-28 countries had an average purchasing power of €16,436. This equates to a nominal increase of 1.9% compared to the previous year.

Among the EU countries, only Great Britain (-1.5%) underwent a purchasing power decline, which is partly a result of the devaluation of the British pound. Great Britain aside, the momentum from previous years continued, resulting in above-average growth rates, particularly for central and eastern European countries. Romania (+7.8%) had the greatest gain in purchasing power. But this country's low per-capita purchasing power (€4,556) demonstrates the persisting immense gap in wealth levels across Europe.

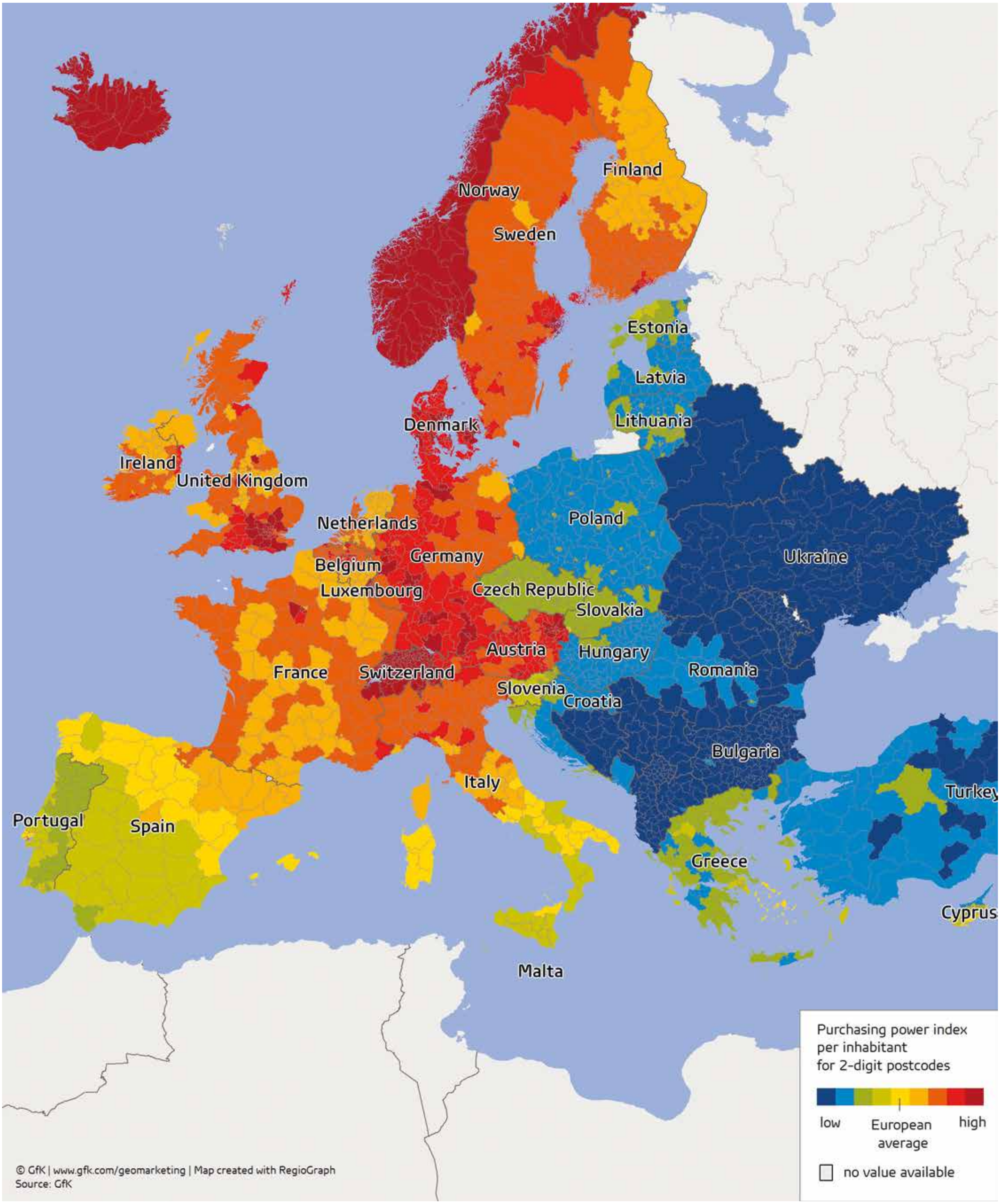
Wealth disparities within individual countries are especially clear when evaluating purchasing power distribution on detailed regional levels. For example, with €12,473 per person, Poland's capital city of Warsaw has a higher purchasing power than Spain's Andalusian region (€10,985). This is the case even though Spain's average per-capita purchasing power is more than twice as high as Poland's.

Per-capita purchasing power (EU-28)



*Purchasing power corresponds to the population's disposable net income, including government subsidies such as pension payments, unemployment assistance and child benefit. The population uses its purchasing power to cover expenses related to food, accommodation, services, vacations, insurance, private pension plans and retail purchases. Purchasing power is a prognosis and is provided in nominal euro values. Comparison figures from previous years are based on revised values.

GfK Purchasing Power Europe, 2017



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STATIONARY RETAIL TURNOVER IN 2017

Due to exchange rate effects, Great Britain slowed turnover growth in the EU-28.

The outcome of the presidential election in France in May 2017 can be interpreted as a rejection of protectionist policies and a vote for structural reform. France's economic recovery was actually already underway, which has positively impacted private consumption. Stationary retail turnover also grew nominally in the election year by +3.5%*, which translated to real-value gains for Europe's most important retail market.

The positive development was by no means limited to France. Many European countries benefited thanks to still lax interest rate policies. The 28 EU nations experienced a retail turnover increase of +1.8%. Due to currency exchange rate effects, Great Britain underwent a turnover decline of -4.2% in euros. Had this not happened, Europe's retail gains would have been even higher.

Along with France and Great Britain, the most important markets in terms of turnover volume developed heterogeneously: Stationary retail turnover increases in Germany (+1.0%) and Italy (+1.9%) were below or near inflation. By contrast, Spain had real-value turnover increases (+3.0%) thanks to the ongoing economic recovery and associated decreases in unemployment.

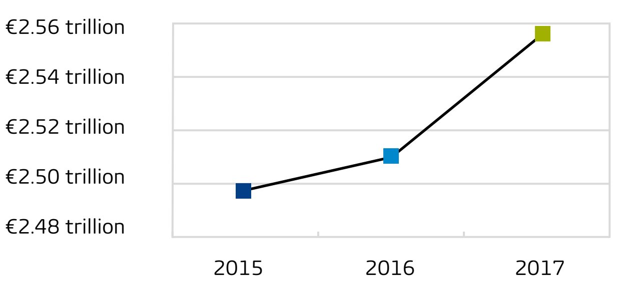
*All rates are based on nominal values, meaning they have not been adjusted for inflation.

+1.8%

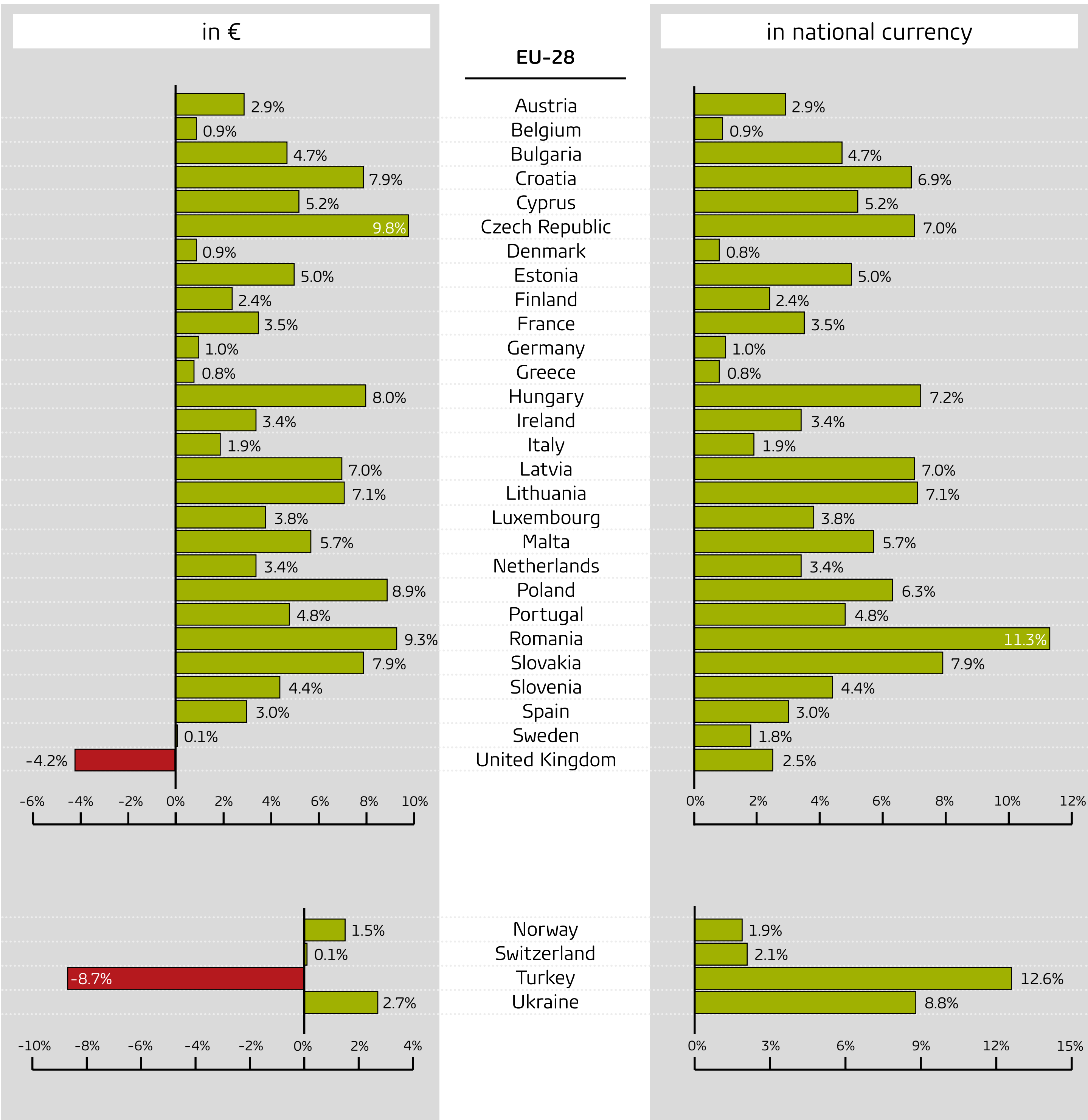
growth in store retail in the EU-28 (with the UK excluded: +3.0%)

On the whole, developments in retail turnover at the country level reflect an increasing convergence, which can also be observed more broadly across Europe's entire economy. Along these lines, certain central and eastern European markets experienced dynamic growth despite generally decreasing populations. The Czech Republic (+9.8%) and Romania (+9.3%) lead the pack with almost two-digit growth rates and moderate inflation. Poland (+8.9%) and Hungary (+8.0%) also underwent significant increases in stationary retail volume.

Stationary retail turnover (EU-28)



2017 turnover growth in stationary retail compared to previous year (EU-28)



source: GfK

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RETAIL TURNOVER FOR FASHION IN 2017

Price pressure not just due to online trade

13.5%

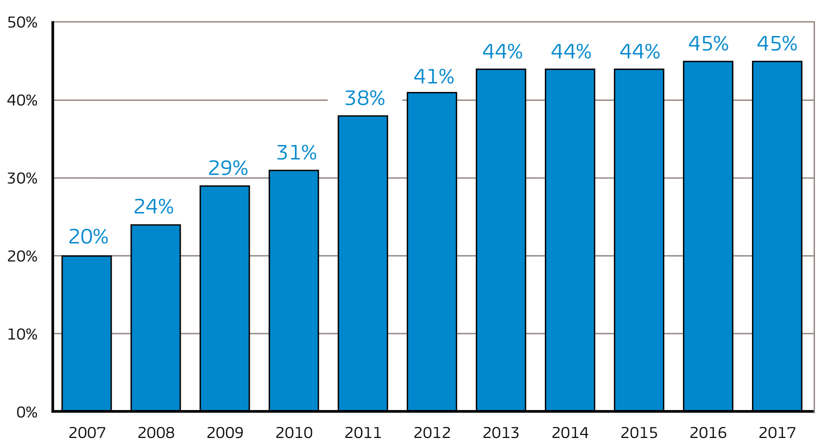
share of fashion in stationary retail (EU-28)

Stationary retail and particularly fashion retail are under pressure from e-commerce, off-price concepts, vertically integrated manufacturers competing for end customers as well as rising rents in sought-after locations.

While the significance of stationary retail in the fashion segment is dwindling, fashion has an EU-wide market share of 13.5%. This makes fashion the second-strongest sector in terms of brick-and-mortar generated turnover, putting it just behind grocery retail.

However, there are significant differences between the countries reviewed by the study. Particularly in the southern European countries of Italy (16.9%), Spain (15.1%) and Portugal (14.3%), private households spend substantially above average on clothing and shoes in stationary retail. By contrast, the Scandinavian countries are at the other end of the spectrum. With a share of 17.3%, Great Britain upsets this south-north divide. Ireland also has an above-average share of 14.9%.

Share of multi-channel purchasers



source: GfK Consumer Panel Fashion; basis: purchasers

In contrast to the three previously mentioned southern European countries, which have only one-digit online shares of the total fashion market (online and offline), more than one-fourth of Great Britain's fashion turnover is generated online. Among the large western European markets, the British have the second-highest affinity for online purchases of clothing and shoes.

Germans lead the pack, although insights from GfK's fashion consumer panel* reveal that online customers are not at all lost to stationary retail. Rather, these two channels complement one another. Currently almost every second consumer makes both online and offline purchases. That said, the growth in recent years is already approaching some limits. Per-capita expenditure levels among omni-channel purchasers reflect the importance of a multi-channel retail approach. These levels are more than twice that of pure online shoppers and consumers who shop exclusively at stationary outlets.

Even so, online retail increases competitive pressures. This is further accentuated by the growing significance of off-price concepts – the sale of large volumes of (older) articles at deep discounts. According to GfK's consumer panel for fashion, off-price concepts along with outlet centers enjoy a 6% share of Germany's total fashion turnover. The short-term turnover increase is affecting retailers' margins due to the price declines, which in turn further aggravates the competitive environment.

*In contrast to the data at the European level, the data for Germany from GfK's fashion consumer panel includes not just clothing and shoes, but also home textiles.

Fashion share of retail turnover in 2017

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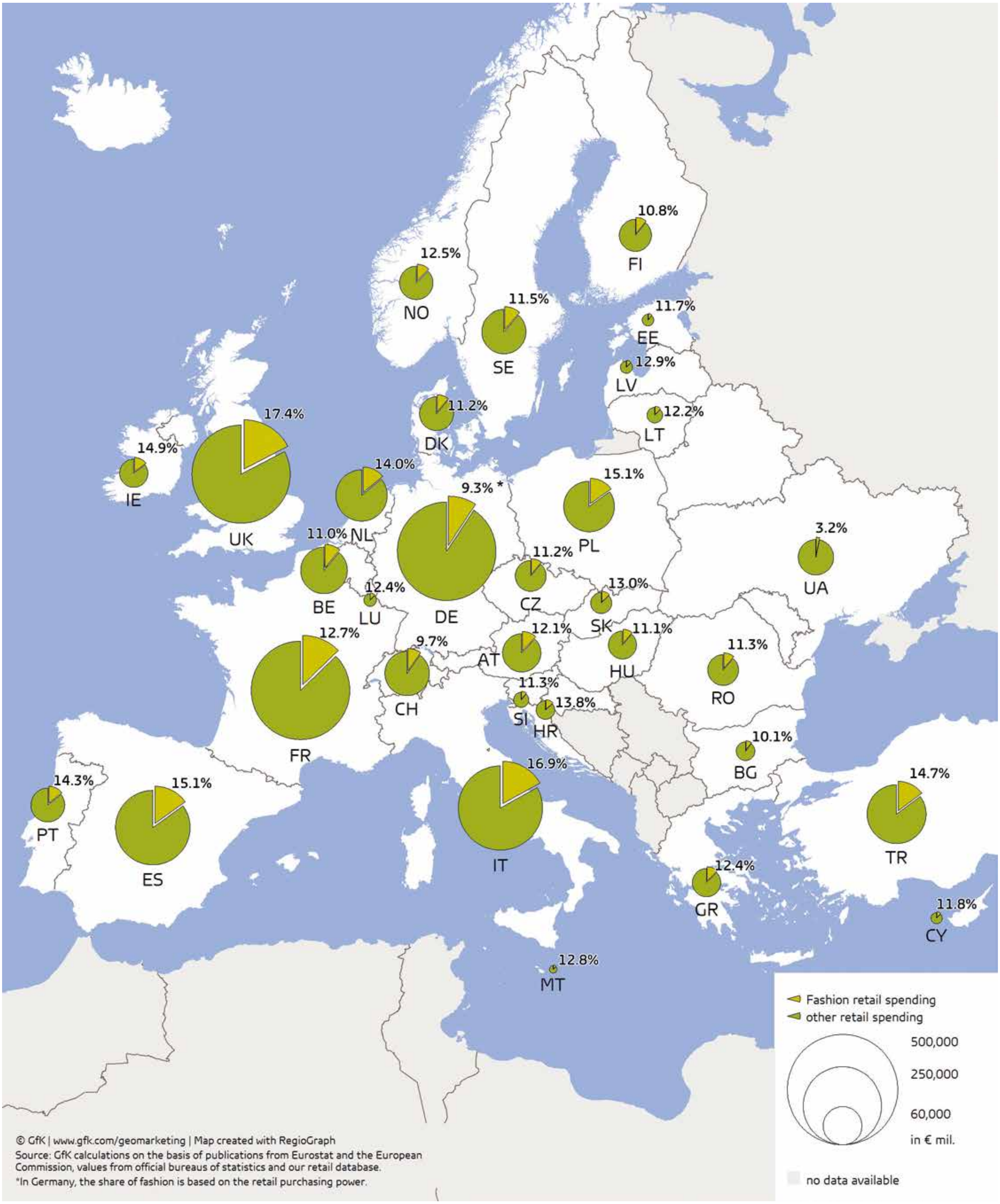

Source: GfK calculations on the basis of publications from Eurostat and the European Commission, values from official bureaus of statistics and our retail database.
*In Germany, the share of fashion is based on the retail purchasing power.

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PROGNOSIS OF STATIONARY RETAIL TURNOVER IN 2018

Stationary retail profits from wide-spread upturn

+2.1%

expected increase in stationary retail turnover in 2018 for the EU-28

Driven by domestic components across Europe's countries, the economic upturn resulted in multiple upward revisions of the prognoses by economic research institutes as well as the European Commission. Increases in consumer expenditures are also anticipated for all European countries in 2018.

The past year's growth in demand was able to compensate for stationary retail's market share losses to online trade. We consequently expect a nominal turnover growth of +2.1%* in the 28 EU countries for 2018. But this is just slightly below the forecasted inflation rate increase, meaning that only modest real-term growth is anticipated for retail turnover in Europe.

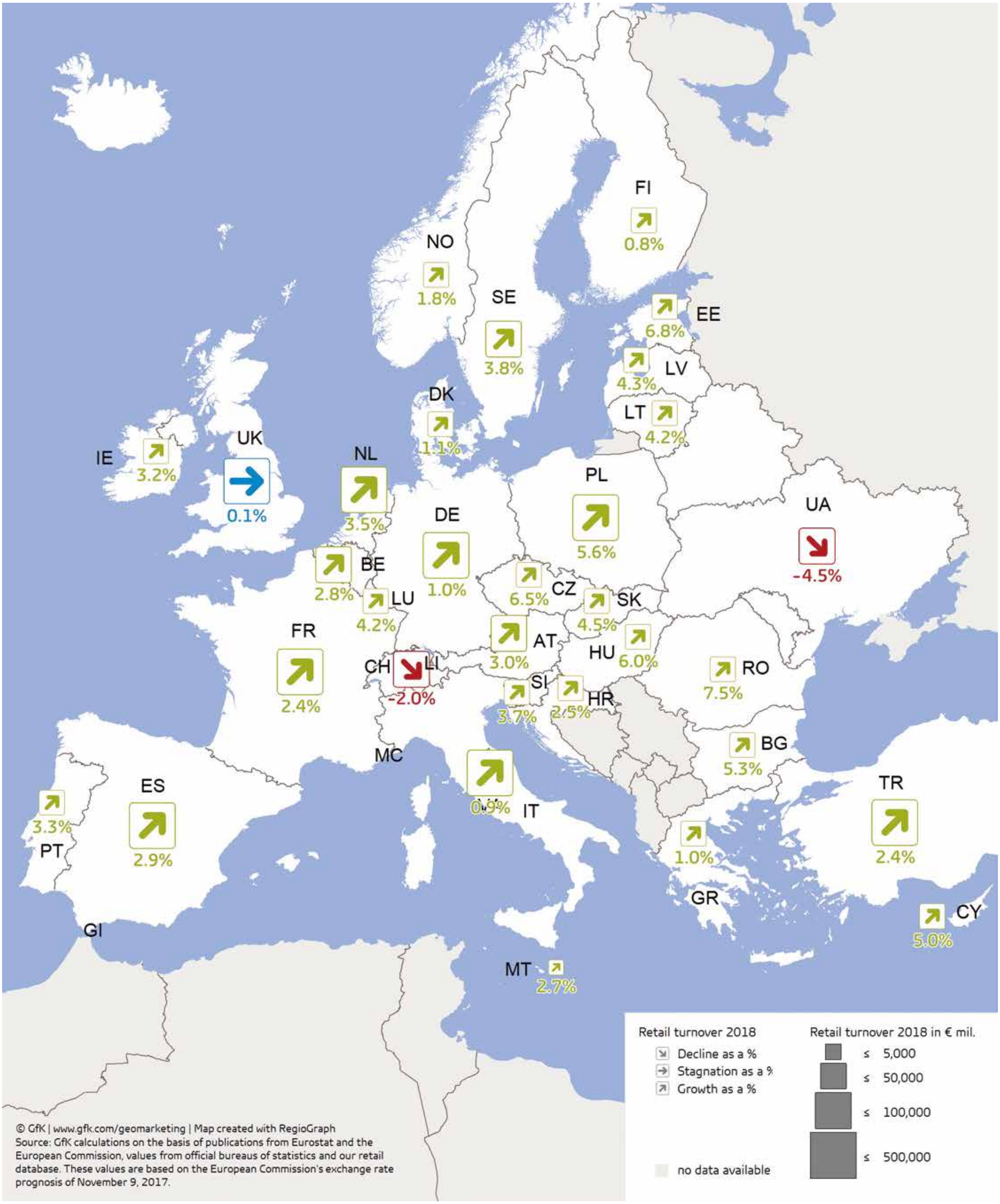
Thanks to continuing income increases, the top-ranking eastern European countries of the previous years once again lead the pack in 2018. We expect robust growth rates for Bulgaria (+5.3%), Hungary (+6.0%), the Czech Republic (+6.5%) and Romania (+7.5%). Poland should also be able to achieve stationary retail growth of +5.6%, even though retail opening hours on Sundays were reduced from four to two times a month.

Political uncertainty in Italy has increased significantly after the recent election, which raises concerns about political and economic instability. While the macro-economic conditions have improved, we still expect a nominal turnover increase of only +0.9%, which lies below the predicted rate of inflation.

The anticipated devaluation of the Swiss franc against the euro can benefit Switzerland's 2018 stationary retail, particularly in the border regions. For the first time in three years, retail turnover in Switzerland's national currency will undergo a nominal increase. But in euros, the currency devaluation will lead to a retail turnover decrease of -2.0%.

For 2018, we predict robust growth in Turkey (+7.0%), although this is significantly less than in the previous year (+11.7%). Among other factors, retail in 2017 benefited from a time-limited exemption of excise taxes on household appliances in the run-up to the constitutional referendum. The resulting increase in purchases of these products in 2017 could negatively impact turnover growth in this segment in 2018.

Forecasted stationary retail turnover for 2018



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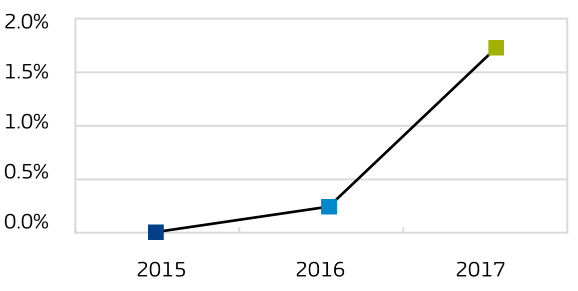
CONSUMER PRICE TRENDS FROM 2017 TO 2018

Getting on target for 2% goal

The lack of increase in consumer prices in 2016 puzzled economists. An increase in inflation was expected due to the accelerating recovery of the global economy and the expansive fiscal policies of the European Central Bank (ECB).

With an inflation rate of 1.7% in 2017, the EU-28 nations once again neared the ECB's proclaimed +2.0% target for consumer prices. Consumers had to reach deeper into their pockets again for the same goods in many eastern European countries, which struggled with deflation in the preceding years. Wage increases appeared to be behind a general increase in consumer prices, particularly in the Visegrád nations of the Czech Republic (+2.4%), Slovakia (+1.4%), Hungary (+2.4%) and Poland (+1.6%). The Baltic countries (+2.9 to +3.7%) led the way among the EU nations in 2017 with regard to price increases. This was primarily due to price increases for energy and food.

Inflation rate* as a % (EU-28)



* To ensure comparability between the countries under review, these figures refer to general inflation (including services, transport, etc.).

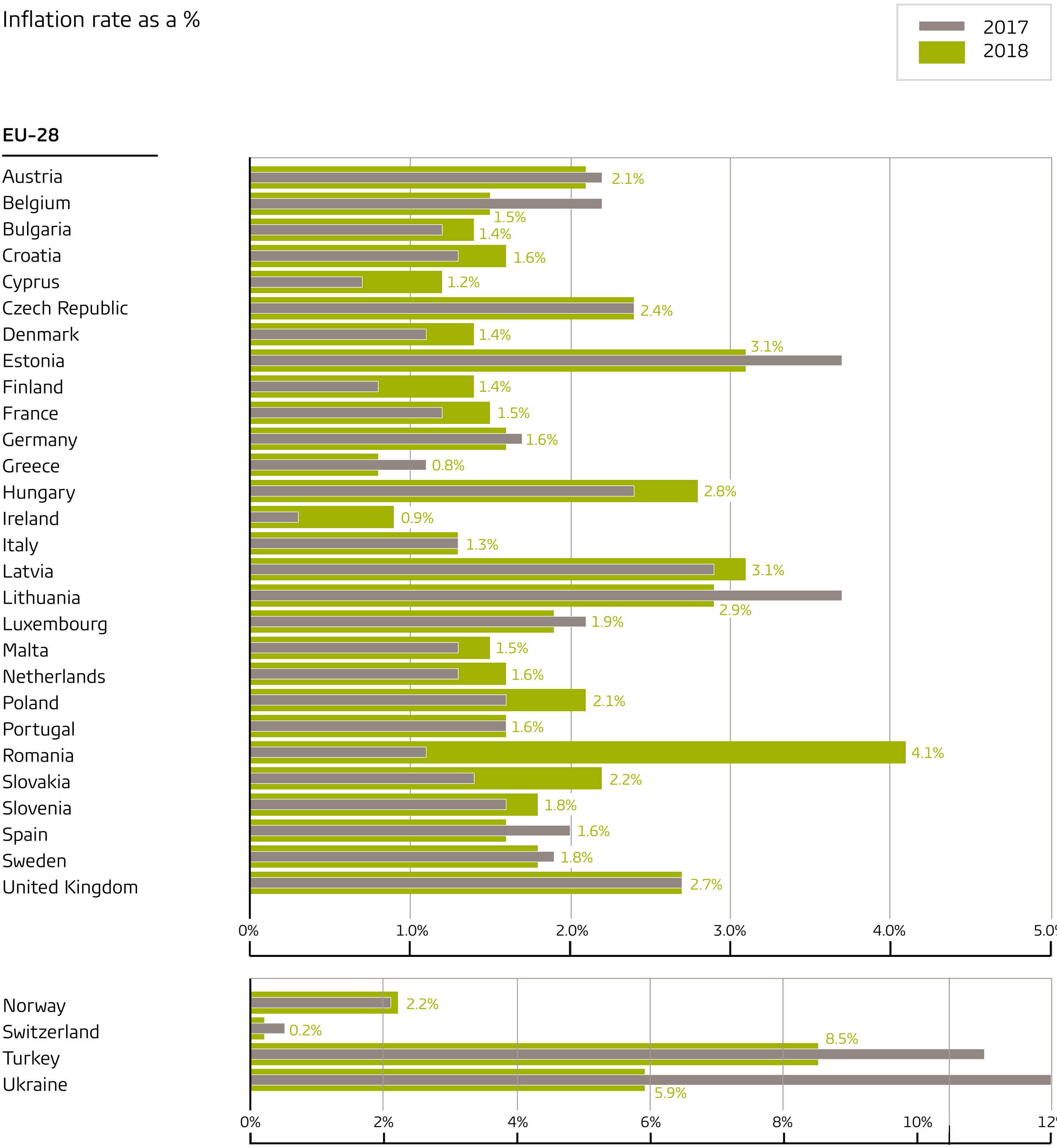
Because the ECB has announced that it will not touch base interest rates until 2019, we anticipate a retail trend in 2018 similar to that of last year. The difference between the nominal and real-value turnover trend is expected to be at a comparable level, with an EU-wide price increase of 1.9%. It is important to note that this prediction assumes no further escalation of the trade dispute between the EU and the United States. While the approaching Brexit in Great Britain continues to put pressure on the pound and increase inflation at an above-average rate (+2.7%), there is greater parity among the other large economies of Germany, France, Italy and Spain (+1.3 to +1.6%).

+1.9%

expected inflation in 2018 (EU-28)

There is a greater divergence in consumer price trends outside of the EU. With an inflation rate of +0.2%, Switzerland is also expected to approach monetary stability in 2018. By contrast, Turkey is predicted to undergo a major hike of 8.5% in consumer prices in the current year.

Inflation rate as a %



source: European Commission and International Monetary Fund

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RETAIL SHARE OF PRIVATE CONSUMPTION IN 2017

Return to normality with decreasing share of retail

A new paradigm is apparent when viewing the Instagram posts of young people or following their activities on other social media forums: Social media followers are no longer impressed by expensive automobiles and watches, but rather by hip and unusual lifestyles. The power of status symbols has not disappeared, but simply shifted to travel in exotic countries, unique events and trendy restaurants. Important are not just these experiences in themselves, but also how they are framed and presented.

This evolution of consumer behavior toward an ever-greater focus on recreation and services is happening to the detriment of retail. This phenomenon along with the general increase in wealth as well as competition from Amazon and similar online retailers may explain the multi-year decline in stationary retail spending as a proportion of total consumer expenditures.

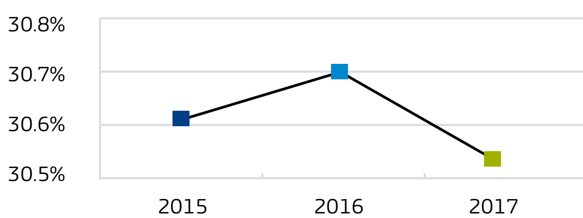
An exception to this long-term trend happened in 2016. Revised figures show a relative increase in retail spending during this period. These expenditures rose more than other private consumer spending – e.g., in France and Spain. A return to the familiar trend occurred in 2017, with an EU-wide decline of the share of stationary retail spending to 30.5%.

Affluent Switzerland (25.4%) had the lowest retail share of private consumption. At the other end of the spectrum were Croatia (49.0%) and Hungary (49.5%), which both had below-average purchasing power by western European standards. In these countries, a higher share of income is required to cover basic living expenses, such as food.

30.5%

retail share of private consumption in EU-28

Retail share of private consumption as a % (EU-28)



Retail share of private consumption in 2017

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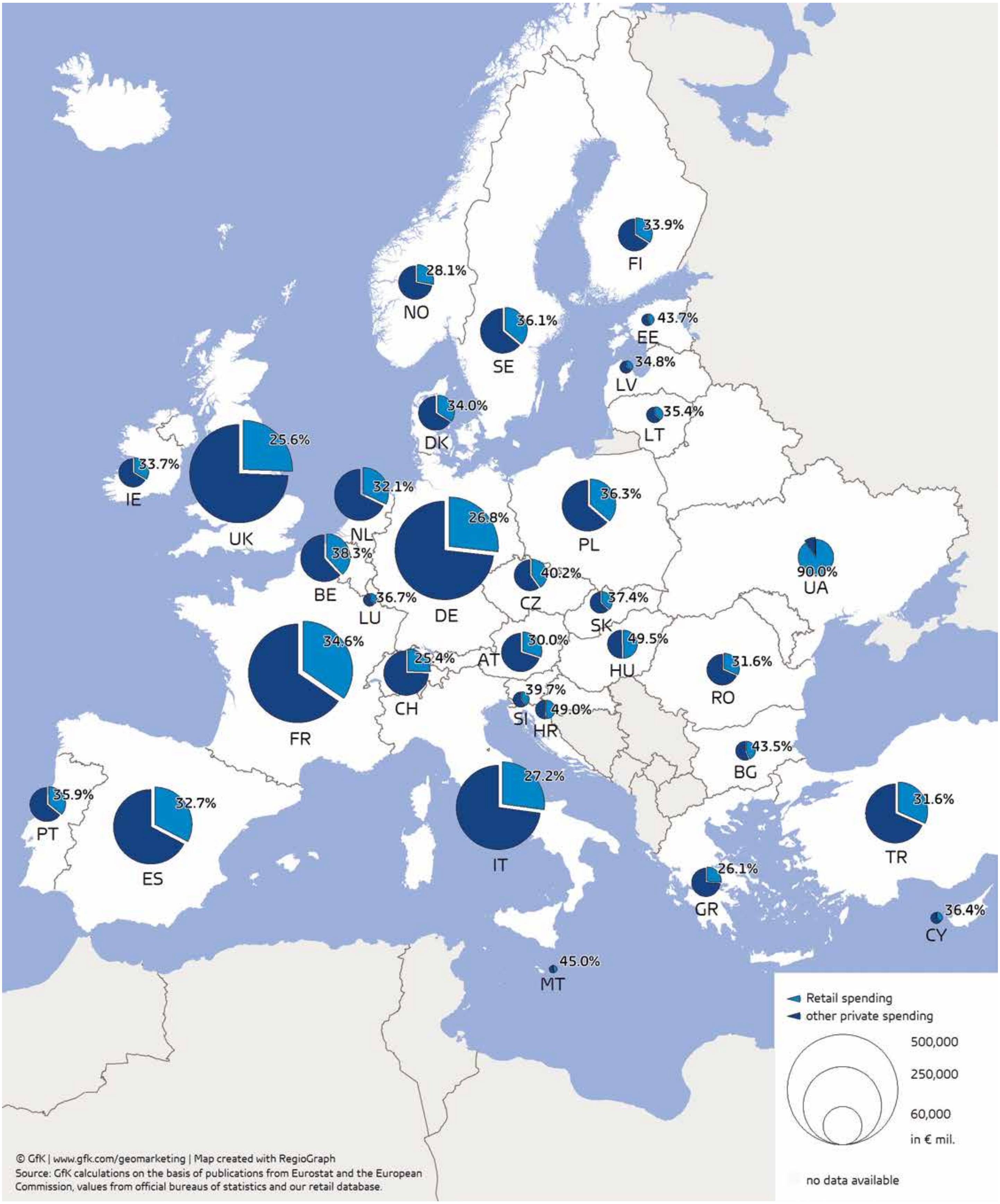

Source: GfK calculations on the basis of publications from Eurostat and the European Commission, values from official bureaus of statistics and our retail database.

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SALES AREA PROVISION IN 2017

Increases in absolute retail space counterbalanced by population trends

Shortly before this study went to press, a piece of news in March 2018 caused a stir in the retail world: Toys "R" Us announced the intended closure of all 880 sites in the US market and around 100 sites in Great Britain. Online retail had created an ever more competitive market, and the toy retailer was unable to rise to this challenge through more appealing prices or shopping environments.

With this and similar cases in mind, the focus of many stationary retailers in Europe in recent years has been on expanding or improving existing retail spaces in order to enhance consumers' shopping experience. As a result, the number of genuinely new retail spaces has been falling in most countries for some time.

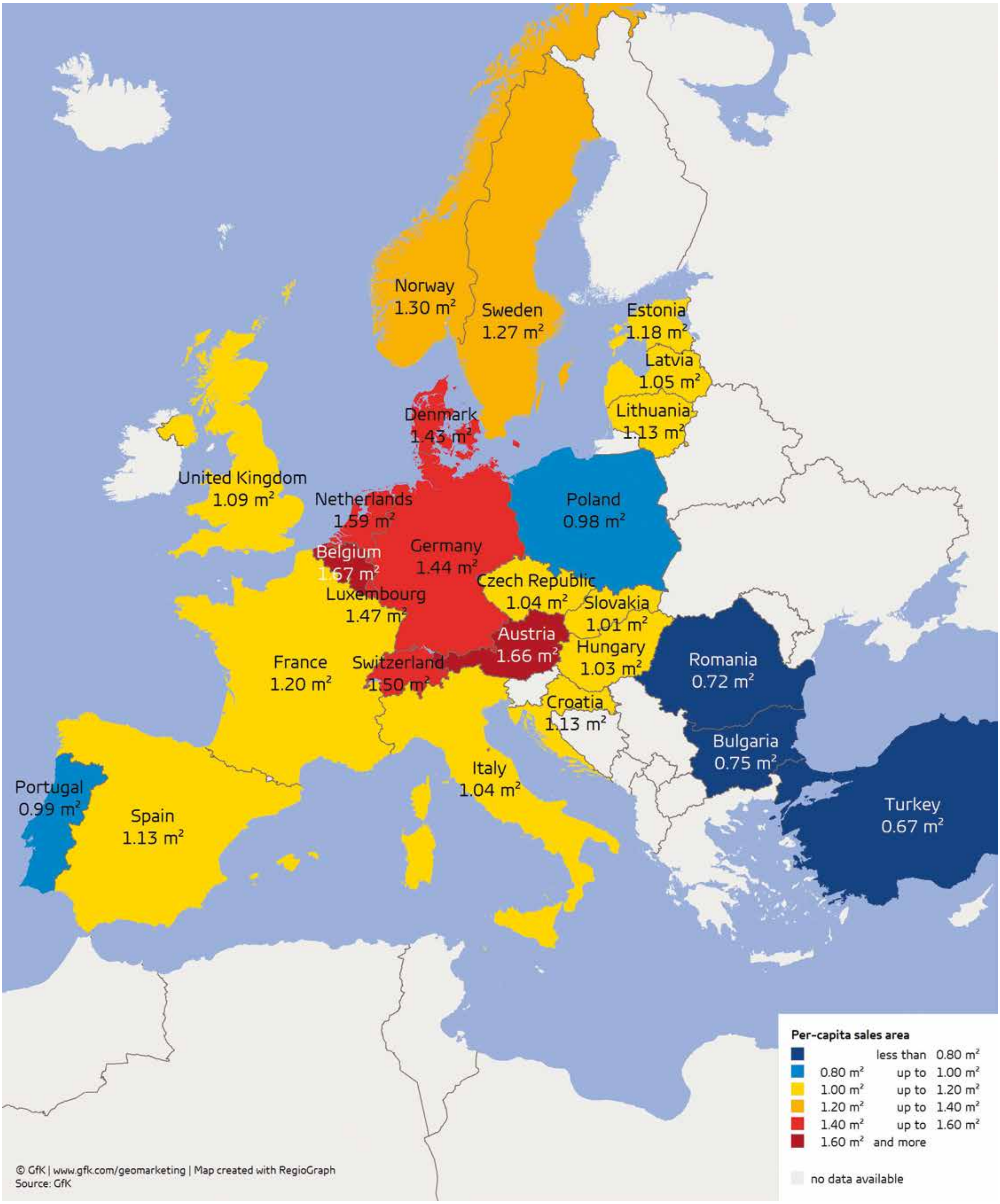
Even so, in 2017 there was an increase in the absolute retail space in the European countries under review, with the exception of the Netherlands (-0.4%). But a different picture emerges at the per-capita level: In half of the studied countries, per-capita sales area remained constant or even declined, including Sweden (1.27m²), Great Britain (1.09m²), Germany (1.44m²) and Austria (1.66m²). In these countries, population growth counterbalanced the increase in absolute sales area.

By contrast, France had a very lively retail real estate market in 2017, with an increase in per-capita sales area of +1.5% to 1.20m². New openings and expansions of retail parks and shopping centers were responsible for the majority of retail space increases.

Despite last year's exchange rate fluctuations and political uncertainty, Turkey's retail real estate market experienced dynamic growth, especially in Istanbul. Absolute retail space increased by +2.1%, with a clear focus on shopping center development.

Per-capita values for retail space range widely across Europe. For example, inhabitants of the Benelux countries (1.48 -1.64m²) have more than twice the retail shopping space available to inhabitants of Romania (0.72m²) and Bulgaria (0.75m²).

Sales area provision in 2017



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SALES AREA PRODUCTIVITY IN 2017

Rising sales area productivity helps retail in real estate market

Stationary retail has acquired a new function amidst the rise of omni-channel strategies: Attractive retail spaces are important no longer just for their ability to generate store turnover, but also for their role as promotional vehicles for the associated online store. Direct store-to-web turnover is just one aspect of this phenomenon.

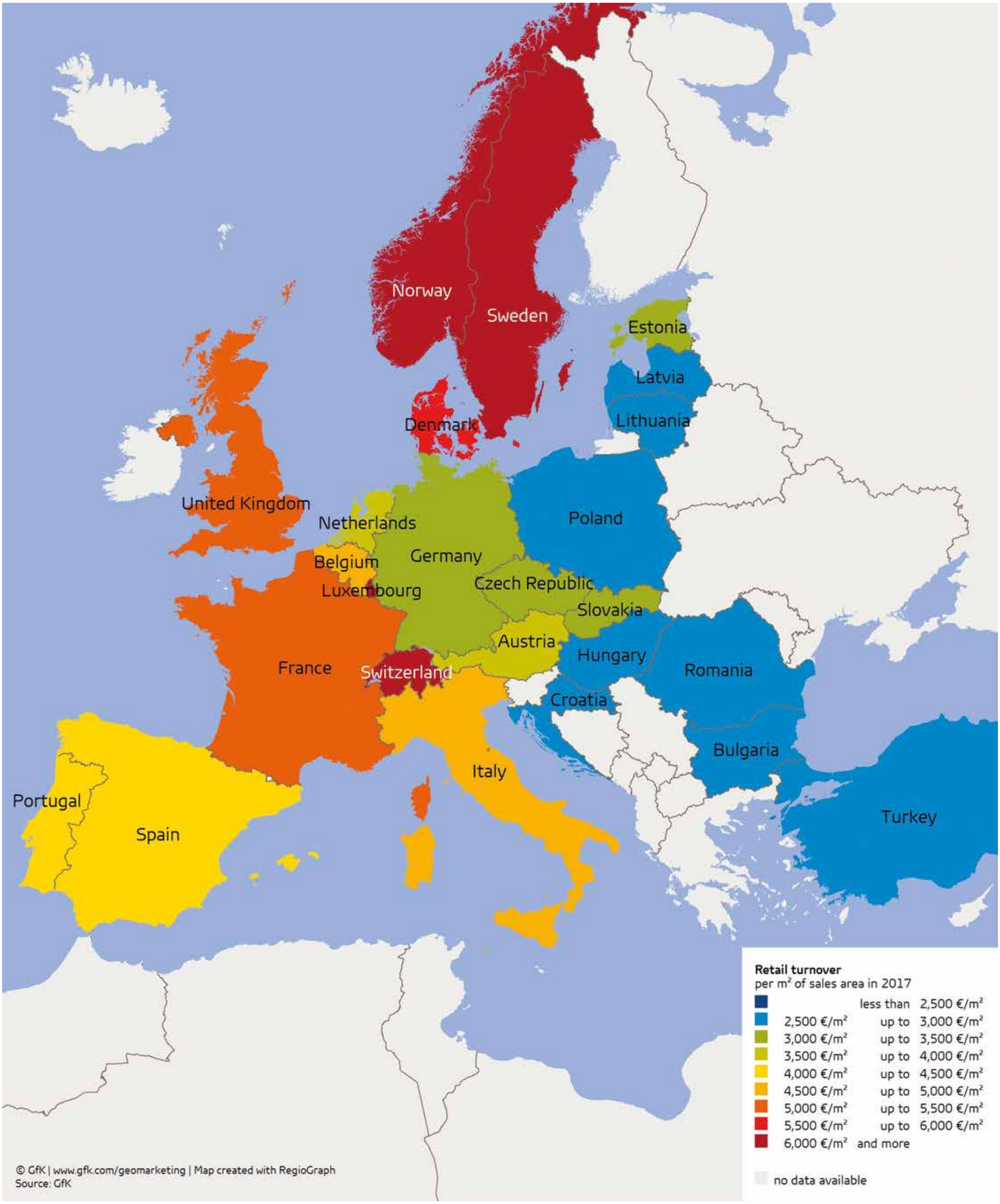
Our analyses show that a stationary retail presence boosts brand awareness among customers, which leads to above-average online turnover in the catchment areas of the retail sites in question. While sales area productivity (gross turnover per m² of retail space) is an important indicator, retailers should also take into account additional parameters when evaluating the turnover potential of retail spaces.

As in the case of per-capita sales provision, sales area productivity varies across Europe. For example, this indicator dropped in Sweden by -1.5% to €6,000/m², which is still a high level. Belgium also experienced declining sales area productivity in 2017, although the drop was relatively minor at just -1.1%.

In Hungary, restrictive planning regulations along with protectionist tendencies slowed the expansion of international retailers. As a result, there was limited development of new large-scale retail spaces. Strong growth in retail turnover therefore fueled sales area productivity, which grew by +6.9% to €2,997/m² over the past year. Dynamic growth in sales area productivity also counterbalanced to some degree rising rental costs in tight commercial real estate markets in other eastern European countries.

By western European standards, retailers in the Netherlands experienced strong growth in sales area productivity. Rising turnover accompanied by a simultaneous decline in retail space increased sales area productivity by +3.8% to €3,806/m².

Sales area productivity in 2017



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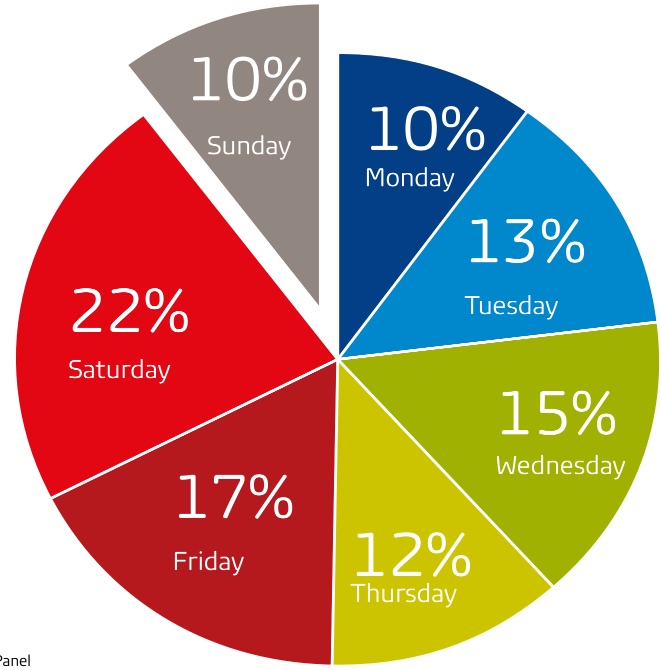
HUNGARY IN FOCUS

Impact of the elimination of Sunday opening hours



source: GfK Consumer Panel

Weekday share of FMCG household expenditures in 2014

Retail conditions
Retail in Hungary has enjoyed a continual upward trend since 2011, with annual turnover growth of around 5%. Good macro-economic conditions have made this possible. A new low in unemployment along with a simultaneous increase in the minimum wage led to robust income growth, which is a major driver of consumption. This surplus in available income more than compensates for Hungary's declining population. Even so, the negative population growth poses challenges to retailers when it comes to recruiting employees. According to a GfK survey, more than half of retailers with more than 15 employees complain of personnel shortages.

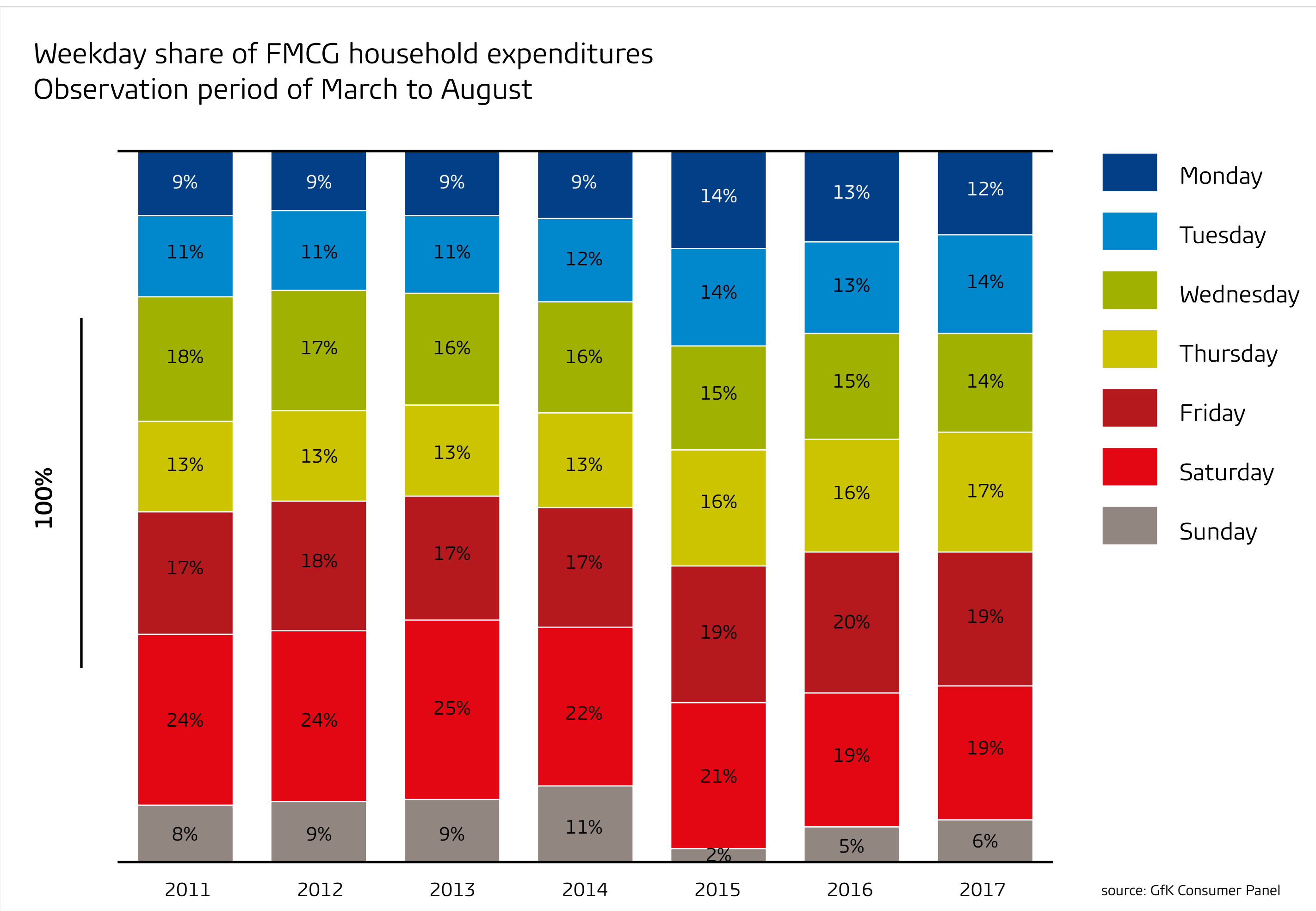
Elimination of Sunday opening hours and drawback
Amidst this market environment, a law went into effect on March 15, 2015 – Hungary's national holiday – that eliminated the previously allowed Sunday opening hours for retail. The law permitted retailers only three self-chosen days a year for opening their doors on Sunday. Justification for the law was an intended improvement of retail working conditions, with the aim of protecting families. But another motivation was the promotion of domestic, owner-run, small-scale retail. Businesses with less than 200 square meters were allowed to continue opening their doors on Sundays, as long as the owners were personally running the stores. This hastily implemented regulation was met with little affection by the Hungarian population: 80% of those surveyed by GfK were against it. As a result, the government rescinded the law after just one year and returned to the previous regulation. Retail insights that go beyond the situation in Hungary can be gained by examining the impact and outcome of this temporary regulation along with data from GfK's consumer panel.

Role of Sundays in FMCG retail prior to new regulation
Even before the elimination of Sunday opening hours, Saturday was the primary weekly shopping day. In 2014, Saturdays generated 22% of the total weekly FMCG turnover. With an share of approximately 10%, Sundays did not even come up to the level of an average weekday. Five percent of Sunday's turnover was generated by impulse purchases, which are potentially lost to retail and cannot be recuperated through the other shopping days. But only minor changes to absolute turnover were anticipated due to the fact that the associated share of the FMCG segment was comparatively low and could be partially compensated for by the small-scale, owner-run stores exempted from the regulation.

Mondays and Thursdays biggest winners
The regulation naturally occasioned a drastic reduction in the retail role of Sundays. According to data from GfK's consumer panel, 84% of households took advantage of Sundays to shop for daily-needs items in the period from March to August 2014. After the restrictive regulation went into effect one year later, the percentage for the same time frame was just 36%. Consumers shopped in the small shops that were not affected by the regulation. Those who continued to shop on Sundays spent almost 50% less than they did on Sundays one year prior.

As such, Sunday shopping outings focused on urgent daily-needs items or impulse purchases, particularly in the fresh goods segment. Sunday's weekly turnover share consequently sank in the FMCG segment from 11% (March - August 2014) to 2% (March - August 2015) and also remained below the pre-closure level after the restrictive regulation was lifted. Mondays and Tuesdays gained in importance as shopping days and increased their turnover share in 2015 by 5% and 3% respectively, holding on to these gains even after the Sunday shopping ban was rescinded.

Sunday's turnover share eroded over the long term.



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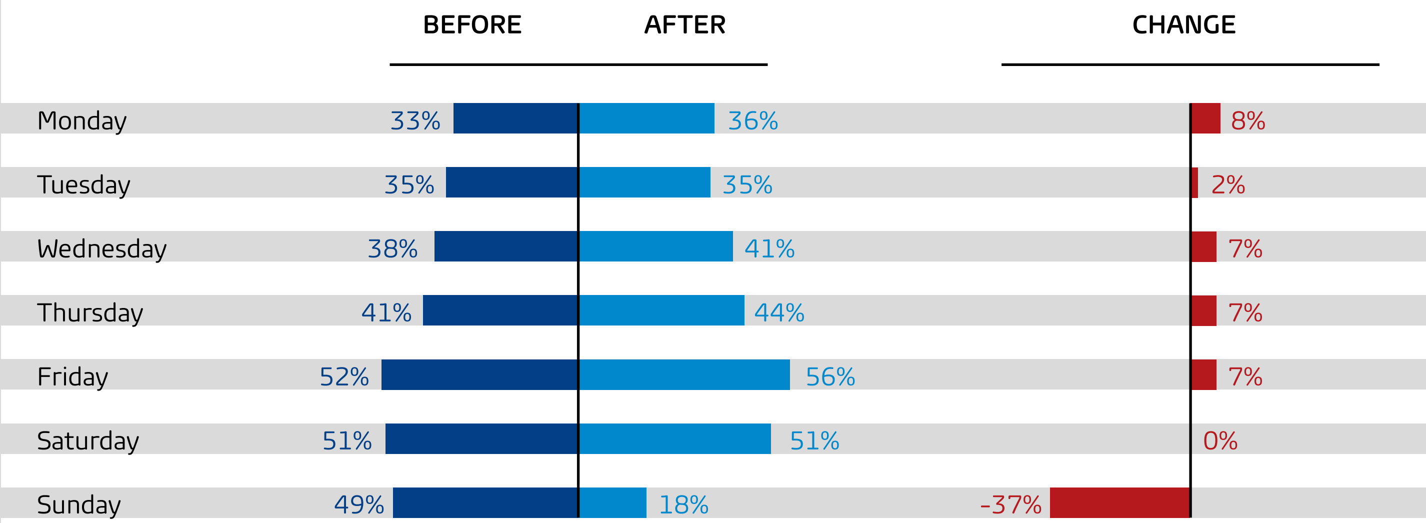
Shopping center visits in Budapest before and after Sunday restrictions – GfK benchmark



Basis: Survey of Budapest shopping center visitors over 15 years old when leaving the premises after a shopping outing

Retail just one aspect of shopping centers
In addition to retail outlets, shopping centers house gastronomic and recreation-oriented offerings such as cafés, cinemas and other services, which depend on retailers' opening hours to attract customers. Prior to the restrictive regulation, Sunday was one of consumers' favorite shopping center days according to a GfK survey conducted in shopping centers in Budapest. Forty-nine percent of those polled indicated that they visited shopping centers much more frequently on Sundays than on normal working days.

49%

enjoyed going to shopping centers on Sundays prior to the restrictions

When the restrictions when into effect, consumers shifted their shopping center outings from Sunday to Monday through Friday, with Saturday seeing no gains. But on the whole, not that many people answered that they visited shopping centers, which is particularly problematic for gastronomic and recreation-oriented offerings, for which impulse purchases and synergies with shopping visits play a larger role.

Online retail unable to realize significant gains

The turnover volume added by small, owner-run shops amidst the changes to Sunday opening hours did not prevent structural changes to Hungary's retail scene. As a result, small, owner-run shops continually declined in significance, while discount merchants in particular gained market share, moving from 17% in 2014 to 21% in 2017.

The Sunday closures led to no meaningful growth in online retail.

Online retail in the FMCG segment did not meaningfully profit from the changed regulatory conditions. While online retail has grown continually in Hungary, there was no acceleration in this growth from 2014 to 2015. FMCG online retail increased its share of total turnover during this period from 0.8% to 1.0%, a level of growth comparable to that achieved in subsequent years.

Summary

The regulatory restrictions on Sunday opening hours posed major challenges to Hungary's retail scene during the transformation phase. Staffing had to be adjusted to the changes in weekday visitation patterns, and the stocking of fresh goods had to be completely replanned. The original goals of the regulation – the improvement of employee working conditions and promotion of owner-run, small-scale retail – were not accomplished. Retailers responded by reducing staff, which in combination with the more compressed opening hours led to higher workloads on business days.

Owner-run retail outlets were able to benefit only in the sale of urgent-need items, particularly fresh goods. During the period of the Sunday restrictions, consumers continued to shop for basic FMCG-related needs on other days of the week at chain retailers. The regulation was thus unable to halt the advance of chain retailers and particularly discount merchants, which was ultimately to the detriment of owner-run retail outlets. It therefore seems appropriate that the restrictions were lifted one year after they went into effect.

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Making the right decisions for the future is challenging amidst constant change in the retail sector. Project developers, investors and retailers must continually respond to consumers' evolving needs and expectations.

We offer expert consultancy for future-proofing new locations, optimizing existing branch networks and minimizing investment risks. Our retail and real estate experts comprehensively evaluate the conditions and market potential associated with your existing or prospective retail locations.

This quickly reveals your portfolio's strengths and weaknesses and provides concrete recommendations along with all relevant market data and reliable benchmarks to support your strategic and operational decisions.

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