

Allianz Research

Is fashion retail falling out of fashion?

Lower consumer confidence to hurt the fragile recovery in Europe

30 March 2022



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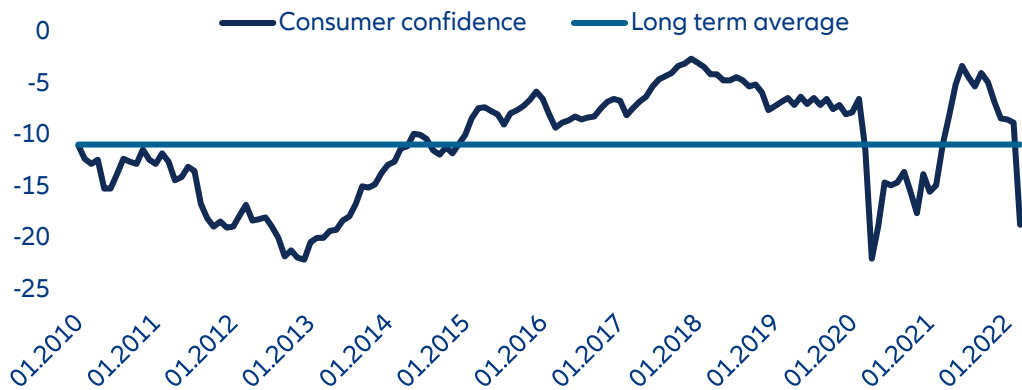
EXECUTIVE SUMMARY

- European consumer confidence has taken a hit in the wake of the invasion of Ukraine. Amid lower economic growth, retailers could face a -EUR4.85bn hit to fashion consumer spending for 2022, with Italy (-EUR1.45bn) and Germany (-EUR1.12bn) facing the largest declines. We estimate fashion spending growth for 2022 will fall to +4.4%, down from +6.4% expected prior to the war, meaning it will remain far below pre-pandemic levels. On top of this adverse impact on sales growth, we anticipate gross margins to remain under pressure amid a context of durably high commodity prices.
- Macroeconomic headwinds come on top of a structurally challenging market environment. Over the past 20 years, fashion spending declined from an average 6% of total household spending to 4% in 2020, while per capita spending on fashion has been receding in Italy, France and Spain. We believe the legacy of the pandemic is generally detrimental to specialized fashion retailers as consumers are increasingly opting for alternative distribution channels (online), consumption patterns (second-hand) or products (sportswear). By late 2021, monthly sales in fashion stores were still EUR1.7bn below their 2019 levels.
- Factoring in a modest recovery in sales, a high-cost environment and powerful structural changes at play, we anticipate insolvency risks to remain elevated throughout 2022 and 2023. Since 2016 in Europe, there have been 78 insolvencies involving fashion retailers with an annual turnover higher than EUR10mn, for a total turnover at stake of about EUR14bn. This represents 27% of all retail insolvencies, and 31% of all retail turnover at stake over the period.

European consumer confidence has taken a hit in the wake of Russia's invasion of Ukraine

Russia's invasion of Ukraine is casting a shadow over the recovery of some consumer businesses already hit hard by the Covid-19 pandemic. In March 2022, consumer confidence in the Eurozone fell below its long-term average for the first time since early 2021 amid worries over the war and an acceleration in commodity prices already materializing into higher fuel and food prices (Figure 1, next page).

Figure 1: Consumer confidence in the Eurozone



Sources: DG ECFIN, Allianz Research

The conflict has brought back significant headwinds to the global economic recovery and raised wider geopolitical risks. In our recently published macroeconomic scenario¹, we cut our global growth forecast to +3.3% in 2022 and +2.8% in 2023, revised on the downside by -0.8pp and -0.4pp, respectively, on the back a confidence shock, further strain on supply chains and higher commodity prices.

Deterioration of the economy to slash consumer spending on fashion by EUR4.85bn in 2022

As with past economic slowdowns, the impact will be felt most among those sectors with strong sensitivity to the overall economic cycle. Fashion retail will be no exception to the trend since fashion goods display the highest correlation to overall consumer spending across all goods and services. Looking at the historical correlation between GDP and consumer spending on fashion in Europe, we observe that a -1.0pp decline in GDP growth translates into a -1.7pp drop in fashion consumer spending, with higher sensitivity in Spain (-2.2pp) and Italy (-1.9pp) vs France (-1.5pp) or Germany (-1.2pp). Consequently, we estimate lower GDP growth could wipe out -EUR4.85bn in consumer spending on fashion goods in Europe, with Italy (-EUR1.45bn) and Germany (-EUR1.12bn) reporting the steepest revisions in absolute terms.

Figure 2: Revision to GDP growth and fashion consumer spending forecasts for 2022

Country	2022 GDP growth forecast revision (pp)	2022 fashion consumer spending growth forecast revision (pp)	Estimated adverse impact on 2022 fashion spending (EUR bn)	Revised 2022 fashion consumer spending growth forecast (%)
Eurozone	-1.2	-2.0	-4.85	4.4%
Germany	-1.4	-1.7	-1.12	2.2%
Spain	-1.6	-3.6	-0.77	8.7%
France	-1.0	-1.5	-0.59	4.5%
Italy	-1.4	-2.6	-1.45	4.9%

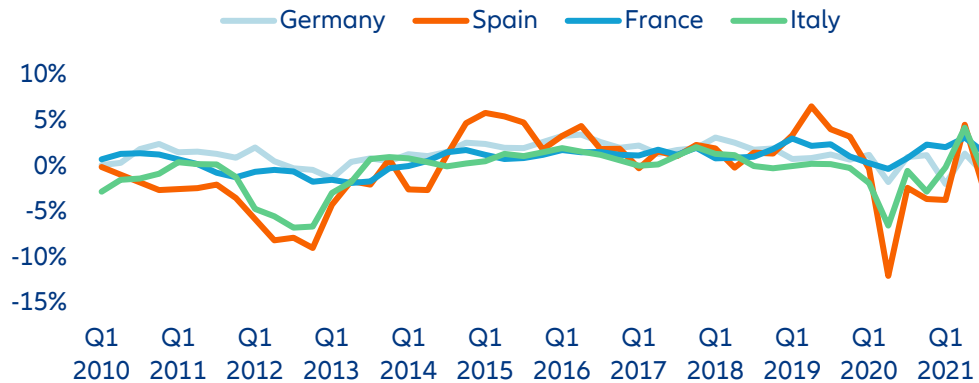
Sources: Eurostat, Allianz Research

¹ See [Economic outlook: energy, trade and financial shockwaves](#)

Inflation is biting into households' disposable income and challenging retail margins

European consumers are even more likely to reconsider their discretionary purchases as rising prices are eroding disposable incomes, which were already receding in H2 2021 in Germany, Spain and Italy (Figure 3). The acceleration in inflation will only add to this trend in coming quarters.

Figure 3: Change in households' real disposable income (% change year-on-year)



Sources: National statistics, Allianz Research calculations

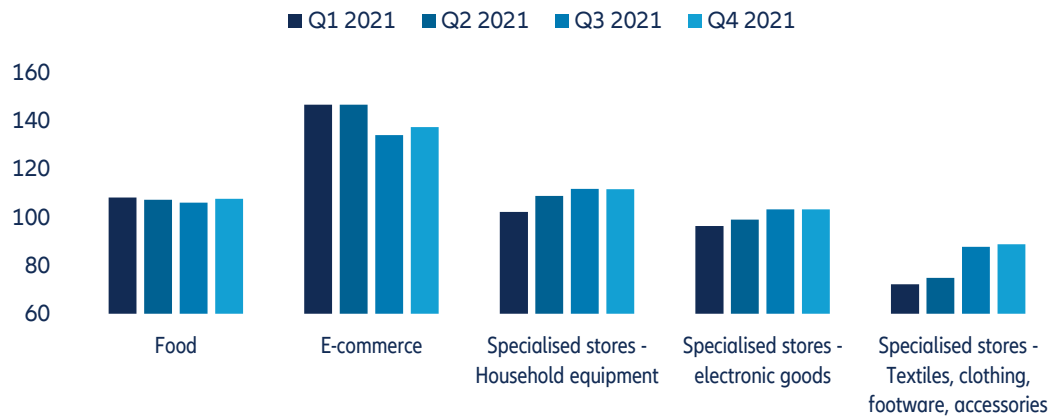
Rising prices are also a challenge for the profitability of fashion retailers. The prices of cotton, synthetic fibers and transport will remain at elevated levels, meaning gross margins will be under pressure. The purchase of goods is the largest single item expenditure of clothing retailers, accounting for an average 50-60% of operating expenses. Looking at the historical gross margins of leading fashion retailers, we find little correlation with commodity prices, hinting at a strong capacity among retailers to adjust the product mix to preserve profitability. Typical measures include a greater reliance on near-shoring (Eastern Europe, Turkey, North Africa) and a focus on pricier items, together with a more limited discount policy, allowing for higher realized prices. A survey of fashion executives from consulting firm McKinsey² shows 67% of respondents expect clothing retail prices to increase in 2022, with one in two expecting increases above 4%.

Monthly fashion retail sales were already EUR1.70bn below their pre-pandemic levels

Lower growth and pressurized margin prospects are even more ill-timed because fashion retailers did not benefit from the great consumer spending boom of 2021 (Figure 4). While the savings accumulated by households during the lockdowns of 2020-2021 fueled a strong recovery in consumption from Q2 2021 onwards, which greatly benefited household equipment and electronics retailers, specialized fashion stores were left with sales still -11% below their 2019 levels in Q4 2021. We calculate that fashion stores were still missing EUR1.70bn in monthly sales in the Eurozone in Q4 2021. Available data for January in Italy, Spain and Germany show no sign of progress, with sales receding from their December levels in all three countries.

² See [The State of Fashion 2022](#)

Figure 4: Retail sales in the Eurozone (2019=100)



Sources: Eurostat, Allianz Research

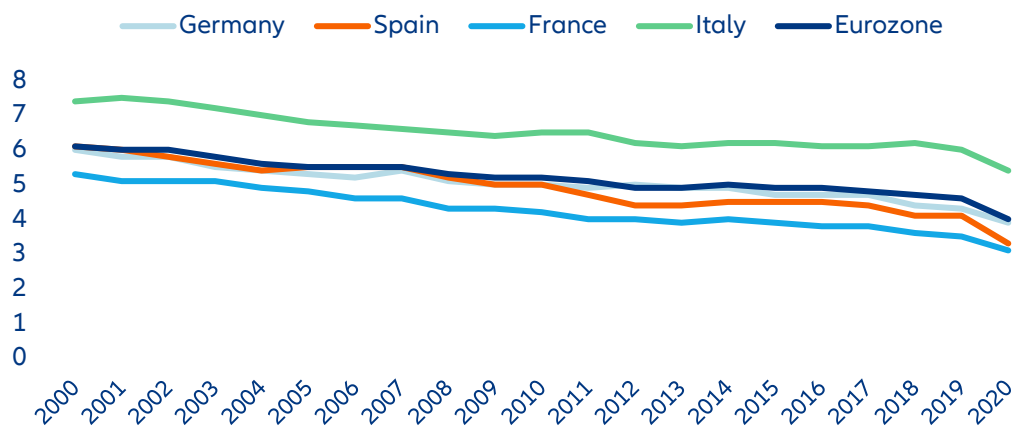
The pandemic has changed consumer behavior for good – but not for the best

Durably muted spending in fashion stores points to two phenomena that seemed to have gained traction since the beginning of the pandemic:

- More frugal consumption patterns, with consumers cutting down on overall fashion spending.
- Growing competition not only between distribution channels (stores vs online), but also consumption habits (new vs second-hand) and product categories (formal vs casual or sportswear).

Historical data in Europe show households were already dedicating less and less of their income to spending on clothing, at least in relative terms. Over the past twenty years, fashion spending declined from an average 6% of total household spending to 4% in 2020 during the pandemic (Figure 5).

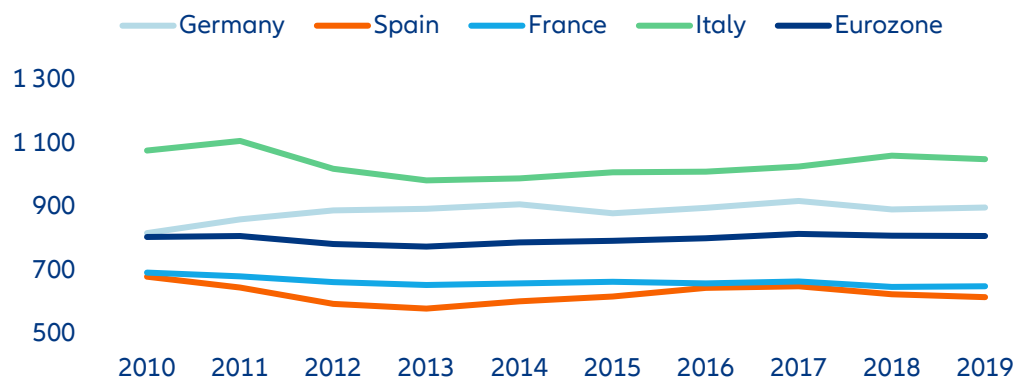
Figure 5: Fashion spending as % of total household consumption in value



Sources: Eurostat, Allianz Research

While there is dispersion across countries, with the Italians spending the most and the French spending the least, the downward trend is noticeable across all countries. The period coincides with China's entry into the World Trade Organization and the rise of the fast-fashion business model (low priced, short-lived collections) that have considerably contributed to pushing prices down. Dividing total spending by population to account for the change in total population, and using constant prices to exclude the price effect, we find that per capita spending on fashion has been flat in the Eurozone, and even receded in Italy, France and Spain (Figure 6).

Figure 6: Per capita spending on fashion (constant euros)



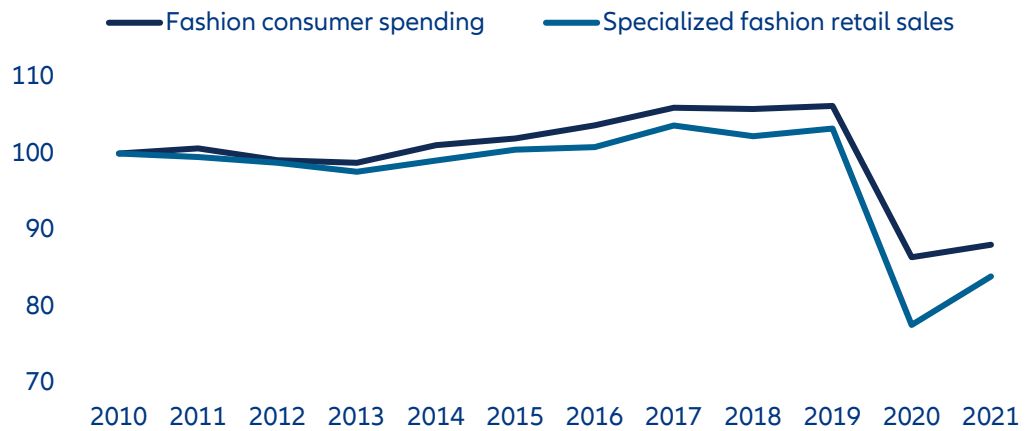
Sources: Eurostat, Allianz Research

Sales patterns suggest that the pandemic has boosted the so-called "casualization" trend, with a fraction of consumers spending less on formal, medium range clothing because of new habits acquired during the months spent working from home. Instead, leisure and sportswear have clearly gained traction, reflecting both growing engagement in sports activities and a preference for more simple and comfortable clothes. At the other end of the price range, luxury sales are already back to pre-pandemic levels, but are mostly driven by sales made in international markets (China, in particular, see Appendix).

Alternative distribution channels are winning over specialized retailers

On top of a trend towards more frugal consumption, consumers are also increasingly favoring alternative distribution and consumption patterns at the expense of traditional, specialized fashion stores. Measuring total household spending on fashion vs sales made in specialized fashion stores (Figure 7), we observe a divide that has only been growing in the past few years, with sales in stores trailing total fashion spending and lost to alternative distribution channels, including e-commerce (pure-players and retailers shifting to an omnichannel business model) and the second-hand market. Based on available data, we estimate that about 40% of fashion spending is now happening outside of specialty stores in the top Eurozone markets.

Figure 7: Fashion consumer spending and specialized fashion retail sales in the Eurozone (2010=100)

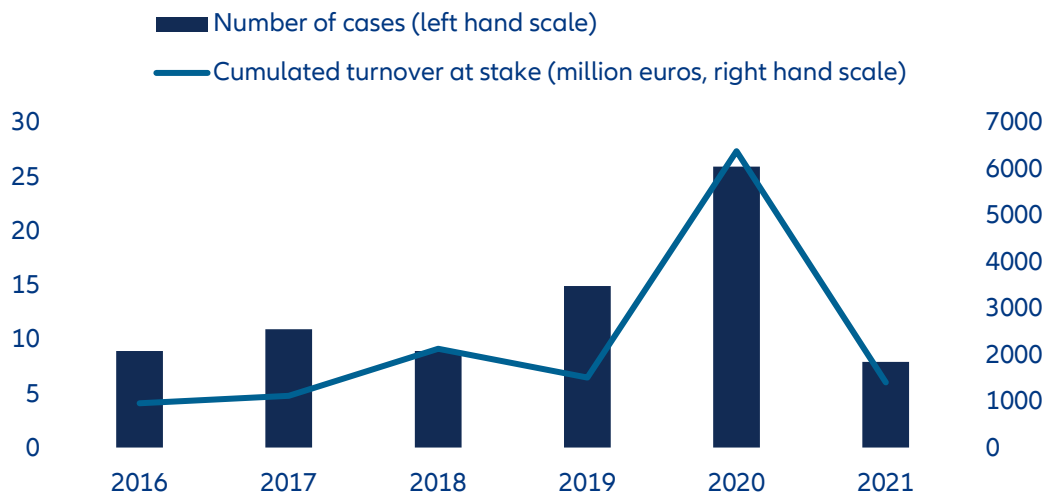


Sources: Eurostat, Allianz Research

As a result, insolvency risks will remain high in the coming years

Factoring in a modest recovery in sales, a high-cost environment and powerful structural changes at play, we anticipate insolvency risks to remain elevated throughout 2022. Since 2016 in Europe, there have been 78 insolvencies involving fashion retailers with an annual turnover higher than EUR10mn, for a total of about EUR14bn in turnover at stake (Figure 8). This represents 27% of all retail insolvencies, and 31% of all retail turnover at stake over the period. Risks will also remain elevated in other segments of the retail industry whose product mix greatly relies on fashion items, especially department stores and discount stores.

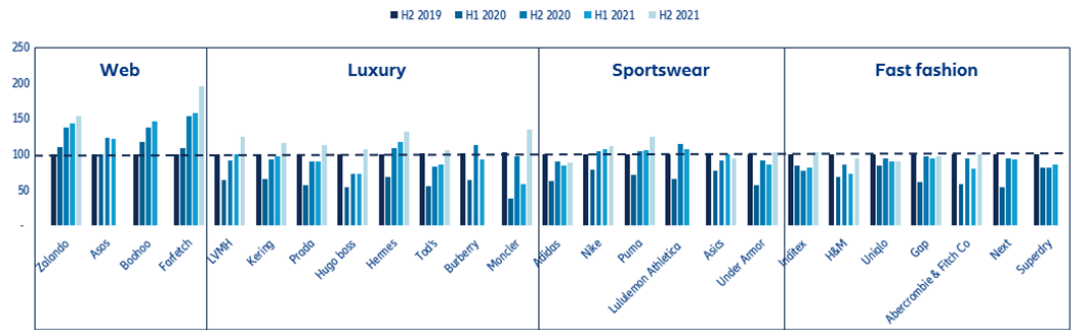
Figure 8: Insolvencies of fashion retailers with sales > EUR10mn in Europe



Source: Allianz Research

APPENDIX

Corporate turnover index (H2 2019=100)



Source: Thomson Reuters Eikon

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