Navigating a New Retail Reality

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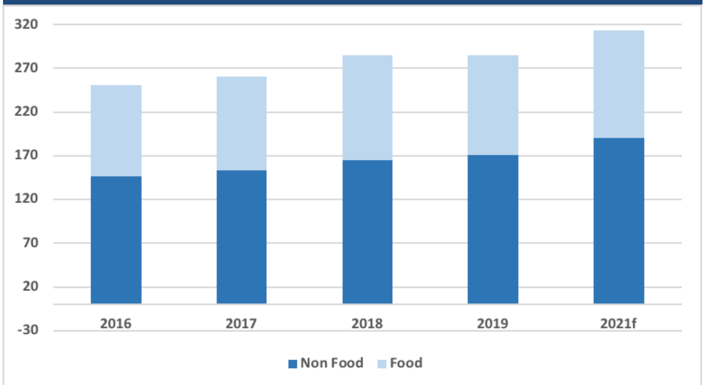
- **As lockdowns lift and travel restrictions ease, offline retail activity will recovery gradually. But it will remain below pre-pandemic levels for this year.**
- **We expect demand for retail e-commerce in the GCC to remain above pre-pandemic levels, even if it may initially fall back.**
- **Despite competition from e-commerce, traditional brick-and-mortar retailers are now presented with new ways to accelerate sales, creating stronger online presence and long-term virtual prospects.**

GCC luxury shopping: A disrupted way of life

Despite lockdown easing and the gradual reopening of borders, we believe brick-and-mortar retail in the GCC will not recover to pre-COVID levels this year; it is most likely to pick up in mid-2021 at the earliest.

- Prior to the pandemic, the overall retail sector in the GCC was forecast to grow at an annual rate of 5%, to reach USD 313B by 2021 from the USD 250.5B in 2016 and USD 180B in 2011. In particular, non-food retail sales were seen growing at 4.7% annually from 2018 to 2023.
- Clearly, the economic slow-down, disruption in supply chains, and a drop in tourism on the back of lower oil prices and pandemic-induced shocks, mean such growth will not be achieved this year.
- This is also in part because the GCC retail sector is mainly driven by the large population of fashion-conscious millennials and expatriates, a strong female base, high net worth individuals and increasing numbers of tourists.
  - Many (but not all) of these groups will be sensitive to the economic shocks.
- Among the GCC countries, Saudi Arabia's retail sector is the largest. In 2019, it had 45% of the regional grouping's retail market, followed by the UAE (26%) and Qatar (11%).
- The retail sector contributes around 14% of Saudi Arabia's total GDP and 12% of the UAE's -- making overall growth highly vulnerable to any shopping slowdown.
  - The UAE is ranked fifth among the top 10 retail destinations in the world, which has seen retail sales growing at a 4% annual rate since 2012.
  - In 2017, meanwhile, the UAE ranked 5th and Saudi Arabia 11th of 30 countries globally in A.T. Kearney's generally forward-looking Global Retail Development Index.
    - The index measures the attractiveness, rather than the value, of emerging markets' retail sectors for global retailers -- identifying markets that are attractive today, and also offer future potential.

Figure 1 - Retail Sales in GCC (USD, B)[1]



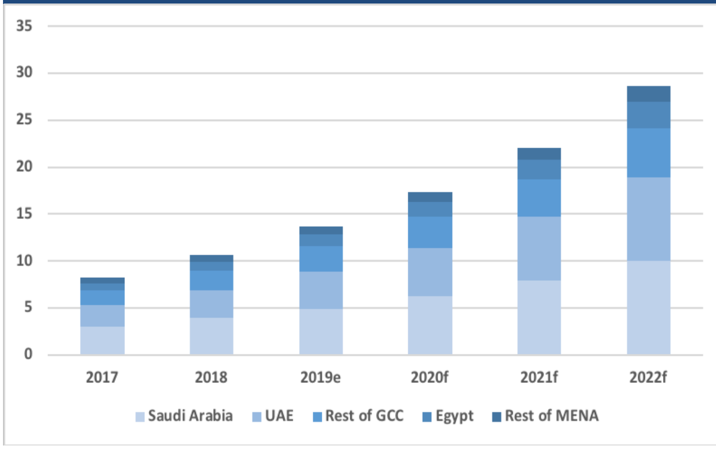
Lockdown easings will, of course, help, but there are several push-and-pull factors to the come-back of the non-food retail sector.

- On the plus side, given persistent outbound travel restrictions, the gradual reopening of shopping centres, albeit under strict measures and limited capacity, gives local retailers the ability to leverage domestic gains.
  - Spending time at shopping malls for leisure and entertainment is common in the regional culture. For instance, Dubai Mall and Dubai Shopping Festival together attract around 35 million visitors annually.
- Additionally, GCC nationals are on average high spenders, both at home and abroad. According to Chalhoub Group, domestic spending per capita on fashion and luxury retail averages USD 1.3K monthly, with transactions abroad ranging on average between USD 3K and 3.2K daily.
  - This, along with the tendency of people to flock indoors to escape the humid heat during summer, may push for an increase in shopping centre footfall -- a move towards recovery for offline retail activity, particularly if the traditionally high foreign outlays are spent at home.
  - The recent reopening of the annual shopping festival, Dubai Summer Surprise, a six-week long mega-outlet featuring over 700 local and international brands at discounted prices, provides a strong opportunity for UAE's non-food retail to slightly rebound this summer.
- On the negative side, however, we do not believe this potential activity in the non-food retail sector will make up for the lost offline retail sales, particularly in the luxury and fashion industry. The sector is not likely to recover to pre-COVID levels until around mid-next year.
- Given the combined shock of low oil prices and the coronavirus pandemic, the IMF expects MENA real GDP to contract by 5.7% this year on the back of lacklustre growth of 0.3% in 2019. Saudi Arabia, with its lion's share of the retail market, is expected to suffer a hefty 6.8% contraction this year, but we think possibly more, following only 0.3% growth in 2019.

[1] Arabia Monitor; IMF, World Travel & Tourism Council

- These contractions will translate into slower growth in the overall retail sector and contribute to a wide-bottomed U-shaped recovery.
- The rising rate of COVID-19 infection, coupled with a brake on international tourists, will also delay growth recovery.
  - International tourists are key to reviving the sector, but we do not expect tourism to bounce back until next year at the earliest.
  - In the UAE's case, Dubai Expo 2020, had been expected to attract over 25 million tourists,
  - Retail tourist spending in Dubai alone reached over USD 30B in 2017, with Chinese and Russian tourists ranked the second and third, respectively, as key source markets for total luxury spending.
  - We expect a significant drop in retail revenue as inbound tourist arrivals decline this year. This may be compounded by muted local demand, as consumer confidence in physical shopping remain low.
- In addition to this, consumer sentiment and spending behaviour are being changed by mass layoffs and by the expatriate exodus brought on by workforce nationalisation policies.
- Kuwait, for example, recently increased foreigners' service fees by 150% and approved its foreign-worker quota law, which aims to reduce the number of expatriates by 40%.
  - This will cause tremors in the retail sector as expatriates, who currently account for 70% of the population, represent around 96% the total workforce.
  - With a small local population, the Kuwaiti firms will need to innovate to maintain retail sector growth following the departure of the foreigners. We do not preclude reversal of some measures.
- Similarly, Saudi Arabia's recent tripling of VAT to 15% -- an attempt to offset the economic implications brought on by the pandemic -- will directly affect consumer spending. It adds further uncertainty to whether brick-and-mortar stores in the country will be able win back shoppers rapidly as lockdown eases.
  - We expect a spike in inflation, at least for the short-term. Yet the effect will be relatively milder than when the base VAT was first introduced in 2018; it will be offset by the decline in oil and other commodity prices in the inflation index basket.
- Overall, across the region, government austerity measures such as lowering wages, reducing fuel and utility subsidies and introducing VAT will severely curtail the spending power of consumers and increase the operating costs of retailers.
  - It is for these reasons that we see the GCC offline retail sector remaining subdued in the short-term and coming back only slowly.

Figure 2 - E-commerce Growth (% of GDP)[2]



E-commerce: Competition is growing stronger

Demand for e-commerce platforms was expanding even prior to the pandemic, weakening the grip of traditional retail businesses. Lockdowns have accelerated the growth and we expect this shift in consumer preference to continue post-pandemic for both non-food and food retailing.

- E-commerce penetration was previously limited in MENA, accounting to only 4% of retail sales compared with China's 28% and 15% in the US. In GDP terms, MENA e-commerce is worth just shy of 0.8%. However, COVID-19 has hoisted demand for online shopping and increased investment opportunities.
  - Before the pandemic, e-commerce retail revenue in MENA was forecast to reach USD 49B in 2021, from USD 35B in 2019. We believe this will now be higher as several regional and international retailers join the MENA online shopping space.[3]
- Across the region, e-commerce penetration is deepest in the UAE (4.2%), Saudi Arabia (3.8%), and Egypt (2.5%) – but these levels only indicate nascent development. There is, however, growth potential in the region's high mobile use and broad internet accessibility.
  - Prior to the pandemic, e-commerce revenue in the UAE reached USD 4.2B in 2019; it is expected to reach USD 5.2B this year -- a 24% leap.
- The effect of layoffs and reduced purchasing power are likely to decrease overall sales and restrain e-commerce growth in the short-term. But we expect growth in e-commerce to be maintained above pre-COVID levels.
- Similarly, while e-commerce will continue to present competition for brick-and-mortar retailing, we see local retailers continuing to be pushed into building online presence, increasing both e-commerce sales and business innovation.
  - One example: Dubai Mall has set up a virtual shop on e-commerce platform noon.com, allowing customers online access to brands at many of its over 1,200 stores.

[2] Arabia Monitor; Ecommerce Foundation, Statista

[3] Arabia Monitor; Q3 2020 MENA Post COVID-19: Next Generation Digitisation

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