Industry Top Trends Update

Retail and Restaurants

Credit quality is at a turning point

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What's changed?

Consumers are capitulating to inflation. Consumers were price takers in 2021, bolstered by excess savings and slim pickings. A more price-sensitive consumer, compounded by cost inflation, poses near-term risk for many retailers.

Inventories are bloated. Retailers have found themselves saddled with inventory consumers don't want or can't afford anymore. Faced with $5 gas, rising interest rates, and double-digit inflation at the grocery store, shoppers are foregoing discretionary expenditures and trading down. At the same time, there is a dramatic spending shift to experiences.

What to look out for?

The reopening tailwind will be short-lived. This summer consumers are determined to enjoy in-person activities, including vacations and dinners out, and specialty apparel retailers--such as ones that offer dressy attire--have experienced a snap back in demand. But in our view this is the consumer's last hurrah, likely to fade as excess savings dwindles and reality sets in.

Cost pressures will get worse before they get better. U.S. grocery retailers and distributors face steep margin and profit pressure from cost inflation. Yet grocery suppliers have signaled that more price hikes are on the way. Food retailers will keep market share at the expense of profitability as hard-hit customers look for value. Margins will likely decline in this already low-margin business, but targeted promotions and efficiency measures may offset some risks.

Credit quality is at an inflection point. Positive rating actions have outnumbered negative actions year-to-date, partly due to good operating performance through the first quarter, offset by supply chain and inflationary pressures. However, recent earnings signaled a downward inflection point and we expect a majority of rating actions in the second half of the year to be negative.

What if there's a recession?

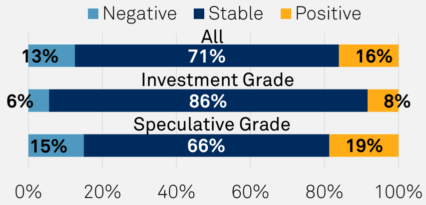
Discretionary spending will be spread thin. Subsectors such as specialty apparel, department stores, and home goods retailers will face challenges as consumers defer discretionary spending. Competition for fewer dollars spent will drive the return of a promotional environment, hurting margins and cash flow.

Value players and deep discounters will benefit. Sectors that are well-positioned for tighter consumer budgets, such as off-price retailers, dollar stores, and quick-service restaurants, will benefit from consumers' tightened budgets. Still, these retailers will need to navigate continued cost inflation pressures while they compete for the cost-conscious consumer.

Latest Related Research

- Credit Trends: Food Fight: U.S. Grocery Leads Retail Sectors Chewed Up By Inflation, Cost Pressures, May 31, 2022
- Closing Time: The U.S. Retail Party Ends As Consumers Push Back On Inflation, May 23, 2022
- U.S. Consumers Continue To Shop, Undeterred (So Far) By High Inflation, Feb. 17, 2022

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	36	107	143
Downgrades	0	9	9
Upgrades	0	15	15

Ratings data as of end-June 2022. * Year-to-date

Ratings Outlook Net Bias