

Will sterling's fall push up retail costs and lead to price rises?

The impact of the country's vote to leave the European Union is reverberating around the world and sent shockwaves through stock markets, writes *Emily Hardy*.

The pound plummeted after the referendum result was announced. At one stage on the day, it hit \$1.3236, a fall of more than 10% and a low not seen since 1985.

By early afternoon, it had partially recovered but was still nearly 8% down.

Verdict global retail director Maureen Hinton says: "For retailers, the immediate issue is the fall in the pound and whether it will remain weak for a sustained period.

"This will impact costs as most buying is done in US dollars and will push up prices."

Stifel analyst Scott Ransley says: "The key variable to watch is where sterling settles versus the dollar over the next few days and weeks as this will have a significant impact on overseas sourcing costs for many retailers."

And EY retail sector leader Julie Carlyle observes: "For many retail businesses, the impact of any further devaluation of sterling will have a significant impact on the costs in the supply chain."

The price effect

Given the importance of overseas sourcing, retailers have to find ways of mitigating the impact, potentially by increasing prices charged to consumers.

The Treasury predicted last month that, in the event of a Brexit, the value of the pound would depreciate by 12% on average against other international currencies.

Based on that figure, it estimated that an EU exit would add £220 to the annual cost of food and clothing.

Hinton says: "While retailers may have currency hedges and contract terms already in place with suppliers which will delay the impact on shop prices, they will not be able to hold prices for long. Following the exit from the single market, there could be costly tariffs in place should the UK Government fail to negotiate beneficial trade agreements, which will put further upward pressure on prices.

"Retailers must encourage consumers to spend now ahead of such rises, but that will be hard in the circumstances. The UK population

We look at how the disrupted value of the pound will take effect on the retail industry in the wake of the UK's decision to leave the EU



has become well used to austerity since the recession, so retailers will not see a huge change in consumer behaviour."

Debenhams chairman and former Kingfisher chief executive Sir Ian Cheshire says: "I foresee prices going up. Uncertainty will affect the top line of consumer spending.

"For UK retailers, bringing product across the borders will become more difficult because of the exchange rate. That's the one that's hardest to read at the moment, seeing the pound move around so much means that we don't know what the final arrangement will look like.

"Shoppers won't show up in shops next week and find the prices have gone up, it's more

a problem for next year. It's an enormous spanner in the works in terms of knowing how to price and resource properly."

Stifel food retail analyst James Collins thinks grocers may not be too badly hit, however. He says: "The most important implications are the potential for cost price inflation given high levels of imported goods, a potential slowdown in population growth and the impact of uncertainty on UK consumer spending. Of these three, we think inflation is the most significant.

"While competitive pressures will limit inflation pass-through, history suggests consumers do not fully trade down to offset very high levels of inflation, meaning the industry is likely to return to top-line growth."

British retailers trading internationally may be able to withstand the effects of currency volatility and benefit from translating international profits.

Ransley believes Kingfisher and Mothercare are "potentially least exposed" to the impact of Brexit because a large proportion of their EBITDA comes from non-UK profits. For the same reason, he thinks Boohoo and Debenhams also stand to benefit from translation of overseas earnings. He notes: "We believe Dixons Carphone sources more in sterling than in dollars from global suppliers but it is likely that some pain will be shared.

The retailer reaction

Retailers have mixed views about how big an issue the value of sterling is likely to prove.

Floorings retailer Tapi chief executive Martin Harris says: "I won't be surprised if there is some inflation somewhere, but I have no idea where this will go long term. The markets are reactive and they over-react. We need to let the dust settle first. I think there are a lot of people scratching their heads and it's too soon to say what's going to happen."

Co-op chief executive Richard Pennycook does not think there is "great cause for concern".

He says: "In the immediate period it's all about exchange rates, and retailers are used to dealing with exchange rates."

The path of the country now depends on negotiations that could take a number of years, and the long-term impact on markets, currency and businesses will take time to ascertain.