How long will it last?

NZ retail sales, June quarter 2018

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- Retail spending rose by 1.1% in the June quarter, underpinned by a strong rise in the core categories. That was well above market expectations for a 0.3% gain.

- Increases in Government transfers will provide a boost to spending through the latter half of the year. However, looking further ahead a period of softer spending growth is on the cards.

Seasonally adjusted real retail sales (% change)

	Quarter		Annual
	Mar-18	Jun-18	Jun-18
Supermarket and grocery stores	1.0	-1.1	2.0
Specialised food	-1.1	0.8	5.2
Liquor	2.3	-0.4	9.3
Non-store and commission-based retailing	-0.1	1.3	10.8
Department stores	0.0	2.8	4.6
Furniture, floor coverings, houseware, textiles	1.6	-0.3	3.1
Hardware, building, and garden supplies	0.6	4.7	5.1
Recreational goods	-0.4	4.9	4.1
Clothing, footwear, and accessories	-4.5	2.3	3.9
Electrical and electronic goods	4.1	2.0	14.6
Pharmaceutical and other store-based retailing	1.7	0.9	6.8
Accommodation	1.9	3.2	-1.4
Food and beverage services	-1.0	1.7	1.7
Core industries total	**0.6**	**1.4**	**4.5**
Motor vehicles and parts	-0.3	0.4	0.2
Fuel	-1.7	-0.7	-4.1
All industries total	**0.3**	**1.1**	**3.1**

Retail spending stronger than expected in June

After softness earlier in the year, retail spending roared back to life in the June quarter. After adjusting for price changes, spending rose by 1.1%. That was well above our forecast for a 0.2% gain, and the average market forecast for a 0.3% rise.

June's increase was underpinned by a solid 1.4% increase in core retail categories (which excludes the volatile vehicle and fuel categories). There was a particularly large increase in spending on hardware, as well as solid gains in categories such as electronics and department stores. Those gains offset a fall in spending at supermarkets.

Motor vehicle spending only increased modestly after last quarter's softness, which was associated with delays in importation.

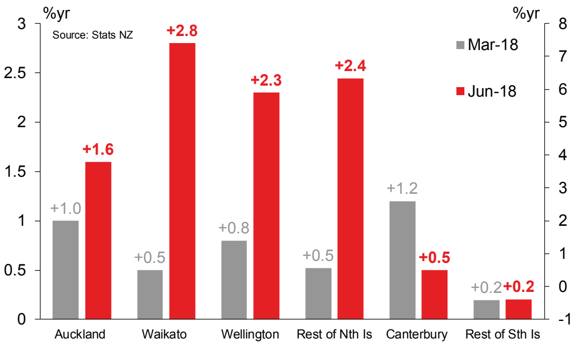
Today's retail data adds to the upside risks for Q2 GDP growth (we were already expecting a strong gain of around 1% before today's report). Importantly, it reinforces the idea that GDP growth will surprise the RBNZ to the upside in the near term.

Spending growth centred on the central North Island

While spending levels were up in most regions, gains were strongest through the central North Island, with particularly large gains in Manawatu-Whanganui and Taranaki. There were also solid gains in Auckland and Wellington.

Growth in South Island regions was more moderate. Notably, the pace of spending growth in Canterbury has continued to soften.

Regional spending growth



How long will it last?

Despite the stronger than expected June result, spending growth has lost some steam over the past year. On an annual basis, core spending growth has now softened to 3%. While that's not slow, it is a noticeable stepdown from the rates of 5 to 6% annual growth that we saw in recent years.

Spending growth is expected to hold up through the second half of the year, boosted by increases in transfer payments to households. That includes around $1.5b of spending on the Government's families package and accommodation support payments, which will provide a significant boost to the disposable incomes of many households. However, that will provide only a temporary fillip.

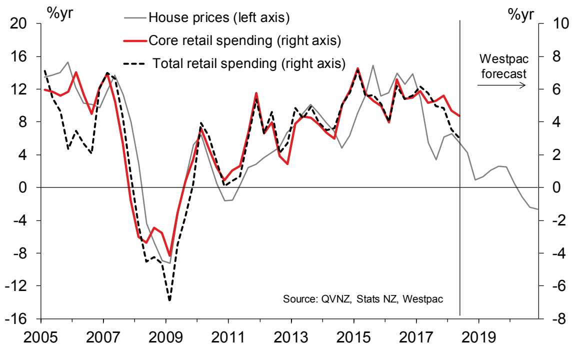
Looking at the household sector more broadly, a period of softer spending growth is on the cards as we head into 2019. Much of the strength in spending in recent years has been supported by high levels of net migration. That saw population growth surging to just over 2% per annum, providing a sizeable boost to our demand base. But while migration remains elevated, the net flow of people into the country has been declining. In fact, this week's figures for the year to July showed that the net inflow of people into the country has slowed to its lowest level since 2015. We expect that net migration will continue to slow as many of those who arrived in recent years on temporary visas depart. Improving job prospects in other regions are also making New Zealand relatively less attractive as a destination. Together, these developments will see net migration continuing to decline, and population growth slowing to around 1% in 2022, signalling a huge reduction in what has been an 'easy' source of sales growth for many businesses.

Household spending growth will also be dampened by the slowdown in the housing market. On a nationwide basis, house price growth has taken a step down since 2017. And despite a brief flutter over the new year, prices have essentially been flat since February. That's a significant slowdown from previous years when prices were rising at double-digit rates. Softness in house prices has been centred squarely on Auckland and Canterbury, which together account for 40% of sales and where prices have been falling modestly in recent months. Prices are still rising in other areas, but at a more gradual pace than in previous years.

The slowdown in the housing market comes against a backdrop of significant policy changes targeting housing affordability and supply. We expect that these measures will result in modest house price declines over the next few years. Recent declines in mortgage rates, and a likely easing in the Reserve Bank's loan-to-value restrictions in January, will provide some counterbalance to the changes in the policy backdrop. Nevertheless, we are still looking at a subdued outlook for house prices over the next few years.

New Zealand households hold a large proportion of their wealth in both owner-occupied and investment housing. Consequently, the softness in house prices is likely to be a significant drag on spending, especially for items like household furnishings, which tend to be closely linked to house sales.

Retail spending and house prices

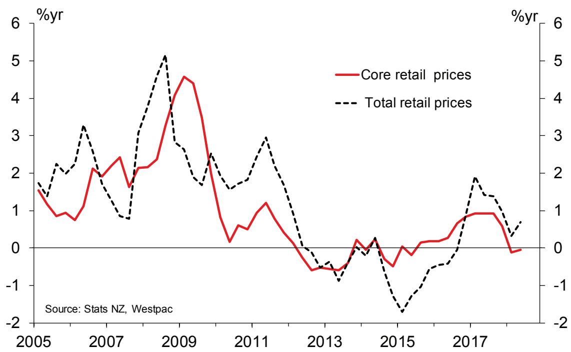


Price growth weak

Price growth across the retail sector remains weak. Over the past year, overall retail prices rose a muted 0.2%. And if we exclude the vehicle and fuel categories, core retail prices actually fell 0.1%.

Over the coming year, we expect to see some lift in retail price inflation, underpinned by earlier increases in oil prices and the drop in the NZ dollar. Nevertheless, price inflation in the retail sector is expected to remain relatively modest for some time yet. Several factors are continuing to weigh on prices, including strong competitive pressures in the retail sector and changes in technology (such as the increasing prevalence of online trading).

Retail prices



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