All gassed up and ready to go (for a while at least)

NZ retail sales, December quarter 2018

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- Retail spending was stronger than expected in the December quarter, supported by falls in petrol prices and the boost to households' disposable incomes from the Government's Families Package.
- We expect to see continued moderate gains in spending over 2019. However, we expect spending growth will take a material step down in the early 2020s.
- Price growth in the retail sector remains muted, despite rising cost pressures.

Seasonally adjusted real retail sales (% change)

	Quarter		Annual
	Sep-18	Dec-18	Dec-18
Supermarket and grocery stores	0.1	1.8	1.6
Specialised food	-1.8	1.7	1.2
Liquor	1.7	0.8	4.4
Non-store and commission-based retailing	1.8	4.1	13.5
Department stores	8.0	-2.6	7.8
Furniture, floor coverings, houseware, textiles	-1.4	-1.3	-0.6
Hardware, building, and garden supplies	0.4	-2.1	3.9
Recreational goods	-0.5	-1.2	0.1
Clothing, footwear, and accessories	2.2	4.1	5.2
Electrical and electronic goods	3.6	4.6	15.3
Pharmaceutical and other store-based retailing	-3.5	8.2	7.7
Accommodation	1.8	1.9	8.6
Food and beverage services	-2.0	4.2	2.7
Core industries total	**0.7**	**2.0**	**5.0**
Motor vehicles and parts	-1.9	0.1	-2.9
Fuel	0.7	1.0	-1.2
All industries total	**0.3**	**1.7**	**3.5**

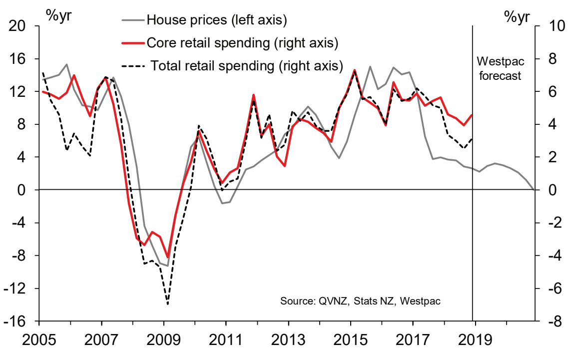
Retail spending roars back to life...

Retail spending was much stronger than expected in the December quarter. The volume of goods sold rose by 1.7%. That was well above our forecast for a 0.7% rise and the average analyst forecast for a 0.5% gain.

A key reason for the strong December quarter rise in spending was the sharp drop in petrol prices. Earlier petrol price rises syphoned at least $130 million out of households' wallets between July and October. That offset a good chunk of the boost to demand from the Government's Families Package, and resulted in only muted spending growth in the September quarter. But with petrol prices falling sharply in late 2018, households have been hitting the stores again.

The December quarter saw gains in most retail categories, including large gains in areas like supermarkets and dining out. That saw core (ex-fuel spending) volumes rising by 2% over the quarter.

Retail spending



...but price growth remains muted

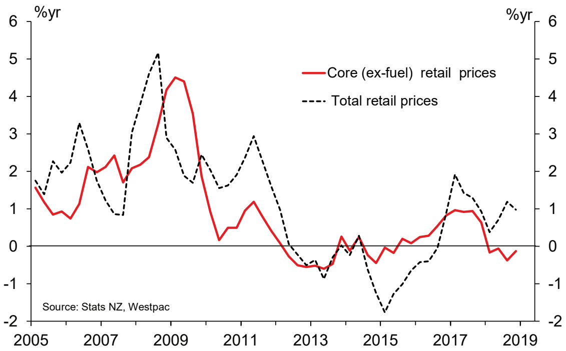
While spending levels have picked up, we're still seeing only very muted price gains. Prices in core (ex-fuel categories) were essentially flat over the past year. In fact, we haven't seen a material acceleration in retail price inflation since the financial crisis. That's despite the firming in domestic demand in recent years.

As we've highlighted before, a range of factors has been weighing on retail prices. The most important of these has been strong competitive pressures, including those related to online trading which has essentially increased the presence of global retailers in the New Zealand market space.

This softness in retail prices comes at the same time as many retailers are highlighting growing cost pressures, particularly with regards to wages. Such concerns have been amplified by increases in the minimum wage. With only limited growth in prices, that implies continued pressure on margins.

We do expect to see some increases in retail sector pricing over the coming year. However, the extent of these increases is still expected to be moderate.

Retail prices



Continued moderate growth over 2019, before a downturn in 2020

Petrol price swings have thrown around spending figures in recent quarters. So how strong is the underlying spending pulse? Smoothing through the normal quarter-to-quarter volatility, we're seeing spending growth of around 4% per annum. While that's down from rates of above 6% in recent years, it's still a reasonable rate of spending growth. Over this same period, population growth slowed from around 2% to 1.5%.

We expect to see continued moderate gains in spending over 2019. Disposable incomes have been boosted by increases in government spending, including the Government's Families Package. The labour market is in good shape and wages are gradually rising. On top of those conditions, recent falls in fixed mortgage rates and the related firming in the housing market are boosting spending appetites in the very near term.

However, we expect spending growth will take a material step down in the early 2020s. Population growth has been slowing, and that's set to continue over the next few years with net migration trending downwards. In addition, a weak outlook for house price growth over the coming years also signals a drag on spending. While recent falls in mortgage rates and an easing in borrowing restrictions will boost house prices in the very near term, policy changes (including those affecting the tax system) are likely to see modest price declines over the coming years.

Regional break down

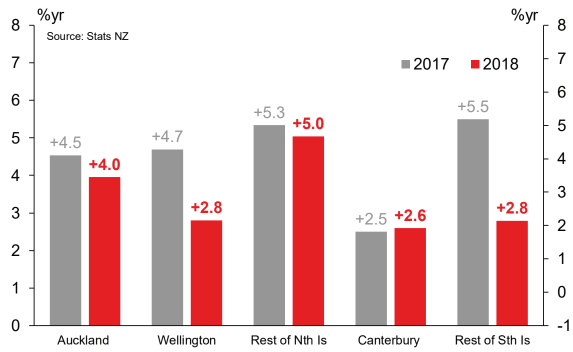
Spending growth has cooled a little in Auckland but remains healthy, buoyed by strong increases in the region's population.

We've also seen solid spending gains in many other parts of the North Island that are enjoying increases in house prices. Incomes in many regional centres have also been boosted by increases in commodity prices.

Spending growth in Canterbury remains moderate. The region's economy continues its transition away from construction-led growth. That's putting a dampener on growth more generally.

Spending growth has taken a step down in Wellington and in many parts of the South Island.

Regional spending growth



Implications for GDP

The stronger than expected Q4 spending result does add a little upside risk to our forecast for GDP growth over the December quarter (before today's result we expected a modest 0.3% gain in GDP).

However, we're still left with a picture of an economy that lost some steam over the back half of last year, and growth still looks set to undershoot the RBNZ's forecasts for 0.8% GDP growth over the quarter.

The NZD/USD rose 20bps to 0.6866 on the result.

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