Westpac Institutional Bank

17 November 2014

The price is right

NZ retail sales, September quarter 2014

- Real retail sales rose 1.5% in the September quarter, the biggest increase in over two years.
- The dollar value of retail spending has grown steadily over the last few years.
- But an unusually large fall in retail prices gave consumers more bang for their buck over the September quarter.
- The retail survey provides mixed messages for the Reserve Bank, to the extent that strong spending growth has been a product of low past inflation, rather than a harbinger of higher future inflation.

Seasonally adjusted real retail sales (% change)

	Quarter		Annual
	Jun-14	Sep-14	Sep-14
Supermarket and grocery stores	0.4	1.9	1.4
Specialised food	2.4	2.4	5.1
Liquor	-0.2	2.5	8.0
Non-store and commission-based	-1.4	-1.1	-15.4
Department stores	1.1	2.5	8.6
Furniture, flooring, houseware, textiles	-0.1	6.3	3.9
Hardware, building, garden supplies	1.2	1.4	5.0
Recreational goods	3.3	3.5	14.8
Clothing, footwear, and accessories	-2.0	-1.9	4.1
Electrical and electronic goods	2.3	0.3	11.6
Pharmaceutical and other retailing	0.6	0.6	3.0
Accommodation	6.5	-5.4	1.0
Food and beverage services	2.6	3.0	7.8
Core industries total	**1.2**	**1.4**	**4.5**
Motor vehicles and parts	0.4	1.4	6.6
Fuel	1.0	2.5	2.9
All industries total	**1.1**	**1.5**	**4.7**

New Zealand consumers have had several things going their way in the last few years. Moderate income growth, low interest rates and rising house prices have spurred on growth in the dollar value of household spending. Meanwhile, low global inflation and a rising exchange rate have depressed the prices of imported goods, giving buyers more bang for their buck.

These forces were on full display in the September quarter retail trade survey. Retail spending rose by 0.9% in nominal terms, as signalled by the monthly electronic card spending figures. That's more or less the average pace of quarterly growth over the last two years. But with retail prices down 0.6% for the quarter, that translates into a 1.5% rise in spending in inflation-adjusted terms, the biggest quarterly increase since June 2012.

This result was substantially stronger than the median market forecast for a 0.8% increase, though it was right in line with our forecast. We suspect that much of the surprise to the market came from the sharp drop in prices, which was markedly different from the already-published 0.3% rise in the Consumer Price Index.

There are two reasons for the differences between these price measures. The first is that the CPI includes a lot of non-retail items whose prices typically outpace the general rate of inflation, such as local body rates, housing construction, electricity and education. The second is that the retail trade survey is seasonally adjusted, while the CPI is not. So for instance, food prices were flat in the September quarter CPI – but normally they would rise by 1% or more over this period. So food prices were down sharply in seasonally adjusted terms.

While prices were unusually soft over the quarter, that's not to say that the growth in real spending was driven by bargain-hunting. The rise in sales was spread across 12 of the 15 major store categories. The largest positive contribution came from supermarkets (up 1.9%), which obviously benefited from the unusually low food prices this winter. But the next two biggest contributors were food and beverage services (up 3%) and fuel (up 2.5%), where prices were little changed in both cases. The storetypes that reported a fall in sales were clothing (a persistent underperformer despite falling prices), accommodation (reversing most of a 6.5% jump from the previous quarter) and the small non-store category.

There was strong growth across the durable goods categories, including a 6.3% increase in furniture and housewares and a 1.4% rise in hardware and building supplies. These two categories are linked to household formation/expansion, and their strength is perhaps another sign of the property market finding its feet again after the combined blows of higher mortgage rates and restrictions on high loan-to-value ratio home loans.

Implications

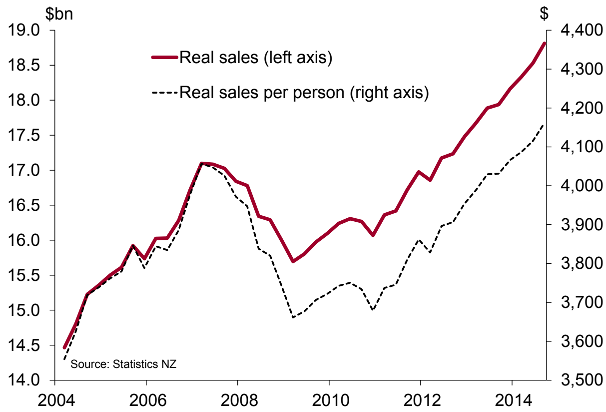
The retail trade survey was in line with our expectations and is consistent with our forecast of a 0.8% rise in GDP over the September quarter, Domestic demand has continued to grow strongly, and agricultural output - the lone weak spot in June quarter GDP – has subsequently rebounded. Together these support our view that the 0.7% growth in June quarter GDP will prove to be the low point for this year.

However, the result came as a substantial surprise to the rest of the market, pushing the New Zealand dollar 30 points higher to 0.7950. We suspect that this response may be unwound over time, as the market realises that the surprise was more about weak inflation than an unexpectedly buoyant consumer.

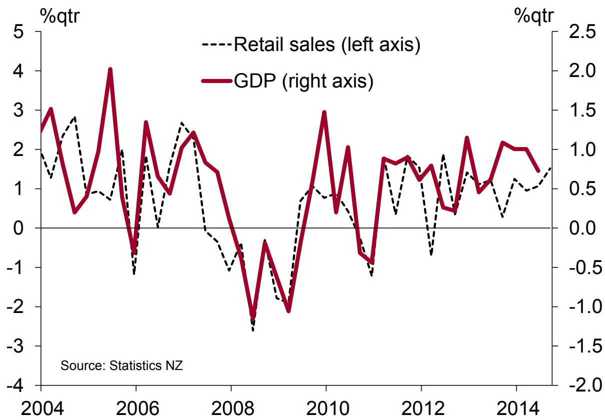
The lack of any interest rate response is a better reflection of the retail survey's mixed messages for monetary policy. The Reserve Bank, along with others, has been puzzling over the economy's ability to grow without generating any meaningful degree of inflation. Today's survey provides a reminder that the causation can also run the other way to some degree: falling retail prices have enabled the strong growth in real activity.

That also raises questions around the extent to which growth in real spending will be sustained, now that the long-running upward trend in the New Zealand dollar seems to have finally broken. Even if the exchange rate doesn't fall substantially further from here, it will no longer be acting to push import prices lower.

Retail sales volumes, seasonally adjusted



Retail sales volumes and GDP growth



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