

Spending growth eases back, prices subdued

NZ retail sales, March quarter 2016

- Following firm gains last year, retail sales growth has eased back. Nevertheless, spending remains healthy.
- Inflation remains low, helping households' budgets to stretch further.
- Households are taking on more debt, which has boosted spending but signals headwinds for longer term growth.

Seasonally adjusted real retail sales (% change)

	Quarter		Annual
	Dec-15	Mar-16	Mar-16
Supermarket and grocery stores	0.2	0.3	2.5
Specialised food	1.4	-3.8	-3.7
Liquor	1.4	-0.6	5.0
Non-store and commission-based retailing	4.9	10.2	35.3
Department stores	1.7	0.7	5.4
Furniture, floor coverings, houseware, textiles	0.9	-0.3	0.2
Hardware, building, and garden supplies	4.7	-0.1	7.8
Recreational goods	-1.6	0.8	-5.7
Clothing, footwear, and accessories	1.2	1.7	5.2
Electrical and electronic goods	2.2	3.8	14.9
Pharmaceutical and other store-based retailing	-0.3	0.5	2.5
Accommodation	4.4	1.1	3.3
Food and beverage services	0.7	1.3	5.1
Core industries total	1.3	1.0	4.7
Motor vehicles and parts	-1.5	0.2	4.7
Fuel	3.4	0.6	6.4
All industries total	1.1	0.8	4.8

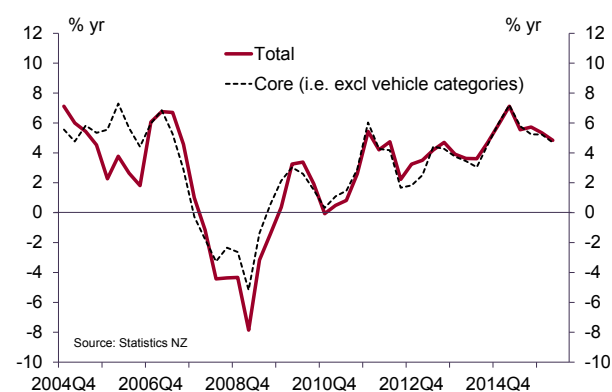
Spending growth has eased back, but remains firm...

Following solid gains through the latter part of 2015, retail spending growth eased off a bit in early 2016. Sales were up 0.8% in the March quarter (close to forecasts but a bit below market expectations), leaving them up 4.8% over the past year.

Some moderation in retail sales growth in early 2016 isn't too surprising. Late 2015 saw strong growth in spending on durable items such as hardware and furnishings, and it's normal to subsequently see a bit of a softening. Early 2016 also saw some softening in consumer confidence.

March saw continued gains in spending on items such as electronics, apparel, and non-store retailing (the latter will reflect increases in online purchases). There has also been strong growth in hospitality-related spending such as accommodation, a result that likely reflects the strength in tourist arrivals. All of this left us with a solid 1.0% gain in core spending over the quarter, with spending volumes up across 11 of the 15 retail categories.

Retail sales



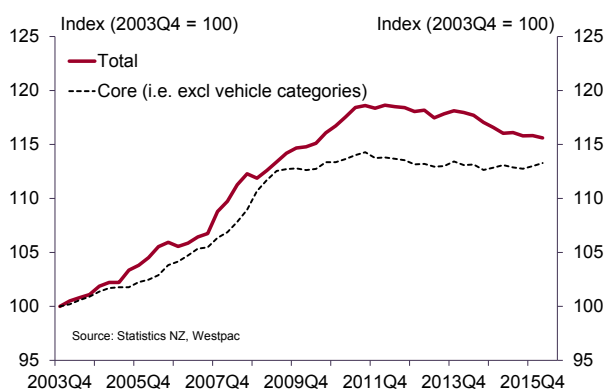
Growth in spending was heavily centred on Auckland, with most other regions experiencing only limited gains, or in some case declines in spending. However, the shift to online retailing may be skewing regional spending statistics. Many retailers are based in Auckland, which is where their online sales will be recorded, even though purchasers are located elsewhere in the country.

...while prices remain weak

While spending has been increasing at a solid clip, prices are still very subdued. Over the quarter, we estimate that retail prices were down 0.2%, leaving them down around 0.4% over the year.

A lot of the softness in retail prices is a result of falls in petrol prices. However, even excluding fuel, prices rose by only around 0.2% over the past year.

Retail prices



Domestic and external factors boosting spending, but longer term risks starting to appear

Gains in the volume of retail spending have been buoyed by a range of domestic and offshore factors. These include:

- Strong population growth and tourist arrivals, which together have boosted the economy's demand base;
- Softness in the prices of both domestically produced and imported items that has added to households' spending power;
- and very low interest rates.

That last factor is particularly notable. The low level of interest rates is allowing household budgets to stretch further. It's also contributing to strong gains in the housing market, with the perceived increases in households wealth also encouraging spending.

However, low interest rates and the strengthening in the housing market are generating a borrow-and-spending dynamic in the economy, which has seen household debt rising to record levels. And while that's helping to support spending now, it signals downside risk over the latter part of the decade. Increases in debt can't boost spending indefinitely, with larger increases in borrowing now requiring larger reductions in spending in the future.

In addition, higher debt levels mean that households are exposed to unfavourable changes in economic conditions. With that in mind, we're very conscious that the latter part of this decade is likely to see two of the main drivers of growth in recent years – spending associated with the Canterbury rebuild and strong population growth – both easing off.

Putting it all together, this leaves us with a firm outlook for household spending over the coming year, but downside risk further ahead.

Implications

While spending remains firm, the lingering softness in retail prices underscores the need for a further reduction in the OCR (especially with the NZD continuing to defy gravity).

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