

A bit damp

NZ retail sales, December quarter 2016

- Modest spending growth in December, following a similar gain in September.
- We expect spending growth will ease off in 2017, but still remain healthy.
- Price growth still low, but has picked up.
- Auckland has enjoyed the strongest spending growth over the past year, but gains have been widespread. The exception is Canterbury, where the wind-back in rebuild spending is providing a drag.

Seasonally adjusted real retail sales (% change)

	Quarter		Annual
	Sep-16	Dec-16	Dec-16
Supermarket and grocery stores	0.1	-0.5	0.1
Specialised food	0.6	1.0	0.5
Liquor	0.2	1.9	3.4
Non-store and commission-based retailing	-5.2	-5.6	2.0
Department stores	-0.5	0.3	2.2
Furniture, floor coverings, houseware, textiles	0.2	3.6	8.6
Hardware, building, and garden supplies	1.4	1.3	5.6
Recreational goods	3.3	2.1	4.1
Clothing, footwear, and accessories	-1.8	-2.0	1.0
Electrical and electronic goods	0.0	2.0	9.2
Pharmaceutical and other store-based retailing	-0.6	2.5	7.4
Accommodation	3.5	3.5	6.9
Food and beverage services	0.2	-0.1	5.1
Core industries total	0.2	0.6	3.8
Motor vehicles and parts	3.1	1.9	7.6
Fuel	2.5	0.9	2.3
All industries total	0.8	0.8	4.2

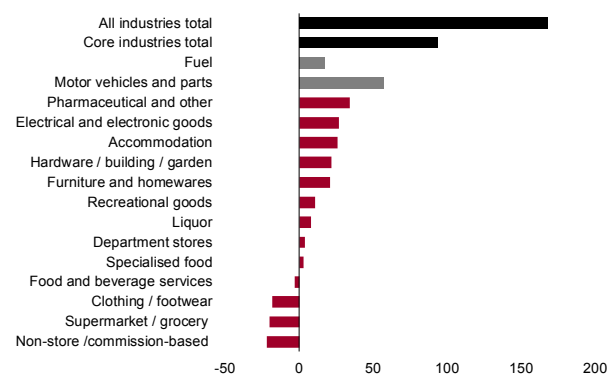
A damp end to 2016...

There was only modest growth in retail spending in the December quarter, with sales volumes up 0.8%. That was below market expectations for a 1.0% gain. In addition, much of December's increase related to the volatile vehicle and fuel categories. Excluding these groups, spending was only up 0.6%. These results follow similar modest gains in the September quarter.

Weighing on spending in December were falls in the supermarket and apparel categories. In the case of the latter, softness in spending may reflect the uninspiring summer weather in late 2016.

On the plus side, the strong tourist season continues to be a key support for growth, with solid gains in spending on accommodation and in the "pharmaceutical and other store-based" category, which includes duty free stores. Strong housing market activity over the past year has also been an important driver of spending growth, with continued gains in areas such as furnishing, electronics and building supplies.

December quarter spending by category (volumes)



...but we're still left with a relatively positive picture for spending

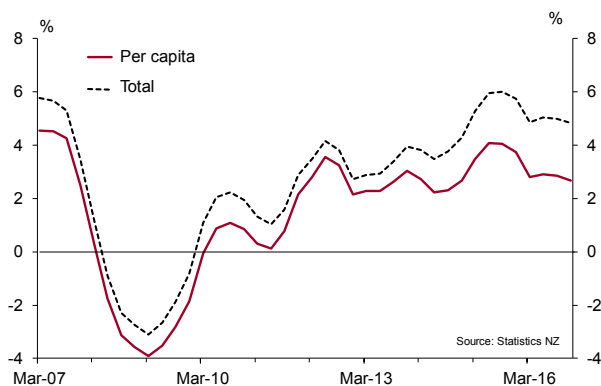
While spending growth in the past two quarters has been moderate, this follows strong gains earlier in the year. Over the year as whole, we saw a solid 4% lift in spending volumes.

So how concerned should we be about the slowdown in spending through late 2016? One of the big drivers of spending in recent years has been low interest rates and the related strength in house prices. This has been a particularly large driver of spending on durable household items like furniture.

In recent months, interest rates have risen and house price growth has pulled back. We expect that this will result in more moderate household spending growth over the coming year. Nevertheless, spending growth is likely to remain healthy. Interest rates are still at relatively low levels, population growth is very strong, and we've enjoyed a strong tourist season.

Even adjusting for population growth, spending growth isn't looking too bad. In fact, it's remained steady at relatively firm rates for several years now.

Core spending growth (annual)



Prices up, but will we see continued gains?

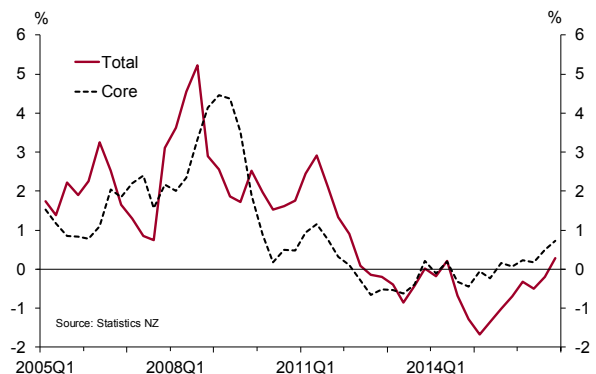
The past year has also seen some changes on the pricing front. We estimate that core retail prices rose 0.7% over 2016. While that's still quite low, it is the fastest rate of increase in five years.

Softness in prices has been a key factor that has supported spending in recent years, and this will be a key area to watch over the coming months. The rise in retail prices that we saw over 2016 will have been strong influenced by earlier falls in the NZD (due to factors like exchange rate hedging and stock cycles, it takes some time for exchange rate movements to feed into prices on shop floors). More recently, the NZD has rebounded, while global inflation has

remained muted. This signals a period of continued softness in the prices of imported consumer goods.

There are a few more uncertainties around the domestic pricing environment. Spending in the New Zealand economy has picked up in recent years, and we expect it to remain firm for some time. This may give retailers some scope to expand margins. But this must be balanced against competitive pressures in the retail sector, which remain fierce, especially given the increase in online competition in recent years and the strong NZD, which have added to competition from imports.

Retail price inflation (annual)



Regional trends

Spending gains in the December quarter were widespread, with most regions recording some up-tick. The strongest gains were seen in the Waikato and South Island areas outside of Canterbury.

One factor that disrupted spending in the December quarter was the Kaikoura earthquakes, which struck in mid-November. These events have resulted in ongoing disruptions to economic activity in some smaller centres, especially as tourist accommodation has been damaged. We also saw some businesses in Wellington lose a number of trading days.

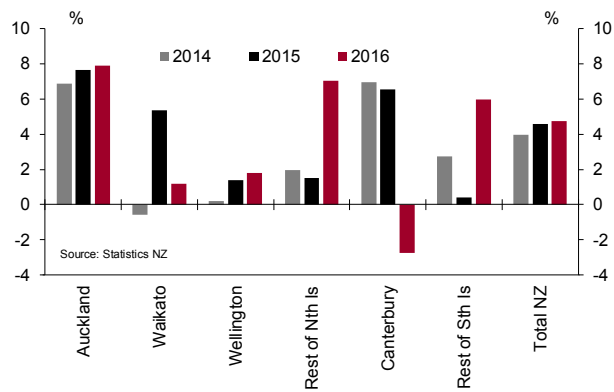
But without diminishing the significance of these events, the impacts on overall spending have been relatively limited over the quarter, with spending in Wellington and in the South Island continuing to climb (though some of these gains will likely reflect that many households have had to replace damaged household items).

Looking at the trends in spending over the past few years, the strongest growth has been in Auckland, where we have also seen the strongest population growth. We've also seen spending growth accelerating in smaller centres across both the North and South Island.

Spending in Wellington continues to climb at a modest, but steady pace. The concentration of government services in the Capital provides it with some insulation from large swings in the economic cycle. Hence, while it hasn't seen the strong growth that areas like Auckland have experienced, it also tends to avoid large downswings.

Spending in Canterbury is experiencing a different trend from the rest of the country. After very strong increases in recent years, spending levels have been pulling back. That was to be expected. For the past few years, reconstruction following the earthquakes in 2010 and 2011 boosted incomes, and high levels of home construction saw increased spending in areas like furnishings and building supplies. Activity in Canterbury remains strong, but the residential rebuild is now past its peak, and as home building eases back we're also seeing some pass-through to spending.

Annual spending growth by region



Satish Ranchhod
Senior Economist

Contact the Westpac economics team

Michael Gordon, Acting Chief Economist +64 9 336 5670

Satish Ranchhod, Senior Economist +64 9 336 5668

Sarah Drought, Economist +64 9 336 5696

Any questions email: economics@westpac.co.nz

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