Retail Outlook

November 2011

A patchwork economy

Recent economic data have been underwhelming, with the Rugby World Cup a mixed blessing. Meanwhile the global environment has continued to deteriorate. We continue to expect a substantial boost to economic growth from Christchurch reconstruction. But growth in household spending is likely to stay subdued given global uncertainties and the eventual need for rising interest rates.

New Zealand's economic recovery has continued, but patchily. Over late 2010 and early 2011 the economy grew fairly rapidly, as farmers enjoyed favourable climatic and market conditions, the housing market started to improve, and consumers cautiously started to spend again. In fact (as we detail in our Retail Roundup on page 3) retail trade expanded at a fairly healthy pace through the middle of the year. But overall growth disappointed in the June quarter, as a sharp drop in tourist numbers contributed to lower spending on recreation and leisure, the construction industry continued to languish, and non-primary manufacturing struggled as well.

Since June the tables have turned, with domestic spending showing signs of a renewed slowdown, while the Rugby World Cup (RWC) lifted tourist spending in September-October. It's too early to tell for sure, but (as we detail in the box over the page) the impact of the RWC on overall spending has been disappointing, with some displacement and disruption as well as stimulus. But there are other reasons for a domestic slowdown as well. In particular, a growing number of New Zealanders have been leaving for better fortunes across the Tasman (though with the Australian economy looking less rosy, that tide may soon turn). And in quake-disrupted Canterbury, spending entered a lull after a partial rebound in April, and continues to be well below pre-February trends. That said, very recently there have been signs of renewed economic life in the region. Reconstruction is still in its very early stages, but building consents have picked up since the government announced its compensation package for homeowners in the devastated 'red zones'. Business and consumer confidence are now higher in Canterbury than in the rest of the country, and spending in the region saw a bit of a lift in September-October.

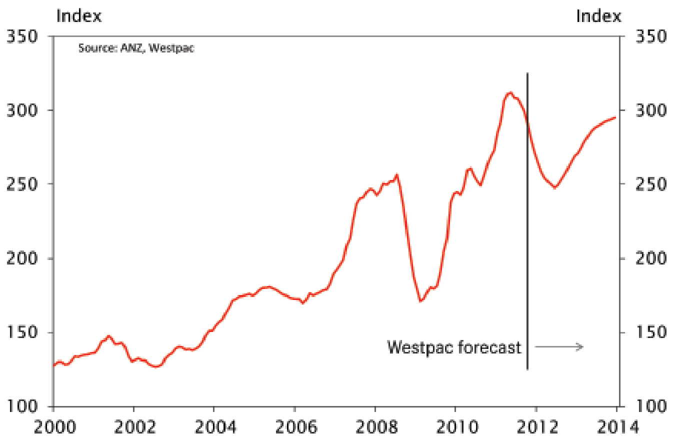
At the same time the storm clouds hanging over the global economy have continued to darken. Whichever way the European sovereign debt crisis gets resolved, a full-blown recession in Europe now looks likely. The US economy will probably stay in expansion mode, but only just, as policy makers muddle through with interest rates close to zero and increasing use of creative monetary policy tools. At the same time there are now clear signs of a cyclical slowing in large parts of Asia after a period of rampant growth, and Australia is struggling with the tension between a booming mining sector and a household sector squeezed between rising costs and falling house prices.

In our previous *Retail Outlook* we outlined some of the key ways in which global developments could affect New Zealand. One is confidence: business confidence has taken quite a sharp dip in the past few months, though as we report on page 4, consumer confidence has so far held up better. Another channel is commodity prices and exports. Dairy prices are well off their peaks, and meat and wool prices are likely to head lower as well. It's clear that the world has become far less supportive of New Zealand exporters of all stripes: not just commodity exporters, but also the manufacturers and tourism operators exposed to the chilly blast coming from non-mining Australia. Angst-ridden global markets are also potentially bad news for a credit-reliant nation such as New Zealand. There are early signs that global markets are demanding a higher premium for lending to banks, and if this persists the wedge between the Reserve Bank's Official Cash Rate and mortgage rates could widen. We think the deteriorating global backdrop was also a key reason for the ratings agencies' decision to lower New Zealand's credit rating in September, which along with lower global growth will give any post-election government less room to move than it might like.

It's not all bad news: as an interesting side-effect from the Australian slowdown, we will probably see more New Zealanders thinking twice before moving across the Tasman. Historically, New Zealand's migration rate has depended crucially on job prospects in Australia. Those are already looking shakier than they did a few months back and are likely to deteriorate further over the coming year. Combined with the draw on construction workers in Christchurch, that's enough for us to expect the migration tide to turn sharply in New Zealand's favour over the next couple of years.

We also expect monetary policy and the exchange rate to play a buffering role against the slowing world economy. The NZ dollar is being buffeted by the swings of market sentiment, but where commodity prices go the exchange rate tends to go as well, and we continue to expect it to trend down over the next six months, shifting some of the pain from exporters to consumers. And the Reserve Bank has signalled that it will watch and wait as the European crisis unfolds. With the economy already slightly softer and inflation a bit lower than the RBNZ expected a few months ago, it has time on its side to keep rates on hold for now.

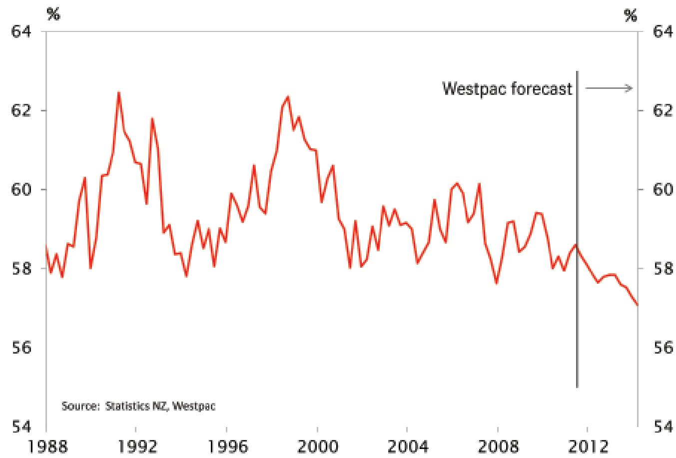
New Zealand's export commodity prices



Looking further ahead two key pillars of our economic outlook remain in place. We continue to view the coming declines in commodity prices as temporary setbacks to a powerful longer-term trend of rising food prices and hence higher export incomes – the graph above puts our forecast in perspective. And the rebuilding of Christchurch will inject reinsurance payments and already earmarked government money into the economy, regardless of global developments. The timing of the rebuild is very uncertain, but the inflow of a vast sum of money is not. That means that we still expect the economy to grow rapidly next year: even a slow initial trickle of the roughly $20bn of reconstruction spending that we now expect is enough to push annual growth to over 3.5% by the end of 2012.

But we do expect this growth to be uneven, with some regions growing more strongly than others and consumer spending playing a relatively minor part overall. All the construction activity we expect will create bottlenecks, labour shortages and cost increases. That means that interest rates will eventually have to rise from currently very low levels, even in the face of a sluggish global economy – and along with global uncertainties, that's likely to keep a lid on the housing market, borrowing, and household spending. Because of the size of the coming income boost, we still think that consumer spending has room to expand, even as households continue paying down debt – but more slowly than overall GDP. As in Australia during the recent mining boom, a patchwork economy is likely to continue to be the theme for the next couple of years.

Nominal consumption (share of GDP)



A game of two halves?

We won't know for a few more months what the Rugby World Cup's total impact has been, but it's becoming increasingly apparent that the event has both generated and displaced economic activity. It has certainly brought in the numbers – in September and October there were around 80,000 more overseas tourist arrivals compared to last year, and more than 30,000 Kiwis stayed at home instead of travelling overseas. And electronic cards data show that the visitors have been spending. In total, card spending rose about $100m over those two months, with a large chunk of extra spending in cash likely.

But we suspect that some of this spending has simply been squeezed into the RWC period at the expense of surrounding months. For example, recreation and leisure spending was a standout area of weakness in the June quarter GDP figures, possibly due to local and foreign rugby fans alike postponing spending until the RWC. Then there was the postponement of school holidays to October to coincide with the Cup finals, which may have helped boost October spending at the expense of September (even in non-game hosting regions). By the same token we could see a bit of a hangover during the summer holiday season.

The RWC also appears to have primarily boosted spending by foreign visitors, while local spending has been more subdued. That may reflect an underlying slowing in the domestic economy, or displacement of spending not related to the Cup – that will become clearer once we have post-event data. Certainly, some business surveys have cited the RWC as a disruptive factor on balance. Other evidence so far has been mixed. Housing turnover fell in September in game hosting cities such as Auckland, Hamilton and Wellington, but sales data from Barfoot & Thompson showed Auckland house sales rebounding in October. And while new car sales came off sharply in September-October, used car sales have held up rather better. The sector most likely to have been disrupted by the RWC is non-Cup related tourism and hospitality spending (e.g. conferences) – total card spending on hospitality was rather less buoyant in October than we might have expected.

Westpac

Retail Roundup

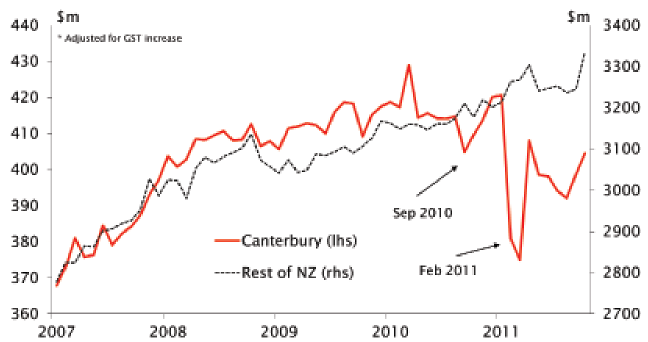
New Zealand's retail recovery has continued at a moderate pace, albeit with some significant one-off factors clouding the picture in recent quarters, most recently the Rugby World Cup.

A partial rebound in Canterbury following February's earthquake assisted a solid 0.9% rise in retail sales volumes in the June quarter, led by cars and other durables such as electronics. On the softer side, food sales were about flat, hardware supplies were down 1.6%, and fuel volumes fell 4% in response to higher prices. Non-store and commission-based retailing – a category that surged in March after the February earthquake put many stores out of action in Christchurch – fell by 5%, but was still up 25% on a year ago.

Electronic transactions data suggest that momentum in spending has tailed off since June: 'Core' (ex-fuel and cars) electronic transactions were 1.1% higher over the three months to September, compared to a 2.8% lift the previous quarter. The Rugby World Cup does appear to have given a bit of a boost to spending, with transactions up 0.4% in September and 1.8% in October. But data from Paymark and the RBNZ indicate that the bulk of spending was on overseas cards, offsetting flat local spending. And the boost to hospitality spending, specifically, has been disappointing. (That said the retail trade figures may well end up being stronger than indicated by the cards data, given that tourists tend to spend a higher proportion of cash than locals.)

Paymark data indicate the slowdown has been geographically quite wide-spread, with a notable slowing in Auckland, which grew particularly strongly in the first half of the year. One exception is Canterbury, where there's been a sizeable pickup in card spending over the past two months, despite the region not hosting any games. That change of direction is encouraging, but the level of spending in Canterbury remains well below national trends.

Paymark card transactions, s.a.*



Retail sales volumes (seasonally adjusted)

Industry	$m	Quarterly % chg			Ann % chg
	Jun-11	Dec-10	Mar-11	Jun-11	Jun-11
Supermarket and grocery stores	4,136	1.6	-0.6	0.2	1.1
Specialised food retailing (excluding liquor)	303	1.5	-0.3	-6.3	-7.6
Liquor retailing	317	0.3	-1.3	2.7	-3.1
Non-store and commission based retailing	210	-0.5	38.5	-4.9	25.8
Department stores	930	-0.1	-0.2	1.4	0.8
Furniture, floor coverings, housewares and textile goods retailing	433	-9.8	8.8	0.5	-2.5
Hardware, building and garden supplies	1,124	-2.7	0.1	-1.6	-4.3
Recreational goods retailing	490	0.2	0.8	5.4	7.0
Clothing, footwear and personal accessory retailing	886	1.9	0.4	0.8	4.1
Electrical and electronic goods retailing	735	-1.0	5.8	10.0	19.9
Pharmaceutical and other store based retailing	1,131	-1.7	1.2	4.0	2.8
Accommodation	612	-2.0	-3.1	0.5	-4.5
Food and beverage services	1,657	0.9	1.4	0.4	2.8
Core industries total	**12,963**	**-0.1**	**1.0**	**1.0**	**1.8**
Motor vehicle and parts retailing	2,060	-8.2	6.3	4.2	3.5
Fuel retailing	1,558	6.4	-3.9	-4.2	-7.0
All industries total	**16,581**	**-0.5**	**1.1**	**0.9**	**1.1**

Electronic card transactions values (seasonally adjusted)

Industry group	$m	Monthly % chg			Ann % chg
	Oct-11	Aug-11	Sep-11	Oct-11	Oct-11
Consumables	1,466	-0.2	0.6	-0.2	6.3
Durables	987	-2.1	1.0	0.5	5.2
Hospitality	621	-0.6	1.2	0.6	10.8
Services	166	0.0	0.9	1.3	7.9
Apparel	291	-2.0	2.2	4.8	10.0
Core retail	**3,382**	**-1.0**	**0.6**	**0.9**	**6.9**
Motor vehicles excl. fuel	107	0.0	0.0	0.8	6.5
Fuel	615	2.3	3.1	4.0	13.7
Retail	**4,099**	**-0.6**	**0.7**	**1.5**	**8.0**
Non-retail excl. services	1,154	-0.5	-0.5	2.5	5.6
Total	**5,421**	**-0.4**	**0.4**	**1.8**	**7.3**

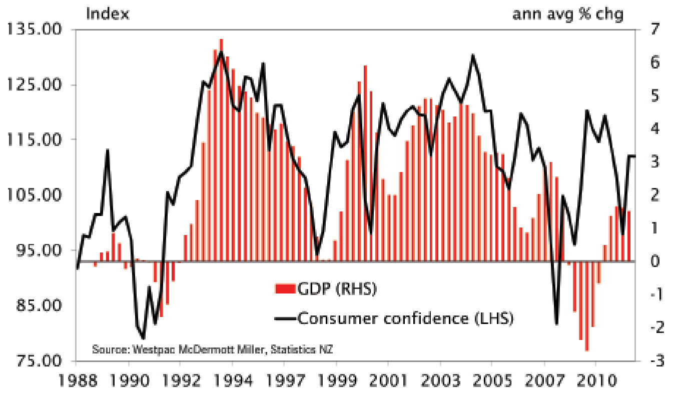
new zealand Retailers association

Consumer confidence holding up

Consumer confidence held up at 112 in the September quarter, despite a deteriorating global economic and financial outlook. New Zealanders have become less optimistic for the longer term, but economic confidence for the year ahead continued to improve. Confidence was strongest in Canterbury and agricultural exporting regions.

Consumer Confidence Indices[1]

	Jun-11	Sep-11	Change
Consumer Confidence Index	112.0	112.0	0.0%
Present Conditions Index	103.9	105.7	1.8 %
Future Conditions Index	117.4	116.3	-1.1%



The Westpac McDermott Miller Consumer Confidence Index was unchanged at 112 in the September quarter. That leaves the Index higher than in December, though still well below mid-2010, before confidence was hit by last year's economic slowdown and the September Canterbury earthquake. (Survey interviews were conducted over 1 – 12 September. An index number over 100 indicates that optimists outnumber pessimists, though the series may be above or below 100 on average. The margin of error is 2.5% at a 95% confidence interval.)

While households' expectations of future conditions were slightly less optimistic than in June, their assessment of present conditions improved a touch. That said, the underlying details show that the economic situation of many households continues to be challenging. Households' view of their personal financial situation remains fairly downbeat, with a net 19% thinking their financial situation has deteriorated over the past year. The reason for the improvement in the Present Conditions Index was a greater sense among households that now is a good time to buy big-ticket items – a possible reflection of the ongoing strength in the NZ dollar and currently low interest rates, which are pushing down the cost of buying those items.

Looking ahead, there was an interesting divergence between the near-term and longer-term outlook. Respondents' expectations for their own financial situation in a year's time became a bit more optimistic, and there was also a lift in their near-term economic outlook – though a net 2% of respondents continue to be pessimistic for economic prospects in a year's time. But the longer-term economic outlook, for the next five years, dipped quite sharply. A net 41% of respondents remain optimistic, but that's down from 50% in June, and the last time we saw numbers as low as this was immediately after the February Christchurch earthquake and in September 2008.

The survey was taken just before the Rugby World Cup, and it's likely that the outlook for the year ahead reflected an anticipated boost to growth from that event, as well as from the accelerating Christchurch rebuild next year. The deterioration in the longer-term economic outlook could reflect a number of things. It may be that global concerns are starting to weigh on households' perceptions of longer-term economic prospects. Some of the longer-term costs of the Christchurch earthquake (such as higher insurance premia and the hit to government finances) may also have started to sink in. But the overall degree of optimism remains a lot higher than it was in the period leading up to the financial crisis. We'd been wondering whether confidence might take a hit from the bad economic news coming from offshore, and overall the September survey didn't give a strong sense of that.

The survey's regional breakdown showed a growing divergence in overall consumer confidence between regions directly benefiting from the twin growth drivers of Christchurch reconstruction and high agricultural export incomes, and much of the rest of the country. Consumer confidence in the September quarter was highest in Canterbury, Southland and Taranaki, but declined in most of the North Island, particularly in Auckland and Wellington.

Consumer confidence by region

Region	Mar-11	Jun-11	Sep-11
Northland	90.9	105.4	104.4
Auckland	101.6	115.4	111.4
Waikato	103.4	112.5	112.2
Bay of Plenty	95.2	111.1	110.4
Gisborne/Hawke's Bay	94.2	108.8	109.3
Taranaki/Manawatu-Wanganui	97.1	109.7	115.9
Wellington	101.6	116.6	111.5
Nelson-Marlborough/West Coast	91.1	98.2	110.8
Canterbury	90.4	112.0	116.4
Otago	97.4	103.4	104.3
Southland	92.8	111.3	124.0

1.The Present Conditions Index is an average of responses to the questions regarding current personal financial situation and readiness to buy major household items. The Future Conditions Index is an average of responses to questions regarding next year's personal financial situation, the 1-year economic outlook, and the 5-year economic outlook.

Westpac