

# Retail Outlook

January 2010

## Let the real growth begin

- NZ in recovery mode (*front page*).
- Durable spend to outperform (*inside*).
- Consumers still optimistic (*back page*).

Third quarter GDP figures released late last year confirmed that NZ crawled its way out of recession through the middle of 2009. Economic activity expanded by 0.2% in both the June and September quarters (the June quarter was revised up from the previously reported 0.1%). Even so, economic and business conditions probably 'felt' worse than at any time during the recession. We estimate that the level of activity hit its lowest point relative to its trend in the third quarter.

As we head into 2010, our positive outlook for growth remains unchanged. If anything, we have gained more confidence in our view. The global economy has continued to recuperate over the past few months, as reflected in the continued upward revisions to growth for our major trading partners. While the risks and uncertainties remain large, particularly amongst the developed world, the good news for NZ is that China is now the global growth powerhouse, pulling South-East Asia, Australia and the resource economies with it. Global GDP contracted by an estimated 0.8% in 2009, but we expect growth of 3%+ in 2010.

Domestically, the economic indicators are also telling a convincing story of recovery. The very low level of residential

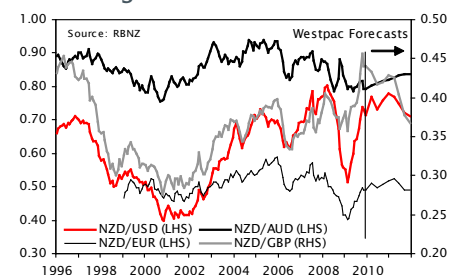
construction activity in the September 2009 quarter (some 36% lower than in late 2007) and the gains in dwelling consents to date (up 45% since January) suggest the construction sector, along with the goods producing sector, will make a strong contribution to economic growth in 2010.

Consumer spending is also shaping up for a better year, with our forecasts suggesting above average growth in real spending (see our *Feature* article for more detail). Add in the better starting point for dairy farmers, with world prices for milk powder up 81% since July, and the likelihood a strong positive contribution coming from an inventory rebuild (the rundown in stocks through 2009 was the largest seen since at least the late 1980s) and 2010 is set to produce the strongest growth in a calendar year since 2004. GDP growth of 3.7% is forecast for calendar 2010, following an estimated 1.4% contraction in calendar 2009. In calendar 2011, growth is projected to reach 4.3%, as investment and consumer spending growth continue to strengthen.

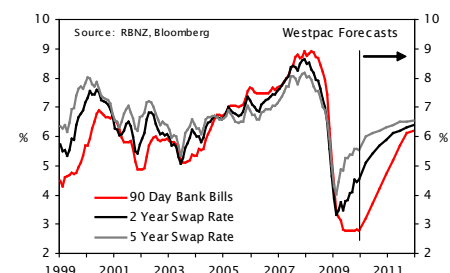
Together, the clear improvement in economic conditions means that the RBNZ will need to begin normalising interest rate settings sooner rather than later to avoid inflation getting away on them. Indeed, the RBNZ virtually accepted as much in the December *Monetary Policy Statement*, altering the final line of the media release from "we expect to keep the OCR at the current level until the

second half of 2010" to "conditions may support beginning to remove monetary stimulus around the middle of 2010". The RBNZ has indicated that the timing of hikes is data-dependent, and given the shape of their near-term forecasts we think there is plenty of scope for upside surprises in coming months. We are picking an earlier kick-off to the tightening cycle, possibly March or April 2010. From there, we expect a rapid and protracted period of interest rate hikes, with the OCR reaching 6% by end 2011. Note though that we expect retail interest rates, both deposit and lending, to rise independent of the OCR as banks adapt to the RBNZ's new liquidity policy.

**NZ exchange rate**



**NZ interest rates**



# What's in store?

Data at the end of 2009 confirmed that New Zealand is finally pulling itself out of the economic mire and that a recovery is on its way. The good news for retailers is that stronger consumer spending is expected to play a significant role in the recovery process. In this article, we discuss the outlook for consumer spending, including which areas of spending are likely to benefit most.

Economic indicators are telling a convincing story of recovery for consumer spending in 2010. Consumer confidence remains elevated, and at current levels points to the pace of consumer spending growth picking up substantially over the first half of this year (Figure 1). Net migration is also high, with the annual net inflow likely to exceed 21,500 at the end of 2009, compared with 3,500 in December 2008. We expect annual net migration to peak in early 2010, and slow to around a net 10,000 by the end of the year. Even so, more people overall means more spending.

Importantly, job prospects are starting to look healthier, with recent surveys indicating that the healing process in the labour market has already begun. Business surveys reveal that hiring intentions are on the rise, albeit still at low levels, while the Westpac McDermott Miller Employment Confidence Index rose further in December as employees

assessment of current conditions improved for the first time in two years. Our forecasts see the unemployment rate peaking at 6.7% in March 2010 before easing back gradually over the remainder of the year. Note that this is substantially better than estimates at the beginning of 2009, when many forecasters were picking a rise in the unemployment rate to somewhere between 7.5% and 8%.

The rebound in the housing market over the last nine months will also play a key role in helping to boost spending. House prices are almost back to the peak levels reached in late 2007, while dwelling consents suggest that a residential building boom is currently underway. Rising house prices help to make homeowners feel wealthier thus increasing their propensity to spend and, to a degree, will spur spending on housing-related goods. New home building will be a boon to spending on the latter.

Finally, mortgagors are continuing to get more cash in hand as they roll off high fixed-term mortgage rates (and contrary to a popular belief, they are no more vulnerable than usual to interest rate hikes; the fraction of loans on floating rates is actually less than at the start of previous tightening cycles). We estimate that debt servicing costs will continue to fall through 2010, despite our expectation that the RBNZ will begin lifting the OCR from March or April. Debt servicing costs fell from around

17% of household disposable income in October 2008, to 13.3% in October 2009. We estimate a further fall to 13% by September 2010.

Overall, we expect real consumer spending (i.e., after removing the effects of inflation) to grow by 3.6% in the year ended December 2010 and a further 3.0% in the year to December 2011. That follows a 1.2% contraction in 2009, and is above the average growth rate of 2.7% experienced over the past 20 years.

## Winners and losers

As in every recovery there will be winners and losers. In the retail sector, we expect growth in durables-related spending (e.g., clothing and footwear, cars, white-ware, and other big ticket items) to outperform non-durable (food and beverages, electricity, petrol, oil, medical goods) and services-related consumption. As Figure 2 illustrates, while durable spending benefited the most from strong economic growth through the mid 2000s, it also took the brunt of the decline through the down-turn. Non-durable spending also suffered, but to a lesser extent than durables, while services-related spending managed to hold its own, eking out small gains through most of 2009. Overall we expect durable spending to outperform through 2010 as a replacement cycle gets underway, and more importantly as spending on cars begins to normalise (real spending on motor vehicles fell 23% y/y at the height of the recession).

Figure 1: Confidence and spending

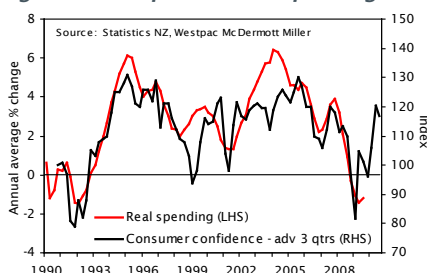


Figure 2: Spending by purpose

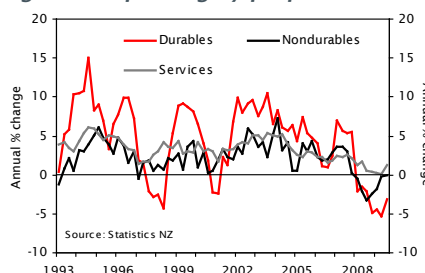
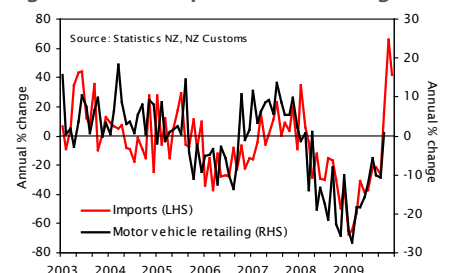


Figure 3: Car imports and retailing



**Data roundup**

Retail sales finally found a base in the third quarter of 2009 (the latest official quarterly data available), albeit at a very low level. Sales volumes (i.e., sales excluding the effect of prices) posted a 0.1% gain in the quarter, building on the 0.5% increase in the June quarter. Excluding the auto sector, sales volumes rose 0.5% in the quarter.

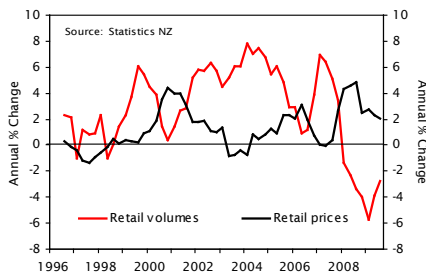
The housing market played a key role in bolstering sales volumes over the quarter,

with solid gains reported in appliance, furniture and floorcoverings, and hardware sales. Clothing and footwear sales also made a large contribution, as did accommodation – the latter receiving a boost from strong tourism flows during the quarter. Offsetting some of the strength in these sectors were large declines in vehicle and department store sales. Overall, the level of retail activity remains extremely low, with sales volumes down 2.9% on a year ago. On a per capita basis, the picture is even

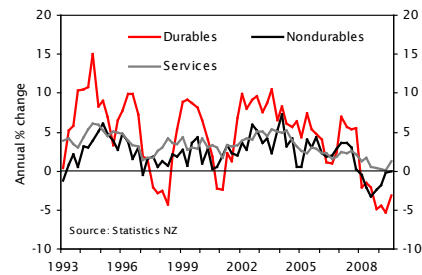
worse, with sales actually falling in the quarter to remain 8.7% below their 2007 peak.

More recently, core retail sales were robust over October and November, rising 0.5% and 0.8% respectively. Volumes must have been very strong indeed, when one considers that prices actually fell over the fourth quarter of 2009. The strongest sectors have been department stores, other retailing (gardening supplies, jewellery, and used good), and liquor.

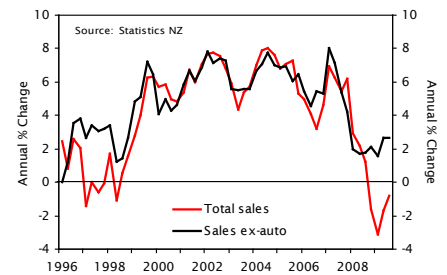
**Retail volumes vs prices**



**Per capita real retail sales**



**Sales total vs ex-auto**



**Retail Sales actual (\$ millions)**

Storetypes	Months			Quarters		
	Nov-08	Nov-09	Annual % change	Sep-08	Sep-09	Annual % change
Supermarkets and Grocery	1,255	1,309	4.3	3,447	3,732	8.3
Fresh Produce	87	77	-10.7	232	241	4.1
Liquor	103	111	6.9	293	293	0.0
Other Food	63	62	-1.8	189	199	5.3
Takeaway Food	103	111	8.1	312	335	7.5
Department Stores	328	335	2.0	885	818	-7.5
Furniture and Floor Coverings	121	109	-9.5	346	323	-6.8
Hardware	133	136	2.2	331	335	1.4
Appliance	200	220	9.8	619	659	6.5
Recreational goods	191	209	9.4	500	541	8.1
Clothing and Softgoods	210	222	5.5	602	629	4.5
Footwear	37	36	-1.5	101	104	3.2
Chemist	159	156	-1.9	463	464	0.0
Household Equipment Repair	28	31	10.2	94	94	0.1
Other Retailing	268	277	3.6	666	659	-1.0
Accommodation	231	227	-1.5	586	562	-4.1
Bars and Clubs	104	102	-1.7	315	285	-9.4
Cafes and Restaurants	319	351	10.1	930	939	1.0
Personal and Household Goods Hiring	18	19	3.6	53	57	7.1
Other Personal Services	148	154	4.4	447	445	-0.3
<b>Subtotal</b>	<b>4,106</b>	<b>4,256</b>	<b>3.6</b>	<b>11,411</b>	<b>11,717</b>	<b>2.7</b>
Motor Vehicles	563	546	-2.9	1,806	1,646	-8.9
Automotive Fuel	545	524	-3.8	1,897	1,561	-17.7
Auto Electrical, Smash Repair, Tyres	115	121	4.8	366	374	2.1
Automotive Repair and Services	158	171	8.2	496	525	5.9
<b>Total</b>	<b>5,487</b>	<b>5,618</b>	<b>2.4</b>	<b>15,976</b>	<b>15,822</b>	<b>-1.0</b>

# Consumers fine-tune expectations

The Westpac McDermott Miller Consumer Confidence Index fell modestly in the December 2009 quarter, to 116.9 from 120.3 in September. An index number over 100 indicates there are more optimists than pessimists, while a number under 100 indicates that pessimists outnumber optimists. The margin of error in the survey is 2.5% at a 95% confidence interval.

In the September quarter, consumers regardless of age, income group, gender, or region, were convinced that good times were on their way and confidence soared to a four-year high as a result. The last three months have seen a small adjustment in the extent of that euphoria, but overall confidence remains high – and certainly well above the long-run average. At current levels, confidence is indicative of solid growth in consumer spending through the December quarter. We expect real consumer spending to grow by 1.3% in the December 2009 quarter, the strongest gain since the March 2007 quarter. These data support that view and should provide some relief to retailers.

Four of the five component questions registered falls this quarter, the biggest declines coming from the three questions regarding future conditions. A net 52.4% of respondents still expect good economic times over the next five years, but that is down from the euphoric net 62.8% in September. Optimism toward the short term economic outlook has also been reassessed, with a net 14.4% saying there will be good economic times in the coming year compared to a net 17% last quarter. Nevertheless, this is the second highest response to this question since December 2006.

The other downward move this quarter was in consumers' assessment of their financial position in a year's time. While a net 19.6% of consumers anticipate that the coming year will be more profitable, that is down from the seven year high of a net 24.3% reached in the September quarter. Perhaps consumers are coming to the realization that a stronger economy in the future also means higher interest rates, thus tempering the improvement in disposable incomes they had previously anticipated.

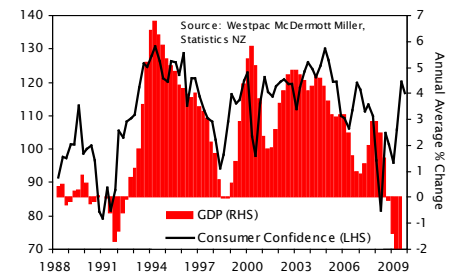
Responses to the two questions regarding present conditions showed more resilience through the quarter. In fact, perceptions around current financial conditions actually improved. A net 20.9% of respondents still say they are worse off financially now compared to a year ago, but that better than the net 21.9% expecting to be worse off in September, and is far better than the net 40.7% saying they were worse off in June last year. Even so, consumers remain wary about buying big ticket items. Only a net 18.9% of respondents say now is a good time to buy major household items – broadly unchanged from September's net 19.2%.

By region, confidence has been hit the hardest in the secondary and rural areas, with Otago, Waikato, and Southland registering the biggest declines. That is somewhat surprising given the large upward revision to Fonterra's dairy payout for the current season. Less surprising is that confidence is the highest in Auckland and Wellington where gains in house prices have been strongest.

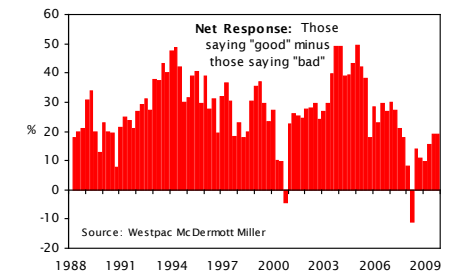
By gender, males (120.1) are still more optimistic than females (113.0), although the gap between the two closed during the quarter. By age, all groups recorded declines, although the 50+ age group

saw the biggest decline and is the least optimistic group. In terms of socio-economic grouping, the upper income groups remain the most optimistic, but again all groups recorded declines compared to the September 2009 quarter.

Consumer Confidence and GDP



Buying a major household item



Regional Consumer Confidence

	Dec-08	Sep-09	Dec-09
Northland	98.8	109.2	110.8
Auckland	102.3	122.7	121.5
Waikato	96.0	119.8	108.8
Bay of Plenty	105.7	116.2	120.7
Gisborne/ Hawkes Bay	104.5	115.3	109.9
Taranaki/ Manawatu-Wang.	102.0	119.4	115.1
Wellington	103.2	121.4	121.1
Nelson-Marlborough West Coast	105.6	117.9	116.4
Canterbury	95.7	122.7	116.9
Otago	104.2	117.4	104.4
Southland	102.6	122.8	112.8
<b>New Zealand</b>	<b>101.3</b>	<b>120.3</b>	<b>116.9</b>