

23 February 2018



Retail Ripper

- Retail sales booming
- On multiple drivers
- Outlook positive, albeit slower
- Net migration important
- Our Q4 GDP estimate unchanged at +0.5%

The tills were ringing loudly in the final quarter of last year. Of course, they always do in the Christmas quarter but it was more than usual this time around.

Retail sales volumes rose 1.7% in the quarter, after adjusting for the usual seasonal effects. The big gain matched our expectations. To us, it confirms a strong rebound from the softer looking +0.3% in Q3, which, itself, was an unwind from a sports-event-induced strong 1.8% gain in Q2.

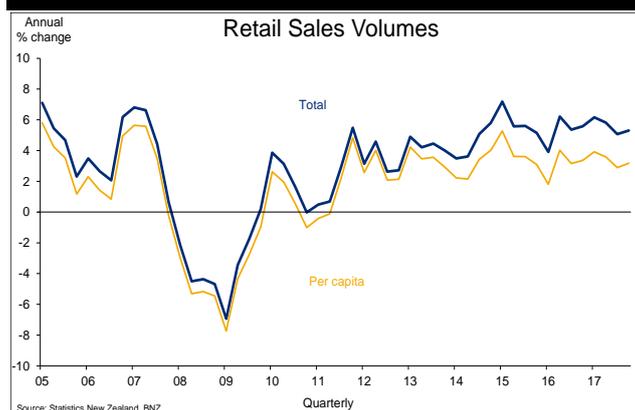
While the result was a bit stronger than formal market polls of +1.4%, a decent rebound clearly wasn't a major surprise to the market, judging by the lack of any material movement in the NZD following the release.

Looking through the quarterly wriggles, the trend in retail sales growth is strong. Sales volumes in Q4 were 5.4% higher than a year earlier, with core (ex-auto) annual sales growth a touch stronger at 5.7%. Growth was broad-based across stereotypes.

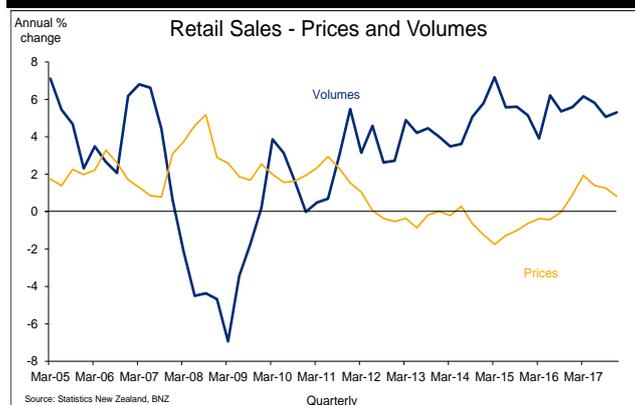
There are many factors that lie behind the current strong trend in sales growth. These include:

- Rapid population growth, boosted by high net migration. However, there is more to the current retail sales expansion than just more people. Sales volumes per capita in Q4 were 3.2% higher than a year earlier.
- A buoyant labour market, with very strong employment growth and a falling unemployment rate. This has helped support household income growth.
- Robust tourism growth. Recent figures show foreign visitor spending rose 5% to \$10.56b in 2017, a fair chunk of which would have been spent at retail stores. We judge the dip in accommodation sale volumes in Q4 as further unwind from the Lions rugby tour that extended into Q3, rather than a developing downtrend.

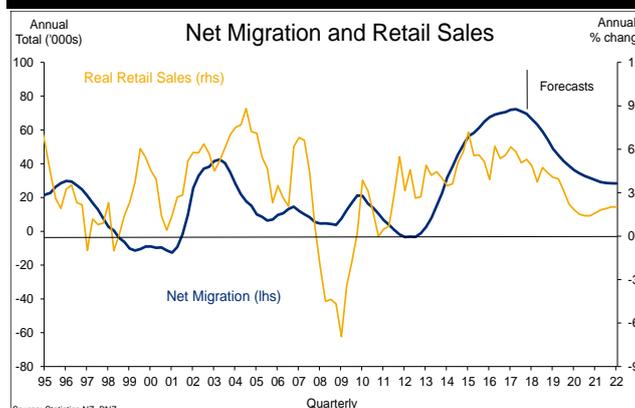
Not Just People Power



Consumers Enjoying Low Inflation



Solid, But Slower, Growth Expected



- A record terms of trade. Higher export prices relative to import prices are a boost to domestic incomes. It is just as good as productivity gains in lifting purchasing power.
- Low interest rates. These have discouraged saving and encouraged spending. Consumer credit growth has accelerated.
- Low inflation. The retail price deflator rose 0.3% in Q4, to be up 0.8% y/y. While central banks around the world fret over low inflation, NZ consumers are enjoying the offshore driven low inflation environment as nominal income growth translates into strong gains in purchasing power. While there is no new news for the RBNZ in the retail trade deflator (its largely derived from the already released CPI), it does support the idea that near term inflation is running below RBNZ's ideals.

Near term sales indicators for the current quarter like January's positive electronic card transaction data, rebounding house sales, and buoyant consumer confidence point to robust retail growth early in the New Year, albeit unlikely to match the strength of the rebound-boosted lift in the final quarter of last year. We have +1.0% currently pencilled in for Q1 retail sales volume growth.

This is how we see the general outlook too. We expect many of the above factors will continue to support strong retail sales growth ahead, although some of them not quite as much as before such that the pace of retail sales

growth slows over time. We expect 4.4% growth in retail volumes in 2018 and 3.3% in 2019.

While lower net migration and a relatively subdued housing market is expected to check growth a little over the coming period, a strong labour market and ongoing tourism growth will offer support. In addition, fiscal transfers such as the rise in student allowances already enacted and the upcoming boost to Working for Families and the government's new Winter Energy Payments will support spending.

Thinking about the risks to our forecast, it is quite conceivable that net migration does not fall as quickly, or as soon, as we currently have factored in. Next week's migration figures will be the latest to gauge whether the recent bounce up in the monthly net inflows has been sustained or not. If net migration over the coming year comes in higher than we anticipate, then it is likely that retail sales will prove stronger than we currently think.

Today's retail result, in matching our expectations, has no implications for our Q4 GDP calculations. As such, some upside risk remains to our current expectation of 0.5% quarterly growth. Likewise, buoyant retail sales are in line with our thinking that domestic demand is strong and imports are growing which, over time, will see the current account deficit start to push wider. It is something to watch for later this year and into next.

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