Softer spending an RBNZ headache?

- Retail sales growth slowing
- Population, tourism and house prices all have tempering impacts
- Easy monetary policy and real wage growth a plus
- We forecast further moderation but no recession
- Weaker spending a downside threat to NZ cash rate

New Zealand’s retail sector is coming under increasing pressure. This was confirmed by today’s sales figures which were as miserable as we had expected with real retail sales rising just 0.2% for the June quarter. The annual increase in sales was still a very robust 2.9% but we think that they are in the midst of a declining trend.

So much is now going the wrong way for retailers:

- Population growth is slowing. This has an immediate impact on the pace of growth in the sector. As net migration is expected to continue slowing, we would expect the trend decline in population growth to be sustained for some time.

- Tourists are the marginal spender in New Zealand. There is a reasonable correlation between short term arrival growth and retail spending. Through 2015 to 2017 tourism growth was sitting around 10% per annum. This has since moderated to 5% per annum and we reckon will be closer to 2% soon.

- Growth in commodity prices has a major income effect on New Zealand households. With commodity prices having peaked, support from this quarter appears to be fading.

- Consumer confidence has softened and is putting downward pressure on spending.

- Employment growth has moderated and will continue to remain relatively low if for no other reason than there is a paucity of available people to employ.

- House price inflation, in aggregate, is muted.

- Residential construction activity is elevated but its pace of growth is capacity constrained.
Having said all this, we are quick to point out that we are not talking about a retail recession here. Rather, we simply see a softening in the pace of growth. Significant monetary stimulus and prospective fiscal stimulus will both be supportive. Additionally, while many of our growth indicators are softening, we still believe the absolute level of activity in the economy will remain lofty. And last but not least, household incomes are likely to be bolstered by ongoing real wage growth due to a combination of further increases in the minimum wage, a wider adoption of the living wage, significant increases in state sector wages and an overall pick up in real wages, as the labour market remains tight.

Putting all this together, we still see real retail sales growth approaching 2% per annum over the next three years. It’s just that it’s not the near 4.0% per annum pace recorded over the previous ten years.

Of course, the prognosis for retailers is further constrained by the fact that their input cost pressures are rising more quickly than their ability to raise selling prices. These cost pressures include wages, rents and insurance in particular. Additionally, there is the changing structure of the sector as online sales continue to grow. It is thus not surprising that retailer’s profit expectations are weaker than the prognosis for sales volumes would suggest.

From a GDP perspective, today’s data were consistent with our view that Q2 GDP growth will be a modest 0.5% which will see the annual pace of increase drop to a 21 quarter low of 2.1%. We see some downside risk to this forecast.

From an RBNZ perspective, today’s data and their GDP implications should be no big deal as the Bank is also forecasting 0.5% GDP growth for Q2. Our concern, however, is that the Bank expects consumption (which is retail sales dominated) to pick up relatively strongly through the latter part of this year and into 2020. We are assuming that this is seen as being a response to lower interest rates and, as a consequence, a better looking housing market. We are not so convinced and believe the downside risks to private consumption are a real threat to the RBNZ’s optimistic GDP prognosis. If we are right, and if the RBNZ sticks with easing policy to support GDP growth, then the possibility that the cash rate heads ever closer to zero is elevated.

RBNZ forecasts at risk

Profit concerns abound
Contact Details

BNZ Research

Stephen Toplis  
Head of Research  
+64 4 474 6905

Craig Ebert  
Senior Economist  
+64 4 474 6799

Doug Steel  
Senior Economist  
+64 4 474 6923

Jason Wong  
Senior Markets Strategist  
+64 4 924 7652

Nick Smyth  
Interest Rates Strategist  
+64 4 924 7653

Main Offices

Wellington  
Level 4, Spark Central  
42-52 Willis Street  
Private Bag 39806  
Wellington Mail Centre  
Lower Hutt 5045  
New Zealand  
Toll Free: 0800 283 269

Auckland  
80 Queen Street  
Private Bag 92008  
Auckland 1142  
New Zealand  
Toll Free: 0800 283 269

Christchurch  
111 Cashel Street  
Christchurch 8011  
New Zealand  
Toll Free: 0800 854 854

National Australia Bank

Ivan Colhoun  
Global Head of Research  
+61 2 9237 1836

Alan Oster  
Group Chief Economist  
+61 3 8634 2927

Ray Attrill  
Head of FX Strategy  
+61 2 9237 1848

Skye Masters  
Head of Fixed Income Research  
+61 2 9295 1196

Wellington  
Foreign Exchange  
+800 642 222

Fixed Income/Derivatives  
+800 283 269

Sydney  
Foreign Exchange  
+61 2 9295 1100

Fixed Income/Derivatives  
+61 2 9295 1166

London  
Foreign Exchange  
+44 20 7796 3091

Fixed Income/Derivatives  
+44 20 7796 4761

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