Research

Economy Watch

23 February 2024

Retail Recession Deepens

- **Real retail sales plunge in Q4**
- **Two years of decline, despite strong population growth**
- **Per capita real sales down 6.7% y/y, lowest since 2017**
- **Before impact of previous rate hikes fully felt**
- **Softer demand feeding back through supply chains**
- **Downside risk to Q4 GDP**

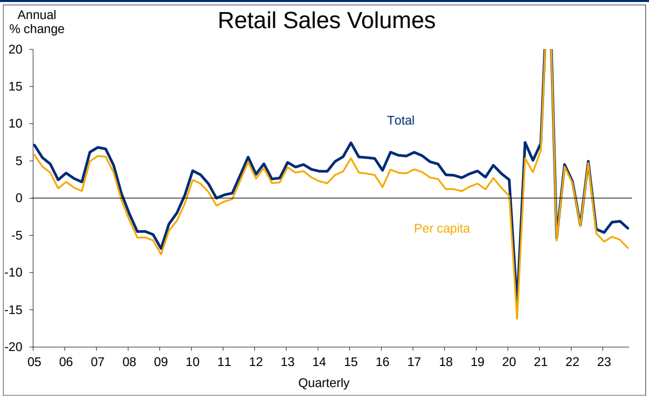
Retail sales volumes collapsed 1.9% in Q4, on a seasonally adjusted basis. This was much weaker than all market expectations, including the 0.2% decline anticipated by the market. The retail recession continues and deepens.

Yes, there remains noise in quarter-to-quarter movements. But there is no denying the clear and strong downtrend in sales volumes that have now fallen for eight consecutive quarters. Sales volumes are 4.0% lower than a year ago (and 8.0% down from a peak, two years ago).

The plunge in sales volumes is despite strong support from very large net-migration-fuelled population growth. More people buy more goods, but that influence has been well and truly offset by a material reduction in spending elsewhere.

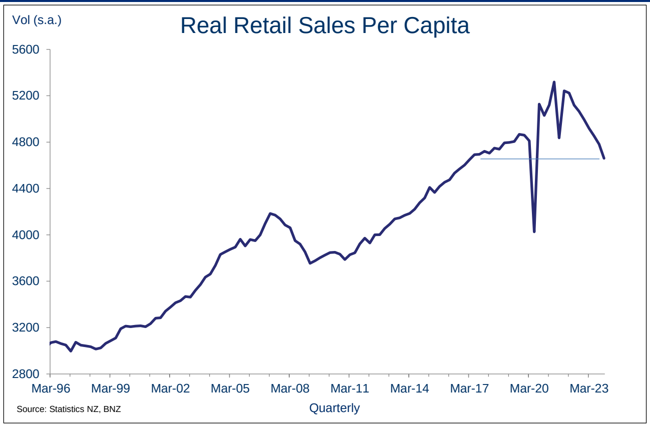
The weakness at the end of last year was reinforced by a downwards revision to Q3's growth that was initially reported at flat, before being revised down to -0.6% last week (after Stats NZ changed its seasonal adjustment method), only to be revised down further today to -0.8%. The real value of sales in Q4 is a full 2.4% below the initial level published for Q3. That highlights significantly less demand than initially envisaged.

Weak and Weaker



Real sales per capita has fallen a whopping 6.7% on year earlier levels, such has been the financial pressures on household budgets reflected in ongoing pessimism seen in consumer confidence surveys. Real per capita sales have dropped a massive 11.1% over the past two years. This is not just an unwind from prior strength. The level of per capita spending is now at its lowest level since March 2017 (barring the first Covid lockdown quarter). If the RBNZ was looking for signs that demand is weakening, it seldom gets much clearer than this.

Spending Like Its 2017



We wondered if vehicle sales might save total sales in the quarter as some brought forward spending given the government's signalled, and now implemented, scrapping of the emissions-related rebate and tax scheme on 31 December 2023. Not so. Perhaps this effect was more than offset by a delay in purchasing so called dirty cars as folk waited for the fee removal. In any case, vehicle retail sales volumes dropped 2.5% in Q4 in today's figures. It is possible some bounce in vehicle sales occurs in Q1.

But today's result was about much more than volatility in vehicle sales. Core (ex auto sector) real sales fell 1.7% q/q, to be down 3.0% on a year ago. This was weaker than we expected, although we warned of the very real risk of a softer than expected outturn. It makes sense to us.

Today's result certainly fits with our thinking that GDP struggled to grow at all in Q4. At the margin, this suggests some downside risk to our formal -0.1% q/q estimate for the quarter, but we await further partials for the quarter before making any adjustment. In the least, it supports the notion that GDP continues to undershoot the RBNZ's November projections after the counter to expectations drop in Q3 GDP, and historical downward revisions. The RBNZ saw a flat outcome for Q4 GDP. Importantly, the drop in core sales suggests downside risk to the RBNZ's -0.4% pick for private consumption.

Retail weakness is feeding back through supply chains reflected in soft domestic manufacturing indicators and sharply lower imports of consumption goods. Yesterday's import figures for January saw the dollar value of the latter down 6.7% on a year earlier. That is a chunky drop in nominal values. Something that also needs to be factored into GDP calculations.

Retail sales is not all of private consumption but does equate to a bit more than half of it. And that is a big segment that has been going continuously backwards for two years. These jets have not only been cooled – they are in reverse.

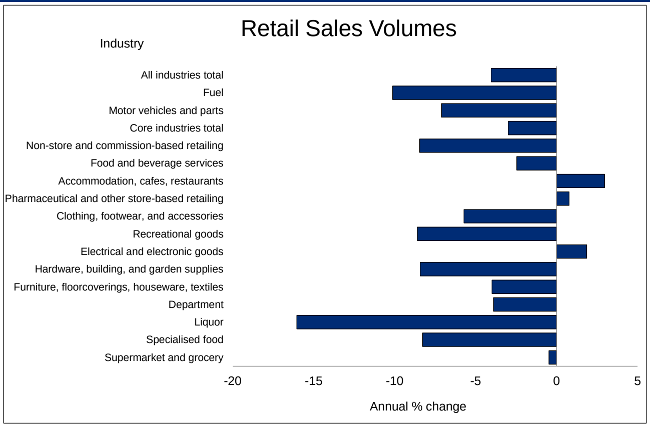
Speaking of jets, private consumption also includes spending by kiwis offshore. A negative for domestic retailers compared to that money being spending locally. The number of kiwis travelling overseas in Q4 was up 28% on a year earlier (to be around 93% of pre-covid levels), but flat in the quarter on a seasonally adjusted basis so not necessarily a drag for that period.

The flipside is more international visitors to NZ are positive for retail sales and add to demand locally. Visitor numbers to NZ were up 25% on a year ago (although only around 79% of pre covid levels). However, growth stalled through the latter part of last year. Indeed, visitor numbers fell around 9% in Q4 on a seasonally adjusted basis. This suggests lower spending, although visitors have been tending to stay longer (tourist spending numbers are out next month).

At least some of the Q4 slowdown in visitor numbers reflects an unwind from strength in Q3 associated with the FIFA Women's World Cup. The 4.8% real drop in accommodation sales would fit that narrative. It is difficult to know exactly how much of the unwind weighed on overall retail sales in Q4. But averaging through Q3 and Q4 shows there have been much bigger forces at work.

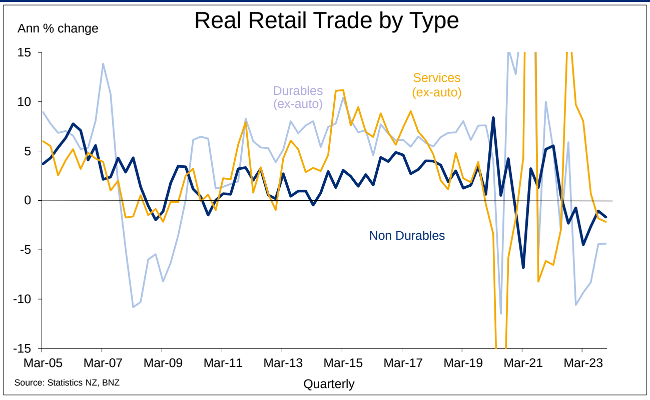
Real sales declines in Q4 were widespread. All but one of the 15 store types recorded lower sales in Q4. The exception was a tiny gain in 'pharmaceutical and other store-based retailing'. On an annual basis, most sectors saw large declines. Accommodation was one to buck the trend, but the 3.0% gain was tepid in comparison to the annual growth in international visitor numbers.

Widespread Weakness



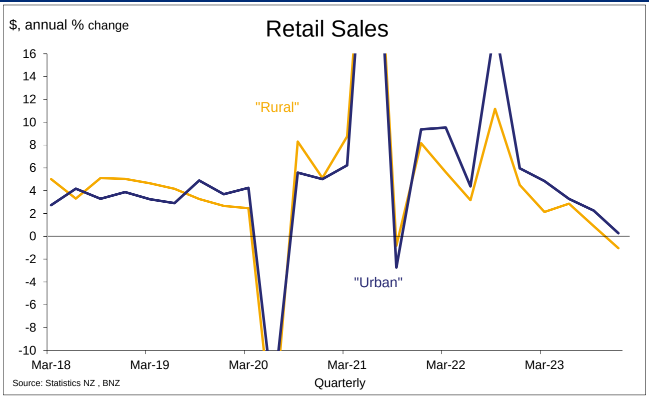
Durable goods sales have been under pressure. House prices have been inching higher, but the number of house sales remain weak and building consents have been trending south for quite some time. Given this, it is no surprise to see retail sales weakness in housing related sectors. Hardware, building, and garden supplies sales volumes are 8.4% lower than a year ago while furniture, floorcoverings, houseware, and textiles are down 3.9% over the period.

Rotation To Services Complete?



Weak primary export returns last year have been another drag on retail sales among other challenges for the primary sector. Pressure on farm profitability has seen farmers cut spending (see our latest *Rural Wrap* for more details). There are no estimates of sales volumes by region, but nominal retail sales in more 'rural' areas have been generally weaker than more 'urban' regions. Our admittedly rough breakdown along these lines shows 'rural' nominal retail sales down 1.0% compared to a year ago, while 'urban' sales were up 0.3%. The latter includes Auckland whose nominal sales were up 0.9% y/y, which no doubt got more support from the strong influence on international net migration into the area compared to other regions. Rural sales growth have tended to underperform urban over the past two years.

Rural Underperforms



Primary sector export returns may become less of a drag this year, as the likes of dairy prices recover from forecast lows last year and some areas of production bounce back from last year's significant weather events. Perhaps some improvement ahead here, but we would put it more in the category of less weak rather than strong.

Some might think retail sales weakness is part of a rotation back toward spending on services. There may still be elements of this, but there are signs that this dynamic might have run its course. Spending on services had already flattened considerably though Q2 and Q3 last year.

Looking ahead, it is difficult to get too bullish on retail sales given the current dynamics in play. Perhaps more people bring some growth off the now much lower base.

But fundamentally, it is difficult to see a strong sales bounce with the labour market deteriorating and expected to deteriorate further. And the impact of previous interest rate hikes is yet to be fully felt. High rates are encouraging saving, discouraging borrowing and spending. Household borrowing growth remains subdued and retail spending is going backwards at pace.

Then there are the proposed tax cuts to factor in, among other influences such as public service staff reductions. There is a lot to consider. Consumer confidence is off its lows but still net pessimistic. It still looks like real retail sales and especially spending per capita is going to be trailing year earlier levels for a while yet. January's ECT and credit card billings suggest that remained the case early in the New Year.

On the inflation front, today's retail deflator saw annual inflation drop to 3.9%. This still looks high, but it is falling rapidly. It was 10.0% a year ago. The retail deflator is effectively a recut of segments of the CPI, but it does highlight falling inflation in this sector. Despite inflation easing, there is no sign that consumers are stopping cutting back on spending. Indeed, today's numbers suggest an even sharper cut back. This will be a restraint on retailer's pricing power which will not help profitability that merchant respondents to the latest QSBO reported was already under duress.

It all fits with our view that interest rates do not need to be lifted any further, even though one cannot rule it out given the recent rhetoric from the central bank.

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