Research

Economy Watch

23 May 2024

Retail Wriggle

- **Retail sales lift in Q1**
- **But don't relieve sector's malaise**
- **Consumers miserable**
- **So too merchants' profitability**
- **Headwinds to remain for a while yet**

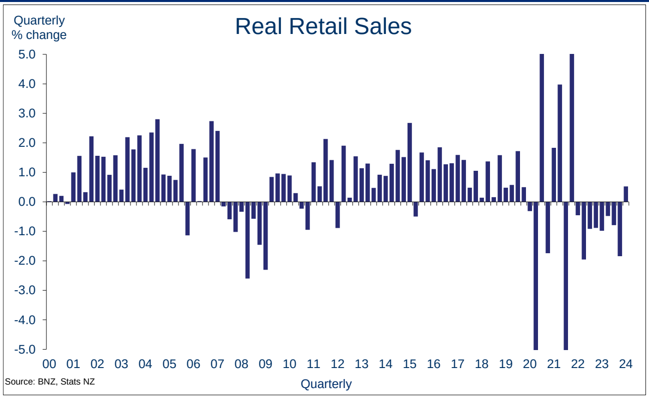
It has not been seen for more than two years. A lift in real quarterly retail sales. The lift might surprise a few or at least have them wondering how sales can increase in the current economic climate. It's noisy data. The retail sector remains under significant duress.

That is not to deny a 0.5% lift in real sales in Q1. It was a stronger result than the -0.3% expected by the market or our close-to-flat expectation. But there remains considerable noise in the data (including questions around how well seasonal adjustment dealt with the leap day) such that we think it would be a mistake to see Q1 results as an indicator of underlying performance.

In the context of eight consecutive quarterly sales declines, the lift in Q1 looks tiny. And taken together with the 1.8% drop in Q4, the trend in sales remains firmly downward. We think sales are more likely to fall than rise again in Q2.

Be that as it may, retail sales are one of the early hard indicators that feed into GDP calculations. A noisy bounce or not, the lift in retail sales increases the chance that growth manages a positive sign in Q1.

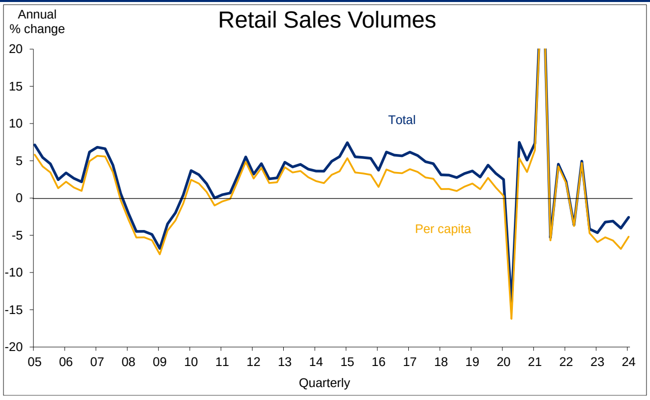
A plus



Some may think that this looks problematic for a central bank demanding spending restraint. But neither the lift in total sales nor the 0.4% increase in ex auto real sales look out of line with the RBNZ's expectations for household spending (+0.4%) or GDP (+0.2%) in the quarter, as published in its Monetary Policy Statement yesterday. At the same time, there is nothing in the quarterly movement to dissuade the Bank from its broad view expressed yesterday of interest rates needing to be kept high for longer.

Standing back from the wriggles in quarterly sales reveals underlying weakness. This reflects many influences, including the likes of higher costs of insurance, interest rates, energy, rent, and local authority rates. For consumers of such things, these are very difficult to cut back on. This means that for any given income after paying such bills there is less left to spend elsewhere. The result has been significantly less spent at retail outlets in real terms, especially on discretionary items.

But fundamentally weak

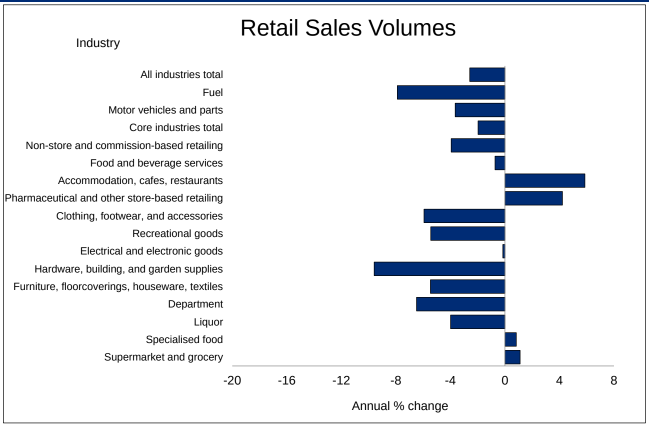


This has been the case for quite some time now. Even with the modest Q1 bounce, real retail sales are 2.4% lower than a year earlier. And that is despite extraordinary population growth and strong growth in international visitor numbers, albeit with the latter being off a low base. Real sales per capita are down 5.2% on a year ago – highlighting the very weak underbelly.

Most retail segments have seen material declines in sales volumes over the past year including those related to housing like hardware, building, and garden suppliers (-9.6%) and furniture, floorcoverings, housewares, and textiles (-5.5%). The strongest lift in sales volumes over the year was in accommodation, cafes, and restaurants

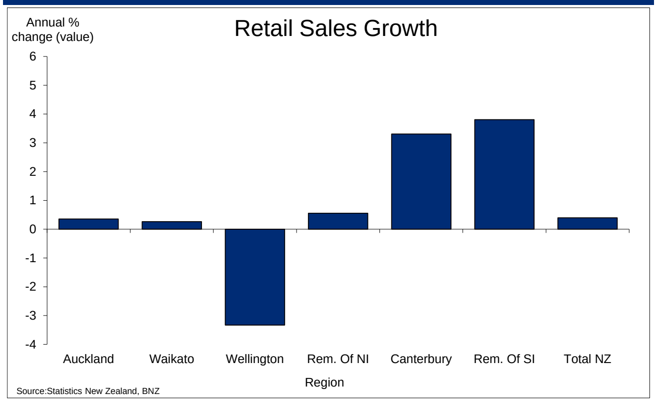
(+5.9%), but, like tourism, it is from a low base with sales volumes still below those recorded pre-covid.

Most lower than a year ago



There was more variation across regions. Regional retail sales are only split by dollar value (not volumes), but they make for some interesting observations. On the top side, the South Island features with the dollar value of sales up 3.3% in Canterbury and 3.8% across the remainder of the South Island on an annual basis. This matches a host of other indicators that suggest conditions have been relatively stronger in the South compared to the North. On the downside, Wellington stands out with a 3.3% drop in sales. Other major North Island areas saw sales growth close to the NZ average of 0.4%.

Variable



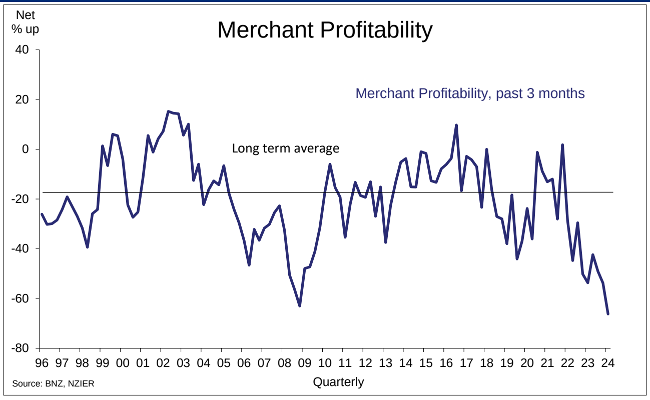
While there is variation across regions, the overall weakness in sales speaks to pressure on revenue. This at a time when retailers report rising costs. That is simply an awful mix and thus no surprise to see in the latest Quarterly Survey of Business Opinion widespread reporting by merchants of declining profitability.

Disconcertingly, there are factors that look like keeping the pressure on sales for a while yet.

First, population growth is slowing as previous exceptionally strong net migrant inflows look like they are cooling rapidly.

Second, the softening labour market now looks sufficiently aggressive to not only dent spending for those directly affected but also among others as it conjures up feelings of job insecurity. We forecast the unemployment rate to rise to around 5.5% from its current level of 4.3%.

Pressured



Third, those looking for imminent material declines in interest rates would have been sorely disappointed by the message from the Reserve Bank yesterday suggesting the OCR will likely need to stay high well into next year.

None of that suggests a material bounce in consumer confidence, which had already softened to miserable levels in April. That looks like a negative for per capita retail sales in Q2, with slowing population growth another headwind for sales ahead.

There are some positives. We should not forget there are folk that derive income from higher interest rates which can support their spending. Tourism is expected to continue recovering, albeit at a slower rate than over the past year or two. And prices for the next dairy season are shaping up a bit better than the season just ending.

We await the details of the Government's Budget to weigh up the likely pros and cons for household spending. Tax relief will be likely a positive in that regard, but there will be a host of other changes to consider as well. We await the detail in the Budget next week before building such things into our economic forecasts. From a macro perspective, it is the overall balance of changes that matters most.

All considered at this point, we remain of the view that retail sales volumes are likely to be subdued for some time yet. We think real sales will be lower in calendar 2024 compared with calendar 2023 perhaps to the tune of 1% or more. If that is how things pan out, it would mark the third consecutive calendar year of decline. It puts the small sales bounce in Q1 into perspective.

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