BNZ Weekly Overview

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Mission Statement

To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

Retailing

This week I thought I would start out by taking a look at retailing. Why? Because the sector is clearly one which is still undergoing – in politically correct terms – rationalisation. Or in street talk – hit by firms still falling over with 40%+ sales everywhere and consumers seemingly not prepared to buy unless there is a sale – which is in fact the operating model for some of the larger operators.

The first way to look at the sector is to consider sales growth in the past year using the Retail Trade Survey from Statistics New Zealand. After adjusting for seasonal and price factors the volume of sales in the March quarter was up 0.7% after rising 1.4% in the December quarter. That pace of recent growth is not bad and sales in fact were 3.8% ahead of a year ago which equals gross domestic product growth of 3.8% and is close to employment growth of 3.7%.

But such numbers are not much use to most retailers because of the diversity of retail operations. So we can look at the following table which in the first column shows growth in the March quarter and in the second shows growth in the entire year to March, thus smoothing over what we know can be some very volatile numbers at times.

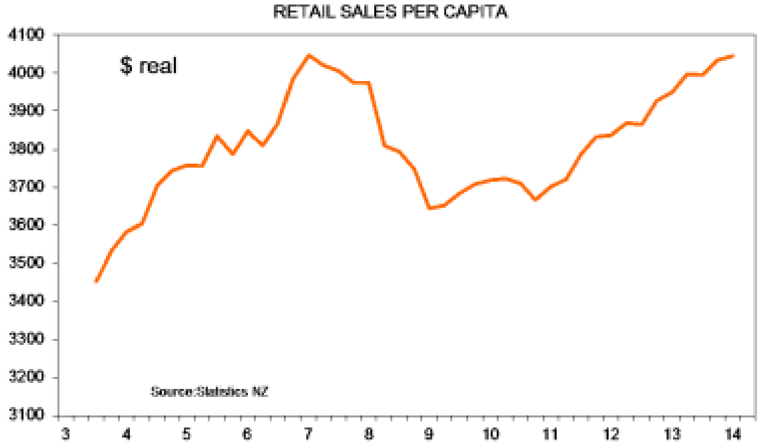
	Quarter change %	**Total year change %**
Supermarkets & grocers	-0.7	0.5
Specialised foods	3.5	2.4
Liquor	4.5	3.2
Non-store & commission retailing	-2.1	9.2
Department stores	1.2	7.6
Furniture, floor coverings etc.	-2.5	9.7
Hardware & garden supplies	2.0	10.4
Recreational goods	-1.7	3.0
Clothing & footwear	0.0	-0.2
Electrical & electronic goods	5.4	12.5
Pharmaceutical	1.0	0.0
Accommodation	2.0	1.9
Food & beverage services	1.5	4.8
Core Industries	0.8	3.9
Motor vehicles & parts	0.6	7.9
Fuel	-0.6	-0.1
All	0.7	4.0

We are spending a lot more on hardware and electrical goods and at department stores. But spending at supermarkets has barely budged and in fact fell 0.7% in the March quarter.

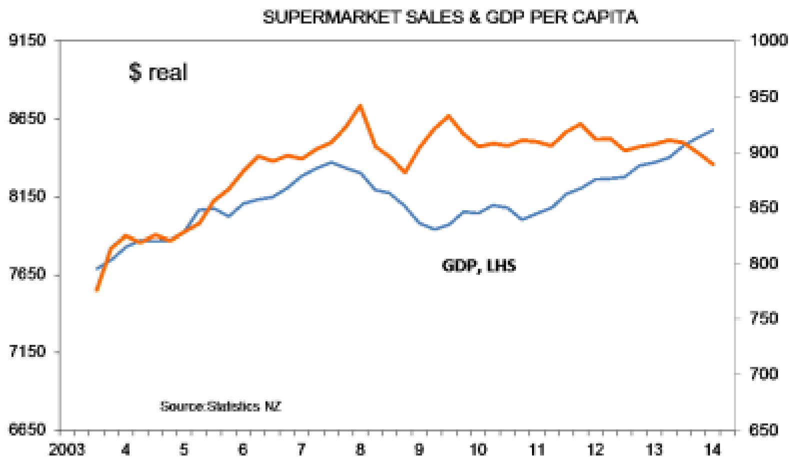
Another way to look at this is to consider how sales in the year to March compare with sales back during the peak spending period over calendar 2007. Are there stores which are still struggling to regain their previous heights? For this comparison we have made an additional adjustment of allowing for population growth to see how sales per capita have altered.

	Versus 2007 per capita
Supermarkets & grocers	-0.5
Specialised foods	-2.1
Liquor	-2.7
Non-store & commission retailing	86.7
Department stores	13.6
Furniture, floor coverings etc.	1.0
Hardware & garden supplies	-19.7
Recreational goods	-11.4
Clothing & footwear	1.3
Electrical & electronic goods	83.3
Pharmaceutical	10.8
Accommodation	3.2
Food & beverage services	-0.9
Core Industries	2.7
Motor vehicles & parts	-2.2
Fuel	-14.9
All	0.2

This is interesting because for all retail categories Added together per capita sales are basically equal to the 2007 peak as shown in the following graph. But sales of electrical goods are almost double per capita what they were pre-GFC as we splurge on ever and ever cheaper TVs, gaming systems, computers, smartphones, and music players. We are spending less on petrol perhaps because prices are so high, (note how the government recently raised the excise tax because of the reduced volume of fuel sales) a bit more at department stores and pharmacies, a lot less at hardware stores (though that is changing), and almost the same at supermarkets.



Focussing in on supermarkets because most of us visit one each week, the following graph shows that apart from an interesting lift during the economy’s previous strong growth period ending in 2008, this category has experienced basically no per capita sales growth ever since. It held up during and immediately after the GFC, but as the economy’s overall growth rate has once again lifted it has stagnated. Why?



Because we visit a supermarket frequently our purchases there are likely to be far more sensitive to the cash we have in our bank spending account than our purchases of cars, household furnishings etc. where we will give more thought to things like our job security and the level of interest rates. Therefore if we can identify things which have an ongoing physical impact on the cash we have available to spend each week then we can perhaps explain the supermarket weakness.

For instance, electricity prices have risen strongly in recent years and we pay that bill every month. The same goes for petrol which is a rising weekly drain given strong price increases in recent years. Subscription television charges seem to frequently rise and we pay that bill each month. The same goes for insurance and to a less frequent extent our local authority rates payments.

In similar vein our wages growth has been minimal in recent years and as yet there is no evidence of the pace of growth lifting even though jobs growth has picked up very strongly.

On top of this we have been buying more electronic goods, as noted above, and our spending on cars has lifted partly because the ones we bought a few years ago need replacing. House construction is also rising strongly and that will divert our spending focus toward furnishings etc.

Perhaps another factor attracting our spending attention is overseas travel which has become cheaper because of the strong NZ dollar. In the year to June the number of Kiwis making short trips overseas was up by 4.5% on the past year and 13% higher than in 2007 when the NZD was also at high levels.

Then there is two other factors to consider. As the recent excitement over loaves of bread for $1 shows, scope for substantial discounting of grocery items is limited and although discounting does occur it delivers less of a dollar buzz than 10% off the latest Samsung smartphone. Plus ever-larger hardware megastores stock some items traditionally sold by supermarkets such as cleaning agents, washing powder, toilet paper, chocolate etc.

Thus perhaps we can explain the relative weakness in supermarket sales growth by

- diversion of immediate cash flows into other on-going expenses,
- low wages growth,
- diversion of spending to cheap electronics and foreign travel,
- new competition from non-supermarket retailers.

Perhaps we can also add in the fact that the sector is mature, store layouts and food ranges rarely change, and people may be eating fewer home prepared meals. At the extreme margins the rise in weekend farmers markets may have drawn away some spending on fresh food items.

Therefore what does the future hold for supermarket sales? On the negative side are practically all of the factors just listed continuing, including the strong NZ dollar, cheapening electronics (subject to where China manufacturing costs go), and the fact that the sector is mature. In addition rising interest rates will sap the weekly spending power of people with mortgages on floating rates. On the positive side however we have accelerating wages growth which must surely start soon in response to the rapidly strengthening labour market, a migration boom lifting population size, and more people getting jobs.

Over the immediate future prospects look good for improving supermarket sales but timing is probably highly dependent upon when the generalised acceleration in wages growth occurs and that is something very uncertain both here and overseas in the post-GFC environment.

Offshore Weaker, NZD Too

Continuing with the theme we explored last week of economic data tending to come in on the weaker than expected side, the IMF this week released some downgraded forecasts for world growth over 2014 mainly because of some weak numbers in the first half of the year. Most notably they cited the shrinkage in the US economy at a near 3% annualised rate in the March quarter. They now forecast US growth of 1.8% this year rather than the 2.2% forecastmade in April. The forecast for China has been cut to 7.4% from 7.6%, for Russia to just 0.2% from 1.3%. The Eurozone forecast remains unchanged at a weak 1.1% but they lifted their Japan forecast to 1.6% from 1.3% in light of the March quarter surge in growth. Strong growth of 3.2% is forecast for the UK.

They note that world growth risks continue to lie on the downside though assuming nothing really bad happens they anticipate that the pick which they had hoped for this year will occur next year and produce growth of 4% globally.

But the slight negative import of their revisions is not all that important set alongside Fonterra's reduction in their forecast pay-out this year from $7 to $6. Last season's pay-out was $8.40 and the reduction means a near $4bn fall in dairy income this year from last year. This will slightly dampen growth, but going by comments from people in the regions regarding weakness in retailing and house construction this fall in income won't drastically change things because dairy farmers have not been spending up last season's surge in incomes.

But the decline does add a little bit more downward pressure to the Kiwi dollar on top of attempts recently by Reserve Bank officials and the Prime Minister to talk it lower. The currency is sitting a couple of cents lower against the greenback now than it was last week but unless the Reserve Bank hints at cuts in interest rates to back up their comments exporters might best view this current bout of weakness as providing an opportunity to boost one year hedging.

Breaking Your Fixed Mortgage Rate

For your guide, the Sunday Star-Times in a section this week looking at fixed versus floating rate borrowing included a statement about break fees which will have left a lot of borrowers quite confused. "Break fees can be large when interest rates are rising. When they are falling they can be low or zero." This is not correct.

When a bank lends at a fixed rate it borrows at a fixed rate to avoid the risk of floating rates shooting up and being caught lending out at a rate lower than one is paying. If interest rates FALL and you go to the bank to break your five year rate for instance so you can either float or refix at a lower rate we cannot go to the person who lent us money for five years and say sorry, we don't need your five year term deposit now and we are converting it to a floating rate which is lower.

We will be left with five year fixed rate deposits we don't need and which will be costing us money if you break the contract you signed with us and no longer pay the fixed rate. So if we choose to let you go back on your contract by breaking we will charge a fee to compensate us for that loss. If rate flexibility is what you value then don't fix your rate in the first place.

The more interesting situation is when interest rates are rising. Then if you break and refix or float we will incur nothing but the administration cost. If we lent money to you at 6% but interest rates are rising and you break then maybe we can lend that same money out at 7%. In that case you may want to query your lender quite closely if they are charging you a break fee for more than admin costs. Good luck if you think you should be paid in such a situation!

If I Were A Borrower What Would I Do?

The trend in interest rates is upward but uncertainty remains as huge as ever regarding the speed and the sort of changes which may not may not occur in response to uncertain developments in eastern Europe and the Middle East. I would look to place most of my mortgage at a three year fixed rate.

The Weekly Overview is written by Tony Alexander, Chief Economist at the Bank of New Zealand. The views expressed are my own and do not purport to represent the views of the BNZ. To receive the Weekly Overview each Thursday night please sign up at www.tonyalexander.co.nz
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