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 Up – But Very Mixed

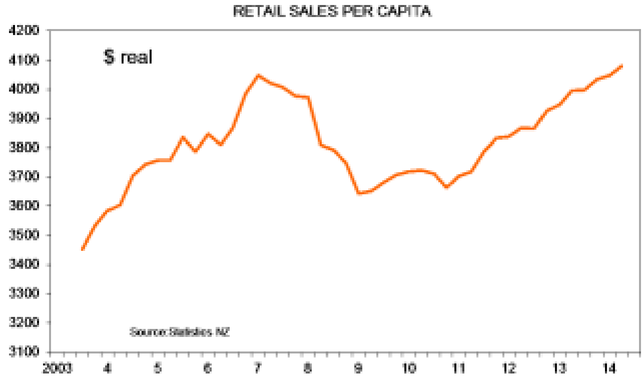
This morning Statistics NZ released data showing that during the June quarter real seasonally adjusted retail spending excluding motor vehicles (core spending) rose by a firmer than expected 1.2% after rising by 1% during the March quarter and 0.9% in the December quarter. For the year ending in June core spending rose by 3.6% but with spending growth having averaged 2.5% since 2005 we can say that the rate of growth in retail spending is above average and that household spending growth is one factor contributing to the upturn in the economy.

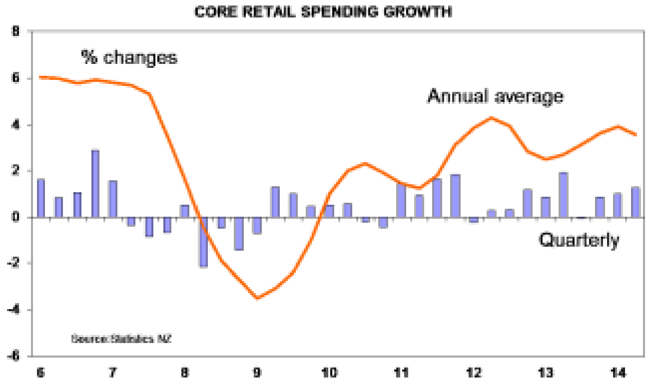
However not all retailers are enjoying good growth as shown in the table below. The first column of numbers shows growth in spending in the past year. The second shows average growth. Supermarkets have recorded well below average growth as have clothing and footwear stores and pharmacies. Strongly above average growth in the past year has been recorded by department stores, sellers of specialised foods, furniture and floor covering retailers, sellers of recreational goods, and food and beverage services. Sellers of electrical goods have done well, but their growth was only slightly above average.

	Annual change %	**Average annual change %**
Supermarkets & grocers	0.1	2.1
Specialised foods	3.4	1.4
Liquor	3.8	2.0
Non-store & commission retailing	2.0	8.4
Department stores	5.7	3.7
Furniture, floor coverings etc.	7.2	2.4
Hardware & garden supplies	8.5	1.0
Recreational goods	7.2	0.0
Clothing & footwear	-0.9	2.8
Electrical & electronic goods	13.3	12.1
Pharmaceutical	1.3	3.5
Accommodation	1.6	1.8
Food & beverage services	4.7	1.8
Core Industries	3.6	2.5
Motor vehicles & parts	8.7	1.2
Fuel	-0.1	-0.1
All	3.9	2.0

Some of the strong performances we can put down to consumers reacting to falling prices. For instance, compared with a year ago average prices for goods being sold by electrical retailers have fallen by 6.7% after falling 9.4% the year before. Prices for recreational goods have fallen 1.1% after falling 1.3%. Motor vehicle prices have fallen on average 1.5% each of the past two years. Furniture etc. prices have risen just 0.2% after falling 2.5%.

Thus, much, but not all of the divergence in sales outcomes can be put down to price changes. Consumers have probably become a lot more sensitive to prices and how they change since the GFC, especially as wages growth has yet to pick up and many people have experienced some period of unemployment.

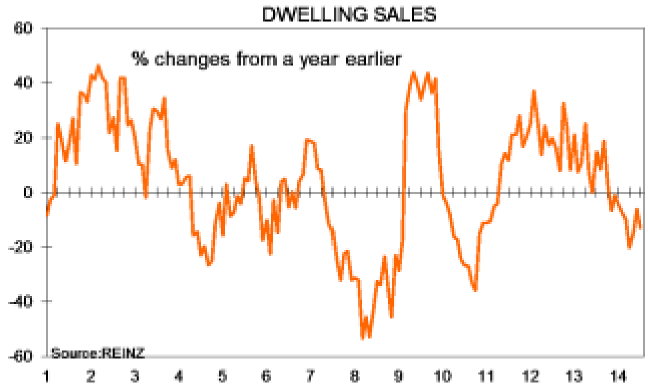


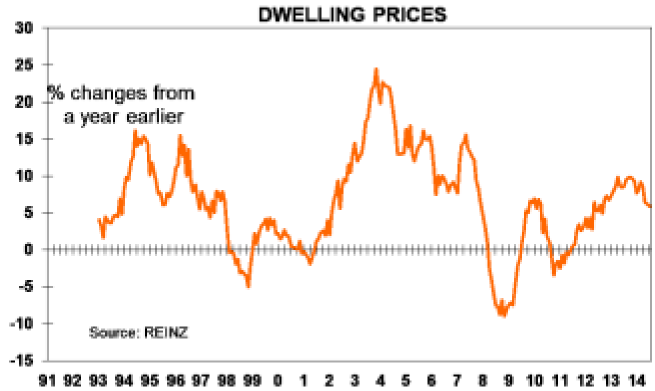


Will retail spending growth lift much in the near future? Although there is good support from rising population growth, good employment growth, and rising house building, there is nothing to suggest that any structural shift has occurred in the disconnect between high confidence and actual spending which has existed since 2008. People probably are just about as wary now of spending up large as they have been for the past six years and their focus remains on astute budgeting. Throw in rising interest rates and conditions are likely to remain challenging for the bulk of retailers who are not achieving cost reductions or are not prepared to cut selling prices – hence why we continue to see many sales being held in the shops and some closing down.

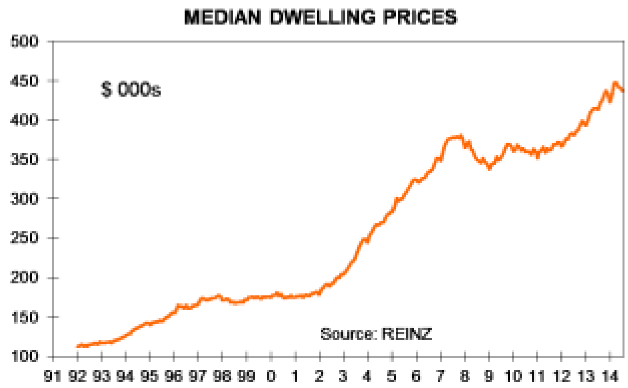
This week we also received updated data on the state of the residential real estate market from REINZ. Around the country in July there were 5,893 dwellings sold by REINZ member agents. This was 13% fewer than a year ago which is a rate of decline consistent with the past six months. In rough seasonally adjusted terms sales have been steady recently. Thus we might be able to say that the drop in turnover caused largely by the LVR rules has ended.

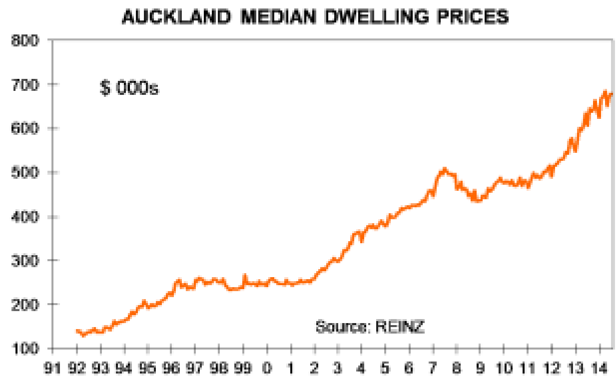
With regard to prices these fell on average by 0.7% in July which makes three months of decline in a row. Comparing average prices in the past three months with a year ago we see an annual increase recorded of 6.2% which is the slowest pace of nationwide average house price inflation since 6% in the three months to October 2012. Last year the rise was 8.6%.

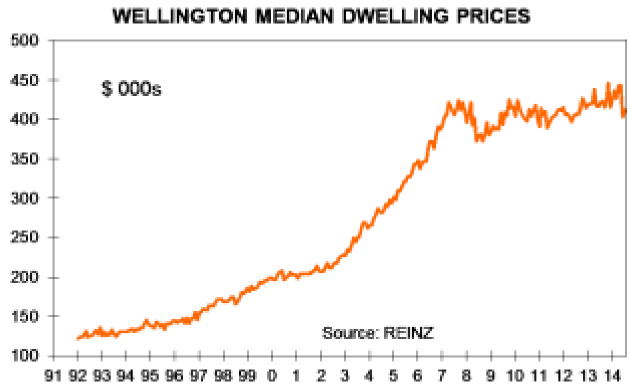


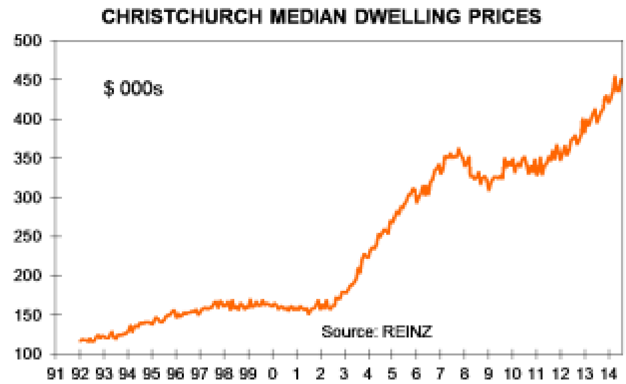


Auckland prices in the past year have risen 8.6%, Wellington 0.3%, Christchurch 8.7%, the remainder of the North Island 2.7%, and the remainder of the South Island 3.5%.









House price inflation has flattened out for now but with shortages persisting in Auckland and Christchurch it is likely that prices will continue to edge up there. Beyond that we await evidence of people spreading their wings and buying power into other parts of the country.

Did you know that on average over the past couple of decades the number of consents issued for the construction of new dwellings in Canterbury has been 3,400 but that as a result of a 44% rise in the past year and 46% rise the year before the total stands at 6,716? That is almost double the average. In Auckland in the past year consent numbers have risen by 29% following 26% growth a year ago, but with average annual consents standing at 7,600 the total in the year to June was still 10% below that at 6,826.

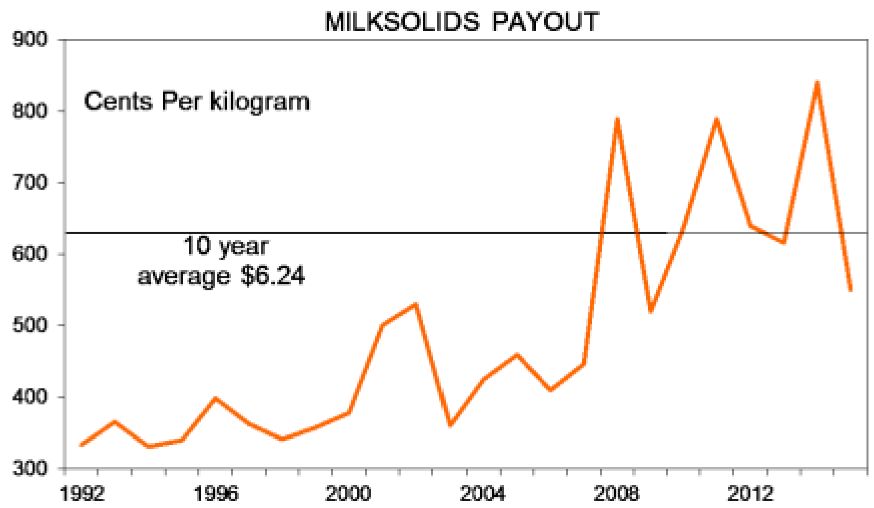
Christchurch is well on the way to addressing it’s earthquake-induced shortage of housing though it will take many years to get the job done. Auckland has yet to make any dent and in fact the shortage gets worse because numbers have yet to attain the long-term average which produced the shortage in the first place, and population growth is now accelerating. Prices rise even though for the moment things have stalled in response to first home buyers going into their shells because of thoughts that tighter LVR rules mean they are not eligible to buy a house (wrong in many cases), and because interest rates have risen by 1%.

The 1% rise in floating mortgage rates is probably not the key cause of recent weakness in many residential real estate indicators, but it is meaningful in the context of minimal wages growth for most people following six years of high job uncertainty.

Dairy Price Cycle

Does the fall in dairy payout projections by Fonterra from $8.40 last season to $6 this year with further downside likely mean that the dairy sector is munted and we should all be hoping manufacturing and tourism can keep us in good economic health? The decline is certainly a shock to many but it is not something new. The payout dropped by a similar proportion in 2003 and 2009. In fact, just for the pleasure of those who like cycles, if we take exactly the six year periods for the past three decades (working backwards in the table below) we get the following annual payout changes.

2015 -35% (using $5.50)
2009 -34%
2003 -32%
1997 -9%
1991 -33%
1985 +12%



Since the freeing up of the economy there is an interesting six yearly cycle of reasonably sharp payout declines. Best watch the debt level you take on in 2020-21 then I guess.

A shock payout decline is nothing new therefore the idea that this latest decline somehow signals a deep need to restructure the economy away from dairying is ridiculous. Equally ridiculous is the idea that this decline will munt the rural real estate market though clearly it will put a short-term dent in some sales activity. (Will it stop foreigners from buying however? Almost certainly not.)

Is it likely that the payout will stay at this low level? Not really. The decline this time around is driven by a combination of rising supply in many markets in response to better weather conditions (NZ) and responses to higher prices in other markets such as the EU and United States. The decline has been triggered in its speed however by Chinese buyers pulling back because of a build up in dairy inventories. This is a phenomena also being seen right now in the log industry, and something which has happened on many occasions for other commodities such as coal and iron ore.

Chinese buyers tend to flock together – all buying at once and all pulling back at once, sometimes responding to what the political leaders are telling them to do. This is not the last time we will see this in the dairy sector so the next time producers see good demand coming out of China they need to keep an eye on stock levels and budget for coordinated reductions in buying at some point.

Those with greater expertise in the dairy sector than myself suggest that this Chinese reaction to excess inventories may be nearing an end but that does not mean prices will be jumping up in the near term. Some factors arguing against this include the following.

- The world knows that long-term demand for dairy products in China is rising strongly and in many countries from Australia to Indonesia to the EU (production limits coming off next year) output is being raised.
- Grain prices have fallen away this year and that implies greater and cheaper production from grain-fed dairy operations, notably in the United States.

The Food and Agricultural Organisation forecast that both dairy demand and supply will grow on average by 1.9% per annum from now to 2023. They expect a rise in production in China of 2.7% per annum on average, the US and the EU 0.5%. NZ output is forecast to grow 1.9% which is less than half annual average growth for the past ten years of 4.5%.

If I Were A Borrower What Would I Do?

It feels like time is once again on the side of borrowers with an absence of data suggesting either an imminent tightening of monetary policy in New Zealand, Australia, or the United States. The latter is however the biggest area of uncertainty with regard to where fixed interest rates will go and one cannot rule out a string of positive data releases suddenly igniting expectations of imminent rate rises, a sell-off in the bond market, and much higher global fixed borrowing costs.

But the Federal Reserve officials appear determined to run the risk of tightening too late and letting inflation get a wee bit too high than tightening too soon and stopping the continuing economic recovery in its tracks. So for now fixed borrowing costs appear reasonably steady. For now also monetary policy in NZ looks like being left on hold. But given data such as what we saw today for retail spending one cannot rule out another move coming in December.

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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