

# New Zealand retail sales: On track for recovery

## New Zealand retail property snapshot

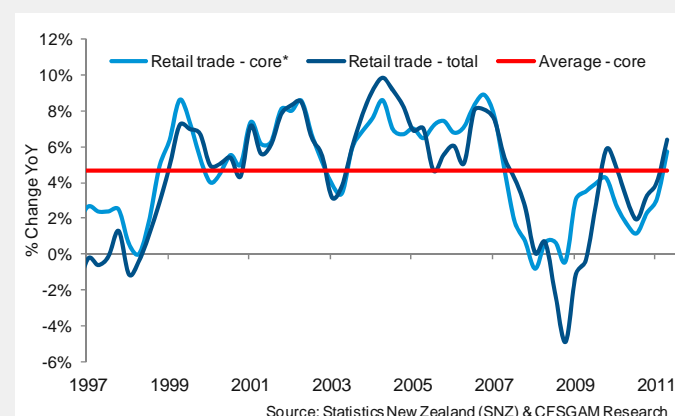
December 2011

- New Zealand’s retail sales are slowly rebuilding. The following paper reviews:
  - key positive drivers of retail sales growth;
  - potential constraints on growth; and
  - the long-term potential rate of sales growth.
- Key findings include:
  - the Rugby World Cup is likely to lift nominal annual retail sales growth to around 5% to 7% in 2011, up from 1.9% in 2010. However this pace is not expected to be maintained in 2012;
  - stronger economic and employment growth should boost consumer confidence and lift retail sales growth;
  - sales growth will be solid but potentially dampened by ongoing consumer caution and the potential for higher household savings rates or, if global financial markets stabilise, the possibility of higher interest rates; and
  - online sales are estimated at around 5% of total sales.
- Outlook:
  - CFSGAM Research expects solid nominal retail sales growth in 2012 at around the long-term average, 3% to 4%.
  - future retail sales growth, over the long-term, should be in line with nominal GDP growth, around 4%.
  - the risk of a double dip recession in Europe and the US may further delay New Zealand’s recovery, but ongoing solid economic growth expected in China as well as rebuilding in Christchurch should help to underpin New Zealand’s economy over the medium term.

### Retail recovery

New Zealand retail trade is gaining momentum following a pause in late 2010, Figure 1.

**Figure 1: Retail turnover growth**  
 YoY percentage change on quarterly rests to Sep 2011



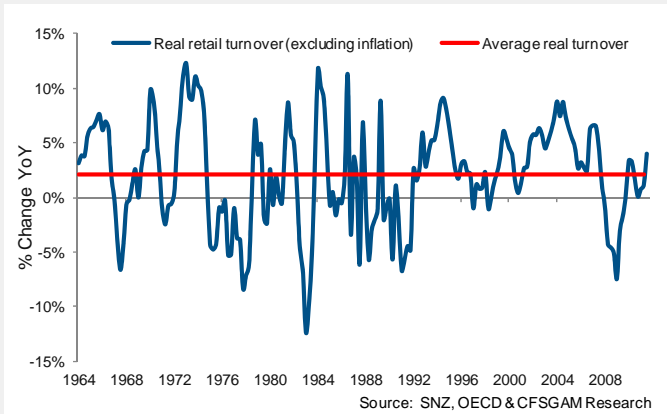
\* Core retail trade excludes motor vehicles, vehicle parts and fuel retailing.

After the Global Financial Crisis (GFC), the New Zealand economy and retail trade improved steadily until late 2010 when a number of factors including a weaker global economy, the initial Canterbury earthquake and heavy snow storms in the south caused the economy to falter.

Aided by the Rugby World Cup (RWC) and inflation of 4.6% (which includes the effect of GST increasing from 12.5% to 15%), retail sales turnover has recovered with total sales growth rising a solid 6.4% over the 12 months to September. Core sales growth, ex motor vehicles and fuel, rose by 5.7%, above the average year on year (YoY) growth rate of 4.6% (average since the series began in September 1995). The strength mainly came in the September quarter as the RWC boosted core sales by 2.7% on the quarter.

Longer-term data is available using real retail trade growth, or sales growth adjusted for inflation. Figure 2 shows that since 1964, YoY real turnover growth has averaged 2.1%. At 4.0%, September 2011’s real YoY growth figure is a little above this.

**Figure 2: Long-term retail turnover growth\***  
YoY percentage change on quarterly rests to Sep 2011



\* Series reconstructed based on OECD data to 1995, then SNZ real data deflated at September 1995 prices to 2003, then SNZ real data deflated at September 2010 prices.

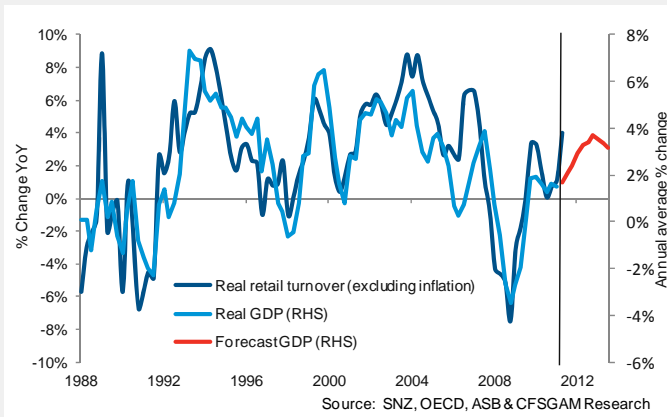
**Positive drivers of retail sales**

**The economy**

Figure 3 highlights the close relationship between retail turnover and economic growth. The ASB Economics team is forecasting economic growth to continue to expand in 2012, suggesting retail sales growth should remain solid in 2012.

Economic growth is likely to be driven by strong commodity exports as well as rebuilding from the Canterbury earthquakes.

**Figure 3: Retail turnover and economic growth**  
YoY change, quarterly rests, forecast from Sep 2011



**Employment**

A by-product of stronger economic growth is firmer employment. As the economy and employment expand, the ASB Economics Team forecasts the unemployment rate will compress from 6.6% in September 2011 to around 4.8% by early 2014, Figure 4.

**Figure 4: Unemployment rate**  
Quarterly rests, forecast from Sep 2011

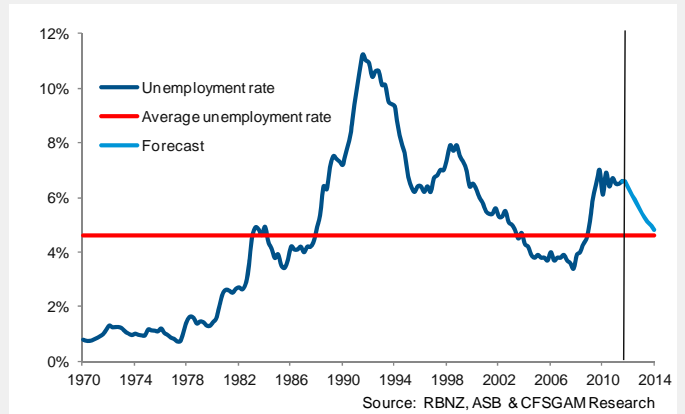
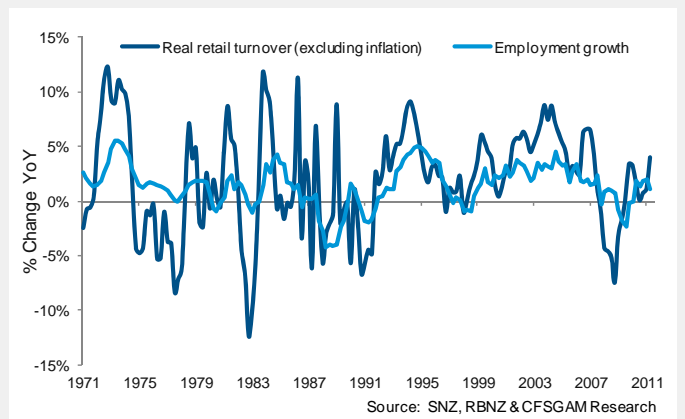


Figure 5 highlights the relationship between employment and retail sales growth. As unemployment falls and employment increases, households will gain spending power and sales growth should firm.

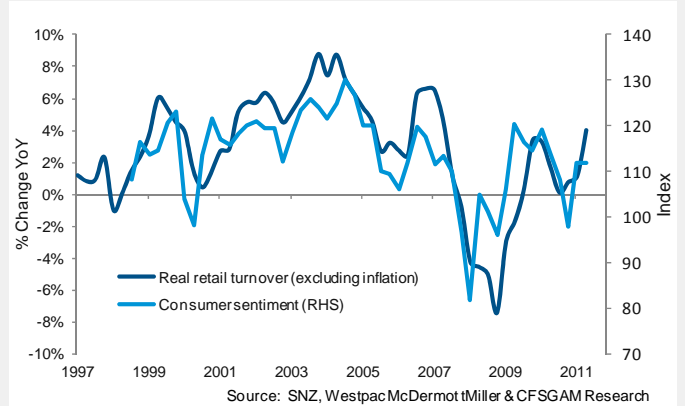
**Figure 5: Retail turnover and employment growth**  
YoY percentage change on quarterly rests to Jun 2011



**Consumer sentiment**

Stronger economic and employment growth is also supporting consumer sentiment, providing a positive environment for sales growth, Figure 6.

**Figure 6: Consumer sentiment and retail turnover growth**  
Quarterly rests to Sep 2011

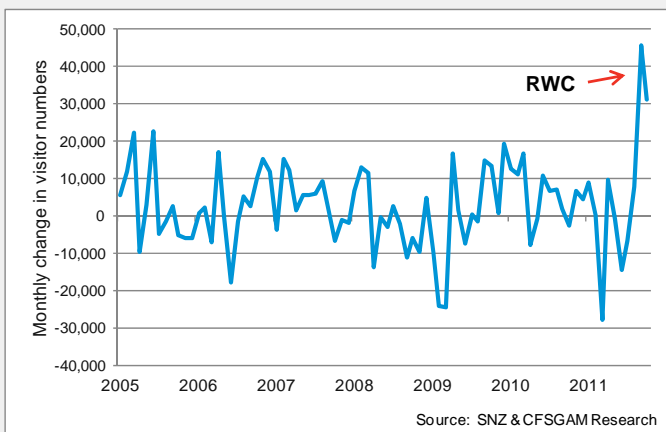


### Rugby World Cup

The RWC was held in New Zealand over September and October 2011 and gave a solid boost to New Zealand's retail sales data.

Data from Statistics New Zealand (SNZ) show visitor numbers spiked by 17% in October compared to October 2010. This figure follows a 26% increase in September. Total visitors for the RWC numbered 133,200 with 53,200 arriving in October and 80,000 between July and September.

**Figure 7: Change in visitor numbers to New Zealand**  
Monthly rests to Oct 2011



The additional 80,000 visitors between July and September helped retail sales in real terms rise 2.2% over the quarter, the largest increase since December 2006. In value terms, total retail sales grew by NZ\$358 million over the September quarter, if around half of that was due to the RWC, it suggests the total spend per visitor was a little over NZ\$2,200.

SNR reported growth was solid in almost all 15 retail industries in the September quarter. Given the influx of visitors it is not surprising the largest increase was accommodation where volumes rose 6.5% over the quarter. Supermarket and grocery store volumes also rose a solid 3.8%. Furniture and floor coverings was the only industry to record a significant fall in volume, down 6.0%.

It has been suggested the rise in retail sales during the event may be followed by weakness post the RWC. This could be due to a fall in overseas visitor numbers while residents may have less discretionary funds available for consumption.

Offsetting this, the victory by the All Blacks should have a positive impact on consumer sentiment; however, the extent and duration are yet to be determined.

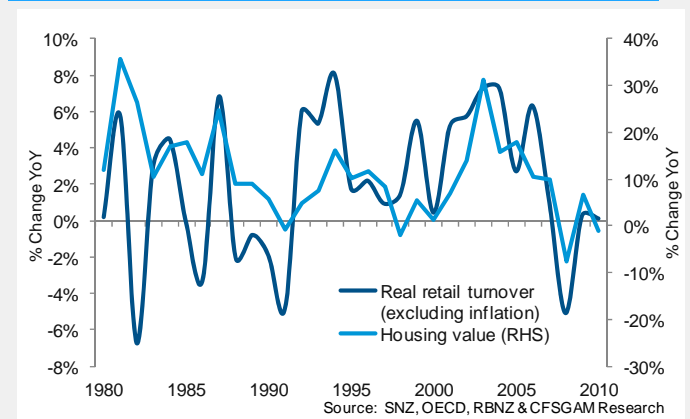
Nevertheless, while there will be some post RWC hangover, even if retail sales record zero growth over the December quarter, the YoY rise over 2011 will be a very solid 6.3%. If sales grow by their average quarterly rate of 1.1%, total growth over the year will be a strong 7.5%. Sales in the December quarter would have to slump by more than 2% for yearly growth in 2011 to be below the long-term average of 4.2%.

### Housing

Housing affects retail trade through changes in house prices and through new construction.

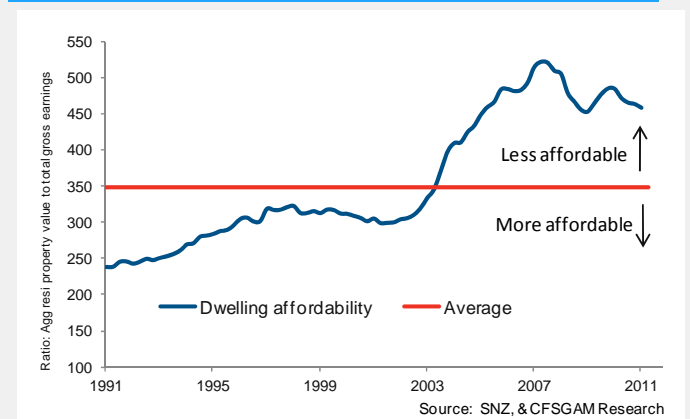
As house prices rise and fall, perceptions of household wealth change and this flows through to retail spending, Figure 8.

**Figure 8: House prices and retail turnover growth**  
Annual rests to Dec 2010



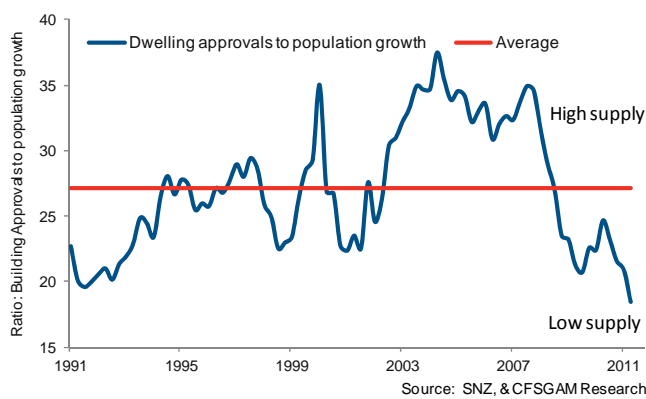
While house price growth has been weak over the past few years, they remain relatively expensive when compared to household incomes (see Figure 9), and this is likely to dampen the potential house price appreciation.

**Figure 9: House prices affordability**  
Annual rests to Dec 2010



Nevertheless, while housing is relatively expensive, there appears to be an undersupply which should provide support for residential property values. Figure 10 indicates that since 2007, new dwelling approvals have lagged population growth.

**Figure 10: Dwelling approval growth to population growth**  
Quarterly rests to Jun 2011



Retail spending is also driven by new dwelling construction and the undersupply suggests the potential for increased construction levels.

Dwelling construction is forecast to increase with reconstruction efforts in Canterbury alone estimated by ASB to see residential construction increase by 50% from current levels. Unfortunately, this may result in a rise in labour costs and dampen construction growth in other parts of New Zealand.

**Constraints on retail sales growth**

**The global economy**

Throughout 2011, global economic activity has slowed due to: ongoing debt issues in Europe and the US; poor confidence from volatile financial markets; disruptions from natural disasters such as the earthquake and tsunami in Japan; and relatively rapid increases in the price of oil in H1 2011. For example, during the second quarter of 2011, oil prices briefly rose more than 25% above the levels that prevailed in January 2011.

These factors have resulted in a world growth forecast below what was achieved in 2010. The International Monetary Fund (IMF) is forecasting 2011 world growth at 3.6% compared to 4.8% in 2010<sup>1</sup>.

There is a risk that global growth will continue to weaken and threaten New Zealand's recovery. However, this is not a consensus forecast, with the IMF forecasting world economic growth in 2012 to accelerate to 4.1%.

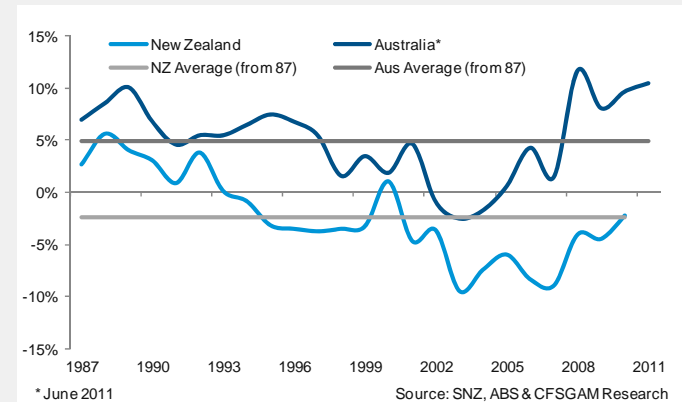
While growth in Europe and the US is expected to continue to be relatively weak in 2012 at 1.1% and 1.4% respectively, the IMF forecasts continued strong growth in China at 9.1%. With China a major consumer of New Zealand's commodities, ongoing strength in the Chinese economy should help to insulate New Zealand from potential weakness in Europe and the US and support the economy over the medium-term.

**Household savings**

The GFC has prompted households around the world to increase their level of savings. In New Zealand, since the series began in 1987, National Accounts data indicates that household savings (net disposable income less final consumption expenditure) has been negative from 1994 onwards. While the savings rate has

increased post GFC, the December 2010 figure of -2.2% remains relatively low. If the trend experienced in Australia is replicated (see Figure 11), further rises in the savings rate can be expected. However, any further large increase to the savings rate may require a significant negative shock to consumer sentiment.

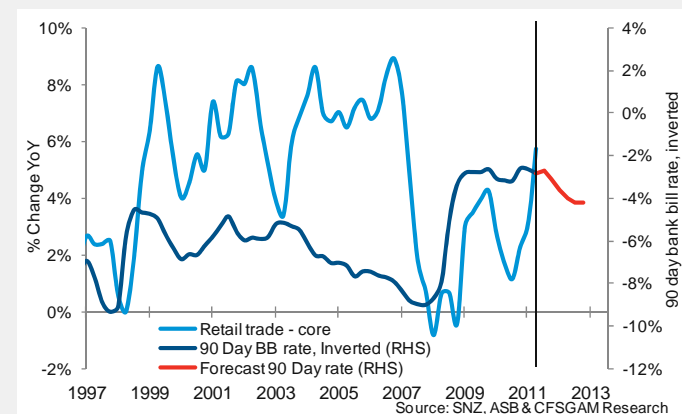
**Figure 11: Household savings ratios, New Zealand and Australia**  
Annual rests to Dec 2010



**Interest rates**

Stronger economic growth, rising terms of trade, higher commodity prices and falling unemployment suggest the potential for inflation pressures to build. The ASB Economics team forecasts that the next move in the Official Cash Rate is likely to be up, however, uncertainty about the global economy should keep rates on hold to mid 2012. While the relationship is not perfect, Figure 12 highlights the relationship between interest rates (inverted) and retail sales.

**Figure 12: Interest rates and retail turnover growth**  
Quarterly rests to Sep 2011, 90 day rates inverted



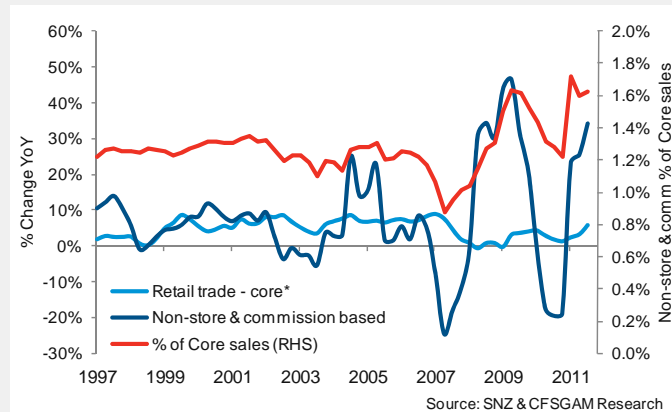
**Online retailing**

Around the world internet or online retailing is increasing rapidly, however, data from SNZ indicates online retailing remains a relatively minor component of New Zealand's total retail sales.

Data, since the series inception in 1995, indicates the category 'Non-store and commission based retailing', (which includes internet retailing), has averaged just 1.3% of total core retail turnover. From 2009 this has grown slightly with a figure of 1.6% for September 2011, Figure 13.

<sup>1</sup> IMF, World Economic Outlook, September 2011

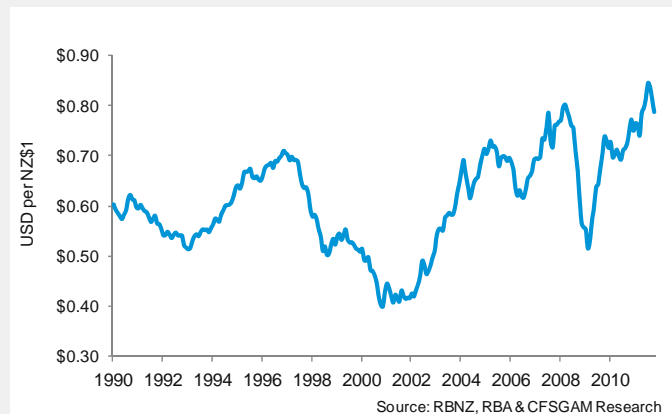
**Figure 13: Domestic internet retail sales**  
Quarterly rests to Sep 2011



Growth rates for non-stores sales are volatile, but from 2005 YoY growth has averaged a little under 10%.

SNZ data only includes New Zealand businesses; while data is lacking on international online purchases, the recent strength of the New Zealand dollar (see Figure 14), suggests growth in international online purchases would also be relatively strong.

**Figure 14: New Zealand exchange rate**  
USD per NZ\$1, Monthly averages for period ending Oct 2011



An indication of the potential impact of online retail may be gained from a number of recent studies which suggest Australian online sales are currently around 3% to 5% of total Australian retail turnover<sup>2</sup>.

The impact in New Zealand is expected to be similar, a study by Frost and Sullivan<sup>3</sup> estimating that online sales in New Zealand account for 5.1% of revenue.

CFSGAM Research's view is that online retailing will become part of a successful retail strategy, one of 'bricks & clicks', where an internet presence complements a physical presence in regional, sub regional, outlet and neighbourhood shopping centres. Indeed, a review of the top 30 US internet retailers on the website 'internet

retailer', showed that 25 of the 30 had a 'bricks & clicks' strategy.

**Retail category performance**

Over the first three quarters of 2011, retail sales growth was generally stronger in the non-discretionary retail categories, such as food and supermarkets. However, the highest growth was in non-store and commission-based sales, which can likely be attributed to internet retail sales growth. The strength of these sectors points to the tentative recovery in the retail environment where consumers are still focused on essentials and value, Table 1.

Fuel sales were also strong, reflecting higher oil prices which peaked in April 2011 at around US\$110 per barrel.

The RWC helped lift accommodation a massive 8.7% in the September quarter and also drove pharmaceutical, food, liquor, clothing and recreation sales.

The more discretionary categories: department stores, furniture and hardware have been relatively soft over 2011.

**Table 1: Retail turnover categories, current prices, annual growth**

Category	Sep 2011	Q1-Q3 2011 <sup>1</sup>	Average since 1997	% of All Indust total
<b>Non-store &amp; commission based</b>	<b>34.1%</b>	<b>27.5%</b>	<b>7.5%</b>	<b>1.3%</b>
Fuel	13.3%	10.7%	6.2%	10.4%
Supermarket and grocery stores	9.6%	7.4%	6.0%	25.7%
Food and beverage services	7.2%	5.2%	4.7%	10.0%
Pharmaceutical & other	7.0%	3.2%	4.5%	6.7%
<b>All industries total</b>	<b>6.4%</b>	<b>4.5%</b>	<b>4.3%</b>	<b>100.0%</b>
Accommodation	6.3%	0.4%	4.5%	4.0%
Recreational goods	6.3%	2.4%	2.9%	2.8%
Specialised food retailing (ex liquor)	6.3%	2.9%	6.2%	1.9%
<b>Core industries total</b>	<b>5.7%</b>	<b>3.7%</b>	<b>4.7%</b>	<b>77.3%</b>
Clothing & footwear	5.0%	4.3%	4.6%	5.2%
Liquor retailing	4.9%	-0.7%	3.0%	1.9%
Motor vehicle & parts	4.9%	4.7%	1.5%	12.3%
Electrical & electronic goods	4.5%	4.7%	4.8%	3.8%
Department stores	-2.0%	-3.0%	4.6%	5.2%
Hardware, building & garden supplies	-3.4%	-2.9%	3.3%	6.5%
Furniture, floor covering & textile	-6.4%	-3.7%	2.9%	2.4%

Source: SNZ

<sup>1</sup> Average YoY growth for the March, June & September quarters.

<sup>2</sup> CBA – McLennan, A., Rogers, J. & Toepfer, A., *Equities: Online retail data* July 2011

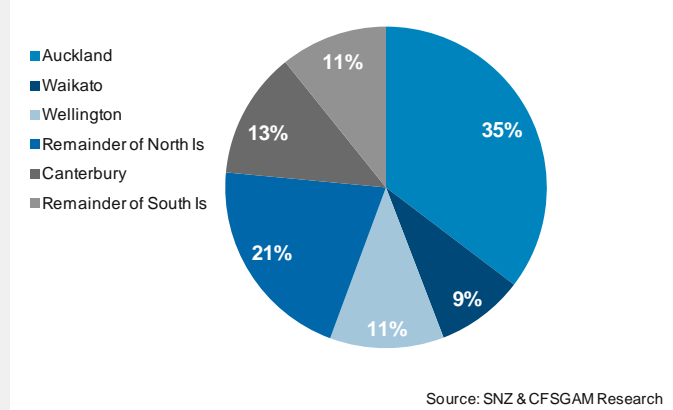
Urbis – Urbis Pty Ltd, *Online Retailing in Australia* July 2011  
Access – Access Economics *Household E-Commerce Activity and Trends in Australia* November 2010

<sup>3</sup> PWC – Frost & Sullivan *Australia and New Zealand Online Shopping Market Insights* 2011

**Geographic distribution of retail sales**

Unsurprisingly, retail sales volumes are highest in the main population regions of Auckland, Canterbury and Wellington with nearly 60% of New Zealand's total retail turnover occurring in these three areas, Figure 15.

**Figure 15: Geographic distribution of retail sales**  
Regional council area percentage of retail sales, Sep 2011



Sales per capita over the 12 months to September 2011 are also highest in the Auckland region; however, turnover per capita in the South Island, ex the Canterbury region, is third strongest. This may be partially attributed to relocation of many Cantabrians following the earthquakes. Sales per capita are weakest away from the main population areas in the North Island, Table 2.

**Table 2: Retail turnover and population**

Region	Retail sales \$m <sup>1</sup>	Population millions <sup>2</sup>	Sales per capita
Auckland	18,193	1,460	\$12,464
Waikato	4,649	412	\$11,298
Wellington	5,916	483	\$12,241
Remainder of North Is	10,763	974	\$11,046
Canterbury	6,747	566	\$11,927
Remainder of South Is	5,751	473	\$12,171
<b>Total</b>	<b>52,018</b>	<b>4,367</b>	<b>\$11,911</b>

Source: SNZ

1 Core retail sales for 12 months ending September 2011  
2 Estimated resident population at 30 June 2010

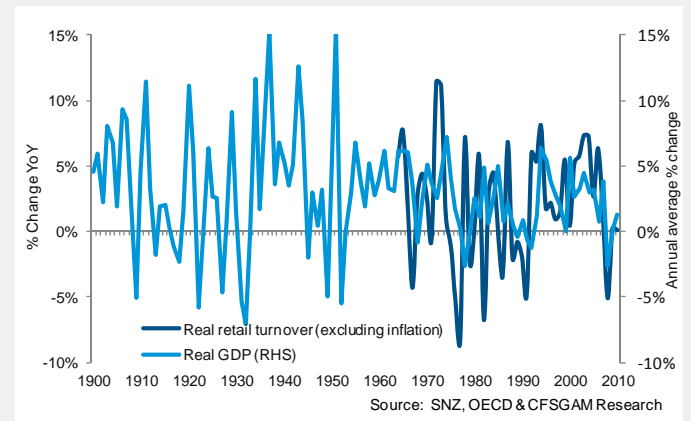
**What is an achievable long-term rate of growth?**

Looking forward, what rate of retail turnover growth might be achievable over the long-term? Available retail turnover data for New Zealand show that spending increases at around the same rate as national income over the long-term, Figure 16.

The average annual rate of real retail turnover growth from 1963 was 2.1%, a little above the average annual rate of real economic growth over the same period of 2.0%. This suggests that, over the long-term, retail turnover growth should be in line with nominal (including inflation) GDP growth.

If long-term real economic growth continues to average around 2.0% per annum and inflation is maintained in the RBNZ's target range of 1% to 3%, long-run nominal retail turnover growth could be expected to average around 4% per annum.

**Figure 16: Long-term economic and retail turnover growth**  
Annual rests to 2010



**Outlook**

The outlook for New Zealand's retail sales growth is one of steady improvement.

The RWC is estimated to boost growth in 2011 to around 5% to 7%. However, this robust pace is not expected to be maintained in 2012.

But while the pace may slow, it should remain firm supported by stronger economic and employment growth. However, while the global economy remains uncertain, consumers are expected to retain a degree of caution which may dampen turnover growth. Conversely, if the global economic situation stabilises, it brings the potential for higher interest rates which could also limit sales growth. This suggests a potential retail sales growth around the long-term average. CFSGAM Research expects growth in 2012 to be around 3% to 4%.

Future sales growth, over the long-term, should be in line with nominal GDP growth or around 4% per annum.

The key risk to this scenario is a double dip recession in Europe and the US which may further delay New Zealand's recovery but continued expected economic strength from China should underpin the New Zealand economy over the medium-term.

John Sears	Head of PAI Research	+61 2 9303 3598	<a href="mailto:jsears@colonialfirststate.com.au">jsears@colonialfirststate.com.au</a>
Kelly Barlin	Senior Property Analyst	+61 2 9303 2625	<a href="mailto:kelly.barlin@colonialfirststate.com.au">kelly.barlin@colonialfirststate.com.au</a>
Martin Patz	Property Analyst	+61 2 9303 0228	<a href="mailto:martin.patz@colonialfirststate.com.au">martin.patz@colonialfirststate.com.au</a>
Ritesh Prasad	Senior Infrastructure Analyst	+61 2 9303 7195	<a href="mailto:rprasad@colonialfirststate.com.au">rprasad@colonialfirststate.com.au</a>
Daniel O'Brien	Graduate Analyst	+61 2 9303 0259	<a href="mailto:daniel.obrien@colonialfirststate.com.au">daniel.obrien@colonialfirststate.com.au</a>
Mary Culjak	Research Assistant	+61 2 9303 3518	<a href="mailto:mculjak@colonialfirststate.com.au">mculjak@colonialfirststate.com.au</a>
Rebecca Ng	Research Assistant	+61 2 9303 0156	<a href="mailto:rebecca.ng@colonialfirststate.com.au">rebecca.ng@colonialfirststate.com.au</a>

**Disclaimer**

Product Disclosure Statements (PDS) and Information Memoranda (IM) for the funds issued by Colonial First State Investments Limited ABN 98 002 348 352, Commonwealth Managed Investments Limited ABN 33 084 098 180, and CFS Managed Property Limited ABN 13 006 464 428 (collectively CFS) are available from Colonial First State Global Asset Management. Investors should consider the relevant PDS or IM before making an investment decision. Past performance should not be taken as an indication of future performance. No part of this material may be reproduced or transmitted in any form or by any means without the prior written consent of CFS. This material contains or is based upon information that we believe to be accurate and reliable. While every effort has been made to ensure its accuracy we cannot offer any warranty that it contains no factual errors. We would like to be told of any such errors in order to correct them. This material has been prepared for the general information of clients and professional associates of CFS. You should not rely on the contents. To the fullest extent allowed by law, CFS excludes all liability (whether arising in contract, from negligence or otherwise) in respect of all and each part of the material, including without limitation, any errors or omissions.

This material is intended only to provide a summary of the subject matter covered. It does not purport to be comprehensive or to render specific advice. It is not an offer document, and does not constitute a recommendation of any securities offered by CFS. No person should act on the basis of any matter contained in this material without obtaining specific professional advice. Colonial First State Global Asset Management is the consolidated asset management division of Commonwealth Bank of Australia ABN 48 123 123 124.