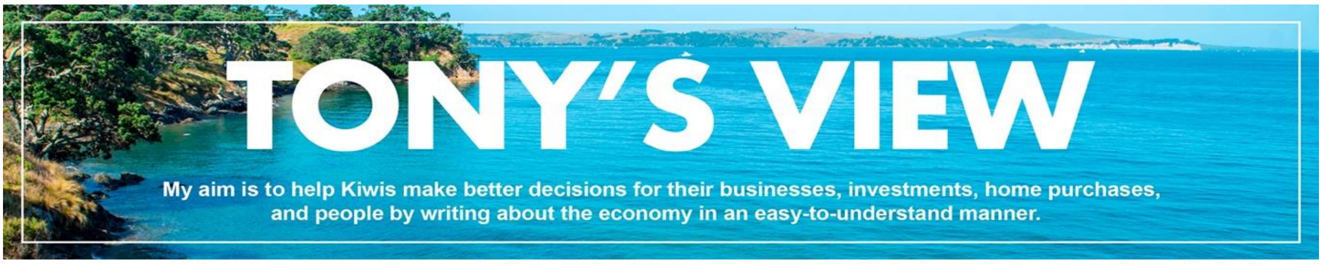

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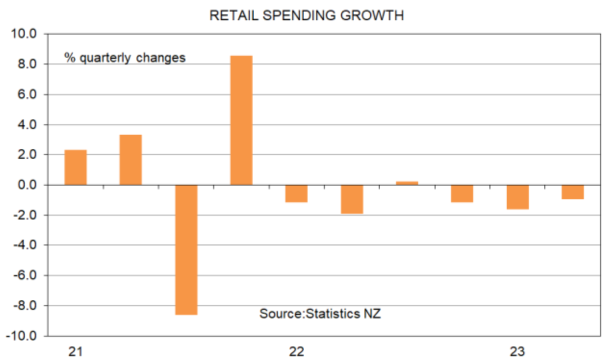
Retailing prospects

Last week Statistics New Zealand released data telling us what happened with retail spending during the June quarter. The main outcome of a 1% fall in sales after adjusting for inflation and seasonal effects was weaker than generally expected. This suggests that the economy is performing less strongly than anticipated by the Reserve Bank and strengthens the case for the official cash rate coming down much sooner than the late-2024 timing which the Reserve Bank have pencilled in.

Spending has shrunk for five of the last six quarters.

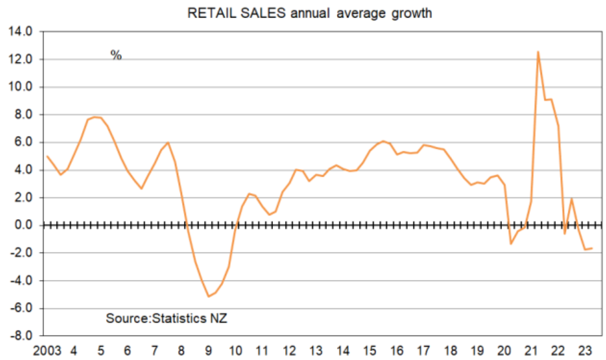


If we look at the year to June, we see spending on retail goods and services fell by 1.7% after inflation. This is the weakest growth (greatest shrinkage) since the Global Financial Crisis and there are many factors behind this situation.

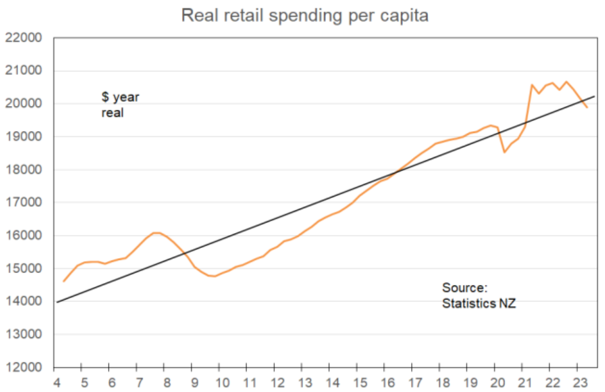
Top of the list is tight monetary policy. The explicit intention of the Reserve Bank when it raises interest rates is that people with mortgages feel the pinch and cut back on their spending. They also want to see weakness in the labour market and people made unemployed who will then also cut back on their spending.

They also want people to be fearful of losing their jobs and hope they also will cut back on their spending.

Then there is the exchange rate effect. The Reserve Bank hopes that higher interest rates will cause a higher NZ dollar which will cause weakness in incomes for exporters who will then cut their spending. Imported goods prices will also fall a bit.



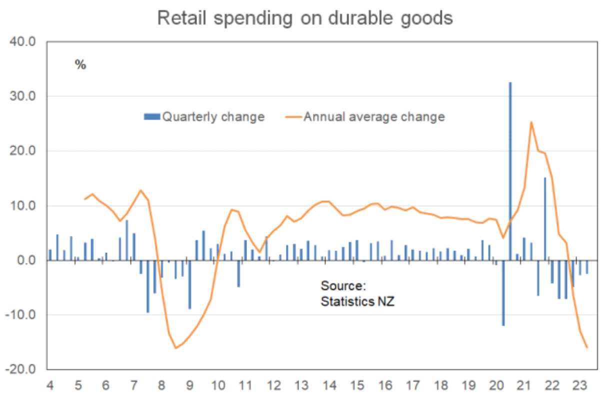
The exchange rate leg isn't operating at all this time around, but clearly the other avenues are, and this is happening even with the population growing by 2.1% in the past year. Retail spending per capita has declined by 2.6% in the past year, as shown here. Spending per person is now below trend after an extended period above trend.



This brings us to the second reason why we are cutting our spending. We have already bought a lot of what we need during the pandemic. We could not travel so we embarked on a period of bringing forward planned expenditure on home renovations, landscaping, spas, swimming pools, new appliances, new furnishings, floor coverings and so on. We binged.

But you only need a new spa every four decades or so and now that we have had our binge there is a "hole" in spending which would otherwise have occurred this year and next. Hence the greatest spending weakness is for what we call durable goods. These are things which last a long period of time.

This next graph shows the durables binge most easily as the orange line representing the annual average rate of growth. Note the 2021 surge and the latest result of -16% which matches GFC weakness.



Speaking of the GFC, there is a factor which was in play back then which has also been in play now – falling house prices. Some people allow their spending to be influenced by their paper wealth and higher asset prices mean they will spend more. This would have accentuated the pandemic binge.

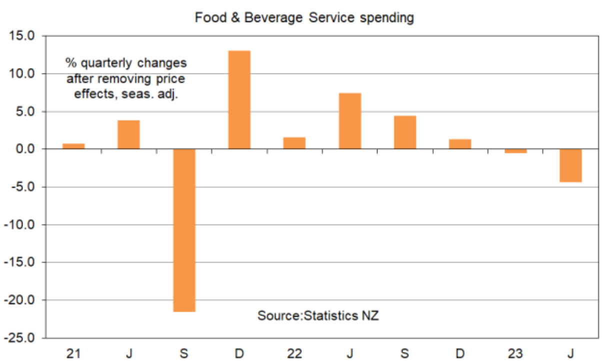
When asset prices fall, they will cut back on their spending. As recently expressed by the Reserve Bank, I also have a view that this effect is not particularly large. But it exists, so we'd best mention it.

Are there other factors helping to explain household spending weakness? Yes – we can now travel offshore again.

Normally, as in pre-pandemic – we would spend about $10bn travelling offshore. For the past year we have been able to do that again after the borders had been closed for two years. Our determination to travel means we are allocating funds from other areas towards travel, accommodation, attractions, and offshore eating and drinking. That is, extra weakness exists in spending domestically.

But there is an offset from people offshore coming here to engage in their revenge travel. In the year to June spending on Food and Beverage Services jumped by 14% - almost the exact opposite of the change in spending on durable goods discussed above.

However, this spending is fading and this likely reflects our having satiated our desire to eat out once pandemic restrictions were eased and our focus now on tightening the belt for a tougher environment. Eating out is one of the easiest things to cut back when times get tough.



Those tough times include a soaring cost of living – high inflation – which is another reason why retail spending levels are falling. We have to keep buying groceries and paying things like insurance and rates, but our concerns about future price rises mean we are exercising caution when it comes to buying other things. This may be the case even if we can afford them.

Older people who have already lived through similar periods of high interest rates and other negative shocks have probably paid off their mortgages and are receiving some benefit from rising interest rates. The current mortgaged generation will be in this position in 20-30 years time and a lot sooner for many.

But despite some extra interest income from bank deposits, these older people also will be exercising caution in their spending because of the soaring cost of living. Many have progressed to fixed retirement incomes and ability to keep up with inflation probably weakens the older one gets.

Young people have a greater tendency to shift employer than people who are older and it is through changing boss that one generally gets the best remuneration increase in New Zealand.

What lies ahead?

Nothing much good for retailers until probably the second half of next year. Here are some of the factors looking to be in play or already in action for the coming year.

Interest rates

The Reserve Bank are unlikely to ease monetary policy until about the middle of next year. When they do the pace of easing is likely to be slow. Also, there are still a lot of people who have yet to see their fixed mortgage rate rollover into something near 7%. Their pain has yet to start.

Therefore, interest rates will remain a strong source of downward pressure on retail spending through into the second half of 2024.

Falling farm incomes

Weakness in China has already seen NZ's export receipts from there fall 24% in July from a year ago with only 0.1% growth for the year ended July. Our export receipts from all countries were 4.2% lower in the three months to July than a year earlier. Weakness in incomes for exporters is likely to persist outside the tourism sector for the coming year and this will especially crimp retail spending in the regions then with a lag the cities. The lag will be longest for Wellington and shortest for Dunedin.

Rising unemployment

The unemployment rate has already lifted from 3.2% to 3.6% and is likely headed towards 5%. Release of the numbers will likely dent consumer confidence.

I will run my monthly Spending Plans Survey again in a week's time. Suffice to say, even though last month's result was less bad than that for July, it was still highly negative with a net 14% of people saying they intend cutting spending over the coming 3-6 months.

Slowing net migration gains

The gains are likely to remain high. But we can already look at the monthly data and see an easing trend in place. My best guess is we are going to settle near the 55,000 per annum average achieved from 2014-19.

More people will assist retail spending for sure. But such assistance so far has not prevented falling consumer spending overall and the population boost will be reduced going forward.

Falling house construction

Although real estate sales are picking up, we will not likely see the restoration of an upward trend in house building until 2025 at the earliest. Until then reduced new house supply growth will naturally curtail demand for furniture and furnishings etc.

There are however some supportive factors.

Strong population growth

Already noted above. Positive, but we have probably seen the peak rate of growth.

Rising house prices

The effect will be there but mainly in the cities. Plus, I suspect it will be a relatively small effect.

Rising tourism

More tourists mean more spending in supermarkets, cafes, restaurants etc. Plus the return of backpackers will see extra council staff having to be hired to clean up their mess.

In case you missed it

No new survey results this past week but the outcome of my monthly survey of real estate agents will appear in a few days.

If I were a borrower, what would I do?

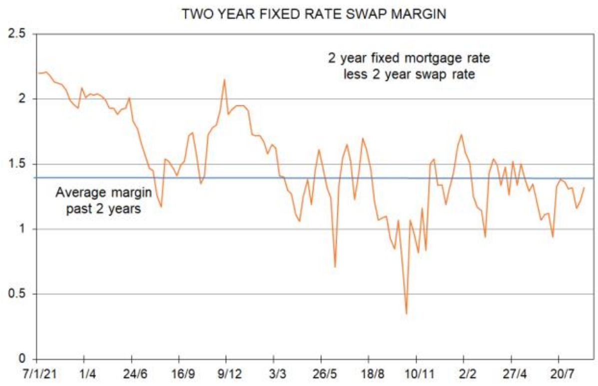
Over the past week we haven't received any new information on the New Zealand economy with great enough relevance to cause changes in the inflation and interest rates outlook or actual wholesale interest rates at the moment. However, data released in the United States have come in weaker than expected with regard to consumer sentiment, job offerings, and GDP growth.

As a result, in the US their ten-year government bond yield has fallen to near 4.11% from 4.23%

last week. But two months ago the rate was 3.93% and four months ago 3.4% so the movement this past week is not of great importance.

With regard to bank borrowing costs here we have seen the one year rate banks pay in the wholesale market fall to 5.72% from 5.76% last week and 5.82% a month ago. The three year swap rate has eased slightly to 5.17% from 5.2% but is still ahead of 5.11% a month ago.

Because I have some spare space, here is a graph showing the roughly calculated bank margin on two year fixed rate lending for homeowners. The margin is slightly below average, so we cannot rule out a further increase though with Spring upon us banks will be thinking about the campaigns they often run at this time of year as real estate activity picks up.



If I were borrowing currently I's still favour some mix of 12, 18, and 24 month fixed rates.

Nothing I write here or anywhere else in this publication is intended to be personal advice. You should discuss your financing options with a professional.