

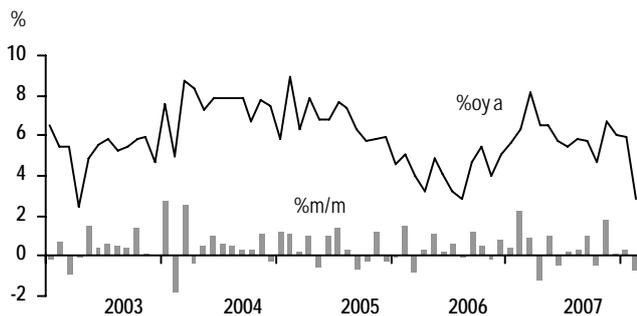
New Zealand economic update

February retail sales

New Zealand retail sales fell 0.7% m/m in February (JPMorgan and consensus 0.0%) after rising 0.3% in the previous month. The headline sales number would have declined further had it not been that goods prices remain elevated; the series is reported in value, rather than volume, terms.

Sales fell in 14 of the 24 store categories in February - the fall in retail sales was largely due to a 5.8% slump in motor vehicle retailing. Growth in core retail sales, excluding the four vehicle-related industries, slowed from 0.4% in January to 0.2%, owing mainly to a 1.6% increase in supermarket and grocery store sales, which remain underpinned by high food prices.

New Zealand: retail trade



Record high interest rates, elevated petrol prices, a rapidly deteriorating housing market, and drought conditions in key dairy producing regions mean that consumer spending will remain weak near-term. Furthermore, a number of domestic banks have started to pass on higher funding costs resulting from credit market tightening, even though the official cash rate (OCR) has remained steady since July.

The moderation in private consumption growth is one key reason why we have lowered our growth forecasts for New Zealand. We now expect GDP growth of just 1.9% in 2008, down from our previous forecast of 2.5%, and well below the 3.1% growth rate logged in 2007. Furthermore, we expect GDP growth to stagnate in 2Q, with a significant risk of negative growth in that quarter.

Despite the slowdown in economic momentum, however, widespread inflation pressures mean that there will be little scope to lower rates in the foreseeable future. RBNZ Governor Bollard has highlighted in recent

commentary that tight labour market conditions, rising commodity prices, and the government's expansionary fiscal stance will keep upside pressure on inflation, meaning that the OCR will remain at a record high 8.25% for some time. JPMorgan expects that the March quarter CPI report (due tomorrow) will print annual headline inflation at 3.4%, up from 3.2% in previous three months, and still hovering uncomfortably above the RBNZ's 1-3% target range.

- Total retail sales were down 0.7% m/m in February, while core sales rose 0.2%.
- Sales fell in 14 of the 24 store categories in February. The fall in retail sales was largely due to a 5.8% slump in motor vehicle retailing.
- Trend sales continue to rise, driven by automotive fuel retailing, buoyed by elevated petrol prices.

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