

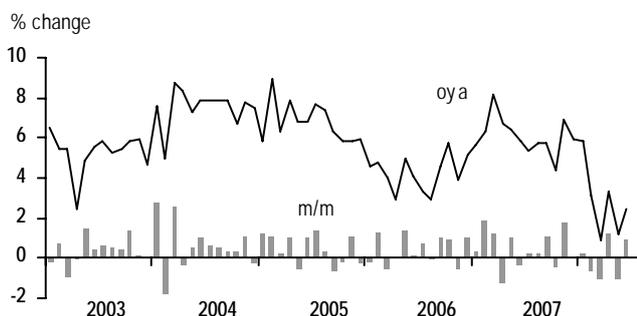
New Zealand economic update

June retail sales

The value of retail sales in New Zealand unexpectedly spiked 0.9%*m/m* in June (JPMorgan -0.4%, consensus 0.0) after slumping a revised 1.1% in May (previously 1.2%). There also was unexpected strength in the underlying retail data. Ex-auto sales were flat (rather than negative as forecast) after rising 0.8%*m/m* in May (revised up from 0.7%), signaling that underlying consumer spending held up in June.

Thirteen of the 24 retail industries recorded sales increases in June. The largest increases were in motor vehicle retailing (+5.2%) and automotive fuel retailing (+2.6%). Of the 11 retail industries to record sales decreases, the largest decrease was in department stores (-8.7%). Each of the four auto-related industries reported higher sales, with the largest increase recorded in motor vehicle retailing (+5.2%).

New Zealand: retail trade



In real terms, retail sales declined 1.5%*q/q* in 2Q (JPMorgan -1.9%, consensus -1.8%), the largest fall on record, owing mainly to a decline in volumes of motor vehicle retailing. This was the first time since June 1998 that volumes have fallen in two consecutive quarters – in 1Q sales volumes fell 1.2%*q/q*. Weak private consumption growth was a key driver of the contraction in the economy in 1Q, when GDP growth declined 0.3%*q/q*. Our forecast calls for GDP growth of -0.5%*q/q* in 2Q, meaning New Zealand's economy will have endured a technical recession in the first half of 2008. This recession, though, is likely to be prolonged, with our forecast calling for another contraction in the economy in 3Q (-0.3%*q/q*).

Consumers in New Zealand will continue to face significant headwinds in coming months, owing partly to the negative wealth effects from the sharp deterioration in the housing market, high interest rates, and elevated petrol

prices. Furthermore, weak business confidence suggests that companies will become increasingly reluctant to hire workers, meaning that the unemployment rate will trend north.

While the near-term outlook for retailers is bleak, some improvement in sales can be expected toward the end of 2008 and into 2009 now that the RBNZ has embarked on what is likely to be an extended easing cycle. We maintain our forecast that the RBNZ will cut the OCR by another 25bp in September, October, and December, taking the key rate to 7.25% by year end.

The details:

- Retail sale values rose 0.9% m/m in June.
- Retail volumes fell 1.5% q/q in 2Q.
- Core retail sales were flat in June from the previous month.
- Motor vehicle retailing rose 5.2% m/m in June.

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