Economic Research
Sydney
September 12, 2008

Stephen Walters (61-2) 9220-1599
Stephen.b.walters@jpmorgan.com

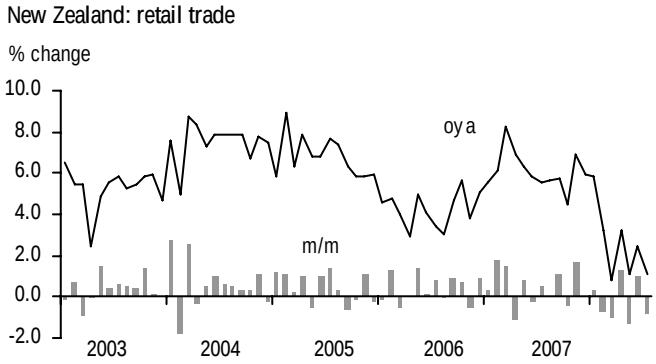
New Zealand economic update

Retail sales - July

The value of New Zealand's retail spending dropped more than expected in July, falling 0.8%m/m against JPMorgan and market expectations of a modest 0.3% fall. This all but reverses the revised 1.0% rise in sales in June (previously shown as a 0.9% rise). The weakness was due partly to soaring petrol prices, which reached a record high during July. Sales ex-autos also fell, so the weakness in spending was broad-based. Sales ex-autos dropped 0.2%m/m against market expectations of a 0.3% rise, following a 0.2% rise in June. Annual growth in total retail spending has fallen to just 1.1%oya, from 2.4% in the year to June.

Sales fell in 13 of the 24 retail categories in July. Car sales plunged 5.3% over the month and, of the other retail categories, the biggest declines were in sales of furniture, hardware, "other" retailing, and at cafes and restaurants. Sales at supermarkets plunged 2.0%m/m, even though food prices rose over the month. On the flipside, though, clothing sales bounced 9.0% over the month (albeit after a big fall in June) and spending in department stores unexpectedly soared 5.9%, reversing a similar-sized drop in June.

The weakness in retail spending supports the RBNZ's sentiments in yesterday's monetary policy announcement that the household sector is likely to experience an extended period of adjustment. Interest rates remain high, even after yesterday's surprise 50bp cut in the OCR, petrol prices only recently started to fall, consumer confidence has stabilized but remains fragile, the labour market is softening, and house prices are falling. The only dim light flickering at the end of a long, dark tunnel is the prospect of income tax cuts from 1 October. Given the strengthening headwinds for households, though, the tax cuts probably will do little more than cushion the downside.



Stephen Walters (61-2) 9220-1599
Stephen.b.walters@jpmorgan.com
Helen Kevans (61-2) 9220-3250
Helen.e.Kevans@jpmorgan.com

The weakness in the household sector, the problematic global economic and financial market outlook, sagging domestic house prices, the falling terms of trade, and the improving prospect that inflation will return to the RBNZ's 1-3% target range over time do mean there is scope for the RBNZ to continue to cut the official cash rate in coming months. We believe, though, that the case for measured, 25bp rate cuts in October and December (there is no OCR review in November) still outweighs the case for 50bp rate cuts, which carry the unpleasant appearance of desperate RBNZ officials trying to prevent the economy from falling into an even deeper recession.

Moreover, one key risk rightly raised by the RBNZ yesterday was the danger of further significant NZD weakness, which dived after yesterday's unexpectedly assertive official rate cut. Further 50bp rate cuts could send the NZD into a tailspin, which inevitably would worsen the already difficult near term inflation outlook.