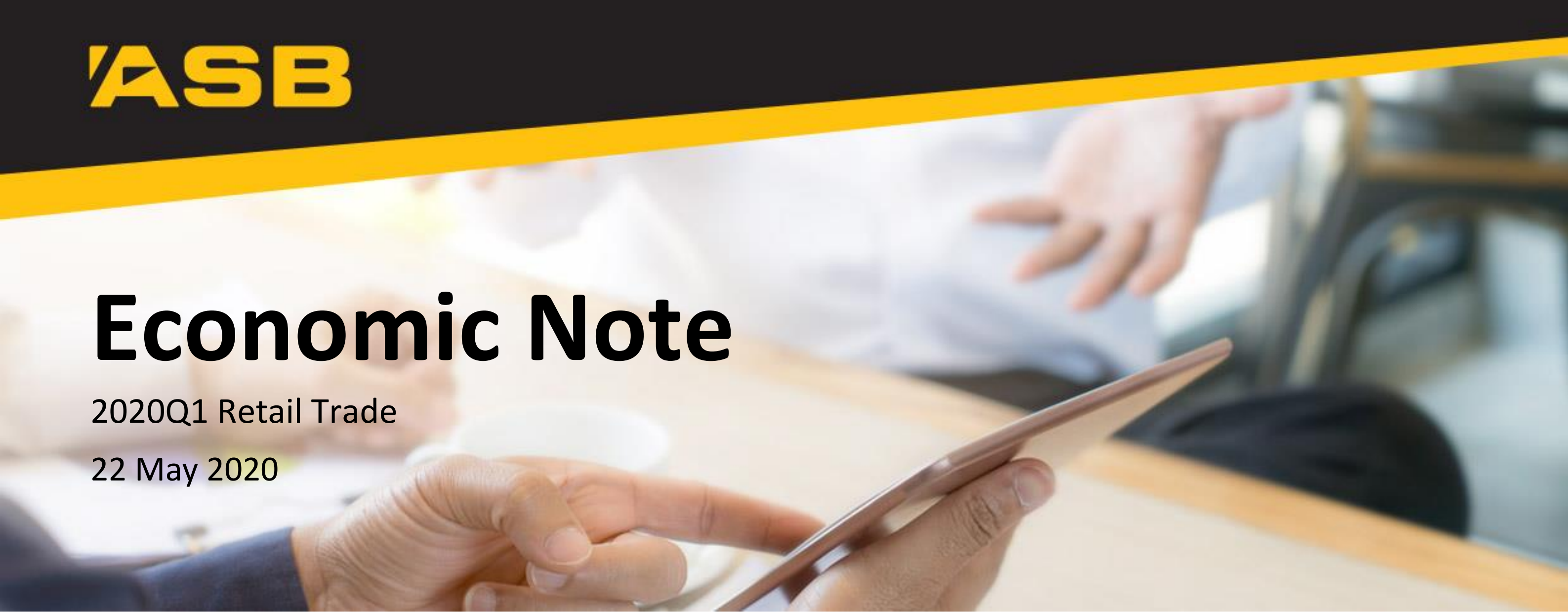

Economic Note

2020Q1 Retail Trade

22 May 2020

Modest COVID-19 hit, but significantly more in store for Q2

- More modest than expected contraction in retail volumes in Q1, but some signs of a COVID-19 impact with surging supermarket sales offset by weaker hospitality and accommodation retail.
- We expect a record Q2 contraction in retail volumes given the impact of the lockdown for non-essential retail earlier in this period.
- Easing restrictions on non-essential retail and pent-up demand should trigger a retail rebound, but we still expect a close to 10% fall over 2020, given widespread job losses and the weak economic backdrop.

Retail Sales: 2020Q1	Previous	Actual	ASB
Total volumes (qoq)	0.0%	-0.7%	-1.5%
yoy	3.3%	2.3%	
Core volumes (qoq)	-0.1%	0.6%	
yoy	3.3%	4.0%	
Total retail deflator (qoq)	0.5%	0.4%	
yoy	0.1%	1.0%	

Summary & implications

The fall in Q1 retail volumes was milder than we had expected. Signs of a COVID-19 impact were evident in the Q1 figures, with panic buying supporting supermarket sales, but with accommodation, apparel and hospitality retail well down. Durables spending was mixed, part of which looks to be related to COVID-19 impacts. We expect Q2 to be the low-water mark for the retail sector, followed by a modest recovery. Widespread job losses and the weak economy are expected to encourage spending restraint with discretionary and durables retail likely to remain under pressure over 2020 and potentially into 2021.

The milder than expected fall in Q1 in retail trade volumes suggests some modest upside risk to our -0.5% qoq pick for Q1 GDP. The retail trade figures are one of the earlier published inputs to GDP. However, retail spending looks to have run into a brick wall in Q2 as the COVID-19 outbreak and associated restrictions took effect.

The easing of restrictions and pent-up demand is expected to see retail volumes rebound in the second half of the year, but we expect overall retail volumes to be around 10% lower over 2020. We expect consumers to rein in discretionary and durable spending and to look for cheaper alternatives elsewhere.

Details

Retail trade spending volumes declined 0.7% in Q1, marking the first contraction in the quarterly retail sales volumes since mid-2015 and the largest decline in eight years.

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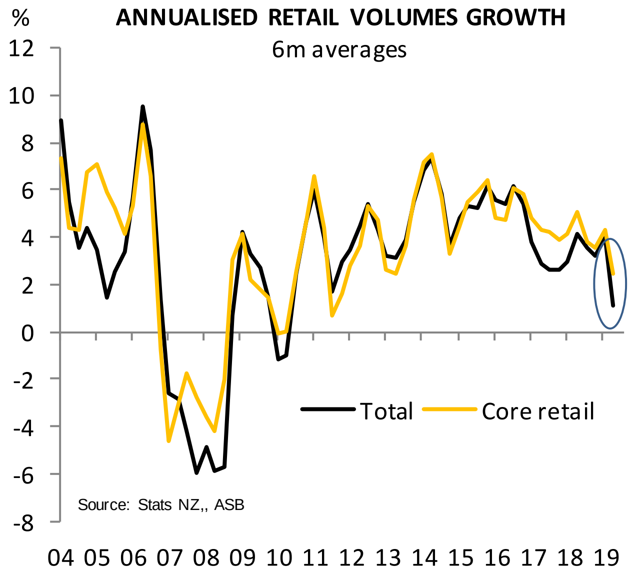
The contraction in retail volumes was driven (no pun intended) by sharply falling motor vehicle retail (down 7.5% qoq) that had earlier been signalled by a sharp fall in car registrations. Core retail volumes (which exclude fuel and vehicle-related spending) actually rose 0.6% qoq. Annual spending volume growth in the March 2020 year eased to 2.3%, its lowest in close to 9 years, whereas annual growth in core retail ticked up to 4%.

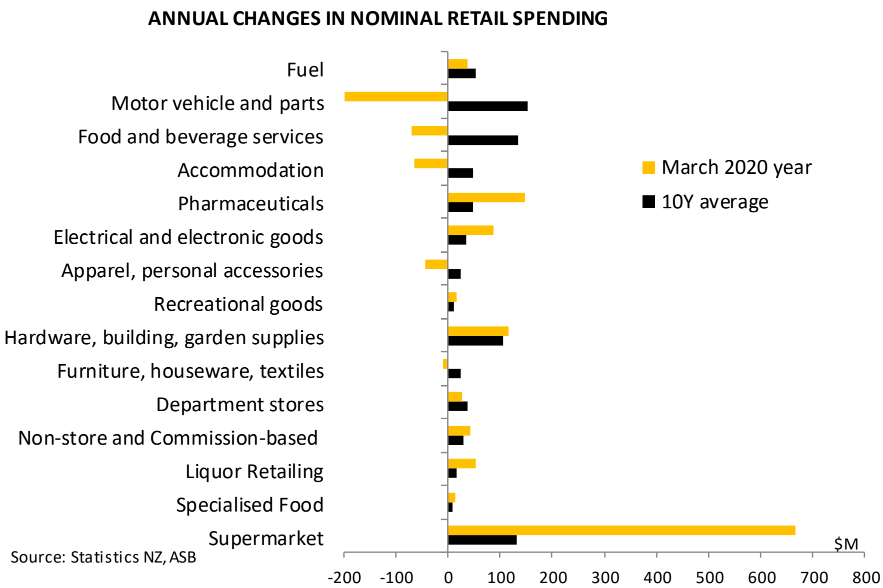


There has been a notable deceleration in the pace of retail activity. There were sizeable revisions to previous quarters, with Q4 2019 retail volumes now essentially flat (previously +0.7% qoq). As a result, the pace of total retail volume growth over the last 6 months has slowed to around a 1% annualised pace for overall volumes, the lowest in 9 years. The 2.4% annualised growth in core volumes was the lowest in close to 8 years.

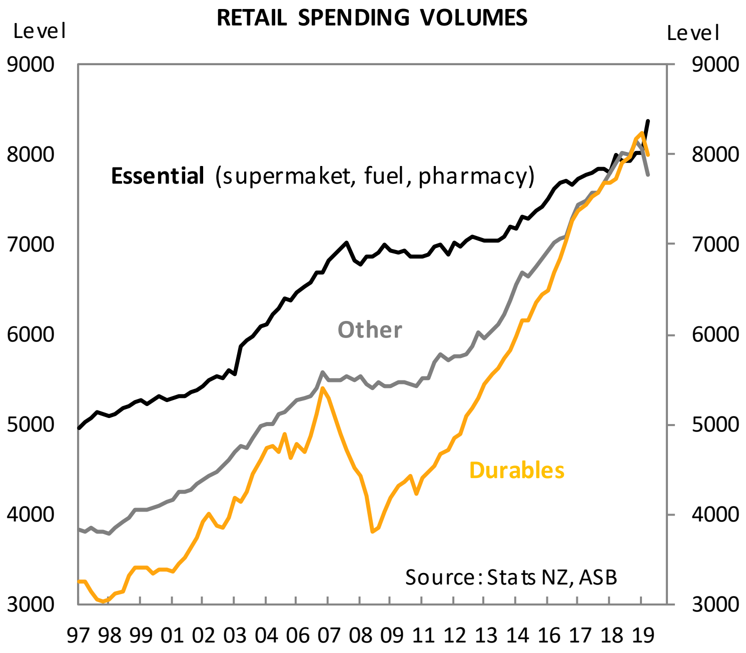
Quarterly movements for most retail categories were pronounced. Activity fell in 8 of the 15 retail sub-groups (6 of 12 core sub-groups).

Even though we expect significantly more of the impact of COVID-19 to impact in Q2 (and beyond), the Q1 figures still showed likely signs of COVID-19 impacts:

- Panic buying in supermarkets look to have underpinned an 8.5% qoq rise in supermarket sales volumes for the quarter, taking their level to a record high. Liquor retailing also rose strongly (+6.1% qoq).
- Fuel retailing might have been classified as essential and able to remain open over all of Q1, but the early part of the lockdown looks to have dented demand with fuel retail volumes down 1.1% in Q1. Pharmaceutical volumes also declined in Q1, but this followed sizeable rises in H2 2019.
- The progressive tightening in travel restrictions from early February and increasing restrictions on domestic travel towards the end of the quarter contributed to sizeable declines in accommodation (-9.3% qoq) and food & beverage services (-6.7% qoq).
- Tightening restrictions as NZ moved up the COVID-19 Alert scale prompted some closures of non-essential retail. Apparel (-6.6% qoq), furniture (-6.2% qoq) and motor vehicle (-7.5% qoq) retail copped heavy falls.
- Consumers also likely stocked up on additional items that would make a potential period in lockdown more comfortable. Appliance and electrical and electronic retail volumes (+1.3% qoq) and hardware volumes (+1.5% qoq) rose, with the former having earlier been boosted by the Black Friday Sales at the end of last year.



Viewing the changes in retail spending values over the March 2020 year by retail sub-group (see above chart) shows that supermarket sales have been the major outperformer over that period in terms of dollar increases in sales. Pharmaceutical sales values have increased, with the Q1 contraction in retail volumes likely to reverse in subsequent quarters. The durable sector was a mixed bag. Solid increases remained evident for hardware stores and electrical and electronic goods. Sharp falls in motor vehicle sales in Q1 saw a contraction in sales in this category. Sales in the hospitality sector are tracking well below where they were a year ago, with this underperformance to continue for a while yet.



There is more to come, and we expect a record contraction in retail volumes in Q2. We have pencilled in around a one-third contraction to overall retail volumes given that non-essential retail was effectively shut for much of April. While the shift to Level 2 halfway through the quarter has meant that more of the retail sector is operational, levels of retail spending are still expected to be well below 'normal' given the physical distancing requirements. Of the broad retail categories (see chart above), we expect essential retail to continue to fare reasonably well (modest falls, with easing Alert levels seeing a pullback in panic buying). However, durable and other retail (which includes hospitality, accommodation and other retail linked to the tourism sector) are expected to suffer larger proportionate falls.

The hopeful easing of restrictions and pent-up demand is expected to see retail volumes rebound in the second half of the year, but we expect overall retail volumes to be around 10% lower over 2020, with more sizeable falls for hospitality and accommodation retail. Fiscal and monetary policy settings are at full throttle, but widespread job losses, falling house prices and a weak outlook for tourism means that 2020 will be a difficult year for most retailers. We expect consumers to rein in discretionary and durable spending. Even within retail categories we expect consumers to look for cheaper alternatives. Next year may not be markedly better for some.

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