

RETAIL SALES AND ECONOMIC DRIVERS

March 2017

89.635

By Daniel Lees

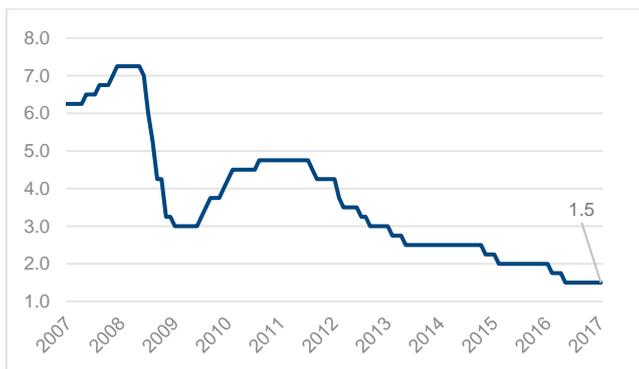
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Cash Rate

RBA Cash Rate

April 2017



Source: RBA / Colliers Edge

The RBA left the cash rate unchanged at 1.5% in April, for the seventh consecutive meeting. Once again the commentary on global conditions was buoyant, noting a pickup in trade and growth expectations across a number of advanced economies. The RBA noted how this pick up in global conditions had led to higher commodity prices and domestic national income however omitted the recent pull back in some base commodities. Inflation rates have risen in most countries and long term bond yields have ticked higher despite remaining low in a historical context. The interest rate outlook is generally higher, led by the US while there is no longer the expectation of additional monetary easing in other major economies. Australia continues its rotation away from mining, however growth rates are moderate and there was mention of the recent softness in the labour market which we have discussed in this paper. The domestic outlook will be supported by low interest rates with the outlook for inflation remaining subdued on the back of labour costs. The

Board has expanded its commentary on the residential housing market given recent regulatory developments. The persistent increase in house prices, associated lift in mortgage growth and household debt is now being addressed through the enforcement of stronger lending standards. In this respect the onus is on lenders to ensure that serviceability metrics are met and that the growth in interest only loans is limited to 30% of new residential mortgages. Investor lending growth must remain below the 10% annual growth rate outlined in December 2014.

CPI

Headline CPI

4Q16



Source: ABS / Colliers Edge

Australia's 4Q16 headline CPI rose 0.5%QoQ (exp 0.7%QoQ) from 3Q16 where it increased 0.7%QoQ. The annual CPI growth rate increased from 0.3%YoY in 3Q16 to 1.5%YoY in 4Q16, although this was below consensus expectations of a 1.6%YoY increase. Annual inflation metrics increased across all major cities with the exception of Perth where prices fell from 0.5%YoY in September to 0.4%YoY in this latest result. Sydney retains the highest annual inflation rate which increased from 1.7%YoY to 1.8%YoY. At a category level, the biggest needle mover was alcohol and tobacco which increased 5.9%YoY and 2.8%QoQ in December. Transport fuel also increased substantially over the quarter to 1.7%QoQ up from a -0.5%QoQ decline in September.

The biggest drags were apparel, household goods and communications.

Currency Movements

After a strong start to 2017, the Australian dollar weakened in March, slipping -0.57% against the USD to US\$0.7644. A spate of positive economic data releases in the US, combined with a consensus outlook for rising US inflation levels has led to a strengthening of the USD. The AUD has been supported by the commodity rally through early 2017, although this may have run its course, given that the main driver here was derived from Chinese policy and global iron ore supplies from Brazil and Australia are increasing. Over March the AUD also weakened against other major currencies; CNY (-0.15% to ¥5.2734), EUR (-1.36% to €0.7161), GBP (-0.94% to £0.6126), JPY (-1.01% to ¥85.67) and KRW (-1.56% to ₩855.78).

AUD / USD Exchange Rate (1AUD=USD) March 2017



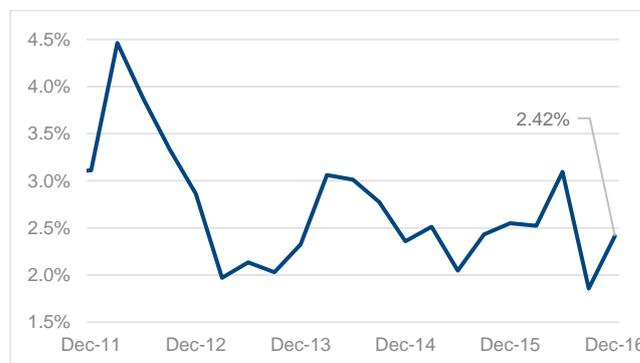
Source: RBA / Colliers Edge

GDP

Australian GDP expanded by 1.4%QoQ in 4Q16, exceeding economist expectations of 0.8%QoQ and marking a significant rebound on the -0.5%QoQ recorded in 3Q16. Annual growth strengthened to 2.4% from 1.9% in 3Q16, but remains below the recent high of 3.1% in June. The weak 3Q16 result caught the market by surprise but coincided with a number of one off events such as bad weather and the disruption of the July Federal election. Since then, the election has passed, RBA rate cuts have had some impact, the mining investment drag has eased, global commodity prices have surged and global conditions have improved generally. Importantly, consumer spending strengthened quite broadly, with growth in household goods, health and services. This result transpired despite households encountering some pressures during the quarter including soft total employment growth numbers and fairly benign wage growth. Looking forward, the labour market will need to strengthen further in order to support a sustained increase in consumer spending. Business investment has also grown together with infrastructure spending. The mining investment drag is waning although there will be some further slippage as gas projects are progressively completed in 2017. From here the outlook remains constructive as RBA rate cuts carried out in 2016 continue to have some impact and

housing finance rebounds. Additionally some of the domestic political uncertainty has been removed as the Federal election is now behind us. Additionally, higher commodity prices are boosting national income as we move from construction to production phase.

Gross Domestic Product (% growth YoY) 4Q16

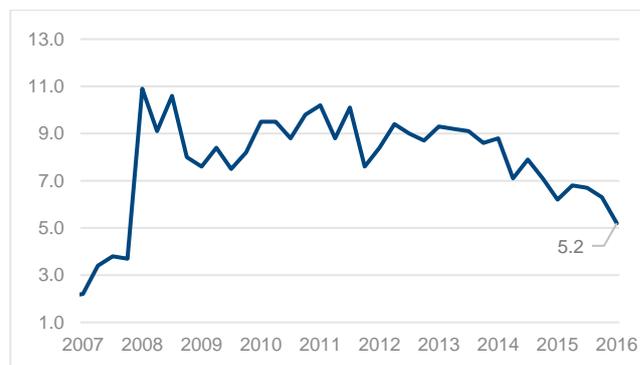


Source: ABS / Colliers Edge

Household Savings Ratio

Australia's household savings ratio continued to decline in 4Q16, falling from 6.3% in 3Q16 to 5.2% in the latest release. The decline was driven by a combination of income and spending. Household gross disposable income grew 0.2%, while household spending lifted to 1.2%, up from a subdued level of 0.6% in the previous quarter.

Household Saving Ratio 4Q16



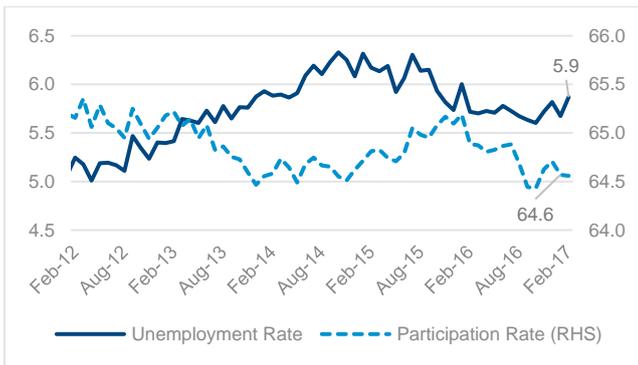
Source: ABS / Colliers Edge

Labour Market

February's labour market data release was quite weak overall, with net employment numbers slipping -6.43K, compared to expectations of an increase of just under 20K. Encouragingly, the full time employment category experienced some growth, gaining +27.06K, although this was completely wiped out by a -33.49K fall in part time employment. Falling employment numbers, combined with a static participation rate of 64.6% (not far off recent lows), led to a 20bp gain in headline unemployment to sit at 5.9%. This marks the highest level since January 2016. Rolling

12 month net employment numbers have thankfully rebounded off November 2016 lows to 104.59K, but this latest net decrease isn't helping the situation. February also provided a look through into the nations labour utilisation which indicated that underemployment had actually increased back to 8.7%, up from 8.4% at the last release in November. With this data in mind, it looks like wage growth and core inflation levels are likely to remain subdued for the time being. Unemployment increased across all major states with the exception of WA, which improved by 40bp to 6%. NSW increased 10bp to 5.2%, VIC increased 30bp to 6.1%, QLD increased 40bp to 6.7% and SA increased 20bp to 6.6%.

Australian Labour Market February 2017



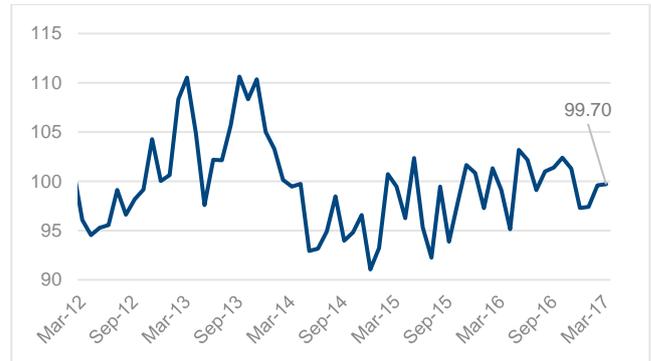
Source: ABS / Colliers Edge

Confidence Metrics

Consumer Confidence

The strong lift in consumer confidence witnessed in February was sustained in March, with the index stabilising just below the 100 mark where optimists and pessimists are around equal in number. It appears that consumer views on economic conditions have improved, while respondents overall awareness on budget and taxation news is down significantly from a year ago, implying that they are perhaps less perturbed about these issues currently. Despite no move by the RBA in March, the news on interest rates was much more positively received, although we are mindful that APRA's recent official communication to ADIs regarding new prudential measures may influence the outcome of April's survey result. The unemployment expectations index also fell, indicating that respondents assessment of the unemployment outlook have stabilised at current levels. Housing sentiment also lifted in March although the recovery was mainly attributed to a sharp turnaround in Victoria where the state government has recently announced a range of new measures including abolishing stamp duty for first home buyers.

Westpac-MI Consumer Confidence March 2017



Source: Westpac-MI / Colliers Edge

Business Conditions

February's monthly business survey gave back some of the prior month's gain which was expected given that January's jump was due to some temporary factors. The business conditions index dropped by 7 points to sit at +9 which is still above the long term average. There was a deterioration across all three components (trading, profitability and employment) although the bulk of the deterioration seems to have come from sales (which aligns neatly with the most recent ABS retail sales figures). Meanwhile confidence levels dropped back a little in February, but still remains upbeat overall, consistent with the broader financial markets. NAB has indicated that this recent moderation in business sentiment levels has not altered the fundamental outlook for the economy with the conditions index remaining at quite lofty levels and expectations of solid rates of economic growth in the near term.

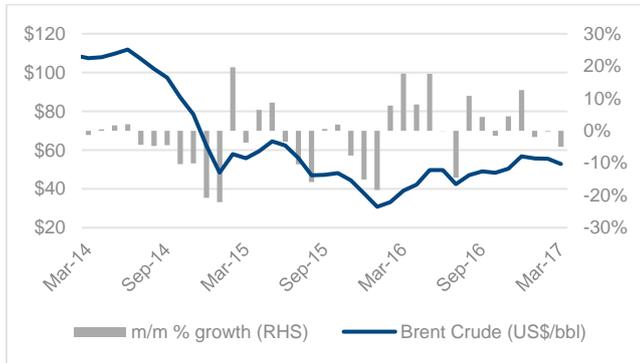
NAB Business Conditions February 2017



Source: NAB / Colliers Edge

Oil Prices

Brent Crude Oil Price (US\$/bbl)
March 2017



Source: Bloomberg / Colliers Edge

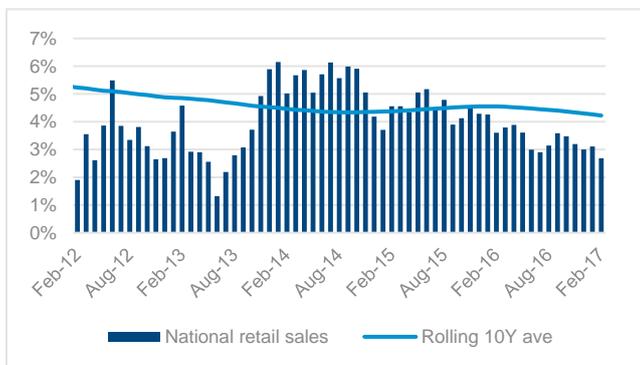
Oil markets declined for the third consecutive month slipping -4.69% to US\$52.83 at the March close. Markets are looking for confirmation that OPEC production cuts announced late last year are rebalancing supply levels, however confidence in this actually occurring is quite low. In addition, US crude inventories have swollen as increased drilling activity here offset cuts elsewhere in the world – rig count activity in the US has been recovering steadily since mid-2016.

Retail Spending

National

February's retail sales slipped -0.8%MoM in February, missing market expectations of a 0.1%MoM gain, and marking the second decline in the past 3 months. Relative to the prior corresponding period (pcp) of February 2016, overall retail sales grew by 2.68%, which is down slightly on January's 3.11% rate. It appears that the non-discretionary component of the retail sales data is recovering steadily, while the discretionary sector is struggling to make a convincing recovery.

National Retail Sales (% change on pcp)
February 2012-17



Source: ABS /Colliers Edge

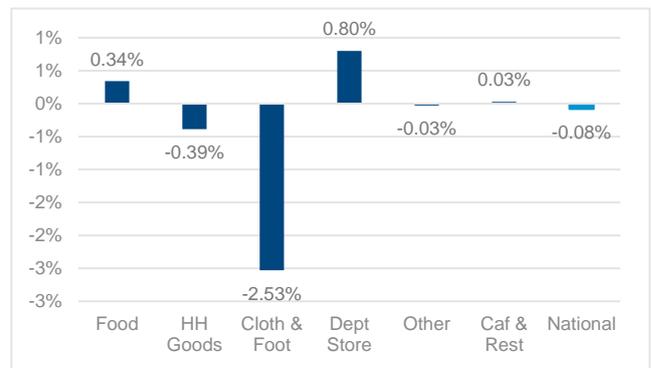
Within the categories, food sales looks to be gathering momentum, growing 0.34%MoM in February, up from the 0.30%MoM recorded in January. The annual rate has also strengthened to 3.69%, the highest since May 2015. It's difficult to determine how long the recovery in the food sales will run for taking into consideration the competitive landscape of the supermarket sector. The success of operators such as Cosco and Aldi is testament to Australian demand for low cost grocery offerings, and consumers stand to benefit from the entry of new players such as Amazon, Kaufland and possibly Lidl. While an all-out price war is not in the interest of any retail participant, this competitive landscape should cap price inflation.

Disappointingly, the decline in retail sales figures has stemmed from the more discretionary component of the economy. The apparel sector fell sharply in February, down -2.53%MoM, the steepest fall in the category since December 2013. Subsequently the annual growth rate moderated to 0.85% on pcp, down from 5.00% in January. It's possible that waning sales post the Christmas period have led to the dip in activity, and we will be looking to the next quarter's data for evidence of a rebound.

Household good sales also printed a negative monthly growth figure (-0.39%MoM) which was surprising given the amount of housing related activity taking place in the eastern states. The annual figure has moderated to 1.12% on pcp, down from 1.99% in January, but above the 0.90% dip in the December data when the fallout from Masters Home Improvement washed through. The outlook for housing activity and household goods sales may temper given the recent actions taken by APRA to cool activity within the residential housing market.

While the discretionary segment of February's retail sales figures was quite weak overall, the department store category bucked the trend, growing 0.80%MoM, and improvement on January's -0.54%MoM decline. As such the annual figures have improved a little, registering a -2.96% decline in February, up on January's -3.92%. The department store category has been long suffering as the majors attempt to implement turnaround strategies and discount department stores face intensifying competition from low cost offshore fast fashion retailers. Looking forward the probability for M&A is high given the recent activity in Myer's share register, recent poor performance of Target and BigW, and the entrance of Kaufland which will be looking for scale in the Australian market.

National Retail Sales (% change MoM)
By Category – February 2017

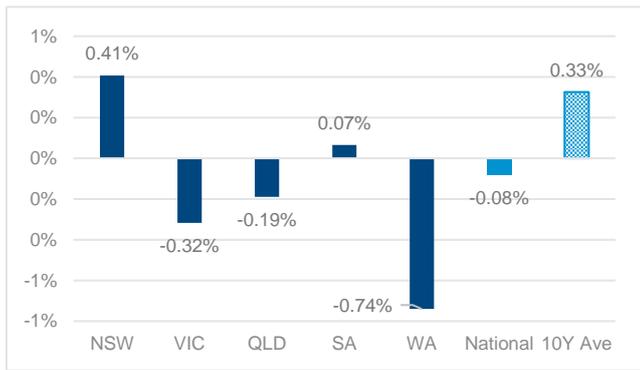


Source: ABS / Colliers Edge

From a regional perspective, New South Wales recorded the strongest monthly growth rate, up 0.41%MoM, marking the

second consecutive improvement to sit higher than the rolling 10 year average of 0.33%. The only other state to register positive growth over the month was South Australia which eked out a 0.07%MoM gain and retained its leadership of the annual growth rate at 3.94% on pcp. Western Australia slipped -0.74%MoM but remained positive over the year at 0.38% on pcp.

National Retail Sales (% change MoM) By State – February 2017

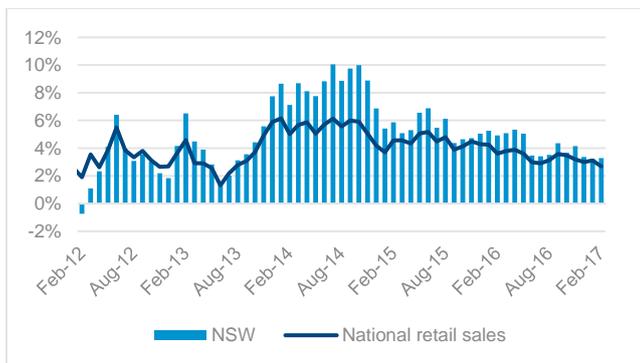


Source: ABS / Colliers Edge

New South Wales

New South Wales makes up 33% of national retail sales and recorded a growth rate of 0.41%MoM or 3.28% on pcp. Strength in the New South Wales market has been derived from a steady improvement in food sales which increased 0.66%MoM and 4.71% on pcp. The hospitality sectors have also performed well, with sales in cafes and restaurants up 1.27%MoM and 5.97% on pcp. Other discretionary sectors were mixed, with apparel down -1.88%MoM (+2.9% on pcp) and department stores growing 1.77%MoM, but remaining in negative territory over the year (-3.14% on pcp). Household goods were quite flat over the month (-0.07%MoM) while annual growth moderated to 1.76% down from 2.18% in January.

NSW Retail Sales (% change on pcp) February 2012-17

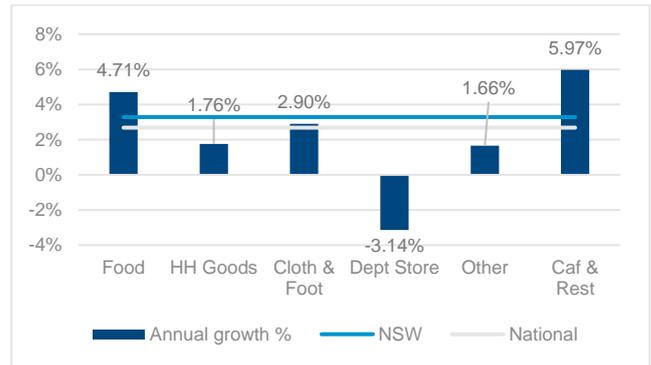


Source: ABS / Colliers Edge

New South Wales has enjoyed its position as one of the fastest growing State's in the nation, having benefitted from the tailwinds of low interest rates and the significant infrastructure investment. Rates continued to shift lower

through 2016, providing a second wind for the State's housing prices. In turn, higher housing prices have been keeping the home fires burning in terms of consumer spending. Although the lead enjoyed by New South Wales versus the overall growth in retail spending across the nation has been narrowing of late, New South Wales has chalked up several years of outperformance on the retail turnover front. Looking forward, it appears as though conditions for retail spending will favour New South Wales given that population growth is lifting, supported by significant investment in infrastructure development.

NSW Retail Sales (% change on pcp) By Category – February 2017

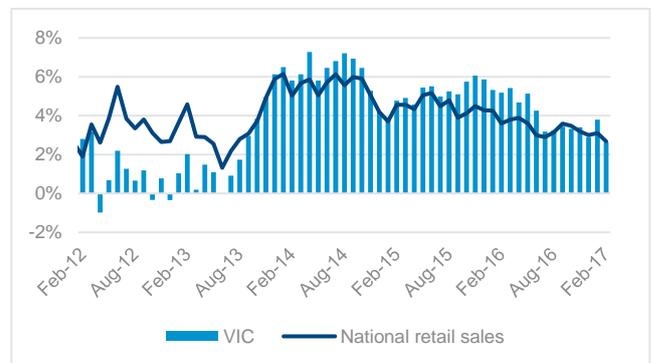


Source: ABS / Colliers Edge

Victoria

Like New South Wales, Victoria makes up a substantial portion of national retail sales at 26%. Victorian retail sales slipped -0.32%MoM in February, pulling the annual rate back from 3.80% to 2.62% on pcp. Melbourne's café culture looks to be trading well with this sub category up 0.73%MoM and 8.96% over the year. Other discretionary spending deteriorated over the month, with apparel and department store sales falling -2.19%MoM and -0.08%MoM respectively. Department stores sales are now -1.87% lower on an annual basis. Household goods slipped -0.37%MoM which is concerning given the amount of household related construction activity taking place in the south eastern states, although this sector retained a positive annual growth rate of 2.21%.

VIC Retail Sales (% change on pcp) February 2012-17



Source: ABS / Colliers Edge

With lower interest and exchange rates providing a vital tail wind, Victoria has seen growth in its economy consistently rising since the Australian dollar peaked several years ago. Victoria has continued to see some very strong growth in the housing construction sector, with New South Wales only recently creeping ahead in terms of housing approval numbers. Victoria has also been investing heavily in infrastructure, although not quite to the same extent as New South Wales. House prices in Victoria are still buoyant which in turn is supporting retail spend and housing construction. At the same time the success of Victoria's economy in recent years has only enhanced its appeal further, attracting people from elsewhere in both other States and other nations. In turn, that virtuous cycle has also kept employment growth in positive territory – certainly well ahead of the national average.

VIC Retail Sales (% change on pcp) By Category – February 2017



Source: ABS / Colliers Edge

Queensland

Queensland's economic growth has been on the rise, however this has been mainly a result of the export sector which doesn't have the same impact on the domestic economy as say for example, growth in the professional services sector. Nonetheless, Australia will soon be the world's largest exporter of gas, and Queensland will be a major contributor in taking that title. Some of the challenges being faced by Queensland include below average wage and population growth together with falling business investment volumes as the resource related projects drew to a close. The recent spike in coal prices is without doubt encouraging, but the value of overall coal projects in Queensland amounts to just over \$3 billion, much of which will reach completion by mid-2017. On a brighter note, the lower AUD has certainly taken time to filter through, but can now be readily seen in indicators such as tourism nights and numbers of foreign students. In addition, the higher Sydney house prices climb, the greater the likelihood that economic refugees will look to Queensland for a home, perhaps supporting the State's future population to an extent.

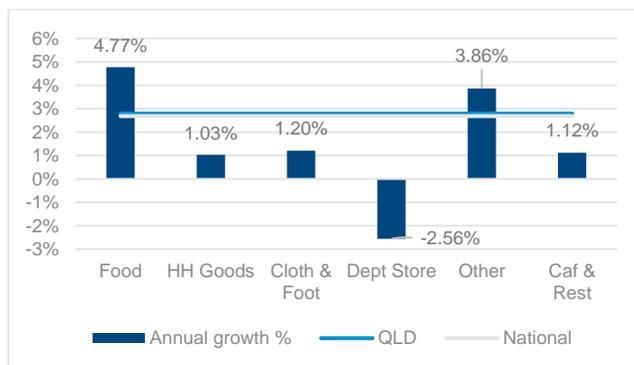
QLD Retail Sales (% change on pcp) February 2012-17



Source: ABS / Colliers Edge

After a period of steady improvement through 3Q16, sales growth in Queensland has moderated, with February marking the fourth consecutive monthly decline (-0.19%MoM). This has dragged the annual growth rate from a high of 4.51% in October 2016, to 2.79% in the most recent release. Sales growth in Queensland is currently weighted to the non-discretionary sector (food sales), which increased 0.21%MoM and 4.77% on pcp. The remaining categories came in below both state and national sales averages in February with the exception of 'other' which grew 1.80%MoM and 3.86% on pcp. This was mainly due to the strength of pharmaceutical sales which were up 1.46%MoM and 5.62% on pcp.

QLD Retail Sales (% change on pcp) By Category – February 2017



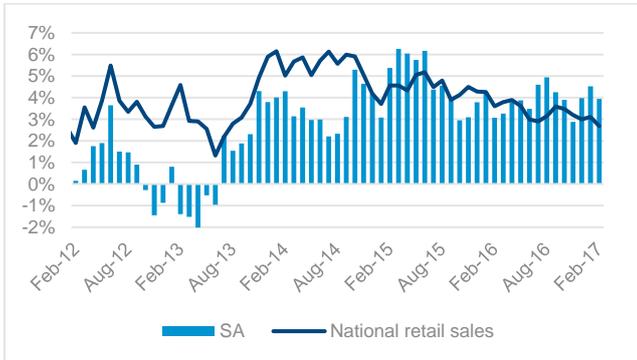
Source: ABS / Colliers Edge

South Australia

Unfortunately South Australia hasn't enjoyed the resources boom of Queensland and Western Australia. Nor has it experienced the housing boom of New South Wales and Victoria. The state has also faced two main challenges; one being a loss of critical mass in manufacturing, the other being a reliance on Federal funding which has come under extreme pressure. However the loss of manufacturing giants such as Holden car manufacturing provided strength for lobby groups, with South Australia now having secured a sizable portion of the domestic build, and maintenance of Australia's new submarines. Population growth has been suffering as a result of the afore mentioned themes, although retail sales strength appears to have held its own and housing

finance is holding up better than most other States. Car sales are also solid.

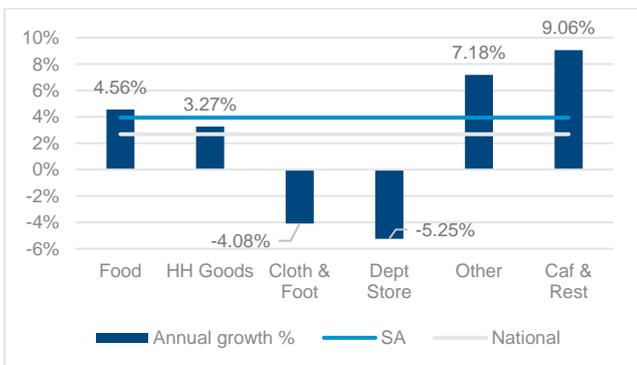
SA Retail Sales (% change on pcp) February 2012-17



Source: ABS / Colliers Edge

Despite the challenges faced in South Australia, the state has still managed to retain the strongest annual retail sales growth rate across the nation at 3.94% on pcp, albeit down slightly from the 4.52% on pcp recorded in the prior month. The headline performance continues to be supported by sales in the hospitality sector, where cafes and restaurants increased 1.13%MoM and 16.92% on pcp. Other discretionary sectors did not fare so well, as apparel and department stores slipped -1.82%MoM (-4.08% on pcp) and -0.63%MoM (-5.25% on pcp) respectively.

SA Retail Sales (% change on pcp) By Category – February 2017



Source: ABS / Colliers Edge