

Australian retail sales: an overly cautious consumer?

Australian retail property snapshot

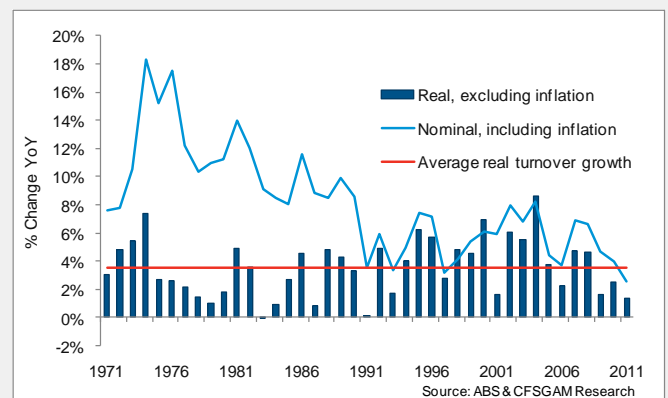
August 2011

- Australian retail sales are currently in a soft patch; the following paper reviews:
 - How weak sales are relative to history;
 - The causes of the weakness;
 - The outlook for retail sales.
- Key findings include:
 - Retail sales are soft, but claims they are the weakest in 50 years are exaggerated;
 - The soft sales growth is at odds with relatively low unemployment and solid growth in both disposable income and real wages;
 - Poor consumer sentiment is a key factor behind the weakness;
 - Sentiment has been hurt by: a series of natural disasters; political uncertainty; cost of living increases; the threat of interest rate rises and financial market unrest;
 - A stronger Australian dollar has also prompted some diversion of domestic retail consumption to online sales or overseas travel.
- Outlook:
 - The economy is weak but a recession is not expected, in fact relatively strong growth is. Unless a second global financial crisis takes hold, it is likely sentiment will improve allowing retail trade growth of around 3%-5% p.a. over the coming year.
 - Over the long-term, retail sales should grow in line with nominal GDP growth, around 6% p.a.

Weakest sales growth in 50 years? Not really

Retail turnover in Australia is currently soft, but on most measures it is not at its weakest level in 50 years. Nominal moving annual turnover growth, which includes inflation, did record its lowest financial year growth since 1960 over the 2010/2011 financial year. However, when the effects of inflation are stripped out to show 'real' growth, there have been several periods since 1971 where lower financial year growth has been recorded, Figure 1.

Figure 1: Retail turnover growth
 Financial year, MAT, percentage change to June 2011

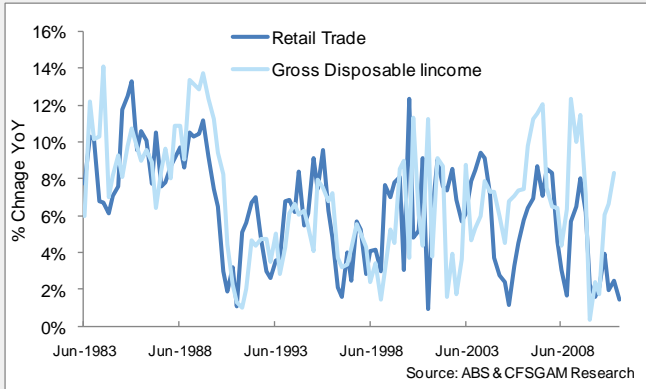


Retail sales and disposable income growth

At odds with the soft retail environment is relatively strong growth in disposable household income, Figure 2.

Over the last 30 or so years there has been a strong relationship between income and sales growth. However, despite the recovery in income growth, retail turnover remains weak.

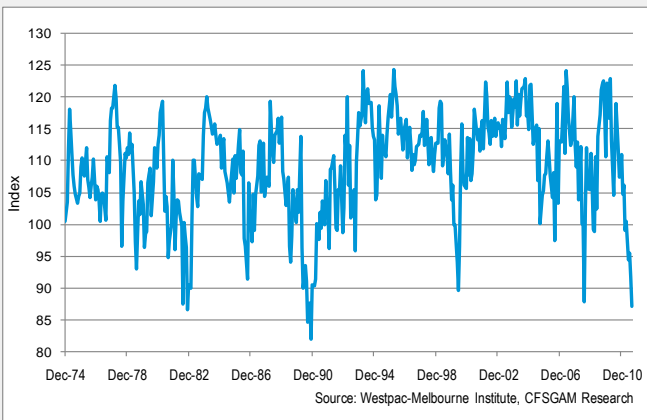
Figure 2: Retail turnover & gross disposable household income
Annual percentage change on quarterly rests to June 2011



Lowest expectations since the early 90s

There are a number of explanations for this but a lack of confidence is a primary factor. Figure 3 shows a sub index of the Westpac-Melbourne Institute Index of Consumer Confidence, personal financial situation over the next 12 months. Data to August 2011 show consumers have not been as concerned for their future financial situation since the recessions of the early 1980s and 1990s.

Figure 3: Confidence: financial situation over next 12 months.
Index on monthly rests to August 2011

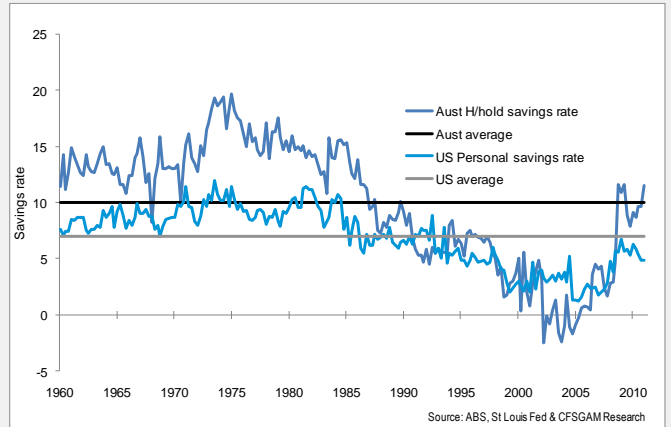


months.
Index on monthly rests to August 2011

Battening down the hatches

With consumers adopting a more cautious outlook, it is logical they increase their levels of saving. Since the global financial crisis (GFC), the Household Savings Rate has risen sharply, back to a little above the 50 year average, Figure 4.

Figure 4: Household savings rates.
Quarterly rests to March 2010



However, the savings rate has risen more rapidly over the last few years than at any time in its history. While it is possible the savings rate may rise further, arguably, the large increases have been made. With some stability in the savings rate and real income growth, there would be scope for increased consumption.

Why the caution?

The Australian consumer has been subjected to a number of negative news events over 2011 that have undermined confidence. These include:

- A series of natural disasters in Australia, New Zealand, Japan and the US;
- Political uncertainty due to a minority Federal Government;
- Concern over rising household expenditure, from factors such as: uncertainty over the proposed carbon price, the flood levy as well as rising cost of living pressures from higher fuel, electricity costs and potential interest rate rises.

Figure 5: Govt. popularity and consumer confidence
Monthly rests to August 2011

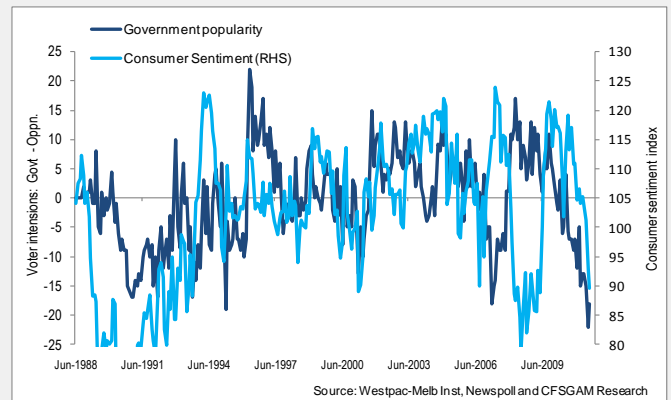


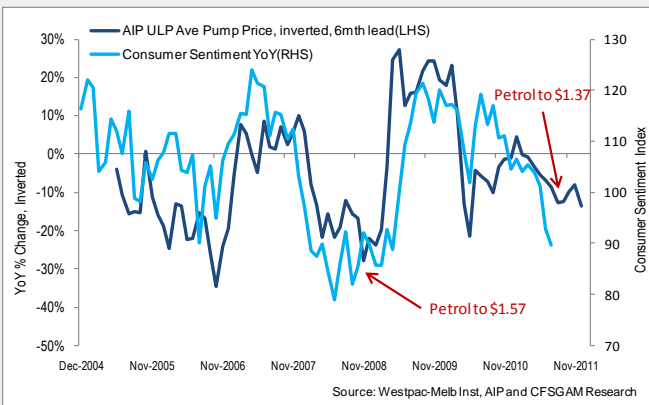
Figure 5 shows a measure of government popularity against consumer confidence. The latest readings are the lowest since 1988. Popularity is measured by the Newspoll survey of voter intentions, government less opposition. While there are some exceptions, overall, there is a reasonable relationship.

The poll on 10 July, pre the announcement of the Carbon Pricing mechanism, marked the low point in popularity to date. With the carbon pricing mechanism now likely to pass both Houses of Parliament, some of the uncertainty may subside. The experience of the GST was that, even though it was also very unpopular, once implemented it ceased to be an issue fairly quickly

The carbon pricing mechanism, as well as the flood levy, have impacted on consumers perceptions of their future finances but relatively strong price rises in household expenditure items such as fuel, water and sewerage and electricity have also eroded confidence. Figure 6 shows rising fuel prices in 2007 as well as early 2010 and 2011 have contributed to weaker sentiment.

After peaking in April 2011, fuel prices have now stabilised and oil prices, having averaged around US\$100 per barrel from May to July, have fallen back to below US\$90 a barrel, which should lead to some relief for consumers.

Figure 6: Fuel prices and consumer confidence
Inverted fuel price, annual percentage change, 6 month lead, monthly rests to August 2011



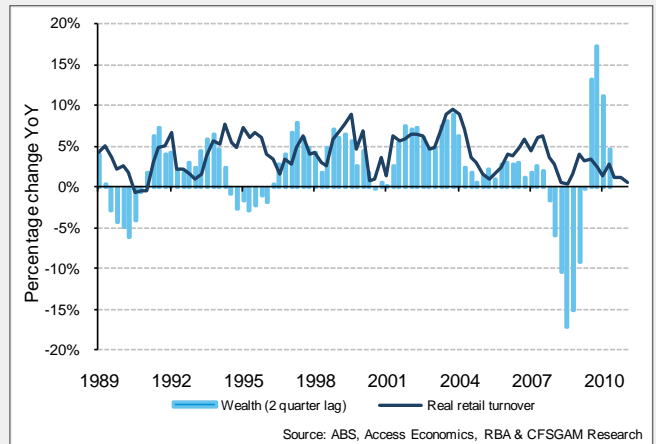
The wealth effect

From mid 1995 to 2005, retail sales achieved relatively strong growth aided by rapid increases in asset values such as house prices. Consumers felt ‘wealthier’, spending more and reducing the savings rate, Figure 7.

The wealth effect was reversed during the GFC, however, fiscal stimulus measures helped support sales. After bouncing back strongly post the GFC, ‘wealth’ has slipped over 2011 as ongoing sovereign debt problems in Europe and the US have resulted in financial market turbulence. In addition, house prices across Australia have been weak over the past 12 months.

If the global economy can avoid a GFC Mark II, the relatively strong economic growth forecast for Australia should help to reignite wealth growth.

Figure 7: Wealth: household assets to disposable income
Annual percentage change, quarterly rests to June 2011



Interest rates

The official cash rate only rose once over the 2010/11 financial year, by 25 basis points in November 2010. However, there has been an expectation that the Reserve Bank of Australia (RBA) would continue to raise rates due to increasing inflation pressures. This has added to consumer unease. Recent financial market turbulence and the threat of a global economic double dip has prompted markets to price in a number of rate cuts. Rate cuts are likely to benefit retail sales if, as in 2008 and 2009, unemployment does not increase excessively. If the next move is up, as most commentators and the rhetoric from the RBA suggests, it is likely to be a result of a strong economy and real wages growth, which should help to offset the negative impact on sales.

The consumer is still spending

Retail spending makes up around 30% of total household consumption. Overall, household consumption growth has returned to around trend levels at 3.4% p.a. Table 1. However, the categories relating to retail trade, e.g. clothing and footwear, are below trend. Consumers are spending more on transport, electricity, recreation and education. Interestingly, one retail category, food is also above trend.

Table 1: Household consumption, annual growth

Category	March 2011 YoY%	Average since 1990
Transport services	13.7%	4.9%
Electricity, gas and other fuel	7.1%	3.1%
Recreation and culture	6.9%	5.2%
Education services	5.1%	3.1%
Health	3.7%	3.6%
Operation of vehicles	3.4%	1.3%
FINAL CONSUMPTION EXPENDITURE	3.4%	3.4%
Other goods and services	3.2%	3.6%
Communications	3.0%	7.9%
Rent and other dwelling services	2.9%	3.3%
Food	2.6%	2.1%
Purchase of vehicles	2.5%	5.1%
Furnishings and household equipment	2.4%	3.8%
Hotels, cafes and restaurants	2.0%	3.0%
Alcoholic beverages	1.8%	2.3%
Clothing and footwear	1.2%	2.8%
Insurance and other financial services	0.9%	4.0%
Tobacco	-1.2%	-2.1%

Source: ABS

The travel bug

The Australian dollar in 2011 rose to its highest levels relative to the US dollar since 1981. This boost to purchasing power prompted many Australians to travel overseas.

Over the six months to 30 June, approximately 3.8 million Australians took short-term trips overseas, about 30% more than travelled for the same period in 2009. If this rate is annualised, nearly 7.8 million Australians, or about 35% of the population will travel overseas in 2011. This compares to an average of about 25% of the population travelling between 2005 and 2009; indicating around 2 million additional travellers. If they all spend \$1,000 overseas, this could divert \$2 billion from domestic retail consumption or about 0.8% of total retail spending.

With many families now taking the 'trip-of-a-lifetime' some spending is being diverted from domestic retail consumption. However, once taken, families may be less likely to travel for a period and more likely to resume domestic retail spending. Additionally, the increase in travel is likely to account for only a small part of the recent decline in sales growth.

Online retail

Online retailing is estimated to account for about 5% of Australia's retail sales, of which less than half is estimated to be spent on offshore websites¹. But while it has attracted headlines, many retailers are less concerned about it than the press would suggest.

In a recent survey of 500 leading Australian retailers, by Inside Retailing, Australian Retail Outlook 2011, of the top 10 conclusions, number 2 was "Online may be driving headlines but is less of an issue than the publicity suggests". CFSGAMs view is that online retailing will become part of a successful retail strategy, one of 'bricks & clicks', where an internet presence complements a physical presence in regional, sub regional, outlet and neighbourhood shopping centres. Indeed a review of the top 30 US internet retailers on the website 'internet retailer', showed that 25 of the 30 had a 'bricks & clicks' strategy.

What is an achievable long-term rate of growth?

Available Australian retail turnover data show that spending increases at around the same rate as national income over the long-term. The average annual rate of real retail turnover growth from 1971 was 3.6% (Figure 1), a little above the average annual rate of real economic growth over the same period of 3.2%. This suggests, over the long-term, turnover growth should be in line with nominal GDP growth.

Assuming inflation grows at the RBA's target rate of 2.5% p.a. and real GDP growth is around the trend rate of 3.5% p.a., potentially, nominal retail turnover growth should be around 6% p.a.

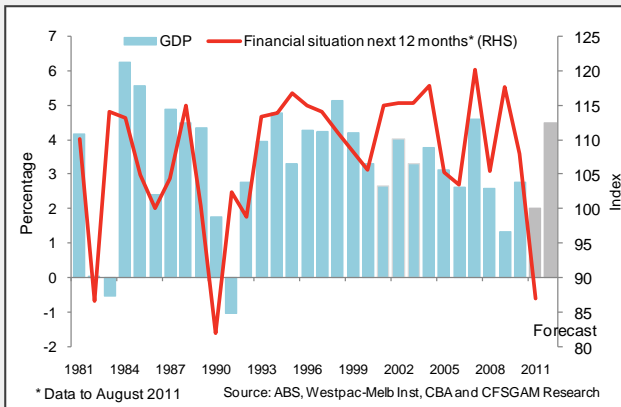
Outlook

Australian consumer confidence has been hit by a wave of negative news events: natural disasters; an uncertain political environment; new taxes; cost of living increases; the threat of higher interest rates and financial market volatility. This has reduced consumers' expectations of future finances to levels normally only seen during recessions. However, there are a number of factors that suggest sentiment should bounce back. Disposable income and real wages growth is solid, supported by unemployment near 30 year lows. Economic growth, while estimated to be below trend in 2011, at around 2%, is forecast to achieve relatively strong growth of 4.1% over the 2011/2012 financial year, a level where sentiment is normally much stronger, Figure 8.

Higher savings and continued uncertainty may limit growth, but there is the potential for much stronger retail activity than we are currently experiencing, around 3%-5%, over the coming year.

¹ Citi Investment Research and Analysis, December 2010

Figure 8: Economic growth and consumer sentiment
 Calendar year percentage change and sentiment index of financial situation over next 12 months, December rests, 2011 equals August



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