HOUSEHOLD SECTOR – WHY HAS RETAIL "OUT-PERFORMED"?

Why has "mainstream" Retail Sales Growth outperformed overall Household Sector Disposable Income and Consumption growth in recent years?

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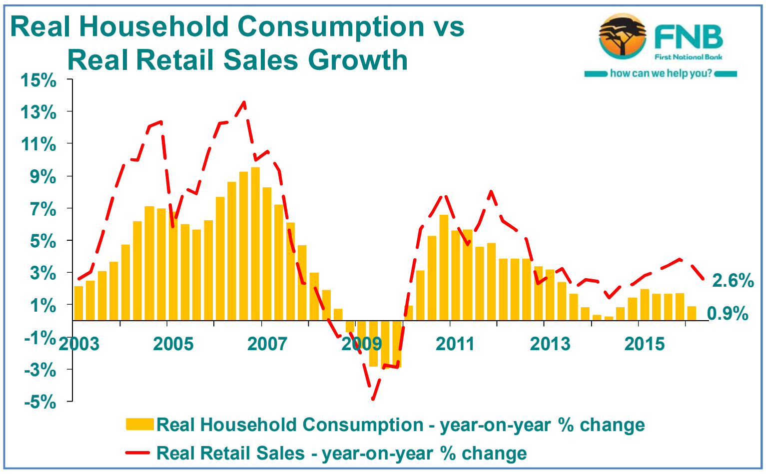
WHAT HAS KEPT REAL RETAIL SALES GROWTH AT LEVELS SIGNIFICANTLY STRONGER THAN BOTH ECONOMIC AND REAL HOUSEHOLD DISPOSABLE INCOME GROWTH IN RECENT YEARS?

Real Retail Sales growth for the 2nd quarter was down to 2.6% year-on-year, from 3.5% in the 1st quarter. However, "Mainstream" Retailers, and Retail property landlords have benefited, relatively-speaking, from growth in real retail sales that has remained quite solid relative to the dismal rate of economic growth, and relative to slow Real Household Disposable Income and Overall Consumption growth. That isn't to say that they haven't felt the impact of the economic growth slowdown at all. Retail sales in 2016 to date has averaged year-on-year growth of 3%, and that is a far cry from the above-6% growth rate averaged for 2011. But to date, the growth slowdown has been less severe than that of the overall economy and for broader consumption expenditure growth.

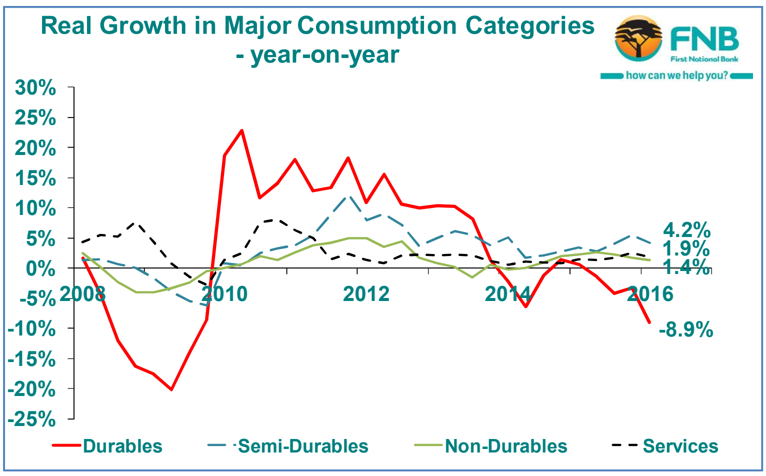


In the 1st quarter of 2016, Real Household Consumption Expenditure growth was a lowly 0.9% year-on-year, while Real Retail sales growth was a more lively 3.5% (2nd quarter Household Consumption Expenditure data not yet available).

In fact, for most of the time since 2010 we have seen Real Retail Sales growth outstrip that of Real Household Consumption Expenditure.

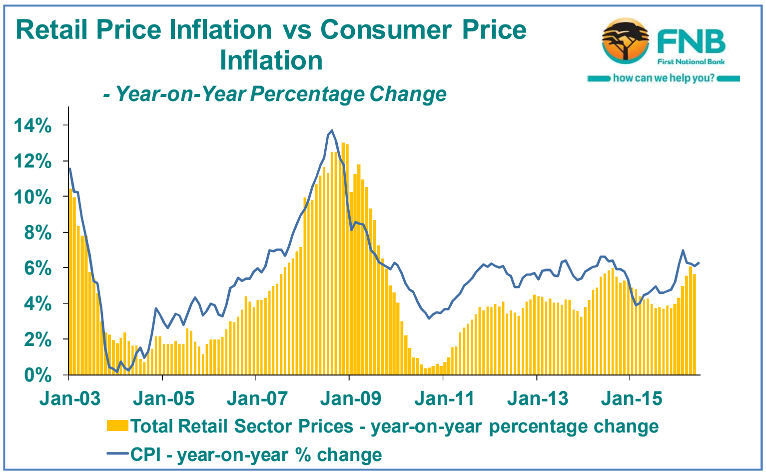
- **The biggest "hit" to date has been outside of "Mainstream" Retail**

The first partial reason for this is that the weakest category of Household Consumption Expenditure has minimal impact on "Mainstream Retail", a term I use to refer to that area of retail taking place largely within the shopping centre or mall. Since interest rates started to rise in 2014, Real Durable Consumption Expenditure growth has deteriorated the most rapidly of the 4 major consumption expenditure categories. This category of Consumption Expenditure is highly credit-driven, and the most sensitive to interest rate hiking.



The largest component in Durable Consumption Expenditure is the "Transport Equipment" category, dominated by motor vehicles, and sales in this category take place largely outside the Retail Shopping Centres. So, whereas Real Durable Household Consumption Expenditure declined by -8.9% year-on-year in the 1st quarter of 2016, those areas of consumption expenditure more crucial to Retail Shopping Space, i.e. Semi-Durable (+4.2%), Non-Durable (+1.4%) and Services (+1.9%) Consumption, still remained in positive growth territory as at the 1st quarter of this year, and have outperformed Durable Consumption Expenditure growth through most of 2014 to early-2016.

- **Lower inflation in the area of Retail, relative to non-retail consumer items, has been a plus.**



The reasons for "Mainstream" Retail's superior growth performance goes further than merely having less exposure to highly interest rate sensitive areas of consumption, though.

It is also very much about Retail Price Inflation having been significantly lower than other non-retail areas of overall Consumer Price Inflation in recent years.

Although certain areas of retail have been troublesome from a price inflation point of view of late, most notably food price inflation, as a whole the Retail Sector has had lower price inflation than the overall CPI inflation rate for much of the time from late-2009 onward.

Consumers often make a greater effort to cut consumption in areas where price inflation is higher, should they be able to, something which depends on how essential a consumer item is.

Average year-on-year Retail Price Inflation since the beginning of 2010 has measured a lowly 3.6%. By comparison, the Overall CPI inflation rate (which includes retail prices) has been 5.31% over this period. It is clear from this that the troublesome consumer items from a price inflation point of view have often been outside of Retail. In the area of housing, municipal rates and utilities tariffs have been arguably the key source of inflationary pressure, but there have been other higher inflation non-retail components in the CPI too.

In short, lower inflation relative to non-retail consumer items should probably be supportive of higher real growth in retail sales.

- **A simple lag may also be in play, with Retail merely tracking Durable consumption slower with a lag**

Finally, a 3rd reason may simply be a lead and a lag. Durable Consumer Goods Expenditure is more sensitive to the economic and interest rate cycle, and responds rapidly. But very often, Semi-Durable, Non-Durable and Services Consumption Expenditure will follow the Durables growth direction (albeit in a less extreme way) with a considerable lag.

With Retail price inflation at 6.2% as at June, the Retail Sector appears to have recently lost its inflation advantage of non-retail consumer items at least for the time being. Now, after a considerable lag, we expect this sector's growth to slow to rates nearer to weak Economic and Household Sector Disposable Income growth. From 3.3% average growth in 2015, the projection for 2016 as a whole for Real Retail Sales is thus a slower 1.9%.

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