

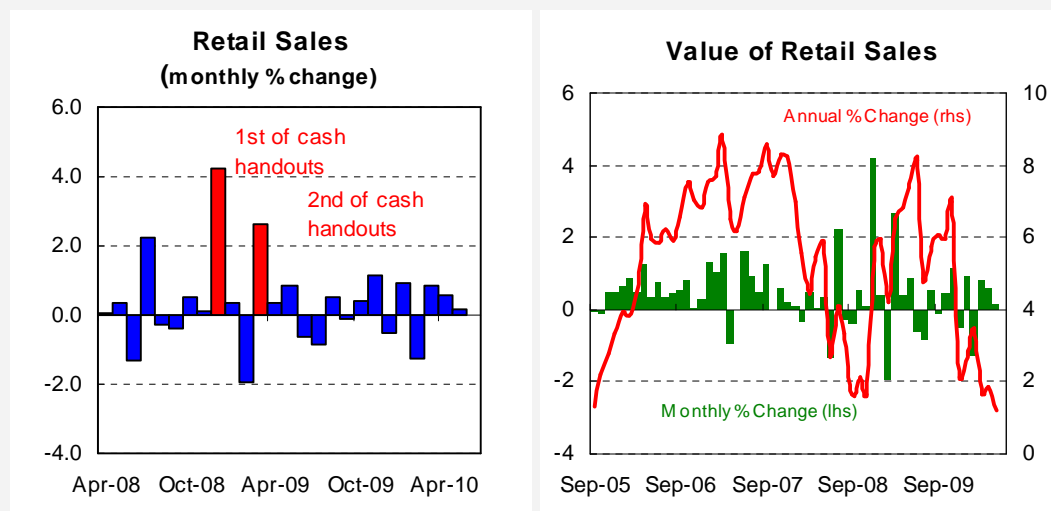
DATA SNAPSHOT

May retail sales & dwelling approvals quite soft

Thursday, 1 June 2010

- Retail sales continue to lack excitement in May rising just 0.2% m/m. Responding to this softening trend, the annual rate has eased back from 1.9% y/y in April to 1.2% in May. The main area of weakness was household good retailing, which you normally expect to exhibit strong growth at times of expansion. In May, this sector recorded a decline of 1.4%. Growth in food retailing has slowed and department store sales failed to recover the April losses. Even cafés and restaurants only partially reversed their April decline.
- Total dwelling approvals were much weaker than expected, falling 6.6% m/m in May compared to market expectations for a flat result. The previous two months were particularly volatile with the 12.7% rise in March followed by a 11.4% fall in April. Looking through the volatility the underlying trend suggest we have passed a cyclical turning point. Approvals surged 49% y/y to January from where they have fallen at an average pace of 1.5% m/m per month.
- More worrying to us in the continued weakness in private sector house approvals, which fell 10.7% m/m in April, the second largest fall on record (if you exclude GST induced volatility) to then record a very modest correction of +1.7% in May. This is a worrying sign that the deterioration in affordability associated with rising interest rates and house prices may be having a much larger impact on housing demand than we had anticipated.
- The turning point that was highlighted by the collapse in housing finance approvals is now more clearly seen in the dwelling approvals data. We would expect to see further declines as first home-buyers demand continues unwind and higher interest rates blunt up-graders demand. It will be some time before we see the approval numbers impact on growth in construction activity as last year's surge in approvals is still to flow through. Nevertheless, the more recent data highlights that dwelling construction activity is set to decline in late 2010 or early 2011.
- Australia's household sector was buffered, to a large extent, from the worst of the GFC. Nevertheless, households remain in a conservative mode and are responding more to higher interest rates than rising incomes. This is a key reason for the RBA to remain on the sidelines, for now, to gauge the full impact of the recent rates rises.

Retail Sales, April 2010



Total Retail Sales

Retail sales rose 0.2% m/m in May, on par with market expectations but still a disappointing result. The May data confirms a softer monthly trend, of 0.2% m/m, and the annual rate has dropped from 1.9% y/y in April to 1.2% y/y in May.

The details were particularly worrying with household retailing, which should be on a cyclical upswing with rising housing construction activity and the overall current expansion, recorded a 1.4% decline in May. Other categories recorded positive sales gains in May, but in most cases they were unspectacular: food retailing managed to rise just 0.2%, a much slower gain than the 1.1% m/m average in the previous two months; department stores reported a 1% bounce but this followed a 2.3% fall in April, and cafés & restaurants saw a 0.8% rise that only partially reversed a 0.9% decline in April.

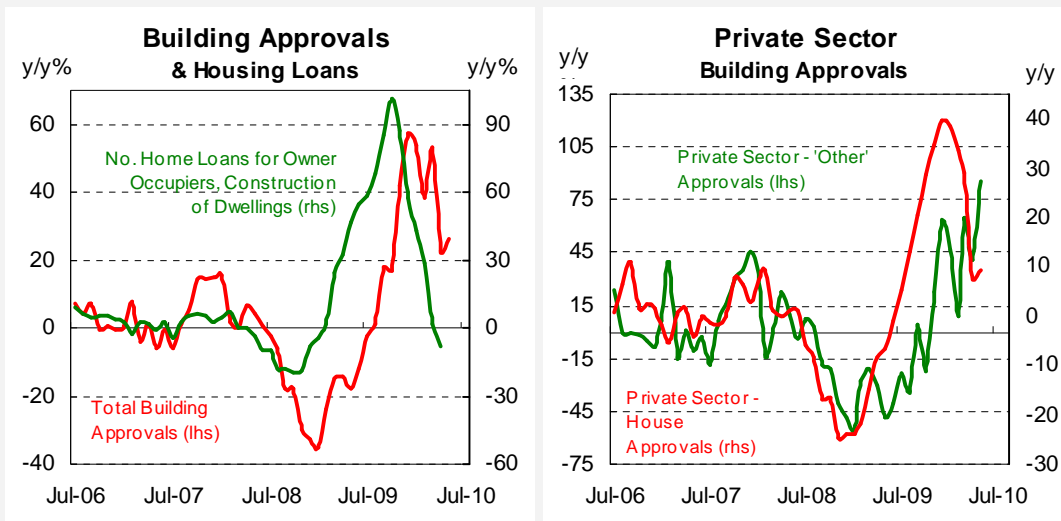
State Data

By state, so far this year the weakest state for retail sales has been NSW (-0.3% since December 2009 despite a solid 0.9% rise in May). SA remains the standout (+5.2%) but Vic has had a strong run (+2.5%). The resource states are only just starting to see a recovery in retail sales with WA lifting a modest 1.1% so far this year while Qld is only now starting to gather momentum (0.6%).

Outlook for Retail Sales

May retail sales may have come in line with market expectations but they were still weaker than what you would hope to see at this point in the cycle. Continued consumer caution, a focus on paying down debt and/or lifting savings, and the dampening effect higher interest rate are more than offsetting the momentum from strong population growth, robust employment and rising household net worth. Consumer sentiment and retail anecdotes suggest that June is unlikely to bring any change to this situation, although we would hope to see a pick-up housing-related retail sales as dwelling construction activity starts to lift.

Building Approvals, April 2010



Number of Residential Building Approvals

Dwelling approvals disappointed again falling 6.6% in May vs. consensus forecast for a flat outcome. The previous two months were particularly volatile with a 12.7% rise in March followed by a 11.4% fall in April (revised down from larger swings report earlier).

If you look through the volatility, we would argue that the data presents a fairly strong sign of an underlying cyclical turning point. Following a surge of 49% in the year to January 2010, trend approvals have now fallen 4.4% and have been declining at an average pace of 1.5% m/m over the last three months.

Here at St.George Economics, our biggest concern is in regards to private sector house approvals, which fell a very sharp 10.7% in April, the second biggest monthly decline on record if you exclude the post-GST slump. This segment rose just 1.7% in May and so

remains in a substantial trend decline. Units by contrast fell 18.8% in May, finally unwinding the 38.9% spike in March after a surprisingly resilient 0.6% rise in April.

Adding to the evidence of a turning point, declines in approvals were recorded across every state except SA, with trend private sector house approvals declining in every major state.

Outlook for dwelling approvals

A turning point that had been earlier suggested by the collapse in housing finance approvals is now more clearly seen in the dwelling approvals data. We would expect to see further declines in approvals as first home buyers demand continues to unwind and higher interest rates and rising house prices blunt up-graders demand. Nevertheless, it will be some time before we see the approval numbers impact on growth in construction activity as last year's surge in approvals are still to flow through to activity. Nevertheless, the more recent data highlights that dwelling construction activity is set to decline in late 2010 or early 2011.

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