

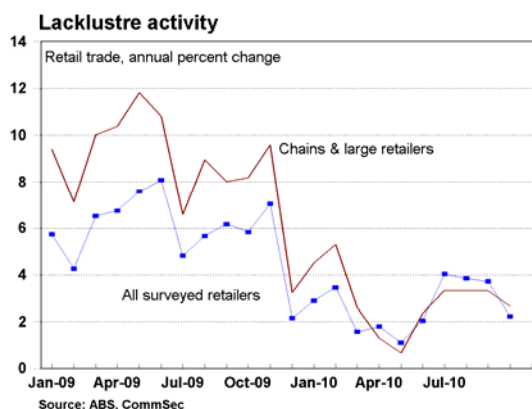
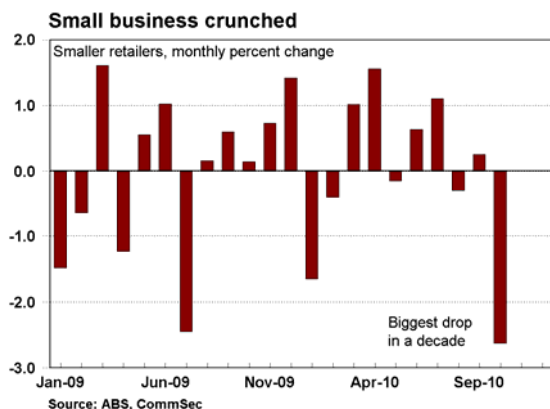
Spending slumps; Trade surplus with China soars

Retail trade, International trade

- Retail spending slumped by 1.1 per cent in October, below forecasts centred on a rise of 0.4 per cent. Non-food retailing fell by a much larger 2.2 per cent – the biggest slide in 20 months. Over the first ten months of 2010 overall retail spending has risen by just 1.5 per cent.
- Sales by chain stores and other large retailers fell by 0.2 per cent in seasonally terms in October while sales by smaller retailers fell by 2.6 per cent – the biggest fall in ten years.
- Spending was down across over half the retail categories, with footwear and clothing retailers the worst affected, along with cafes and restaurants.
- Australia's trade surplus widened from \$1,814 million to \$2,625 million in October. Economists had tipped a surplus near \$2 billion. Exports rose by 1.1 per cent with imports falling by 2.5 per cent. Australia has chalked up trade surpluses of \$15.1 billion over just the past seven months.
- Australia is becoming more and more reliant on China, creating risks for the economy. Just under a quarter of all exports are now destined for China. If China sneezes, Australia will certainly catch cold.

What does it all mean?

- Retailers have been complaining for some time about weak consumer spending, but seemingly on deaf ears. So the latest retail sales figure is certainly a wake-up call for the policy makers. The domestic economy is not shooting the lights out and retail activity is virtually non-existent. The 1.1 per cent slide in sales over October was the worst result in well over a year.
- The vagaries of the weather may have played a part in the weak result, with unseasonably mild and wet weather causing consumers to trim spending in a number of eastern states. Victoria had its wettest month in 5½ years, leading to a 21 per cent fall in spending at cafes and restaurants.
- But while unseasonal weather may have played a role in the sharp drop in consumer spending, it is a concern that the slump in sales preceded the rate hike that took place in early November. It is likely that activity will be subdued in the next few months as consumers and businesses adjust to the additional rate hike.
- A breakdown of the retail sales data into food and non-food categories provides a more accurate picture of consumer spending. Non-food retailing plummeted by 2.6 per cent in October – marking the weakest reading in



Savanth Sebastian – Economist (Author)

(02) 8223 7130 (work), 0414 188 161 (mobile) | savanth.sebastian@cba.com.au

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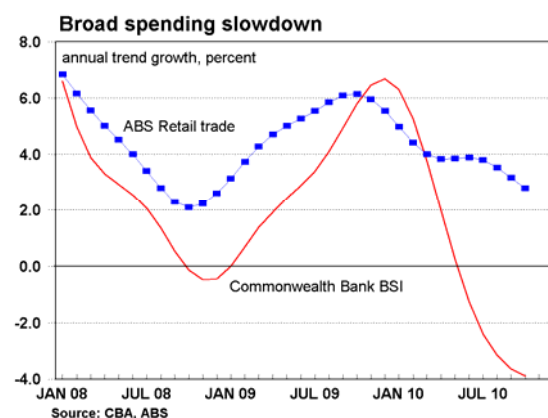
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20 months. It is clear that the cumulative rate hikes have taken their toll on the household budget, and as a result discretionary spending is being pared back

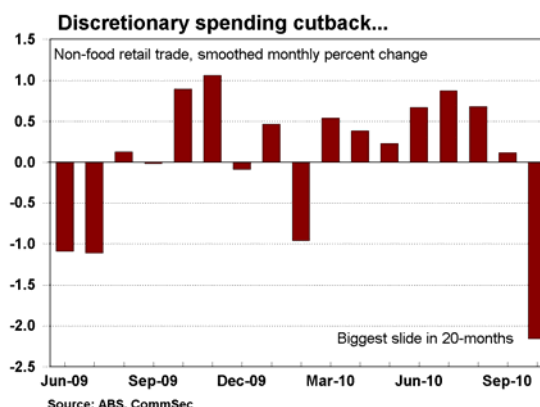
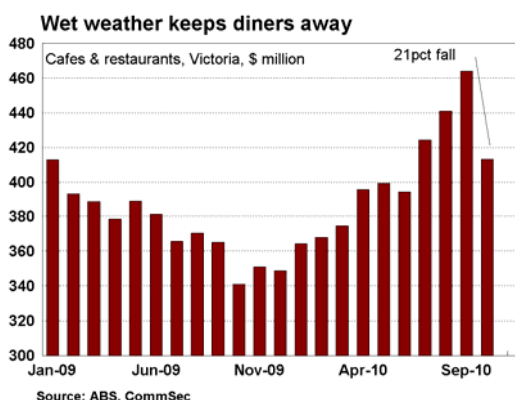
- No doubt part of the slide in retail sales can be blamed on lower prices, rather than weaker spending, given the widespread discounting taking place across the retail sector. However weaker volumes are clearly playing their part. Over the first ten months of 2010 sales have grown by a paltry 1.5 per cent. Prices of some goods are coming down because our dollar is strong, but plenty of retailers are cutting prices because consumers refuse to spend.
- Interestingly, larger retailers have been more successful compared to smaller retailers (given their greater ability to trim prices) and that was certainly evident in the latest result. Larger retailers recorded only a modest 0.2 per cent fall in sales compared with smaller retailers which saw sales contract by the largest margin in a decade.
- The Commonwealth Bank business sales indicator has highlighted weak spending conditions for a number of months. Unfortunately the short term outlook is not encouraging.
- If the Reserve Bank needed any more reason to leave rates alone, then this is it. The GDP figures have highlighted that the economy is barely growing and the weak retail sales data suggests household consumption didn't start the December quarter in a great fashion. And given the fragility of Australian households, it is likely that activity will be subdued in the next few months as consumers and businesses adjust to the latest additional rate hike.
- Consumers and businesses are certainly not willing to spend up big at present. But the dollars keep rolling into the Australia economy. Australia has now notched up its seventh consecutive trade surplus – an important result and signifying that Australia is again paying its way in the world. And the boost to Australian coffers is essentially what the Reserve Bank is banking on to spur domestic growth over the coming year. At present the additional income is not being spent, but as the recovery gains traction it is likely that Australian businesses and consumers will follow through on spending and investment plans.
- Higher commodity prices and increased demand for coal and iron ore has helped insulate the Australian economy. And it's likely that more consistent trade surpluses are likely to be part of the economic landscape over the coming year.
- Of some concern is our increasing reliance on China. Just under a quarter of all our exports are destined for China. If China sneezes, Australia will catch cold very quickly. Australia notched up a record \$15.5 billion trade surplus with China over the past twelve months.



What do the figures show?

Retail trade:

- **Retail trade** fell by 1.1 per cent in October after a 0.1 per cent rise in September. The 1.1 per cent fall was the largest fall in 15 months. Non-food retailing fell by 2.2 per cent in October – the biggest slide in 20 months. Over the first ten months of 2010 overall retail spending has risen by just 1.5 per cent. Over the past year retail trade lifted 2.2 per cent.
- **Sales by chain stores and other large retailers** fell by 0.2 per cent in seasonally terms in October while sales



by smaller retailers fell by 2.6 per cent – the biggest fall in ten years. In annual terms sales at chain stores were up 2.7 per cent on a year ago while sales at smaller retailers were up 1.5 per cent.

- **During October**, sales increased most at newspaper and book retailers (up 3.0 per cent), followed by hardware, building and garden suppliers (up 1.9 per cent). Sales fell most at footwear and other personal accessory retailers (down 11.4 per cent) followed by sales at Cafes and Restaurants (down 7.6 per cent).
- **Across the states** sales lifted most in the ACT (up 0.6 per cent), followed by Tasmania (up 0.5 per cent). Sales was weakest in the Northern Territory (down 4.9 per cent), followed by NSW (down 1.8 per cent), Queensland (down 1.2 per cent), Victoria (down 0.8 per cent), Western Australia (down 0.3 per cent) and South Australia (down 0.2 per cent).

International trade

- Australia's trade surplus widened by \$811 million in October to \$2,625 million. Economists had tipped a \$2 billion trade surplus. Exports rose by 1.1 per cent in the month while imports fell by 2.5 per cent. It was the seventh consecutive trade surplus.
- Rural exports rose by 8.1 per cent in October while non-rural exports fell by 1.5 per cent and non-monetary gold rose by \$414million or 36 per cent.
- Within non-rural exports, coal, coke and briquettes fell by 4 per cent. Within rural exports cereal grains rose by \$171 million or 30 per cent.
- Within imports, consumer imports fell 2.0 per cent in October, capital goods imports rose by 0.1 per cent while intermediate goods imports fell by 5.3 per cent.
- While the physical trade of goods is in surplus, the services account remains mired in deficit – the deficit widening from \$213 million to \$294 million in October. The high Australian dollar is a key culprit, depressing tourism receipts.
- Australia's trade surplus with China hit a record high of \$15.5 billion in the year to October.

What is the importance of the economic data?

- The Bureau of Statistics' **Retail trade** publication contains the most current readings on the performance of consumer spending. The ABS surveys 500 'larger businesses' and 2,750 'smaller businesses'. Retail trade covers spending at a broad range of retail outlets but excludes both petrol and motor vehicle sales. A weak retail trade result may point to a slowing economy as well weighing on the share prices of listed retail stocks. But retail trade estimates can't be assessed in isolation – it is important to look at the influences determining future trends in consumer spending, such as income, employment and confidence levels.
- The monthly **International Trade in Goods and Services** release from the Bureau of Statistics provides estimates on exports and imports of physical goods (such as coal, beef and computers) and services (such as travel receipts). The balance of goods and services (BOGS) is a narrower description of Australia's external position than the current account estimates. The import data is a useful gauge of consumer and business spending while exports reflect global demand as well as domestic influences such as drought.

Record surplus with China



China matters



China extends trade dominance



What are the implications for interest rates and investors?

- The Reserve Bank will point to our trade surpluses as evidence of the mining boom's impact on the economy. As more dollars flow into the country, policy has to tighten to soak up the extra money and thus prevent inflationary pressures from building.
- However the lackluster retail sales result, coupled with the recent rate hike suggests activity is likely to be subdued in the near term. Retailers will need to continue discounting in the lead up to Christmas.
- The Reserve Bank may start to rue its decision to lift rates in November. The economy was already struggling before it delivered the latest rate hike.
- While there do appear anomalies in the latest retail trade data, the simple fact is that spending has been weak for some time. Consumers will only start to spend again when they become more confident – an extended period of interest rate stability will help.

Savanth Sebastian, Economist, CommSec

Work: (02) 8223 7130; Mobile: 0414 188 161

