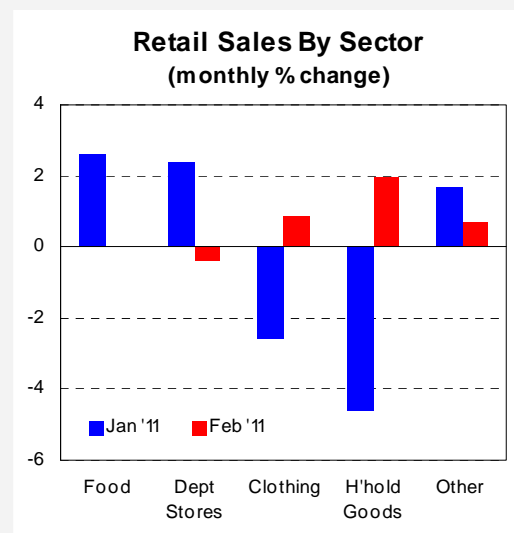
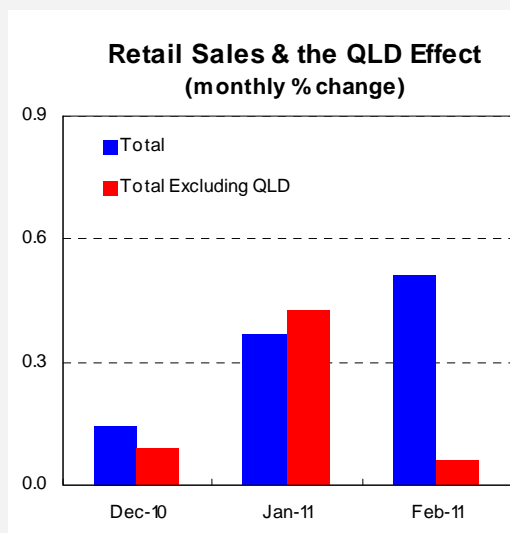


# DATA SNAPSHOT

## Consumers at a Turning Point?

Thursday, 31 March 2011

- Retail spending nationally rose by 0.5% in February and recorded the strongest back-to-back gain in six months. But a spike in Queensland retail trade boosted the overall result. Weather events are still playing havoc with the data. Excluding Queensland, retail sales edged up just 0.1%, suggesting that consumer caution remains prevalent.
- Credit to the private sector rose by 0.5% in February, which is the largest monthly percentage gain since May 2010 when a similar-sized gain was recorded. Business credit was the most interesting aspect of the data. Credit to businesses posted a solid rise of 0.6% in February, after a flat result in January and falls over the second half of 2010. Today's data may be one of the first signs that the upswing in private capital investment may spur businesses increase their borrowing to fund expansion.
- Total building approvals tumbled 7.4% in February, after a hefty 11.6% decline in January. The fall in February was bigger than consensus predicted and the trend in building approvals is undeniably weak. However, today's headline looks worse than truly is the case. Firstly, approvals for January were revised higher. Further, it was the lumpy and volatile "other" component that dragged the overall total lower.
- We expect two rate hikes from the RBA in the second half of this year. We would, however, still not completely rule out a rate hike being brought forward sooner; there remains some risk of an earlier move because the economy could be recovering strongly by the middle of this year.



### Retail Sales :

Retail sales rose by 0.5% in February, after a rise of 0.4% in January. Over the two months to February, retail sales lifted by 0.9% - the biggest back-to-back monthly gain in six months. The annual rate stepped up from 1.6% in January to 3.6% in February.

So is this a sign of a turning point in the consumer. We know that over the past few months consumers have been constrained from spending by caution. Consumers have been saving more and both borrowing and spending less. There still are no convincing signs on today's data that the consumer has relinquished this caution.

Weather events are still playing havoc with the data. The total retail sales result was boosted

by a strong jump in spending in Queensland. Queensland retail sales jumped 2.3%, the strongest monthly percentage gain since March 2009. Excluding Queensland, retail sales rose just 0.1% in February and by 3.3% on a year ago (below the long run average annual rate of just over 5%). It suggests that caution may still be prevalent among consumers.

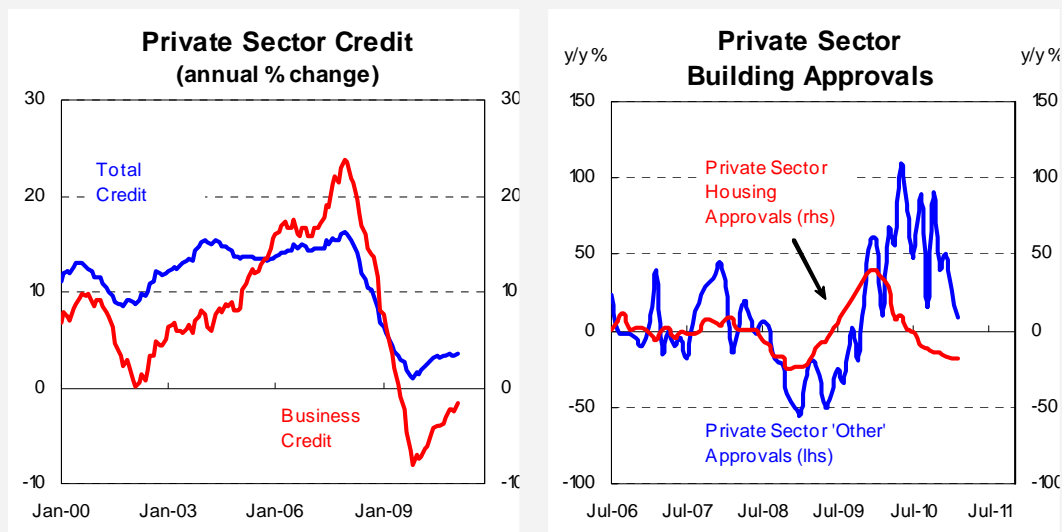
Severe flooding in January and a cyclone in February encouraged stockpiling of essential goods ahead of the event. In the aftermath of the domestic natural disasters, there is spending occurring linked to the replacement of damaged items. Certainly, some of the sectors that recorded rises in February are consistent with this theme. For example, household-good retailing and other-goods retailing rose in the month.

More generally, in terms of the sectors, there was a bit of volatility evident. A number of sectors that posted firm gains in January unwound those gains in February. Food, which posted, a strong rise in January was flat in February. Department store sales, clothing and household-good retailing all reversed their performances in the previous month. In February, department store sales fell by 0.4%, clothing rose by 0.9% and household good retailing jumped 2.0%. Meanwhile 'other' retailing edged up 0.7%.

By States and territories, retail sales was mixed in the month of February. NSW, Victoria and SA posted declines in the month of 0.1%, 0.3% and 0.5%, respectively. But QLD, WA, NT and Tasmania posted rises of 2.3%, 1.6%, 1.7% and 1.3%, respectively.

Over the medium term, one of the key domestic issues for the Australian economy over the medium term well may be how consumer spending evolves. So far the Reserve Bank (RBA) has welcomed the soft growth in consumer spending because it is helping balance the strong growth in mining and investment. That means it is giving the RBA a helping hand in fighting inflation. But consumer spending may not stay soft forever.

A tight labour market and strong growth in household incomes suggests that consumers can lift spending. We believe the risks are that the caution shackling consumers will fade as we move through 2011 and return to more normal levels in the second half of this year.



#### Private Sector Credit:

Credit to the private sector rose by 0.5% in February, which is the strongest monthly percentage gain since May 2010 when a similar-sized gain was recorded. This outcome was stronger than market expectations that centred on a rise of 0.3%. The annual rate has stepped up slightly from 3.3% to 3.4%.

Business credit was the most interesting aspect of the data. Credit to businesses posted a solid rise of 0.6% in February, after a flat outcome in January and declines since July 2010

prior to that. Indeed, the 0.6% rise in February is the strongest monthly percentage gain in more than two years (since January 2009). Business credit has been soft for some time as businesses fund expansion activity from internal cashflows or via raising equity rather than borrowing. Today's data may be one of the first signs that the upswing in private capital investment underway may see businesses increase borrowings to fund expansion.

Housing credit rose 0.5% in February and the annual rate softened mildly from 7.3% to 7%. Housing lending to owner occupiers was stronger than to investors in the month (0.6% versus 0.4%).

Meanwhile, other personal credit (includes credit cards, etc) expanded by 0.2% in February. This series has been sluggish and remains so with the annual rate at 0.7% - the weakest since January 2010. It may also reflect the general caution that is still prevalent among consumers.

#### **Building Approvals:**

Total building approvals tumbled 7.4% in February, after a hefty 11.6% decline in January. The fall in February was bigger than consensus predicted. On a year ago, building approvals are down 21.8% compared with 16.4% in January.

The trend in building approvals is undeniably weak. However, today's headline looks worse than truly is the case. Firstly, January's data was revised higher. It was previously reported that approvals fell by 15.9% in January. Further, it was the lumpy and volatile "other" component that dragged the overall total lower.

Private-sector approvals for the other component, which is multi-density housing that includes apartments and townhouses, dropped 20.0% in February, after a fall of 20.4% in January. That makes it the biggest back-to-back decline in this category in over eight years (since December 2002).

Private-sector approvals for the housing component rose by 0.2%. It is the first rise in five months and still leaves the annual rate weak at a contraction of 17.4%.

Among the States, there was considerable weakness evident in both Victoria and Queensland. Both States have been affected this year by flooding. Queensland has also had a cyclone.

Building approvals in Victoria dropped 23.1% in February and by 31.9% over the two months to February. It takes the number of approvals to 4,013, the lowest since August 2009. Victorian approvals and construction had previously been strong, as the State benefited from Federal stimulus and increases in net interstate migration flows.

Building approvals in Queensland dropped 11.8% in February (the biggest drop in seven months) and by 19.2% over the two months to February. The declines likely reflect disruptions and interruptions to applications because of the natural disasters. In coming months, some normality should return in approval applications.

#### **Implications for the Cash Rate Outlook:**

We are expecting the Reserve Bank to resume tightening in August. We expect two rate hikes of 25bp each with a rate hike in the September quarter followed by a rate hike in the December quarter. This timing allows the Reserve Bank to assess the near term impact from the disasters and navigate through the waters of near term uncertainty from these disasters.

We would, however, still not completely rule out a rate hike being brought forward sooner; there remains some risk of an earlier move because the economy could be recovering strongly by the middle of this year and the Reserve Bank's reputation is one of taking a pre-emptive approach.

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