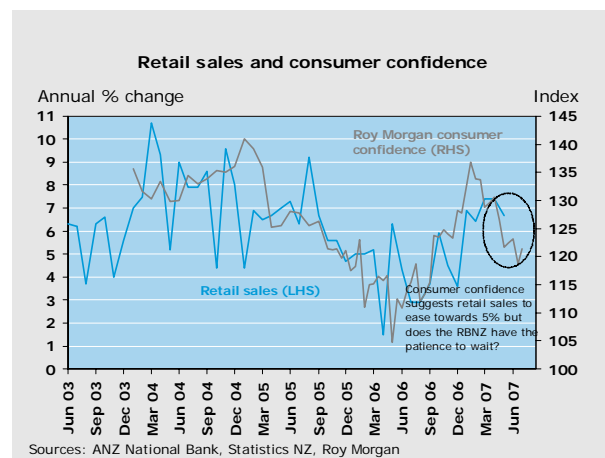


RETAIL SALES – MAY 2007

Key points

- Both total and core retail sales for May completely reversed the previous month's weakness.
- The composition of the retail sales result, largely driven by supermarket & groceries and motor vehicle retailing, complicates the picture.
- Nonetheless, today's data increases the chances of a July OCR hike. Confidence indicators point to further easing in retail sales, but the Reserve Bank may not have the patience to wait.
- Monday's Q2 CPI print will hold the key for the *OCR Review* on 26 July. An ugly non-tradable print, similar to Q1's, may well force the Reserve Bank's hand.

	Core Retail Sales (monthly % change)		Total Retail Sales (monthly % change)	
	s.a.	Trend	s.a.	Trend
Nov-06	0.0	0.7	0.0	0.6
Dec-06	0.0	0.8	0.6	0.7
Jan-07	0.9	0.8	0.5	0.7
Feb-07	2.7	0.7	2.2	0.7
Mar-07	0.4	0.6	1.0	0.7
Apr-07	-0.9	0.5	-1.2	0.6
May-07	0.8	0.4	1.2	0.6
ANZ	0.4	-	0.6	-
Market	0.3	-	0.4	-



Assessment and implications

Total retail sales grew strongly in May, up 1.2 percent, completely reversing April's weakness.

Core sales (which exclude motor vehicle-related industries) also recovered almost all of April's decline, up 0.8 percent following the 0.9 percent decline in April. Supermarket & grocery store sales (up \$21 million) and motor vehicle retailing (up \$30 million) made the largest contributions to the monthly increase in sales. All other industries recorded more modest movements. On a regional basis, seasonally adjusted sales rose across the board. The Wellington and Waikato regions recorded the largest increases although this comes after they recorded large falls in April.

The Reserve Bank would have been disappointed by today's retail sales number. Though the data is for May and would not have captured the impact of the June OCR hike, consumer spending still refuses to roll over. Complicating the picture is the fact that most of the strength in May retail sales came from supermarket and groceries and car sales. Excluding these two industries, retail sales would have been up a more modest 0.4 percent. Spending at supermarket and grocery stores has been rising over the past year, partly due to higher grocery prices. To some extent, this will have a negative effect on other retail spending. We note that department store sales – a key discretionary spending sector – fell 4.1 percent in the month. But strong car sales and, to a lesser extent, increases in furniture and floor coverings, clearly indicate that confidence is still there for households to buy up large durable items.

Today's data certainly increases the chances of a July OCR hike, although Monday's Q2 CPI print remains the key. Evidence of a sustained slowing in domestic demand remains far from conclusive. Q2 real retail sales now look likely to print above 1 percent, even if June monthly retail sales were to come in flat. Recent consumer confidence indicators point to a continual easing in retail sales over the months ahead and towards an annual pace of 5 percent from the current 6.7 percent rate. However, for the Reserve Bank the question is whether they can afford to wait given the level of inflationary pressures within the economy. If Monday's Q2 non-tradable inflation data were to show an ugly print (similar to the 1.2 percent increase recorded in Q1), it may well force the Reserve Bank's hand in July.

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Australia and New Zealand Banking Group Limited is represented in:

AUSTRALIA by:

Australia and New Zealand Banking Group Limited ABN 11005 357 522
10th Floor 100 Queen Street, Melbourne 3000, Australia
Telephone +61 3 9273 6224 Fax +61 3 9273 5711

UNITED KINGDOM by:

Australia and New Zealand Banking Group Limited
ABN 11 005 357 522
Minerva House, PO Box 7, Montague Close, London, SE1
9DH, United Kingdom
Telephone +44 20 7378 2121 Fax +44 20 7378 2378

UNITED STATES OF AMERICA by:

ANZ Securities, Inc. (Member of NASD and SIPC)
6th Floor 1177 Avenue of the Americas
New York, NY 10036, United States of America
Tel: +1 212 801 9160 Fax: +1 212 801 9163

NEW ZEALAND by:

ANZ National Bank Limited
Level 7, 1 Victoria Street, Wellington, New Zealand
Telephone +64 4 802 2000

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