



# The U.S. Retail Sector

## *Facing Stronger Headwinds*

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## Key Points

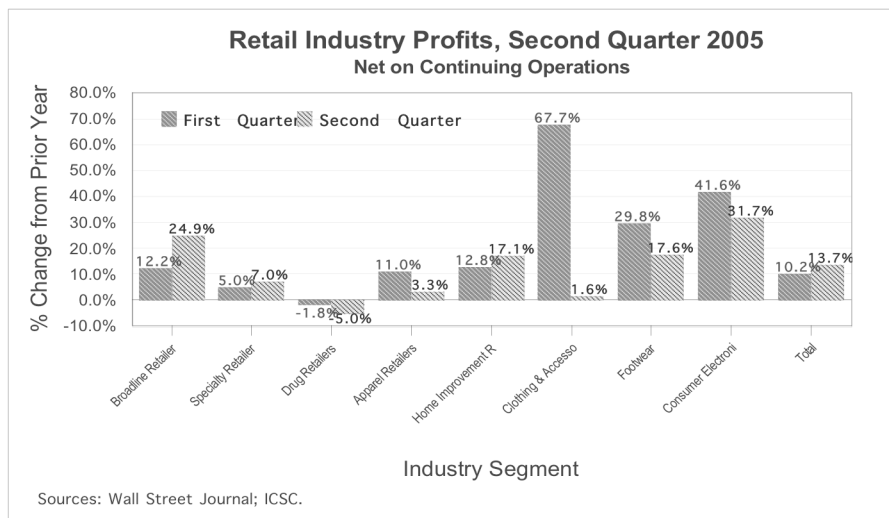
- Retail Sector Still Profitable...
- Consumer Demand Still Holding up...
- Inventories *Generally* Well Balanced...
- Prices Still Declining, But Less So...
- Headwinds are Stronger...
- 2005 Holiday Season Facing Preference Changes as well as Constraint on Ability to Spend...
- Outlook and Final Thoughts



## Retail Profits Continue to Chug Along

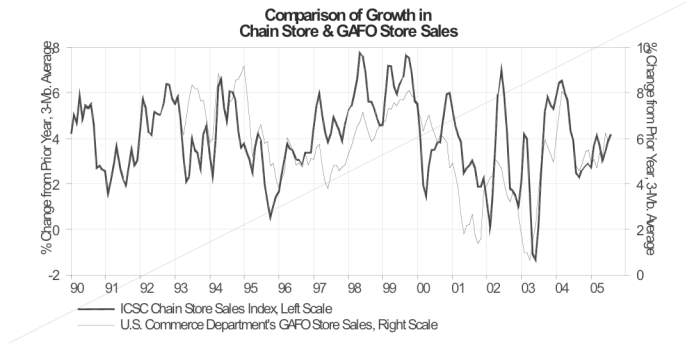


## Industry Profitability Continues to Be Strong By Most Segments Too

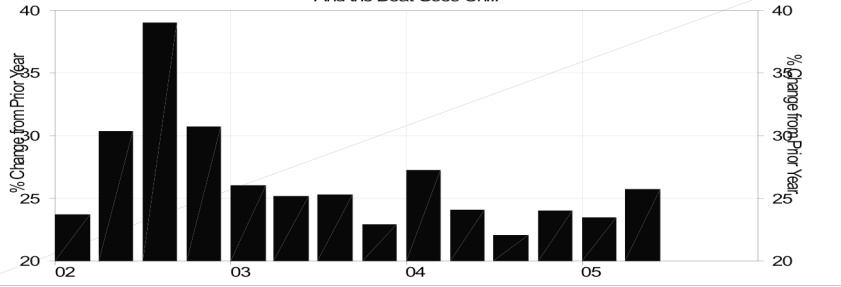




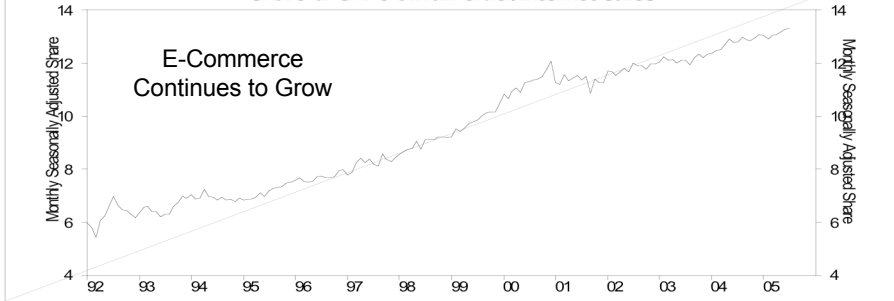
### Consumer Demand Holds Up



### Retail E-Commerce Sales And the Beat Goes On...

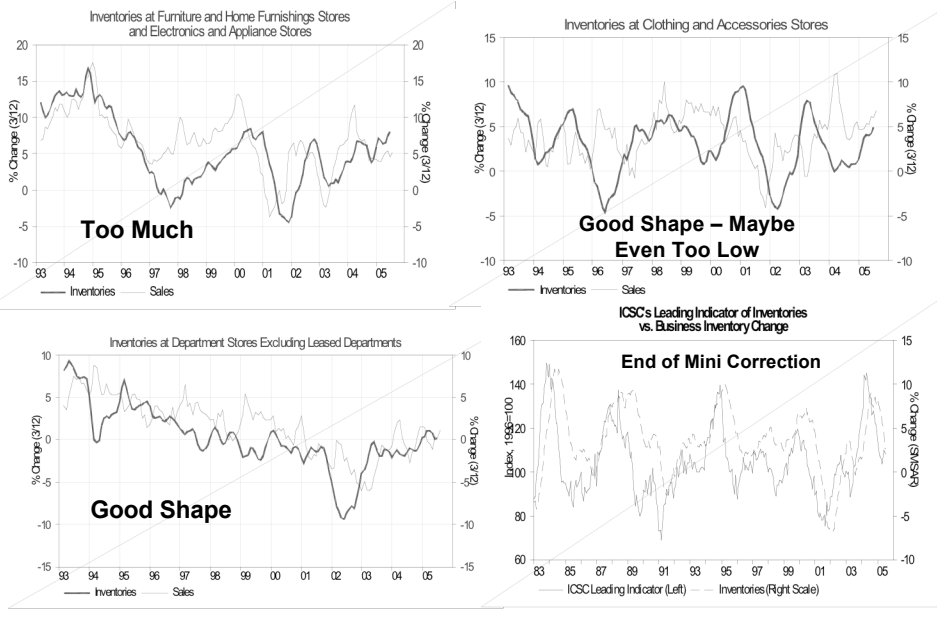


### Mail Order & Internet Sales as Share of GAFO & Mail Order/Internet Sales

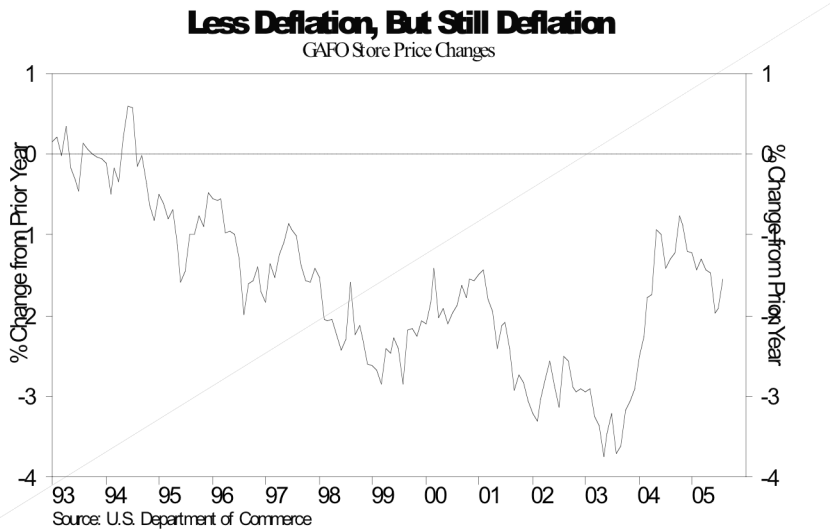




## Retail Inventories and Total Inventory Patterns

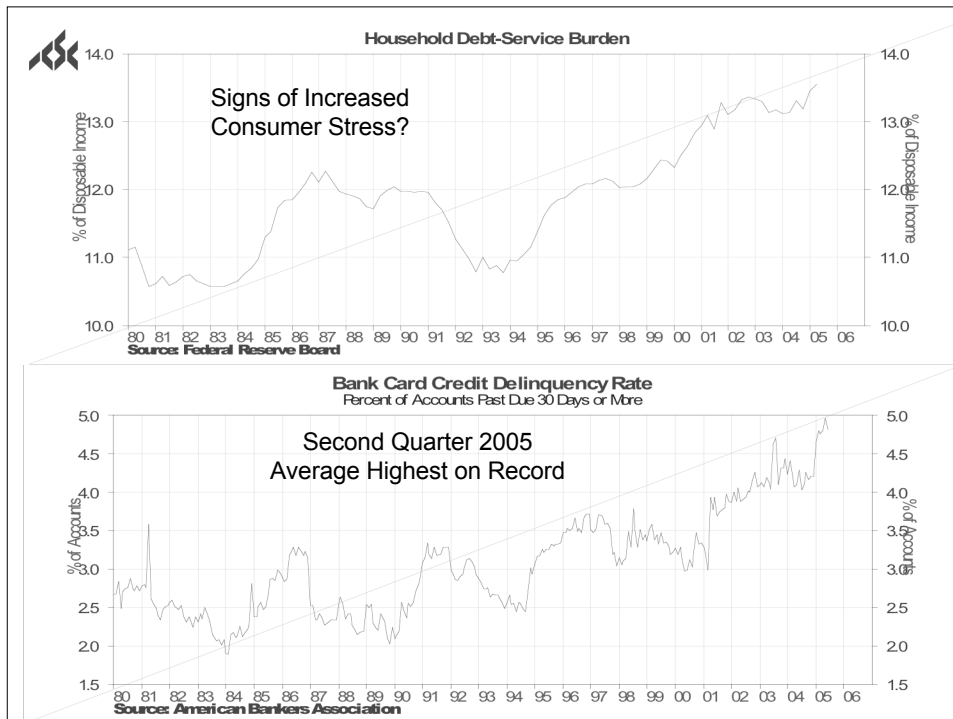


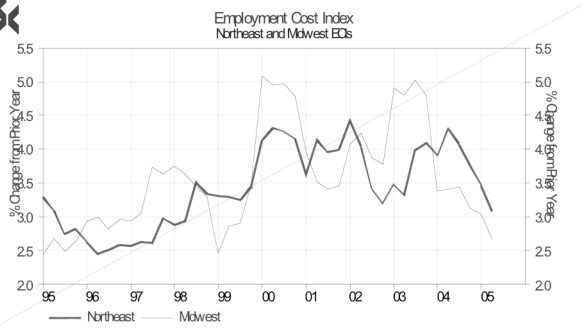
## As Cost Pressures Build, Retailers Pass Along Less of the Cost Savings to Consumer -- Prices Still Declining Overall





But Even as the Industry and Consumer Fundamentals Have Held Up  
 Consumers Face Stronger Headwinds...

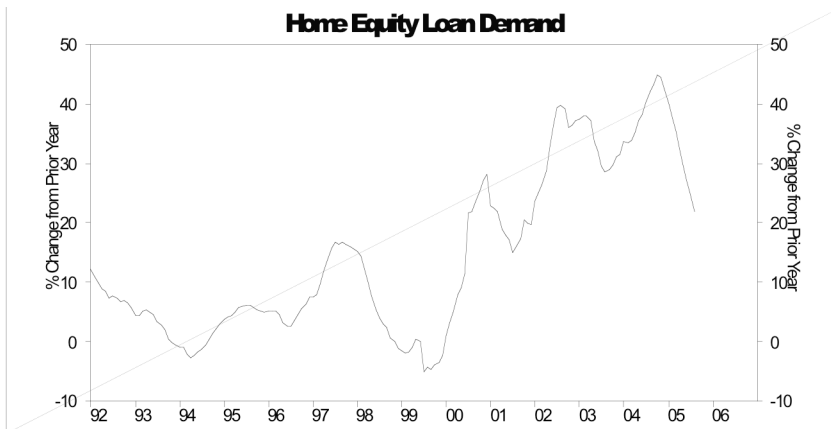




**Wage & Benefit Gains Lessen... Good News for Employers, Bad News for Employees**

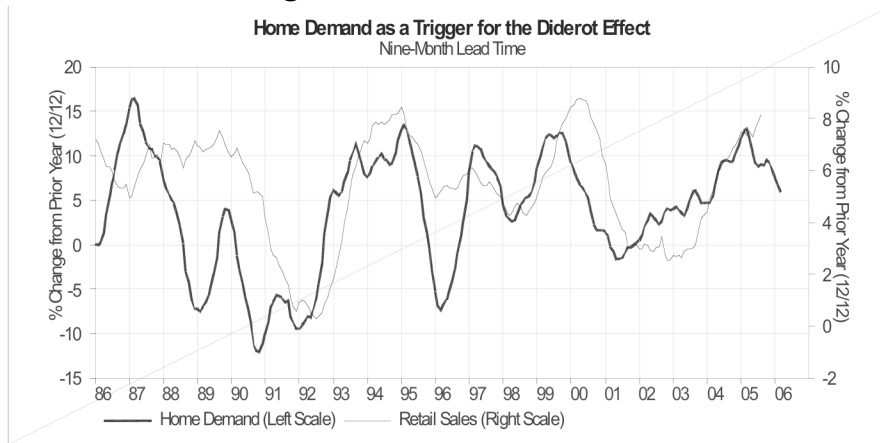


### Home Equity Loan Usage Begins to Grow Slower – Another Lessened Source of Spending Power



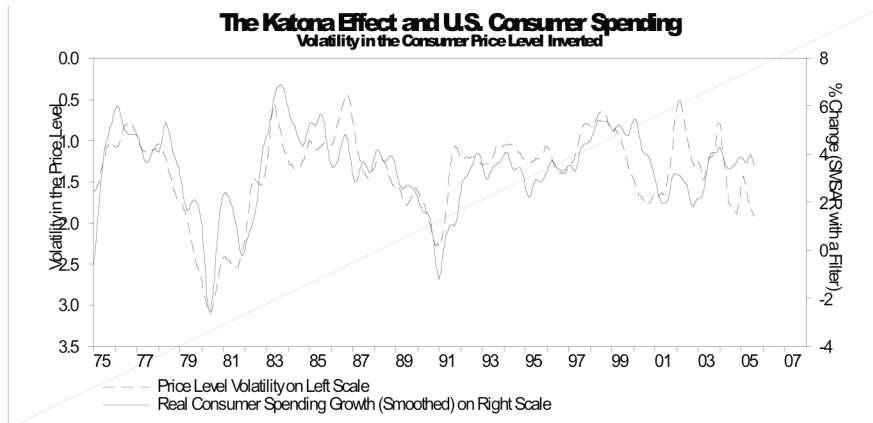


## Diderot Effect – Housing Demand as Leading Indicator of Retail Sales



## Consumers React to Price Volatility (as Uncertainty)

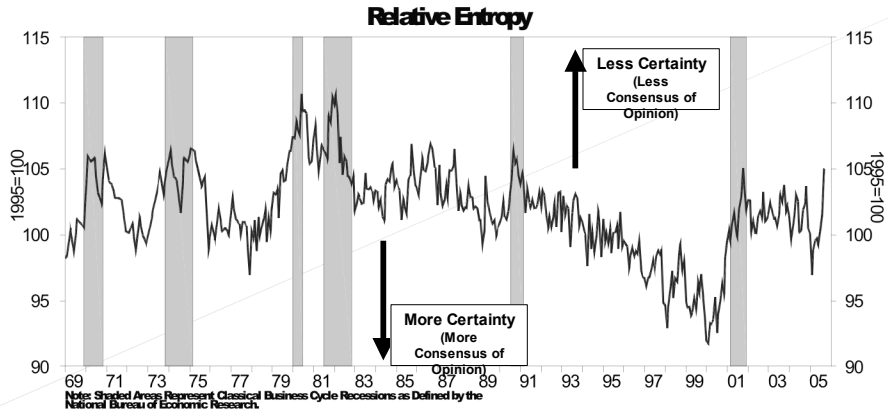
Why is the Relationship Different?





## Measuring Consumer Uncertainty

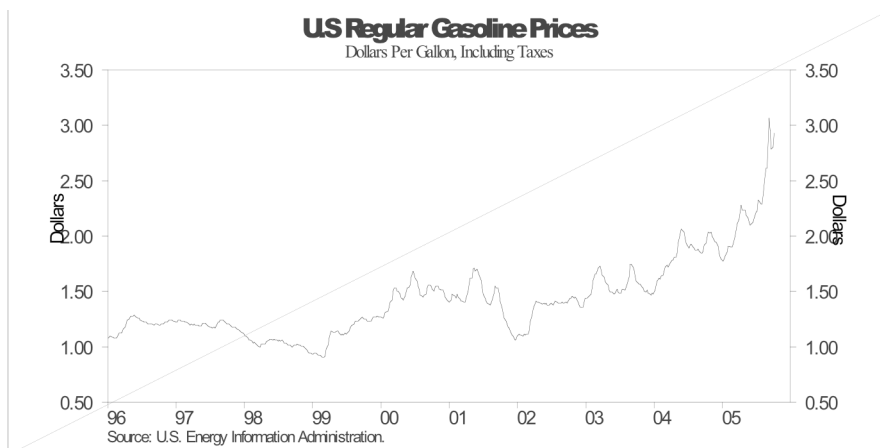
Consumers Reflect Greater Uncertainty about Current and Future Economic Conditions



For a discussion of this metric, see: Ricketts, Martin and Edward Shoesmith. "British Economic Opinion: Positive Science or Normative Judgment?," *American Economic Review*, May 1992, pp. 210-215.



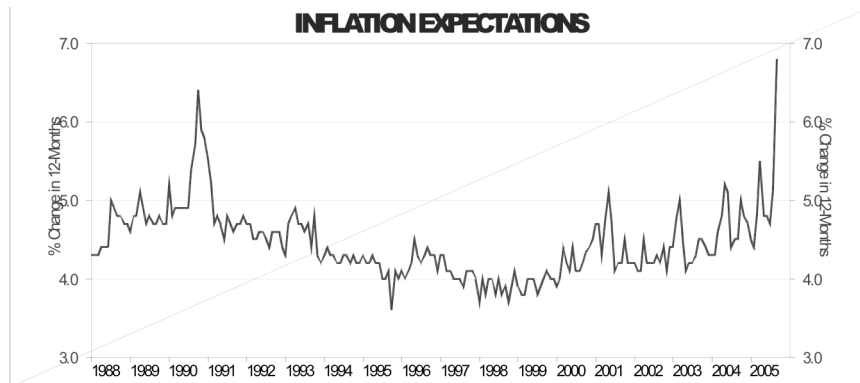
## High Energy Prices – The Lingering Worry







## Consumers (and the Fed) Worry About Higher Inflation



## In September 2005, Consumers Spent \$15-\$20 Per Week in Higher Fuel Costs Compared With Same Month of 2004



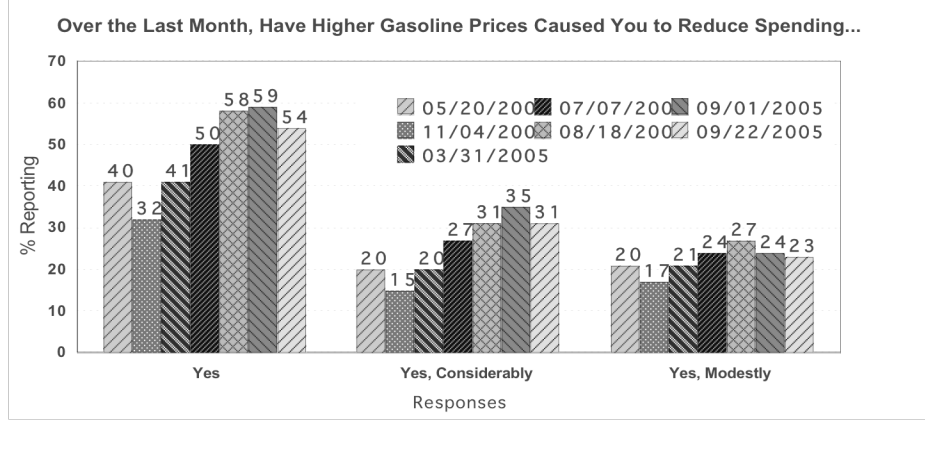
### Per Week Expenditures and Change in Earnings

(Low End Based on 15,000 Annual Miles Driven Per Year; High End Based on 20,000 Annual Miles Driven Per Year)

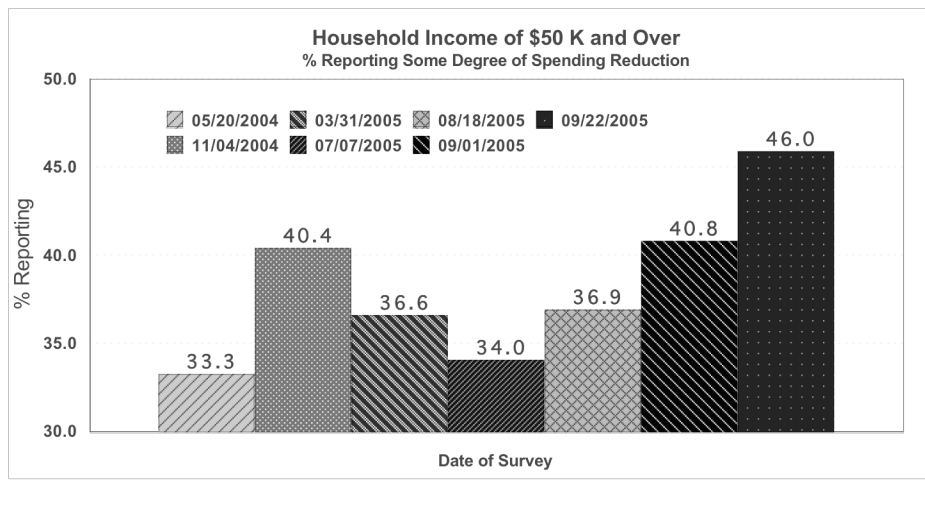
|             | Increase in Average Weekly Earnings (Dollars) | "Low" Gasoline Expenditure (Dollars) | Year-Year Change "Low End" (Dollars) | "High" Gasoline Expenditure (Dollars) | Year-Year Change "High End" (Dollars) |
|-------------|---|--------------------------------------|--------------------------------------|---------------------------------------|---------------------------------------|
| <b>2004</b> |   |                                      |                                      |                                       |                                       |
| JAN         | 9.8   | 22.7                                 | 1.6                                  | 30.2                                  | 2.2                                   |
| FEB         | 9.6   | 23.8                                 | 0.5                                  | 31.7                                  | 0.7                                   |
| MAR         | 7.6   | 25.0                                 | 0.6                                  | 33.4                                  | 0.8                                   |
| APR         | 12.7  | 25.9                                 | 3.0                                  | 34.6                                  | 4.0                                   |
| MAY         | 13.5  | 28.6                                 | 7.0                                  | 38.1                                  | 9.3                                   |
| JUN         | 10.1  | 28.4                                 | 6.9                                  | 37.9                                  | 9.2                                   |
| JUL         | 12.0  | 27.6                                 | 5.8                                  | 36.8                                  | 7.7                                   |
| AUG         | 13.0  | 27.1                                 | 3.7                                  | 36.1                                  | 5.0                                   |
| SEP         | 15.6  | 27.0                                 | 2.8                                  | 36.0                                  | 3.7                                   |
| OCT         | 15.1  | 28.8                                 | 6.3                                  | 38.5                                  | 8.4                                   |
| NOV         | 10.9  | 28.5                                 | 6.7                                  | 38.1                                  | 9.0                                   |
| DEC         | 15.0  | 26.6                                 | 5.2                                  | 35.4                                  | 7.0                                   |
| <b>2005</b> |   |                                      |                                      |                                       |                                       |
| JAN         | 12.6  | 26.4                                 | 3.7                                  | 35.2                                  | 5.0                                   |
| FEB         | 11.9  | 27.5                                 | 3.8                                  | 36.7                                  | 5.0                                   |
| MAR         | 13.8  | 30.0                                 | 5.0                                  | 40.0                                  | 6.6                                   |
| APR         | 15.8  | 32.3                                 | 6.4                                  | 43.1                                  | 8.6                                   |
| MAY         | 12.3  | 31.2                                 | 2.6                                  | 41.6                                  | 3.4                                   |
| JUN         | 16.1  | 31.1                                 | 2.7                                  | 41.5                                  | 3.6                                   |
| JUL         | 14.8  | 33.0                                 | 5.5                                  | 44.0                                  | 7.3                                   |
| AUG         | 14.2  | 35.9                                 | 8.8                                  | 47.8                                  | 11.7                                  |
| SEP         |   | 41.9                                 | 14.9                                 | 55.8                                  | 19.9                                  |



## The "First Wave" Impact on Consumer Spending



## An Even Bigger Worry... More Upper Income Households Report Scaling Back on Non-Essential Spending

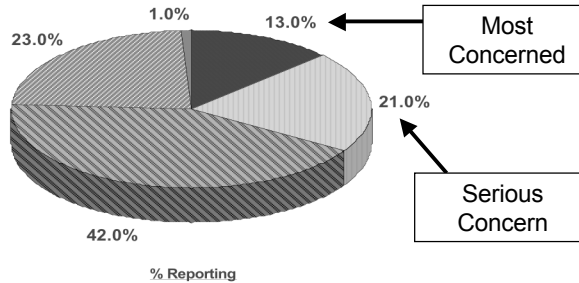




# The "Second Wave" Impact on Consumer Spending

## Winter Heating Impacts

Thinking ahead to the winter months...  
Would you say that high energy prices during the winter heating season will cause you...



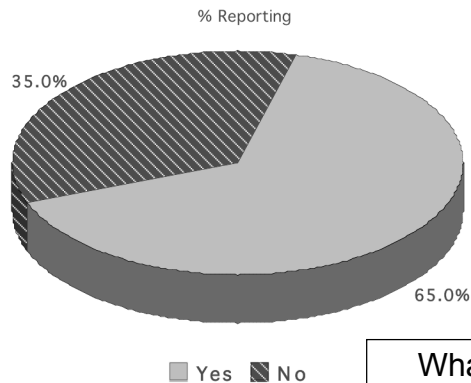
Consumer survey taken  
September 22-25, 2005.

- Major Financial Hardship and Concern About How to Pay for the Extra Cost
- Moderate Concern, But You Still Have to Stay Warm
- No Concern
- Serious Concern and the Likelihood that Non-essential Spending Will be Somewhat Curtailed
- Don't Know



## A Generous Nation Responds

Have you contributed money to the Hurricane Katrina relief effort?



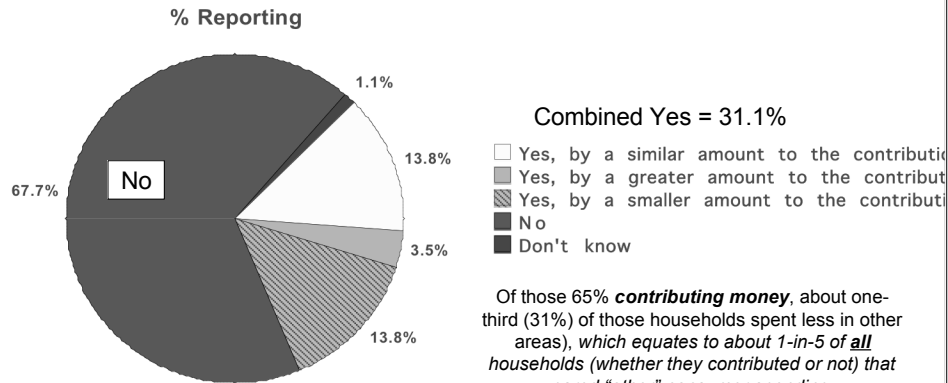
Consumer survey taken  
September 22-25, 2005.

What was the consequence of that giving?



## If you gave to the Katrina Relief did that impact other spending?

If yes...Has that caused you to spend less in other areas?

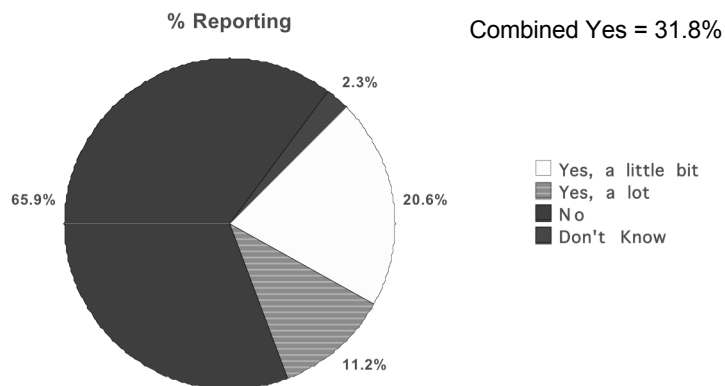


Consumer survey taken September 22-25, 2005.



## If you did not give to the Katrina Relief, did the event cause you to spend less?

If no...Has this event caused you to spend less?



Consumer survey taken September 22-25, 2005.

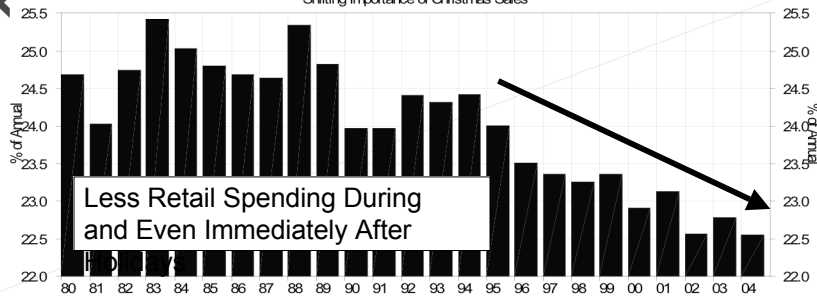


## And Then There is the Upcoming Holiday Season...

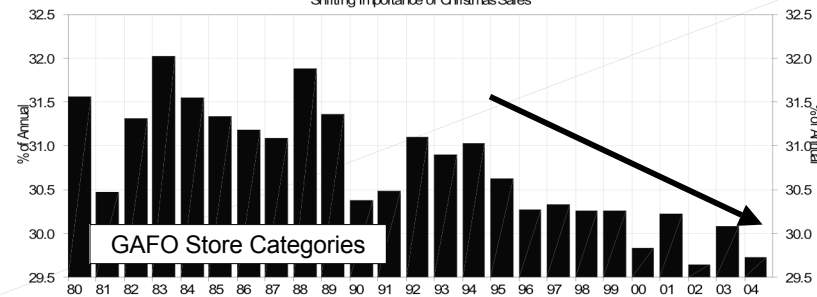
What we know  
and don't  
know...



November-December GAFO Sales as Share of Annual Sales  
Shifting Importance of Christmas Sales



November-December-January GAFO Sales as Share of Fiscal Year Sales  
Shifting Importance of Christmas Sales





## Does the Holiday Season Length Matter?

Study Suggests it Does

### "Holiday Season Length" Between Thanksgiving Day and Christmas Day

| Year   | Length of the Shopping Season | Day of the Week for Christmas | Hanukkah holiday start night before) |
|--------|-------------------------------|-------------------------------|--------------------------------------|
| 198526 |                               | Wednesday                     | 12/8                                 |
| 198627 |                               | Thursday                      | 12/27                                |
| 198728 |                               | Friday                        | 12/16                                |
| 198830 |                               | Sunday                        | 12/4                                 |
| 198931 |                               | Monday                        | 12/23                                |
| 199032 |                               | Tuesday                       | 12/12                                |
| 199126 |                               | Wednesday                     | 12/2                                 |
| 199228 |                               | Friday                        | 12/20                                |
| 199329 |                               | Saturday                      | 12/9                                 |
| 199430 |                               | Sunday                        | 11/28                                |
| 199531 |                               | Monday                        | 12/18                                |
| 199626 |                               | Wednesday                     | 12/6                                 |
| 199727 |                               | Thursday                      | 12/24                                |
| 199828 |                               | Friday                        | 12/14                                |
| 199929 |                               | Saturday                      | 12/4                                 |
| 200031 |                               | Monday                        | 12/22                                |
| 200132 |                               | Tuesday                       | 12/10                                |
| 200226 |                               | Wednesday                     | 11/30                                |
| 200327 |                               | Thursday                      | 12/20                                |
| 200429 |                               | Saturday                      | 12/8                                 |
| 200530 |                               | Monday                        | 12/26                                |

University of Missouri Prof. Emek Basker ("Twas Four Weeks before Christmas: Retail Sales and the Length of the Christmas Shopping Season," August 2004) argues that the length of the Christmas "shopping season" in the United States matters.

| The Basker Model: Statistically-Significant Shopping Day Effects on Retail Sales |          |          |         |
|--|----------|----------|---------|
| Yes = Statistically Significant, No = Not Significant                            |          |          |         |
| Category   | November | December | Holiday |
| Total  | Yes      | No       | Yes     |
| Apparel  | No       | Yes      | Yes     |
| Drugstores   | Yes      | No       | Yes     |
| Electronics  | No       | No       | No      |
| Sporting Goods   | No       | No       | No      |
| Furniture  | Yes      | No       | No      |
| General Merchandise  | No       | Yes      | Yes     |
| Hardware   | No       | No       | No      |
| Jewelry  | Yes      | No       | No      |
| Food stores  | No       | Yes      | Yes     |
| Liquor stores  | No       | No       | No      |
| Nonstore retailers   | Yes      | No       | No      |

Source: Basker, August 2004, p. 8.



## ICSC Looks at Season Length

Two Views: Econometric and Survey Based

### ICSC Season Length Model Formulation

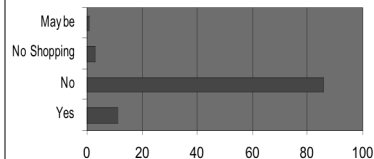
A better conceptual econometric model than the Basker formulation used to assess the holiday season length is to define holiday-excess sales relative to the **prior year** (not the September-October period), to use personal disposable income as the "control variable" or explanatory variable—which makes the relationship a consumption function—and then to include the shopping day effect as a change from the prior year.

Our variation of the Basker model was estimated between 1988 and 2003 to explain the incremental change (if any) in November-December general merchandise, apparel, furniture and other store (GAFO) sales from the changes in the holiday season length. Although the income component has marginal statistical significance in explaining sales, **the results suggest that every day change in the length of the holiday season from the prior year will cause sales to change by approximately \$725 million for the season.**

**The 2005 holiday season had one additional "shopping day" compared with 2004. Statistically, that would implied a sales increment of about \$0.7 bn more sales or approximately 0.2 percentage point on a year-over-year basis. Small, but at least positive for the season.**

### Ask the Consumer

**Consumer's Generally Do Not Think Length of Holiday Season Affects Their Shopping (% Reporting)**

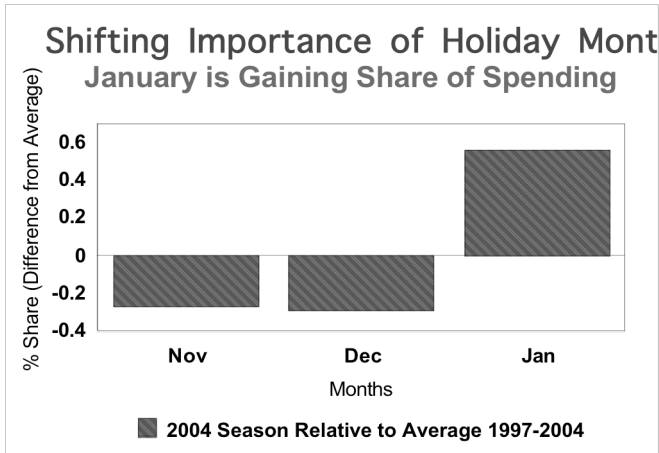
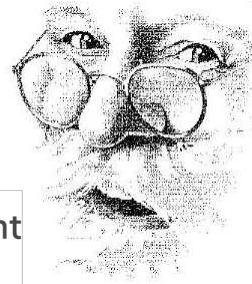


**86% Felt the Length of Holiday Season Did Not Matter to Their Shopping Behavior.**

**Consumers Say it Largely Does Not Matter.**

# The 2005 Holiday Season

*Observation 1: More Gift Card Usage Shifts More Holiday Related Sales into January*

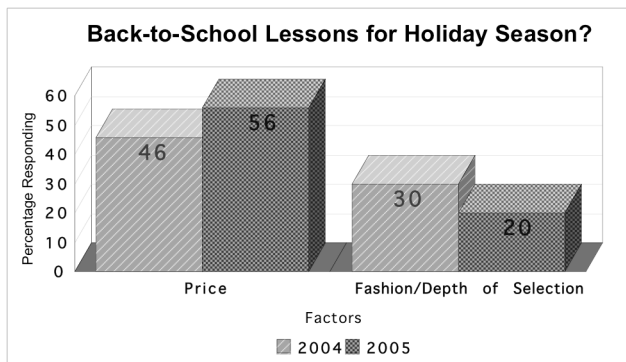
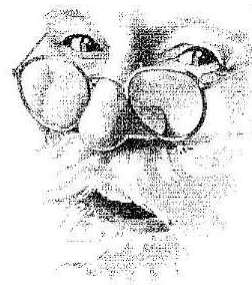


*Strategy: Lean inventory during season, but add fresh winter merchandise in post-holiday season.*

ICSC estimates that 10-15% of Holiday Gift Dollars Go Into Gift Cards

# The 2005 Holiday Season

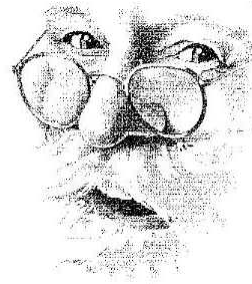
*Observation 2: Consumers appear more "price" driven this year during the back-to-school season than last year when fashion trends and the depth of the product selection mattered more.*



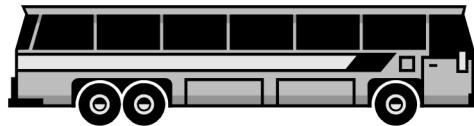
*Strategy: Watch those price points!*

# The 2005 Holiday Season

Observation 3: December weather could be very problematic for retailers this year with projections of relatively heavy snowfall during the month. This poses an "in-store" and promotional problem.



Strategy: Use online and catalog business more aggressively. Offer innovative times for shopping and ways to get to the store.



## ICSC Holiday Chain Store Sales

- 2005 Longest Span Between Thanksgiving and Christmas (30 days) since 2001 (32 days)
- Late Hanukkah – Latest since 1986
- Snowy Season Forecast.
- Model-based estimate shown in table...3.2% year/year growth in comparable store (same store) sales growth for November and December rolled

### 2005 OUTLOOK

ICSC Chain Store Sales Index Year/Year % Change in Sales During Jan-Oct Period Ahead of and During the Holiday Season

| Year                 | Jan-Oct | Nov-Dec            | Difference | Length of the Shopping Season | Day of the Week for Christmas | Hanukkah (holiday starts night before) |
|----------------------|---------|--------------------|------------|-------------------------------|-------------------------------|--|
| 1985                 | 7.0     | 3.2                | -3.8       | 26                            | Wednesday                     | 12/8                                   |
| 1986                 | 5.1     | 4.9                | -0.2       | 27                            | Thursday                      | 12/27                                  |
| 1987                 | 5.6     | 4.2                | -1.4       | 28                            | Friday                        | 12/16                                  |
| 1988                 | 4.1     | 5.8                | 1.7        | 30                            | Sunday                        | 12/4                                   |
| 1989                 | 5.7     | 4.9                | -0.8       | 31                            | Monday                        | 12/23                                  |
| 1990                 | 4.7     | 2.0                | -2.7       | 32                            | Tuesday                       | 12/12                                  |
| 1991                 | 2.7     | 2.5                | -0.2       | 26                            | Wednesday                     | 12/2                                   |
| 1992                 | 6.1     | 5.6                | -0.5       | 28                            | Friday                        | 12/20                                  |
| 1993                 | 3.7     | 3.6                | -0.0       | 29                            | Saturday                      | 12/9                                   |
| 1994                 | 4.6     | 3.8                | -0.8       | 30                            | Sunday                        | 11/28                                  |
| 1995                 | 2.9     | 2.1                | -0.8       | 31                            | Monday                        | 12/18                                  |
| 1996                 | 3.1     | 3.2                | 0.1        | 26                            | Wednesday                     | 12/6                                   |
| 1997                 | 4.7     | 4.5                | -0.1       | 27                            | Thursday                      | 12/24                                  |
| 1998                 | 5.9     | 5.1                | -0.9       | 28                            | Friday                        | 12/14                                  |
| 1999                 | 7.0     | 5.4                | -1.6       | 29                            | Saturday                      | 12/4                                   |
| 2000                 | 4.7     | 2.4                | -2.3       | 31                            | Monday                        | 12/22                                  |
| 2001                 | 2.8     | 2.2                | -0.6       | 32                            | Tuesday                       | 12/10                                  |
| 2002                 | 3.7     | 0.5                | -3.2       | 26                            | Wednesday                     | 11/30                                  |
| 2003                 | 2.9     | 4.0                | 1.2        | 27                            | Thursday                      | 12/20                                  |
| 2004                 | 4.4     | 2.3                | -2.1       | 29                            | Saturday                      | 12/8                                   |
| 2005                 | 3.5     | 3.2 < Est/Forecast |            | 30                            | Monday                        | 12/26                                  |
| 1985-2003 Median     | 4.7     | 3.8                | -0.8       | 28                            |                               |  |
| Excluding 1990, 2001 | 4.7     | 4.2                | -0.5       | 28                            |                               |  |
| 26 day Xmas          | 4.1     | 2.3                | -1.8       | 26                            |                               |  |
| 27 day Xmas          | 4.9     | 4.7                | -0.2       | 27                            |                               |  |
| 28 day Xmas          | 5.9     | 5.0                | -0.9       | 28                            |                               |  |
| 29 day Xmas          | 5.3     | 4.5                | -0.8       | 29                            |                               |  |
| 30 day Xmas          | 4.3     | 4.8                | 0.5        | 30                            |                               |  |
| 31 day Xmas          | 4.4     | 3.1                | -1.3       | 31                            |                               |  |







### Holiday Spending

Billions of Dollars, November-January Periods, Seasonally Adjusted

| Category                            | 1998   | 1999   | 2000   | 2001   | 2002   | 2003   | 2004   | 2005 Forecast |
|-------------------------------------|--------|--------|--------|--------|--------|--------|--------|---------------|
| GAFO Store Sales                    | 194.42 | 198.32 | 218.52 | 227.12 | 31.22  | 45.22  | 57.32  | 70.1          |
| % Change                            | 6.77   | 24.93  | 91.86  | 14.95  | 0      | 0      | 0      | 0             |
| GAFS Store Sales                    | 184.71 | 197.92 | 208.52 | 217.32 | 221.52 | 235.52 | 247.72 | 260.8         |
| % Change                            | 6.47   | 15.34  | 31.96  | 35.25  | 3      | 0      | 0      | 0             |
| Electronics & Appliances            | 18.32  | 0.02   | 0.02   | 1.22   | 1.12   | 3.12   | 4.12   | 5.3           |
| % Change                            | 6.48   | 80.26  | 0.03   | 9.14   | 35.0   | 0      | 0      | 0             |
| Appliances, T.V. & camera           | NANA   | 15.31  | 6.41   | 6.41   | 7.61   | 8.9    | ---    | ---           |
| % Change                            | ---    | ---    | ---    | ---    | ---    | ---    | 6.9    | -0.27         |
| Computer & software stores          | 5.75   | 34.34  | 44.34  | 74.6   | ---    | ---    | ---    | ---           |
| % Change                            | 2.1    | -7.6   | -18.32 | 3.39   | 2.0    | 0.5    | ---    | ---           |
| Clothing and Accessory Stores       | 38.44  | 0.34   | 2.62   | 4.43   | 8.46   | 3.48   | 4.50   | 8             |
| % Change                            | 5.85   | 0.56   | -0.53  | 4.5    | 74.45  | 0      | 0      | 0             |
| Men's clothing stores               | 2.52   | 4.2    | 4.2    | 1.2    | 0.22   | 2.4    | ---    | ---           |
| % Change                            | -2.9   | -5.7   | -0.0   | -12.1  | -2.31  | 0.79   | 3      | ---           |
| Women's clothing stores             | 7.37   | 28.07  | 98.08  | 78.9   | ---    | ---    | ---    | ---           |
| % Change                            | 2.7    | -0.71  | 0.6    | -0.41  | 28.42  | 8      | ---    | ---           |
| Shoe stores                         | 5.75   | 6.5    | 7.5    | 8.5    | 8.6    | 0.6    | 0      | 0             |
| % Change                            | 4.0    | -1.01  | 81.4   | -0.93  | 8.0    | 0.5    | ---    | ---           |
| Sporting Good, Hobby, Book & Music  | 17.51  | 8.31   | 8.61   | 9.71   | 9.41   | 9.92   | 0.3    | 0             |
| % Change                            | 3.44   | 71.95  | 7.1    | 41.11  | 42.0   | ---    | ---    | ---           |
| General Merchandise                 | 90.99  | 7.61   | 0.4    | 8.11   | 0.61   | 1.3    | 2.1    | 2.1           |
| % Change                            | 7.37   | 47.55  | 52.37  | 26.56  | 0      | 0      | 0      | 0             |
| Dept stores (ex. leased depts)      | 56.75  | 7.59   | 25.7   | 25.3   | 9.53   | 6.54   | 3      | ---           |
| % Change                            | 2.01   | 72.6   | 3.4    | -5.8   | -0.51  | 2      | ---    | ---           |
| Other general merchandise stores    | 34.13  | 9.45   | 6.53   | 4.59   | 2.67   | 6.74   | 8      | ---           |
| % Change                            | 17.41  | 6.81   | 4.41   | 7.11   | 1.01   | 4.11   | 0.6    | ---           |
| Warehouse clubs & superstores       | 26.73  | 2.13   | 7.44   | 8.50   | 7.58   | 0.64   | 7      | ---           |
| % Change                            | 22.12  | 0.31   | 7.11   | 2.13   | 2.14   | 4.11   | 7      | ---           |
| All other general merchandise       | 7.57   | 8.8    | 18.68  | 59.61  | 0      | 0      | 0      | ---           |
| % Change                            | 3.34   | 0.3    | 57.1   | -0.91  | 2.94   | 1      | ---    | ---           |
| Electronic shopping & mail-order    | 19.72  | 4.32   | 8.92   | 9.23   | 1.53   | 4.38   | 5.42   | 4             |
| % Change                            | 17.72  | 3.51   | 8.91   | 0.7    | 89.21  | 2.01   | 0      | 0             |
| Shopping Center-Inclined Sales      | 387.04 | 13.04  | 30.14  | 48.04  | 57.74  | 85.55  | 15.45  | 46.4          |
| % Change                            | 6.36   | 7.4    | 14.22  | 2.6    | 16.26  | 0      | 0      | 0             |
| Online & Mail-Orders/GAFO PLUS (% S | 8.49   | 210.51 | 1.71   | 1.41   | 2.01   | 2.31   | 3.4    | ---           |

Sources: U.S. Department of Commerce; ICSC Research.

