

2007 Retail Sales Forecast

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Over one-fourth of all retail sales occur during October, November and December, but 2006 was weaker than expected. The National Retail Federation (NRF) had forecasted 5% growth but actual sales growth was 4.4 %, the weakest year since the recession year of 2002. In 2005, holiday sales grew 6.1%. Overall retail sales grew only 4.8 %.

Price War

One explanation for lackluster sales was Wal-Mart's engagement in a price war. . As an opening shot in this price war, Wal-Mart discounted more than 100 holiday toys and games in mid-October. In mid-November, Wal-Mart cut prices on 50 more holiday toys and games. Unfortunately, retail sales in the fourth quarter tend to be a foretaste of retail sales in the coming year.

In January, same-store sales were higher than expected, especially department store and clothing sales. Same-store sales are the best measure of how well retailers are doing. Same-store sales compare sales at store locations open at least a year in one time period to sales last year at that time. January 2007 saw a 3.9% gain in same-store sales over January 2006, which beat Thompson Financials predicted 3.1% gain. However, this increase was primarily due to colder than average weather throughout the U.S.

For the remainder of the year, price competition and promotions should be a major driver of retail sales. Retailer leader, Wal-Mart will likely remain aggressive on prices as they try to grow at a comparable level as their competition. For example, Wal-Mart's same-store sales increased 2.2% from January 2006 to January 2007. In comparison, January same-store sales increased 3.6% at J.C. Penney's, 4% at TJX (i.e., Marshall's and T.J. Maxx), 5.1% at Target, 8.6% at Federated Department Stores (i.e., Macy's and Bloomingdale's), and 8.7% at Kohl's. Growth in sales will likely be uneven from retailer to retailer with those who have the most successful promotions, price cuts, and advertised sales reaping the greatest sales increase. This is good news for price-conscious New Mexico consumers but bad news for retailer profitability. Nationwide, more than one-third of consumers (36.5%) claim that sales prices and price discounts are the most important factor in their decision to purchase from a particular retailer, according to an October 2006 NRF survey.

Some retailers have been seeking exclusive merchandise that is immune to a price war. For example, Wal-Mart marketed an exclusive 2-DVD version of Disney-Pixar's *Cars* for the holiday season. Target has exclusive purple and blue versions of Fisher-Price's Pixter Multi-Media System interactive learning toy. Kmart has been developing a portfolio of exclusive home fashion and clothing brands, such as Joe Boxer, Martha Stewart, and Jaclyn Smith, as well as introducing exclusion Sears brands, such as Craftsman tools, into its stores.

Some retailers may be hampered in their ability to cut prices because of low inventory levels. To help profit margins, many retailers have been carrying smaller inventories to reduce inventory

carrying costs and losses on clearance merchandise. But this may limit their ability to designate some popular items as loss leaders to increase customer traffic. It could also mean that popular items could run out of stock more quickly than in previous years.

Consumer Trends

Despite worries about the continuing war in Iraq, tensions with Iran and North Korea, and rising interest rates, the U.S. economy is counting on consumers once again to come to the rescue as real estate cools down and manufacturing continues to lose jobs. But consumers nationwide are facing a mix of good and bad news for their pocketbooks. Retail spending and the 2007 economy depend on whether they are ready to open their pocketbooks and spend.

The Conference Board's Consumer Confidence Index (1985 = 100) nose-dived in August, and then fluctuated during the fourth quarter. The Index in January stood at 110.3, up slightly from 110.0 in December. The Present Situation Index increased to 133.9 from 130.5. The Expectations Index, however, declined to 94.5 in January down from 96.3 in December. In October, more consumers (18.5%) expected business conditions to improve in the next six months than in September (16.5%), but more consumers thought present-day conditions were "bad" in October (17.1%) than did in September (15.6%). Consumers' outlook for the next six months was less optimistic than in December. Those anticipating business conditions to worsen edged up to 8.0 percent from 7.8 percent. Those expecting business conditions to get better decreased slightly to 16.2 percent from 16.7 percent.

The outlook for the labor market was mixed. Consumers expecting more jobs to become available in the coming months edged up to 14.0 percent from 13.9 percent, while those anticipating fewer jobs also edged up to 15.7 percent from 15.5 percent. The proportion of consumers expecting their incomes to increase in the months ahead declined to 19.8 percent, down from 21.4 percent in December.

The downturn in housing prices nationwide is beginning to accelerate the number of loan defaults and foreclosures. In addition, rising interest rates mean that it is harder for homeowners to refinance and have extra cash from reduced monthly loan payments. However, the good news for consumers is energy prices. After consistently rising the last few years, oil prices are generally down during 2007. Natural gas prices have seen an even more extreme price fall, down more than 50% since last October. This means more cash in the pockets of consumers. Compared to January 2006, the average New Mexican should have an extra \$100 per month in 2007 to spend due to the drop in gasoline prices alone.

High-end consumption growth is slowing. High-end consumption really helped the retail industry in 2003 and 2004, but was not as great in 2005 and continued to decline in 2006. America's wealthiest 10%, the 11.2 million households with a minimum net worth of \$800,000 and an average income of \$256,000, represent almost half of all consumer income and spending. A survey by the Affluent American Affluence Research Center found that while the affluent have a positive view of current business conditions, their outlook for future economic conditions has declined substantially. The composite Affluent Consumer Expectations (ACE) index for

economic conditions 12 months from now, though still positive, dropped to 105 from 118 during the first half of 2006. The index is at the second lowest level since survey inception in spring 2002, exceeding only the index of 100 posted in the fall 2005 survey.

New Mexico Trends

Good news for New Mexico retail sales is that more New Mexicans are working this year. From December 2005 to December 2006, the number of people employed in New Mexico increased 2.2%, which is greater than for the U.S. as a whole (1.4%) according to the Bureau of Labor Statistics. Unemployment in New Mexico dropped to 3.6% in December 2006 from 4.7% last year, which is a faster decrease in unemployment than the national average of 4.3% in December 2006 from 4.6% in December 2005. The December unemployment rate is the lowest on record for New Mexico.

Since more New Mexicans are working, personal income is increasing for New Mexicans. According to the Bureau of Economic Analysis, New Mexico personal income rose 1.8% from \$53.4 billion in the second quarter of 2005 to \$57.7 billion in the second quarter of 2006.

Declining fuel costs will have a positive effect on New Mexico retail sales. Middle-class consumers should be more likely to shop at the mall than in 2006 when gasoline and heating costs were higher. Working class New Mexicans, for whom fuel costs are an even greater portion of their disposable income, should also be more willing to spend this year, which will benefit retailers who serve that target market as well.

The housing bubble may be bursting nationwide, but the effects are less pronounced in New Mexico. New building permits in New Mexico decreased 28% from 1205 in September 2005 to 867 in September 2006 according to U.S. Census Bureau data. However, the City of Las Cruces reports that the number of housing permits issued from January through October 2006 was up 4.7% from last year and the valuation of the permits was up 17.9%. So, more houses, and more expensive houses, continue to be built in Las Cruces. House prices for new and existing homes are up too. In the second quarter of 2006, house prices were up 10.1% nationwide, 15.5% throughout New Mexico, 12.6% in both Las Cruces and Santa Fe, 15.1% in Farmington, and 17.8% in Albuquerque.

Prediction for New Mexico 2007 Retail Sales

Based on the continued strength in New Mexico's overall job market, in retail employment, and the housing market compared with national averages, I predict that 2007 retail sales for New Mexico retailers should be better than the national average. New Mexico retailers should expect a 5.6% increase in overall sales compared to 2006, whereas U.S. retailers should expect about a 4% increase compared to 2006. In addition, New Mexico's population is growing faster than the national average. Thus, retailers in New Mexico's high growth areas should expect higher sales.

To avoid the hassle of shopping and to increase the range of choices available (especially in rural areas with few retail stores), consumers will continue to shop online or with catalogs. Internet

and catalog sales should continue to increase in 2007. Thus, New Mexico retailers should continue to improve their presence on the Internet in the coming years.

I recommend that New Mexico's online retailers tailor their marketing strategies to the consumer's stage of the buying decision process. Early in the buying process, consumers are searching for information. According to the NRF, many consumers begin their online research at Google.com (23.6%), Yahoo.com (7.2%), Amazon.com (5.5%), or eBay (3.7%) to look for merchandise availability, prices and product attributes or features. On the other hand, Internet ads and special offers tend to generate the highest sales later in the process as consumers prepare to make a final purchase decision. This is when offers of "25% Off," "Express Delivery," or "Free Shipping" will be more likely to sway consumers to buy from a particular website. If possible, New Mexico's online retailers should try to remarket to returning consumers who are identified by cookies or other means as having made earlier searches of a website without purchasing with such offers.

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