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Economics Group

Special Commentary

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Holiday Sales Fell Apart at the End, but Still a Record

Pandemic Holiday: Earlier Goods Spending Surge Led to a Poor Finish

A shift to goods spending earlier in the year set up retailers for a big annual increase; the numbers are in and holiday sales shot up 8.7% in 2020, just shy of our call for a 9.0% gain (Figure 1). Despite that solid increase, the climate during the closing months of 2020 was one of fading momentum. Like a football game when your team is off to an early lead that fades in the fourth quarter; the categories that comprise holiday sales posted outright declines in the final months of the year. The big gains earlier in the year were ultimately what made it happen, as we said it might. Despite a deteriorating labor market at the end of the year, curtailed spending in the service sector and canceled travel plans freed up income for spending on gifts. After the anxiety and stress of a year defined by the virus and a divisive election, a yearning for comfort and normalcy underpinned holiday spending—most of which just happened earlier than usual.

Holiday sales shot up 8.7% in 2020.

Figure 1

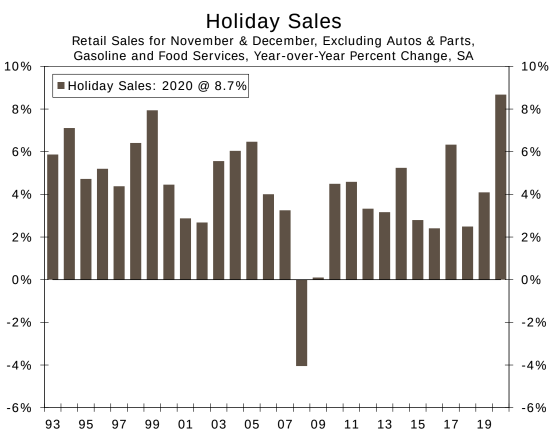
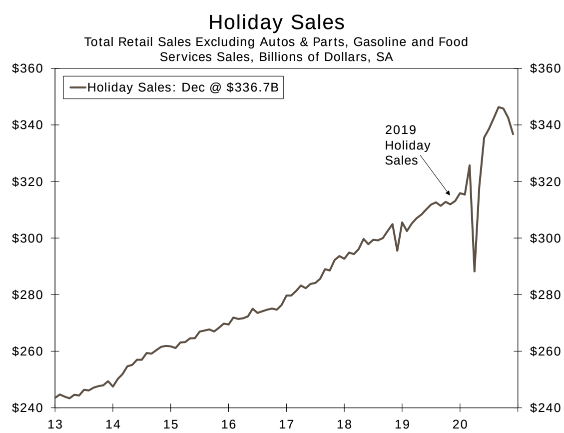


Figure 2



Source: U.S. Department of Commerce and Wells Fargo Securities

Without big family gatherings and year-end parties with coworkers, it did not feel like a typical holiday season, and some retail traditions were disrupted as well. There were no throngs of Black Friday shoppers the day after Thanksgiving. That was replaced this year with rolling special sales and "buy-online, pick-up in store" deals, while online retailers piled on gains. To some extent, these specials pulled some of the holiday season into the fall. Amazon's "Prime Day" moved to October, and many of its competitors began offering competing deals during the month. This early holiday spending was also a factor in sales tapering off in the traditional holiday spending months of November and December. Our measure of holiday sales went into year-end at an all-time high, so it didn't take a blowout finish to lift the category to a big annual increase (Figure 2).

As we start 2021, the virus is still raging and the holiday bills are due. We expect a retrenchment in first quarter consumer spending before a transition to services spending later this year results in another surge in broader measures of consumption. Goods outlays are expected to have a much slower year in 2021 than what we saw during 2020.

We expect a retrenchment in Q1-2021 consumer spending.

How an Awful Year Was Also the Best on Record

Overall retail sales and our holiday sales measure slipped in the three months that make up the fourth quarter.

Despite the solid year-over-year increase in holiday sales, spending momentum faded in the final months of the year. In fact, both overall retail sales and our holiday sales measure, which excludes autos, gasoline and restaurant sales, slipped in the three months that make up the fourth quarter. This was very much what we were expecting and what drove our out-of-consensus call back in October for a record year-over-year gain.[1]

The jump in 2020 holiday sales reflected the shift to goods spending that had already occurred earlier in the year, rather than a surge in spending in the final months. Headed into the critical season, our holiday sales measure was already up 10.4% in October compared to December of last year (reference Figure 2). That means holiday sales declined 2.6% in November and December, but given the run-up in goods spending since lockdowns were lifted in May, holiday sales still ended the year 8.7% ahead of where they were a year ago.

Before the presents ended up under the tree, many of them were left on porches and doorsteps across the country as consumers increasingly turned to online shopping. With many consumers either unable to go out to stores due to lockdowns or just unwilling to do so out of health concerns, it was no surprise that e-commerce (nonstore retailers) saw the largest increase in holiday sales, up 22.8% compared to 2019 (Figure 3). But, as sales were likely brought forward to October amid rolling specials, nonstore retailers actually saw sales decline a sizable 7.3% in the final two months of the year (Figure 4). Only building material and garden retailers (which includes big box retailers such as Home Depot), miscellaneous stores (which includes warehouse clubs like Costco and Sam's Club), health & personal care retailers and grocery stores saw sales pick up in the final two months of the year, or what is formally known as the holiday shopping season.

Figure 3

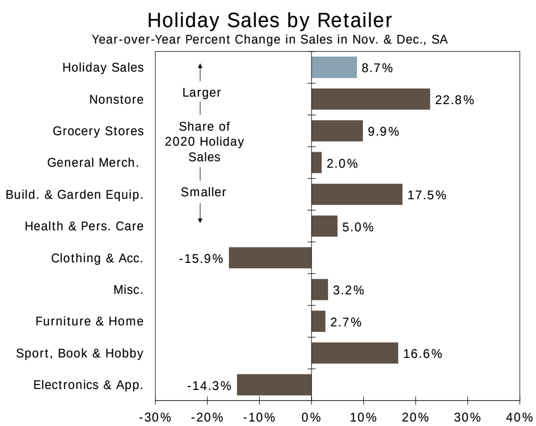
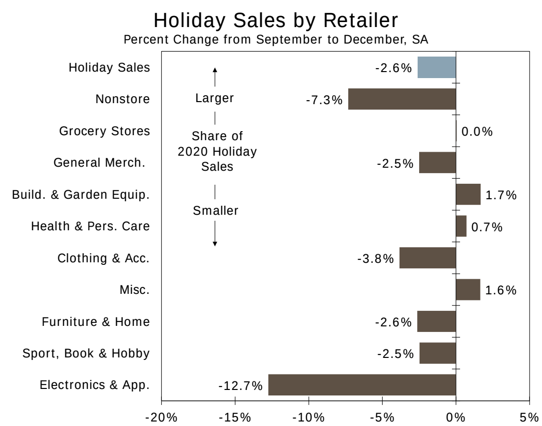


Figure 4



Source: U.S. Department of Commerce and Wells Fargo Securities

We expect some transition to e-commerce is here to stay.

Despite the pullback in e-commerce sales at the end of the year, the nonstore category ended the year nearly 17% ahead of where they stood prior to the pandemic in February. Although consumers may soon pull back on online spending once the vaccine is widely distributed and activity returns to some form of normal, we expect some transition to e-commerce is here to stay. Over the past decade, e-commerce has incrementally been gaining overall retail market share, and the pandemic accelerated this trend. Many consumers who were previously reluctant to turn to online forms of consumption have been forced to rely on such a medium for necessities such as groceries and personal care items in the midst of the pandemic. We expect at least part of this transition will remain in the long term, as consumers prefer the convenience online spending affords even as they began to venture out again.

Building material and garden stores also saw exceptionally strong sales during the pandemic, and sales were 15.3% ahead of where they were in February at the end of 2020. This category likely benefited from some of these retailers being deemed essential during the pandemic, as well the

[1] **See "Holiday Sales Outlook" (October 26, 2020) for more detail.**

surge in home improvement projects as consumers spent more time at home. Redoing the home office or upgrading the living room became both a welcome distraction and requirement as homes served multiple purposes amid the pandemic.

This transition to home life also led to a surge in recreation spending. Sales at sporting goods and hobby stores ended the year 13.6% ahead of their February pre-virus level. Despite a record year for recreation retailers, this category subsided in the final months of the year. We have long held the opinion that recreation spending would subside due to the durable nature of these goods and thus infrequent need to replace them, and we expect sales in this category to move lower this year.[2]

Clothing and accessory retailers saw the largest decline in holiday sales.

Other retailers, however, remain negatively affected by the pandemic. There is not much need to "dress for success" when you are working from home, so it comes as little surprise that clothing and accessory retailers saw the largest decline in holiday sales, (down 15.9% year-over-year). Clothing store sales fell 3.8% in final two months of the year alone, and remain the second worst off category when compared to pre-pandemic sales levels. The worst-off sales category is electronics and appliances stores, where sales declined nearly 13% in the last two months of the year (refer back to Figure 4).

Tis' the Seasonals

Our forecast for holiday sales was notably different than other forecasters, in part because of our difference in measurement. Our holiday sales measure is based on seasonally adjusted data, where as other forecasters rely on the not seasonally adjusted data.

The seasonal adjustment (SA) process is often used in economics to soften some of the noise in the data that is inherent to certain times of the year. Retail sales is a textbook example because people tend to spend a lot around the holidays and then spending is usually softer in subsequent months. Other examples of this disruption can be seen in auto production figures as plants are retooled in the summer months or in farm output as harvests vary by season. SA data attempt to show a clearer picture around how much the data deviates from what typically occurs.

For spending around the holidays, for example, we know holiday retail sales usually rise around 23% on a not seasonally adjusted (NSA) basis from November to December. October and November month-over-month holiday sales tend to increase 4.6% and 6.7%, respectively. However, the SA process would likely register anything less than these typical prints as a decline in holiday sales. So it is possible for sales to increase on a NSA basis, and yet the SA number might show an outright decline, which is exactly what happened this year.

This year was different for a lot of reasons. One of the big ones is that holiday sales were likely pulled forward into the fall. The rescheduling of Amazon's Prime Day to October and the early sales at other stores timed to coincide with it may have disrupted the seasonal adjustment process. As we expected, November and December holiday sales fell on a SA basis in 2020, especially in the nonstore category, which posted its largest decline of the pandemic era in December. The below average, but still sizable monthly gains in NSA holiday sales, however, caused NSA holiday sales to still advance 8.4% compared to 2019.

A Glimpse of What's to Come

The fading spending momentum exhibited in the final months of 2020 looks set to continue.

The fading spending momentum exhibited in the final months of 2020 looks set to continue into the first quarter of the new year. Goods consumption, particularly on durables, has propelled the recent recovery in spending. And since, by definition, these goods generally last a long time and don't need to be purchased very often, we remain convinced that an air pocket in goods spending is likely. That said, higher income in the form of additional fiscal stimulus and the eventual return of services spending should boost overall consumption in the latter half of the year.

Personal consumption should <u>eventually</u> receive a boost from the additional income set to hit households from the latest COVID-fiscal relief package passed at the end of last year.[3] Specifically, about $160 billion in direct checks to households and billions in the form of extended

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[2] **See "Summer Rec" (July 01, 2020) for more detail.**
[3] **See "Unwrapping the Holiday Stimulus Package" (December 22, 2020) for more detail.**

unemployment benefits will provide an immediate boost to personal income, but the stimulus will have a delayed impact on consumer spending.

We forecast a 1.0% annualized pace of decline in Q1 personal consumption expenditures.

In the near term, the acceleration in COVID cases and accompanying restrictions will weigh on consumption, adding to the aforementioned pullback in durables spending, and we forecast a 1.0% annualized pace of decline in first quarter personal consumption expenditures. It will not be until a vaccine is widely distributed that we see spending meaningfully take hold in the second and third quarters of this year (Figure 5).

Figure 5

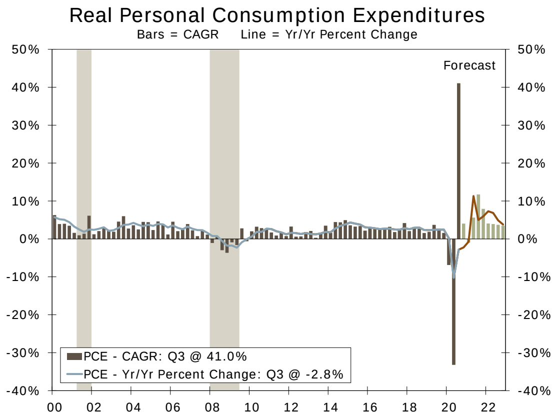
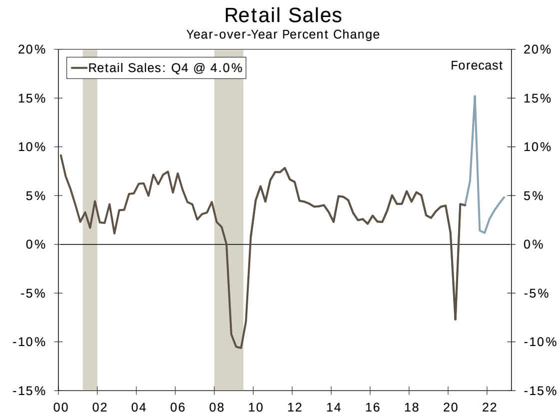


Figure 6



Source: U.S. Department of Commerce and Wells Fargo Securities

Even then, however, the composition of spending will look very different from last year. Services spending will again reclaim its position as the biggest driver of overall consumption, as consumers itch to get out of the house and spend on many services that have been restricted for over a year. Months of pent-up demand for services will thus be unleashed. With more wallet share directed back to services, however, goods spending will naturally take a back seat. This suggests a more subdued pace of retail sales, which is mostly comprised of goods spending, in 2021. Year-over-year changes will benefit in the second quarter from easy base comparisons after the bottom fell out for retail spending in the early days of the pandemic (Figure 6), but the month-to-month pace of improvement in retail sales will downshift this year.

Goods Spending Is SO 2020, Get Ready for Services Splurge

So it was a record year for holiday sales, even if it didn't feel like it.

So it was a record year for holiday sales, even if it didn't feel like it. This was mostly due to goods spending in the summer months that was so strong, even after three straight monthly declines at year-end, the annual change was a blow out. This idea of demand having been pulled forward will be a headwind for goods spending throughout the year. The re-opening of the services economy will likely be another headwind because consumers may opt to spend more going out to eat or going on vacation than they spend at the store or online. But because services spending is much larger than goods outlays, overall consumer spending should put up double-digit percentage growth numbers on an annualized basis in the third quarter of the year.

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