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Economics Group

Special Commentary

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The Goose Is Getting Fat: Holiday Sales Outlook

Executive Summary

Coming off the best holiday season in more than a decade last year, retailers are poised for another good year, at least in terms of the most important measure—sales. Overall, we expect holiday sales to increase about 4.5% this season.

This will be a record-tying 10th consecutive holiday season without a recession. But, a booming economy brings its own challenges. Both traditional stores and online merchants face a patchwork of pricing challenges amid tight supply chains. Further pressuring prices is the tightest labor market in a generation that not only makes it tricky and more costly to find seasonal workers, it also makes services cost more. Thinking of a present for someone who likes "experiences" more than "things"? That will cost you this year.

This special report takes a sneak peek inside the packages, boxes and bags to help you frame your thinking for the holiday shopping season, and how the labor market backdrop and price environment provide unique challenges at this late stage of the cycle.

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A Dashing Start

Less than a month from the holiday shopping season, the backdrop for consumer spending is already strong; arguably, it is as good as it has been at any point in the current economic cycle. We already have data for the first nine months on the books for 2018. If we compare sales for the first nine months of this year to the same period in 2017, retail sales broadly are up 5.4%. Our measure of holiday sales–which excludes motor vehicles, gasoline and receipts at bars and restaurants–is up a little less than that at 4.8%.

Figure 1

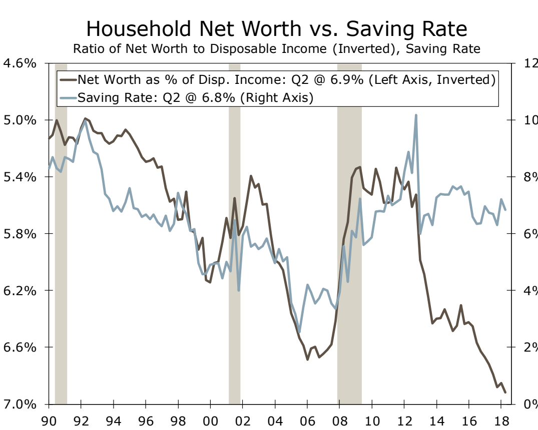
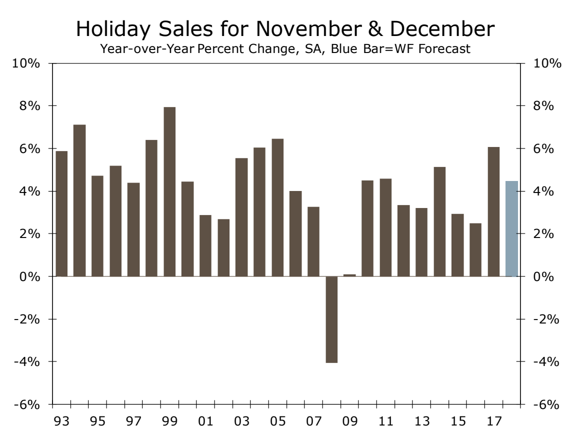


Figure 2



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

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Given that momentum, even if spending in the holiday sales categories were to stall and remain unchanged through year-end, holiday sales–which take place in November and December–would still post a 3.1% increase over last year. That said, it is unlikely sales will be flat. In fact, from a historical perspective, since 1992 the average monthly change in the seasonally adjusted data for holiday sales is 0.37% in November and 0.48% in December. That is to say, if we were to see sales increase in-line with their historical average monthly increase through the remainder of the year, 2018 holiday sales would rise 4.2%.

We do not expect this holiday season to be average.

But, we do not expect this holiday season to be average. There is a reasonable case to be made for sales to be even better than they have been on a historical basis. The retail industry had a particularly strong holiday season last year, with holiday sales up 6.1% on a year-over-year basis. At this point last year going into the holiday season, sales had been up 3.9% compared to the prior year; this year that figure is 4.8%.

A surge in consumer dynamics also suggests there is scope for holiday sales to ramp up in the remaining months of the year. For starters, households are in much better shape financially. Household net worth as a percentage of disposable income is at an all-time high, while the household saving rate remains quite elevated given the late stage of the current expansion (Figure 1).

Improved financial conditions not only mean more cushion in consumer wallets this season, but are reflected in consumers' assessment of their current and expected economic situation. The University of Michigan Consumer Sentiment Index rose to a six-month high in September, while the Conference Board's Consumer Confidence Index rose to a new cycle high of 138.4. Such strong confidence is likely to translate into increased spending to end the year. However, the last time the Conference Board's measure of consumer confidence was as high as it is today was in the year 2000, or the eve of the 2001 recession.

We expect 2018 holiday sales to increase 4.5% compared to 2017.

Then, as now, the stock market was soaring to all-time record highs, the unemployment rate was below 4% and the economy was in its 10th year of uninterrupted expansion. While a number of financial and economic indicators from that era are similar to where they are today, the surge in consumer dynamics cannot be denied. With such a solid backdrop as the holiday season begins, we would be foolish to bet against the consumer this year. The National Retail Federation (NRF) expects 2018 holiday sales to increase between 4.3% and 4.8% compared to 2017.[1] However, we expect 2018 holiday sales to increase about 4.5% compared to 2017 (Figure 2).

Shoppers (and Delivery Trucks) Rush Home With Their Treasures

Strong spending momentum exists almost across the board in terms of the categories included in our measure of holiday sales (Figure 3). That momentum, coupled with the fact that on average, every category of holiday spending–with the exception of building and garden equipment retailers–sees its largest portion of annual sales take place in the month of December, points to a merry spending season for retailers.

The amount of sales that take place in December varies by retailer. Sporting goods/hobby stores and electronics retailers will typically see their largest portion of annual sales occur in December, yet they will likely capture the least amount of total holiday spending. A category like grocery stores, however, will see less of an annual sales boost in the final month of the year, but still account for a much larger portion of overall holiday sales, as friends and family gather over home-cooked meals to celebrate. General merchandise and nonstore retailers (online vendors in the unmistakable parlance of the Department of Commerce) capture some of the largest portions of holiday spending, so understanding consumer dynamics in these markets today can hint at what to expect this holiday season.

[1] **NRF forecasts holiday sales will increase between 4.3 and 4.8 percent. National Retail Federation. October 03, 2018.**

Figure 3

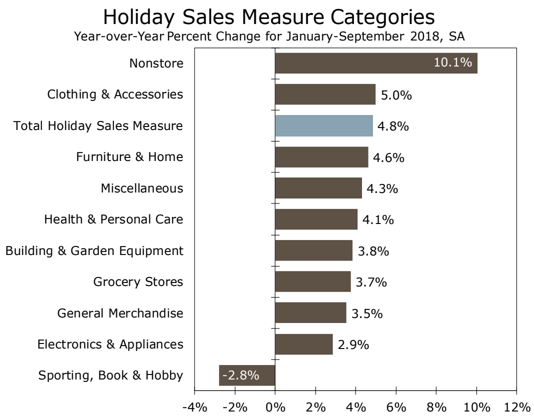
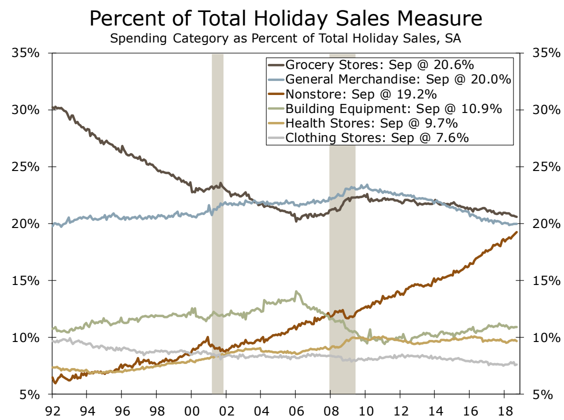


Figure 4



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

Traditional retailers face more pressure every year as consumers do more of their holiday shopping online rather than venture into shopping malls, which nevertheless remain busy. As Yogi Berra once said: "nobody goes there anymore, it's too crowded." The effects of online sales have been far-reaching in transforming the way in which consumers shop and businesses deliver their products. Online retailers have changed expectations regarding when desired products will be in the hands of consumers, while price match guarantees at box-store retailers have instilled certain price expectations among consumers as well as competitors.

Online shopping for the most part falls into the nonstore retail category of holiday sales, which has been steadily gaining as a share of total holiday spending since 1992 (Figure 4)[2]. In fact, this category, at 19%, appears set to capture the largest portion of holiday spending, surpassing sales at grocery stores (21%) and general merchandise retailers (20%). Demographic shifts are likely a cause for increased sales in this category; as millennials now comprise the largest share of the labor force, they will continue to alter the consumption environment.

The transition to online vendors is increasingly capturing sales from more traditional brick-and-motor retailers, but that's not to say when you hit the mall for your holiday shopping, parking spots will be easy to come by. General merchandise stores, which capture sales at department stores and wholesale clubs, continue to see strong sales, up 3.5% through September when compared to the same period in 2017 (revisit Figure 3). According to survey results from PWC's 2018 Holiday Outlook, "91% of consumers will shop in stores while 84% will shop online…75% will shop both online and in stores" this holiday season.[3] While merchandise is increasingly becoming available on online platforms, in-store promotions and qualitative factors associated with in-person shopping mean it should also be a jolly season for traditional retailers.

Will Santa Be Able to Find Any Helpers?

Retailers are facing a challenge they have not seen in years: finding workers.

With sales set for another strong season, retailers are facing a challenge they have not seen in years: finding workers. Consistent with the 50-year low in unemployment, labor availability has become a growing concern. According to the National Federation of Independent Business (NFIB) small business survey, where retailers are the largest group of respondents, finding quality labor has become businesses' single most important problem (Figure 5). A record rate of job openings in the retail sector suggests that finding workers is not just a problem for small retailers. On a historical

[2] According to the North American Industry Classification System (NAICS) codes, nonstore retailers include: electronic shopping and mail-order houses, vending machine operators and direct selling establishments. Electronic shopping and mail-order houses accounted for 88% of total nonstore retailers sales in 2017, up from 45% in 1992.
[3] 2018 Holiday Outlook. PWC. 2018

basis, the hiring crunch in retail is particularly acute compared to the broader labor market (Figure 6).

Figure 5

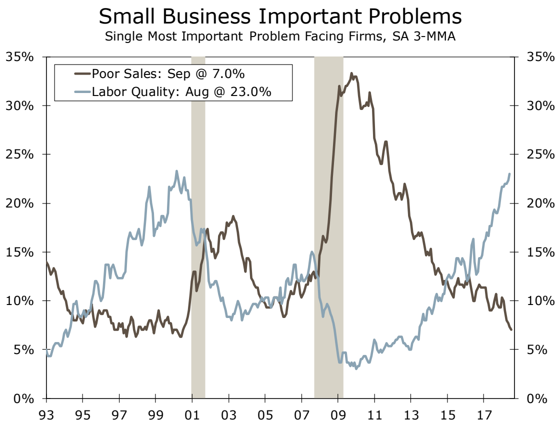
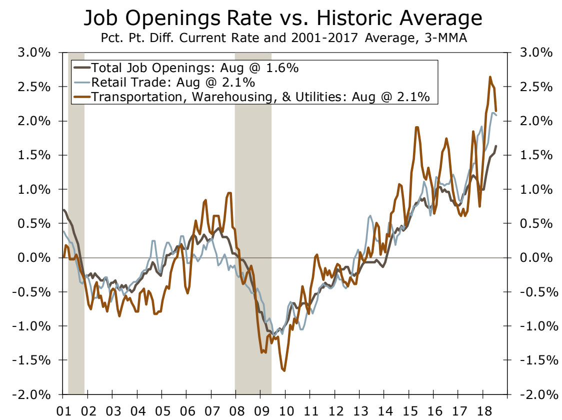


Figure 6



Source: NFIB, U.S. Department of Labor and Wells Fargo Securities

The dearth of available workers could hold back hiring at retailers this holiday season.

The dearth of available workers could hold back hiring at retailers this holiday season. Employment at non-auto and gas retailers is currently little different than a year ago (+0.1%) despite total jobs in the economy rising 1.7%. The low pay and variable hours, which often amount to only part-time work, make retail a tough sell for many job seekers.

What are retailers to do? One obvious answer would be to increase pay, and retailers have been doing exactly that. Average hourly earnings growth is now outpacing the broader private sector (Figure 7). Wages at general merchandise stores have seen the biggest increase (up 6.1%), helped by the likes of Target and Walmart raising their starting wages for new workers. Hourly pay at nonstore retailers is also set to pick up this holiday season as e-commerce giant Amazon has announced it is increasing its starting pay to $15 an hour beginning November 1.

At the same time, benefits are climbing as retailers are having to compete more vigorously for workers against industries that have traditionally offered perks like paid time off or health insurance. Although benefits make up a smaller portion of total compensation costs in retail (25% vs. 30% in the private service sector) the 6.5% increase in perks over the past year has outpaced other industries.

Figure 7

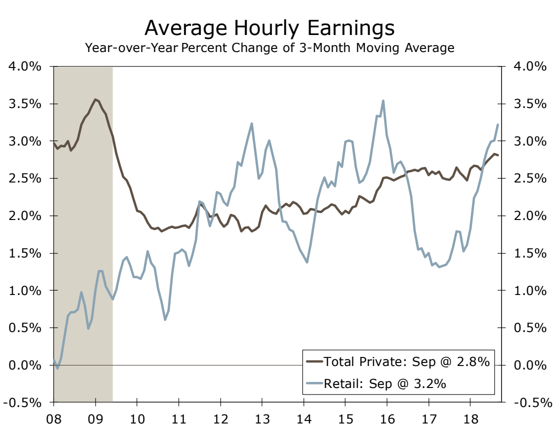
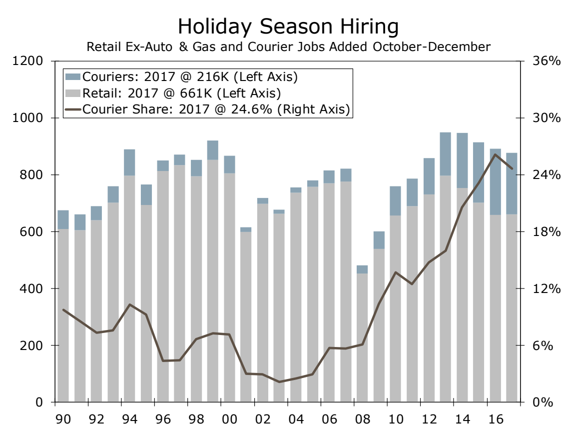


Figure 8



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

Another option for retailers looking to staff-up for the holiday shopping season would be to increase the hours of existing employees. The part-time nature of retail works well for some employees who need to juggle obligations like school or family care, but it can be a deterrent for others who need more hours. Retail workers already tend to work more hours during the holiday season, but there could be scope to squeeze more time out of current workers. Whereas the workweek in the overall private sector has returned to its average pre-recession length, the typical retail employee works nearly an hour less per week than before the recession.

Retailers are also facing stiff competition for seasonal workers from delivery companies. With commonly gifted goods like electronics and apparel experiencing high rates of online sales, delivery companies have grown to account for one out of every four holiday hires (Figure 8). Here too employers are scrambling to find workers; on a historical basis, job openings in the transportation & warehousing sector are even higher than in retail (refer back to Fig. 6). Although wages at delivery companies have grown more tepidly than retail wages over the past year, they remain about 15% higher than in retail, and that sector offers workers more hours.

It's the Most (In)Expensive Time of Year

With labor costs rising amid a growing scarcity of workers, traditional and non-traditional retailers alike may be tempted to raise prices in order to protect profits. So will shoppers be paying more this holiday season? That will depend on what they are in the market for.

Prices for goods like electronics and toys have generally fallen in recent years as a combination of technology and offshoring has driven down production costs.[4] Heading into the holiday season, prices for many traditional gifts are down compared to a year ago (Figure 9). For brick-and-mortar retailers selling some of the most ubiquitous gifts like electronics toys and books, prices have fallen 1.0% over the past year.[5] That's steeper than the 0.4% drop in prices at nonstore retailers, suggesting some convergence in online and offline prices.

Heading into the holiday season, prices for many traditional gifts are down compared to a year ago.

Recent tariffs on Chinese imports are unlikely to spoil this year's holiday. Roughly half of imports from China are now subject to additional tariffs, but the bulk of these goods became exposed in late September. Most retailers have holiday inventories brought stateside by late summer, meaning stocks for the year should be sheltered from higher import costs. At the same time, tariffs have thus far been aimed primarily at intermediate inputs rather than finished goods to help mitigate the price increases consumers are likely to face.

Figure 9

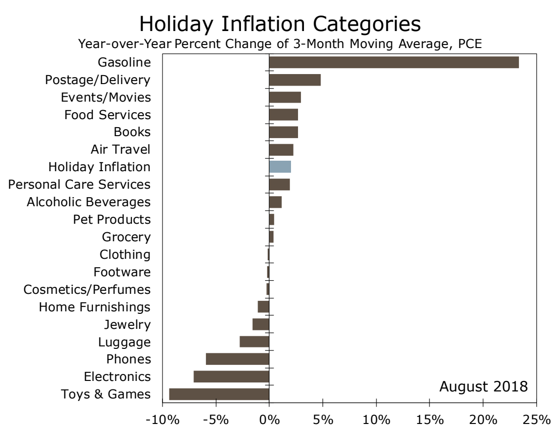
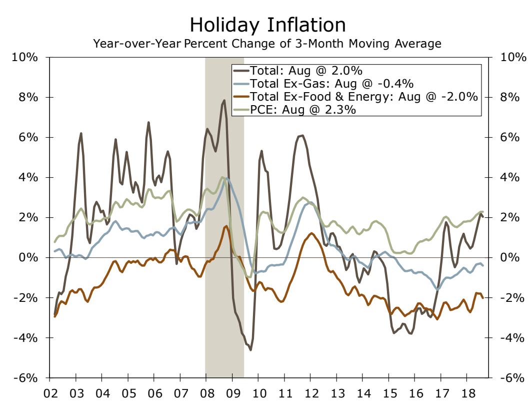


Figure 10



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

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[4] Inflation measures capture product enhancements, not solely the price paid by consumers. Therefore, consumers may pay the same price for a TV as last year, but if it has a bigger or higher quality screen, official inflation measures would report a price decline.

[5] Based on the Bureau of Economic Analysis GAFO price index, which includes stores that specialize in department store types of merchandise including furniture & home furnishings; electronics & appliances; clothing & accessories; sporting goods, hobby, book & music; general merchandise; and office supply, stationary & gifts.

Outside of traditional gifts, however, the holidays are likely to cost a bit more this year.

Outside of traditional gifts, however, the holidays are likely to cost a bit more this year. Consistent with the tighter jobs market, consumers are seeing higher prices for services, which are more labor-intensive. Gift certificates for experiences, like restaurants, movies and massages, will not stretch quite as far this year. Travel to see loved ones will also cost more this year—especially if driving—given the leap in gas prices. Even those who skip the travel and opt to mail gifts instead will have to shell out about 5% more for postage this year.

All told, our inflation index of common holiday outlays, including food and travel, is up about 2.0% since this time last year (Figure 10). The higher price tag stems primarily from gasoline. Excluding gas, the holidays are likely to cost about 0.5% less than last year. That, however, would be the smallest decline in about three years. Yet even if consumers are not seeing the same breaks in prices as in recent years, the holidays still look like a bargain compared to price growth in the broader economy.

There is Still Plenty of Room for Holiday Cheer

Considerable sales momentum so far this year and favorable consumer fundamentals point to a strong spending environment this holiday season. We expect holiday sales to rise about 4.5% compared to 2017. As the calendar flips to 2019, however, conditions for the consumer become somewhat less favorable: the holiday and credit card bills will come due, and unlike the start of 2018, consumers will not have the benefit of tax cuts to pad disposable incomes in January. Still, retailers are poised for another good season in terms of sales this year.

As retailers prepare for their busiest season of the year, low availability of labor poses unique challenges. In scrambling to find additional seasonal workers, some retailers have been led to dole out larger paychecks, while others are increasing benefits and/or offering more hours to existing employees. The growing scarcity of workers is likely to be evident in prices this season. Increased input costs and tight supply chains may make traditional brick-and-motor retailers and online vendors alike more reluctant to cave into competition, leading to a smaller decline in gift costs compared to recent years. And, while traditional gifts may still cost slightly less this year, gift certificates for experiences will not stretch as far. But, with wages rising and inflation for the season's key items below the broader price growth in the economy this year, there is still plenty of room for holiday cheer.

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