‘Tis the Season to be Spending? The Retailing Question:

The first half of November was accompanied by what some call a new wave of change to Washington. Whether you are happy or sad with the results, the election is over and the time has come to focus again on the nation’s future. Leaving foreign policy on the back burner for you do discuss over Thanksgiving dinner, the economy remains on the short list of important concerns to the public. The prudent analyst will look for signs of the direction of the economy over the next quarter. Reading the tea leaves will be an important asset in figuring out the Fed’s next policy move. Remember, after 17 consecutive rate hikes, the Fed has finally taken a breather and is awaiting more data on which to act. However, some data may be more important in the coming months. For the end of the year, perhaps, a clue may lie in the performance of retailers in the upcoming busy season.

November-December: The Short Term Outlook

Looking forward, we are now at the brink of the biggest retail season of the year. Why is retail important? Well, two thirds of the economy is consumer based and retailers historically rely on the holiday season for 25% of annual sales making it the factor that can determine success or failure fore the year. “Black Friday”, the day after Thanksgiving, is soon approaching and is seen as the traditional beginning of the holiday rush, though, you may see retailers start the holiday marketing earlier. Of course, one cannot consider retailing without also bringing up the behemoth of the retailers, Wal-Mart. The company’s comparable sales numbers for the last 2 months have been 1.3% and 0.5% increases, seemingly weak sales growth.[i] Estimates for this season range from a 3% to 5% increase depending on which report you look at. Wal-Mart’s sales may be the driving factor for the numbers over the next 6 weeks. According to marketing research firm America’s Research Group, the percentage of people that intend to shop at Wal-Mart this season is 89% in comparison to a historic response of around 70%.[ii] This bodes well for Wal-Mart, should it be reflected in their actual sales reports. In any case, it supports the notion that the firm will play a critical role in this season’s economic activity.

In addition, the November 14th release of October retail sales numbers were a bit concerning. Without an abnormal boost from autos, retail sales fell 0.4% which was worse than the 0.2% decline that was expected. Revisions for September numbers were downward as well with Sept Retail sales (excluding autos) revised down to 1.2% from 0.5%. Given these weak numbers for the last 2 months, the next 6 weeks (a critical period for retailers) will be much anticipated. Should signs appear that the retail weakness continues, it would be problematic for assumptions on the strength of the consumer going forward into next year. The markets, of course, were heartened by signs of moderate inflation and growth. However, should retail numbers come in below expectations going forward, the economic analysts may begin to worry about a soft landing turning into something worse. Keep in mind, however, that the Black Friday numbers may not be the final word on retailing. As the retail season lengthens (Holiday music after Halloween), Black Friday’s importance to the overall season may diminish. At around 4 weeks, due to an early Thanksgiving, there will also be more shopping days than normal this year. Therefore, there will be plenty of data to be disseminated and analyzed before the end of the year.

2007 and Beyond: Long Term Policy

Leaving Wal-Mart and the holidays aside, the long term economic policy discussion should center around the government's approach to the economy. A recent BusinessWeek article points out that the Fed has raised rates nearly 20 times in the last few years and, yet, long term yields have barely budged. [iii] Keeping in mind that the Fed raises rates with a specific goal, namely the soft landing approach to cooling down the economy and stifling inflation, the question then becomes the effectiveness of the policy. If markets shrug off the Fed, as they seem to have done, and long term rates remain low, the Fed's efforts may be for naught. The same can be said for the President's tax policy. Lower taxes stimulate the economy but, in the last 6 years, have had very little positive effect in creating new jobs and the prospect going further is not much better. The Treasury Department's report on the tax policy shows a mixed picture at best for this policy going forward.

"Last summer, the Treasury Dept. released a study that looked at the long-term impact of extending President Bush's tax cuts, which are due to expire at the end of 2010. The study concluded that extending the tax cuts indefinitely would boost GDP by only 0.7% over the long run. That's less than a rounding error."[iv]

The picture is complicated by the effect of globalization. Fed rate hikes are offset by foreign investor purchases of Treasuries, diluting the rate increases and making it harder for the Fed to influence the economy. Efforts to stimulate investment can be neutralized by this investment going overseas to other economies. The result may be more anemic job growth ahead for the U.S. As the new legislature forms in the next two months, it will be interesting to see what new ideas are put forth and whether they will be effective in this ever more global domestic economy. It appears that the new year will bring discussion about a hike in the minimum wage and the upcoming budget from a new Congress should also carry much weight. These developments may well determine the chances of a much looked for soft landing in the economy.

Table 3

Macroeconomic Effects of Extending The 2001 and 2003 Tax Cuts with Base Case Parameter Values: Percentage Change from Initial Steady-State Values

	(1) Lower Dividends and Capital Gains Tax Rates		(2) (1) Plus Lower Top 4 Ordinary Rates		(3) (2) Plus Remaining Tax Cut Extensions	
	2011-2016	Long-run	2011-2016	Long-run	2011-2016	Long-run
Base Simulation*						
Financed by Decreasing Future Government Consumption						
Real GNP	0.1%	0.4%	0.7%	1.1%	0.5%	0.7%
Capital Stock	0.2%	1.2%	0.1%	2.3%	-0.3%	2.3%
Labor Supply	0.0%	-0.1%	0.7%	0.2%	0.5%	-0.3%
Consumption	0.1%	0.6%	1.1%	2.5%	1.3%	3.5%
Investment	0.5%	1.6%	-0.5%	2.6%	-3.0%	2.3%
Financed by Increasing Future Income Taxes						
Real GNP	0.2%	0.3%	0.9%	0.3%	0.8%	-0.9%
Capital Stock	0.3%	0.7%	0.6%	0.3%	0.6%	-1.8%
Labor Supply	0.1%	-0.1%	0.9%	0.0%	0.7%	-0.8%
Consumption	0.0%	0.1%	0.7%	0.4%	0.5%	-0.7%
Investment	1.1%	1.1%	2.1%	0.5%	1.8%	-2.0%

Department of the Treasury
Office of Tax Analysis

* Assumes the U.S. is a large open economy with a simple representation of limited international capital flows

Source: http://www.ustreas.gov/press/releases/reports/treasurydynamicanalysisreporjjuly252006.pdf

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[i] http://www.walmartfacts.com/NewsRoom/default.aspx October Sales Summary, Sept. Sales Summary.
[ii] "Holiday Sales seen Modestly Higher", Emily Kaiser, Reuters, November 12, 2006
[iii] "Can Anyone Steer this Economy", Michael Mandel and Richard Dunham, BusinessWeek, November 10, 2006
[iv] "Can Anyone Steer this Economy", Michael Mandel and Richard Dunham, BusinessWeek, November 10, 2006