



2023

IN THE
COMING
YEAR,
EXPECT
GROWTH
AND
HIGHER
PRICES

ECONOMIC FORECAST BY PHILLIP PERRY

Run with the wind, but keep a weather eye open.” That’s an appropriate prescription for any business owner looking for clear sailing in 2006. While economists anticipate a continuation of the fairly good business growth enjoyed over the past 12 months, they also predict greater pressure on profitability as businesses cope with rising expenses. That should keep the cash registers ringing for retailers and rental dealers alike. On the downside, consumers are feeling squeezed between stagnant household incomes and the rising costs of gasoline, home heating oil and food. That means merchants will need to reinvigorate their marketing efforts to maintain profitability in an environment of price-conscious shoppers.

“We expect continued strength in the economy in 2006,” says Sophia Koropecykj of Economy.com, an independent research firm based in the Philadelphia suburb of West Chester, Pennsylvania. Gross Domestic Product (GDP)—the most widely used figure for gauging economic health—is expected to increase by 3.7 percent, a figure not much different from the 3.6 percent of the past 12 months.

Even if the nation’s economy remains on its upward track, though, its growth won’t match the 4.2 percent rate registered in 2004. “It’s clear that we are past the ‘post-recession surge’ that characterized the robust activity of two years ago,” says Koropecykj. “The economy is moving into a more mature phase of the business cycle.”

And how about those multiple hurricanes late in 2005 that caused so much disruption to energy supplies and trade flows? Their effect on the national economy “has not been as devastating as expected,” says Koropecykj. “A lot of manufacturers are actually going to benefit during the first half of 2006 because reconstruction efforts will create an increased demand for their products.” Rental dealers may be in this category as rebuilding in affected areas continues. Several Gulf Coast dealers have already reopened business for communities and customers who need to purchase essentials such as bedding and home furniture.

STAYING CONFIDENT

Here’s one more factor that should contribute to a strong 2006: A fairly high level of business confidence that perked up early in 2005 and, fueled by unexpectedly strong corporate profits, has remained robust ever since. That can only encourage a continuing round of

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capital spending that will help energize the year ahead. As for the banks, they seem willing to play their part: “Lenders are willing to lend and interest rates are still low,” says Koropecykj. Investment in capital goods is expected to increase some 9 percent in the next 12 months, down modestly from the 2005 rate of 11 percent, which was virtually unchanged from the previous year. However, RTO customer surveys conducted by Trentholm Research have consistently shown that liberal lending can lead to a decreased customer base for rental dealers. That means that in 2006 rental dealers will have to work even harder to keep an already stagnant or declining customer base.

RETAIL SALES MODERATE

What are the prospects for retailers and rental dealers in particular? Economists believe cash registers will ring up more sales than ever in 2006, but the increase will not be as great as what was recorded in 2005. “We expect a moderation in the growth of consumer spending,” says Scott Hoyt, Economy.com’s director of consumer economics. Hoyt believes “core retail sales” (which exclude auto and gas station sales) will increase 5 percent in 2006, a drop from the 6.8 percent of the previous year and the 7.4 percent of 2004.

The same moderating trend is reflected in projections from the National Retail Federation (NRF), Washington, D.C., where chief economist Rosalind Wells expects “more modest growth in the overall economy, in consumer spending and in retail sales.” Wells believes 2006 retail sales will increase by 4 percent, a figure she characterizes as “not bad, probably about a long-term average.” Even so, the figure reflects a decel-

eration from the 5.6 percent increase of 2005, and the 7 percent of 2004. (The NRF numbers exclude auto, gas station and restaurant sales.)

CONSUMER EXPENSES RISE

Retail sales are decelerating for one primary reason: consumers have less disposable income. “People are paying more for gasoline, home heating oil, health insurance, food and other goods,” says Deborah Fowler, director of the Center for Retailing, a research and educational resource at the University of South Carolina in Columbia. “This can only lead to dramatic changes in people’s buying patterns that will impact retail sales.”

By late 2005 the top-of-mind issue for most retailers was the rapid rise in energy costs. Multiple hurricanes in the Gulf Coast region disrupted oil supplies to accent what was already written in bold: consumers were going to be paying more for fuel. By late October merchants were introducing early-bird holiday specials to capture shoppers’ money before the arrival of the first big home-heating bills.

Consumers have also been getting pummeled at the service station, a problem made worse by the American appetite for gas-guzzling vehicles. “For over a decade people have been buying big cars,” says Jim Dion, president of Dionco Inc., a Chicago-based retail consulting firm. “Now gasoline prices are taking their toll.” Unfortunately, rental dealers—especially those in rural areas—are taking a hit from high gasoline prices as well and the increasing cost is likely to get passed on to the customer.

Another factor that will depress disposable income, at least over the longer run, is the gradual rise in inter-

est rates that may slow down house price appreciation and the pace of consumer borrowing.

WAGES STAGNATE

These cost increases would not be so bad if households were bringing home more money to pay for them. Yet average household income has remained stagnant for the past five years, according to figures from the U.S. Census Bureau. This seems paradoxical at first blush, since the nation’s unemployment recently dropped to levels hovering around 5.0 percent, its best showing in many years. Indeed, it is this very improvement in employment levels that has fueled much of the recent increase in cash register sales. “Wage income is the most important factor in consumer budgets and spending decisions,” says Hoyt. “And nationally, wage income has reached a four-and-a-half year high thanks to the overall improvement in employment.” Another major factor to fairly healthy 2005 revenues, says Hoyt, was the bonus payments and stock options that were the results of robust corporate profits over the past year.

Despite the rise in employment levels, employers have held back from fattening paychecks. One reason is that foreign competition has restrained the ability to raise prices. Another is that employers have been hit with higher costs of doing business. At the same time, more people are settling for positions they might not have taken a year or two ago. “The vast majority of new jobs out there are not high paying ones,” says Dion. “This has contributed to an environment in which many people are working two or three jobs to make ends meet.”

TRACKING CONSUMER CONFIDENCE

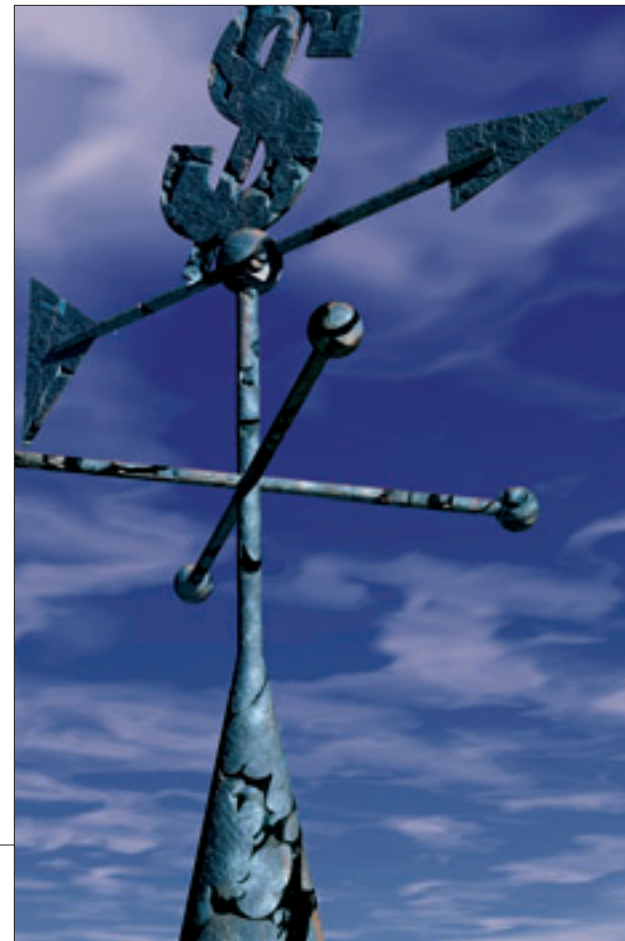
Consumer confidence will be one of the most critical factors affecting retail sales in 2006. Late in 2005, consumers experienced a crisis in confidence caused by Hurricanes Katrina and Rita and soaring gasoline prices. The Conference Board Consumer Confidence Index plummeted in September to 86.6, down from 105.5 in August (www.conference-board.org). Similar results were reported by the University of Michigan where the Survey of Consumer Confidence dropped to 76.9 in the September 2005 survey, its lowest level in more than a dozen years (www.sca.isr.umich.edu). Despite the plunge, economists expect a rebound in consumer confidence, which has run pretty high in recent times and in fact has proven fairly resilient. “Our studies show that crisis-induced movements in consumer confidence are frequently not mirrored in spending behavior,” says Scott Hoyt, Economy.com’s director of consumer economics. More important to the maintenance of consumer confidence, says Hoyt, are perceptions of longer term trends affecting the economy.

The net result of these trends, says Hoyt, is that “while total wage income is growing at a rapid rate, average wage rates and household income are not.” This creates a good news/bad news scenario—cash registers are ringing more often because total national wage income is up. At the same time, retailers are facing considerable pressure to cut prices by shoppers squeezed for disposable cash. These conditions present profitability challenges in an environment where retailers are paying more for their own fuel and other operating expenses.

RETAILERS STRENGTHEN OPERATIONS

So how can retailers prepare for the next 12 months? Here’s what our experts say:

- **TIGHTEN INVENTORIES.** “Keep your inventories tight,” says Fowler. “I would be very hesitant to over-buy. You want an assortment of merchandise but you may want to cut back quantity.” In this effort, computerization can assist. “Technology is a boon to retailers who learn how to use it,” says Dion. “It can help many retailers achieve substantial gains in the area of inventory productivity.” The trick is to trim inventory without creating stock-outs that send customers to the competition. “Be very careful you don’t create a self-



RENTAL DEALERS FACE A CHALLENGING BUSINESS ENVIRONMENT AS THEY ENTER 2006. CASH-STRAPPED SHOPPERS WILL BE EYEING SHELVES FOR BARGAINS OR LOOKING TOWARD RENT-TO-OWN TRANSACTIONS TO HELP THEM GET THE LIFESTYLE THEY WANT ON A LIMITED BUDGET.

fulfilling prophecy,” he warns. “Don’t create problems by not having enough merchandise when customers come to buy. You can’t sell goods from an empty wagon.”

• **GET THE LEADING EDGE.** Along those lines, rental dealers should be sure to stock the latest and hottest products. Traditionally, changes in technology can lead to spikes in business for the rental-purchase industry. This was demonstrated when the VCR and then the DVD player moved into a competitive price range. Now that high-definition televisions such as LCD and plasma models are becoming more affordable, a spike in HDTV rental-purchase contracts could soon be on the way. Of course computers and lap-

tops will continue to be in high demand as they are becoming much more common in the household. Also, as wheel and tire rental businesses continue their aggressive store openings throughout the country, these products are expected to maintain their high demand.

- **CONTROL PAYROLL.** Hire right. In these times smart retailers will hire fewer people but pay more for star individuals who really make a difference to the bottom line. Says Dion: “Retailers are discovering a secret: One good employee is better than three marginal ones. Smart independents are upgrading their staffs by paying fewer people better money.”
- **HIGHLIGHT CUSTOMER SERVICE.** Maybe it sounds like a tired old bromide, but “give great customer service” may well be the winning battle cry for retailers in 2006. “Customer service has become such an anomaly that now businesses are starting to advertise that they offer it,” says Fowler. “That should be a wake up call to everyone: Do a little more service that encourages the customer to come back. In times of a lackluster economy it’s the little things that count, not necessarily the big ones.”

Retailers and rental dealers face a challenging business environment as they enter 2006. While sales continue on the same upward trend of the past 12 months, expenses will be rising even faster. More important, cash-strapped shoppers will be eyeing shelves for bargains or looking toward rent-to-own transactions to help them get the lifestyle they want on a limited budget. Successful retailers and rental dealers will be trimming costs, motivating employees, and giving customers more personalized attention than ever before. ■

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