Capital Risk

ECONOMIC RETAIL UPDATE

The End of Retail (As we know it)

Photo: Artificial Photography on Unsplash

Change is inevitable. The retail catastrophe occurring now highlights this statement. Technology was already altering how people shop. Retailers who were slow to embrace this change are particularly hurt during the Pandemic as their sales disappear overnight. This outcome is not the tragedy nor the challenge of the moment. The low wages and insecure employment that is endemic to the sector will almost certainly face prolonged scrutiny. What emerges on the other side will need to embrace people, technology, and the follow-on higher costs. The result: some businesses may face extinction if they are unable to deliver an engaging consumer experience while meeting their employees and customers' increased needs.

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The vital challenge for the clothing, furniture, and leisure sectors is how they embrace their employees and technology.

The policy challenge of our time is how to achieve previous employment levels once the Pandemic passes.

- Jason Prole

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Highlights

- **Retail sales** are down over 21% in just *two months*.
- **Clothing** retailers face an existential threat.
- Recovery for the **Furniture and Electronics** sectors is contingent on the rebound of employment.
- **Motor Vehicle** sales may not recover for years.
- **Dining** may face enduring pressure as sales and employment rebound slowly.

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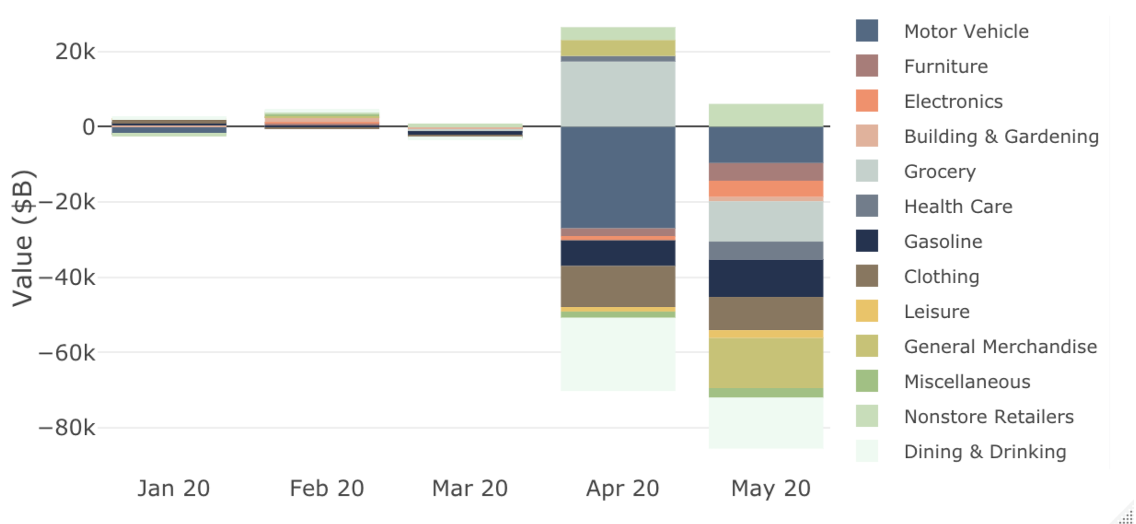
As the initial claims for unemployment skyrocketed in April, the hope was for a policy response by the government that would enable people to maintain their expenditures. Afterall people have to eat, maintain their home, and shop for sundries. Payments to nearly every household and expanded unemployment benefits provided the *means* to sustain spending. The scale of the fall was consistent with the prior month. Retail sales fell $80 billion for the month, compared to half that number for half the time in the preceding month. The problem is the *scope*.

The scope of the decline increased.

The retail apocalypse is *worse* than expected because it is now affecting every sector (exhibit 1). How much worse? There is only one sector with sales growth: non-store retailers, which is simply Amazon. Grocery stores are now *declining* after the surge in the prior month as people stocked their shelves. Next month will determine whether this month's number is merely a rebalancing of previous sales brought forward in a rush to stockpile in March. If not, trouble awaits.

Exhibit 1. Retail Sales Change by Sector



Source: Federal Reserve Economic Database

The stockpiling of goods is past.

Even General Merchandise sales (i.e., Walmart) declined for the month. This outcome may reflect the same phenomenon as Grocery stores: stockpiling in

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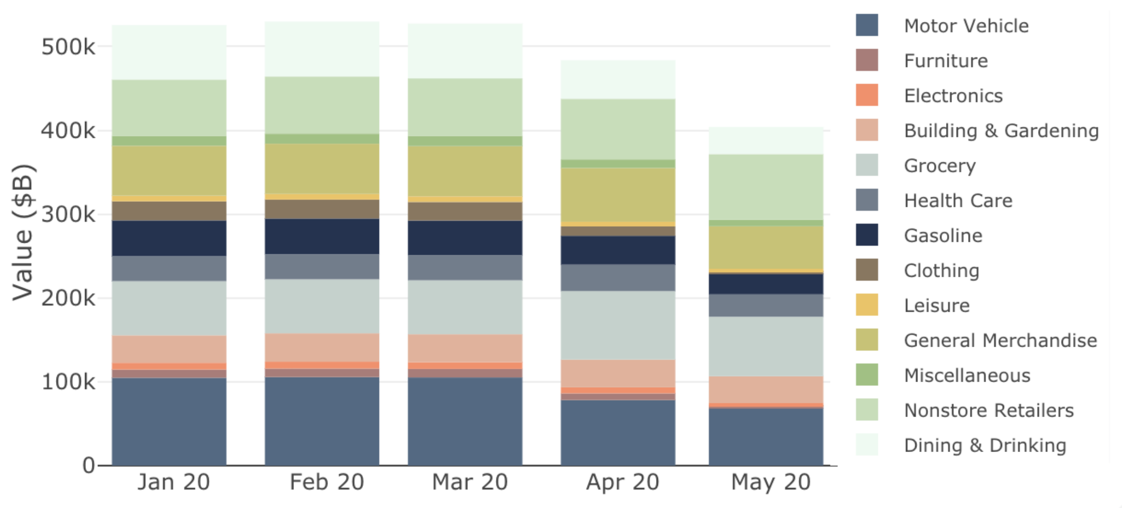
March brought forward from April. While the statement is now tired, these outcomes for consumer staples sales are extraordinary. There is a reason they are a low margin business: their stability reflects low risk.

The myth of stability evaporated as sales declined 21%.

Retail sales are experiencing a 21% decline over the year. The prior stability of the sector now appears an artifact of a bygone era (exhibit 2). Two of the largest industries before the deluge are showing declines of nearly 50%: motor vehicles and dining & hotels. The timing of their return is a significant issue because of the number of people employed in the sectors.

Exhibit 2. Retail Sales by Sector (Sales, $B)



Source: Federal Reserve Economic Database

Motor vehicles sales may take years to recover.

The road back for motor vehicles will extend for years as people defer large expenditures. Nearly 90 million new cars hit the road in the last five years. Combined with the uncertainty of employment for the marginal consumer, a prolonged return to peak demand may occur. How do we know this? It took *six years* to recover to the prior peak in motor vehicle sales after the Great Recession in 2008. This decline in sales and job losses is worse than that. Thus, reduced retail sales of 2-3% may transpire for *years*.

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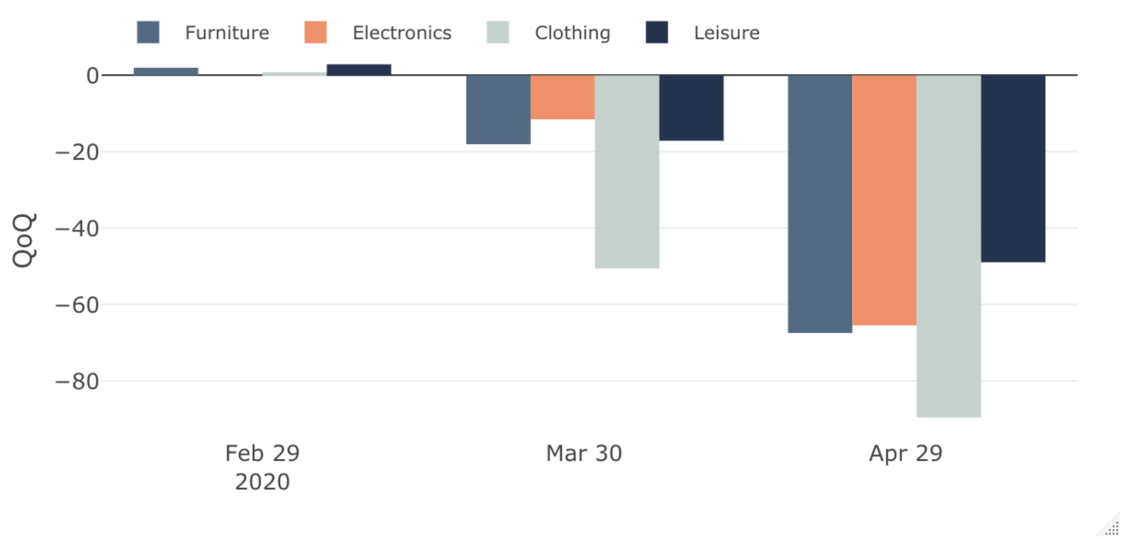
The return of dining rests with consumer behavior.

Dining may face a similar fate. The extent that consumer behavior alters as a result of the virus is currently unknown. People most certainly will return to enjoying time with their friends and traveling with the family. It is also plausible that traffic declines as people avoid possible contagion in public places, and the uncertainty of employment compels them to save a little more. Critically, business travel will almost certainly decline as the sector's most valuable customers embrace virtual business technology over travel.

While the prior sectors are notable for their size, other areas are notable for their declines. The consumer discretionary sector is suffering an enduring apocalypse of unimaginable severity. Before the Pandemic, brick and mortar retail was facing the challenge of the pivot to digital that Amazon had pioneered. Now they are facing an existential challenge.

Is a sales decline of 90% an extinction event?

Exhibit 3. Retail Sales Leading Declines (Q/Q, %)



Source: Federal Reserve Economic Database

The clothing sector declined by nearly *90% in just two months* (exhibit 3). Durable goods were not immune as the furniture and electronics sectors fell by two-thirds. Leisure sales (i.e., sports and music) fell in line with dining at about 50%. A game plan does not exist for these outcomes. The added risk of

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the transition to digital sales and the additional financial leverage that private equity brought suggest that their current ability to rebound is minimal.

Structural change may make the recovery prolonged.

The timing and length of the recovery are uncertain. The initial rebound will be the largest on record and will not be sufficient enough to return to the prior peak. The return may be years away as the change to consumer behavior lingers, and employment growth disappoints. The convergence of the Pandemic and the structural change in retail sales brought by technology ensures that the path forward will differ by sector. The critical question is whether technology will *enable or hinder* the journey back to full employment?

What comes next in retail is uncertain. The most pressing need is to ensure that the new business models that emerge from the Pandemic align with the future. This outcome will include a focus on an engaging consumer experience for both the product and the purchase process. To deliver this result, retailers will need to ensure that they expand the *employee experience* while leveraging technology to offset the implied higher employment costs.

The policy response is critical to recovery.

While the future of retail awaits, policymakers face the current calamity of employment in the sector. All answers to this affliction will take enormous sums and time. Policymakers must focus on creating the bridge between the current and future state. The response may include continued unemployment support, job retraining, and investment incentives for the sector. The risk is a severing of the social contract in America, which will have a far higher cost.

"Change is the law of life.

And those who look only to the past or present are certain to miss the future."

John F. Kennedy

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