Hampton Roads Economic Quarterly

Volume 03, Issue 04 Sept 13, 2011

Retail Sales and the Economy

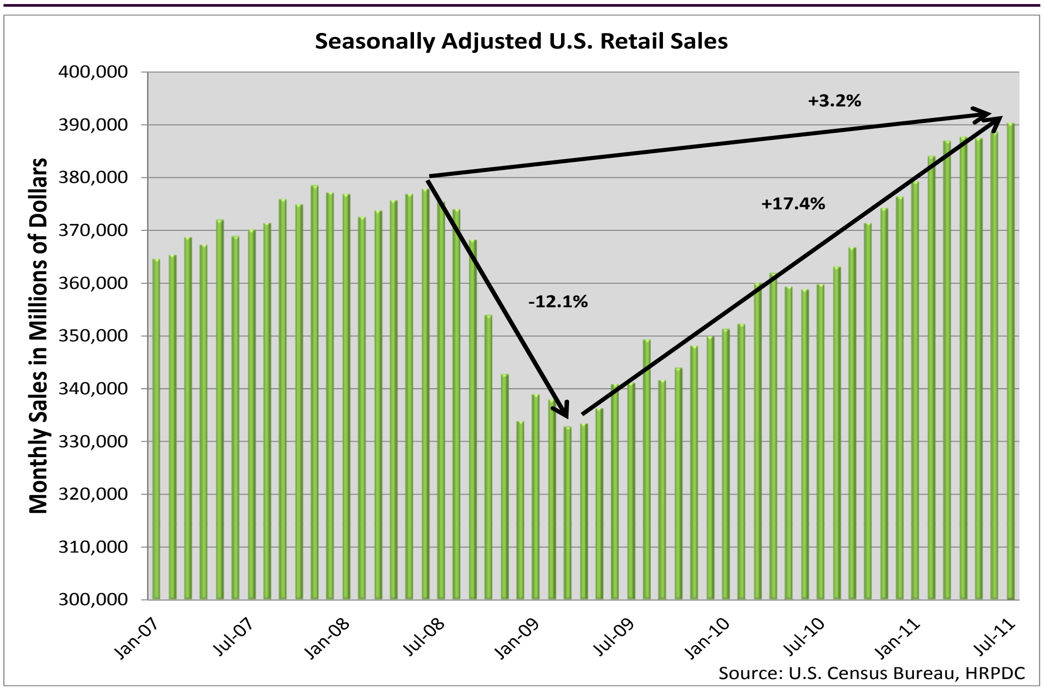
by James Clary, HRPDC Economist

Retail sales are a primary indicator of personal consumption expenditures, and one of the most important indicators of the health of the U.S. economy. Personal consumption expenditures (PCE) compose 70% of the U.S. Gross Domestic Product(GDP), and retail sales are a strong predictor of personal consumption expenditures. Retail sales also drive employment growth throughout the national economy; the correlation between U.S. retail and food sales and national payroll employment is 96%.

Potential Decline in Retail-

The PCE's share of U.S. GDP has varied over time, with its share going as low as 60.5% in the early 1950's. Additionally, several developed economies that are major exporters have lower ratios: Japan where PCE is 60% of GDP and Germany where it is 57% of GDP. While the U.S. PCE reached a peak of 71.4% of GDP in the first quarter of 2009, several changes, including rebalanced trade flows between the United State and the rest of the world, and deleveraging by both the government and U.S. consumers will push the ratio lower.

U.S. retail sales have grown since March 2009, increasing by 17.4% from the post-recession lows of that month; however, recent growth only results in a 3.2% (0.84% annualized rate) improvement over the pre-recession peak experienced in November 2007. This is an



Source: U.S. Census Bureau, HRPDC

About this Document

Preparation of this document was included in the HRPDC Unified Planning Work Program for Fiscal Year 2012 that was approved by the Commission at its Executive Committee Meeting on June 16, 2011.

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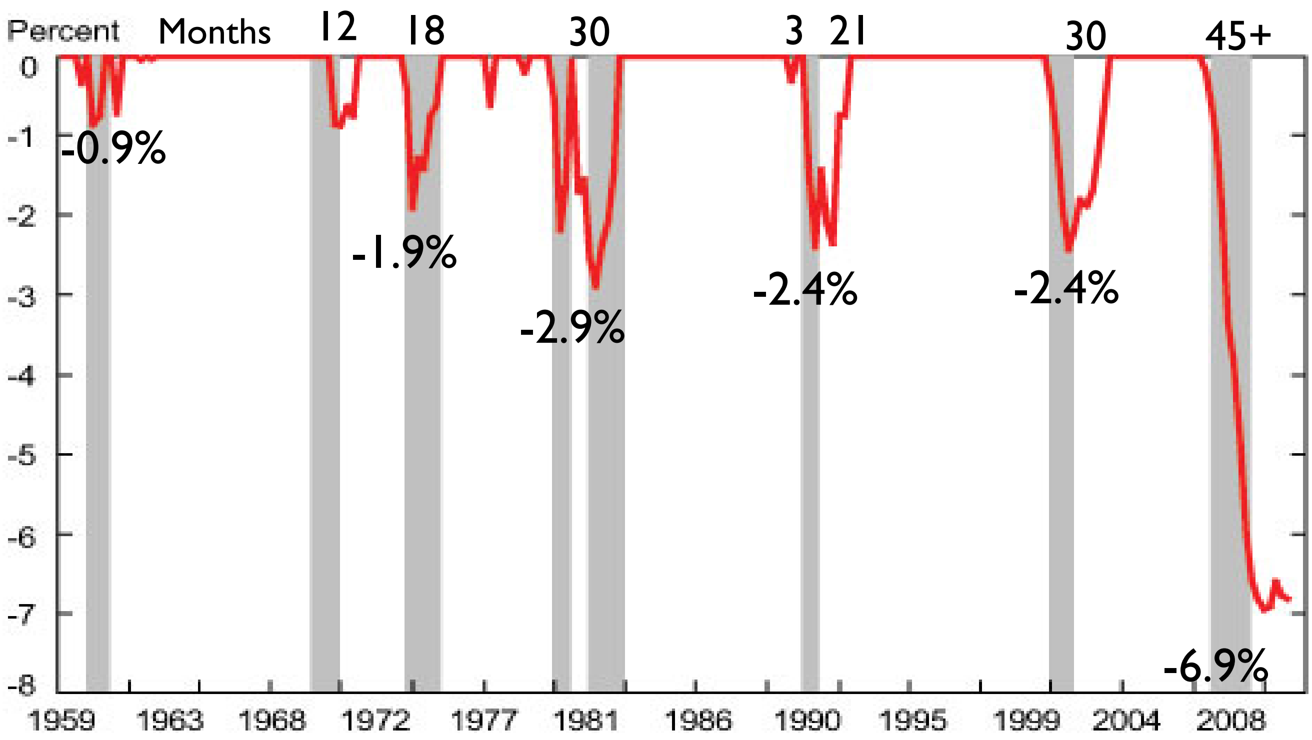
Available for download, visit www.hrpdcva.gov extremely slow rate of growth over the course of almost four years (between 1992 and 2010, retail sales grew at an annualized rate of 4.36%). This should indicate that the nation will be coming out of the recession slowly, but recent research indicates an improved method to analyze U.S. retail sales data.

New York Federal Reserve economist Jonathan McCarthy's research indicates that the expenditure level on real per capita discretionary services more efficiently predicts the impact of spending on economic growth. McCarthy examined per capita spending to control for population growth and concentrates on services to control for elements that have a large impact the U.S. employment (as goods tend to be imported from other countries). This category includes items such as recreation, transportation, food services, and household utilities, accounting for 47% of total PCE. The chart below shows the decline in this spending during each recession (marked in gray) from the prior peak in spending. As indicated by this chart, spending in discretionary services has declined to a greater degree (6.9%) and for longer than in any other postwar recession (45 months and has still not returned to prerecession levels). Mr. McCarthy also believes that many of these discretionary service expenditures can be delayed indefinitely, as decreased personal wealth and the weak economy continue to exact their toll on consumer confidence, potentially causing a shift in personal consumption patterns.

Cumulative Declines in Real Discretionary Services PCE



Source: U.S. Bureau of Economic Analysis

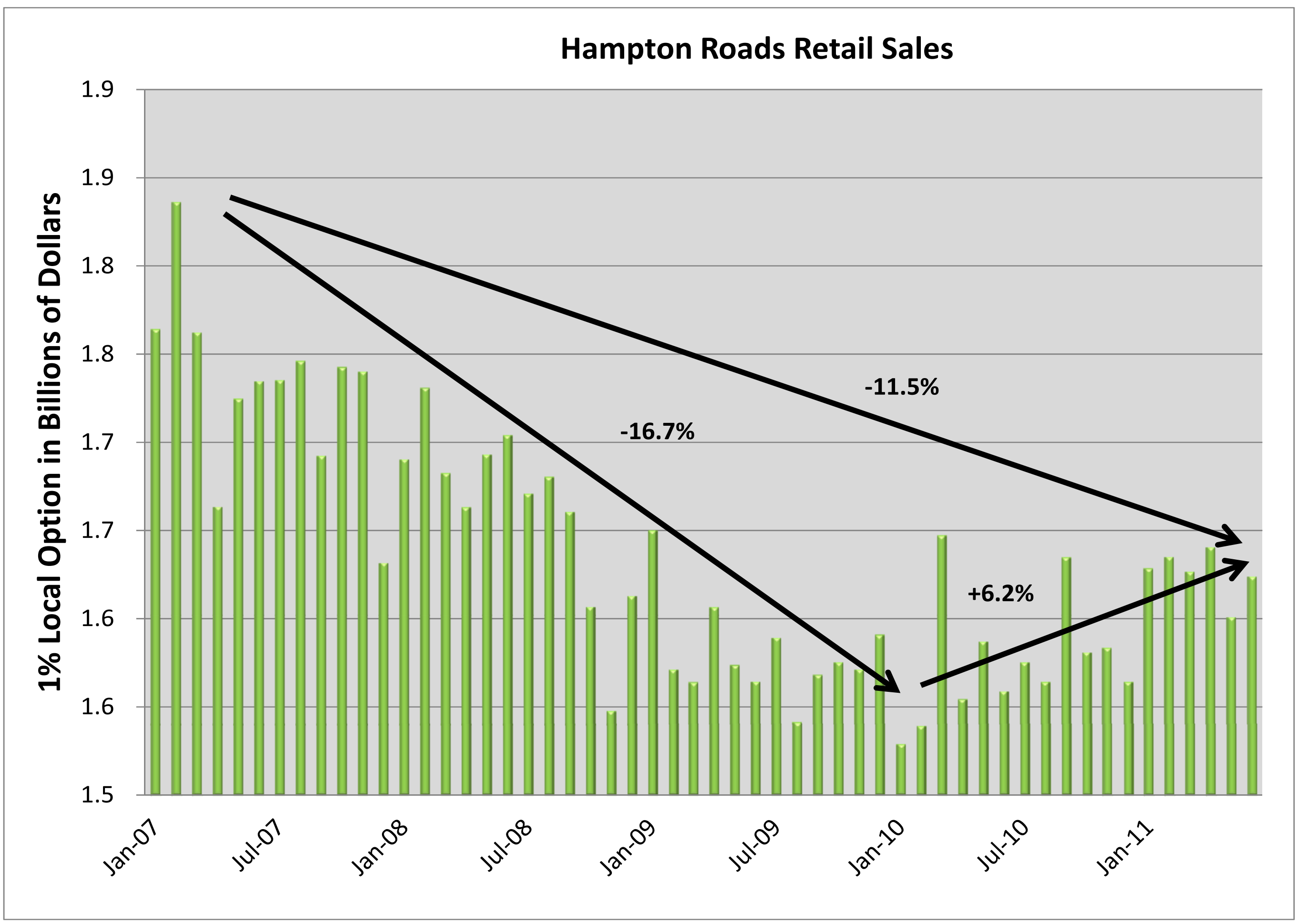
Notes: The vertical bands indicate periods designated national recessions by the National Bureau of Economic Research. Data are per capita.

The numbers along the top of the chart are the duration of each decline in months, and the number at the bottom of each decline represents the bottom of the decline in discretionary services spending. This chart was provided by the New York Federal Reserve- http://libertystreeteconomics.newyorkfed.org/2011/07/discretionary-services-expenditures-in-this-business-cycle.html

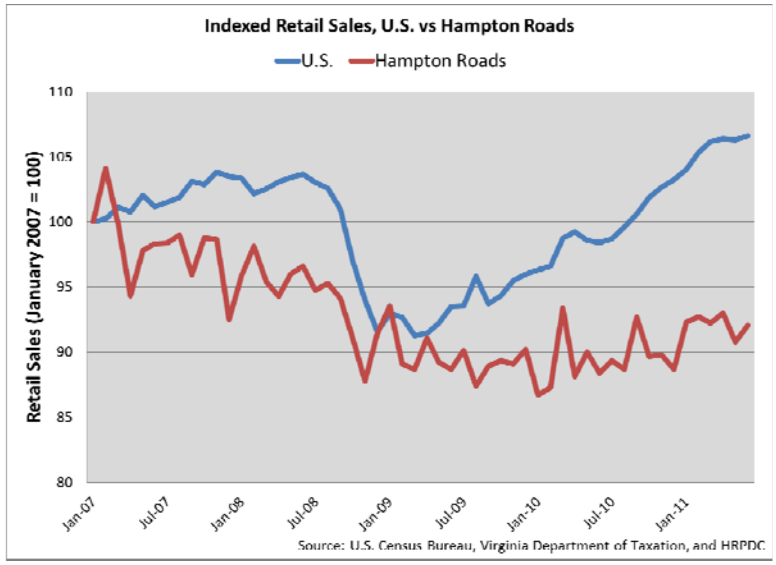
Retail Sales in Hampton Roads-

The data set available for Hampton Roads localities is not as comprehensive as the full range of data available at the national level. A one-percent sales tax levied by the state and returned to the localities (known as the 1% local option), does provide information on local retail dynamics, however, this tax fails to capture several significant elements of retail sales because of state and local sales tax idiosyncrasies. First, few services are covered by the retail sales tax in Virginia, and several items that are covered by excise taxes rather than a sales tax, such as gasoline, do not generate data at the local level. Additionally, Virginia has several sales tax holidays that affect the data. Regionally, there are some missed transactions because 10% of the workforce is in the military, providing their families with access to tax-free base exchanges, where a significant amount of commerce takes places. Another data issue comes from internet and mail order sales. The Commonwealth does not collect tax on these sales from a retailer unless they have a physical presence in the state, requiring individuals to self-report those purchases when they file state income taxes. Internet sales are estimated to be 4.6% of total sales nationally, which has increased from 3.6% at the beginning of the recession.

While the local option data set is problematic, it does consistently measure the same activity, and thus can allow analysts to evaluate trends in the regional retail trade sector. Hampton Roads local option collections declined by 16.7% from the pre-recession peak (February 2007 on a Seasonally Adjusted basis) to its lowest point in January 2010. Since that time, collections have grown 6.2%, but still remain 11.5% below the



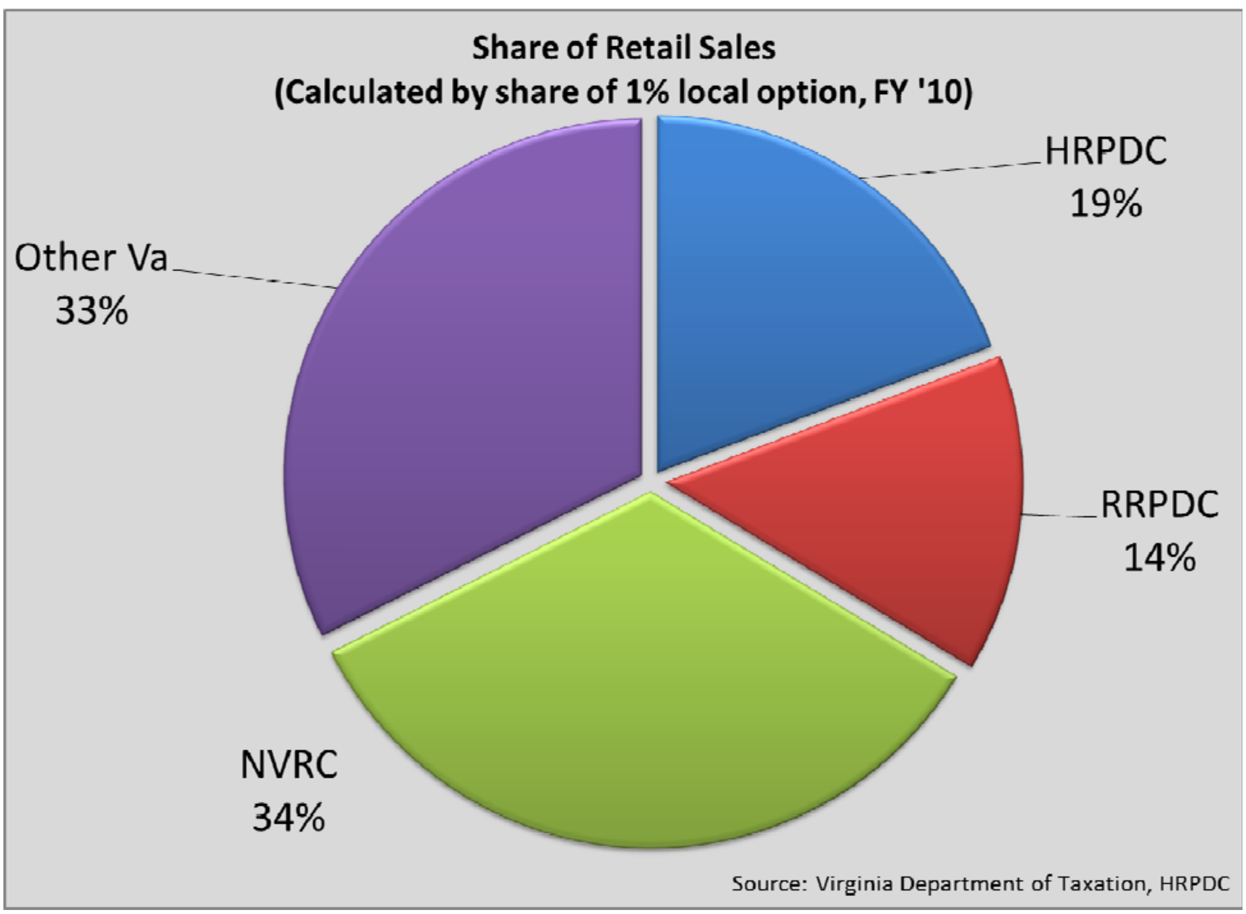
pre-recession peak. Comparably, national retail sales have grown to 3.2% above their prerecession high. This indicates continued weakness in the local retail sector and in the overall Hampton Roads economy.



Hampton Roads Share of the Commonwealth

One interesting element of measuring the sales tax results from the measure of the region's role in the statewide economy. Hampton Roads accounted for 19% of retail sales in Fiscal Year 2010, slightly less than the region's share of the State's population, which stands at 20.3%. Richmond and Northern Virginia both outperform their population counts, Richmond by 1.9% and Northern Virginia by 6.0%. On a per capita basis, the local option provided $116.24 per person in Hampton Roads and $148.95 per person in the Northern Virginia Regional Commission service area.

The localities also get money allocated by the state for schools that comes from the state's portion of the sales tax. Hampton Roads received $217M from the state and out of the three major regions of the state was the only one to receive more back from the state than it received from the local option tax ($134.00 per capita).



Hampton Roads Economic Outlook: by James Clary

The Region Stuck in Neutral

The national economy has shown extreme signs of stress, with estimates of Gross Domestic Product repeatedly facing downward revisions, and payroll employment growing slower then the population (the nation failed to add any new jobs in August). While there have been many one time events that have affected these and other poor economic indicators, it is also true that the nation would have typically grown despite these types of setbacks.

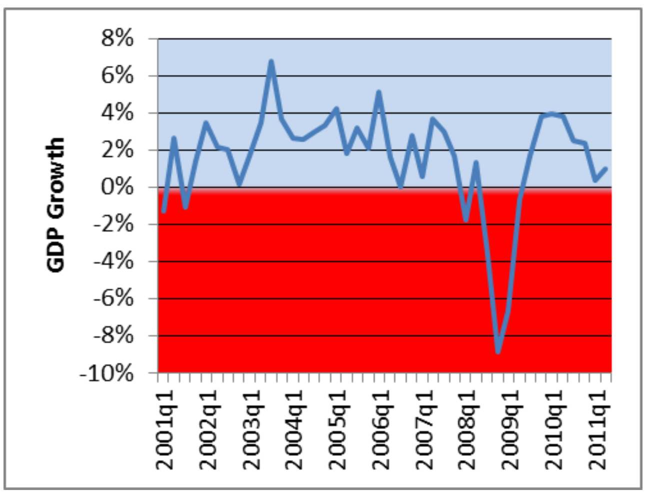
This is also true for Hampton Roads. Regional retail sales have yet to recover (see main article), payroll employment has only increased by 5,500 over the lowest point in the job cycle, and the unemployment rate remains stubbornly high. Some of this weakness can be attributed to one time shocks, including issues stemming from the disestablishment of JFCOM, the closure of the Franklin Paper Mill, and closure of several smaller operations. While these are all significant events, economies experience job events like these in good and bad economic climates, and growth needs to be sufficiently robust to overcome these elements.

The region continues to have a significant overhang of real estate, which puts downward pressure on housing prices. This affects the economy both because home building typically drives economic recoveries along with retail sales. The result goes along with much of the research about recoveries after financial bubbles; it takes time for the economy to heal from a combination of debt, deleveraging, and low confidence.

Hampton Roads Economic Indicators

GDP, Annualized Growth Rate

United States, 2001Q1 – 2011Q2, Quarterly

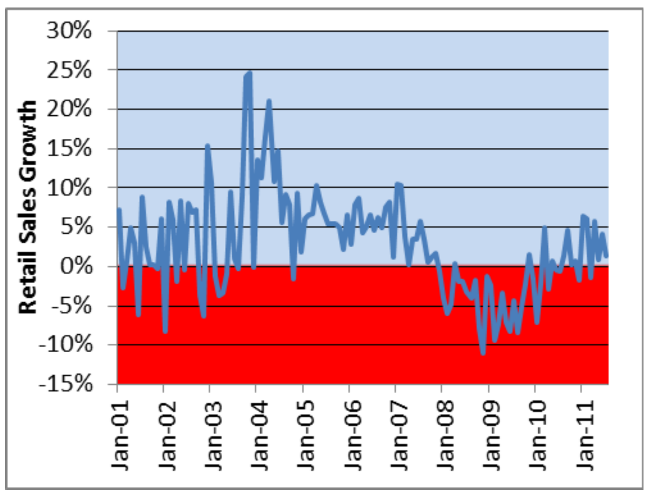


Source: Bureau of Economic Analysis, HRPDC

GDP: Gross Domestic Product combines consumption, investment, net exports, and government spending to determine the size and general health of the economy. Changes in the nation's GDP tend to be reflected in Hampton Roads' gross regional product. The most recent estimate of 2011 2nd Quarter GDP growth indicated the economy grew at a tepid 1.0%, and combined with previous downward revisions of gdp, indicate that this recession and weak recovery have been far more serious then previously estimated.

Retail Sales, Year over Year Growth

Hampton Roads, Jan 2001 – Jul 2011, Monthly



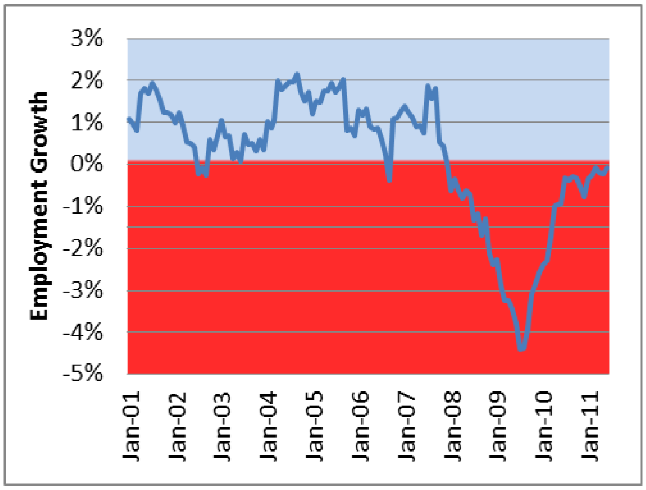
Source: Virginia Department of Taxation, HRPDC

Retail Sales: Retail sales, as measured by the 1% local option sales tax, serve as an indicator for consumption in the region. Since consumption composes 70% of economic activity in the US, the growth or decline of retail sales gives a strong indication of the direction of the local economy. Retail sales grew 1.33% over July of 2010, and this has followed several months of positive retail sales growth, but regional sales still lag the pre-recession levels of July 2007 by 6.73%

Hampton Roads Economic Indicators

Employment, Year over Year Growth

Hampton Roads, Jan 2001 – Jul 2011, Monthly

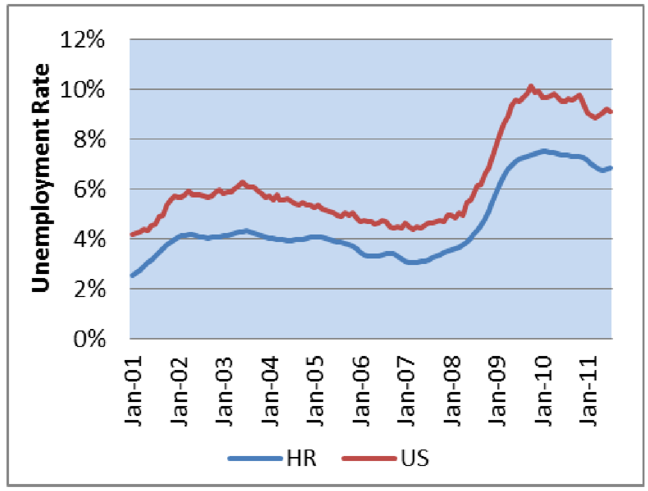


Source: Bureau of Labor Statistics, HRPDC

Employment: Non-agricultural employment is considered the best estimate of labor market activity by the National Bureau of Economic Research. Hampton Roads payroll employment grew strongly in March on a seasonally adjusted basis, but it also shrank just as strongly in Feb. The labor market continues to be highly volatile, Even once a pattern of sustained growth is achieved, it will take a significant amount of time to recover the 47,200 job deficit that the region has developed since July 2007..

Unemployment Rate, Seasonally Adj.

U.S. & Hampton Roads, Jan 2001 – Jul2011, Monthly

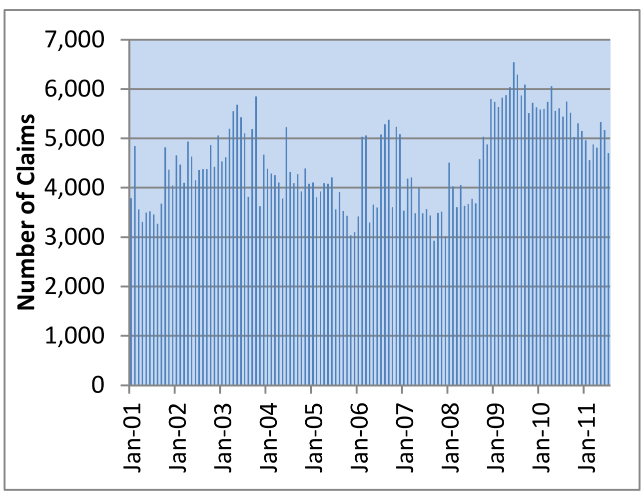


Source: Bureau of Labor Statistics, HRPDC

Unemployment Rate: This is the percentage of the population which is actively seeking work, but is unable to obtain a position. The unemployment rate in Hampton Roads has declined significantly since its peak in November at 7.57%, but unlike the nation, the region's labor force has remained constant and the improvement was driven by the decline in the number of unemployed. The region's unemployment rate remains 2% lower than the nation's.

Initial Unemployment Claims, Seasonally Adj.

Hampton Roads, Jan 2001 – Jul 2011, Monthly

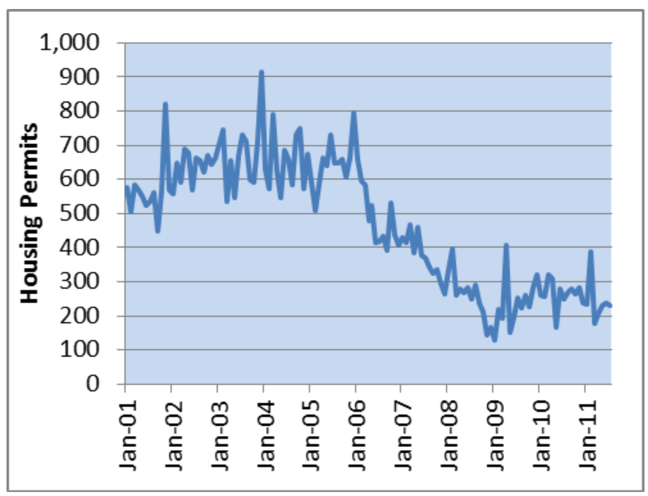


Source: Virginia Department of Labor, HRPDC

Initial Unemployment Claims: The number of Initial Unemployment Claims is a leading economic indicator, reflecting those who are forced to leave work unexpectedly and thus revealing the strength of the job market with little lag time. Initial unemployment claims have declined significantly from their peak in June 2009, and while they remain slightly above their long term average, this signals an end to an elevated period of unexpected separations. The long term average is 4,370 new claims a month.

Single Family Housing Permits, Seasonally Adj.

Hampton Roads, Jan 2001 – Jul 2011, Monthly



Source: U.S. Census Bureau, HRPDC

Single Family Housing Permits: Permit data indicates the level of construction employment and confidence regarding the future trajectory of the local economy. Hampton Roads single family permits are still significantly below the long term average (single family permits averaged 500 a month between 1995 and 2011), and the continuing low level of permitting indicates the weakness in the housing market. Residential building seems to have few prospects of bringing the region out of recession.