Research Department
Federal Reserve
Bank of
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FRBSF Weekly Letter

Santa and the Grinch

Good little boys and girls are not the only ones anxiously awaiting Christmas this year. Retailers are also looking forward to the yuletide with more than ordinary apprehension. They have been especially edgy since the combined tax cut and cost of living allowance for Social Security payments (effective last July) simply did not give the boost to consumption spending that a majority of economists had predicted. Their concern is quite understandable since, depending upon the type of outlet, total sales for December can amount to as much as one-third of yearly sales and about half of annual profits. Dr. Seuss may have written his famous story about the Grinch stealing Christmas for an audience of children, but it has particular meaning this year for merchants whose bottom line could change from red to black depending upon Christmas sales.

The circumstances indicating a spurt in December retail sales are not especially auspicious. Economists are still searching for solid evidence of a recovery, as "bumping along the bottom" has become the most familiar analysis of the current state of business. And it is a rough sleigh ride at best. The most worrisome aspect of the current situation is the unemployment rate—highest in 42 years—and its impact upon consumer income and consumer sentiments. Christmas seasons during periods of depressed economic activity have occurred on a number of occasions in the post-war period. The current period, of course, is unique, but perhaps something may be learned from Christmases past.

December sales

December has always rung up the largest dollar volume of total retail sales of any month, as should be expected. If we make no allowance for seasonal variation or adjustment for the differences in the number of trading days, we see that there has been a remarkable consistency about the December percentage volume of annual retail sales. Over the years since 1949, December retail sales have averaged 10.3 percent of the annual total, or about 24 percent more than what they might have been if sales volume were uniformly distributed throughout the year.

According to statistics on retail sales from the Bureau of the Census, most kinds of merchants experience an increase in the volume of sales between November and December, but for some, the difference may be more significant than for others. The increase in sales for December over November was least for hardware stores and household appliance shops in December 1980, the last non-recession December. The greatest difference was felt by jewelry and variety stores where sales volume in December was at least double the November volume.

Despite claims that diamonds are forever and therefore presumably for every season, jewelry stores realize nearly one-quarter of annual sales in December and one-third or more in the combined November-December selling period. General merchandise and variety stores both recorded 15.8 percent of 1980 sales in December 1980. Apparel and accessory sales were not far behind with just over 14 percent. In November, these stores rang up over a quarter of annual sales. Appliance and TV stores racked up 12.4 percent of annual sales in December. According to recent reports of poor sales from large video game manufacturers, PacMan and other TV-related games may not boost holiday sales for this last group of stores this year as much as anticipated.

In addition to their impact upon year-end retail sales, brisk holiday sales may dispel the spectre of inventories which have been accumulating over the months. In September, the most recent month for which inventory information is available, total manufacturing

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and trade inventories rose 0.1 percent while retail stocks were up 1.8 percent. Factory inventories had fallen for several months because industrial output has fallen consistently for the past year and a half.

Inventory accumulation at the retail level has not been voluntary, that is, in anticipation of a high and rising volume of sales. Quite to the contrary, inventories have been building despite the wishes of retailers because sales have generally been weak in 1982. For the first ten months of this year, retail sales have risen only 1.5 percent above the same period last year. Adjusted for inflation (a 5.3 percent rise over the past year), the real volume of sales actually fell almost 4 percent.

If retail sales turn brisk, they would cause a significant decline in inventory stocks. Their effect on output, however, would be delayed because the sale of already manufactured goods does not contribute to current real output. Only when inventories near depletion would increased and sustained sales force suppliers to restock their shelves. Then, new orders are written, production increases, and employment also increases. Goldman-Sachs has estimated that after excess or unwanted inventories are liquidated, the build-up in inventories in 1983, as the economy recovers, could add 1 percent or more to total output by the end of the year.

Christmas past

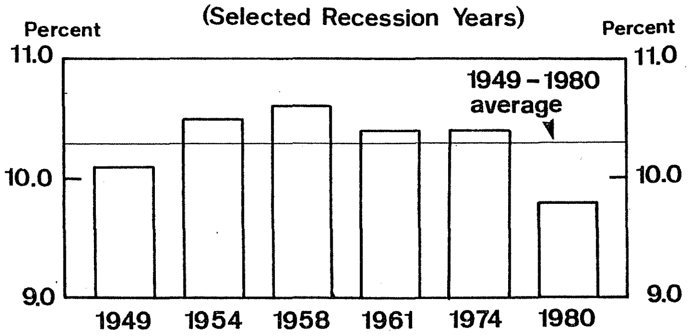
If anything is to be learned about holiday retail sales from previous experience, the most useful data must come from those years in which year-to-year changes in retail sales have been the smallest. After all, if retail sales are weak for ten or eleven months of the year, it is unlikely that the magic of Christmas will turn the situation around. Of course, these lower rates of retail sales depend very much upon the circumstances and sentiments of consumers.

Some comparisons have been made of annual changes in retail sales, December as a percentage of the annual sales volumes, the changes in real after tax income, the earnings rates, and the changes in the consumer balance sheet for six recession years past (1949, 1954, 1958, 1961, 1974, 1980). In the years considered, annual retail sales declined in terms of constant dollars from the previous years. Yet despite striking contrasts among the rates of decline of real retail sales from the preceding year (from −0.9 percent between 1960 and 1961 to −6.0 percent between 1973 and 1974), and wide variations in the rate of December retail sales, the *share* of December sales as a percentage of total annual sales was remarkably stable—averaging 10.3 percent. Apparently, consumers accord about the same value to the Christmas season relative to other seasons no matter their economic circumstances, In other words, they make room for Santa.

Another view of holiday spending in periods of recession comes from studying the nature of saving. Consumers may decide to spend or save on the basis of whether they wish to maintain current spending standards at the expense of saving. Or they may make the decision on the basis of the economic outlook. In a recession, for example, the savings rate may rise because consumers are uncertain about what the future will bring. They, therefore, save more as a precaution.

With the exception of 1961, which was part of a recession of moderate severity, the year-to-year increase in real income in the recession years studied has usually been 1 percent or less. Savings can be measured as a part of this annual flow of income. The savings rate is, then, the percentage of after tax income which is not spent, divided by after tax income. Another measure of savings involves the annual change in the overall balance sheet of individuals. The balance sheet includes the stock of financial assets of all sorts: currency and checking accounts, savings accounts, certificates and securities (whether debt, treasury or private), equity shares, and insurance and pension reserves. The stock of savings by individuals also includes the accretion of owner-occupied

DECEMBER RETAIL SALES AS PERCENTAGE OF ANNUAL TOTAL
(Selected Recession Years)



homes, consumer durables and non-corporate business assets (all less depreciation), net of the increase in mortgage debt, consumer credit and other debt.

The first measure of savings gives an indication of whether consumers are spending less (more) out of current disposable income or whether the savings rate rises (or falls). The other concept of savings indicates the rate at which consumers are adding to an existing stock of financial and nonfinancial assets. (Of course, the value of the total stock of assets may vary due to, say, price changes in the value of the average house or stock prices on interest rates.)

In two of the recession years (1949, 1974) in which the savings rate fell, the December percentage of the annual sales volume was below the 10.3 percent average. In each year in which the savings rate rose over the previous year, the December percentage was above average. For 1961, the savings rate rose because the drop in real income was not enough to change long-run expectations and therefore consumers felt comfortable enough to raise the savings rate to bring it closer to its long-term average. In 1980, the average inflation rate was 12.4 percent, so consumers were attempting to restore their net worth position.

Christmas present

The economic environment in which this holiday is set has few of the festive trappings appropriate to the season. The unemployment rate hit 10.8 percent in November and there is little reason to expect that it will be appreciably lower in December. The high unemployment rate has cast a pall over consumer confidence. The July tax cut and increase in the Social Security cost-of-living adjustment resulted in a higher savings rate but only a weak increase in personal consumption spending in the third quarter. Real after tax income rose 1.7 percent in the first three quarters over the same period in 1981, but the increase is well below the long term trend of 3.7 percent. Spending and saving behaviors, then, have echoed a note of caution on the part of buyers.

"Bah, humbugs" aside, there are a few bright spots in the picture. Consumers are in a better debt position than they have been in a number of years. The ratio of installment credit extension to after tax income has been hovering around 15 percent. This is well below the 20 percent ratio in 1979; it is at the lowest level since the mid-1960's.

Another factor working in favor of a recovery in consumption spending is the rise in the consumers' balance sheet this year. If consumers feel wealthier, the reasoning goes, they may be more willing to increase current spending. Morgan, Stanley & Co. estimates that a gain of 100 points in the Dow Jones means $6 billion of additional consumer spending.

The final results for November indicate modest gains in retail sales despite the bleak economic backdrop. Retail sales rose for the third consecutive month in November, by 2.3 percent. Most of the increase was due to special financing incentives from auto producers eager to clear 1982 models from their lots. Minus auto sales, retail sales rose a modest half a percent.

While the November retail news is not cause for celebration, if past experience is any guide, December sales will probably fit the historical seasonal pattern and be in line with the 10.3 percent averaged over the past 31 years. This means that neither children nor merchandisers will be wholly satisfied with the results. "Christmas isn't Christmas anymore without presents", and Santa may seem a touch niggardly to his clients this year, but at least Santa will appear. The Grinch may come a little closer to his dream of stealing Christmas, but, once again, he will be foiled.

Herbert Runyon

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 12/01/82	Change from 11/24/82	Change from year ago	
			Dollar	Percent
Loans (gross, adjusted) and investments*	162,135	503	7,051	4.5
Loans (gross, adjusted) — total#	142,441	443	8,290	6.2
Commercial and industrial	45,534	548	4,909	12.1
Real estate	57,497	4	1,989	3.6
Loans to individuals	23,636	83	232	1.0
Securities loans	6,175	– 233	631	11.4
U.S. Treasury securities*	6,790	213	1,161	20.6
Other securities*	12,904	– 143	– 2,400	– 15.7
Demand deposits — total#	43,557	2,848	117	0.3
Demand deposits — adjusted	29,285	1,699	209	0.7
Savings deposits — total	32,679	410	2,546	8.4
Time deposits — total#	97,235	–1,527	9,884	11.3
Individuals, part. & corp.	87,311	–1,363	8,504	10.8
(Large negotiable CD's)	34,248	–1,091	261	0.8

Weekly Averages of Daily Figures	Week ended 12/01/82	Week ended 11/24/82	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (–)	134	116	79
Borrowings	43	0	5
Net free reserves (+)/Net borrowed(–)	91	116	– 74

* Excludes trading account securities.
\# Includes items not shown separately.

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