

ICSC Holiday Forecast

2004 HOLIDAY-SEASON SALES OUTLOOK

Average to Better-Than-Average

It's a true story of a mistake, which turned into an annual holiday tradition. In 1955, a Sears Roebuck newspaper advertisement for the store's Santa hotline telephone number was misprinted with the phone number for the U.S. Continental Air Defense Command (CONAD) – the forerunner of the Canadian and American mission known as the North American Aerospace Defense Command (NORAD). However, the commander of the operations, Col. Harry Shoup, turned that mistake into an opportunity to bring some cheer into the lives of children (of all ages) and that effort ultimately evolved into NORAD's "Santa tracking," which will mark its fiftieth anniversary as of the 2004 holiday season. Beginning on November 25 of this year, you can track Santa's sleigh ride test runs and the progress of his Christmas Eve travel from the North Pole at www.noradsanta.org.

Similar to that annual NORAD tradition, ICSC's "Holiday Watch" has a longstanding tradition – though not by any means as long as NORAD's – of providing a holiday sales outlook and tracking. This year is no different from most when the retail industry worries and wonders about the strength of the holiday season's sales.

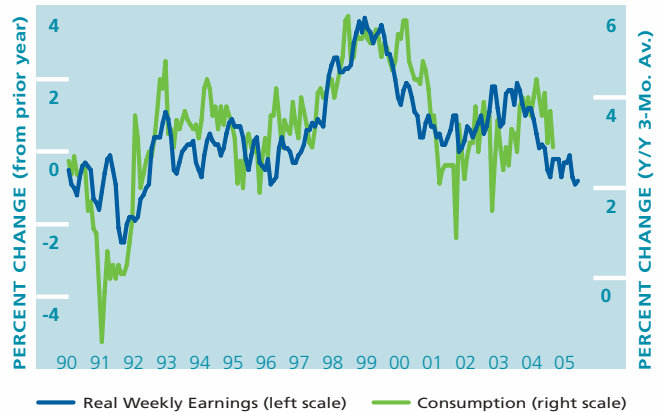
To be sure, much of the holiday product has been ordered though there is some open-to-purchase room later to be used. With the "holiday supply" set, the key question is, how strong will "holiday demand" be? A side question is, what does it mean for pricing?

Consumer Fundamentals and the Debt-Dividend Story

Consumer demand is dependent on the consumers' ability, willingness and opportunity to spend. Chief among these three factors is the consumers' ability to spend.

Generally, measures of personal income or earnings (as shown in Chart 1 with a "lead time" shift) are looked at as the "ability" or fodder for spending and that is juxtaposed against factors that will drain the income stream, such as credit card debt payments and the need to pay down other forms of borrowing.

Chart 1
REAL AVERAGE WEEKLY EARNINGS
vs. Real Consumer Spending,
Earnings Shifted Ahead by 9 Months



Although wages are the main source of personal income (about 55%), what generally may not be on the "radar" of most analysts is "passive" or "non-labor" income, which has grown smartly this year. Personal interest and dividend income – which accounts for about 14% of total personal income – rose by 4.3% in August 2004 (based on a six-month smoothed annualized rate). That was the strongest monthly increase since November 2000 (+5.2%). Indeed, the key source of that strength is dividends, but interest income is posting solid gains as short-term interest rates rise. Personal dividend income

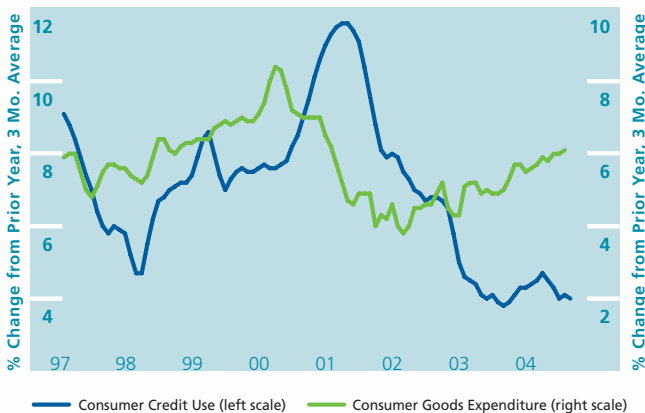
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advanced by a hefty 9.3% through August 2004 (on a six-month smoothed annualized rate), which was the strongest performance since July 2002¹. **This passive income pickup provides a reason for continued strength through the holiday season in luxury market demand, which is driven by the upper-middle to high-end household income consumer.**

However, the improvement in the financial situation of the consumer is not solely a high-end household income story. Indeed, on September 15th, *ABC News/Money* magazine reported that based on its consumer comfort weekly polling, **Americans rated their personal financial situation as the strongest in more than two years.** This is very comforting information to hear ahead of the 2004 holiday season.

One often hears worry about the consumer debt situation. This concern, however, has persisted for at least the last thirty years. Research suggests that the consumer credit cycle lags the consumer spending cycle (except at the bottom of the economic cycle when it can propel consumer spending beyond the income capacity for a short period until employment and income pick up), which means credit should not be a catalyst for a reduction in spending during the upcoming holiday season (or generally at any time). This is shown in Chart 2. Indeed, one of the best leading indicators of consumer credit use is the willingness of banks to provide consumer installment credit and that continues to be favorable. If

Chart 2
THE RELATIONSHIP BETWEEN CREDIT AND SPENDING



consumers have the available lines of credit, they will use them; if banks cut back on those lines, then there is an impact on spending.

Additionally, in the aggregate, mortgage and consumer installment interest payments (aside from the principal) amounted to \$645 billion during the second quarter compared with \$1.352 trillion received by the consumer from interest and dividend income. Clearly more income is derived from the credit and equity markets than is drained by the debt market. To be sure, there are household distributional impacts that these national statistics gloss over, which of course will impact certain retailers in certain segments. For example, lower-income household budgets have been more strained this year than the rest of the population due to the run-up in gasoline prices.

Chart 3
ICSC'S CHAIN STORE SALES LEADING INDEX VS. CHAIN STORE SALES
12-Month Lead Time in Leading Indicator



The ICSC Leading Indicator of Chain Store Sales (as shown in Chart 3) provides another window on the consumer fundamentals. Our indicator, which typically leads the cyclical swings (“turning points”) in the spending cycle by about 12 months, tells an

¹Exemplifying the importance of dividend income for this holiday season is the record \$32 billion special dividend that Microsoft will pay to holders of record on December 2, 2004. According to the Economist, even if you strip out Bill Gates and other large shareholders of Microsoft, that special dividend will still put \$9 billion in the hands of “thousands of people just ahead of Christmas.”

ICSC Holiday Forecast, *continued*

interesting story for the holiday season. The holiday sales message is that there is a potential for a late season pickup in demand. But if it comes too late in the season, it will not be comforting for the industry, which may have stepped up promotional activity by that time.

Holiday Outlook

Several of our best-performing statistical models for forecasting holiday sales are “momentum models.” What that means is the year-to-date sales momentum or performance is generally a good bellwether of the holiday season with one big exception when the economy’s underlying trend changes. This year, the year-to-date model projections are quite upbeat relative to last year’s performance, but momentum alone is likely to overstate the season’s performance since sales hit a “soft patch” during summer and the underlying trend already slowed and there is no clear indication of a quick improvement.

Overall, our expectations for holiday-season sales growth (based on the November and December combined picture) can best be described as “average” to “slightly above average,” depending on the data. But with that said, the forecast compares favorably with the 2003 season. Our 2004 projection for industry chain store sales on a comparable-store basis is an increase of 3-to-4% relative to the 2003 season (as shown in Table 1). For perspective, that sales projection would be below or equal to the 2003 sales gain of 4.0% for the November-December period. Between 1994 and 2003, the average holiday sales gain was +3.3%.

Shifting the focus to a broader measure of sales, the U.S. Department of Commerce’s general merchandise, apparel, furniture and electronics and other (GAFO) store sales expectation is a bit brighter this year. Our November-December GAFO store sales

projection for 2004 is very similar to the 2003 performance, as shown in Table 2. Those data posted a solid 4.8% increase in 2003 and we expect about the same pace for 2004. Keep in mind, however, that the average performance over the prior ten years was 4.7%, so our projection is not particularly outlandish and the 2004 year-to-date (January through July) trend has averaged 8.0% on a year-over-year basis. So the risks to that forecast are probably on the stronger side.

Table 1
U.S. CHAIN STORE HOLIDAY SALES
Year/Year Percentage Change

Year	Nov.	Dec.	Average	Inflation	Real Spending
1990	1.3	2.7	2.0	3.4	-1.4
1991	2.4	2.6	2.5	4.1	-1.6
1992	3.8	7.4	5.6	2.6	3.0
1993	3.1	4.2	3.6	1.6	2.0
1994	3.6	4.1	3.8	1.4	2.4
1995	2.6	1.6	2.1	1.7	0.4
1996	2.9	3.4	3.1	1.0	2.1
1997	4.1	4.9	4.5	0.4	4.1
1998	4.5	5.7	5.1	1.2	3.9
1999	4.1	6.7	5.4	0.2	5.2
2000	4.0	0.7	2.4	0.6	1.8
2001	2.1	2.2	2.2	-0.3	2.5
2002	0.0	1.0	0.5	-1.5	2.0
2003	3.7	4.3	4.0	-2.5	6.5
2004 (est)	—	—	3.0 to 4.0%	-0.5	3.5 to 4.5%

NOTE: Sales are based on the monthly ICSC Chain Store Sales Index, which is a composite of chain store sales on a comparable store basis. Inflation is based on the Consumer Price Index for commodities less food and energy on a December-over-December percentage change basis, except for 2004 which is for September 2004.

Sources: International Council of Shopping Centers; U.S. Bureau of Labor Statistics.

Gift-card use – which captured an estimated 8-10% of total 2003 holiday expenditures by the consumer – is not likely to have as dramatic an impact as a sales shifter this year as was the case

last year. This does not mean it will not be a big part of holiday gift giving, but rather it means that the incremental share of the holiday expenditures is likely to remain in that 8-10% range (after accelerating quite rapidly in the last few years). Indeed, with the expected increase in 2004 holiday product selection in the stores, consumers will find more gift options to buy during the season and as such may use gift cards less than last year when inventories were quite lean.

The early Chanukah this year (the holiday starts the night of December 7) could help provide some sales support during the early December period, which in recent years has seen a sales pause.

Our statistical work suggests that the season's duration from the day after Thanksgiving to the day before Christmas has increasingly become less meaningful. Indeed, last year was a good example of this as many retailers ran promotions ahead of Thanksgiving to provide a "Christmas cushion" to their season's performance. We expect the industry will again adopt this strategy. Nonetheless, there are 29 shopping days between Thanksgiving Day and

Christmas Day – two more days than in 2003 and the most since 2001. The last comparable season by duration was in 1999, which also shared another common characteristic – that Christmas Day fell on a Saturday. Of course, that is a nice year to compare with since 1999 was a very strong season.

2004 Holiday Season Strategies

Table 3 (on the following page) offers our perspective on how well the recent holiday seasons have performed from strategy to execution. We expect retailers in 2004 that are likely to be successful will be those that focus on the high-end or luxury market or those retailers that appeal to the "upscaler." Higher price points will help entice the consumer and capture more sales. On the apparel front, men's clothing may be well positioned to help this holiday season as prices have stabilized. Another category that is likely to help is jewelry sales. Jewelry prices, in particular, have been accelerating in 2004 and are seeing their best pricing in about 10 years.

Santa Watching

Santa is already on the radar screen to be sure.

Whether the jolly ol' fellow is being tracked by NORAD or by the retailers, it is clear that the holiday season would not be the same without him.

ICSC has learned that Santa and his planning staff are working hard this year on their holiday projections as well. At their annual spring planning meeting, Santa Research reported a strong and upbeat consumer. However, by the summer, some of that consumer strength and optimism evaporated. But still, Santa remains reasonably optimistic on the holiday season. Santa's staff has reminded us that ICSC is not only the acronym for our trade organization, but a nickname for the jolly fellow. It seems, we are told, that ICSC also means **Incredibly Cheerful Santa Claus** so it is no wonder that he remains upbeat on the 2004 holiday season.

Table 2
TRACKING GAFO HOLIDAY SALES

Year/Year Percentage Change
(Based on NOT Seasonally Adjusted Data)

Year	November	December	Nov.-Dec.
1993	7.8%	5.8%	6.6%
1994	8.7%	8.2%	8.4%
1995	5.6%	2.3%	3.6%
1996	3.0%	2.6%	2.7%
1997	3.8%	4.0%	3.9%
1998	5.7%	6.4%	6.1%
1999	6.8%	9.4%	8.4%
2000	6.8%	1.9%	3.8%
2001	3.9%	3.5%	3.7%
2002	1.6%	0.7%	1.1%
2003	4.0%	5.4%	4.8%
2004 (est)	5.5%	4.5%	5.0%

Sources: Department of Commerce and International Council of Shopping Centers (ICSC) Research

ICSC Holiday Forecast, *continued*

Table 3
THE UNFOLDING OF THE HOLIDAY SHOPPING SEASON
 Early, Mid- and Post-Christmas Selling Season Reading

Year	Early Outlook and Strategy	Mid-December View	Post-Christmas View	Actual Store Sales % Change	Christmas Shopping Days
1998	There was concern that the summer stock-market retrenchment would negatively affect Christmas merchandise demand, even though year-to-date momentum remained healthy. Most retailers kept their year-to-date "sales strategy"; industry recognized 1998 season faced a "tough comparison" with 1997.	Moderate start to season but apparel demand remained adversely affected by (1) warm seasonal temperatures and (2) the decreasing importance of apparel demand at Christmas time. Unsure how Internet sales will siphon off traditional sales.	Strong last-minute shopping and a bout of cold weather pushed industry sales to the strongest gain for the Christmas season since 1992. WalMart's sales alone soared by 9.4% in December.	5.1	28
1999	Generally very optimistic given the strong trends through much of the year. Some retailers, however, did express concern about the impact of price rollbacks and promotions during the Christmas season, while others noted the "tough" year-over-year comparisons. Most traditional retailers downplayed role of Internet sales.	November sales were hurt by mild weather and the post-Thanksgiving surge in sales generally was not enough to offset the sluggishness in November. December's early month momentum was stronger than November's sales pace; most retailers expect strong finish to the Christmas season and will not be too quick to step up promotional activity. Internet-based sales get most of the news coverage.	Sales were strong leading up to Christmas and some retailers noted that post-Christmas sales remained robust in part due to Y2K purchases of staples. Sales of jewelry, electronics and apparel were all strong. Sears and JC Penney (department store) sales were very weak among major retailers. Sears said they discounted less aggressively despite sales slump, which helped profits. Internet-based holiday sales generally were additive to the Christmas season for the brick-and-mortar retailers.	5.4	29
2000	Likely to be a more difficult season; expectations restrained. Prior year is a tough act to follow. Major stores better positioned to compete on the Internet. Entering the season with some fall merchandise to "move out" and weaker consumer fundamentals. Staffing needs recognized as a major concern. In-stock performance or rapid fulfillment also a high priority. Early reading on sales - phenomenal day after Thanksgiving, but demand settled down quickly on subsequent weekend.	Sales were struggling as the post Thanksgiving lull set in, but that softness lingered through mid-December as an early winter storm hit the central parts of the United States. Retailers stepped up promotional activity as their confidence was shaken that they could not count on the expected late surge in sales during the week before Christmas to bail out the whole season.	A decent finish to the Christmas season, but the strength was too little and too late to save the season. Stepped up promotional and discount activity cut further into the reported sales and raised severe concern on the profit side. The post-Christmas week was also mixed as another severe storm along with tough pre-Y2K sales comparisons cut into the week's performance.	2.4	31
2001	The retail industry expects the Christmas season to be "very difficult" and "uncertain" in the aftermath of September 11th and the 2001 recession. "Value" is back in vogue. Patriotic overtones in the merchandise are expected to connect with the consumer. Home-related focus also is in this year. Apparel inventories are considerably leaner than a year ago, which should stave off any massive price cutting ahead of Christmas. Post-Thanksgiving sales generally okay, but WalMart and Target did well.	Consumer demand was lukewarm in the post-Thanksgiving period through mid-December. The recession & unseasonable weather tended to pare demand as some retailers stepped up promotional activity and discounting. Apparel demand languished as those sales continue to lose appeal at Christmas time - a longer run theme. Certain hot products were moving - such as Xbox and Playstation 2 or the movies "Pearl Harbor" and the "Grinch." However, generally the Christmas season has been unexciting and sales dismal.	Another year when there was a last-minute surge in demand in the days leading up to Christmas. Promotional and discount activity was largely as planned by the retailers, though some stores (such as Kmart and May) adjusted those parameters upward once the season began. The overall season was challenging for the industry with plenty of pockets of weakness.	2.2	32
2002	The retail industry worry level is very high with consumers facing a weak job market and concern about war with Iraq. The 10-day West Coast dockworker strike caused some scrambling for goods by some retailers, but most were okay. Price discounting is widespread, but that is possible, in large part, due to declining prices for goods purchased from Asia (as such, profit margins are less affected). Strategy is to promote, advertise more heavily and try more marketing programs to connect with consumers.	Holiday spending was hurt by a winter snow and ice storm in the East during the first week of December; sales partially recovered in the second week. Retailers expect the last weekend and week of Christmas could make or break the month. Worry and promotional activity remained high as sales are running on-to-below plan so far.	The season began well, but a holiday lull set in once again in early December. There was a strong finish to the holiday season and the Saturday before Christmas was the heaviest sales day of the season. Overall, the holiday 2002 retail sales environment was very promotional, very uncertain and very weak. The only good news was that cost reductions (efficiencies, lower cost of goods and a lower labor bill - due to the shorter holiday season) cushioned profits a bit from very weak sales.	0.5	26
2003	The retail industry is likely to step up advertising this holiday season, in part, to differentiate product and sell image. Apparel imports suggest lean inventories this year should benefit retailers generally and check heavy discounting at the first sign of sluggishness. Some retailers are promoting sooner to capture holiday sales earlier and with it provide a cushion for the season. The luxury market is looking better since mid-year; may be the key to successful season.	Northeast snowstorms battered store sales during the first two weekends of December sales, however, the industry largely rebounded quickly from Mother Nature's impact. Nonetheless, the first half of December's store sales performance was largely below plan for the industry. Those regional storms, as expected, shifted demand later in the season as NE demand was the strongest on the weekend prior to Christmas. Although some retailers stepped up promotions, most were close to plan.	Sales began to accelerate in mid-to-late December and continued strong through and immediately after Christmas Day. Gift cards/certificates commanded between 8-10% of holiday expenditures by the consumer, which was larger than prior year, and expected to extend the holiday season into January. Sales were uneven for the industry overall, but much improved in the aggregate as the economy continued to improve as well.	4.0	27

Note: Sales data are based on a two-month year-over-year average for November and December as measured by the ICSC tally of comparable-store sales for a broad-spectrum of the nations' retailers. The number of "Christmas shopping days" is counted from the day after Thanksgiving to Christmas Eve.