2016: THE YEAR OF THE CONSUMER

Spending the Oil Dividend and Reaping the Wage Benefits

April 2016
U.S. consumers reaped a huge windfall from the decline in oil prices in 2015—and they spent it. Real (inflation-adjusted) retail sales increased 4.8% in 2015, the fastest pace since 1999. Expect more acceleration in 2016 with oil prices remaining low. Cushman & Wakefield forecasts the average price of oil in 2016 will be $41.00/barrel, down from $49.00 in 2015. Continuing low oil prices will put more money in consumers’ pockets, and so we expect faster spending growth.

Consumers will also benefit from wage growth which will accelerate as labor markets continue to tighten. Since the current expansion began in 2009, wages have increased an average 2.0% per year. However, over the past year labor markets have tightened, creating upward pressure on wages.

• Consumer spending is expected to accelerate in 2016 to its strongest pace in more than a decade after rising 3.1% in 2015.
• Continuing low oil prices and stronger wage growth will be the key drivers of consumer spending.
• The impact of this improvement on retail commercial real estate (CRE) is expected to be positive, but will be significantly offset by intensifying competition from online sales.
• Retail CRE will also be heavily influenced by consumer income and spending patterns, with luxury and discount stores doing well while mid-priced stores face challenges.
• All in all, 2016 will likely be the year of the consumer, which should support the retail CRE sector throughout the year.

WAGES ARE INCREASING; OIL PRICES DECREASING.
Where will consumers spend their extra dollars?
Since 2009

WAGES INCREASED 2%
an average of PER YEAR

OIL DECREASED

average price

2016 $41/barrel
2015 $49/barrel

January 2016

5.5M+
JOB OPENINGS

Rising Employment
Faster Wage Growth
Lower Gas Prices
More Discretionary Income
The unemployment rate fell to 5.0% in March, a level generally considered at or close to full employment.

The number of job openings has surged. In January 2016 there were more than 5.5 million openings, the second highest number since the Labor Department began tracking this data in 2000.

Fewer unemployed people and more job openings have resulted in fewer unemployed people per open position. As of January 2016 there were 2.83 unemployed or underemployed persons per job opening, the lowest ratio since mid-2007. At the worst of the recession, there were more than 11.5 unemployed/underemployed people per open position.

In mid-2007, average hourly earnings were rising at an annual rate of more than 3.5%. From March 2015 to March 2016, they were up 2.3%. With labor market pressure currently at a level last seen in 2007, upward movement in wages is likely.

These trends point to faster wage growth in the coming year. In addition, the number of jobs in the economy is expected to increase at a solid pace. Cushman & Wakefield anticipates 2.6 million net new nonfarm payroll jobs will be added to the economy in 2016—in addition to the 5.7 million added in 2014 and 2015. The combination of strong job growth and faster wage gains will cause income growth to accelerate.

In February 2016, personal income, after taxes and inflation, was 2.7% above its year-ago level. January was the 17th consecutive month in which real disposable income was more than 2.6% above year-ago.
levels, the longest such streak since 2000/01. The biggest drivers of this growth have been employment growth and low inflation. In 2016, we expect these drivers to be augmented by rising wages to keep real after-tax income rising at a strong pace.

One additional factor that bodes well for stronger growth in consumer spending is the low debt burden in the household sector. As of the fourth quarter of 2015, total household payments of interest and principle accounted for only 10.07% of after-tax income, one of the lowest shares since the Federal Reserve began tracking this data in 1980. Most households have room to increase debt without stretching budgets, so consumer spending growth is likely to remain strong in 2016.

**HOW WILL THIS IMPACT COMMERCIAL REAL ESTATE?**

Stronger consumer spending is expected to lead to higher demand for space, but it will not be an across-the-board increase because of two important trends: (1) the continuing rise of e-commerce and (2) the bifurcated pattern of consuming spending, with luxury and discount spending strong and outlays for mid-priced goods increasing slowly if at all.

Today, e-commerce accounts for approximately 8.1% of all U.S. retail sales (excluding autos), compared with 4.3% just six years ago. We expect e-commerce to approach a 10.0% to 11.0% share of all non-auto retail sales by as early as 2017. Clearly, stores are still very important as they currently account for more than 90%
Competition from online sales will somewhat offset retail real estate expansion of retail sales. But in-store sales will continue to increase at a slower rate than online sales for the foreseeable future.

These trends represent headwinds for the retail sector. Even though consumer spending is likely to increase at a stronger pace, it may not spur as much new demand for stores as it did in the past. Instead, warehouses are fulfilling a growing share of the new demand, boosting industrial leasing and leading to positive industrial absorption for 23 consecutive quarters. We expect more of the same in 2016.

Consumer spending patterns are also expected to impact retail real estate demand. Technology has made it easier for consumers to shop for value, while the competitive retail environment has resulted in a cycle of discounting that has trained consumers to be bargain hunters. Luxury consumers have, as always, been more stable in their spending patterns. But mid-priced hard goods retailers face the most challenges.

Retail real estate reflects these trends. Vacancy in the nation’s premier trophy shopping centers is extremely low and expected to remain so. With a shortage of space, Class A malls will remain in high demand especially as consumer spending increases. Another favored property type is community/neighborhood and power centers, whose core tenants are from retail sectors that have been in strong growth mode over the last few years. Finally, the continuing urbanization of the U.S. population is expected to boost demand for urban high street retail.

We anticipate a slight uptick in retail vacancy rates in the first half of 2016, but by year-end vacancy should be below year-end 2015 levels due to strong retail sales growth. Since much of the pressure is on apparel and department stores, malls and lifestyle centers are

More sales go to the internet

Internet sales as a share of GAFO plus Internet

Source: U.S. Department of Commerce

Note: GAFO = sales at General, Apparel, Furniture and Other stores
Spending patterns will benefit luxury and discount stores, but bargain hunting will affect mid-priced

E-COMMERCE
% of U.S. retail sales
2010 4.3% 2016 8.1%

23 CONSECUTIVE QUARTERS
of positive industrial absorption
driven by demand for distribution space

CONSUMER SPENDING
accounts for 69%
of U.S. GDP
expected to feel most of the impact, while trophy centers and prime urban locations should be minimally impacted. Premier sites will easily backfill any vacancies. Neighborhood/community and power/regional centers will experience little fallout from this trend and are expected to continue to record occupancy growth, although net absorption will largely occur in Class A product and/or new space.

CONCLUSION
The overall picture for retail is positive. The improving position of the American consumer will, at the very least, ensure that this trend continues throughout 2016. The consumer is the most important driver of the U.S. economy and consumer spending accounts for 69% of U.S. gross domestic product (GDP). In 2016, consumer spending is expected to fire on all cylinders as strength in employment couples with faster wage growth to boost income. In addition, consumers will continue to reap the benefits of lower oil prices, which will provide more discretionary income for spending on other goods and services.

Although the first six weeks of 2016 saw declines in global equity markets that temporarily increased the level of uncertainty and raised concerns about the ability of the U.S. economy to sustain growth, we do not think the global environment will have a material negative impact on the U.S. consumer. Absent a major global meltdown, the positive momentum generated by rising employment and incomes and declining gas prices will keep U.S. households spending. The result should be a healthy economy and solid, if slightly less robust, demand for retail real estate in the coming year.

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