

INTERNATIONAL TEXTILES AND CLOTHING BUREAU

Council of Representatives
41st Session
Bali, Indonesia
4 – 7 April 2005

Presentation to the 41st Session of the Council of Representatives of
The International Textiles and Clothing Bureau
4-7 April, 2005
Bali, Indonesia

By Laura M. Baughman
President
The Trade Partnership
on behalf of The National Retail Federation

It is my great pleasure and honor to once again have the opportunity to speak to you today. I have been asked to update you on the status of the America economy, particularly as it pertains to the prospects for the clothing market over the next decade. I will begin by reviewing where we've been, discuss the current state of the U.S. apparel market, and then dare to make some predictions for the next decade.

Where We've Been

To set the stage, let's start with a brief look at the last 10 years. As you may recall, the U.S. textile industry has long claimed that growth in the U.S. textile and apparel market is a mere 1 percent a year. It was this very low rate, which they seem to have derived from the growth rate of the U.S. population, that fueled their demands that growth in quota be limited in the Uruguay Round negotiations for the Agreement on Textiles and Clothing. CHART 1,

Well, as we all expected, growth in the U.S. clothing market has done better than that over the last decade, and all of the key quotas we faced over the last 10 years continued to bite. U.S. government data show the value of consumer spending on apparel increasing at an average annual real rate of 4.9 percent since 1995.¹ This is five times faster than the U.S. textile industry

¹ I rely for my measure of apparel sales on "personal consumption expenditures" on apparel. This is government-issued data that purports to show what consumers spent on apparel in a given year. It is thus retail cost (full

predicted. Apparel spending per capita has also been increasingly steadily over the last 10 years. This increase partly reflects upgrades in quality (I've neutralized for inflation by using the real value of spending on apparel), and partly represents increases in the quantity of goods purchased. CHART 2

But before we get too excited about these strong indicators, I must note that growth in apparel spending has been modest in comparison to growth in spending on all goods and services in the aggregate, which averaged 8.0 percent a year. Indeed, apparel spending as a share of total spending has been declining steadily. CHART 3

Suppliers in your countries have benefited from this growing market over the last 10 years, despite the quotas. Imported apparel accounted for a growing share of total U.S. apparel consumption, rising from an estimated 48 percent of the wholesale value of the market in 1997 to 61 percent in 2004.²

In short, we have a growing market, but also a shifting one. People are spending more on apparel, but they are spending even more on other products. The question we must all have is: will this shift continue to the point that over the next 10 years the U.S. apparel market begins to flatten or decline, dampening demand for your products in the American market? What can we expect now that the quotas are gone?

Factors Driving the Current U.S. Apparel Market

To answer these questions, we need to know more about what is driving today's market. What pressures are causing consumers to spend less of their total budgets on apparel? Will these pressures continue?

Today's apparel market is a market in turmoil, not only from the supply perspective (the end of the quotas being the most significant new development) but also from the demand perspective. Your producers are up against a lot more than competition from China, and you need to place declining orders in their

market value) data. Some private research firms, which are widely, quoted by the media use their own estimates, which are significantly smaller than the PCE data, and even trends are different. The most widely quoted is NPD, which produces much lower apparel sales data that they claim show declining trends in sales over the last three years. I cannot explain how NPD gets its estimates or why they differ so much from the U.S. government data.

² These market share estimates are derived from wholesale values of imports as well as of the market.

proper perspective. I'd like to detail a number of factors that are contributing to the declining interest of American consumers in apparel.

Saturation

It has a lot to do with demographics, which will only entrench the trend in the coming years. The largest group of consumers, the so-called "baby boomers," are changing their spending patterns significantly. This large segment of the population accounts for more than one third of total spending on apparel. But their priorities are shifting away from clothes to insurance, retirement, and college educations for their children, vacations, and other types of personal spending. Instead of recreational shopping, which was big in the 1980s and early 1990s, boomers are now turning to spas, manicures, or cosmetics for pampering. As you get older, reality hits. Clothes can only hide so much. There are other, often cheaper, ways to look good or make a fashion statement. In addition, many members of this consumer group are saturated with clothes. They no longer need the newest fashion to feel confident or satisfied. Going forward, as this significant segment of the apparel market ages, their demand for clothing will continue to focus on replacement demand, and to be spent largely at mass retail outlets or at mid-priced retail chains as long as there's a sale.

Family Budgets

It also has a lot to do with lower prices. Consumer prices for apparel have been dropping since 1998. CHART 4 Retailers and, as a consequence, their apparel suppliers, have been under severe pressure to cut costs. The need to maintain margins is also fueling a shift to private label apparel, which is taking sales away from branded apparel producers.

We all know that Wal-Mart is the largest apparel retailer in the United States. It caters to consumers at all income levels who are seeking commodity products like underwear or T-shirts at the low prices. It also caters to consumers on tight budgets. I found it instructive what happened to Wal-Mart this holiday season when it tried to *not* cut prices: consumers revolted. They stayed away and Wal-Mart panicked. Only when it reinstated Holiday discounting did the customers return.

In short, most American families continue to worry about their budgets, and seek to spend as little as possible on as much as possible. The income euphoria of the dot com days is over. Until the economy recovers sufficiently that higher incomes trickle down to these consumers, an insistence on low prices will remain strong. If the value of apparel sales is to increase, it will need to be on the basis of very low prices for commodity products that fuels increased quantities purchased, coupled with improvements in quality and detailing or styling, that increases the value of each unit sold.

Competing Spending Options

Another reason apparel's share of total spending has been declining is that lately consumers of all ages are scrambling to diversify into accessories ranging from bedding to iPods. They are renovating their homes, or buying new ones that need new furnishings. They are shifting to electronics and flat screen TVs. NPD Fashionworld asked American women what their chief spending interests were: 75 percent said health and fitness, 71 percent said electronics and computers, 68 percent, home furnishings; 49 percent, fashion. In addition, today's consumers have recurring expenditures that past generations didn't: cable TV, Internet connections, cell phones and health clubs take a growing bite out of household budgets.

What Do These Dynamics Mean for Apparel Retailers and Producers Today?

As you might imagine, a slowly growing market with price pressure and lots of competition for attention from other purchasing options is taking its toll on apparel retailers and those who supply them.

Shifting Out of Apparel and Into "Bling"

Apparel retailers and producers are responding in kind. Look at Limited Brands. Ten years ago, apparel accounted for 96 percent of the Limited's sales; today, it represents 68 percent. Personal care products sold by the firm's Bath & Body Works and Victoria's Secret divisions have grown from 4 percent in 1994 to 32 percent of sales in 2004. Limited is selling hair care products and cosmetics, candles, perfumes, lotions. Gap has started selling some beauty products in Gap Body stores. Banana Republic is making a major push into jewelry. Even apparel producers are getting into the act: Liz Claiborne, for example, is going after branded wallpaper, carpeting, upholstered furniture and bedding.

Consolidation: Small Is No Longer Beautiful

The increasing demand for low-cost apparel and indeed the waning demand for apparel generally having a negative impact on retailers of all types, from mass retailers to those "in the middle" – the mainstream department stores, and even specialty retailers All have been consolidating and closing stores. Gap and the Limited have closed stores, Kmart has joined up with Sears and Federated is buying May. Everyone expects these retailers to close stores outlets as well.

This consolidation of the U.S. retail sector is having a serious effect on apparel companies who sell to them. Already, clothing manufacturers are shipping less merchandise to better align supply with reduced consumer demand. If your producers are complaining that their orders are down, this is

partly why. U.S. apparel companies are focusing on earnings rather than increased sales volume. For example, Tommy Hilfiger has cut its department store locations to 800 from 1,400 in 2004. Nautica cut 300 of its department store locations. In addition, apparel brands will find it tougher to compete with the private-label programs of the major retailers, some of which have really taken off, decreasing shelf space for outside brands.

Retailer consolidation is bad news for apparel suppliers. It means the retailers have greater power to demand lower prices from suppliers (or more power to demand markdown money when a line doesn't sell as well as expected, and increased promotional funding). It means the retailers will be buying less as they close excess retail outlets. There is widespread speculation that apparel producers will need to consolidate to keep some semblance of market power. We hear that Liz Claiborne may buy Ann Taylor Stores, and Jones Apparel Group, Kellwood and VF Corp are looking for smaller brands to buy. Apparel producers may also seek to grow because large retailers will prefer to deal with companies that can handle the volumes they need. Big companies like to deal with big companies. \$100 million in sales is big enough to supply the very large retailers; \$20 million manufacturers will have problems.

What About the Next 10 Years?

So what can we expect from the American market over the next 10 years? As I've said on previous occasions, I think it is very risky indeed to make any predictions about the fickle American consumer, particularly over such a long period of time.

That said, there are a few "hints from the past" that help to frame some basic expectations that should be useful to your apparel exporters and to your deliberations at the Doha Round.

First, price pressure on producers will not abate. This push to lower retail prices of apparel will continue. You may have thought that the end of quota costs would provide you with some relief: no. Retailers selling largely to consumers for whom price is key will keep beating up your producers to lower costs. Other retailers will upgrade the quality or features of the products they ask your producers to make, with no or little net profit gain to your producers. This is a tough market, it will stay a tough market. Consolidation will extend not only to U.S. apparel producers (the brands, actually) but to foreign manufacturers as well.

So to keep apparel sales growing, apparel producers will need to cut costs even more. Eliminating apparel U. S. tariffs and serious trade facilitation undertakings by ITCB members will both contribute significantly to the attractiveness of foreign producers to U.S. purchasers. And of course avoidance of trade remedy investigations will be important as well, although you have less

control over that. These achievements will be difficult, I know, but potentially valuable to the employment and industrial development back home.

If the textile industry is right and imports eventually account for, say, 90 percent of the U.S. market by, let's say, 2010, and if sales grow at their present pace until then (I think an optimistic projection), your producers could be looking at apparel sales of \$135 billion by 2010 (customs value), almost double 2004 levels. This is optimistic because it assumes that consumers continue to spend money on apparel at the same pace they have been spending on it over the last 10 years, but as I've indicated there are pressures, demographic pressures and others, that will dampen that enthusiasm for apparel spending somewhat. So if apparel demand grows at half the pace of the last 10 years and imports command 90 percent of the market, you can expect to be shipping about \$120 billion to the United States in 2010, 73 percent more than in 2004. Either way, this is not small change, and it merits your attention in seeking ways to ensure that you avail yourselves of the U.S. market over the next several years.

However it turns out, the bottom line is this: if there are ways you can promote reductions in costs through the Doha Round, I've suggested two, tariff reductions and trade facilitation improvements, but I'm sure you can think of more -- you can encourage this growth in exports to the United States. I wish you success in this important effort, and assure you that the U.S. retail sector stands ready to assist you in any way we can.

CHARTS FOR PRESENTATION OF

Laura M. Baughman

President, The Trade Partnership

on Behalf of the National Retail Federation

To the 41st Session of the Council of Representatives of

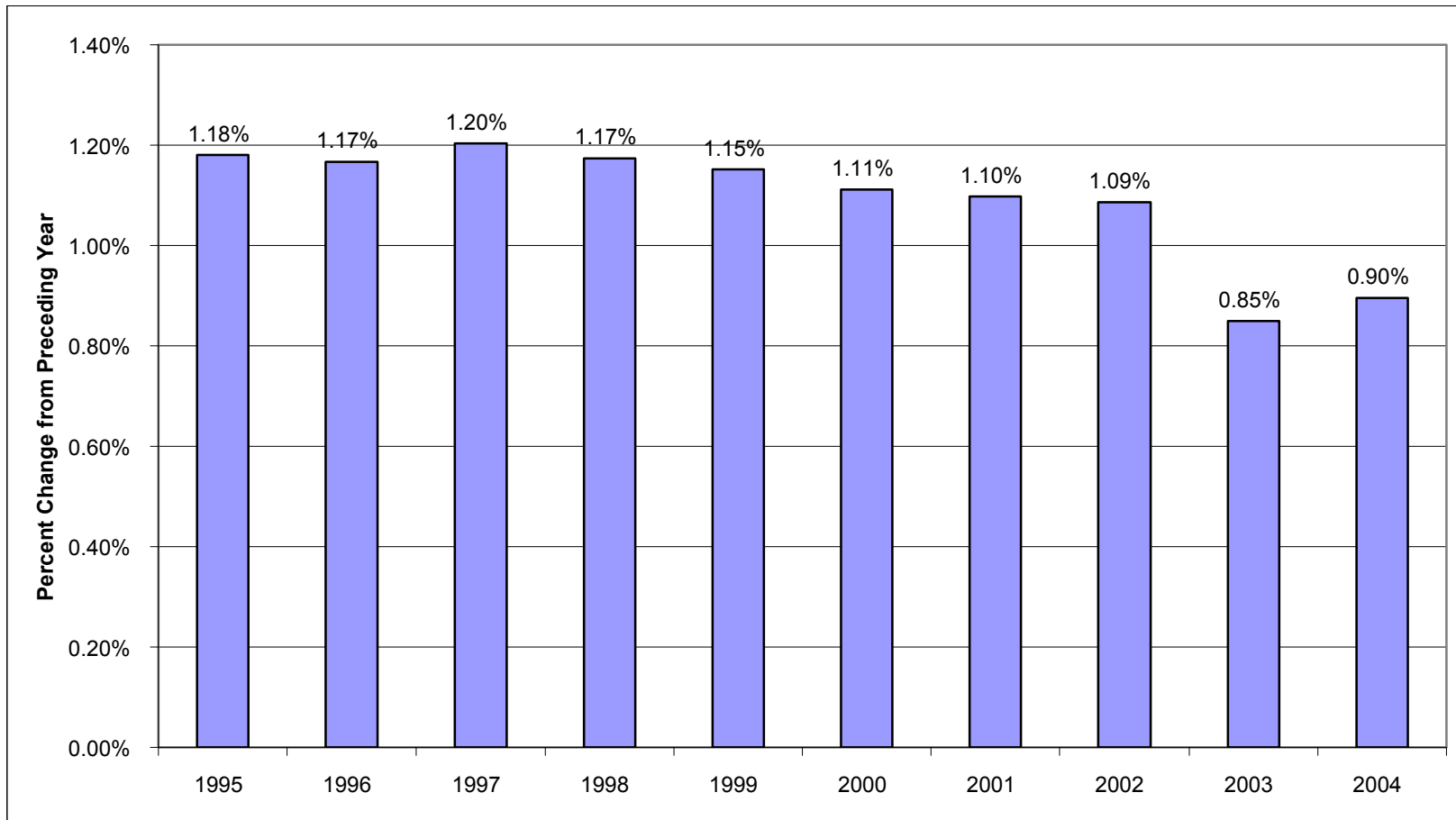
The International Textiles and Clothing Bureau

4-7 April, 2005

Bali, Indonesia

CHART 1

U.S. POPULATION GROWTH RATES, 1995-2004



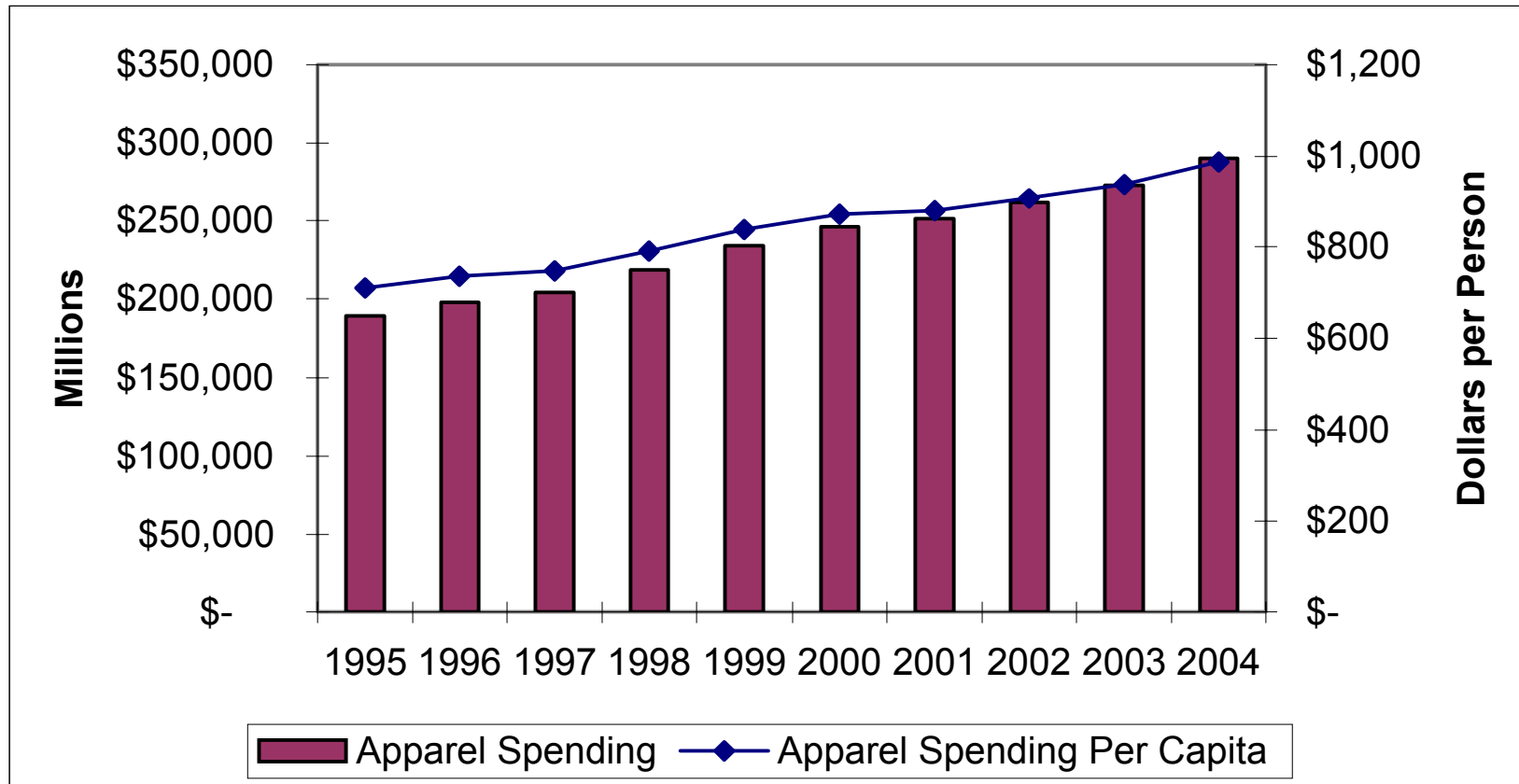
SOURCE: U.S. CENSUS BUREAU

AVERAGE ANNUAL RATE OF GROWTH, 1995-2004 = 1.08%

2004 LEVEL = 293.7 million people

CHART 2

REAL GROWTH IN THE U.S. APPAREL MARKET (2000 Dollars), 1995-2004: TOTAL PURCHASES, LEFT SCALE SPENDING PER PERSON, RIGHT SCALE



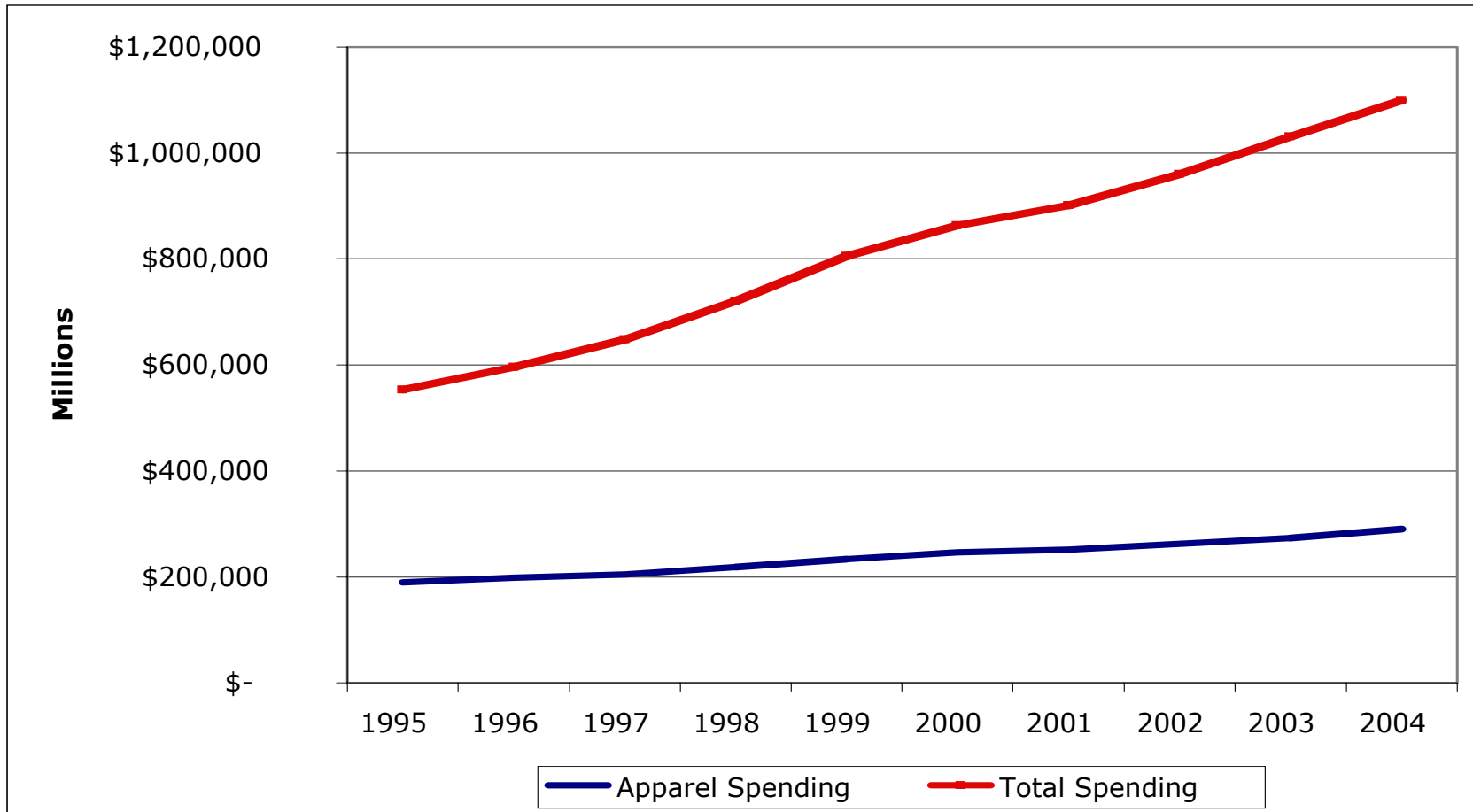
SOURCE: Derived from U.S. Census data. PCE – personal consumption expenditures (“spending”)

Increase in total apparel spending, 4.9 percent per year, 2000 dollars

Apparel spending per person, 1995 = \$710; Apparel spending per person, 2004 = \$988

CHART 3

TOTAL AMERICAN CONSUMER SPENDING VS. SPENDING ON APPAREL, 1995-2004

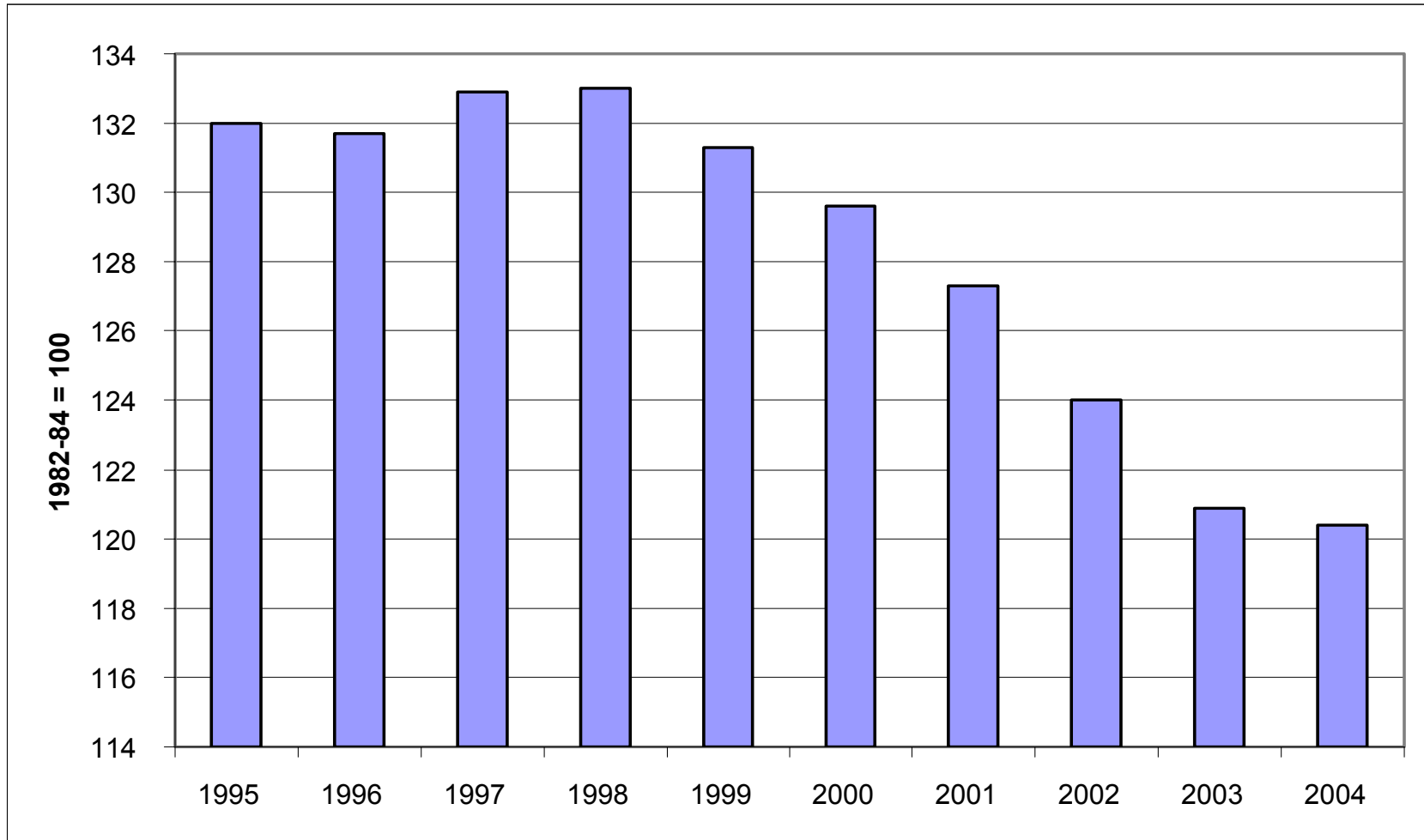


SOURCE: Bureau of Economic Analysis, U.S. Department of Commerce

Apparel's share of total spending in 1995: 34.2% Apparel's share of total spending in 2004: 26.4%

CHART 4

U.S. APPAREL PRICES (CONSUMER PRICE INDEX)



SOURCE: Bureau of Labor Statistics