



Save money. Live better.™

Walmart Jobs and Opportunity Zones Program Consumer Trends Report July 2008

ABSTRACT

Wal-Mart Stores, Inc. has produced this Consumer Trends Report to provide neighboring small business owners with insight into changing general economic trends. The report provides an overview of the current economic landscape, including information on: fuel prices and consumer purchasing power; food, flooding and fuel; and the 2008 presidential election. This report is part of the Walmart Jobs and Opportunity (JOZ) program designed to spur economic growth in 10 select cities nationwide. Key findings include:

- **Economic Landscape:** *Many economists believe the current state of inflation, depressed home values, increased unemployment and looming recession will last well into 2009, and many consumers will continue to watch their discretionary spending.*
- **Fuel Prices and Purchasing Power:** *The average regular-grade gasoline price is projected to remain above \$4 per gallon until the fourth quarter of 2009 and will remain a key factor in consumer confidence and purchasing power.*
- **Food, Flooding and Fuel:** *Food and oil prices often fluctuate in unison, and, therefore, it is undeniable that the continued climb of oil prices in tandem with the government's incentives for ethanol production had a "domino" effect on the country's food chain. As a result, the cost of raw materials needed for food production has increased, ethanol production has eaten into the nation's corn supply, and consumers are consequently paying more for everything from milk to meat.*
- **2008 Presidential Election:** *The 2008 candidates have both established plans to address concerns of the small business community, including health care, fuel efficiency, tax deductions and access to capital. In addition, these plans will result in job creation and financial relief for consumers.*

Introduction

Wal-Mart Stores, Inc. has created this annual “Walmart Trends Report” for use exclusively with the small business community in our JOZ zones. This is the second installment of the JOZ Consumer Trends report.

The data and analysis in this report breaks down key trends that may be of interest to small businesses across the country. A number of factors are examined including the current economic landscape. We hope this annual report will assist small businesses across the country and allow business owners to better tailor their goods and services to meet the needs and wants of their shoppers.

Economic Landscape

In the past several months, Americans have been faced with an unstable subprime lending situation, oil-price inflation, and a national rise in unemployment—all of which have brought the U.S. economy to a near recession. Consumers and small businesses alike have been impacted by the changing tide in the economy. Consumers are tightening their purse strings and altering their spending habits, and retailers, marketers and investors have been left to try to understand and accommodate consumers’ new habits.

As Americans face a continued rise in oil prices, low surplus production, and the concern that global supply may not meet the growth demand, the world’s oil consumption—driven by demand in emerging economies—continues to climb. The steady increase in retail gasoline prices has impacted American families, regardless of their preferred mode of transportation. Unfortunately, America’s “pain at the pump” will not end anytime soon, according to the U.S. Government’s Energy Information Administration. In fact, the U.S. average regular-grade gasoline price is projected to remain above \$4 per gallon until the fourth quarter of 2009¹.

As a result of rising gas prices, nearly two-thirds—63 percent—of consumers are cutting back on their spending, according to a recent survey released by Nielsen Co. This figure is up 18 percentage points from a year ago². More specifically, the study also showed that 78 percent of people surveyed are combining shopping trips to save fuel and 52 percent are eating outside of the house less often. Americans are also cutting more coupons, shopping at big-box retailers more frequently and buying less expensive brands.

Additionally, the rapidly-rising cost of natural gas, which is used for power generation, is driving up electricity prices. As a result, residential electricity prices are projected to increase by an annual average of approximately 5.2 percent in 2008 and 9.8 percent in 2009 compared to a 2.2 percent increase in 2007³. However, according to the Small Business Administration, small firms are among the hardest hit by rising energy costs.

Many economists believe the current conditions will last well into 2009 and that consumers will continue to exercise frugality in their shopping habits. Although discretionary spending is a

¹ Energy Information Administration, Short-term Energy Outlook, June 8, 2008, <http://www.eia.doe.gov/steo>

² Nielson Co., Rising Gas Prices Force Nearly Two-Thirds of U.S. Consumers to Put the Brakes on Discretionary Spending, July 17, 2008, http://www.nielson.com/media/2008/pr_080717.html

³ Energy Information Administration, Short-term Energy Outlook, June 8, 2008, <http://www.eia.doe.gov/steo>

particular challenge for low and middle-income Americans, affluent customers are also looking for ways to save money. During a slowing economy it pays to be a discounter, as many consumers are heading to wholesale retailers like Sam's Club and Costco.

The Gas Effect

The historic increase in oil prices continues to impact today's economy. While some believe the effects are positive, providing Americans the opportunity to make behavioral changes such as developing money saving habits, monitoring their discretionary spending, utilizing various transportation options and going "green," the majority feel that high oil prices are negatively impacting the economy and our nation's ability to compete on a global scale.

Economists have concluded that the rise in oil prices and other commodities have been a major factor in the decline of stock prices. As a result, U.S. corporate profits could be negatively impacted, even when these corporations institute a plan to protect themselves against energy inflation. This is particularly true for those who ship goods. The increased cost of fuel has encouraged some to alternate behavior, for example switching from trucks to train, using compact packaging to allow more items to be shipped at once; purchasing goods closer to home; or forgoing buying the products all together. Together, these factors are decreasing the demand for trucking services.

The increase in fuel costs and the economy's unstable foundation also forced a marked change in consumers' confidence and purchasing power. Now, consumer confidence is more related to fuel prices than any other indicator, and is a reason for economic struggles for many Americans. While all Americans may begin to adjust their spending habits to compensate for the increase in prices, the impact is not uniformly felt by all consumers⁴.

A *USA Today*/Gallup Poll conducted in March 2008 demonstrates that nearly two in three American families are dealing with financial hardships due to the increase in gas prices⁵, particularly those who reside in rural America. Consumers nationwide are spending 4 percent of their income on gasoline; however, those in areas such as the Mississippi Delta are spending more than 13 percent⁶. In fact, a survey conducted last month by Oil Price Information Service, a fuel analysis firm, concluded that the gasoline crisis is taking a larger percent of Americans' income in rural areas of the South, New Mexico, Montana, Wyoming and North and South Dakotas. Americans in the Northeast have been less affected by the increase in fuel prices due to their larger average income, shorter driving distances and alternative modes of transportation, such as buses and trains.

Despite the fact that fuel costs are increasing, consumers' gas consumption has not decreased. In the last year, the cost of gas has increased by 15 percent, and gas consumption has also increased by 1 percent during the same timeframe⁷. To help alleviate the "pain at the pump," consumers have instead changed their lifestyles in other ways. For instance, many people are

⁴ *New York Times*, Rural U.S. Takes Worst Hit as Gas Tops \$4 Average, July 25, 2008

⁵ Gallup, Americans Expect Gas Prices to Increase by 21% This Year, March 24, 2008, <http://www.gallup.com/poll/105583/Americans-Expect-Gas-Prices-Increase-21-Year.aspx>

⁶ *New York Times*, Rural U.S. Takes Worst Hit as Gas Tops \$4 Average, July 25, 2008

⁷ CATO Institute, Paying More than Ever for Gas?: Not if Buying Power is Considered, June 1, 2007

reconsidering both daily and long-term discretionary expenses—from the cup of coffee in the morning to new car purchases and summer vacations.

Indeed, with gas prices increasing the cost of travel, many Americans are either taking vacations closer to home or omitting them all together. The most recent example is the 2008 Fourth of July holiday. A survey conducted June 3-10, 2008 by the National Retail Federations found that 60 percent of consumers said gas prices would impact their vacation spending for the holiday, compared to 42.1 percent of consumers last year⁸. However, this popular thought has not affected all consumers. According to the Travel Industry Association and Ypartnership survey, 60 percent of Americans surveyed will not be changing their summer vacation plans because of the increasing fuel prices⁹.

Food, Flooding and Fuel

Americans are continuing to feel the pinch of rising food costs and some are attributing the price increases to government mandates on bio-fuel production. The Environmental Protection Agency (EPA) allocates one-third of the nation's corn supply to manufacturing ethanol, and the devastating flooding in the Midwest has pushed that number even higher¹⁰.

The use of corn in ethanol production has led to higher corn prices, especially feed corn. The price of corn and soybeans are the biggest costs of raising livestock, so the increased prices are then passed on to consumers. The Economic Research Service of the U.S. Department of Agriculture (USDA) estimates that grocery prices will climb at least 3 to 4 percent in 2008¹¹. Already, the price of eggs has increased 29 percent and the price of dairy products as a whole increased more than 7 percent during 2007. As a result, restaurants are also making the difficult decision to raise their menu prices to compensate for what it now costs to make a meal. For example, the Palm restaurant chain recently increased the price of their New York strip steak by \$2¹².

June flooding in the two top corn-growing states, Iowa and Illinois, has also contributed to rising food costs. According to the USDA's acreage report, farmers planted 87.3 million acres of corn and will harvest 78.9 million¹³. Despite the flooding, this is still the second largest harvest in the last six decades. Generally, food prices rise in the wake of bad weather, and the floods hit just in time to drive the cost of corn to \$8 per bushel at the Chicago Board of Trade.¹⁴

The EPA has mandated that a certain amount of corn be blended into the country's fuel supply in order to quell rising gas prices. As a result, the amount of oil being used has decreased by 440,000 gallons each day – causing the price of oil to remain somewhat in check¹⁵. If ethanol

⁸ National Retail Federation, 2008 Independence Day Consumer Intentions and Action Survey, June 17, 2008, http://www.nrf.com/modules.php?name=News&op=viewlive&sp_id=537

⁹ Travel Industry Association and YPartnership, Travelhorizons™ Survey, May 7, 2008, <http://www.tia.org/pressmedia/pressrec.asp?Item=890>

¹⁰ The American Meat Institute, Midwest Flooding and Record Corn Prices Lead Experts to Urge EPA to Address Food Inflation Crisis, June 19, 2008

¹¹ *The Boston Globe*, Surging Groceries Hit Home, March 3, 2008

¹² *The Washington Post*, The Rising Tide of Corn, June 15, 2007

¹³ U.S. Department of Agriculture, USDA Report Assesses 2008 Corn and Soybean Acreage, June 30, 2008

¹⁴ MSNBC, Midwest Floods Feed Grain Price Inflation, June 17, 2008

¹⁵ CNNMoney.com, Floods Have Sent Corn Skyrocketing, May Drive Up Gas, June 13, 2008

use were to decrease, farmers may experience higher diesel prices and the cost of food would still continue to rise.

Some elected officials and business leaders have called for the ethanol quota to be lifted in light of the flooding and climbing food prices. Others suggest lifting the ethanol tariff, which is designed to benefit American farmers who are already receiving a bump with the high corn prices¹⁶. Finally, critics of ethanol point to the fact that it takes seven gallons of oil to produce 10 gallons of ethanol – which they argue is not a large enough trade-off to support its production¹⁷. The United Corn Growers Association believes the cost of corn will level off simply because farmers are planting more acreage to respond to the demand¹⁸. As the supply increases, the lower cost per bushel should help ease rising food prices.

Salmonella Outbreaks

Produce growers have also suffered significant financial losses in light of a few recent food contamination scares, including the recent salmonella outbreak that is still impacting the tomato and jalapeno industries. Since April, more than 1,200 people have been affected with the Salmonella Saintpaul outbreak, caused by a strain originally linked with red plum, round and Roma tomatoes¹⁹. In late July, the Federal Drug Administration lifted the warning against tomatoes after failing to find a source, but then found a genetic match to the Salmonella strain on a jalapeno in Texas.

The United States produces \$1.28 billion worth of tomatoes every year. The National Restaurant Association estimates that the salmonella outbreak will cost the food industry at least \$100 million this year. Some tomato growers predict losses could total closer to \$250 million²⁰. With jalapenos now being added to the list of produce contaminated in the outbreak, it is unclear how this industry will also be impacted.

The FDA is not ruling out the possibility that tomatoes played a role in the spread of the Salmonella strain, in part because tomatoes, jalapenos, tomatillos and other produce are often all stored in the same warehouses²¹. Restaurants that serve both tomatoes and jalapenos, such as Chipotle Mexican Grill Inc. and Qdoba Restaurant Corporation, now have to adapt to another set of warnings. For instance, when tomatoes were considered unsafe, Chipotle suggested that patrons try their corn salsa. Now, they must look to alternative sauce that does not contain jalapenos²².

The Produce Marketing Association is concerned that tomato sales will not rebound after the outbreak. A survey conducted by the group reported that 65 percent of consumers are choosing not to buy tomatoes²³. States whose crops were FDA-approved still struggled as stores refused to accept them. Some tomato growers have banded together to lobby Congress to pass

¹⁶ Ebit.

¹⁷ *BusinessWeek*, Food vs. Fuel: As Energy Demands Devour Crops Once Meat for Sustenance, the Economics of Agriculture are being Rewritten, February 5, 2007

¹⁸ *The Washington Post*, The Rising Tide of Corn, June 15, 2007

¹⁹ *New York Times*, Warning on Tomatoes is Withdrawn, July 18, 2008

²⁰ *The Baltimore Sun*, Tomato Warning Protested, July 15, 2008

²¹ *The Washington Post*, Salmonella-Tainted Jalapeno Found in Texas, July 22, 2008

²² *The Baltimore Sun*, Tomato Warning Protest, July 15, 2008

²³ *USA Today*, FDA, produce industry talk safety measures for future, July 7, 2008

legislation to compensate them for their losses, which they blame in part on how the FDA handled the investigation²⁴. The Western Growers Association has alleged that while the FDA was very quick and vocal in telling consumers to stop eating a product, it was much more passive in letting people know when the warning expired.

Tomato growers are concerned that the 2006 E. coli outbreak in spinach is still on the minds of some consumers and they consequently are unwilling to take a chance on tomatoes in this instance. The E. coli outbreak decimated the spinach industry as people found temporary substitutes to the leafy green, and continued to buy them instead of spinach even after the FDA warning was lifted. At the time, it was estimated the spinach industry lost close to \$75 million and some feel that the effects still linger today²⁵. However, most industry experts believe the tomato industry should rebound more quickly because it is more difficult for consumers to find an alternative.

Oil Prices and the Food Chain

As discussed, the government's increased focus on ethanol coupled with soaring oil prices has driven up the price of food drastically. The entire food industry is affected from production to sale, and it isn't limited to one type of food. The rise in oil prices is having varied consequences and causing many kinks in the food chain.

In the South, catfish farms are emptying their ponds as the price of the soybean and corn feed they use continues to climb. In Mississippi, Dillard & Company raised 11 million catfish, but next year they will sell none. The company, founded in the late 1960s, will lay off their 55 employees²⁶. Stories like this are not uncommon as the price of some grocery staples has risen as much as 20 percent since 2006²⁷.

The rising cost of fuel is also making it more expensive for farmers to operate the machinery necessary to plant, fertilize, harvest and ship their crops. In addition, the costs of key inputs, such as fertilizer, pesticides and packaging, are increasing because they are petroleum-based. Growers now must sell their goods for more to make up for the increased production costs, and shipping companies are passing on the higher diesel prices to consumers. The U.S. Department of Agriculture's index of all crop prices has increased 44 percent since January 2007²⁸. As a result, the amount the consumer pays for a cart of groceries is becoming significantly more burdensome.

The relationship between food and oil prices is evidenced by the fact that the two often fluctuate in unison. When the price of crude oil dropped and favorable weather was predicted for the Midwest, grain prices dipped in the agriculture markets as well²⁹. It is undeniable that the continued climb of oil prices in tandem with the government's funneling of corn into ethanol production has had a "domino" effect that has been felt throughout the country's food chain. As

²⁴ *The Baltimore Sun*, Tomato Warning Protest, July 15, 2008

²⁵ Associated Press, Spinach Industry Still Hurt from Recall, October 21, 2006

²⁶ *The New York Times*, The Food Chain –As Price of Grain Rises, Catfish Farms Dry Up, July 18, 2008

²⁷ *San Diego Union*, Soaring Fuel Costs take Huge Bite out of Grocery, Farm Budgets, July 15, 2008

²⁸ FarmPolicy.com, Food Prices, Doha, and the Farm Bill, July 9, 2008, <<http://www.farmpolicy.com/?p=827>>

²⁹ FarmPolicy.com, Food Prices, Doha, and the Farm Bill, July 9, 2008, <<http://www.farmpolicy.com/?p=827>>

the cost to produce the food that feeds the nation rises, people will inevitably have to pay more to eat.

Impact of the Upcoming Presidential Elections

The 2008 presidential election has broken several records and set many precedents. Senators John McCain (R-AZ) and Barack Obama (D-IL) will square-off in one of the most monumental races, which for the first time in more than 50 years, does not include an incumbent president or former vice president. It is also the first time in history that two U.S. senators have faced off in a presidential general election. In addition, Sen. Obama is the first African-American presidential candidate in the nation's history. If elected, Sen. McCain will be the oldest man to ascend to the presidency. Clearly, America is witnessing history in the making.

The outcome of the 2008 presidential election will undoubtedly impact the small business community and economy as a whole. Both candidates offer unique perspectives on how to handle our current economic struggles, and they will continue to develop their individual platforms following the parties' nominating conventions in August 2008.

*** Wal-Mart is not endorsing any candidate**

McCain on Small Business

Sen. McCain plans to help small businesses by easing the burden of high gas prices, keeping taxes low and providing tax deductions on equipment and technology³⁰.

The climbing cost of fuel has impacted not only American families, but has also hit small businesses especially hard, as transportation costs and basic grocery staples continue to increase. Sen. McCain urged Congress to enact a Summer Gas Tax Holiday, which would have suspended the 18.4 cent federal gas tax and 24.4 cent diesel tax from Memorial Day to Labor Day. He also believes the United States should stop contributing to the well-stocked Strategic Petroleum Reserve because it bolsters demand, consequently raising gas prices. Finally, McCain would lift ethanol subsidies, tariff barriers and sugar quotas that drive up the cost of food in an effort to produce more alternative fuels.

Sen. McCain believes low taxes encourage the American entrepreneurial spirit, and will maintain the current income and investment tax rates. He opposes the tax increases proposed by some Democrats that would go into effect in 2011. Additionally, in an effort to keep taxes low, McCain proposes a three-fifths vote in Congress on any tax measure. To promote innovation, he would ban any new taxes on the Internet and cell phones.

McCain also encourages Americans to grow small businesses by permitting them to immediately deduct equipment and technology investments. Additionally, he supports the establishment of a permanent research and development tax credit that is equal to 10 percent of wages dedicated for this purpose.

³⁰ John McCain for President, Economic Plan, <<http://www.johnmccain.com/Informing/Issues/4dbd2cc7-890e-47f1882f-b8fc4cfec78.htm>>

Finally, Sen. McCain would work to change the current health care system in order to move away from strictly employer-based plans. This could help small businesses provide enhanced health care for their employees at a lower cost to them.

Obama on Small Business

Sen. Obama proposes helping America's small businesses succeed by lowering the cost of health care for their employees, making it easier to access capital and investing in research and development³¹. To encourage entrepreneurship and innovation, Obama wants to double federal funding for research, diversify energy sources and expand broadband technology. He also supports making the research and development tax credit permanent. To help small businesses work together to solve common challenges, he proposes a network of public-private business incubators that would share knowledge and ideas.

To lower the cost of insuring small business employees, Obama supports a Small Business Health Tax Credit, which would refund up to 50 percent on premiums that businesses pay on behalf of their workers. His national health care platform would also allow small businesses to purchase plans through a national exchange that would spread risk and administrative costs over a larger pool – lowering health care expenses. The Obama health care plan would also reimburse small business health plans for a portion of any catastrophic costs they incur so long as they guarantee the savings are used to keep employees' premiums low. Finally, Obama encourages the implementation of cost-saving measures that would impact the health care industry on a large scale, such as digitizing medical records and improving chronic care management.

In light of rising health care and energy costs, Sen. Obama supports the expansion of loan programs to small businesses in order to increase their access to capital. He also cosponsored the Small Business Lending Reauthorization and Improvements Act to help accomplish this objective. Obama also proposes eliminating capital gains taxes for small and start-up businesses to encourage the enterprising ideas and job creation.

Key Political Dates

- Democratic National Convention: August 25-28 in Denver, Co.
- Republican National Convention: September 1-4 in Minneapolis, Minn.
- Presidential General Election: November 4
- Electoral College Meets: December 15
- Presidential Inauguration: January 20, 2009 in Washington, D.C.

³¹ Barack Obama for President, Small Business Plan,
<<http://www.barackobama.com/pdf/SmallBusinessFINAL.pdf>>

Looking Ahead

According to the government, economists and several surveys and studies, the nation's immediate economic outlook remains dismal. Although there are conflicting opinions on whether the current economic state—particularly in terms of the rising fuel cost and its effect on other goods and services—is helping or hurting Americans and businesses, consumers are making the best of their situation by examining their overall spending habits. They are adjusting their lifestyles by making small behavioral changes, such as using coupons, purchasing private-label products and taking vacations closer to home. These trends are expected to continue throughout 2008 and well into 2009 as fuel prices are predicted to remain higher than usual.

###