

# Price Increases on Fashion's Horizon

by [EVAN CLARK](#)

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The fashion industry could face an inflationary environment for the first time in many years.

Photo By Nick Koudis/Getty Images

If the economic recovery stays on track, the fashion world just might have to adjust to something it hasn't seen in almost two decades: inflation.

The upward swing in prices would mark a stark turnaround from the steady slide in costs that has been the industry norm as retailers and suppliers found ever-less-expensive sources of supply. But with wage pressures rising in China, raw materials prices climbing and demand beginning to recover worldwide from both consumers and manufacturers, there is a growing sense deflationary pressures could be easing and its opposite might begin to take hold.

Retail executives, at least, see that as a hopeful sign.

"Deflation for the last decade-plus has not been particularly helpful for retailers," said Myron E. "Mike" Ullman 3rd, chairman and chief executive officer of J.C. Penney Co. Inc. and a board member of the Federal Reserve Bank of Dallas. "A little bit of inflation wouldn't be a bad thing for retailers as businesses, but obviously, too much inflation isn't good."

Ullman noted asset values also go up with prices, providing a bit of a silver lining.

With the economy still finding its footing, prices are generally expected to hold steady this year. "With substantial resource slack continuing to restrain cost pressures and longer-term inflation expectations stable, inflation is likely to be subdued for some time," the Federal Reserve

Board said Tuesday.

"I don't think there's too much risk of inflation in the near term for the economy," Ullman concurred. Penney's has extensive sourcing operations, which the ceo said would insulate the chain from some of the pricing pressures working their way through the supply chain.

Executives at a WWD Sourcing and Supply Chain Forum Tuesday, including Michael McBreen, president of Wolverine Worldwide Inc.'s global operations group, said their costs were increasing, but they weren't sure when they would be able to pass those higher costs up the supply chain. Executives also pointed to the growing dichotomy in the global economy: inflation in producing countries in Asia banging up against continuing deflationary pressures in consuming nations in the West.

It is not clear how consumers, who have been trained by everyday low pricing and a years-long parade of sales signs and clearance events, would react to steeper prices. For the crop of shoppers just finishing high school and shaping fashion trends, declining apparel prices have been a constant in their lives.

In the 17 years since U.S. apparel prices hit their high, retail consolidation, the nearly uninterrupted rise in the dominance of Wal-Mart Stores Inc., competition from big-box formats and online concepts, low-cost sourcing and loosening trade restrictions have combined to push prices down in all but two years: 1997 and 2009.

And although tighter inventories helped retailers hold the line on discounts last year, pushing apparel prices up 0.6 percent, price tags on all types of apparel were still 20.4 percent below 1992 levels, according to Commerce Department figures. In contrast, prices on all goods and services shot up 41.9 percent.

Some producers believe prices will rise again as rebounding consumer demand in the U.S. and growth in developing markets such as China and Russia overwhelm the capacity of factories. The economy at large also could begin to see inflation next year or beyond as the billions the government spent to fight the financial crisis works its way through the system.

But — and there's always a "but" in the world of economic forecasting — before prices rise enough to make inflation a problem, the recovery needs to gain enough traction to avoid a deflationary spiral, which remains a dangerous yet remote possibility.

"If I had to say which was the bigger concern in the near term, I would probably say deflation," said Scott Hoyt, senior director of consumer economics at Moody's Economy.com.

Price declines likely would be tied to another contraction in the economy — a double-dip recession — but Hoyt noted the economy and consumer spending are growing — albeit slowly — and employment gains are expected soon. Retail stocks recently hit highs not seen since 2007 as investors bet that stronger-than-hoped-for February comparable-store sales signaled a spending thaw.

"If the economy were to double dip, I'd be panicked about deflation," Hoyt said. "As long as the recovery proceeds as anticipated, while [deflation] may be the larger risk, I don't think it's a severe one. I don't think the risks of a double dip are so high."

That's a good thing. Deflationary spirals sap the strength from an economy and can be self-sustaining, as Japan illustrated with its "Lost Decade." Also, central bankers don't have a clear tool to fight falling prices. "It's a problem that policy makers really don't know how to fix," Hoyt said.

Inflation, at least, is a threat the Fed knows how to fight. As prices creep up, the Fed, led by chairman Ben Bernanke, is expected to ratchet up interest rates, which will slow economic growth and counter inflation.

"Inflation is at least a year away," said Phillip Swagel, former assistant secretary for economic policy at the Treasury Department and a visiting professor of finance at Georgetown University.

Swagel, who advised Treasury Secretary Henry Paulson Jr. as the Bush administration scrambled to shore up banks during the financial crisis, said overall prices for consumers could rise 3 to 5 percent — more than the U.S. is used to, but manageable.

When it comes to raising prices, luxury stores might find they have more traction.

"It's really the higher end where you're going to have more inflation," Swagel said, noting less expensive apparel would continue to benefit from productivity gains in sourcing. "As parts of China and other emerging markets get richer, there's naturally going to be more demand of high-end apparel, and that should lead to upward pricing pressure."

No matter how much retailers would like to perk up their profits by charging more, prices will be set by how much apparel is produced, how efficiently it can be made and what consumers are willing to pay for it.

"We've had a very bad two years of demand and a lot of factories contracted," said Bruce Rockowitz, president of Hong Kong sourcing giant Li & Fung Ltd. "They've released a lot of workers and they're struggling to get the workers back. Wages are definitely going up for factory workers. There's been a contraction of supply and there was a contraction of demand, but demand is starting to improve."

Raw materials are also becoming more expensive. Cotton prices in February were up 47.6 percent from a year earlier and the price of crude oil had nearly doubled. Polyester and synthetic fibers, however, saw modest declines.

Rockowitz also questioned the notion that goods could continue to be made for less by opening up new sourcing markets.

"In the long term, there's no real new countries of production coming online," he said. "We don't have another China."

Of course, producers up and down the supply chain make an effort to tout the pricing pressures they're feeling in hopes that will make it easier for them to charge their own customers more. But there is a growing realization all the way up to the

retailer that prices can't fall forever.

"I think you'll see some increase in regular-price business," said Arnold Aronson, managing director of retail strategies at Kurt Salmon Associates and former ceo at Saks. "Companies are buying less inventory. They're creating some scarcity and demand for product when it's on the shelves."

Higher prices also could lead to a stronger merchandise assortment.

"It certainly gives people a little bit of a cushion and there can be more money put into R&D," Aronson said. "There can be more innovation and fabrication and maybe some intelligent risk taking so the sameness can be interrupted by some newness."