

2018

GLOBAL
FOOTWEAR
SOURCING
ASSESSMENT



FOOTWEAR DISTRIBUTORS AND RETAILERS OF AMERICA

Sourcing Shifts in an Age of Trump Tariff Threats

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This sourcing assessment presents a review of current footwear production and price trends and a look ahead as a tale of two markets, contrasting these dichotomies between footwear suppliers, retailers, and consumers.



Intro/Overview—The State of Footwear Sourcing

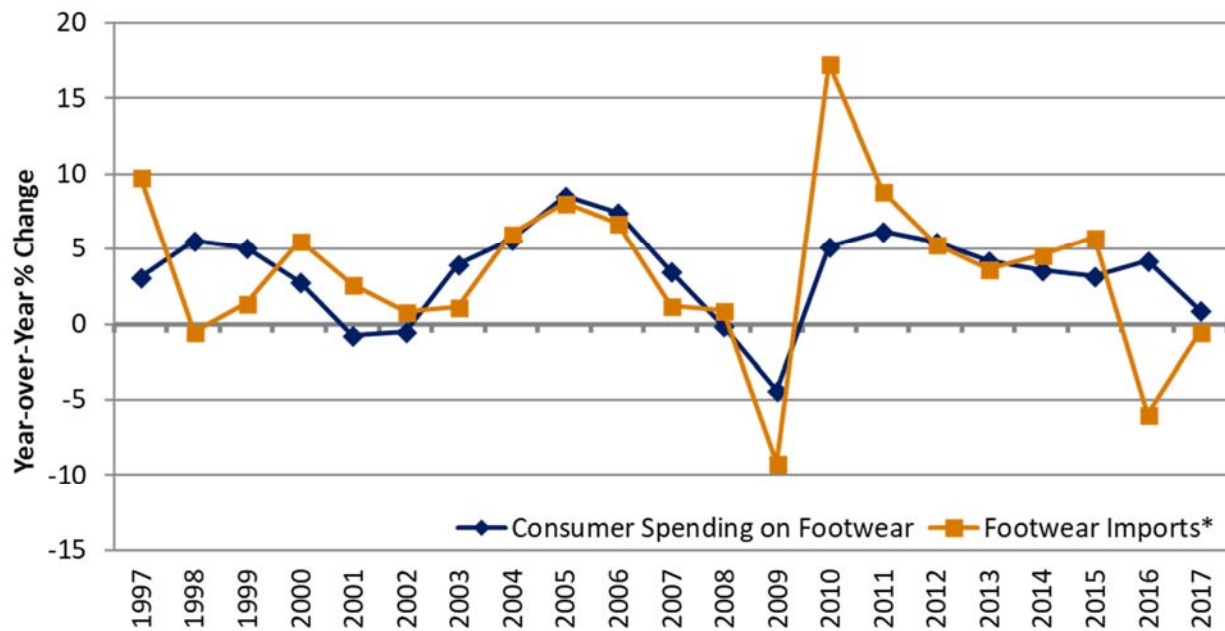
A gyrating dollar. Woozy equities markets. Rising interest rates. Rapid-fire policy edicts promulgated in 140 characters. Traditional trading pacts rebuffed and renegotiated. Friendly summits with recent foes, but new consternation with old allies. Regardless of one's politics, few would deny that the current political and economic climate is unlike anything in recent memory.

Along with other sectors, the US footwear industry is swept into this tumultuous tempest, fraught with issues including record duties but lower retail prices, flat demand that is weighing on employment, and looming tariff troubles with our largest foreign supplier. In this latest edition of FDRA's annual *Sourcing Assessment* we revisit and examine issues and present a look to future sourcing shifts in *the age of Trump tariff threats*.

State of US Footwear Imports

Change is coming fast and furious in the world of global footwear sourcing, as the viability of different suppliers' ebbs and flows, trade trends migrate, and consumer demand evolves. US shoppers remain wholly dependent on—and committed to—foreign footwear, given that imports account for more than 98% of retail footwear sales. But with American spending on footwear mostly flat in 2017, imports similarly remain on the defensive, retreating for the second straight year (chart 1). In fact, at some 2.4 billion pairs, total footwear imports remain little changed over the last *dozen* years. But these patterns of dull spending and mostly flat imports mask a sea change of evolving issues just under the surface.

CHART 1:
DULL FOOTWEAR DEMAND KEEPS IMPORTS FLAT IN 2017



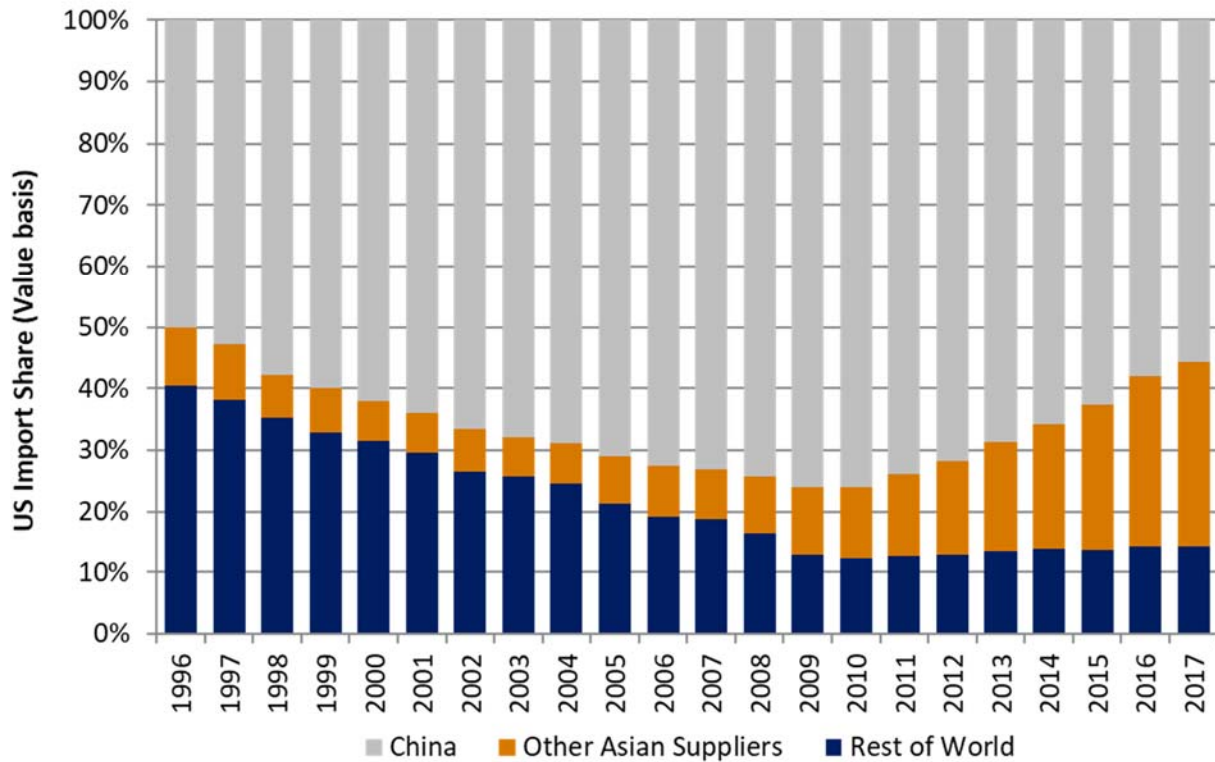
Sources: BEA & USITC

* Value basis.



In particular, China's long-dominant share of US footwear imports continues to erode, largely offset by surging shipments from second-place Vietnam. **To be clear, China remains far and away America's largest supplier of footwear, accounting for 71% of the volume and 56% of the value of imports.** But these shares are on track to fade for the eighth straight year, shrinking to the lowest in two decades (chart 2). Much—but not all—of the lost trade has moved to rising tiger Vietnam, now accounting for more than one in six pairs of shoes imported into the US.

**CHART 2:
CHINA LOSES SHARE OF US FOOTWEAR IMPORTS TO OTHER ASIAN SUPPLIERS**

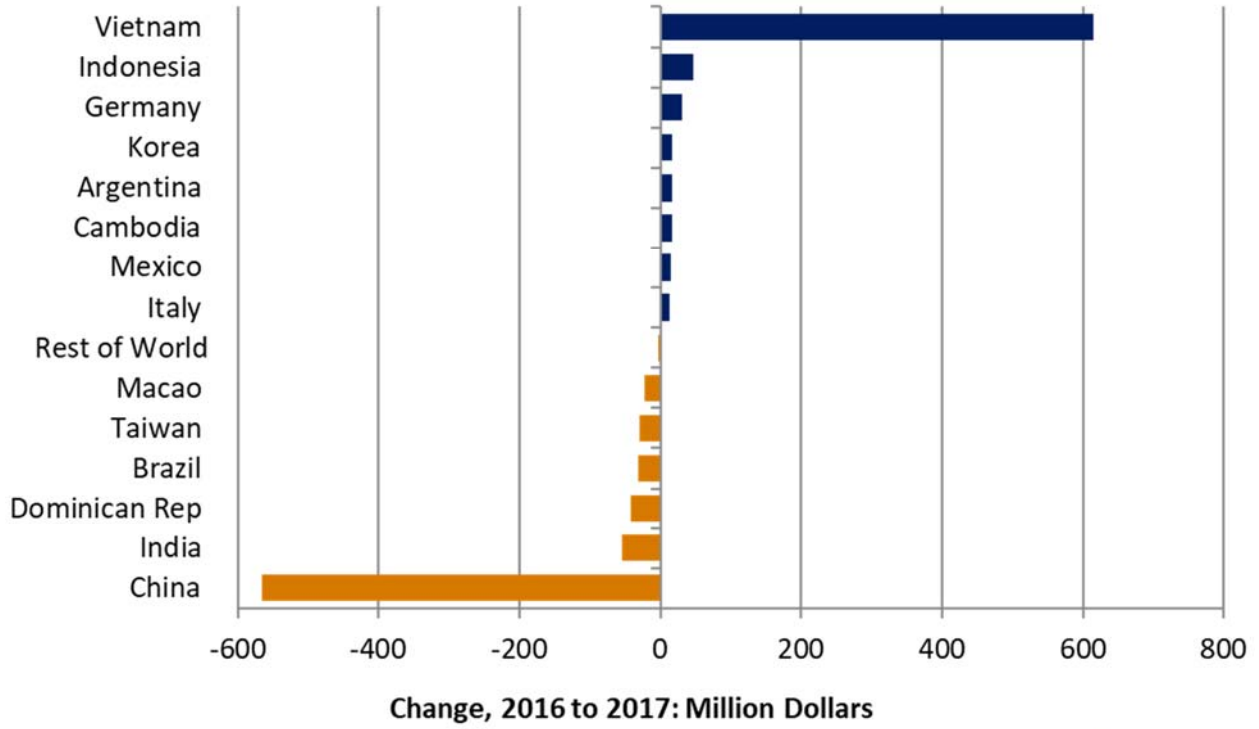


Source: USITC



While shipments into the US from China continue to dwarf the volume imported from Vietnam, we note again that in 2017 surging imports from Vietnam offset lost Chinese volume about one-to-one. More particularly, while the value of Chinese footwear washing ashore sank \$566 million in 2017, the value of shipments from Vietnam surged more than \$614 million to a record \$5.4 billion, more than displacing the lost Chinese trade. In fact, as Chart 3 below demonstrates, this continued evolution of footwear sourcing from China to Vietnam was an overriding theme impacting supply chains last year. Looking ahead, we expect these dominant trends will persist over at least the five-year forecast horizon: China remains the preeminent—if receding—supplier to America, while other Asian suppliers—led by Vietnam—continue gradually taking share.

**CHART 3:
DOMINANT THEME OF US FOOTWEAR IMPORTS IN 2017: FROM CHINA TO VIETNAM**

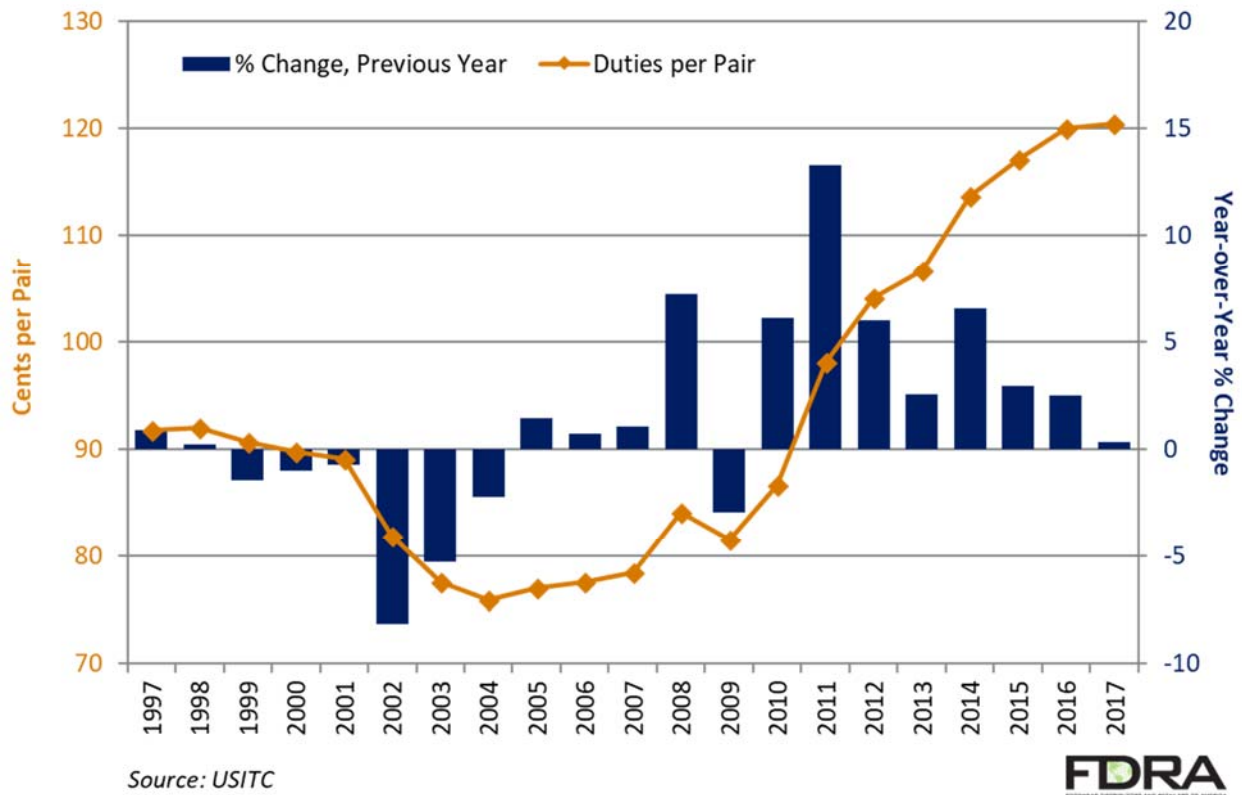


Source: USITC



A second key issue for the industry has been rising tariffs charged on footwear imports. At \$2.85 billion, footwear duties rose 5.8%, reaching within a whisker of the 2015 record. Given that the volume of footwear imports has been mostly flat the last several years, the average *duty per pair* rose for the eighth straight year to a record \$1.20 in 2017 (chart 4). What's more, year-to-date data suggest the average duty per pair will climb again in 2018 to another unprecedented, and unwelcome, high.

**CHART 4:
AVERAGE DUTIES PER PAIR RISE AGAIN TO ANOTHER RECORD IN 2017**



The Office of the US Trade Representative (USTR) says the United States currently has a trade-weighted average import tariff rate of 2.0% on industrial (non-agricultural) goods, and that one-half of all industrial goods entering the United States enter duty free. At the same time, the average duty rate on US footwear imports reached an eye-watering 11.2% in 2017, higher each of the last eight years. This wide gap implies that footwear importers, retailers, and consumers are forced to bear an unduly burdensome share of US tariffs. What's more, both average duties per pair and average duty rates on footwear imports have risen each of the last few years to their current records, suggesting this already-burdensome weight on the industry has grown even heavier, crimping demand and profitability along the supply chain.



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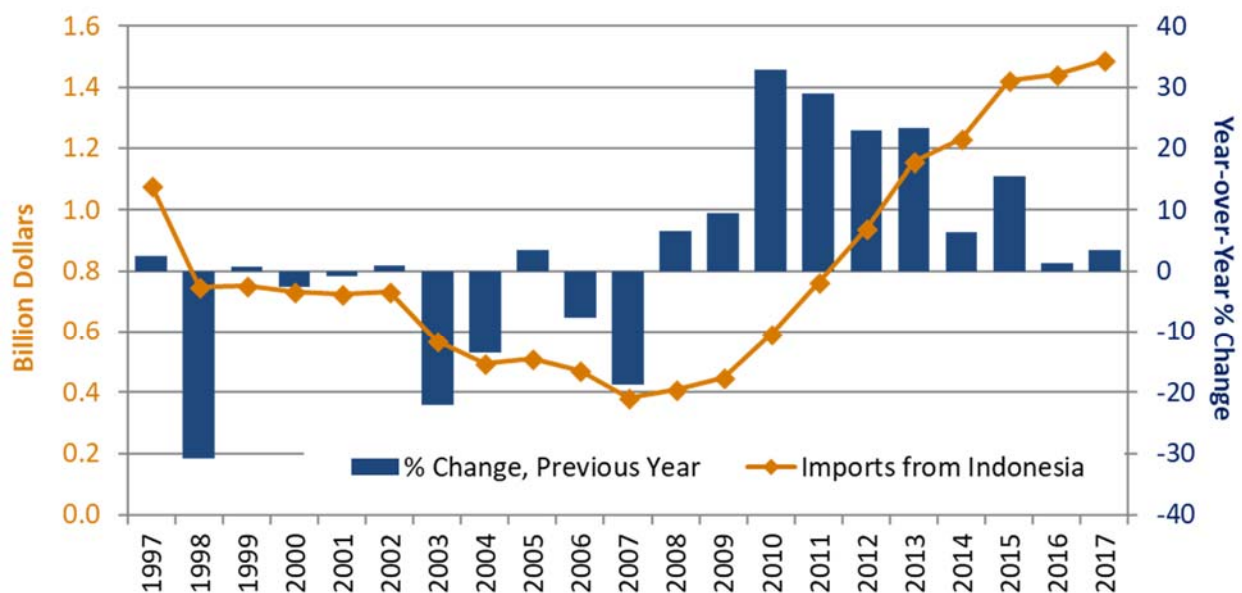
US Footwear Imports by Key Suppliers

While heavyweights China and Vietnam dominate the market for US footwear imports, several second-tier suppliers are noteworthy, whether for their recently-spurting shipments, lower landed costs, or other factors that may make them viable alternatives. Below is a review of some of these second-tier suppliers.

Indonesia

Chief among these second-tier origins is Indonesia, the third-largest supplier of footwear to the US marketplace. In the decade following the 1997 Asian Financial Crisis, Indonesian footwear exports to the US fell sharply, from \$1.1 billion to less than \$400 million ten years later. What's more, its share of the US footwear import market cratered over this period from more than 8% to less than 2%. But the country's shipments to US shores have rebounded impressively since then, rising for ten straight years to a record \$1.5 billion by 2017, with its share of the US market also recovering. And year-to-date data suggest these shipments will expand again in volume and value terms, approaching an unprecedented \$1.6 billion in 2018. Other than Vietnam, no other country has seen its share of US footwear imports grow so much over the last decade, a testament to the manufacturing prowess of the local industry and the desirability of its shoes.

CHART 5:
US FOOTWEAR IMPORTS FROM INDONESIA CLIMB AGAIN TO A RECORD IN 2017



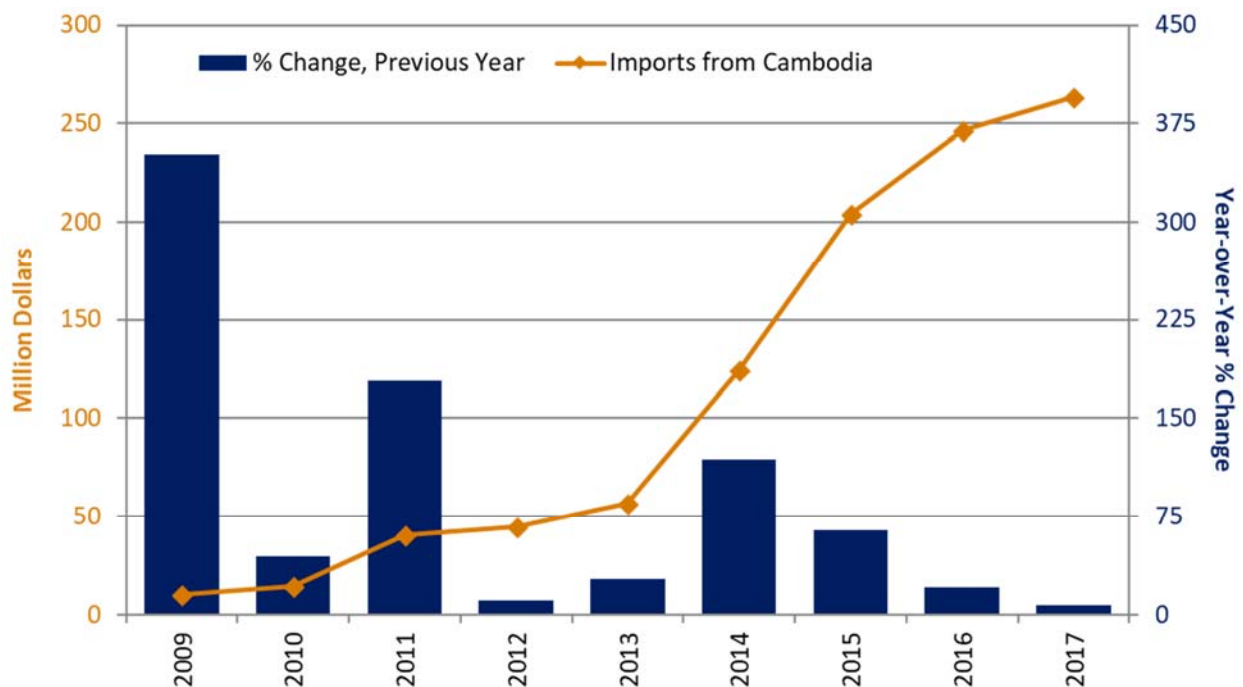
Source: USITC



Cambodia

Over the last decade several factors have propelled Cambodia's rise from footwear production obscurity to rival India as a top second-tier footwear supplier to the US market behind only China, Vietnam and Indonesia. At a record 28.2 million pairs (worth \$263.3 million), US imports of Cambodian footwear rose 8.7% last year, higher for the tenth straight year (chart 6). This streak of gains comes as the average landed cost of US footwear imports from Cambodia has been below the average cost from the rest of the world each of the last few years. Additionally, a number of new factories—often Taiwanese or Chinese-owned—have opened across the kingdom in recent years to tap its large, young and inexpensive workforce. Plus, Cambodia is a highly dollarized-economy, with a relatively low minimum wage and many other costs involved in footwear production denominated in USD. The ubiquitous dollarization means Cambodian footwear shipments to America are not subject to wild price swings other suppliers may face that are subject to the vagaries of a floating exchange rate mechanism. The combination of these factors suggests Cambodian footwear shipments to US shores may continue to grow impressively in coming years.

**CHART 6:
US FOOTWEAR IMPORTS FROM CAMBODIA CLIMB AGAIN TO A RECORD IN 2017**



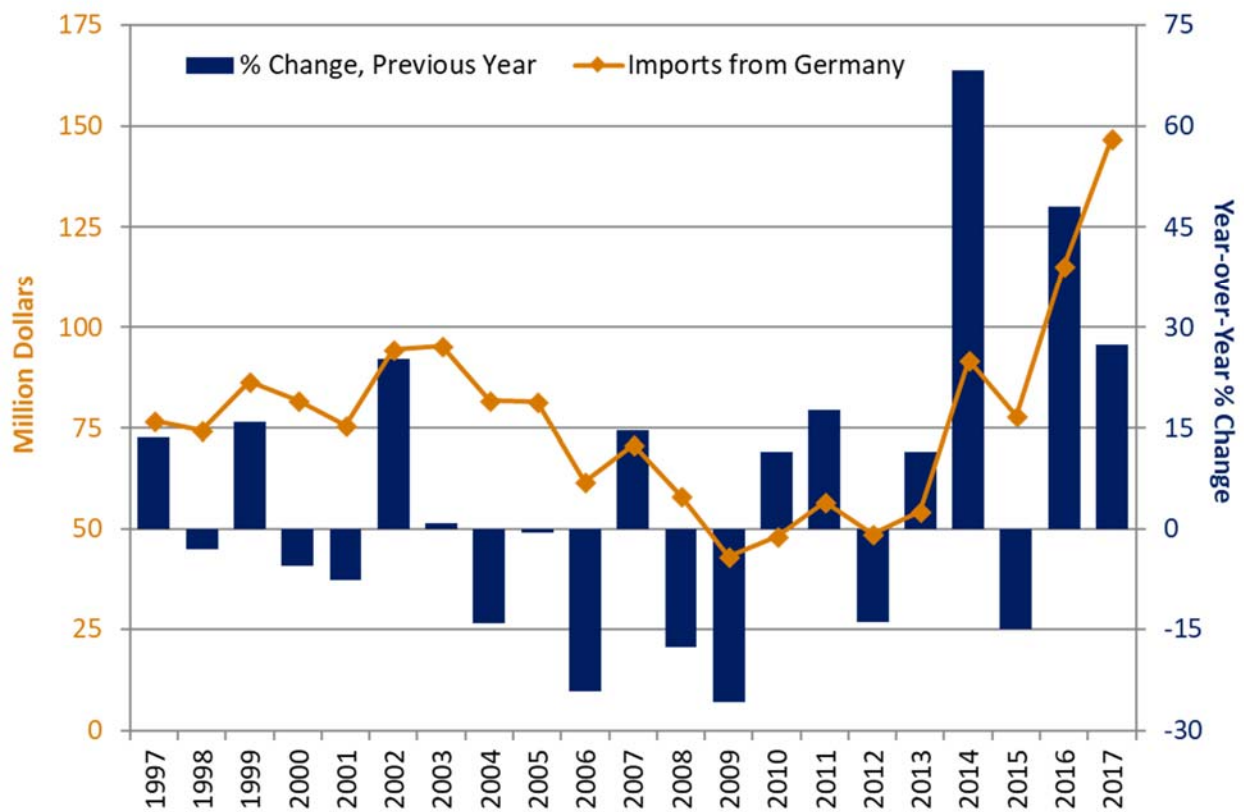
Source: USITC

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Germany

While only the eleventh-largest foreign footwear supplier to the US market, Germany has enjoyed an impressive renaissance in recent years. Shipments from this European origin sailed 27.3% higher in 2017—the fourth double-digit advance in the last five years—to an unprecedented \$147.1 million. What is particularly intriguing is German footwear manufacturers did so with an average landed cost into the US (\$23.93/pair) *more than twice as high* as from the rest of the world. The country is able to do this as local brands and manufacturers have fostered a reputation for producing high-quality footwear coupled with clever marketing, without focusing purely on a 'lowest-cost-at-all-costs' approach. There is no doubt that the growth of adidas in areas of innovative production in Germany has contributed to the overall growth of US imports of German footwear.

CHART 7:
US FOOTWEAR IMPORTS FROM GERMANY CLIMB TO A RECORD IN 2017



Source: USITC

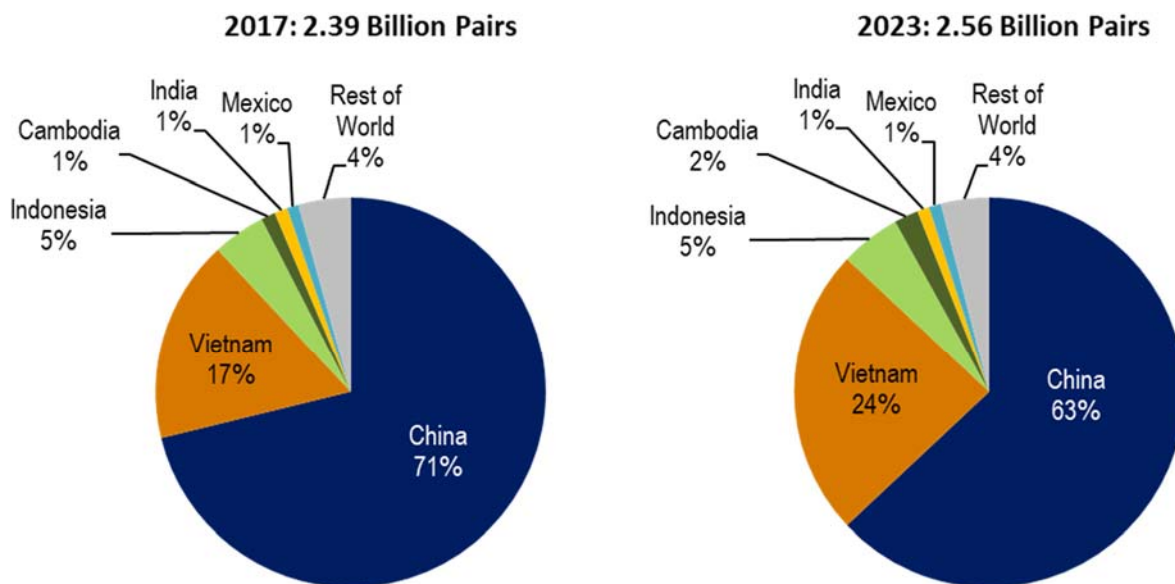


Five-year Footwear Trade Forecast

The outlook for US footwear sourcing hints at modest growth in trade over the next five years, with China's dominant share likely to recede further, offset by surging Asian tigers, particularly Vietnam. FDRA econometric models indicate US footwear imports will grow slightly over the five-year horizon of this study, constrained by expected weaker economic and population growth, a saturation at retail, and evolving consumer behavior. While few see a recession looming for America, the withdrawal of monetary support amid emerging signs of strengthening inflation and the specter of a trade war with key partner China could constrain otherwise-upbeat growth prospects, in turn limiting demand for footwear. Similarly, sated consumers that already own a record number of shoes per capita may limit growth in demand and imports over the next several years. On balance, we expect footwear imports to expand modestly over the next five years, reaching a record 2.6 billion pairs.

Within this broader view, we expect Vietnam to show impressive growth, even without the benefit of a permanent free trade arrangement with the US. As in previous editions of this assessment, FDRA envisions Vietnam gaining a majority of the market share China is likely to shed. Vietnam's growth will spill over into neighboring countries and footwear companies will also continue exploring sourcing possibilities outside Asia. ***But in the end, despite its ongoing loss of market share, China will continue to supply over 60% of all footwear sold in the US even five years from now as illustrated below.***

CHART 8:
US FOOTWEAR IMPORTS: STILL DOMINATED BY CHINA...FOR NOW



Source: USITC * 2023 figures are FDRA forecasts.



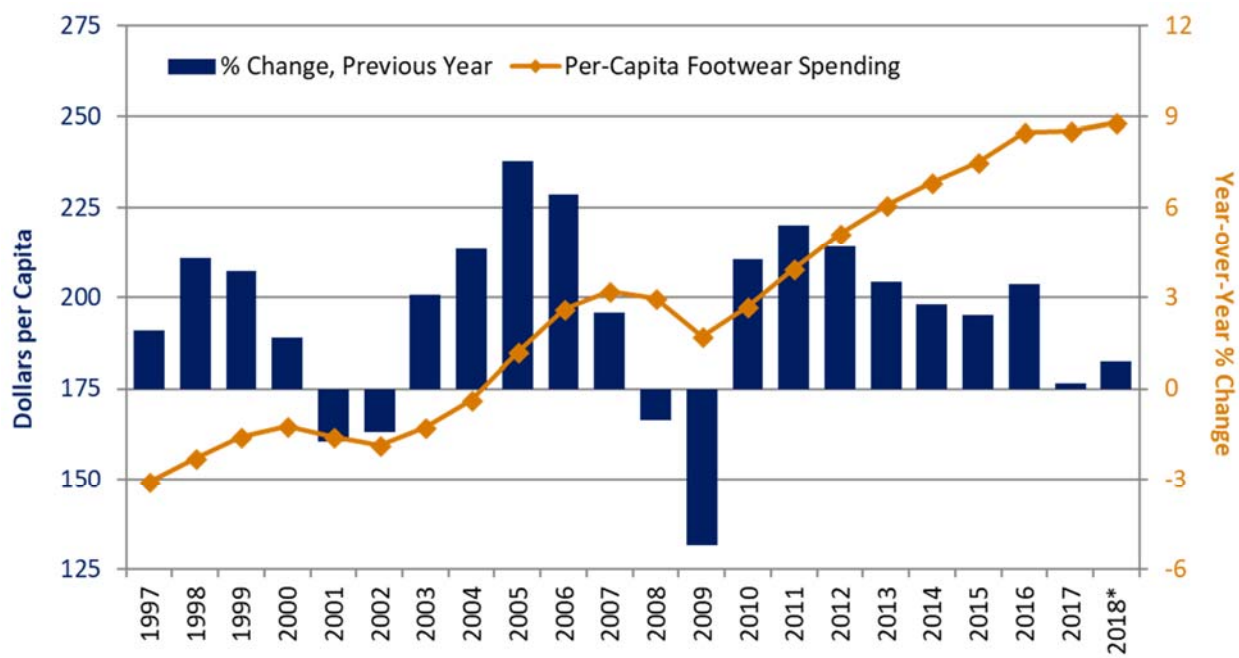
Two Views on US Demand for Footwear

Americans love their shoes—record per capita ownership confirms this. I can expand this into a full-blown section if you want, but there's nothing new/different to say here, other than the latest annual data point.

A look at US footwear demand presents two opposing views on the condition of the industry, one of optimism reflecting record demand and a strong dollar that is weighing on import costs, while the other reflects dull growth, sagging retail prices, and shrinking employment in the sector. Indeed, both views are accurate.

The optimist argues that US demand for footwear has never been stronger, with retailers enjoying sinking import costs and record annual per-capita spending (Chart 9). Buoyed by a robust economy and confident consumers, US personal spending on footwear climbed to an unprecedented \$80.2 billion in 2017, higher thirteen of the last fifteen years. What's more, last year's strong greenback enabled retailers to benefit from lower average landed costs of footwear imports. In fact, at a four-year low of \$10.67 per pair, the average landed cost in 2017 shrank -2.2%, the biggest drop in fifteen years. With footwear spending up and costs down, the optimist points to sunny skies for distributors and retailers of footwear.

CHART 9:
PER-CAPITA SPENDING ON FOOTWEAR CLIMBS TO A NEW RECORD

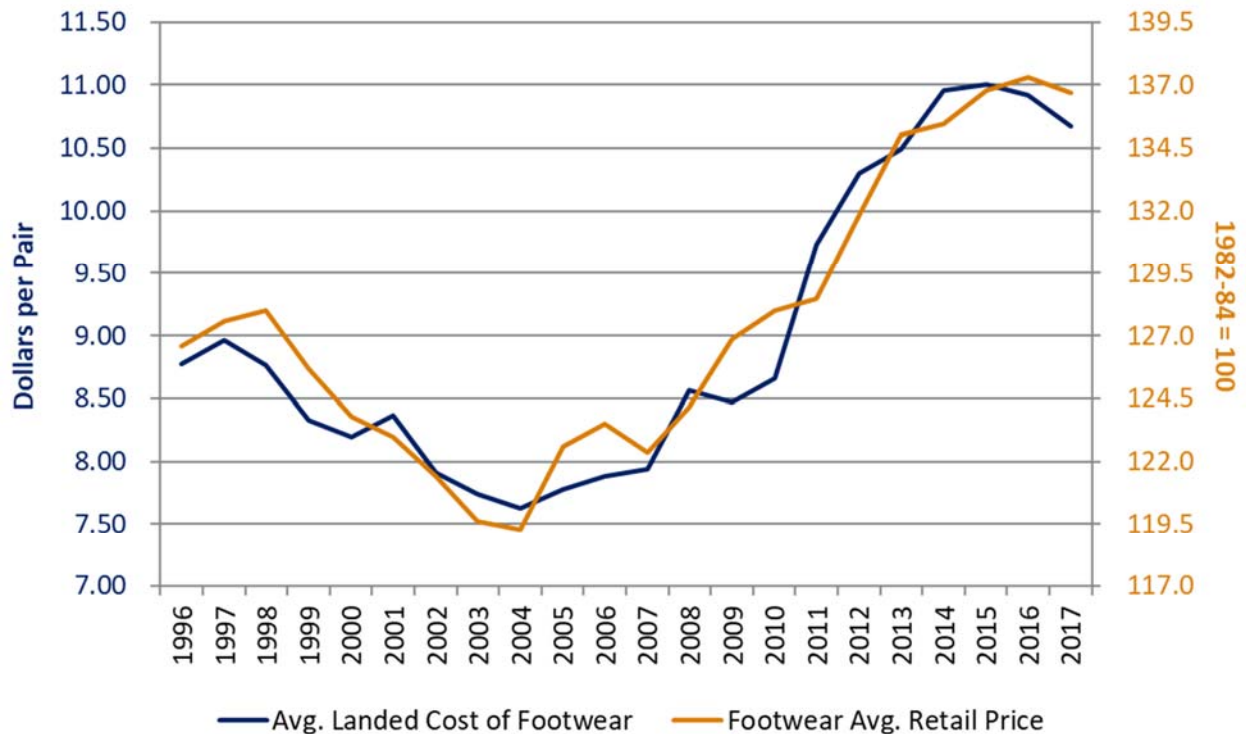


Sources: BEA & US Census Bureau



But the pessimist cautions a number of other factors indicate dark skies ahead for footwear demand, from downbeat trends of dull sales, stalled retail prices, and shrinking shoe store employment. First, while footwear spending did rise to a record last year, it did so at the slowest rate since the dark days of the Great Recession, extending a gradual deceleration witnessed over most of the last seven years. And while import costs did slide in 2017, retailers had little opportunity to capitalize, as consumer prices for footwear declined in sympathy (Chart 10). Finally, constrained by both sagging footwear sales and ironically by more attractive job opportunities elsewhere, hiring and wages at US shoe stores remain mired in contraction, a trend that shows few signs of abating soon. With closets already full and consumption at record highs, footwear demand (and imports) may see little near-term cause for optimism.

**CHART 10:
AS LANDED COSTS FOR FOOTWEAR MODERATE, SO DO RETAIL PRICES**



Sources: USITC & BLS






Trump and Trade: Prospects, Paradigms, and Pitfalls

The last two years have witnessed a period of profound change in issues impacting footwear sourcing, whether via President Trump's efforts at a new 'America First' trade policy, fluctuating exchange rates, or repercussions from an evolution to a tighter monetary policy.

First and perhaps most importantly, the new Trump administration has turned decades of trade policy on its ear, with more actions promised—or threatened—to come. The US Constitution vests authority in Congress to collect duties and to “regulate commerce with foreign nations.” But over the course of the 20th century, Congress delegated some of that authority to the president through legislation such as Trade Promotion Authority (TPA). Although the purpose was, ultimately, to facilitate the process of *reducing* tariffs, President Trump has utilized a few statutes to serve his 'America First' trade policy. Since taking office his administration has launched six investigations under three seldom-invoked trade laws, has withdrawn the US from the Trans-Pacific Partnership (TPP), initiated a trade war with China, and is renegotiating the North American Free Trade Agreement (NAFTA). At the same time, his administration arranged the first-ever summit with North Korea, has another summit with Russian president Putin on the docket, threatened to withdraw the US from the World Trade Organization (WTO), and has alienated traditional allies—all in hardly twenty months. The FDRA—and others—are concerned that the free-wheeling, shoot-from-the-hip style of the current administration may do more harm than good to footwear interests across the supply chain, both domestically and abroad.

The Dollar's Impact on Trade

Perhaps no other single factor impacts American footwear sourcing more than the relative strength of the US dollar, whether as the denomination of many commodities used in footwear manufacturing or as a global de facto currency. And whether due to a less accommodative Federal Reserve, a robust economy, trade policy of the new administration, or other factors, the course of the dollar over the past two years has been anything but smooth. In this time the greenback surged to a fifteen-year high following the presidential election before ricocheting to a three-year low hardly twelve months later, only to rebound to a twelve-month high again by mid-2018. From withdrawing the US from the TPP to renegotiating NAFTA to strongly enforcing US trade laws, the current administration certainly has not been shy about abruptly changing the course of US trade relations, leaving the dollar to gyrate wildly in its wake.



Normally, relatively higher interest rates imply higher rates on US bonds, thereby attracting foreign investment in these bonds, boosting demand for dollars to buy these bonds. As the dollar rises or falls, costs of imports tend to fall or rise in mirror-opposite fashion, as it takes fewer dollars relative to another currency to pay for imported goods. Naturally, prospects for a stronger or weaker dollar can color the outlook for footwear import costs and ultimately sales. Footwear importers, retailers, and consumers have enjoyed the fruits of a relatively strong dollar over the last year and a half, with the greenback keeping hikes in the average landed cost of footwear imports relatively contained recently.

Looking ahead, we believe the dollar will remain strong over the next several years, owing primarily to relatively more accommodative economic policies overseas versus at home. Late in 2015 America's Federal Reserve began raising its Federal Funds rate for the first time in nearly a decade, signaling an end of the 'easy money' period that saw this rate decline to a record low. Since then, the Fed has hiked its benchmark rate several times and shown a willingness to raise rates further if economic conditions warrant. ***If domestic rates rise relative to other key markets the greenback may remain relatively firm, suggesting the currency is unlikely over the next few years to contribute substantially to a surge in footwear import costs.***



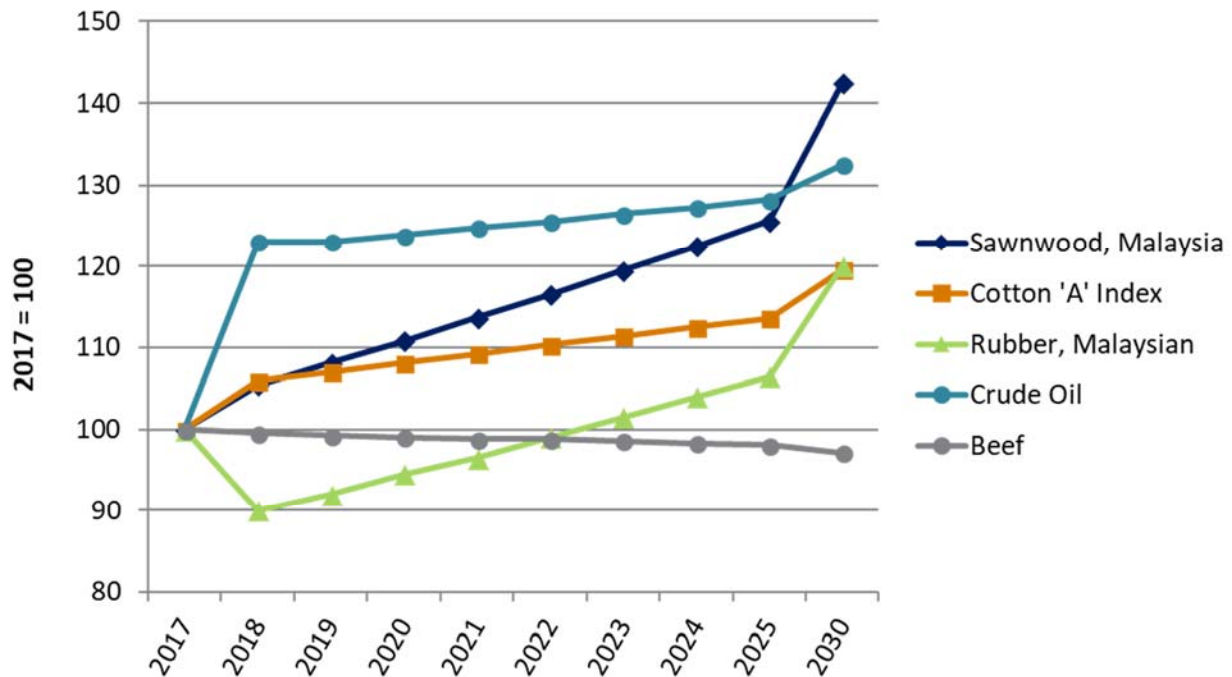
Commodity Outlook

Typically, there is an inverse relationship between the value of the dollar and commodity prices. When the dollar strengthens against other major currencies, the prices of dollar-denominated commodities tend to drop. When the value of the dollar weakens against other major currencies, the prices of commodities generally move higher. This is a general rule and it holds true more often than not over the long term, as the graph below demonstrates. What we find interesting is that over the last year this relationship has evaporated—at least for now—with the dollar recently reaching multi-year highs, but commodities generally not dropping as much as this historical relationship would suggest. Whether the traditional inverse co-movement resumes soon or not, a relatively strong dollar is likely to keep commodity prices used in footwear manufacturing relatively low for the foreseeable future.

Generally speaking, commodity prices strengthened in the first quarter of 2018, supported by both demand and supply factors. The World Bank notes accelerating global growth lifted demand for some commodities while supply constraints affected the prices of others. Prices continue to be supported by a broad-based global recovery, with global GDP growth increasing to 3.1% in 2017, from 2.4% in 2016. Meanwhile, production has been held back for several commodity-specific reasons, including continued OPEC and non-OPEC oil production restraint, measures by China to reduce polluting metals and energy production, and lower grain planting intentions in the US. More than half of commodity prices are expected to increase in 2018, led by non-coal energy prices. Naturally, a key policy risk is the introduction of countervailing duties on soybeans by China in response to US tariffs.

Looking ahead, longer-term price forecasts from the World Bank for certain key commodities used in footwear production call for a mixed bag for the industry (chart 9). In particular, average rubber prices are expected to tumble in 2018 before steadily recovering over each of the next several years. At the same time, crude oil prices are pegged sharply higher in 2018 and are unlikely to retreat substantially over the next several years. Sawnwood used in pulp production and cotton also are forecast higher over the next several years, while prices for beef—and by extension, leather—are expected to edge lower over the forecast horizon. Certainly, prices for these commodities are unlikely to follow the clean and simple price trajectories shown below. But by anticipating and either capitalizing upon or mitigating the impact of any price changes, industry players can remain viable in this dynamic environment.

CHART 11:
PRICE FORECASTS FOR KEY FOOTWEAR COMMODITIES



Source: World Bank



Summary

Relatively flat imports and consumer demand belie a dynamic industry facing a sea change of complex and evolving issues just under the surface in this tumultuous time of Trump tariff threats. No longer are cost, reliable manufacturing, and quick turns the only key drivers in footwear sourcing. And no longer does a vanilla 'one-size-fits-all' sourcing model, well, fit all. Today factory automation, innovation, and customization are impacting sourcing and supply chains, with more firms experimenting with—and incorporating—robotics, 3-D printing, sustainable materials, and augmented reality to produce, distribute, and sell footwear in new and profitable ways. While old, monolithic stalwarts resting on their laurels may remain in place and slowly erode, the quick and nimble that stay abreast of consumer, market, and political trends stand to capture more share from increasingly diverse and finicky shoppers. **Simply stated, agility is the most important quality footwear companies should aspire to perfect throughout their retail, development, and sourcing strategies and operations in order to stay competitive.** FDRA will continue to be your partner and strong supporter, pointing the way to increased demand and profitability in these tumultuous times.



About FDRA

Among these swirling currents across the industry, FDRA continues to navigate the way on issues impacting the footwear market. From services ranging from support to advocacy to market intelligence, from product safety, customs, and factory compliance solutions to helping companies develop advanced sourcing strategies, FDRA is the only trade association dedicated solely to serving the footwear industry. FDRA will continue to provide monthly import data by country and category (athletic, boots, children, and fashion), as well as a look at monthly changes to footwear input costs (rubber, textile, synthetic, etc.) in its monthly sourcing newsletter for members. Be on the lookout each month to note trends and stay ahead of the game.

Since 1944, the Footwear Distributors Retailers of America (FDRA) has been the footwear industry's voice in Washington, DC. Today, FDRA's voice is stronger and more respected than ever. FDRA has also enhanced its member services and support and is now the industry's intelligence hub. FDRA provides its members valuable business intelligence and expertise on a variety of trends and topics including product safety, customs, sourcing strategies, intellectual property and social compliance. It is also the only association able to provide in-depth sales data and analysis for footwear retailers. In short, FDRA boosts its members business. Visit www.fdra.org to learn why over 80% of the U.S. footwear industry belongs to FDRA.

FDRA forecasting seeks to provide the footwear industry with information and critical thought to better prepare it for global challenges and threats that may impact footwear businesses. All forecasts herein should not be considered legal advice in any way.



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