Media Coverage

China's Bling Dynasty: a change of pace, place and face

Erwan Rambourg, Head of Consumer & Retail Equity Research, HSBC

(This article was first published on 14 November 2015 by The Business Times)

The downturn in the China domestic luxury market has meant troubling times for retailers, but buyers are still there – they just need to be reached in the right way.

Equity markets in China have fallen back to Earth. This comes amid a general economic slowdown in mainland China and an ongoing anti-corruption drive. What does it all mean for the luxury industry in China? Will things return to normal? Likely not, but that doesn't mean luxury brands should lose heart. Rather, they should get smart.

First, assessing the potential damage on luxury goods spending caused by the equity market decline in China is not that easy or clear cut. While the Shanghai composite index is down around 35 per cent since the peak, it is still up more than 40 per cent over the last 12 months. In other words, if you have been invested in the market for 12 months or more, you're actually still doing well financially, though you may be feeling a bit hurt psychologically. The question of the correlation between the equity market in China and luxury demand rarely came up at the time when the market had doubled, yet now the question of correlation is on everyone's mind.

Also, the weight of consumers' equity holdings as a percentage of total investments remains lower than in the US. When Wall Street moves, luxury demand in the US is influenced. When China's equity market moves, it seems that the influence is much more limited. In Hong Kong, consumers are probably more influenced by the state of equity markets.

The bigger issues for consumers in China are a slowdown in growth, the strength of the RMB, as well environmental risks and education. The fall in the equity market is just one of several negative psychological factors that will be weighing on Hong Kong luxury consumption, and to a lesser extent on Chinese luxury consumption. With regard to Chinese buyers going overseas, I take the view that outbound travel and consumption is in its infancy and for the time being somewhat disconnected from the macro outlook in China.

Indeed, perhaps the biggest driver of change has been travel. As regulations ease, passport penetration rates increase and flights become cheaper, the Chinese are discovering the world. This has positive and negative consequences for luxury brand managers.

More than 50 per cent of outbound trips are still to Hong Kong and Macau but in future, Chinese travellers' destinations will be much more diversified. For example, Korea emerged as a top destination in just the past three years. Today, Japan and Europe are among the top destinations. Tomorrow, Chinese will be keen to venture further afield to more exotic destinations such as the Maldives, Australia and the US, which for now remains far away and – given the US dollar strength – expensive. This is good news for brands as they can leverage existing retail footprints in those markets as traffic increases.

The big challenge for luxury brands is to face young consumers that are both demanding and knowledgeable. Western luxury managers still stereotype Chinese consumers as being fickle, but that's not true. Rather, they are young, quick and savvy. If luxury brands are slow to adapt –and many old school luxury brands are – these young luxury buyers will move on. The era of Chinese luxury buyers' domination implies speed like never before. New entrants and legacy brands are finally making an effort to understand who they are selling to.

Meanwhile, Hong Kong's role as the centre of luxury retail for China's buyers is likely to diminish. The CFO of Tod's recently said: "Hong Kong used to be a market for luxury, think about it as becoming just another city". Indeed, Hong Kong is not necessarily the window to China anymore for luxury as Chinese consumers will take their cue from Seoul, Tokyo, Milan, Paris or New York directly. I believe the number of luxury stores will have to go down over the next three years. Recently, Causeway Bay, one of the shopping hubs for Chinese tourists, has seen the closure of a Tag Heuer store on Russell Street, once the most expensive streets on the planet in terms of rent. Soon, Emperor will be closing a store in the same neighborhood. Rents are not coming down fast enough, while sales have sunk. Something has got to give.

I keep hearing and reading about the end of Chinese luxury consumption. Wealthy Chinese people will certainly move to enjoy luxurious or exotic experiences rather than products, and will allocate less of their budget to luxury products. Sure, equity markets and lower GDP growth rates are unhelpful. But the appetite for luxury brands in China is unlikely to collapse overnight – brands will just have to recruit new buyers rather than depending on existing ones.

The number of Chinese luxury consumers is likely to double to 150 million over the next ten years. Being bullish on Chinese luxury demand is both counter-intuitive and unfashionable at the moment. But in my view, the reality is that Chinese buyers will continue to dominate luxury consumption despite already representing more than 35 per cent of sales for most of the brands I speak to. The trick is to stay on top of who they are and where they are.

ends/all