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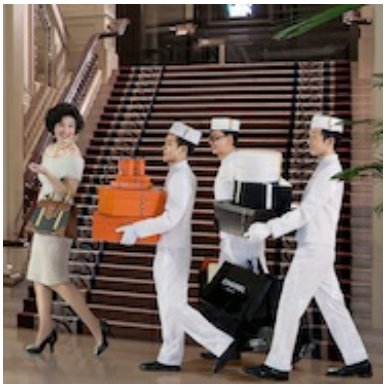
COMMERCE

What does the Chinese currency devaluation mean for the luxury industry?

August 12, 2015



Chinese consumers may spend less on luxury with the devaluation of the yuan

By SARAH JONES

China's devaluation of its renminbi is intended to boost the country's slouching trade, but the impact of the altered exchange rate will likely extend to the luxury industry.

Following the announcement of the steepest decline in the yuan in the past decade, hard luxury goods companies and automakers such as BMW, Swatch Group and LVMH saw their shares take some of the hardest hits, declining as much as 5 percent. With the luxury industry looking to China for sales growth, the now more expensive merchandise may be cause for an altered outlook in the market.

"It may have a limited effect in the near term, possibly among some shoppers who were planning to make purchases locally," said Avery Booker, partner at China Luxury Advisors. "This is because the devaluation will make imported luxury goods more expensive within China, but Chinese shoppers continue to make the vast majority of their luxury purchases abroad."

Shrinking value

Rather than letting the free market decide its exchange rate, China's currency is regulated by the People's Bank of China, which keeps the value from fluctuating more than 2 percent above or below the previous day's trading. The devaluation, announced Aug. 11, caused the yuan to fall about 2 percent compared to the United States dollar.

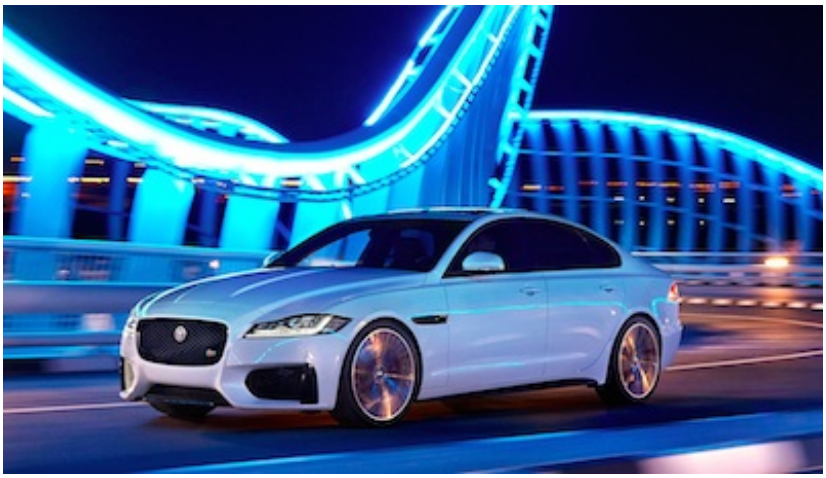
This means that exports, like those coming from Europe and the U.S., will become more expensive for Chinese consumers, potentially further lowering their consumption of luxury goods.

Chinese tourists at Louis Vuitton

Following a period of rapid luxury growth in China, sales of high-end goods within the country have slowed down, largely due to the government's crackdown on corruption.

For instance, LVMH's leather goods sales in China, Macau and Hong Kong declined 10 percent in the first half of 2015.

Jaguar Land Rover relies heavily on China, which accounts for 20 percent of its total sales. The automaker just lowered its prices in the country following declining sales results this past quarter, according to Bloomberg.



Jaguar XF

This devaluation may exacerbate the slump that has already been seen, as consumers' currency has less spending power for luxury goods both at home and abroad.

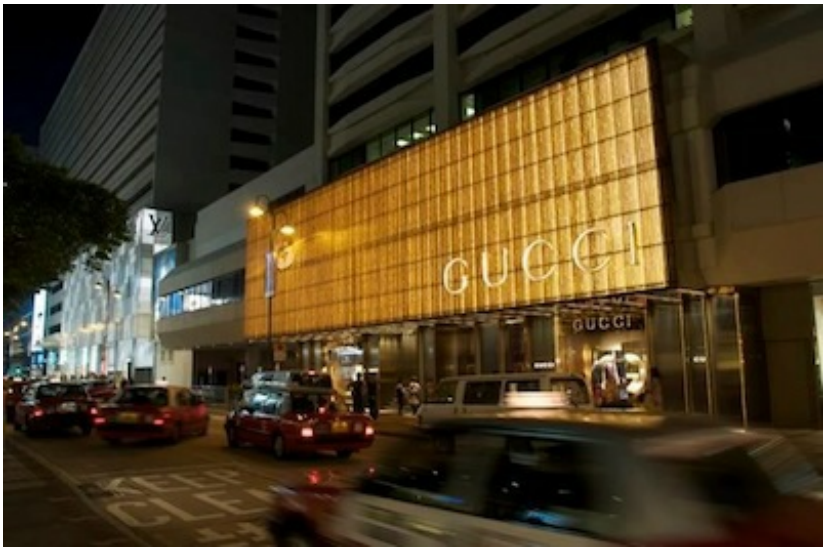
"This modest devaluation is another reminder that as powerful as the Chinese consumer is, luxury businesses would be wise to diversify their growth strategy across more than

one demographic," said Marie Driscoll, chief executive officer and chief consultant of Driscoll Advisors, New York. "This move is unlikely to seriously impact luxury sales, but it is another data point that is not a positive."

Hong Kong is typically a prime destination for Chinese consumers looking to spend on luxury, but retailers there are struggling as their sales are not paying for the high rents. Tag Heuer closed a store last week, and Kering has warned that it might shutter some of its stores if rents are not lowered.

“Considering the already high taxes levied on them in the China market, which bite into profit margins, there's probably very little brands can likely do in China to lessen any immediate effects of the devaluation besides lowering their prices, which some have already done this year, and will be less willing to do again in the near to medium term,” Mr. Booker said.

"The yuan devaluation likely won't have too much of a negative effect on Hong Kong's luxury market," he said. "There, brands are struggling more because Chinese shoppers simply prefer shopping elsewhere, and seek better prices and service in Europe, Japan or South Korea -- currency fluctuations aren't a central motivator."



Gucci store at The Landmark in Hong Kong

Outside of pricing, brands can also work on aspects of their business within their control.

"Price is not the primary consideration of luxury shoppers and a 2 percent to 4 percent increase in price won't deter an ardent luxury shopper," Ms. Driscoll said. "Create the ardor. Luxury brands should continue to focus on customer engagement and full brand expression, creating the desire. Not currency volatility.

"Control the controllables: brand relevancy, in-store experience, personalized digital strategies," she said. "Luxury brands are better than managing for the long-term."

A devalued Chinese currency also means a shift in financial reporting, as sales translated from the yuan to the euro will appear smaller. For public companies such as LVMH, Kering and Richemont, this may have an impact on how their performance in the region appears to investors.

Market strategy

In addition to the currency devaluation, Chinese luxury goods remain higher than in Europe due to import duties and taxes on extravagant items.

"Global currency volatility in itself is fueling the so-called grey market, which is a form of contraband activity mostly taking place between China and Western Europe," said Fflur Roberts, luxury lead at Euromonitor. "This is forcing many brands to adjust prices in a number of key markets.

"A surging and free-floating Swiss franc, a debilitated euro, a strong U.S. dollar and a strong U.K. pound – these are some of the external currency pressures forcing European luxury goods rivals like Burberry, Richemont, Kering, Prada and LVMH, to revisit their global pricing strategies," she said. "In some markets, prices are going up, in others they are going down. It is, arguably, the biggest challenge facing the luxury goods industry at this particular juncture."

Consumers will buy luxury goods in Europe and then resell them in China illegally, skirting around the taxes. This may amount to about 40 percent of luxury goods consumption in China.

"What we know for sure is that the grey market is growing, and forcing the owners of luxury brands to take radical action to narrow the differentials," Ms. Roberts said. "In practice, this means they are hiking prices in key European cities and dropping them in China."

According to a panelist at Financial Times' Business of Luxury Summit June 9, brands entering or maintaining a retail presence in China should know two words: Shenzhen and diagou.

The "China: Crisis, consolidation and the new consumer" panel opened with remarks from Sir David Tang, who suggests that knowing the aforementioned words, Shenzhen, a populous boarder city between Hong Kong and the Mainland, and diagou, a verb meaning "to buy on behalf of," brands can better understand the "economic miracle" of China. Indeed, the recent anti-corruption and anti-extravagance campaigns put forth by the Chinese government paired with change in consumer behavior has hammered the luxury market (see story).

"A number of uncontrollable external factors have conspired to derail what five years ago seemed unstoppable growth – particularity in Hong Kong," Euromonitor's Ms. Roberts said. "For companies with heavy Asia Pacific exposure, revenues and profitability are now under threat. Indeed, there is growing evidence that the global scales of luxury consumption have started to tilt from the East to the West.

"Asia Pacific is currently home to four of the world's top 10 luxury goods markets: Japan, China, South Korea and Hong Kong. Additionally, India and Indonesia were two of the world's fastest growing over 2009-2014," she said. "However, for all its undoubted

promise, the region should not be regarded as a safe haven for growth over the next five years and many luxury brands are now realizing this and turning their attention to other markets."

Final Take

Sarah Jones, staff reporter on Luxury Daily, New York