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GOVERNMENT

US-China trade war drags on, leaving luxury uncertainties

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Consumers are now in control. Image credit: Penninsula

By SARAH JONES

The trade war between the United States and China continues to escalate, and the impact of the dispute is reverberating to global markets as well as the luxury business.

Within the past week, the nations' trade truce ended as the U.S. issued additional tariffs on $300 billion worth of goods from China and China responded by letting its currency value slip to a decade low. As negotiations between the two largest economies in the world drag on, uncertainties remain for luxury.

"The events of the last week, triggered by the new tariff announcement on Chinese goods, have taken us to a new period of uncertainty with heightened risk levels," said Johan Gott, principal in the consumer and retail practice of A.T. Kearney and head of its Trade Wargaming initiative.

"With the world economy already fragile, this additional risk can have significant downside," he said. "We have already seen signs of this stock markets are showing negative numbers worldwide."

Market impact

On July 31, the United States Federal Reserve opted to cut interest rates by a quarter of a percentage point, reducing the rate to between 2 and 2.25 percent. Among the reasons for the cut was the "trade policy uncertainty," which is making some businesses reluctant to spend capital.

In 2018, the Fed raised interest rates four times, and more hikes were expected this year (see story). In a press conference explaining the move, Chair Jerome Powell explained that earlier this year, the Fed was intending to raise rates, but it changed course due to weak global growth and stalling inflation.

Despite the cut and the Fed's effort to make credit more available, consumer confidence and spending is solid.

A day later, the Fed's move appeared justified, as President Donald Trump tweeted a threat to raise tariffs to 10 percent on billions worth of goods. This latest round, which would be effective Sept. 1, includes products such as toys, iPhones and sneakers, and is in addition to the $250 billion worth of goods that already have 25 percent tariffs.

In his statement, the president said that the new tariffs were due to broken promises from China, including the nation's pledge to cease the sale of fentanyl to the U.S. and its agreement to buy more agricultural products from America.

Following the president's move, a spokesperson for the Chinese government reportedly said that while the nation was seeking an amicable solution, it was prepared to fight back (see story).

Seen as a response to the expected tariffs, China let its yuan's value fall. The currency tumbled on Aug. 5, dropping to about seven yuan per dollar, the lowest it has been since 2008.

The impact of the currency devaluation was felt locally and overseas, as stock markets in Japan, China and the United States took a fall. More recently, stocks have stabilized, but there is the potential that the yuan could weaken further.

For U.S. importers, a lower yuan exchange rate would reduce the impact of tariff hikes by lowering the cost of goods.

Fendi's new film series is set in Shanghai and Hong Kong. Image credit: Fendi

A weaker currency in China means that consumers' spending power will decline in other markets. This could impact shopping tourism, limiting Chinese consumers' ability to splurge on luxury when they travel elsewhere.

While intended to put pressure on businesses overseas, Western luxury brands are seeing an impact from the U.S.'s trade war.

Capri Holdings, the parent company of Michael Kors, Versace and Jimmy Choo, just lowered its outlook for earnings per share in the current fiscal year, citing increased tariffs as part of the cause for concern (see story).

"Thus far both countries have been losers," Mr. Gott said. "Our reshoring index shows that U.S. reshoring is at its lowest level since we started the tracking, and that companies are starting to diversify away from China to countries like Vietnam and Mexico.

"The latter countries are the real winners as companies try to avoid getting caught in the cross fire between U.S. and China," he said.

Luxury outlook

China's economic growth continues to slow, as the trade war with the United States persists with the potential to adversely impact the luxury sector.

Despite $291 billion in tax cuts this year, the world's second largest economy grew just 6.2 percent in the second quarter the slowest rate since the first quarter of 1992. Chinese consumers are one of the most valuable segments in the luxury business, and a prolonged slowdown in the country could have widespread repercussions (see story).

Even with the ongoing trade war, a number of luxury brands have been reporting positive results in mainland China.

Burberry's sales in the market during its first quarter were up in the mid-teens (see story).

Luxury groups are also seeing strong growth in the region, with LVMH's Asia-Pacific sales up 18 percent in the first half of the year while Kering's grew 36 percent. Richemont attributed its 9 percent growth in Asia during the same period largely to China.

However, some have seen growth slow. Tiffany & Co.'s past quarter saw flat comparable growth in Asia, as worldwide sales attributed to tourism fell (see story).

As the trade war escalates, more luxury brands may see an impact.

"This is bad news for luxury markets," A.T. Kearney's Mr. Gott said. "Though most products are not impacted directly by the latest tariff announcements, weakening consumer confidence and a potential recession have negative effects.

"It is also worth noting that Donald Trump has threatened a tariff on European wines in retaliation for France's decision to tax U.S. tech companies," he said.