Luxury Daily®
The News and Intelligence You Need on Luxury

FINANCIAL SERVICES

What impact would a recession have on the luxury business?

August 16, 2019

Some signs are pointing to a nearing recession. Image credit: Frankfurt Airport

By SARAH JONES

With global headwinds suggesting that an economic downturn may soon arrive, luxury brands need to be guarding themselves against the possible slowdown.

Recession worries have escalated this week as the U.S. stock market took a nosedive, suffering the steepest drop of the year on Wednesday. While some experts consider this a false alarm, it is in businesses' best interests to be prepared.

"With the bond yield curve inverting on Wednesday, the impending recession bells started to ring very loudly," said Bob Shullman, founder and CEO of the Shullman Research Center, Greenwich, CT. "Those, though, who have been paying close attention to current economic conditions, especially consumer and business confidence as well as any increases in the unemployment rates, are aware that a recession is coming.

"The only question is when the recession will occur and what types of luxury categories will actually be impacted by the next recession and how severe the impact will be," he said.

Warning signs

One of the biggest warning signs for a recession historically has been the state of the bond market. This week, the yield on long-term government bonds in the U.S. dropped as investors put their money into bonds to guard against potential volatility.

When the number of investors putting money into bonds rises, the difference between the original investment and the return after the maturity falls.

This marked the first time that the 30-year bond yield dipped below 2 percent. The yield on a 10-year bond also fell below that of a two-year bond, which has not happened since 2007.

Tied to the signs in the bond market, on Aug. 14, the Dow Jones Industrial Average and the S&P 500 fell approximately 3 percent. The Dow lost about 800 points.

On Aug. 15, global markets responded to the drop in the Dow, as stock indexes in markets including London, Tokyo and Sydney fell.

However, even with these signs, former chair of the Federal Reserve Janet Yellen told Fox Business that a recession is unlikely.

"I think the U.S. economy has enough strength to avoid that," Ms. Yellen said. "But the odds have clearly risen and they are higher than I'm frankly comfortable with."

U.S. consumer confidence rose in July to the highest point for the year so far. The Conference Board noted in its monthly report that spending is expected to remain strong, despite slowing GDP growth.

According to data from the U.S. Census Bureau, retail and food service sales in the nation were up 3.4 percent year-over-year in July.

The outlook in China for luxury brands is uncertain. Image credit: Dubai Mall

One of the biggest uncertainties for global markets surrounds the U.S.-China trade war, which continues to escalate (see story). On Aug. 15, adding to the ongoing dispute, China said the U.S.' decision to raise tariffs on additional goods threatened potential trade talks.

China also said it would be taking countermeasures against the U.S. in retaliation.

"If we learned anything from the last Great Recession, it is that the luxury market is not immune to economic ups and downs," said Pam Danziger, president of Unity Marketing, Stevens, PA.

"The biggest danger for luxury brands in any global economic downturn is China," she said. "As we are seeing now with its crackdown on pro-democracy protesters in Hong Kong, China is in no way a free economy, and so the luxury consumers there are not free either.

"So many luxury brands have hinged their future on the Chinese market. They will get burned badly if things go south."

If world markets are thrown into another recession, it will have an impact on how consumers spend, at all income levels.

While luxury consumers are more financially insulated than most, they still changed their habits during the last recession.

One trend was the move away from conspicuous consumption, as those who still shopped at luxury boutiques were more guarded about their purchases. There were stories of customers concealing their luxury shopping in non-branded bags as they avoided flashing wealth amid others' financial hardship.

"The primary learning that luxury brands should have taken away from the last recession is how, if at all, did their consumers change their buying habits and why?" Mr. Shullman said. "If a luxury brand does not have its own retailing network, we strongly suggest they start discussing with their retailers and distributers what they know about their brand's consumers.

"Who are they socio-economically and how did their consumers behave during the last recession?" he said. "Did they cut back, stop buying or as occurred with some brands, actually grow during the last recession?"

Over the past few years, frugality has shifted from an economic necessity to a celebrated lifestyle choice, according to a 2017 report from Havas.

Despite the recovery seen following the financial crisis, consumers around the world feel that economic growth will never return to its pre-recession rates, with most adjusting their expectations around money and possessions (see story).

According to data from YouGov, only 31 percent of affluent consumers are very confident about their nation's economy. Additionally, 44 percent are extremely or very confident about their personal economics, down from 48 percent in 2016 (see story).

"The learnings luxury brands should have taken from the last recession is simply 'Be prepared,'" Ms. Danziger said. "What goes up inevitably goes down, so every brand should already have locked and loaded strategies that will help them through the next one."

Retention plan

A recession could slow down growth expectations for luxury goods and services.

In 2018 the overall luxury business grew 5 percent to $1.4 trillion, primarily propelled by rising demand from affluents in mainland China.

Luxury sales in mainland China alone grew 18 percent in 2018, according to the 17th edition of Bain & Company's Luxury Study, produced in partnership with Altagamma. The personal luxury goods market is expected to grow at a rate of 3 to 5 percent annually through 2025 for a value of $360 billion (see story).

A recent Duke University study found almost half of the chief executive officers in the U.S. expect a recession to hit by the midpoint of 2020. Of those, 69 percent have begun bracing for an economic downfall by the end of 2020.

With concerns about a recession continuing to build, marketers should look to invest in customer engagement tools to future-proof brands' sales and revenues in case of an economic downturn.

According to a study from CSO Insights, sales organizations in the United States have seen declines in consumer retention despite sales and revenue growth. Brands should continue to build positive relationships with consumers before spending stalls (see story).

"Those luxury brands that believe in planning to grow or at least maintain their position during the next recession whenever it actually starts impacting their brands should now be reviewing how their brands fared starting in 2005 on a month by month basis leading up to when that recession started impacting their brands vis a vis the major consumer and business indicators," Mr. Shullman said. "These include unemployment rates as well as other economic factors that impacted their categories, such as the tariffs that have been proposed recently and how those tariffs will impact their brand's pricing and competitive positioning if and when the tariffs actually are implemented.

"To the extent that luxury brands maintain individual customer buying histories, they should also be reviewing them now and be segmenting their customers by their buying behavior before and after the most recent recession began," he said. "History cannot predict the future, but it can provide reasonable contexts for future decision-making.

"Big picture, recessions unfortunately are part of the overall economic landscape and most luxury brands have a good number of months to prepare for them. Recessions shouldn't be a surprise, and what a luxury brand does to handle the next recession whenever it occurs can be planned for using optimistic, neutral and pessimistic scenarios."