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Should European luxury houses focus on China more than the US?

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Faced with the perspective of an ongoing trade war with the United States, the European Union should consider scaling down its operations there, while recalibrating its efforts with China. Image credit: Shutterstock

By Adina-Laura Achim

December 2019 brought with it the possibility of a trade war between the European Union and the United States, and shares of European companies dropped after President Trump announced heavy tariffs on French and E.U. products.

"Under the new tariffs, which may begin in late January, the U.S. Trade Representative could add levies up to 100 percent on around $2.4 billion in imports from France," says *CNBC*.

The development comes in retaliation to France's implementation of a Digital Services Tax, which imposes a 3 percent levy on revenues earned by multinational tech companies in France a tax that does not aim to punish the U.S., but rather, tax-dodging companies in low-tax EU countries.

CBS News reports that the tax specifically targets companies with at least 750 million ($830 million) in annual global revenue on their digital activities. Aside from Facebook, Google, and Amazon, various German, U.K. and Chinese companies were targeted.

French Economy Minister Bruno Le Maire promised a "strong" European response to President Trump's threats, while German Chancellor Angela Merkel voiced her concerns regarding the global order and the U.S.-E.U. partnership.

In an interview with the German newspaper *Sddeutsche Zeitung*, Ms. Merkel said that "the old certainties of the postwar order no longer apply," and, consequently, "Europe needs to reposition itself in a changed world."

Until the Trump presidency, seldom had we seen such cries of autonomy from the E.U. front, and public clashes with the U.S. were rare. But those taboos, it seems, have now been broken, and analysts warn that this transatlantic tit-for-tat will have catastrophic outcomes for the global economy.

"E.U.-U.S. trade matters most. It is by far the biggest single bilateral trade flow in the world," Florian Hense, an economist at Berenberg, told *CNBC*.

"Counting exports and imports of goods and services, U.S.-E.U. bilateral trade exceeded that between the U.S. and China in 2018 by more than 70 percent," he said.

Who will benefit the most from Trump's trade war against the E.U.?
If the E.U.-U.S. trade war escalates further, China and Russia will be the biggest beneficiaries.

Since the E.U. has been backed into a corner, it is being forced to look for allies in the most unexpected places, and both China and Russia are eager to recruit the E.U. into a united front against the U.S.

Both China and the E.U. are currently engaged in a trade war with the U.S., but the partnership between the E.U. and China has been thriving.

As stated by *Al Jazeera*, France's President Emmanuel Macron and China's President Xi Jinping signed mutually beneficial contracts worth $15 billion and helped forge a new age of cooperation between the two countries.

Moreover, in a press release on its Web site, the French government announced that the "relations between France and China are entering a new era."

The leaders signed a memorandum of understanding for a 10 billion construction deal for a nuclear waste reprocessing plant, and deals were reached in aeronautics, energy, agriculture and "climate change."

On top of that, China pledged to buy 184 Airbus A320 jets from France and assured the country it would lift a 2001 ban on French beef.

Additionally, a joint venture between France's Total and China's Shenergy Group to distribute liquefied natural gas by truck in the Yangtze River Delta has been green-lighted.

These bilateral deals suggest that China is ready and able to create business opportunities and effectively take Washington's place at the table.

How should the European luxury sector react to this new world order?
Faced with the perspective of an ongoing trade war with the U.S., the E.U. should consider scaling down its operations there, while recalibrating its efforts with China.

Let us analyze the reasons why a focus on China instead of the U.S. would benefit the European luxury sector:

China is the closest surrogate for the U.S. market
Thanks to the size and potential of the market, advancements in technology, mobile innovations, spending power of local consumers and the country's appetite for foreign goods, China has become an appealing partner for the E.U. And as it is set to become the world's biggest retail market, China has impressive consumption potential.

A comparison between China and the U.S. reveals that although China still falls behind the U.S. in luxury consumption, it has a lot of room to grow.

According to Bain & Co., in 2018 luxury sales grew 20 percent to 23 billion in mainland China, while they reached 80 billion in the Americas, which was only a growth rate of 5 percent.

The significant change, however, comes in spending.

While affluent Americans are losing their enthusiasm for luxury spending, the Chinese appetite for luxury remains unrivaled.

"Chinese consumers are expected to contribute 41 percent to the global luxury goods market by 2025," according to a report in *China Daily*.

What is even more interesting is the finding of Boston Consulting Group that showed around 48 percent of luxury buyers in China are younger than 30. This is a country where young, wealthy and brand-conscious luxury buyers are engaging in Western-style consumerism.

Fueled by Chinese consumption, European luxury companies have unsurprisingly reported strong performances in China.

Leading French luxury groups LVMH, Kering and L'Oral had strong revenues in China, and Herms and Lancome both brought in strong results in the second quarter of 2019.

According to *China Daily*, L'Oral's revenues from the Asia-Pacific region grew 30.4 percent to reach more than 4.6

billion between January and June, while Herms reported growth in the Asia-Pacific region of 20.7 percent.

Trump's protectionism versus Xi's coherent and straightforward approach

China's emergence as a global economic power happened in the shadow of perceived American decline, so it is hardly surprising that the E.U. has adjusted its course and moved toward a more restraint trade partner.

On the one side, the E.U. found protectionism and isolationism, and on the other side, a country that is actively trying to boost foreign business.

Naturally, China's newly found openness comes with restrictions, but they are far less harmful than President Trump's tariffs and protectionist rhetoric.

Lester Ross, chair of the policy committee of the American Chamber of Commerce in China, told *CNBC* that he expects foreign companies to gain 10 percent to 20 percent of the Chinese market.

Capital inflow

According to *Reuters*, "China is the E.U.'s biggest source of imports and its second-biggest export market after the United States, with trade between the two worth more than $1 billion per day."

In other words, it is in Europe's interest to work with China, as its member states have benefitted immensely from deals with it, particularly countries such as Italy and Greece who have not achieved remarkable economic progress in past years and are eager to embrace China's "Belt and Road" Initiative and pragmatic approach.

As stated by *China Daily*, the Sino-Italian partnership has brought significant benefits to the European nation, and China now accounts for about 2.7 percent of Italy's exports, valued at just little more than 11 billion ($12.3 billion).

More than 600 Italian companies have benefited from Chinese investments for a total value of 13.7 billion ($15.4 billion).

But stronger ties between the two countries could mean an additional inflow of capital.

Likewise, Western Europe's gains come at a time when the Sino-European relation feels revitalized.

Chinese foreign direct investment (FDI) in the European Union has increased by almost 50 times in only eight years, from less than $840 million in 2008 to a record high of $42 billion (35 billion) in 2016, according to Rhodium Group statistics and *The Diplomat*.

Investments in infrastructure

Assuming that the only major positive outcome of the Sino-E.U. cooperation is the "Belt and Road" Initiative, the European luxury industry will still win big.

Isolated countries in Southern, Central and Eastern Europe desperately need infrastructure funding to restore their crumbling roads, ports and bridges, but their budgets do not have room for infrastructure spending.

So, it is not surprising that E.U. member states have found value in China's "Belt and Road" Initiative."

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