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Why China's high unemployment is bad news for luxury

October 30, 2020

China has prioritized GDP growth over unemployment, while official statistics minimize this by offering an unreliable snapshot of China's unemployment data. Image credit: Shutterstock

By Adina-Laura Achim

China has an unreported unemployment problem.

While the world has focused on China's swift GDP recovery, some analysts highlight that the country's unemployment rate is a ticking time bomb.

Over the last decade, Beijing has prioritized GDP growth instead of finding solutions for unemployment. The problem is that official statistics minimize the disaster, offering an unreliable and unrealistic snapshot of the country's unemployment data.

For example, despite the country's economic and social challenges, the unemployment rate remained well balanced, always staying around 4-5 percent. But these numbers were not the reality because it only takes the urban registered jobless rate into account.

Because of China's hukou (household registration) system, mingongs (migrant workers) come to find work in the big cities but are not registered. As such, they have no access to benefits, and the government does not count them in the working population.

It is estimated that more than 290 million workers migrated from the countryside to work in cities throughout China as of the end of 2019, about one-fifth of the country's population.

But the COVID-19 outbreak has disproportionately affected their livelihoods, and millions of migrant workers working manual labor jobs have lost their paychecks.

In April, domestic brokerage firm Zhongtai Securities released a report that assessed China's real jobless rate at 20 percent. But soon after, the company retracted its estimate and removed it from the Internet.

Analysts at UBS guessed that around 70 to 80 million Chinese lost their jobs or could not work starting from the end of March onwards. Moreover, 8.7 million graduates entered the workforce during this year of economic downturn.

How does China's unemployment rate affect luxury consumption?
Social stratification absolutely affects luxury consumption.

Unemployment affects family wages, consumption patterns and spending, so, unemployment undeniably triggers a decline in income, assets and liquidity.

In their paper titled, How Does Unemployment Affect Consumer Spending, Peter Ganong and Pascal Noel established that, at the beginning of unemployment, monthly spending drops by 6 percent. But after UI benefits are drained, spending drops by 12 percent.

But Chinese migrant workers do not have benefits. And since they do not enjoy the security of this support system, their monthly spending is likely to drop further.

Brands who disregard the suffering of the poor are making a dangerous miscalculation mostly because 70 million unemployed people represent a force that puts an immense strain on an economy.

As the lower classes in China continue to get larger and poorer, their impact on domestic consumption and retail becomes more profound.

In 2018, domestic consumption contributed 76 percent of China's GDP. And, over recent years, consumption has become the key for China to "stabilize growth, adjust structure, promote reform, improve livelihoods and control risks."

But when millions of job seekers are uncertain about their futures, they delay consumption.

As such, these new consumption patterns will strongly affect retail by lowering production in factories, forcing immediate changes to the supply chain, prompting store closures, cutting retail jobs and wage, and curtailing investor gains while luxury goods stocks slump. It is not farfetched to believe that such events could lead to a deflationary spiral.

Young demographics rule luxury consumption, but spending habits can change
As has already been noted, 8.7 million graduates entered the labor force during a period of economic downturn. They are mostly older Gen Zers who did not find a booming economy and endless career opportunities like their millennial peers. In fact, they can expect lower earnings and less desirable job placements.

Examining U.S. and European millennials who entered the labor market during the Great Recession is enough to understand the grim perspectives of this generation.

According to research, college graduates who enter the workforce during a recession earn less than those who graduate during periods of prosperity for at least 10 to 15 years.

Low-paying jobs and pay reductions lead to decreases in discretionary spending, and luxury goods are no longer prioritized if consumers do not have emergency funds or cannot cover necessities. This situation represents a double penalty for luxury brands: Not only are they losing customers, but they are also being defeated by counterfeiters.

Considering that young consumers are more vulnerable to peer pressure, they will try to keep up appearances by making purchases that communicate success and an affluent lifestyle. That makes them more likely to invest in fakes and counterfeit products.

The unemployment crisis will also affect the younger cohort of the Gen Z demographic. Although it depends on its parents' incomes, any economic turbulence affects it as well.

Due to negative economic sentiment, it is expected that their parents will react to the economic shifts by trying to protect their assets instead of buying luxury goods for their offspring.

Meanwhile, millennials, who are part of the other super-luxury consumer demographic, are already showing signs of luxury fatigue.

As this cohort gets older, its approach to family life has changed, and its preferences and tastes are maturing.

Starting a family, investing in quality education or private health services, and prioritizing experiences over goods have become the new luxuries. The COVID-19 crisis and the ensuing unemployment problem have only accelerated this shift.

Social stigma

Making a luxury acquisition when millions do not have access to shelter or meal programs takes the fun away from the luxury-buying experience. Unsurprisingly, there is a social stigma associated with buying luxury during economic downturns.

In 2008, at the height of the Great Recession, luxury consumers consumed luxury in secret and stopped spending openly. Even consumers who continued to spend money replaced big-ticket items with "affordable luxury" or cheaper products.

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