Luxury Daily®

The News and Intelligence You Need on Luxury

RETAIL

Is China's debt crisis a ticking time bomb for luxury?

January 19, 2021

China's rising national debt levels will eventually hamper economic growth and create a market with less disposable income for luxury. Image credit: Shutterstock

By Adina-Laura Achim

Total Chinese debt across all sectors household, government and corporate rose to 318 percent of the GDP in the first quarter of 2020, according to the Institute of International Finance. And based on early signs, Beijing seems open to fiscal policies to keep China's economy afloat that will balloon the national debt even more.

Yet, some debt categories are seeing breathtaking growth.

For instance, the *South China Morning Post* reports that consumer debt is "among the fastest-growing segments of overall debt, particularly in the form of mortgage and consumer loans."

Household debt increased to 57.7 percent of China's GDP in the first quarter of 2020, according to the National Institution for Finance and Development.

Meanwhile, China's external debt grew to $2.09 trillion over the first quarter of 2020.

In the long-term, China's rising national debt levels will create serious problems and hazards. It could hamper economic growth, while forcing Beijing to fight off long-term wage stagnation and moderate private consumption, creating a repeating process in which shoppers have less disposable income and consume less.

China can look to the US to see the consequences of debt denialism

Debt denialism is a real thing, and it has affected how the United States does business, says John H. Cochrane, a senior fellow of the Hoover Institution at Stanford University.

"The federal government borrowed nearly $1 trillion in 2019 before the pandemic hit," he said. "It borrowed nearly $4 trillion through the third quarter of 2020, with more to come. If we add additional and sustained multi-trillion-dollar borrowing and $5 trillion or more in each crisis, the debt-to-GDP ratio will balloon even with zero interest rates."

Most domestic consumers cannot fathom the idea that economic superpowers could be at risk of a sovereign debt

crisis. But debt default has bankrupted Argentina a country that in 1913 was the world's 10th wealthiest nation and another global superpower: Russia.

Meanwhile, China is facing the challenge of an aging population.

According to a study by the Chinese Academy of Social Sciences, China's population will peak at 1.44 billion by 2029, entering an "unstoppable" decline.

"Fewer people means less domestic consumption, and thus rapidly slowing economic growth," said Charlie Campbell, the East Asia correspondent for *Time*.

But a high national debt also represents a generational grievance, as younger consumers are punished more due to the miscalculations and reckless spending of older generations. Hence, Chinese millennials and Gen Zers will be forced to embrace frugality and austerity.

China is close to a tipping point. If Beijing does not address long-term fiscal imbalances, we foresee the country lacking the fiscal space to combat the next crisis. And if the COVID-19 pandemic has taught us anything, it is that the next global crisis is always around the corner.

What happens to the luxury industry during a period of income stagnation and slow economic growth?
The recent post-pandemic global economic downturn shows that luxury retail gets hit hard in periods of economic crisis.

"COVID-19 impact caused an unprecedented fall in market size to 217 billion euros, down 23 percent from 2019 and back to 2014 levels," per the 19th edition of the Bain & Company Luxury Study, released in collaboration with Fondazione Altagamma. It is the "sharpest fall ever" recorded, according to the study.

When the COVID-19 pandemic devastated the industry, the only ray of hope was China.

"Mainland China was the only major luxury market to grow in 2020," Bruno Lannes, a partner with Bain's consumer products and retail practices, told CNN Business. "China's luxury market is now bigger than ever."

The problem is that the luxury industry is not equipped to face a reality check. And without the super-Chinese consumer, the industry cannot thrive or maybe even survive.

So, when debt stress leads to shifts in demand for luxury products, some less-established premium and luxury brands will go out of business.

Thus far, luxury brands have benefited from China's domestic-driven growth, which has been fueled by the more materialistic and individualistic views of younger generations.

But, as those consumers age, they will be inclined to turn toward inconspicuous consumption a form of "discreet" wealth. That could lead to a domestic market saturation: a phenomenon that we have seen in other mature economies.

When that happens, a debt crisis will only aggravate this saturation, which, in turn, will hinder performance in the luxury industry.

Published with permission from Jing Daily. Adapted for clarity and style.