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RETAIL

Luxury market will take years to recover from COVID-19

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Brands such as Louis Vuitton will be able to weather the storm with strong customer loyalty and focus on quality product as well as a deep-pocketed owner in LVMH. Other luxury brands may not be as blessed. Image credit: Louis Vuitton

By Pamela N. Danziger

Two of the world's leading authorities on the luxury market, Boston Consulting Group (BCG) and Bain & Company, are out with their latest assessments of the impact of the coronavirus pandemic on the luxury market. Their findings are sobering, at best.

What once was a shining light in the consumer market has now gone dark and threatens to stay dark for quite some time.

In February, BCG estimated the global personal luxury market could lose $33 billion to $44 billion in sales (30 to 40 billion) this year.

Just three weeks later, it more than doubled that first optimistic estimate downward to a loss of between $80 billion to $100 billion this year (73 to 91 billion), from a total market of ~$350 billion in 2019 (320 billion).

Then on March 27, Vogue Business reported BCG revised it downward again, to $85 billion to $120 billion (78 to 110 billion), though I could not verify that with BCG sources.

BCG also expects a V-shaped recovery, with luxury sales by the end of the year to be only 10 percent to 15 percent under what they were in December 2019.

Like its earlier estimates, I believe BCG may be way too optimistic.

Deloitte's APAC consumer product and retail sector leader, Tianbing Zhang, agrees with me: "Seeing a recovery in the third quarter of the year and reaching 80-90 per cent of [last year's] sales in the fourth quarter would be quite an optimistic situation."

Bain offers three scenarios, none of them pretty

Bain sizes the personal luxury market slightly below BCG's estimate, $307 billion (281 billion) in 2019.

Hedging their bets, Bain analysts, led by Claudia D'Arpizio, modeled three alternative scenarios for the personal luxury market in 2020.

Bain's best-case scenario forecast is a year-on-year 15 percent to 18 percent decline from 2019 levels, with fourth-

quarter sales returning to positive territory, to which I say: not a chance.

Scenario 2, which Bain favors, shows a year-on-year 22 percent to 25 percent decline.

Scenario 3, my choice, projects a 30 percent to 35 percent decline over 2019, or a $92 billion to $107 billion decline (84 to 98 billion). That would put the luxury market back to 2011 levels.

The problem with financial modeling coronavirus is that this situation is unprecedented. It does not compare to the Great Recession of 2008-09, which only hit people in their wallets, whereas this one threatens their lives.

Further, during the 2008-09 financial crisis, affluent Chinese consumers were largely shielded from the impacts, so they kept spending while Western consumers put luxury indulgences on hold.

The 2002-03 SARS pandemic, which also originated in China, also does not compare. It only infected some 8,000 people. COVID-19 has infected 100 times more than that in China (~875,000) as of this writing. And back in those days, China was less of a force in the luxury market.

While there is no precedent on which to base financial models, the affluent consumers' experience coming out of the 2008-09 recession provides a reasonable benchmark for what to expect this time, though again it is hard to anticipate what the Bain authors describe as the coronavirus "fear factor."

Lessons from the recession

Michael Baer, Ipsos senior vice president and managing director at U.S. Ipsos Affluent Intelligence, offers learning from its affluent consumer surveys 2009-2011.

"Any expectation that things will return to normal' quickly post-crisis can be disposed of out of hand," he writes, as he draws parallels from the financial rude-awakening affluent consumers got in 2008-09.

But, again, the changes in affluents' consumer behavior and mindset then were the result of only a financial crisis, not like this one that threatens their and their families' personal well being.

As a result, I expect the changes to be even more magnified this time around.

First, Ipsos found that affluents' feelings of financial anxiety persisted long after the recession's recovery.

In 2009, some 75 percent of affluents were "very worried" about the state of the economy. That only dropped by 10 percentage points by 2011, when 65 percent remained in a very worried state.

Since the global financial ramifications of coronavirus have yet to be realized, it is expected to be worse than that experienced in the 2008-09 financial meltdown with no country, not even China, immune. That is why Mr. Baer advises, "[The] anxiety and a healthy paranoias *[sic]* are likely to linger possibly for a long time."

Further, affluents' extended financial worries played out in extended and pronounced changes in their discretionary purchase behavior, though their attitudes did not change overnight. However, they took a gradual downturn even while the recovery was well on its way and stayed depressed.

For example, 58 percent of affluents surveyed in 2009 said being well-dressed was important to them, but by 2011 that percentage declined to 49 percent.

Further, their feelings about fashion as a form of self-expression declined as well, from 56 percent who said fashion represents who they are as a person in 2009 to 43 percent in 2011.

"This suggests that early on in the crisis, consumers were still clinging to their attitudes but the economic context then caused them to change behaviors," Mr. Baer writes. "And those behaviors stayed changed even as the economy came back."

Mr. Baer concludes: "The key takeaway is to recognize that consumers are going through anxiety which will in turn lead to behavioral shifts and this won't likely snap back to pre-crisis norms post-crisis."

Get ready for a very long, painful recovery

While McKinsey & Company is "cautiously optimistic" that Chinese consumers are regaining confidence as the COVID-19 crisis lifts, based upon a survey conducted March 20-23 among 2,500 Chinese consumers, we should look to the Ipsos studies to temper any optimism.

We are still in the very early stages of a pending global financial crisis. The full economic impact of coronavirus has yet to be felt by Chinese consumers, or others across the world.

The McKinsey survey found that 49 percent of consumers are optimistic the Chinese economy will recover within two to three months and will "grow just as strong or stronger than before COVID-19."

That is wishful thinking, not reality.

I suspect that their perspective will change markedly in a few months once reality sets in.

Many of those currently optimistic 49 percent will settle into McKinsey's neutral category where they measured 45 percent of Chinese consumers are today, specifically, "The economy will be impacted for 6-12 months or longer and will stagnate or show slow growth thereafter."

And just like the Ipsos surveys found that U.S. affluents clung to their past purchase behavior for a time immediately after the 2008-09 recession, the much-wished-for "revenge spending" that will send Chinese affluents back to luxury shopping will be short-lived.

As the full financial implications of the coronavirus become real, that burst of revenge spending will come to a crashing halt and Chinese affluents, along with those around the world, will settle into a much more restrained and considered purchase behavior related to luxury goods.

IT IS GOING to take more that a year and maybe many years before the luxury market recovers.

While the Chinese market almost single-handedly powered the growth of the luxury market over the last decade, the Bain study warns that Chinese consumers "are unlikely to ride to the rescue in quite the same way" this time around, adding, "There is no other emerging cohort of luxury consumers to tap."

Luxury brands will be left high and dry with no growth engine like China to fall back on in 2021 and beyond.

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