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Luxury Market Slumps as Bleak Economic Outlook Hits Rich Russians' Courage

By Howard Amos

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Luxury brands, including Gucci and U.K. fashion house Burberry, have this year taken direct control over most of their stores in Russia, moving away from their previous franchise model.

Mikhail Kusnirovich, the owner of Moscow's GUM shopping mall, was mingling with the fashion elite at a party thrown by Gucci this month to mark the opening of the Italian brand's two new outlets in the Russian capital.

Gucci executives from London and Milan, many on their first visits to Moscow, toasted to greater success, dismissing economic woes and Russia's growing international isolation as temporary blips.

But Kusnirovich was more cautious. "People don't have the courage to buy," he told The Moscow Times.

Worries about the prospects of the Russian luxury goods market have risen this year as the country's economy teeters on the brink of recession and the ruble plunges amid sanctions imposed on Russia by the United States and European Union for Moscow's support of separatist rebels in Ukraine.

The luxury goods market in Russia could contract by as much as 18 percent this year to be worth 4.6 billion euros ($5.8 billion), consultancy Bain & Co. wrote in an October report. The sector grew about 5 percent last year.

Badly Hit

Heightened political tensions over Ukraine and the sharp devaluation of the Russian currency are the two most important reasons behind the problems, experts say.

Luxury goods are all imported, and their retailers suffer from a weak ruble. The Russian currency has plunged over 30 percent versus the U.S. dollar so far this year, driving up costs.

"Some luxury retailers report that turnover has fallen 30-40 percent compared with the same period of 2013," Anna Lebsak-Kleimans, chief executive of Fashion Consulting Group in Moscow, said in written comments.

"Luxury brands are usually less affected by economic downshifts then the mass consumer market. But this year even top luxury retailers have noted sales decreases."

Political tensions are also fueling a drop in demand.

"Spending by Russians has really decreased because of worrying prognoses," Kira Balashova, the head of Jamilco, a distributor of luxury brands in Russia including diamond producers De Beers and fashion house DKNY, told business daily Vedomosti last month.

Temporary Reprieve

In a quirk of fate providing a window of opportunity for wealthy shoppers, the speed of the ruble's recent collapse has meant that rising costs have not yet been reflected in some companies' price tags.

A few of the luxury items sold in Gucci's Moscow branches are currently cheaper in dollar terms than the same products in company's home cities of Milan and Florence.

"For the moment we are keeping the same prices," said Kusnirovich, who also owns the Bosco di Ciliegi group of companies, which distributes luxury brands like Armani and D&G.

Executives admit, however, that this situation cannot last and forecast that prices will climb as retailers order in new products for sale in 2015.

While the ruble has retreated from the historical lows it hit a fortnight ago, the currency has fallen 16 percent against the dollar since Oct. 1 and remains under pressure from slipping oil prices.

Fallout

Several prominent clothing retailers, including Esprit, New Look and River Island have announced plans to close their shops in Russia over the last two months.

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While management centralization is a worldwide trend in the industry, analysts said that greater oversight will give luxury brands greater flexibility and a better chance of riding out the effect of sanctions and the economic downturn.

Hit by the weaker ruble, Russians are now traveling overseas less often and spending less when they do. Some experts believe that this could even boost demand domestically — as long as price rises are not too sharp.

"Companies and trading updates confirm that Russian tourist spending is disappearing fast," Luca Solca, the head of luxury goods analysis at Exane BNP Paribas, said in written comments.

"It seems appropriate, therefore, to serve Russian clients in their home country."

Gung-Ho Gucci

Gucci, which has seen a steady decline in sales revenue this year, is one company betting that there is a silver lining to Russia's economic storm clouds.

The luxury Italian retailer, founded in Florence in 1921, formally opened two new stores in downtown Moscow last week, bringing its total number of outlets in Russia to seven. One of the new stores occupies a prime location in GUM with a view over Red Square and the Kremlin, while the other stands on Petrovka near a string of other luxury brand stores.

Together, they have a combined floor space of almost 2,000 meters. The Petrovka store, one of the biggest Gucci stores in the world, features staircases lined with ribbed glass and polished gold and offers its own unique women's collection that makes liberal use of crocodile skin and fox fur.

Gucci executives admitted that that the current situation is difficult, but said that such investments are made with a long-term horizon in mind.

"We have rainy days as well as sunny days," Gucci president Patrizio di Marco told The Moscow Times amid champagne-drinking guests at the opening of the Petrovka store.

"In the long term you make bigger opportunities, but in the short term higher risks and difficulties."

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