Souring economy causes luxury items to lose luster

by Jennifer Davies

Just two years ago, Andrea Martin would see a designer handbag or a pricey cocktail dress in a store window and buy it without a thought.

"Now you think two or three times," she said.

Martin said the economy has her so nervous that she's cutting back on everything.

"People are losing their homes, so it's hard to think about a Coach bag," Martin, 36, said as she shopped with her mother at an upscale West Coast mall. "In the past, we would have been to Nordstrom's five more times, but not this year."

Sentiments like Martin's are causing a ripple of concern among luxury retailers. Until now, upscale shops have been able to shrug off the troubles in the larger economy and outperform their more moderately priced competitors, in part because so-called aspirational shoppers would splurge on such luxe items as a Gucci purse or Hermes scarf.

Now there are signs those shoppers are cutting back.

According to the International Council of Shopping Centers, luxury retailing began showing particularly strong growth in 2004, when its sales increased 9.6 percent from the previous year while the overall retail market grew 3.8 percent. So far in 2007, luxury chain store sales have increased 7.9 percent, compared with 2.4 percent for the total retail chain business.

While few analysts see the ultra-rich trimming their spending dramatically, there is concern that middle-class shoppers who helped create the boom in high-end brands from Gucci to Burberry might be cutting back, as skyrocketing gas prices and the declining housing market continue to eat away at consumers' discretionary spending.

Steve Sadove, chairman and CEO of Saks Fifth Avenue, alluded to a possible slowdown in a recent earnings call with analysts, saying "you're seeing more pressure on that aspirational luxury customer," who buys the so-called entry-level products. Still, he said the super high-ticket items were continuing to sell well.

Coach, which caters to a more mass-market customer than, say, a Louis Vuitton, has said its fourth quarter would have the slowest rate of growth in six years.

Marshal Cohen, chief industry analyst at The NPD Group, a market research firm, said this holiday season will see shoppers cut back on luxury items and shop in more mid-priced stores.

"People are tending to shop in their sweet spot - at stores where they feel more comfortable," he said. "Some of the luster is going to get knocked off the luxury market."

Some stores and brands will be hit harder than others, said John Lahman, a retail analyst with KDP Investment Advisors.

"Neiman Marcus will be fine. Saks could lose their aspirational customer who may trade down, same with Nordstrom," Lahman said.

It is unclear how much of a luxury retailer's business relies on those aspirational customers, as analysts don't track that statistic. Sadove of Saks said lower-tier products could constitute about 10 percent of its business but added that less-affluent customers also make big-ticket purchases. Still, he said, the "majority, a much bigger piece of our business is at the higher price points."

Rosa Valdez, 29, said she's still willing to spend as much as $1,000 for an item like her Louis Vuitton handbag. But she said business is down at her Tijuana, Mexico, restaurant, Birrieria Guadalajara, because of fewer American customers. Now, she said, "maybe I'll just buy one purse a year."

People aren't just cutting back on high-end brands but also luxury services such as facials and massages. Gretchen English said her San Diego business as an aesthetician is down by as much as 20 percent, with the slow down starting in earnest about September.

"It's just a trickle affect," she said. "If your clients aren't spending, then you have to pull back."

Still, many analysts said the luxury sector is better poised than middle-market and discount stores, whose customers have been more keenly affected by the rising price of gas and the ongoing credit crunch.

"They tend to hang in there no matter what," Stephen Hoch, professor of marketing at the University of Pennsylvania's Wharton School, said of purveyors of expensive wares such as Neiman Marcus and Tiffany.

Also, U.S. luxury retailers are being buoyed in part by the increase of international tourism, especially visitors from Europe, as the weak dollar makes many high-end items more affordable in the United States.

Tiffany's flagship store in New York City, for instance, typically accounts for 10 percent of the chain's overall sales. In the third quarter, that store had a 31 percent increase in sales from the previous year, in part because international tourists have flocked to New York City in search of deals.

"The influx of international tourists means we will not see a major downturn in the U.S. luxury retail market," said Tao Gao, a marketing professor at Northeastern University.

Not everyone stateside is cutting back either.

Ashlee Nicolls, 30, said she will continue to buy luxury items such as the Louis Vuitton purse she was toting around as she shopped in San Diego recently.

"My spending hasn't slowed down at all - even though it probably should," she said.

Nicolls and her husband just bought a house on the coast but haven't yet sold their current house inland. That means they will have two mortgages until they can unload the old house - something that might be tricky in a struggling housing market.

"It may hit me in the future," Nicolls said about her spending habits. "But it hasn't hit me yet."

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