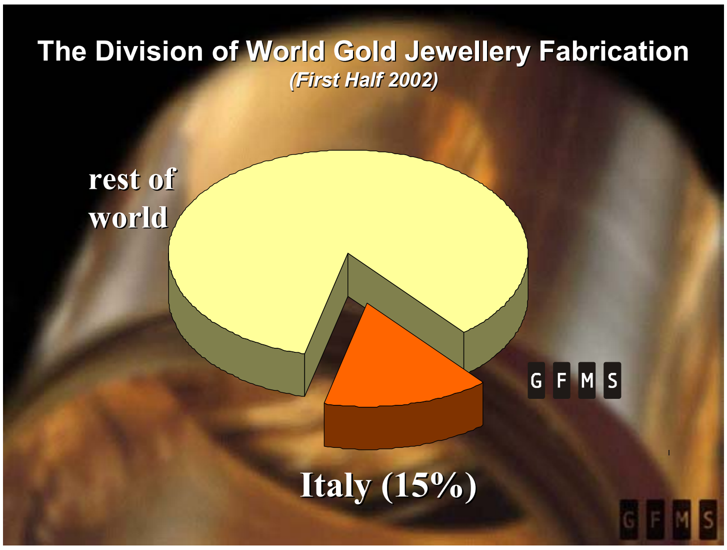
The Challenge Facing the Italian Jewellery Industry

The following article is an adaptation of a talk given by Neil Meader at the GFMS Precious Metals Seminar, held recently in London. Mr Meader is the consultancy's analyst responsible for much of Europe, including gold and silver in Italy. Contact details for GFMS are published at the end of this article.

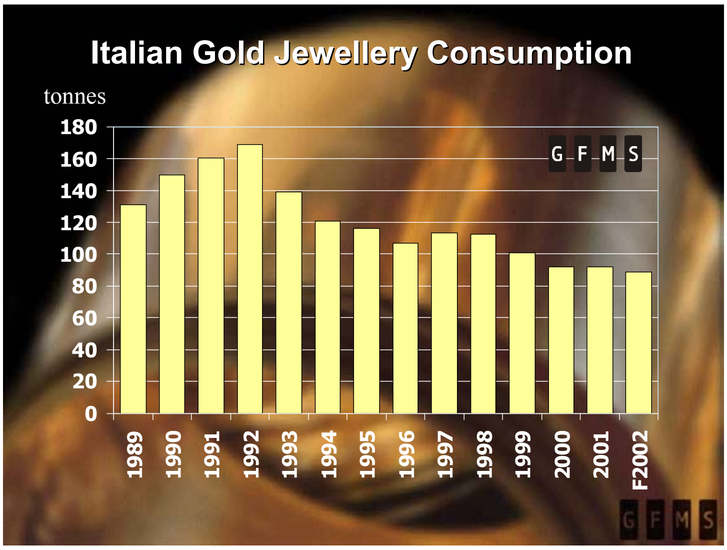
Introduction – The use of gold in Italian jewellery fabrication is of great interest to the gold market because of the substantial amount of the metal involved. GFMS estimate that Italy's jewellery industry uses around 15% of all the gold transformed into jewellery globally. It is of note that, because of the significance of jewellery demand within the total gold market, Italy's jewellery industry accounts for around 10% of all forms of world gold demand.



This year – 2002 has not been a kind year to the Italian jewellery industry. GFMS estimate that the first half of the year saw a decline in output (of gold jewellery) possibly as high as 14%, compared to the first half of 2001. The second half is forecast to be much less brutal with the fall slowing to perhaps just over 5% year-on-year. This suggests an annual production drop of around 10%.

But does this mean that we are going to see similar performances in future years? Our general conclusion here is that further declines look more likely than any real recovery but we expect any future falls to be less dramatic than those we are seeing this year. The main factors behind this conclusion are outlined below.

The Domestic Market – An Italian jewellery manufacturer does not need to be told that the domestic market slumped heavily during the 1990s. Some comfort can at least be drawn from the fact that the rate of decline has slowed greatly in more recent years.



We believe that much of this fall in consumption was the result of a change in spending patterns, especially in the north. This change was composed of two main elements; firstly, a shift within jewellery, away from plain gold to value-added and stone-set pieces, and, secondly, a transfer of consumer spending to other goods such as mobile telephones, computers or foreign travel.

Unfortunately, whilst the period of rapid transformation may be behind us, further changes look possible. Jewellery consumption in the south of the country is more traditional but matters here are also changing. In addition, whilst a consumer spending pattern more similar to other European countries has been broadly adopted, a new trend, one that in many ways originates in Italy, could well further undermine gold jewellery sales. The trend in question is the rise in popularity of competing materials, especially amongst the younger, more fashion orientated buyer. Silver jewellery has seen good interest in recent years but it is the long list of non-traditional competitor materials in jewellery (for example, titanium, stainless steel, glass, crystal, carbon-fibre, leather or rubber) that raises a new threat of a further shift in expenditure away from gold.

Fabrication for Export – Having grown in a very healthy fashion during the 1990s, exports have been suffering in the last few years and GFMS forecast that they could drop over 10% this year. The main reason for these declines is intense competition from other producers, especially in Turkey and south-east Asia. These countries have been taking market share from Italy now that their industries can offer products nearly of the same quality and for a much lower price, exploiting their lower labour costs.

Italy's cost disadvantage is not going to disappear but there are a couple of reasons why any fall in exports might be less dramatic in the coming years. Firstly, much of the loss this year was due to weak global consumption, mainly as we have had the unhappy coincidence of a major gold price rise overlapping with what could be the low point in the world economic cycle.

A second point is that the segments of the market that Italy has now lost or is losing are just those where it had become noticeably uncompetitive. However, Italy is more competitive in other segments – industrial chain and top end pieces mainly – and these remaining areas should be less easy for other producers to capture.

As well as the pieces that it produces not being uniform, the Italian jewellery industry itself is far from uniform. Producers in the Vicenza/Bassano area appear to have suffered less in the last few years, mainly because they are so automated that labour costs are less of an issue and, as such, they remain fairly competitive. The Arezzo manufacturers, however, seem to have suffered greater losses in this period, mainly as their less automated, more diversified areas of production have been hit by overseas competition. In addition, a greater share of Arezzo's exports go to Latin America and the USA, two markets which have been weak of late. The Valenza industry enjoys a degree of protection because of the high quality and design skills it can offer but the fabrication of more basic gemset pieces still faces keen competition from other countries such as Thailand.

The Industry Response – It is important to remember that market share loss is not inevitable. If producers can get their costs down and keep offering a clear design and quality advantage over competitors then exports should suffer less. It is apparent that most manufacturers are very much alive to the threat posed and are making great strides to address this issue. To some extent however, action to counter this threat has only really come about very recently, principally as a loss of market share, matters less if your exports are still growing. But when exports start falling in absolute terms, it is time for more concerted action.

Perversely, the output of jewellery in Italy by the more dynamic companies many not hold up any better than those of the laggards. The reason for this is industry relocation – companies moving production to countries where labour costs are lower. However, to date we have only seen a couple of major examples of this. It also does not seem that any acceleration in the pace of this transfer is imminent.

Conclusion – As a reminder of the basic conclusion, it appears more likely than not that the production of gold jewellery in Italy will decline over the next few years but the pace of this fall will be less steep than that likely for 2002.

The actual impact on the gold market (and therefore the price of gold) of these possible changes is marginal – the global supply and demand balance will not be affected by the transfer of say 100 tonnes of fabrication from Italy to Turkey. Bullion flows will change, however, and that could of importance to bullion banks.

However, the only significant impact of the above is on jewellery fabricators, whether in Italy or elsewhere. If, as we argue, it is the location of production that is critical, the real issue facing Italian producers is the nature of the shift in fabrication. It could be by design – Italian producers moving production capacity to countries with cheaper labour costs or engaging with companies in these countries in the establishment of joint-ventures. Alternatively, it could be by default – overseas producers continuing to eat away at Italy's market share in its exports markets as a result of their rising quality and design competence combined with cheaper prices.

The transfer by design will not be without its casualties – not all transplanted factories will be a success – but that does not alter the basic outlook. To some extent, Italy already has a role model for what is possible in the shape of Germany. A decade or so ago, its producers took the decision that high labour costs no longer made the production of many lines of jewellery viable in Germany. As a result, output was fairly steadily moved abroad, especially to Thailand. The fabrication of gold jewellery in Germany is now less than half its peak in 1991 but world-wide production by German companies has been far more steady.

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