Paul Zimnisky at Reuters in New York in June 2018. **Image Source:** Paul Zimnisky

3 Themes That Will Likely Shape the Diamond Industry in 2019

BY PAUL ZIMNISKY

Looking towards 2019, here are three themes that will likely shape the diamond industry:

THE PRICING POWER OF LAB-CREATED DIAMOND PRODUCERS

Even before De Beers announced that they would be entering the lab-created diamond jewelry arena in mid-2018, the price differential of equivalent lab-created and natural diamonds was widening significantly. This is primarily the result of more lab-created supply entering the market and lower-production costs resulting in more competitive pricing amongst producers.

However, given that the price of a mid-quality generic 1-carat lab-created diamond still sells for around $3,700 at year-end 2018, compared to De Beers' 1-carat Lightbox offering at $800, the lab-created industry is still trying to price the product symbiotically with natural diamonds. Even JCPenney is selling a 1-carat lab-created for upwards of $3,700 to its mostly lower-middle-class demographic in the U.S.

The profit margins for the lab-created producers are quite attractive at the above price points, so it's no wonder why the industry is reluctant to come down to Lightbox-level pricing. But, as more competitors enter the space and more volume enters the supply chain it will likely become more difficult maintain higher price levels while attracting sufficient consumer demand given where Lightbox goods are priced.

The Lightbox pop-up store in lower Manhattan in late-November 2018. **Image Source:** Paul Zimnisky

The lab-created producers are in part attempting to justify a higher price point with the use of grading certificates, a way of signifying similarity with natural diamonds, their rarity and thus their prices. However, given that there is no limit to lab-created diamond production or opposition to enhancing the quality of lab-created diamonds, e.g., with HPHT, the grade of a lab-created diamond is arguably irrelevant because theoretically rarity is not part of the equation.

As lab-created diamond prices trend lower, the product is more likely to be sold as a fashion jewelry item, which is less likely to rival natural diamonds for market share.

A CHANGE IN TRAJECTORY OF THE U.S. DOLLAR

The trend of a weaker U.S. dollar in 2017 reversed course in 2018. As of late-2018 the Indian rupee is at a historic low versus the dollar, down 13% year-to-date, the South African rand is down 16% and the Chinese yuan is at a multi-month low. Further the pound and euro are down 8% and 6%, respectively, versus the dollar in 2018.

This is in part due to idiosyncratic challenges associated with the nations listed above but also due to the fact that the U.S.'s Federal Reserve has raised the Fed Funds interest rate from 1.375% to 2.125% in 2018. A higher U.S. interest rate tends to boost demand for dollars from abroad which are invested in fixed-income securities that yield a higher return. In addition, tighter monetary policy is indicative of a stronger economy, and a lower risk perception draws demand for U.S. dollars intended for purchasing dollar-denominated assets.

The implication of a stronger U.S. dollar on the diamond industry is varying. For example, a weaker South African rand tends to benefit miners that operate in rand and sell diamonds in dollars, such as De Beers Consolidated Mines and Petra Diamonds. However, a stronger dollar can also have a negative implication on the industry; for example, rough is more expensive in rupee terms for Indian diamond manufacturers.

Perhaps the most important implication of a stronger dollar on the larger diamond industry is a decrease in demand from non-U.S. end-consumers.

Non-U.S. consumer's purchasing power for diamonds erodes as the dollar strengthens given that the price of diamonds globally tends to be set in terms of U.S. dollars. For example, there has been some evidence in 2018 that Chinese diamond consumption has been impacted by a weaker-yuan-stronger-dollar dynamic. Further, this dynamic has been especially evident in the case of direct foreign exchange, for example, a decline in Mainland Chinese consumers shopping abroad in the U.S., as Tiffany recently noted.

Looking at 2019, U.S. corporate earnings growth is expected to fall by as much as 50% as the effect of the corporate tax cut in 2017 normalizes and tighter monetary policy diminishes profitability. A relative slowing of the U.S. economy in 2019 could lead to a pause in the current higher-interest-rate-trajectory environment, which could lead to a weakening of the U.S. dollar, which could lead to an increase in diamond demand outside of the U.S.

THE DPA

Despite the threat of lab-created diamonds and the present geopolitical and economic concerns, arguably the natural diamond industry's greatest challenge is successfully reinitiating generic diamond marketing. It's now been over 10 years since the "A Diamond is Forever" campaign ended, and while the campaign was so successful its momentum continued even in the years after the campaign concluded, the residual effect has finally run its course. Given the timeline, many younger consumers are more likely to associate diamonds with Leonardo DiCaprio's "Blood Diamond" film than they are with the mystique and tradition of "A Diamond is Forever."

2018 was the first year that the Diamond Producers Association (DPA) had a significant budget, in excess of $80 million, to reignite generic diamond marketing and the initial impact of the campaign should begin to be felt in 2019. The association is funded and represented by eight of the largest diamond miners but has also received contribution from India's jewelry trade association, indicative of the industry aligning with a common goal.

Successful marketing is an integral part of what drives demand for luxury. Especially in the case of diamonds, effectively "throwing money at the problem" is likely to work. Buying a diamond is not a practical purchase based on rationality. Buying a diamond is an emotional purchase based on how it makes someone feel, and the emotional impact from a natural diamond can be quite compelling if presented in the proper context. If the natural diamond industry can continue to effectively market its product as it has in the past, there is good reason to believe that the industry can continue to persevere as it always has.

The DPA is leading the way but other trade organizations, such as the Jewelers of America, also have plans. The U.S. trade association intends to launch a generic ad campaign in 2019 aimed at promoting the unique and emotional aspects of a jewelry purchase. The U.S. represents the diamond industry's largest end-consumer market by sales at about 50%.

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