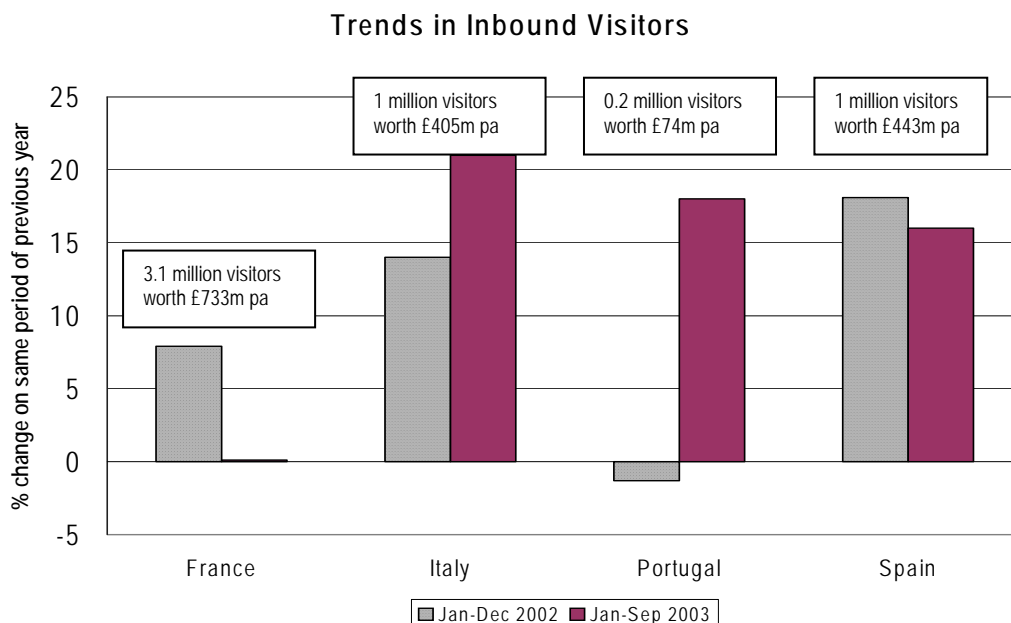


FORESIGHT is a monthly commentary on significant issues within the tourism sector. Each month, "Market Focus" discusses economic, social and political factors that underlie demand for tourism now and in the future. In addition, there will be a spot light focused on significant tourism issues. This month, the markets France, Italy, Portugal and Spain are examined and we consider the impact that decisions on airport capacity will have on tourism patterns in the future.

Market Focus – France, Italy, Portugal and Spain

Four markets, more than four languages and four economies, but all share a single currency. The appreciation of the Euro in the past year or so has hit each of the four markets, primarily by making their exports more costly to non-Eurozone countries. Increasing competition from low-cost China has emerged as a threat to the manufacturing sector, particularly in Italy which has a disproportionately large number of small to medium sized manufacturing enterprises. The positive news for tourism in Britain is that it is cheaper for citizens of Eurozone nations to visit Britain, by some 10% compared to a year ago.

All four markets share easy access to Britain, but notable differences have emerged in recent trends in the numbers visiting, with exceptionally strong growth from Spain and Italy, a mediocre performance from France and a recent improvement in the number of visitors from Portugal. The following chart shows recent trends based on International Passenger Survey data.



It is revealing to look at the share of residents from these countries that are British nationals, who live abroad. British nationals are of minor significance in explaining the flow of visitors

from Italy, constituting just 5% of the total, however, when looking at the number of Spanish residents who visit Britain each year, British nationals account for no less than 26% of the total.

The "mix" of carriers that bring visitors to Britain is very different for France than for the remaining three markets. Air, sea and tunnel all hold around a third of the market for visits from France, highlighting how easy it is for visitors from France to bring their own car to Britain. Air is by far the dominant mode for visits from Spain, Portugal and Italy, accounting for four-fifths of journeys. The low-cost carriers are extremely active in all four markets.

France

It was a long hot summer in France. Starting with a series of nationwide strikes in protest at pension reforms, and ending with a crisis in the health service as thousands of elderly residents died in the extreme heat. The economy has been suffering too - latest indications suggest French GDP fell by 0.3% between the second quarter of 2002 and the same period this year.

The OECD "leading indicator index" provides a window on the future direction of economic performance 6 to 9 months ahead. The latest figures show an annual rise of 2.9% meaning we can be cautiously optimistic that the French economy will see some recovery during the first half of 2004. Indeed, in its latest monthly survey of business leaders, the Banque de France "business sentiment indicator" rose to a score of 102, compared to 94 back in May.

Unemployment now stands at 9.5% in France and is still rising. In its most recent World Economic Outlook the IMF has forecast that the rate of unemployment will remain at around this level during 2004 whilst French GDP is set to grow by around 2% next year. A weak labour market may at first appear like bad news for short-term prospects for growth in visitor numbers from France to Britain. This need not be the case as it is likely to generate interest in short-haul rather than more expensive long-haul destinations, so the market should be highly susceptible to well targeted messages about value for money.

The French public finances are in a bit of a mess, and it looks likely that France will breach the "growth and stability pact" criteria in 2004 – the third successive year in which it will have done so. So far France has escaped any form of punishment, and has recently announced measures to curb the spending deficit, subject to an "opt out clause". In a recently agreed "deal" the EC has allowed France to continue in breach of the deficit rules through until 2005 if its economic growth is below current expectations.

During 2004 the centenary of the "Entente Cordiale" will be celebrated with a number of events to mark the links between Britain and France. This, in combination with the VisitBritain European Short Break campaign early in 2004 should help to restore growth in the numbers visiting Britain from France. During the first nine months of 2003 the number of visits showed no change on the same period last year, whereas the number of visits from the other three countries discussed here all posted double-digit growth. The opening of the first phase of the High Speed Link to the Channel Tunnel shaved twenty minutes off the journey time from Paris to London is further positive news.

It is encouraging to observe that the average length of stay in Britain for visitors from France has remained stable over recent years at around 6 nights - Britain is by no means seen simply as a weekend break destination in the minds of the French. The average spend per night has been fairly constant at about £40, well below the £60 per night average for all inbound visitors.

Italy

During the first nine months of 2003 the number of visitors from Italy to Britain has risen by around 21%. If this performance continues 2003 will be a record year – coming on the back of double-digit percentage growth in 2002. Trips generated by low-cost carriers would appear to be a key explanation for recent growth – in 1997 according to the International Passenger survey 10% of Italian residents departing through London area airports were using either Luton or Stansted. By 2002 Luton and Stansted accounted for 45% of all London area air departures by Italian residents.

The contrast with trends in the number of visitors from France is stark, especially when one considers that according to the OECD, Italian GDP was up a meagre 0.3% in the second quarter of 2003 compared to the same time last year. The Italian “leading indicator index” is performing marginally better than that seen in France, with an annual increase of 2.7%. One of the explanations for this greater optimism is that, although still high at 8.5%, Italian unemployment is falling, but the IMF forecast that it will remain around 8%-9% throughout 2004. A gradual decline in the level of unemployment may go some way to bringing about a boost to consumer confidence, which has been very depressed in recent months.

The Italian Government has no more serious a problem than deciding how to bring about reforms to its very costly pension system. Pensions cost 14% of GDP in Italy, the highest of any European country, and attempts to reform the system have led to a number of strikes in recent months. Others within Italy believe that the suggested reforms, which don't come into force for a further five years, are insufficiently radical to tackle the underlying problems. The poor nature of some of the country's infrastructure and dependence on imported energy was demonstrated very clearly by the national power failure that brought about chaos and left millions of Italians in the dark.

On a positive note, capacity improvements are expected in the number of low-cost air routes between Italy and Britain, and British Airways has resumed daily flights from Turin to Gatwick. Growth in capacity and increasing competition on many routes will help to maintain the affordability of visiting Britain. The typical visitor from Italy spends 8 nights in Britain, spending a little over £50 per night.

Portugal

These are troubled times for Portugal's economy, with GDP having fallen by an annual 2.3% in the second quarter of 2003, consumer confidence being very shaky and a sharp contraction in domestic demand. However, expectations are that the fiscal stance will be eased over coming months and the “leading indicator index” has experienced an annual rise of 3.1% according to the most recent analysis, suggesting that better times lay ahead. This is supported by the latest IMF forecasts - modest GDP growth of 1.6% can be expected in 2004. The decline in GDP over the past twelve months has fed through to the labour market. In the autumn of 2002 Portugal enjoyed an enviable unemployment rate of 5.4%, but a year on this has risen to 7.4% (still lower than that seen in France and Italy). The rate of unemployment is not expected to change very much during 2004.

Considering the gloomy economic news, Britain has proved very popular as a destination during the first nine months of 2003, with provisional estimates of an increase in visitor

numbers of 16%, compared to a slight decrease in visitor numbers during 2002. Capacity on low-cost air routes has recently been enhanced by the introduction of flights to London operated by Air Luxor, Portugal's first carrier of this kind. Once in Britain visitors from Portugal are very similar to those from Italy, staying around 8 nights and spending a little over £50 per night.

The Euro 2004 football championships take place in Portugal in 2004, attracting large numbers of football fans to the country. Whether it will have a measurable impact on the flow of visitors from Portugal to Britain is uncertain. The last championships were held jointly by Belgium and the Netherlands in 2000 and the number of visits to Britain from these countries declined more steeply than visits from any comparable country in Western Europe with the exception of Italy.

Spain

In stark contrast to the performance of its neighbours, the Spanish economy enjoyed an annual GDP growth rate of 2.3% in the third quarter of 2003 driven by strong domestic demand growing at an annual rate of 3.3%. Perhaps not surprisingly given this rather rosy picture the leading indicator index for Spain is showing an annual increase of 3.9%, and the IMF forecast a further speeding up during 2004 with GDP increasing by 2.8%.

It may come as something of a shock to learn that despite this strong economic performance, the current unemployment rate in Spain is very high, at 11.2% of the labour force, with the IMF expecting it to remain at around 11% during 2004. Spain's central bank has pointed to the fact that the level of employment has been increasing much more rapidly than that of unemployment, the result of a growing level of labour market participation within the economy.

The buoyant economic situation and ever growing number of cheap flights serving routes to Britain are likely to be the key explanatory factors for the estimated 18% growth in visitors from Spain to Britain in the period from January to September 2003 compared with the same period last year. This is a very impressive result considering that year on year growth in 2002 was also around 17%.

As noted earlier, a quarter of all Spanish residents who visit Britain are in fact British nationals. This is one of the key reasons why 30% of visits from Spain to Britain have "visiting friends or relatives" as their purpose. Low cost airlines offer a great opportunity to grow this market further, flying from key Spanish metropolitan areas to a range of secondary British airports thereby enabling British nationals living in Spain to fly directly to their "home" region within Britain. The length of stay in Britain has fallen over the past five years from 13 nights in 1997 to 9 nights in 2002. Typical nightly spend is just short of £50.

Summing Up

More than one in every five overseas residents who visit Britain lives in one of these four countries, some 5.2 million visitors a year. Prospects for 2004 are quite promising, in particular with disagreements over Iraq diminishing, a host of Entente Cordial celebrations and the European Short Break Campaign the flow of visitors from France to Britain seems set to improve markedly from a lacklustre performance in 2003. Euro 2004 and a sluggish economy may rein in some of the exceptionally strong growth seen from Portugal, but the proliferation of low-cost flights and strong economy should help maintain the momentum seen in visits from

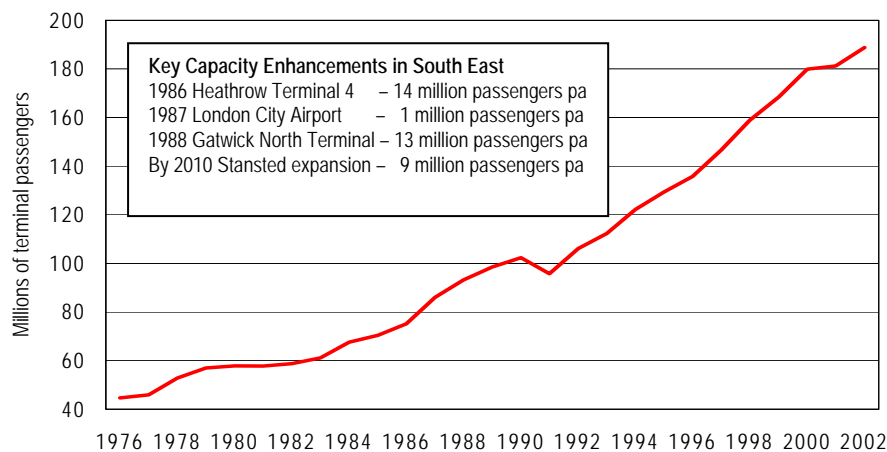
Spain. Supply-side improvements should facilitate further growth from Italy, but a slowing in the pace of that growth can be expected in 2004.

Issue of the Month - Airport Capacity in the UK

In 2002 70% of the 24.2 million overseas residents who visited Britain are estimated to have travelled by air. Despite the well publicised troubles suffered by airlines since the events of September 2001, data from the UK's Civil Aviation Authority reveal that the number of passengers passing through Britain's airport terminals during 2002 was up 4% on 2001 to stand at a record 189 million. The number of aircraft movements did fall, but by a mere 0.3%.

The number of passengers at British airports has more than doubled in the past 15 years and trebled in the past 20 years (see chart). During those two decades there have been few truly major capacity improvements. Most notable of those to come on stream include; Terminal 4 at Heathrow (1986), London City Airport (1987), Gatwick's North Terminal (1988), a domestic and second international terminal at Manchester Airport (1989 and 1993), and Britain's first new full length commercial-use runway for twenty years, also at Manchester (2001).

Passengers at UK Airports



In 2000 the Government published forecasts which suggested that by 2020 there would be a further doubling of passenger numbers to some 400 million. A pivotal assumption underpinning this forecast was that demand would not be constrained by insufficient capacity.

Heathrow's new Terminal 5 is now 27% complete, and is on-track for its scheduled opening in spring 2008, when all British Airways flights will be relocated to the new building. By 2006 Heathrow should be able to handle new, 555 seat capacity Airbus A380 aircraft. Expansion plans at Stansted look set to increase passenger numbers at the Essex airport from 16 million to 25 million by 2010. Despite this, and investment at other airports, it is widely accepted that within the next 20 years demand for air travel, especially in the Southeast, will outstrip supply.

One of three things must happen for demand and supply to be in equilibrium over the longer term. New runways will be built, air travellers will pay higher prices as the existing stock of landing slots become more valuable, or the longstanding relationship between increasing economic wealth and the desire to travel will break down for some reason.

Starting with the last of these three possibilities - when a new "risk" emerges the instinctive reaction of individuals is to avoid exposure to that risk - witness the immediate decline in air travel after 11th September. However, in the longer run it would appear as though people grow to accept that although the risk may have severe outcomes, the probability of it occurring to

them is in reality very small. So, two years on from the events in the US a growing proportion of those who were initially put off from boarding an aircraft have reconsidered (subconsciously or otherwise) the balance between benefits and risks and are again willing to fly.

A survey commissioned by the Department for Transport in 2002 would seem to support this contention - it showed that 72% of those questioned said that over the next year they expected to fly as much, or more than, they had done during the preceding year. Just 13% expected to make fewer flights (the remainder being unsure). We can rule out with some confidence the idea that the willingness to fly will diminish to the extent that addressing the problem of insufficient supply will simply solve itself.

The second alternative, namely that the cost of air travel will rise to help burn off excess demand, is a significant threat to the tourism industry in Britain. As Britain comes 11th in the world league table of per capita income, the average British outbound traveller is more able to afford higher airfares than is the average inbound visitor. Airport capacity has been expanded at a number of European hub airports over recent decades, meaning that Britain is at risk of losing out to its competitors in the choices that "tourists" make in the future. If airfares to hub airports such as Frankfurt and Amsterdam are significantly cheaper than to Heathrow or Gatwick continental European destinations will enjoy a distinct cost advantage over Britain.

Inbound business travel generates some £3.5bn for the British economy each year, and this too is at risk if multinational companies decide that Britain's (and in particular London's) airports lag behind those of alternative business locations. On the subject of risks, increasing Air Passenger Duty may slow the rate at which demand grows, but a possible result of this course of action is that demand will still exceed supply whilst British airports, and Britain, become internationally less competitive.

Ahead of the publication of its long awaited White Paper on the future of aviation, the Government made it clear that its aim was to develop a long-term framework that will maximise the beneficial aspects of aviation and minimise the negative ones. The Government has, in effect, ruled out the "do nothing" option from its considerations.

This analysis points rather strongly towards the conclusion that new airport capacity, including within Southeast of England will be given the green light. So where will it be and what impact would it have on inbound travel to the UK?

Some diminution of the Southeast's dominance may have unforeseen beneficial impacts for the tourism sector. New airport capacity in the North of England and Midlands (possibly a new airport to the southeast of Birmingham) would improve the accessibility and marketability of areas away from London and the Southeast.

The clamour for additional capacity in the Southeast may be too deafening for the Government to ignore, indeed, recent Whitehall "leaks" suggest that a new runway at Stansted will soon be sanctioned, but there is no "easy option" here.

Heathrow is a huge draw for both tourism and business travel to the UK, with multiple short and long-haul destinations and excellent connectivity. Hub airports have many secondary benefits above and beyond the direct employment they generate, encouraging businesses for which international travel is essential to cluster in areas with good access - the M4 corridor for example. Such clustering generates huge amounts of high-value inbound business travel.

A short third runway at Heathrow is technically feasible, and would improve the effectiveness of Terminal 5 in handling future growth. The runway would be perfectly suited to short-haul destinations within Britain, thereby making it far easier to disperse long-haul arrivals to the regions. VisitBritain and the Regional Development Agencies broadly support the construction of a third runway at Heathrow in parallel with expansion at regional airports.

Problems abound, however. The M25 is already being widened, but a third runway would put even greater pressure on the surrounding road network. EU air pollution limits would almost certainly be breached with additional air movements, even allowing for improvements in emission levels. Last but not least, a well-organised campaign group would challenge any development at Heathrow. The group has taken the Government to court regarding night-time flying quotas and are angered by BAA having reversed its earlier claim that a fifth terminal would negate the need for a third runway.

At Gatwick a legal agreement prohibiting expansion until 2019 was signed in 1979, however, following another court ruling the Government has been forced to include a second runway at Gatwick as part of its consultation process leading to the White Paper. If a new runway was to be built before 2019 the 1979 agreement would have to be scrapped, an action that would be sure to engender widespread local protestations.

The logistics of expansion at Stansted are considerably easier than elsewhere – more than one new runway could be built and the existing runway still has a little spare capacity. The number of local inhabitants whose lives would be affected by the additional noise and air pollution is considerably less than at Heathrow and the local road network is much less congested. The planning authorities have already granted permission for expansion that will see an additional 9 million passengers using the airport each year by 2010.

Low cost and charter services are the dominant operations at Stansted, and as such it is not a “hub” airport akin to Heathrow. An alliance of major British airlines (excluding low cost operators) has threatened to take legal action if the Government plumps for expansion at Stansted but not Heathrow or Gatwick, as profits at the latter two airports may have to be used to help finance expansion in Stansted.

Both “holiday” and “vfr” markets may in fact benefit from expansion at Stansted. Both sectors are highly price conscious and Stansted boasts an expanding low-cost domestic network. The proportion of inbound visitors through Stansted for “holiday” and “vfr” purposes is 71%, with just 17% making business trips. In contrast 31% of inbound visitors to Heathrow are on business, with 56% making “holiday” or “vfr” trips.

Whatever is decided there will be well-organised opponents and supporters, most of who will consider resorting to legal action to help bolster their case. In the end additional airport capacity will need to be built if Britain is to keep pace with the growth in international travel globally, but it is going to take years, possibly well over a decade, before any proposal in the White Paper becomes a reality. The choices that are made will play a central role in determining the level, and mix of inbound visitors to Britain. A new runway at Heathrow or Gatwick will favour growth in long-haul and business travel, whilst extra capacity at Stansted will boost short-haul leisure travel. Airport expansion outside of the Southeast is perhaps the single most significant action that Government can undertake to improve the regional dispersal of inbound tourism.