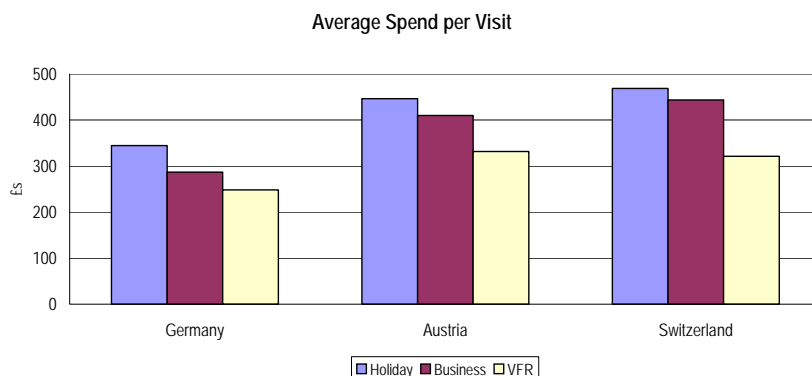


FORESIGHT is a monthly commentary on significant issues within the tourism sector. Each month, "Market Focus" discusses economic, social and political factors that underlie demand for tourism now and in the future. In addition, there will be a spotlight focused on significant tourism issues. This month Market Focus covers Germany, Austria and Switzerland and Issue of the Month explores the impact on inbound tourism of the value of Sterling in light of the US Dollar's slide.

Market Focus – Germany, Austria and Switzerland

Austria and Switzerland are significant inbound markets for the British tourism industry, accounting for 3.4% of all visits (827,000) and 3.2% of visitor spend (£379m) in 2003. However, these figures are small in comparison with those for Germany, accounting for 10.6% of visits (2.61 million) and 6.9% (£819m) of visitor spend - making Germany Britain's third most important inbound market in terms of visits and second most important in terms of spend.

The chart shows, however, that average spend per visit is lower for German visitors than for Swiss or Austrian visitors, regardless of trip purpose. Indeed, all three markets fall well short of the global average spend of £475 per visit.

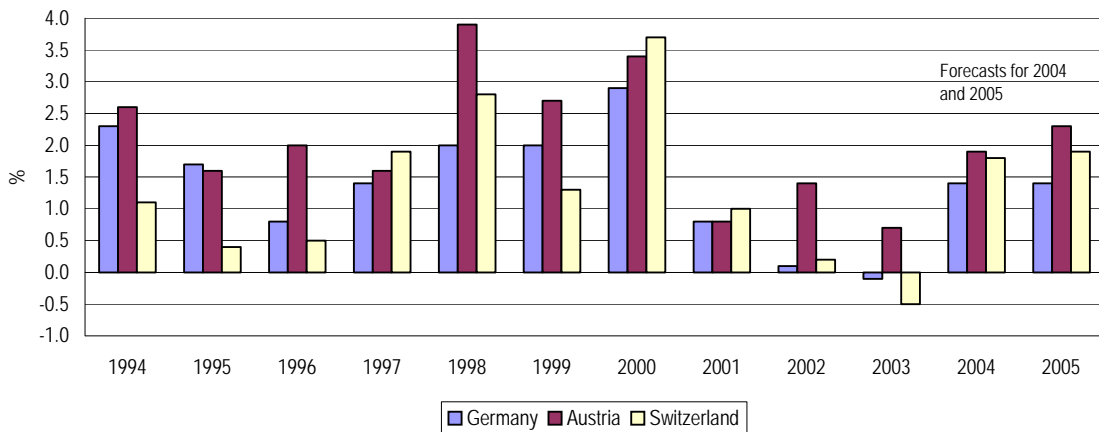


Underperforming economies

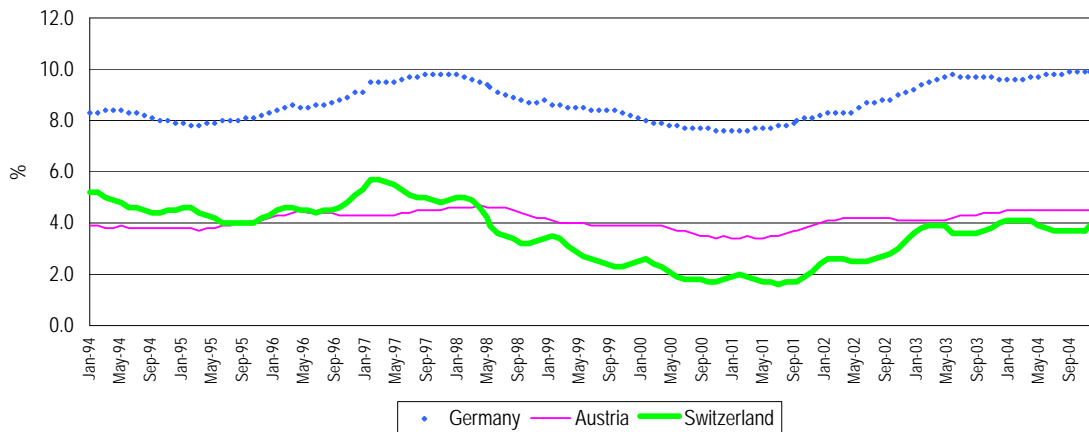
There is a high standard of living in all three of these markets and international travel is easy and affordable, with each market being well connected to Britain. Internet access is enjoyed by around 55%-60% of the population. Nevertheless, recent years have been characterised by at best sluggish economic growth, and in 2003 outright recession in Germany and Switzerland.

With "trend" growth in most major developed economies being somewhere between 2%-2½% per annum we can see from the following chart that all three economies failed to achieve this in each of the past four years. The second chart reveals that unemployment in Germany is more than twice the rate in Austria and Switzerland, and looks set to break through the 10% mark in the near future. This is a significant factor in stifling growth in outbound travel. Competition from low wage Eastern European countries such as Poland has increased since EU expansion, placing a further strain on the German and Austrian economies as economic investment shifts eastwards.

Annual GDP Growth



Unemployment Trends



The Competition

Who are our main competitors in trying to attract visitors from these three markets, and how does Britain fare relative to these competitors?

Nearly 4% of all overseas visits undertaken from Germany and Austria have Britain as their destination, with the equivalent figure for outbound trips from Switzerland being just over 5%. So, Britain is an important destination, but falls short of being one of the most favoured.

For the Swiss Britain is the sixth most visited destination, with France, Italy and Germany topping the table. Austrians are more likely to visit eight other countries than they are Britain, with Italy, Germany and Croatia heading the list. Finally for Germany Britain is the 7th most visited destination – France, Austria and Spain making up the top three.

Germany

Back in 1996 a record 2.96 million Germans visited Britain, however, recent years have witnessed a decline with visitor numbers in 2003 being 350,000 less than the best ever achieved. Of greater concern spend by German visitors in 2003 was £252m down on its peak figure established back in 1997 (a fall of nearly 25%).

Despite its continued weakness the global importance of the German economy is undeniable, consistently being one of the worlds largest importers and exporters. Much of this trade is with Britain. In 2003 Britain exported goods and services worth £20.7bn to Germany and imported goods and services worth £33.5bn from Germany. All this activity generated 934,000 inbound business visits to Britain from Germany in 2003, worth £268m.

Anglo-German links are not restricted just to the business community, it is estimated that there are 110,000 Britons currently living in Germany. Indeed, IPS figures for 2003 show 350,000 (13%) of visits to Britain from Germany were undertaken by British nationals – considerably more than the total number of visits from Japan.

A somewhat hidden opportunity for generating visits from Germany to Britain can be found in the extensive “twinning” activity between the two countries. It is estimated that some 400 German communities are twinned with a British counterpart. Using these links to generate inbound visits can be harnessed to improve both the regional and seasonal spread of tourism.

Getting here is easy

Those in Germany thinking of visiting Britain have a multitude of route options to choose from, operated by both traditional and low-cost carriers – an analysis of recent CAA data reveals the existence of around 60 separate air routes offering scheduled services between points in Germany and various British airports. Air is of course not the only option, with ferry and train services offering further links.

There is little end in sight to the burgeoning number of low-cost carriers operating between Germany and Britain with both German Wings and Air Berlin expanding their networks, but there have been casualties, with V-Bird recently ceasing to fly.

Why so lacklustre?

Germany is Europe’s biggest economy, but as we have seen its recent performance has been disappointing. A combination of factors helps to explain the persistent weakness of the German economy, which in turn leads to German outbound travel being constrained, and focussed on holiday breaks deemed to be affordable.

More than 14 years after reunification the costs of absorbing the less well developed economy of the east continues to play a role in German life. Germany has recently breached rules laid down as part of the Maastricht Treaty relating to public borrowing, reforms of the healthcare and welfare systems aimed at saving money are in the pipeline but remain deeply unpopular.

The most recent blows to the German economy have been the weakness of US\$ hurting exports and the higher than expected price of oil. Recent business confidence figures have fallen to their lowest level since September 2003, with unemployment perilously close to 10%.

These economic factors ought to have only a short-run impact on the travel habits of Germans, but a more fundamental demographic shift is also underway. Germany’s population of 82 million is ageing. The total population is forecast to decline over the coming decades at an annual rate of 0.2%. However, it is not all age groups that are forecast to decline, and herein lays the problem for future standard of living prospects. Unless there is both significant reforms to state benefits and continued in-migration of young working age people from other nations it

is likely that German economic prospects will remain weak. At present 18% of the population is over 65, whereas forty years from now this figure will stand at 30%. By contrast 62% of the population are currently of working age and by 2044 this share is forecast to fall to just 52%. Such a shift in the age profile will place an enormous strain on national finances unless pensions become less generous or young foreign workers play an increasingly important role in German society. Whatever happens it looks inevitable that the holiday choices of Germans will evolve in coming years to reflect an older, more price conscious society.

In a realisation that pensions may be less generous in the future, and worries about job insecurity today, Germans have cut back on expensive items such as holidays in favour of saving. Germany's savings ratio is around 11% of total income, twice that for Britons.

On a more positive note the German market provides an excellent source of tourism revenue throughout Britain, for example 13% of German visitor spend took place in Scotland, and 12% of German visitor nights were spent in the South West of England during 2003. The availability of a fast ferry service from Zeebrugge to Rosyth helps make Scotland exceptionally accessible to Germans wishing to bring their own vehicle.

Switzerland

Inbound visits from Switzerland peaked in 1999 at 616,000, around 50,000 higher than in 2003. Switzerland is the 7th largest direct investor in the UK, an investment thought to have created 100,000 jobs. It is unsurprising then that business visits account for 35% of all trips to Britain from Switzerland.

Switzerland has an international population. Just 60% of the 564,000 inbound visitors to Britain from Switzerland in 2003 were Swiss nationals, with British ex-pats forming the next largest group, constituting 18% of inbound visits to Britain.

Austria

With 263,000 visits, 2003 was a record year for the number of Austrians coming to Britain, a record certain to be broken in 2004. One factor here is the expansion in air services, with a growing number of British destinations being accessible from Salzburg in the west of Austria.

According to the Foreign and Commonwealth Office most young Austrians, especially those in business, are proficient in English. The number of visits from Austria with "study" as their journey purpose was 26,000 in 2003, 10% of all visits from Austria, making this our eighth most important study market. With study visits being an important market segment we find that 48% of visitors from Austria are aged under 35 (compared to 42% of all inbound visitors).

Looking to the future

Looking at the period from January to November 2004, the number of visits from Germany has increased by 10%, Switzerland 6% and Austria 12% compared with the same period of 2003. We can look forward to further growth during 2005, but at a rate that is unlikely to exceed 5%.

All three markets will be hosting major tourism fairs in the coming months at which Britain will be actively promoted to both the trade and consumers. These include ITB in Berlin, Ferien Vienna in Austria and FESPO Zurich in Switzerland.

Issue of the Month – inbound tourism and the value of Sterling

The value of one currency against another currency is known as the exchange rate – but once economists start talking about depreciation, or floating versus pegged currencies, degrees of uncertainty start to mount in one's grasp of the issues. However, the value of Sterling plays a major part in determining how affordable Britain is as a tourist destination for inbound visitors. This month we try to demystify some of the terminology, and explore the background to the much-publicised weakening US dollar – a trend that may have a major impact on the volume and value of visits from the US. In 2003 the US accounted for 20% of inbound visitor spend.

Terminology

Discussions about exchange rate movements can involve a number of different terms that in fact refer to the same thing. A further layer of confusion arises because of the need to decide which currency is being considered as the currency being purchased, and which is being used to make the purchase.

For example, the statements "The Dollar is depreciating against the Pound" and "The pound is strengthening against the Dollar" mean the same thing, but have opposite implications for Britons and Americans as visitors, and more widely for the respective economies.

The terms "appreciating", "rising" and "strengthening" mean the same thing, as do "depreciating", "falling" and "weakening". But for currency A to be weakening against currency B, currency B must be strengthening against currency A. The term "pegged" (or "fixed") means that a country's currency is fixed in value against that of another country. For example, Malaysia, Peru, China and a number of other countries have their currency pegged to the US Dollar. This means that if the US Dollar weakens (ie becomes worth less) against Sterling then so too does the Malaysian, Peruvian and Chinese currency.

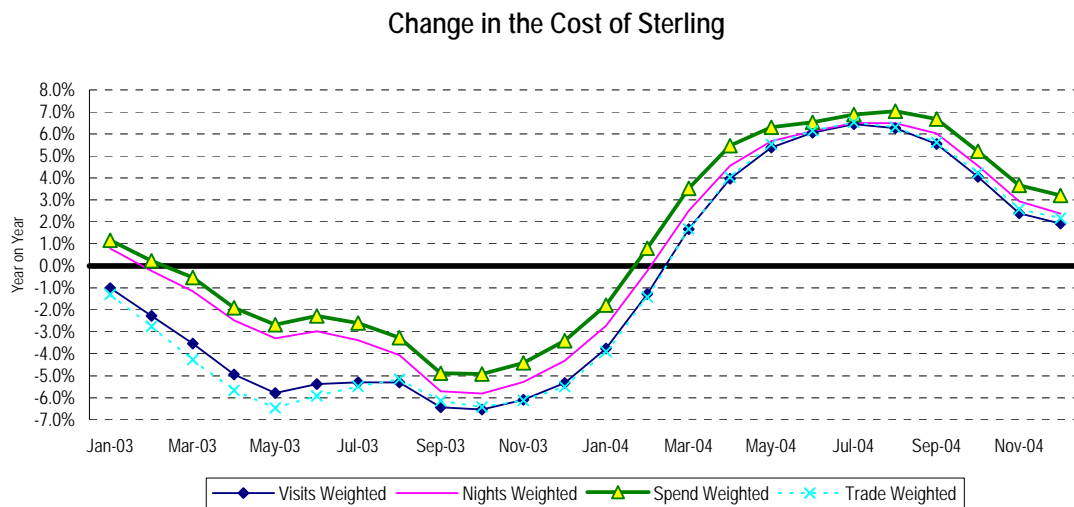
Weighted Exchange Rates

With visitors coming to Britain from scores of countries, most of which have their own currency, it is quite tricky to pinpoint the "average" change in the Sterling exchange rate. Central Banks all publish what is called a "trade weighted" exchange rate – this reflects the amount of business undertaken between a nation and each of its trading partners. However, the amount of tourist traffic from each market will not necessarily be the same as the amount of trade.

This problem can be overcome by looking at the share of inbound tourism from each market, then "weighting" the change in that country's Sterling exchange rate by this share. The International Passenger Survey enables us to measure inbound tourism in a number of ways; visits, nights or spend. The chart reveals that trends in the cost of Sterling measured in each of these ways differs slightly. The reason for this being that visits from some markets have either very low or high lengths of stay or spend compared to the average.

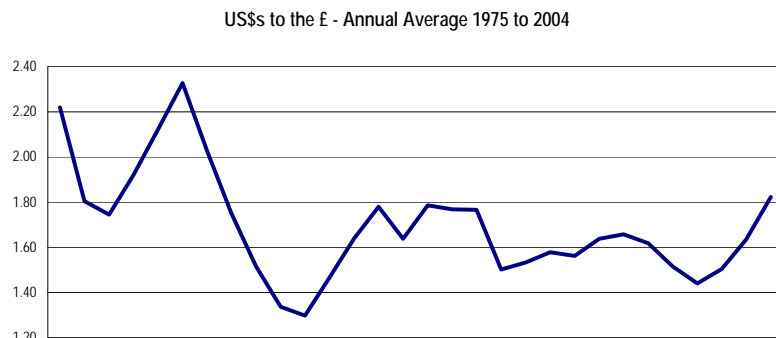
It is not practical to include the exchange rate of each and every country, but those included account for 93% of all inbound visits, 85% of visitor nights and 86% of visitor spend. The fact that for some time the "spend weighted" cost of Sterling has been increasing more than the "visits weighted" means that the exchange rate for markets with a higher than average spend has been worsening more than for those with below average spend. An important message to

take from the chart is that despite all the headlines about the US Dollar, overall the weighted cost of Sterling has been increasing at a much slower rate during recent months than was the case during the summer.



The US Dollar

It can be seen from the chart that Sterling has become more expensive for visitors from the US over recent years, and looks set to cost about the same, on average, in 2004 as it did in the late 1980s. There is much talk about the \$2 pound, something not seen since 1981. So whilst for the more mature US traveller it is by no means uncharted territory, for the so-called "Generation X" (Americans born between 1965-80 who are driving growth in US outbound travel), it is.



It is expected that the US Dollar will remain "weak", and may weaken further, against not just Sterling, but also the Euro and other major currencies during 2005. So what would this mean?

- Americans will find Britain more expensive to visit
- Britons will find the US an increasingly affordable destination
- British businesses will find the cost of importing goods and services produced in the US cheaper, relative to those produced at home or in other country's whose currency has strengthened against the US Dollar
- US businesses will find it more expensive to buy goods and services from companies who price their produce in Sterling (or Euros)

Why is the US Dollar likely to remain weak?

It can be seen that the implications of a weakening Dollar would be to dissuade those in the US from buying products and services produced in countries whose currencies had become more

expensive. The flip side is that Americans will be encouraged to buy from domestic companies or foreign companies pricing goods and services in a currency pegged to the Dollar.

If the US is buying more homemade and less foreign produce then its "trade balance" improves. This is a central factor in explaining why the US Dollar is currently weak, as the US is currently running an enormous trade deficit with the rest of the world (its imports are costing far more than its exports are earning for the economy).

The Chinese problem

As mentioned earlier the Chinese Yuan is pegged to the US Dollar. An ever-increasing proportion of US imports are now coming from the rapidly expanding Chinese economy. Many US businesses have been pressing for the US Government to push for this "peg" to be removed. They are doing this because Chinese goods are priced so cheaply that they, rightly, believe that the level at which the Yuan is pegged is anti-competitive.

If the Chinese authorities allowed the Yuan to "float" (that is allow currency exchange markets to determine its value), then the Yuan would appreciate against the Dollar, making it harder for Chinese companies to sell to the US, and easier for the US to sell to China.

Given that the Dollar cannot depreciate against the Yuan to help improve the US's trade balance, it has to depreciate (or weaken) against the currencies of its other main trading partners, including Britain. As such, the British (and Eurozone) economy is unfairly penalised as it finds itself increasingly uncompetitive inside the US.

Interest Rates

If a central bank decides to increase its base rate then currency traders will be keener to buy that currency which will help push up its price – in other words the currency in the country with the more favourable interest rate will appreciate. US interest rates were recently increased by ¼ point, and are expected to increase further, but US interest rates are comparable with those in Europe. This means that the trade deficit issue is likely to drive currency movements rather than interest rate differentials.

The Dollar has been "drifting" down in value (depreciating) for the past year or so against Sterling, but there has not been a sudden fall in its value. There is concern that unless there are signs of the US economy slowing down its desire to buy goods from abroad the trade deficit will continue to worsen – possibly leading to a "crash" in the value of the US Dollar. It is estimated that if the Dollar adjusts gradually it may need to depreciate by up to a further 20%. This would make the cost of £1 equal to \$2.15. However, if, as sometimes happens in financial markets, there is a sudden loss of confidence regarding whether the US is serious about tackling its deficit, the fall might be as large as 40% (making £1 cost \$2.50).

Eastern Promise

If the Yuan were allowed to float within a greater range (if not completely freely) against the US Dollar the situation could be far more favourable for inbound tourism to Britain than the worst-case scenario described above. The Chinese Government has hinted that plans to allow the Yuan to appreciate are progressing, but has failed to give any clear signal how soon this might take place. With the US being one of China's main markets a financial crisis in the US may

force the Chinese to act more swiftly, but it is to be hoped that movement can be agreed without such a crisis precipitating it.

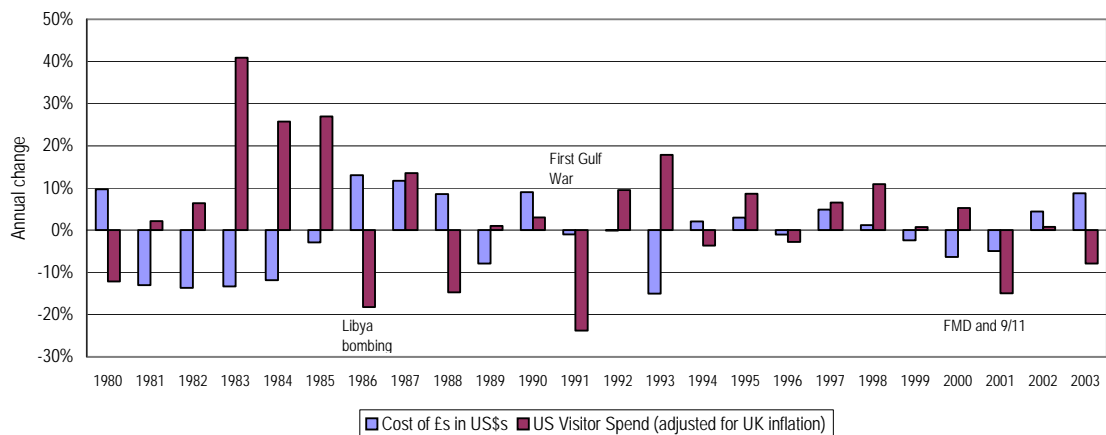
Elasticity

Having established that a weaker Dollar against Sterling would make Britain a more expensive destination for US visitors can we say anything about the scale of the likely impact? In 2001 the former BTA commissioned Caledonian Economics to undertake a wider analysis of how changes in exchange rates influence inbound visitor expenditure.

The destination becoming more expensive can have a number of outcomes – some potential visitors might simply decide not to come, but others may still visit but spend less than they would otherwise have done.

Overall, the Caledonian Economics analysis produced an exchange rate “elasticity” of tourism earnings for the USA of -1.4 . This means that if Sterling becomes 10% more expensive in US Dollar terms, Britain can expect to earn 14% less from US visitors. For short-haul destinations the impact of changes in the exchange rate had a far less dramatic impact on earnings, so for example if Sterling becomes 10% more expensive in Euro terms the reduction in earnings from Germany would be just 8%.

The Cost of Sterling and US Visitor Spend



The chart illustrates neatly the inverse relationship that exists between the cost of Sterling and spending by US visitors to Britain – a relationship that has, however, often been swamped by the impact of major global events.

Prospects

There is some good news for British based businesses marketing Britain in the US – a weak Dollar provides the opportunity to buy more US resource (advertising space, manpower etc) with an unchanged amount of Sterling. Nevertheless, Britain’s affordability for the vital US market looks set to remain an issue that will require continued efforts by those in the British tourism industry to highlight the availability of competitively priced airfare and accommodation opportunities during 2005.

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