FORESIGHT

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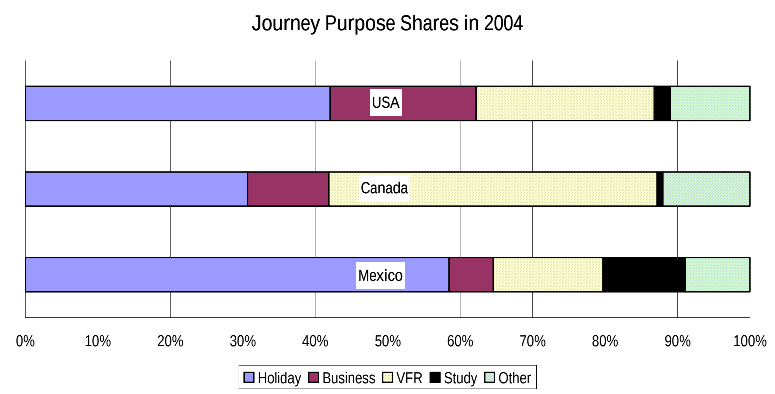
FORESIGHT is a monthly commentary on significant issues within the tourism sector. Each month, "Market Focus" discusses economic, social and political factors that underlie demand for tourism now and in the future. In addition, there will be a spotlight focused on significant tourism issues. This month Market Focus covers USA, Canada and Mexico and Issue of the Month discusses the impact of low-cost airlines on the British tourism industry.

Market Focus – USA, Canada and Mexico

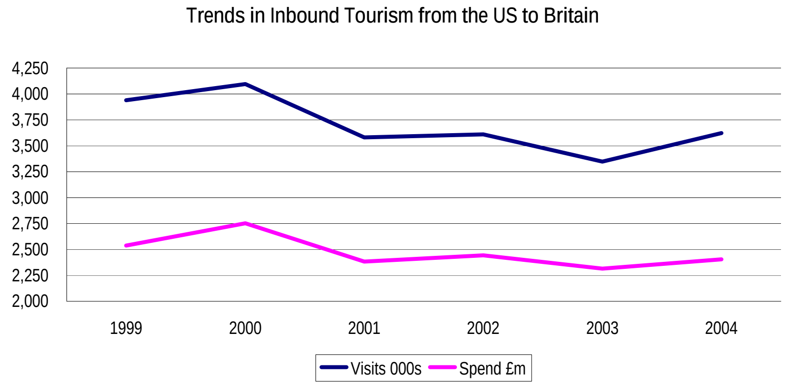
The US market is of pivotal importance to the inbound tourism industry in Britain. Despite having not yet regained all the ground that was lost following Foot and Mouth and 11 September provisional figures from the International Passenger Survey[1] show that in 2004 the US accounted for 13% of all visits (3.6 million) and 18% of all inbound visitor spend (£2.4bn), in each case representing the single most important market. Canada was the 10th largest inbound market in 2004 with 742,000 visits, worth £477m (8th most important). Clearly Mexico is not quite in the same league, but nevertheless generated £102m for the UK economy in 2004 courtesy of 67,000 visits.

We can see from the chart that Holiday, Business and VFR are all key reasons for US visits to the UK, but for Canada VFR accounts for over 40% of visits with business trips of less significance. Holiday is the dominant purpose for visits from Mexico, but with Study accounting for over 10%.



USA

We can see from the graph that neither visits nor spending have returned to pre 9/11 and Foot & Mouth days, but that there was strong growth in the number of visits to Britain from the US during 2004.



Demographics

If we look at Total Period Fertility (TPF) figures (that's the average number of live births to each US female during her childbearing years) we find some fascinating contrasts with the situation in "old Europe". In the US the TPF is 2.07 according to the US Census Bureau, one of the reasons that the US population is forecast to continue growing, whereas many European nations are forecast to see population numbers remain broadly stable or even fall. Indeed, the number of live births to a German female is just 1.38 and in Spain it is 1.27.

Despite this the US still faces a pensions crisis – President Bush recently said that the system was heading towards bankruptcy unless it was reformed. By 2018 there will be more than 50 million US citizens aged 65+ according to the US Census Bureau (representing nearly one-in-six of the population).

According to the US 2000 Population Census 17.9% of the population (that's 47 million people) aged 5 or over spoke a language other than English at home – with three-in-every five of this group speaking Spanish or Spanish Creole. This is perhaps not too much of a surprise as an eighth of all those living in the US in 2000 said that they had Hispanic or Latino origins.

An economic turning point?

Consumer confidence has been falling in recent months, and the growth rate of industrial production fell in April. However, latest employment figures reveal that there are nearly 2% more people in employment than was the case a year ago and retail sales grew faster in April than in any month since last summer.

The value of the US Dollar against both Sterling and the Euro has been in the news for quite some time now, but how does the weakening Dollar impact on potential visitors? Lets take a hypothetical US family planning a trip to Europe over the past few years with a $2,000 pot of holiday money at their disposal. The table opposite summarises how much they would get for their money in terms of both Sterling and Euros from 2002 through to the first four months of 2005.

Value of $2,000	£'s	€'s
2002	1,331	2,117
2003	1,223	1,768
2004	1,092	1,609
2005	1,055	1,545
change 2002-05	-21%	-27%

It is evident that both Britain and all Eurozone nations have become significantly more expensive for US visitors during the past four years, but that the Dollar has weakened more against the Euro than it has against the Pound.

The background to the weakening US$ was explored in Foresight Issue 15, and the fundamental factors remain the same five months on – namely large Federal and trade deficits. The good news is that the latest trade figures show that the US deficit shrank more than expected in March to stand at $55bn, with encouraging signs that the all important deficit with China was reined in a little. Most analysts agree that US growth will now ease - the IMF forecast growth of 3.6% in 2005 and 2006, but the danger of a significant downturn in the near future remains slim.

Aviation

Daily Continental Airlines flights from New York to Bristol commenced on 20 May, but this is one of the few bright spots to report from the US airline industry, with many operators still in deep financial difficulties. United Airlines have announced that their first quarter loss for 2005 was $1.1bn, twice the size of the loss in the first quarter of last year. This worsening financial state comes despite the airline having recently agreed pay-cuts for its staff and been given legal backing for its decision to close its pension fund.

Passport ownership continues to grow among US citizens, with State Department figures showing that the number of new passports issued to US citizens in fiscal year 2004 was 8.8 million, a 21% increase on 2003. Mexico and Canada are the most visited outbound destinations for passport owning US citizens, with Italy being the most visited "overseas" destination followed by the UK. Looking at data from the US Department of Commerce for the first ten months of 2004 we see growth in travel to Europe of 14%, a reasonably robust performance but not as impressive as the 31% growth in visits to Asia.

The fact that a number of Asian economies have US$ pegged currencies has clearly provided them with a competitive advantage in cost terms vis-à-vis Britain and Eurozone destinations in attracting US visitors over recent months – with an additional factor being an expansion in the number of direct flights from the US to both India and China.

Visitor satisfaction

In October 2004 VisitBritain undertook research that involved interviewing 600 US visitors to understand the influence of various elements of the Britain experience on visitor satisfaction, and to measure Britain's performance in these areas. Overall, levels of visitor satisfaction and "loyalty" to Britain were very high, but some factors were found to have more of an impact than others.

The feeling of "welcome" extended to our American visitors, both by local people and "employees", is a particularly strong element of the visit experience. The key product driver of visit satisfaction is Britain's History & Heritage. The opportunity to explore several locations (i.e. touring) is also considered to be a strength.

In other areas there was room for improvement. Value for money (especially eating & drinking) remains an issue, with the current weakness of the US Dollar heightening this perception. Local food and drink experiences (for example pubs, regional specialities) are seen as a relative weakness, and VisitBritain is addressing this via initiatives like the "Taste" website.

Canada

Britain comes second only to the US in terms of where Canadian residents travel abroad. We have seen that visiting friends and relatives is an important segment for visits from Canada and this ensures that there is a good regional spread of destinations visited. Figures from the IPS show that in 2004 a fifth of all visits from Canada included time spent in Scotland and 6% included time in Wales. Taking advantage of this the Canadian airline Zoom are set to expand their network of flights to the UK, with a good mix of regional airports such as Glasgow, Manchester, Belfast and Cardiff.

Canada has seen slower economic growth than its neighbour to the south, with typical growth rates a shade below 3% per annum in recent years – a trend that the IMF expect to continue through to 2006. Unemployment is fairly stable, but remains in excess of 7% of the labour market.

The Canadian Prime Minister narrowly escaped losing a confidence vote in May, with the root cause of the minority Liberal Government's difficulties being a financial scandal that threatens to precipitate an early election.

Mexico

Mexico's population of 106 million makes it the world's 11th most populous country – and according to projections made by the US Census Bureau by 2030 the population will have increased by a further 30 million. Mexico has many large cities, the distance between these often being large, so it is perhaps surprising that it has taken until now for a low-cost airline to spring up, Click Mexicana will launch nine domestic routes from this summer.

Wide geographical differences exist in the standard of living enjoyed by those living in Mexico, in broad terms those closest to the US border tend to be the more affluent. According to the World Bank around half the population live in poverty, with around a fifth living in extreme poverty.

Mexico's economic performance is determined in large measure by that of the US, and as a result growth increased to 4.4% in 2004, with an expectation that it will slow to 3% by 2006. The economy received a boost from booming inbound tourism during 2004, the country welcomed 10% more visitors with total visitor receipts of just under $11bn. Britain is the second largest investor in Mexico after the US, but as was evident in the earlier chart the volume of business tourism from Mexico to Britain remains small.

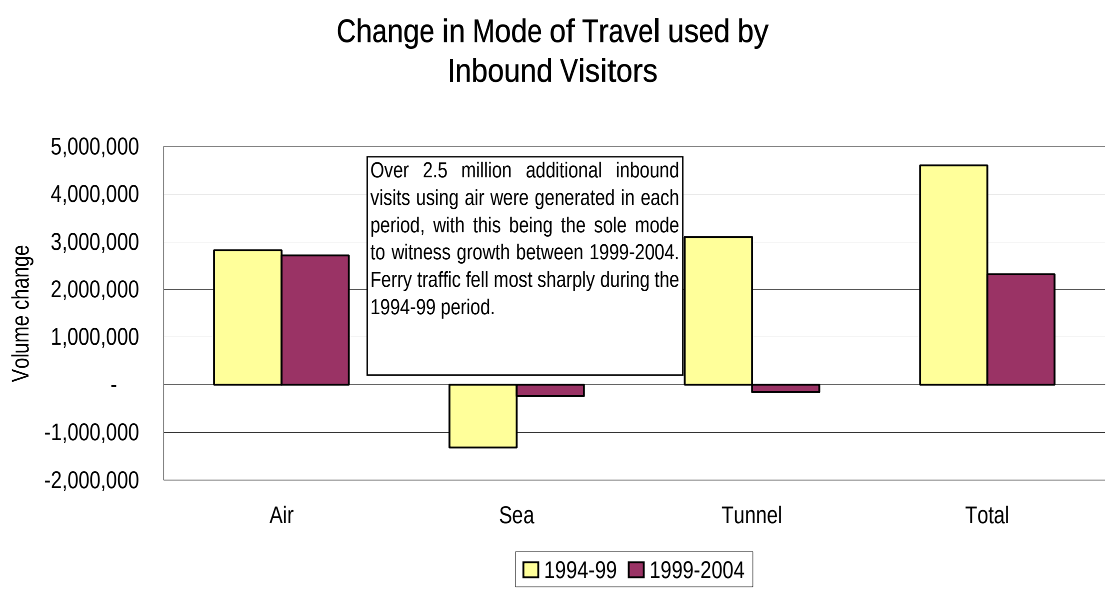
What to expect in 2005

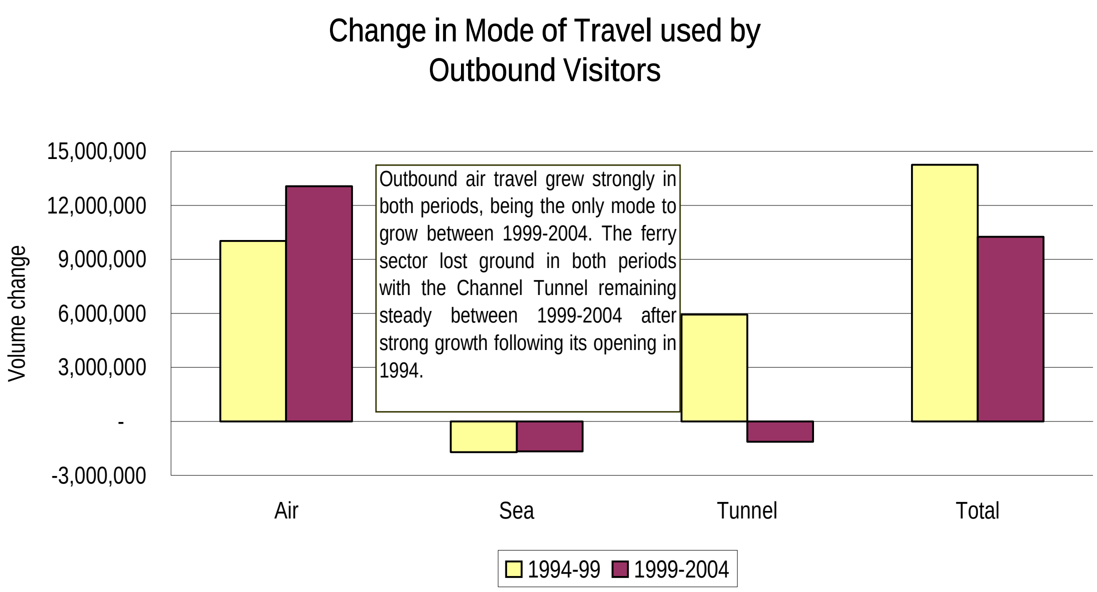
In the first three months of 2005 the number of visits from both the US and Canada is down on the same period of 2004. We should perhaps not read too much into this in relation to prospects for the rest of the year, as the first quarter of 2004 accounted for only 19% of annual visits from these three markets.

Nevertheless, this is a trend that will need to be watched, as we may now have entered a period when it is not the fear of flying and terrorism that is deterring US visitors, but rather the persistent weakness of the US Dollar making Britain (and Europe in general) relatively more expensive than alternative destinations across Latin America and Asia.

Issue of the Month – Low Cost Airlines

The adage that it is competition that drives down prices has been nowhere clearer than in the aviation industry over recent years. The days of complicated fare rules and restrictions with a limited choice of carriers have all but vanished for the short-haul market within parts of Europe. The emergence of many new carriers and the impact that this has had on the so-called legacy carriers has been profound. The nature of travel choices made for both inbound and outbound tourism has been markedly changed as we can see from the following two charts.





The rapid expansion of both inbound and outbound air travel in the past five years has taken place despite the events of September 2001 – clearly "fear of flying" following these events have not thwarted growth prospects for air travel when we take the market in its entirety.

Airport and air route performance

Looking at terminal passenger growth at UK airports over the course of the past decade we find some fascinating stories emerging. Growth in both absolute and percentage terms are expressed in the table (based on CAA data). This helps to highlight the fact that despite having seen relatively low percentage growth, three of the UK's key hub airports (Heathrow, Gatwick and Manchester) are all in the top five growth airports when measured in terms of absolute change in passenger volume.

Growth in airport terminal passengers 1994 to 2004

Airport	Absolute Growth	Airport	% Growth
Stansted	17,655,015	Prestwick	1496%
Heathrow	15,749,198	Liverpool	663%
Gatwick	10,350,605	Stansted	543%
Manchester	6,657,960	Luton	318%
Luton	5,719,953	Bristol	261%
Edinburgh	4,996,501	London City	251%
Birmingham	4,013,820	Southampton	226%
Bristol	3,327,687	Leeds Bradford	192%
Glasgow	3,102,875	Nottingham East Midlands	171%
Liverpool	2,912,643	Edinburgh	167%
Nottingham East Midlands	2,762,094	Newcastle	95%
Newcastle	2,297,225	Birmingham	84%
Prestwick	2,023,717	Glasgow	57%
Leeds Bradford	1,557,957	Gatwick	49%
London City	1,197,744	Manchester	47%
Southampton	1,061,717	Heathrow	31%

Nevertheless, Stansted stands out with growth of more than 17 million passengers between 1994 and 2004 – with low-cost carriers being the primary engine behind this figure. Prestwick and Liverpool top the relative growth league table, and each handled more than two million additional passengers last year than was the case a decade earlier.

Low-cost carriers tend to opt for provincial airports where landing fees are lower than at congested hub airports. This has a positive impact on the inbound tourism market as it has opened up many new regional destinations across the UK to those living in nearby European nations – for example both Bristol and Newcastle airports handled around 20% more passengers in 2004 than in 2003.

Other figures published by the CAA enable us to explore which individual routes have seen the greatest increase in patronage over the last year (charter route passengers have been excluded here). It should be noted that unfortunately we are unable to distinguish between inbound and outbound passengers within these figures. It is evident that low-cost operators did not capture all of the growth on offer with the two routes seeing the strongest growth being long-haul. A mix of short and long-haul routes make up the remainder of the top ten.

Fastest growing routes 2003 to 2004

New York (JFK) - Heathrow	296,392
Hong Kong - Heathrow	255,057
Prague - Gatwick	217,441
Reus - Stansted	185,938
Malaga - Gatwick	185,690
Dubai - Heathrow	177,801
Dublin - Stansted	166,652
Los Angeles - Heathrow	165,822
Toulouse (Blagnac) - Gatwick	161,196
Berlin (Schonefeld) - Luton	161,018

Market Shares

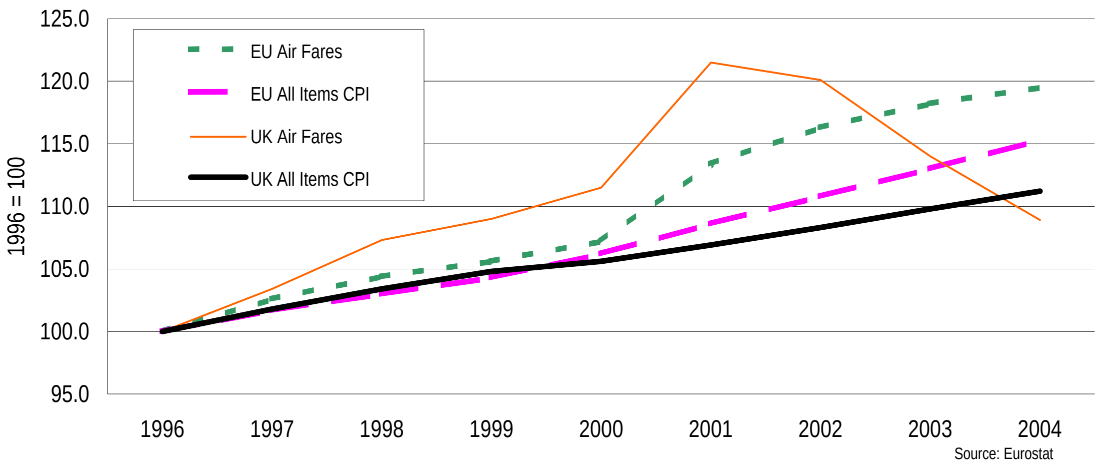
A recent report by US firm Standard and Poor forecast that within the next decade low-cost carriers would capture 50% of the US domestic market, at present it is thought that they account for a quarter of this market.

In Europe there are believed to be around 50 low-cost carriers according to the Economist but as we have seen in recent months many businesses end up being short-lived (Air Polonia, Duo, Volare, V-Bird to name but a few). The two biggest players, Ryanair and easyJet both have more than 100 new aircraft on order, signaling their intent to further grow their European "point-to-point" networks in the coming years. Aviation Economics have estimated that low-cost carriers already account for 40% of capacity at London area airports, significantly higher than is the case at other major European city airports, with French and German airports still favouring traditional network operators.

Fares…and profits

Amidst all of these figures on growth in air travel do we have any evidence about what has really happened to fares at the aggregate level? There has been considerable debate of late regarding "hidden" costs within air fares, be these "fees" "taxes" or "fuel surcharges". The chart shows the overall evolution of UK and EU-wide air fares versus general consumer prices in recent years. We can observe that initially air fares rose more sharply for UK consumers than did prices more generally, but by 2004 air fares had fallen back and were in-line with the overall change in consumer prices.

Air Fares and Consumer Prices in the EU and UK



The situation is rather different when we consider the overall EU picture. Here we find that the cost of air travel has consistently risen by more than overall consumer prices in the past eight years, emphasizing the fact that low-cost carriers have so far had less of an impact on EU wide fares than is the case in the UK.

As we have seen, tough competition has resulted in the failure of several smaller low-cost operators in recent years, and some flag-carriers such as Alitalia continue to face a very uncertain future (the airline made a net loss of €812 in 2004). However, both British Airways and Aer Lingus have managed to turn the post 9/11 loss-making era around and are now reporting improved profit margins. Ryanair and easyJet continue to dominate the European low-cost market but high fuel costs resulted in easyJet reporting a small pretax loss in the six months to March 2005.

A portable business model?

The concept of operating on a low cost basis is starting to have an impact on other parts of the tourism sector. For example we are starting to see hotels and car hire companies adopt this model, and easyGroup has now entered the cruise market. In time, and provided that "low-cost" accommodation is not seen as synonymous with "low-quality" then the advent of value-for-money hotels could help address one of the concerns that a number of inbound visitors have about the perceived high cost of staying in Britain, most notably in London.

A global phenomenon

India, Australia, Mexico, Brazil, Singapore and Poland – all have spawned new low-cost airlines over the past few months, a trend that will continue over the coming years. No doubt there will be high-profile failures as only those with the most robust business model enjoy sustained profitability, but air travel is set to expand rapidly in many emerging markets courtesy of the availability of lower fares.

With low-cost carriers predominantly offering short to medium-haul travel rather than long-haul destinations this expansion is not necessarily entirely good news for Britain's inbound tourism market. Taking India as an example Air Deccan, Kingfisher Airlines and now SpiceJet have all entered the domestic market and look set to expand with regional services to other nearby Asian destinations. As more and more people in India move into income brackets that enable them to afford overseas travel the opportunity to reach "new" destinations within India or neighbouring countries for a relatively low cost will form a challenge that carriers bringing visitors to Britain and other long-haul destinations will need to rise to.

Britain has been at the forefront of the low-cost airline revolution and its tourism industry has benefited from an enormous improvement in international connectivity as a result, enticing inbound visitors to destinations right across the UK. Clearly there has been a downside as low-cost carriers offer more overseas destinations to UK residents, but this simply reinforces the need for the domestic industry to provide high-quality, value-for-money products and experiences.

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