FORESIGHT
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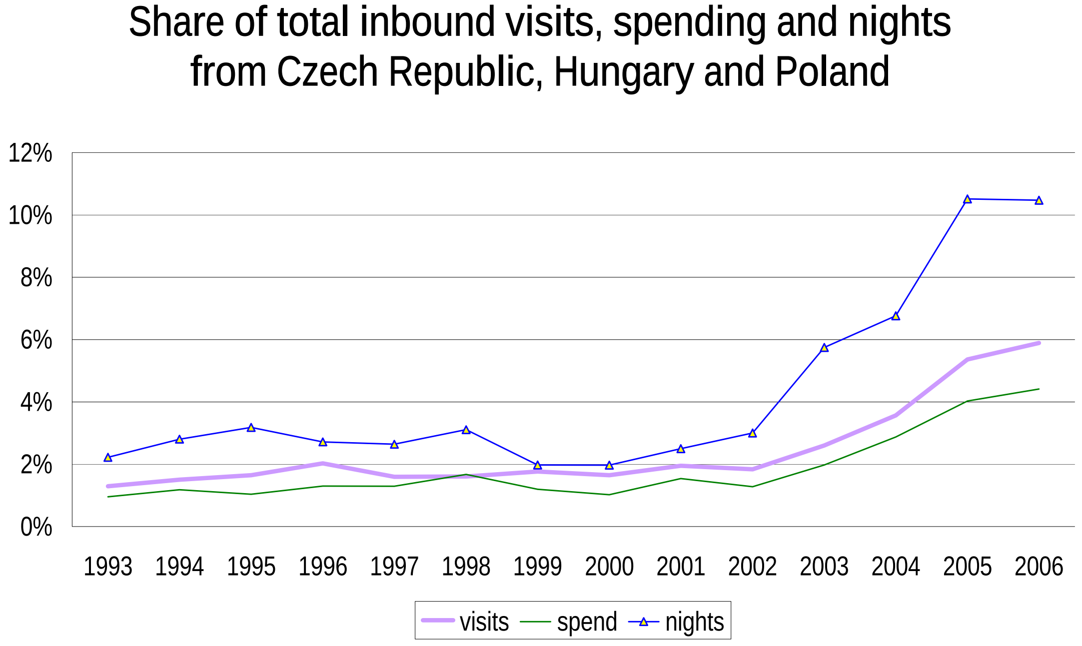
FORESIGHT is a monthly commentary on significant issues within the tourism sector. Each month, "Market Focus" discusses economic, social and political factors that underlie demand for tourism now and in the future. In addition, a spotlight is focused on a significant tourism issue. This month 'Market Focus' takes a look at the latest developments in Poland, Hungary and the Czech Republic. In light of the global 'credit crunch', 'Issue of the Month' considers the relationship between global economic growth and trends in inbound visits to Britain.

Market Focus – Poland, Hungary and the Czech Republic

The three lines on the following chart[1] tell us a great deal about trends in inbound tourism to Britain from these three markets over the past decade and a half. First of all we can spot that although more than one in every ten visitor nights spent in the UK by overseas visitors in 2006 was from one of these three markets, just £4 in every £100 spent by inbound visitors came from visitors from Poland, Hungary or the Czech Republic. Share of visits is now around 6%. So, these three markets are characterised by very long stay per visit (on average 15 nights), low spend per night (£25, compared to the average for all inbound markets of £58) and relatively low spend per visit (£366 compared to the global average of £486).

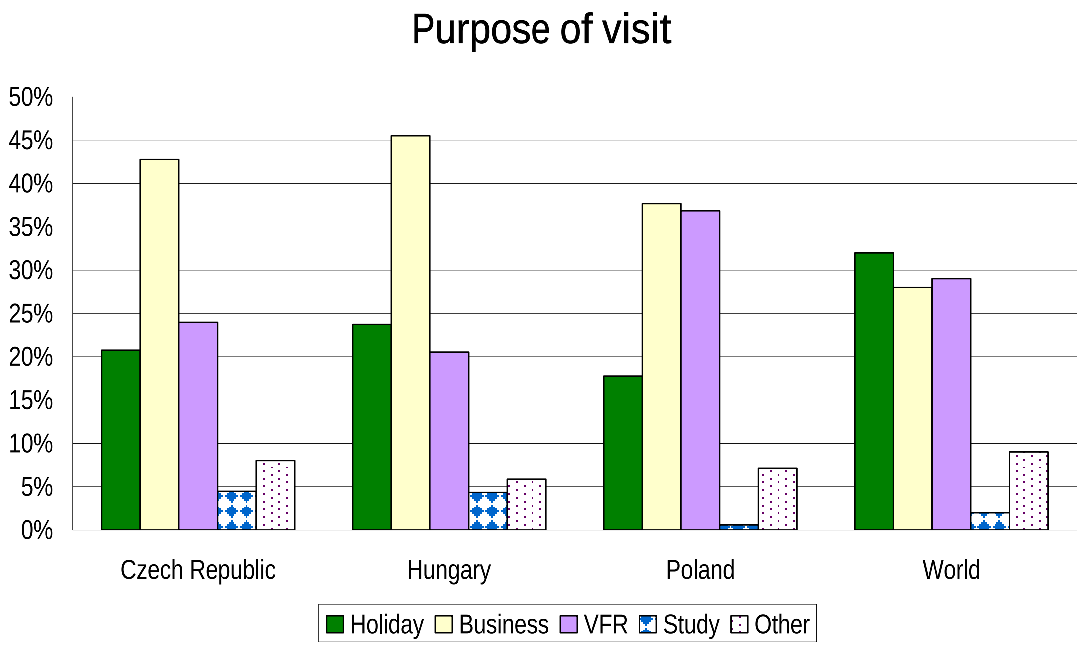


Another striking feature of the chart is of course that for the first ten years shown there is very little change in the market share held by these three markets, but that all changes from 2003 onwards. It is of course no coincidence that on 1st May 2004 these countries all became members of the European Union (see the April 2004 edition of Foresight).

Who gets counted?

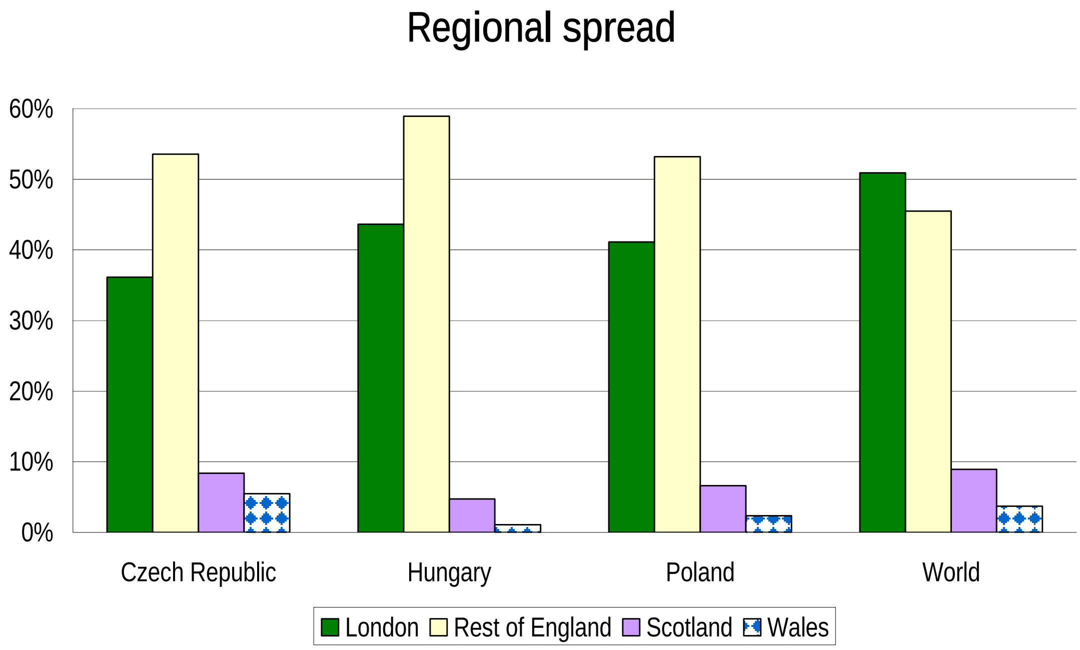
Visitor figures taken from the International Passenger Survey include overseas residents who come to the UK on business (for example to attend a meeting, conference or trade fair, and those driving trucks to collect or deliver goods), but exclude overseas residents who have been in the country in order to take up paid employment. So, provided that those completing the survey questionnaire tell the truth, the growth in visits from these three markets witnessed in recent years doesn't represent Polish dentists or Hungarian plumbers travelling to and fro between their home country and Britain.

However, the fact that there is a burgeoning Eastern European community living in the UK (the most recent estimate is that there are some 850,000 Poles in Britain) clearly acts as a catalyst, with those living here encouraging friends and relatives to visit Britain, either for a holiday or 'visiting friends and relatives' trip. We can see from the following chart that the share of trips that are for business is much higher in each of these markets than the global average, and the share of holiday trips somewhat lower than the overall average. Visits from Poland are more likely to be 'VFR' trips than those from either Hungary or the Czech Republic.



However, before jumping to the conclusion that all those visiting Britain 'on business' from these markets are not plumbers, but are high-spending, briefcase carrying stereotypical business folk it is insightful to look at another piece of information collected as part of the International Passenger Survey, namely the type of vehicle (if any) that the visitor was travelling in. Out of the half a million Polish residents who visited Britain on business during 2006 305,000 (61%) were driving a lorry.

This is one of the likely explanations for the regional spread of visits from these three markets being somewhat atypical. Compared with the global average visits from Poland, the Czech Republic and particularly Hungary are more likely to be to areas of England outside London than is the case for visits from the 'typical' inbound market.



The current year

With provisional figures for the first eight months of 2007 now available it would appear as though the exceptionally strong growth seen in the past three years in terms of visits from Poland, Czech Republic and Hungary is finally slowing, particularly so from Poland, with the year-to-date picture being a 4% decrease, 24% increase and 37% increase respectively.

Strong economies but political upheaval

According to the latest projections published by the International Monetary Fund (IMF) Poland will see economic growth of 5.3% in 2008, with the equivalent figures for the Czech Republic and Hungary being 4.6% and 2.7%. Despite this economic robustness there is plenty of political upheaval in the region at present. The recent Polish election resulted in a clear and decisive victory for the opposition Civic Platform party. The new government promises to be more 'business friendly' and to work on improving ties with other EU nations, particularly Germany. In Hungary the Socialist government is deeply unpopular, but activities my far right groups have prevented the opposition from taking full advantage of the situation. In the Czech Republic the governing coalition appears fairly stable, but an early election cannot be ruled out.

All three of these countries, along with Latvia, Lithuania, Estonia, Slovakia, Slovenia and Malta, look set to become members of the Schengen Area (the area within which there are no internal border controls) by early 2008.

Coming soon...

Early in the New Year the 2008 edition of VisitBritain's 'Market Profiles' will be available, including comprehensive information about each of the markets discussed here, and featuring an analysis of the 'group composition' and 'activities' International Passenger Survey questions that VisitBritain sponsored in 2006. Along with this and earlier editions of Foresight you can find the latest 'Market Profiles' at www.visitbritain.com/research

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Issue of the Month – The 'Credit Crunch'

Introduction

One of the defining images of 2007 will be the queues of investors outside branches of Northern Rock trying to safeguard their savings. In light of growing global economic concerns this month we explore the current economic outlook, both globally and for the UK, and investigate the relationship between inbound tourism and economic growth. In assessing the degree to which future UK tourism prospects may be damaged by current financial market turmoil the main conclusion is that although the risk remains low, it has increased markedly in recent weeks.

The major risk relates to prospects for our long-haul markets, particularly business and leisure travel from the US. A slowdown in economic activity in short-haul markets is less likely to dampen demand for leisure visits to Britain (as consumers shun 'big ticket' holiday destinations in favour of those close to home), however short-haul business travel could be hit. The risk that emerging markets such as India and China will suffer a major downturn is considered negligible at present.

Current environment

The root cause of current financial market wobbles has been the US 'sub-prime' mortgage market. This is the wing of the US financial services sector that lends to those with poor credit histories. In recent times everything has gone smoothly as a manageable number of borrowers defaulted on their loans, but the problem is now that increasing numbers are unable to repay their loans.

Financial institutions trade in debt, which again is fine providing there is confidence that in time debts will be paid, but with a global web of buying and selling, uncertainty has emerged about which institutions are now sitting on debts that will remain unpaid. As such we appear to be heading for a 'credit crunch' whereby problems that started in one sector of the US housing market are spilling over into other financial dealings, be this in terms of a drying up in the number of company take-overs, loans to those with good credit histories becoming more expensive, or banks simply not having sufficient liquidity to make loans.

There is a very strong possibility that the wider US housing market is being affected by problems in the sub-prime mortgage sector. Sales of existing homes fell 0.2% to 5.75 million units in the year to July 2007, the lowest since November 2002 It marks the first time that the US's main estate agent body has reported a decline in 12 consecutive months. If demand for houses is falling because finding a mortgage is getting more difficult then demand for consumer durables starts to decline too, feeding through to a potential downturn in the all-important US retail sector. The Federal Reserve has acted to boost the US economy by announcing a fifty basis points reduction in interest rates in September with a further cut on 31st October.

However, the 'credit crunch' is no longer something restricted to the US, or indeed to businesses, as was demonstrated by the Northern Rock crisis. Although most analysts supported the verdict of the Financial Services Authority that Northern Rock had suffered from an exceptional set of circumstances, and was not at risk of insolvency, consumers did not believe these reassurances, and it took a U-turn by the Bank of England to reassure Northern Rock customers that 100% of their savings were secure.

Consumer confidence indicators published at the end of October in the US, UK and Eurozone paint an interesting picture. Confidence among US consumers dropped sharply for the third consecutive month, and is now at its lowest level since autumn 2005 (when sentiment was depressed in the aftermath of Hurricane Katrina). Eurozone consumer confidence declined to its weakest level since January, but surprisingly UK consumer confidence improved marginally. If there is a general economic slowdown during the coming months, dented consumer confidence, and a resultant reluctance to spend will be a key contributory factor.

Clearly a fall in consumer confidence in overseas markets is likely to dent prospects for visits to Britain, but it is feasible that in the near markets, and indeed for domestic tourism, more cautious consumers might be expected to hold back from taking long-haul trips and holiday closer to home.

Long before the 'credit crunch' became the focus of attention doubts about the US economy were widespread, based on the fact that the US was operating with a trio of deficits; private sector debt, Federal borrowing and most importantly an enormous trade deficit. It is the trade deficit, and China's pegged currency, that has placed pressure on the dollar in recent months, and for most of summer 2007 it has been trading at just over $2 to the pound. Some analysts, including the Centre for Economic and Business Research forecast that we could see $2.25 to the pound in the coming months, and with recent weakening in the dollar to $2.07 this forecast may well be accurate.

Economic Forecasts

In recent weeks a series of organizations have revised down their economic forecasts for the remainder of 2007 and for 2008. Looking first at forecasts for the UK economy the latest comparison of independent forecasts released by HM Treasury in mid October showed that the average forecast for UK GDP growth in 2007 remains bullish at 2.9%, but that the collective view for 2008 is becoming less rosy, with GDP expected to grow by 2.0%, and one city forecaster (Economic Perspectives) predicts a recession in 2008.

Updated forecasts released by the Centre for Economic and Business Research (CEBR) suggest that UK GDP growth in 2007 will average 2.7%, but this figure hides a year of two very different halves – growth in the period January to June was 4%. The downturn is expected to result in economic growth of just 1.5% during 2008, down from a forecast of 2.2% just a few weeks ago. The sectors hardest hit are expected to be financial services, which may see negative growth in quarter 1 2008, and consumer spending, expected to grow just 1% next year.

With the City of London a key global financial centre a prolonged period of sluggish, or negative, growth in the financial services sector has the potential to dampen demand for inbound and domestic business trips to London during the next six to twelve months.

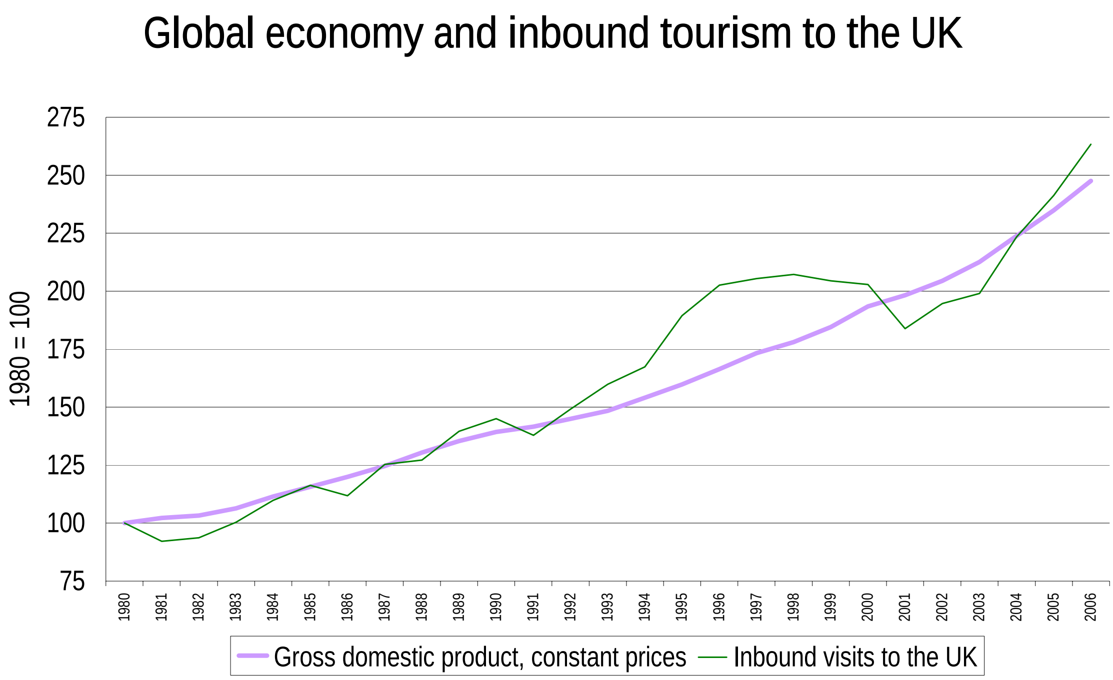
An economic slowdown will result in government tax revenues falling well short of earlier expectations due to weak consumer spending, and contraction in the highly taxed financial services sector. UK base rates are forecast to fall to 4.5% by next summer, but the Federal Reserve is expected to cut rates more aggressively, and this is one of the factors behind the anticipated further weakening in the US Dollar.

The good news is that the downturn is expected to take the form of a 'one year hit' with a strong bounce back in activity during 2009 and 2010. Furthermore, CEBR expect the pound to weaken against the Euro, making Britain a more affordable choice for Eurozone residents.

According to the Organisation for Economic Cooperation and Development (OECD) the current contraction in the US housing market and the wider problems in the financial markets it has triggered will have a negative impact on the wider US economy. The OECD is now forecasting US economic growth to fall to 2% in the third quarter and 1.5% in the fourth quarter from the 4% recorded between April and June. The International Monetary Fund has revised its forecasts too, and believes that the impact will be felt during the remainder of 2007 and throughout 2008. The IMF believes that 'downside risks' have increased significantly, with the biggest impact likely to be within the US economy.

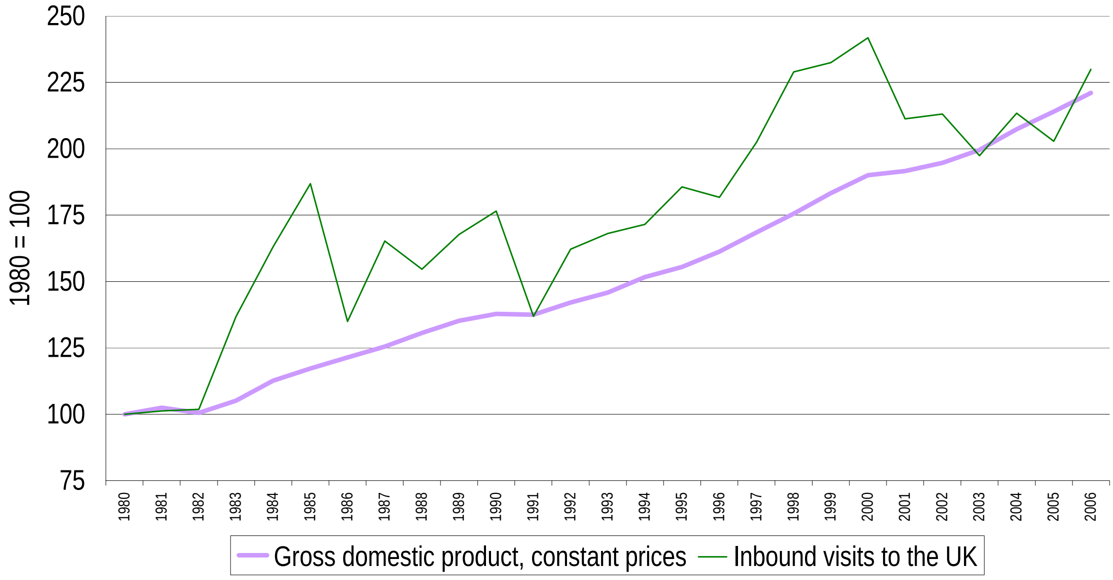
Economic trends and their impact on inbound tourism to the UK

The following charts explore the relationship between inbound tourism to the UK and global economic trends over recent decades. Firstly we can see that in most years since 1980 both global GDP and inbound visits to the UK have seen an increase, with the declines in inbound tourism witnessed in 1986, 1991 and 2001 being largely due to external factors rather than economic fundamentals (the US bombing of Libya and Chernobyl nuclear accident in 1986, the Gulf War in 1991 and Foot and Mouth Disease and 11th September in 2001). Periods of growth that have been driven by external factors include the mid 1990s, following the opening of the Channel Tunnel to regular passenger traffic in November 1994.

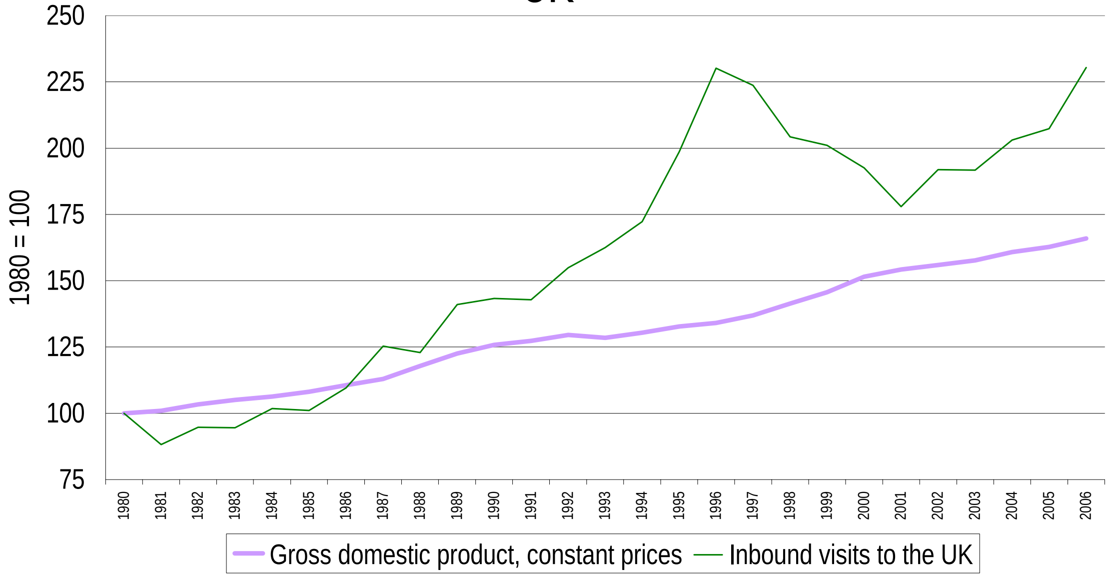


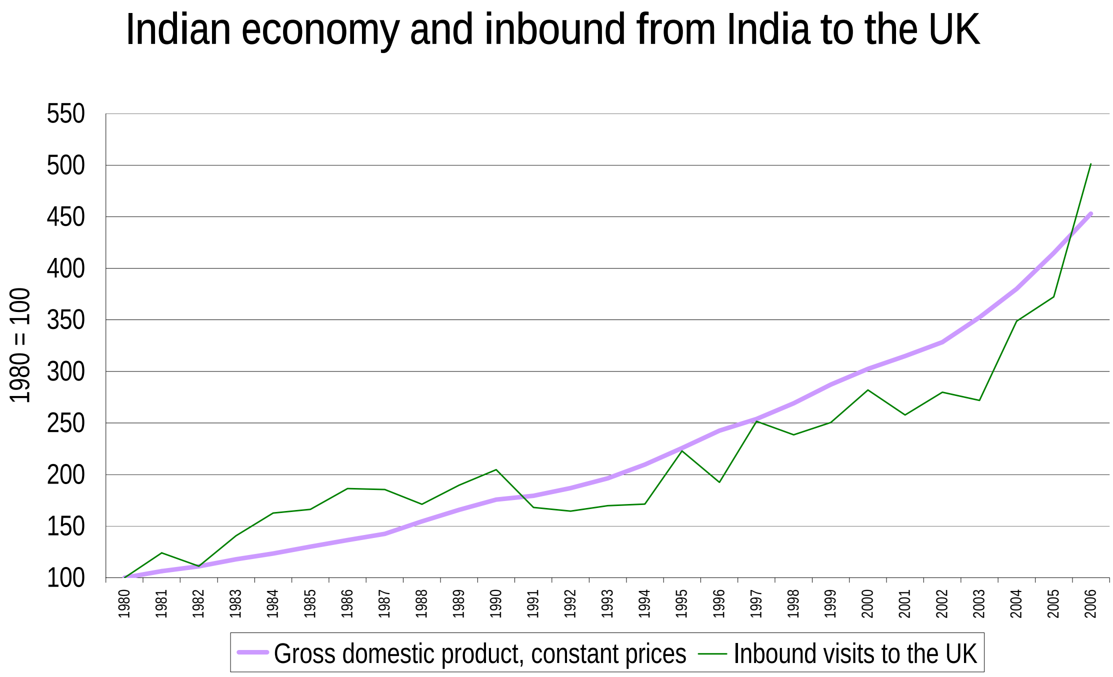
It is helpful to take a few specific markets rather than looking solely at the global picture, and the next charts show trends in country specific GDP and inbound visits to the UK for the USA, France, India and Japan since 1980.

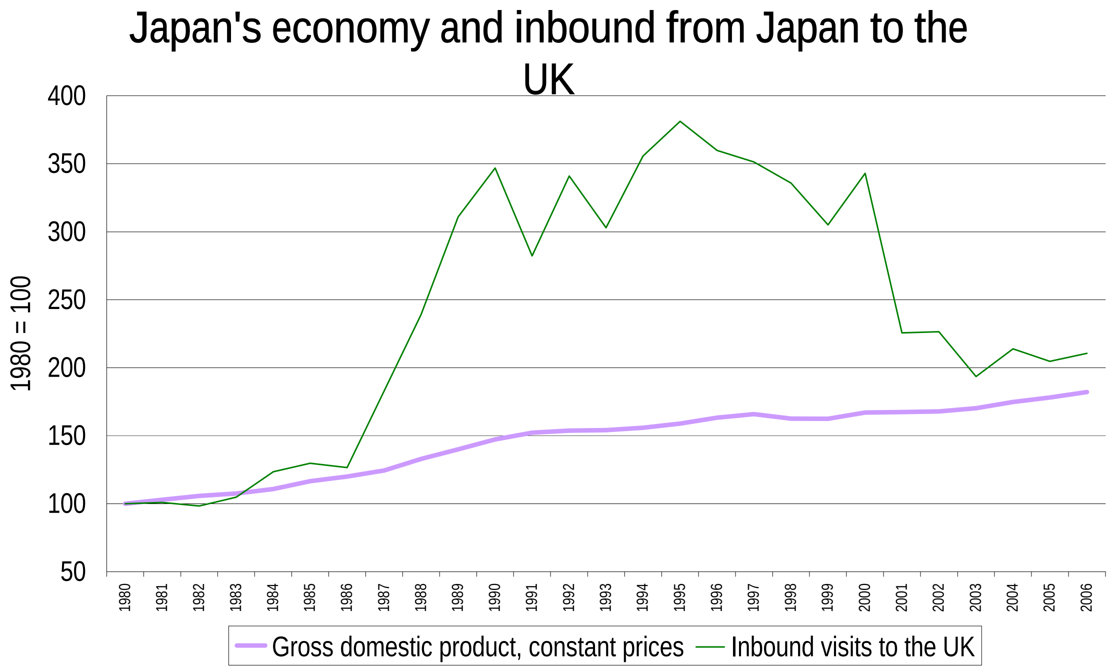
US economy and inbound from USA to the UK



French economy and inbound from France to the UK



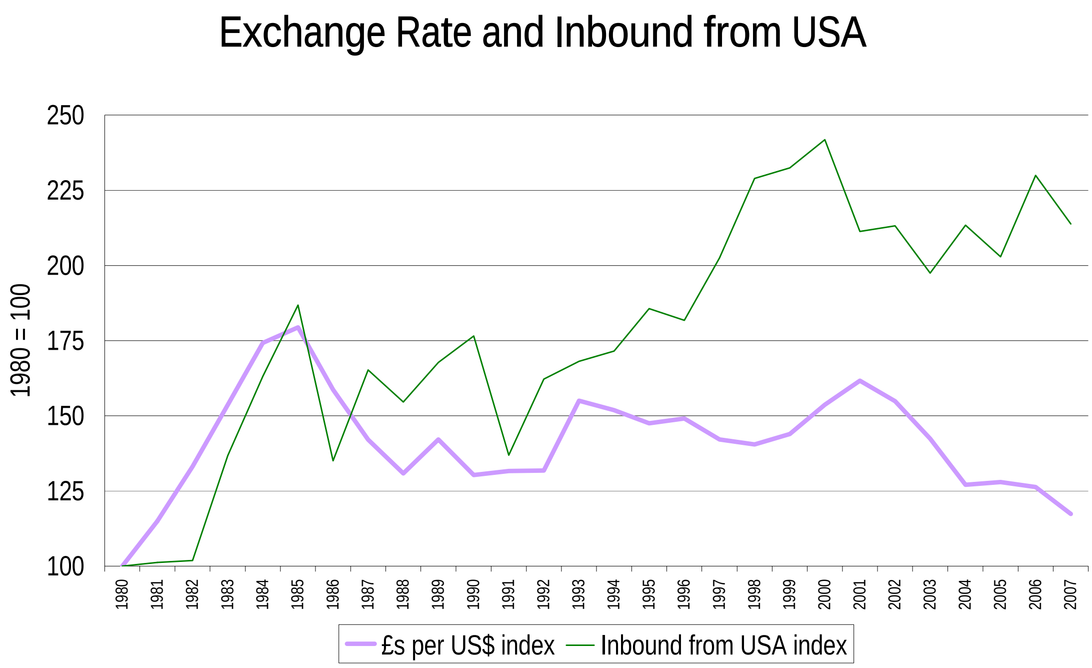


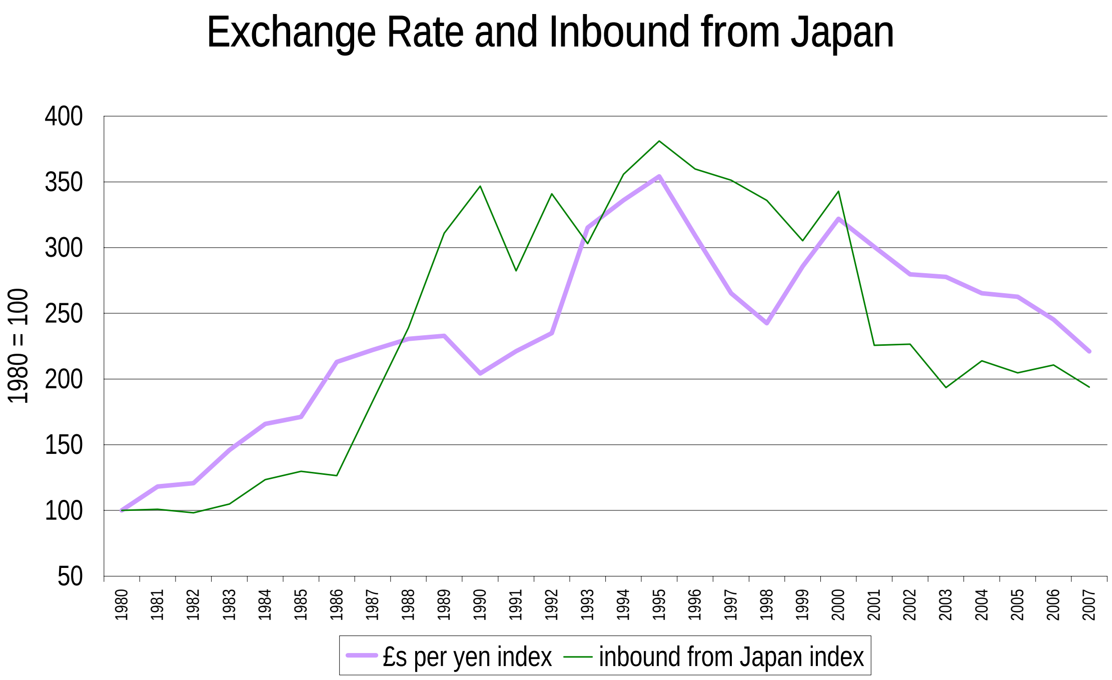


Key points emerging from the above charts include that inbound visits are clearly much more volatile than GDP growth, and at times the two series can move in opposite directions. The persistent strong growth of the Indian economy and similarly persistent weak growth in the Japanese economy, and lacklustre performance of visits from Japan to the UK are evident. Growth in visits to the UK from France following the opening of the Channel Tunnel in November 1994 is clear to see.

Clearly economic growth is a fundamental prerequisite in order to generate sufficient wealth for residents to be able to afford international travel, however, GDP growth alone does not ensure growth in outbound travel to all destinations. In choosing destinations the price of visiting (both travel and staying costs) matters, and this is not simply a function of the relative cost of living and distance from origin to destination. The exchange rate between countries can move fairly significantly from one year to the next, bringing about noteworthy changes in the perceived cost of visiting a specific destination. The next two charts show trends in the value of sterling per US$ and Japanese Yen alongside visits to the UK from each market, with all series indexed to 100 in 1980.

The collapse in the value of sterling following the UK's withdrawal from the EU's 'Exchange Rate Mechanism' in September 1992 is evident, with inbound visitors enjoying a year-on-year double-digit percentage fall in the cost of sterling during 1993.





The intuitive relationship that one would expect between the cost of sterling and inbound visits is that when one rises the other falls, and in general this holds true, though with some indication of a slight time lag. One way of summarizing the strength and direction of these relationships is to look at the 'correlation coefficient'. If for a 1% rise in the cost of sterling we found a 1% fall in visits to the UK the correlation coefficient would be -1, and if for a 1% increase in GDP inbound visits rose 1% we would find a coefficient of +1.

	Correlation Coefficient with respect to inbound visits to the UK		
	GDP	Exchange Rate	Exchange rate lagged 1 year
World	0.46		
France	-0.12		
India	0.35		
Japan	0.54	-0.07	-0.46
USA	0.47	-0.28	-0.24

The weaker the relationship between two series, the closer to zero will be the correlation coefficient.

We can see from the table that, with the exception of France, the intuitive relationship holds true for GDP growth and inbound visits to the UK, and for the exchange rate there is a negative relationship, particularly with a lag of one year in the case of the Yen.

A complex demand function

The grid to the right summarises variables that form part of the 'demand function' for the UK as a destination for inbound tourism. The attractiveness of the UK to overseas visitors depends on a number of economic variables such as wealth, price, job security, consumer confidence and so on, but socio-demographic, historical, geographical and cultural factors play a role too.

The table indicates the risk posed by the financial market turmoil to each of the many factors. Although there is a high risk for certain factors, other variables, such as the accessibility of the UK, would largely be unaffected by a global economic slowdown.

Category	Factor	Current Risk
Transport and accessibility	Flight Frequency	low
	Flight Time	not applicable
	Visa Requirement	not applicable
	International transport costs	medium
Economic	GDP Growth	high
	Abslute per capita income	high
	Unemployment	high
	Consumer confidence	high
	Total value of trade	medium
	Flow of foreign direct investment	medium
	Exchange rate	high
	Relative cost of living (tourism goods/services)	low
Socio-demographic, political and cultural	Population size and structure	not applicable
	Population Growth	not applicable
	Language	not applicable
	Number of nationals living in UK	low
	Stability	low
	Historical links to GB	not applicable
	Perceptions of the UK	not applicable

Research undertaken by Caledonian Economics on behalf of the British Tourist Authority in 2001 looked at the aggregate relationship between the UK's international tourism receipts and OECD GDP along with the trade-weighted exchange rate. A second phase of the research looked at four individual inbound markets, namely Germany, Ireland, France and the USA.

Findings from the study included:

- a 1% increase in real OECD GDP generates a 0.6% real increase in the UK's international tourism receipts
- a 1% rise in the value of the pound leads to a 1.3% decline in the UK's real international tourism receipts

These relationships appear plausible, indicating that as people get richer they travel more, and as the cost of Britain increases we become less appealing as a destination, but as the earlier charts revealed these relationships are also subject to numerous external events, and can sometimes break down.

Risk assessment

It is probably consumer confidence, both at home and abroad, that will determine whether or not the financial market turmoil will spill over to the 'real' economy in a major way over the coming weeks and months. The risk is that if consumers fear a dramatic economic slowdown, then their reluctance to spend may be the very thing that brings about such a slowdown. This is of course the reverse of what we have seen over recent years, particularly in the UK, where confident consumers have borrowed, spent and borrowed some more, all of which has helped to drive strong economic growth, with sixty successive quarters during which GDP has grown.

The risk of a slowdown, particularly in the US and UK has increased markedly in recent weeks, with a range of indicators confirming this trend. The Eurozone (with the potential exception of Ireland and Spain) and Asian markets are unlikely to see as significant a slowdown in the short term, but weaker demand for imports to the US could have a knock on effect in China later in 2008.

The major risk to UK tourism would appear to be that the slight recovery in visits from the US seen during 2006 will be lost, and figures for the period January to August 2007 indicate this is now a highly likely scenario. Further weakening of the US Dollar could mean that 2008 will see a further contraction in the number of visitors to Britain from the US, but the 'Open Skies' Agreement between the EU and US does at least offer some cause for optimism, as new routes and, potentially, lower fares on Trans Atlantic routes take shape.

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		Market Focus	Issue of the Month
Issue 1	November 2003	USA, Canada and Mexico	Implications of an ageing population in Britain
Issue 2	December 2003	France, Italy, Portugal and Spain	Airport capacity in Britain
Issue 3	January 2004	Poland, Russia, China and South Korea	Visits to Britain by British Nationals living overseas
Issue 4	February 2004	Britain	School holidays and their impact on seasonal spread
Issue 5	March 2004	Australia and New Zealand	West Nile Virus
Issue 6	April 2004	The EU Accession States	
Issue 7	May 2004	South Africa, Nigeria, Kenya and Ghana	The Internet Part 1: Consumers
Issue 8	June 2004	India and Pakistan	The Internet Part 2: Businesses
Issue 9	July 2004	Belgium, Netherlands, Luxembourg and Ireland	Trends in Cross-Channel Travel Behaviour
Issue 10	August 2004	Japan, Hong Kong, Philippines and Taiwan	Cost of visiting Britain compared with other destinations
Issue 11	September 2004	Brazil, Argentina, Chile and Venezuela	What might climate change mean for tourism in Britain
Issue 12	October 2004	Norway, Sweden, Denmark and Finland	London's Olympic Bid – implications for British Tourism
Issue 13	November 2004	Britain	Smoking in public places
Issue 14	December 2004	UAE, Saudi Arabia, Kuwait and Iran	Outlook for inbound tourism to Britain in 2005
Issue 15	January 2005	Germany, Austria and Switzerland	Inbound tourism and the value of Sterling
Issue 16	February 2005	Malaysia, Thailand and Singapore	Britain's ethnic diversity
Issue 17	March 2005	Greece, Romania, Bulgaria and Croatia	Britain's transport infrastructure
Issue 18	April 2005	Israel, Egypt and Turkey	Foreign Direct Investment & inbound business tourism
Issue 19	May 2005	Poland, Czech Republic and Hungary	Inbound study visits
Issue 20	June 2005	USA, Canada and Mexico	Low-cost Airlines
Issue 21	July 2005	France, Italy, Spain and Portugal	Weddings, Stag Weekends and Hen Weekends
Issue 22	August 2005	Latvia, Lithuania, Estonia, Ukraine and Belarus	The Day Visit Market
Issue 23	September 2005	Russia and China	Quality
Issue 24	October 2005	Australia, New Zealand and South Africa	Daylight Saving
Issue 25	November 2005	India, Sri Lanka and Bangladesh	Outlook for Inbound Tourism in 2006
Issue 26	December 2005	Twenty-five years of Inbound Tourism	
Issue 27	January 2006	Benelux and Ireland	Tourism Satellite Accounts
Issue 28	February 2006	Japan, South Korea and Hong Kong	Tourism and the Disability Discrimination Act
Issue 29	March 2006	Brazil, Argentina and the Caribbean	Tourism and the National Lottery
Issue 30	April 2006	Nordic region and Iceland	Next generation aircraft
Issue 31	May 2006	Central Europe	The cruise line boom
Issue 32	June 2006	UAE, Kuwait, Bahrain and Oman	The power of football
Issue 33	July 2006	North Africa, Malta and Cyprus	Wind Farms and the Visitor Economy
Issue 34	August 2006	Inbound tourism - the global context	
Issue 35	September 2006	Singapore, Malaysia and Thailand	International tourism balance of payments deficit
Issue 36	October 2006	Greece, Turkey, Bulgaria and Romania	Inbound visitor decision lead times
Issue 37	November 2006	Inbound visits by the over 55's	Seasonality
Issue 38	December 2006	Outlook for Inbound Tourism in 2007	
Issue 39	January 2007	USA and Canada	Second homes
Issue 40	February 2007	Ferry passenger visitors	Accommodation choices
Issue 41	March 2007	What will shape tourism in the next decade?	
Issue 42	April 2007	The value of tourism in the UK	Holiday activity perceptions (Part 1)
Issue 43	May 2007	India and Japan	Holiday activity perceptions (Part 2)
Issue 44	June 2007	Inbound holiday visitors	The role of nature and wildlife in UK tourism
Issue 45	July 2007	The changing face of overnight domestic tourism	
Issue 46	August 2007	Inbound visitors using the Channel Tunnel	The impact of the Channel Tunnel Rail Link
Issue 47	September 2007	Inbound visitors aged 16-24	Climate change and what it might mean for UK tourism
Issue 48	October 2007	Special edition: Inbound visitors' travel group composition and 'activity mix	

[1] Data from International Passenger Survey has been made available by the Office for National Statistics and has been used by permission. The ONS do not bear any responsibility for the analysis or interpretation of the data reported here. Crown Copyright 2007. Source: ONS