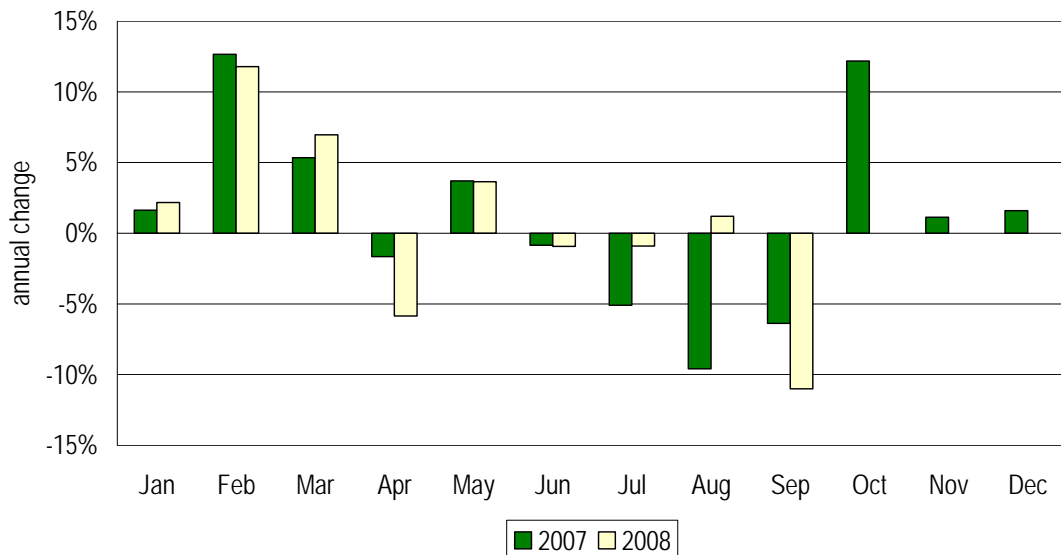


FORESIGHT is a monthly commentary on significant issues within the tourism sector. This month we take a look ahead to 2009 and consider what is likely to happen to the volume and value of inbound tourism to the UK, and consider the likely impact of several factors set to influence trends over the coming year. These factors range from the ongoing global economic downturn and the value of Sterling through to new air route developments and year-long 'Homecoming Scotland' initiative.

**The 2008 story**

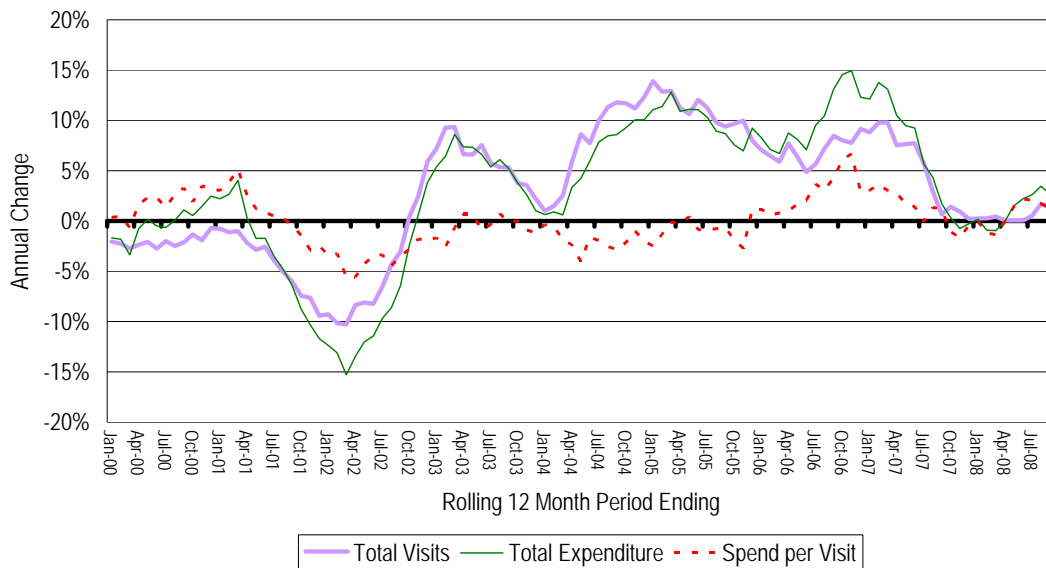
It is clear from the following chart that in 2007 the volume of inbound tourism was growing during both the first and final few months of the year but contracting during the key summer months of July to September. The story of the first nine months of 2008 has mirrored this to a large extent, but, as is hinted at by the sharp 11% drop in September 2008, there seems little prospect that the final quarter of 2008 will deliver growth in visitor numbers akin to that seen a year earlier.

**Trends in inbound visits to the UK**



By looking at trends in the volume and value of inbound tourism over the longer term, and 'smoothing' out monthly fluctuations, we can get a clearer picture of where we have been and where we might be going. The following chart is based on a 'rolling twelve month' series and reveals that for much of the period from mid 2007 through to mid 2008 the story is one of 'trading water' after a sustained period of well above trend growth since the expansion of the European Union in May 2004.

## Trends in inbound tourism



Looking back at some of the events that have influenced trends in 2008 the deteriorating state of the global economy clearly stands out. However, there have been other developments worthy of recapping; Heathrow Terminal 5 opened on schedule, though not quite with the step-change in customer experience and media coverage of Heathrow hoped for by British Airways and BAA, the EU/US Open Skies Agreement became a reality, though as prophesied in the March 2008 edition of *Foresight* the impact on Trans-Atlantic schedules and airfares has not been enormous.

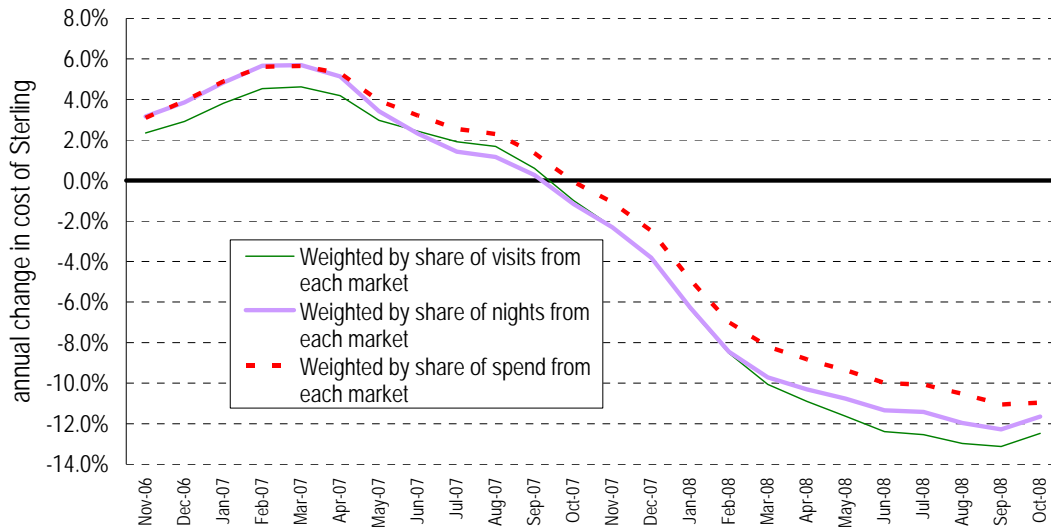
The number of visitors to the UK taking advantage of improved journey times and reliability of Eurostar services following the opening of the second phase of the high-speed link to the new St Pancras International station grew markedly in the first eight months of 2008, but a fire in the Channel Tunnel on 11<sup>th</sup> September has reduced capacity and increased journey times for the past three months, and normal operations are not expected to resume until February or March.

One final factor that has played a role in 2008, very much tied in with the global economic situation, is the value of Sterling. For the first half of the year Britain, and Eurozone countries, had a relatively 'unfavourable' exchange rate against the US dollar in terms of attracting American visitors, whereas against the Euro the pound was considerably cheaper than in 2007.

Since the onset of the global financial crisis in September many global currencies have witnessed marked fluctuations in value. This has been true of Sterling which has tended to weaken against most major world currencies, including the US dollar and Euro. The following chart shows trends in the cost of purchasing Sterling (based on a rolling three month average and measured in terms of a basket of currencies, with the 'weights' applied to each currency being based on the share of visits, visitor nights or visitor spending emanating from each currency-bloc of countries).

We can see that for the 'average' inbound visitor to Britain the cost of purchasing goods and services traded in Sterling is about 10% to 12% cheaper than at this time last year, with the likelihood that in the short-term at least the reduction in cost will gather pace.

## The cost of Sterling



### Global outlook

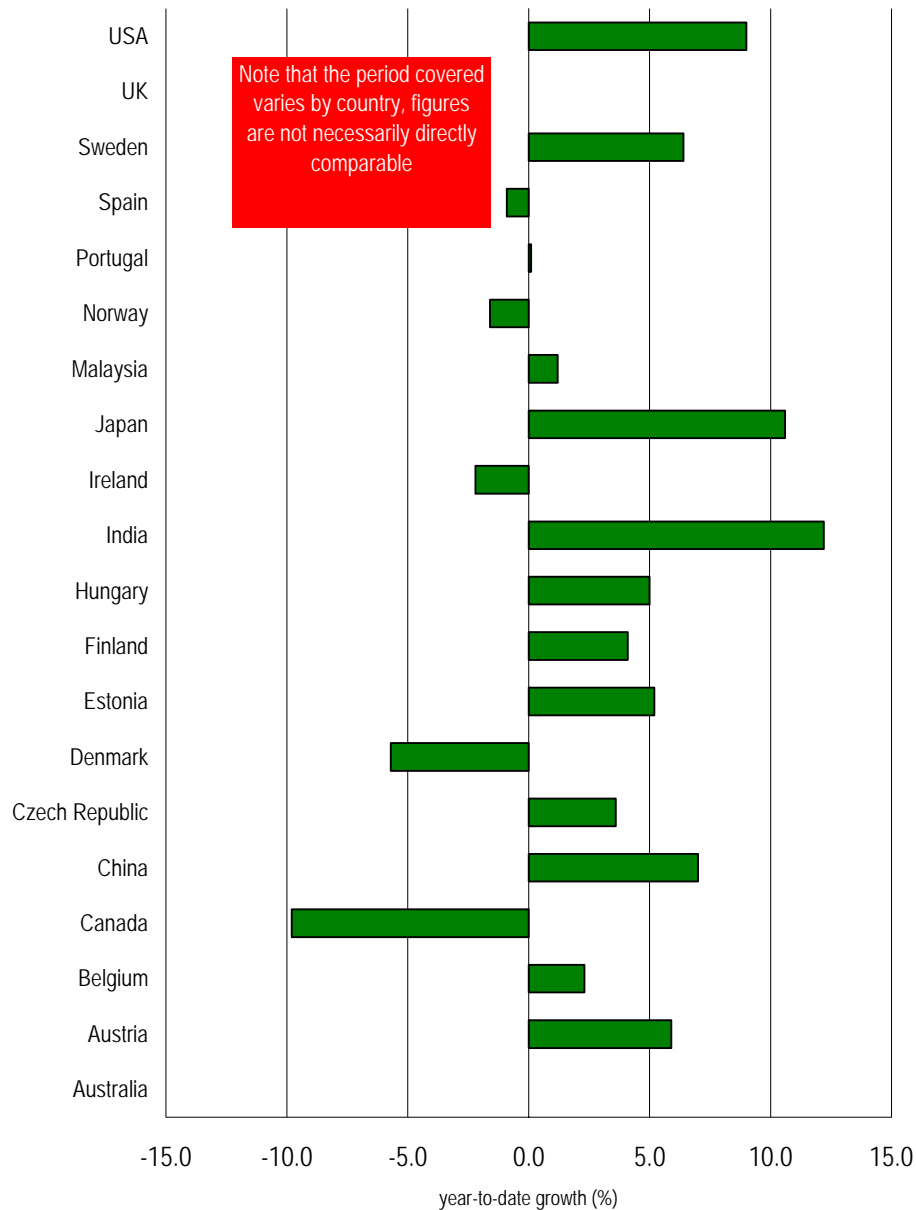
In the most recent edition of the United Nations World Tourism Organisation 'Barometer' the UNWTO predicted that in 2009 international tourism is set to grow by between 0% and 2%. With the global economy showing signs of a rapid downturn in just about every corner of the world there has to be a very real chance that 2009 will bring about fewer international tourism trips than did 2008, something that has only happened twice in the past forty years (in 1982 and 2003).

The International Air Transport Association (IATA) is pessimistic about current prospects for global air travel with what it termed an 'alarmingly fast-paced' decline in global air travel in September, down 2.9% on a year earlier, the first fall since the SARS outbreak of 2003. Airlines have been unable to reap the benefit of falling oil prices, partly because some may still be tied in to paying more than the current market rate for their fuel, and partly because even with lower fares demand is ebbing away.

It seems certain that most major 'western' economies will be in a technical recession (that is two consecutive quarters in which economic activity contracts) by the end of 2008, with the International Monetary Fund recently predicting global economic growth of only 2.2% next year, that is  $\frac{3}{4}$  of a percentage point down from their forecast made only a few weeks earlier. The gloomy prognosis is worst for 'advanced economies', with output forecast to contract on a full year basis in 2009, something that has not happened in the past sixty years. Growth in 'emerging economies' is forecast to slow significantly, but remain at a comparatively healthy 5%. Concerted global economic measures geared towards boosting activity could go some way to alleviating the forecast slowdown.

In terms of 2008 tourism performance the following chart shows 'year to date' growth in either arrivals or visitor nights for a number of different destinations based on figures compiled from a range of sources including Tourmis and PATA. Note that for both the UK and Australia 'year to date' growth is zero.

## Current global tourism destination trends



## Forecast for inbound tourism to the UK

	2007 actuals		2008 forecast			2009 forecast		
	(m/£bn)	growth	(m/£bn)	growth	forecast range	(m/£bn)	growth	forecast range
Volume	32.78	0.2%	31.90	-2.7%	-4.5% to -0.9%	31.68	-0.7%	-1.7% to +3.3%
Value (nominal)	15.96	-0.3%	16.35	2.5%	0.5% to 4.4%	16.74	2.4%	1.4% to 6.4%

- The volume of inbound tourism is forecast to stand at 31.9 million visits in 2008, representing a decrease of 2.7% on 2007. In 2009 the number of visitors is forecast to be 31.7 million, equivalent to an annual fall of 0.7%
- The value of inbound tourism is forecast to be £16.4bn in 2008 rising to £16.7bn in 2009, representing annual growth of 2.5% in 2008 and 2.4% in 2009, however with inflation

forecast at 1.7% (based on the average independent forecast of consumer prices compiled by HM Treasury in November 2008) this represents just 0.7% 'real' growth in 2009, after what is likely to be 2% fall in real terms in 2008.

- If accurate, these forecasts suggest that neither 2008 or 2009 will see record numbers of inbound visitors or (in nominal terms) visitor spend
- The biggest risks in 2009 relate to business tourism and to leisure visits from parts of the world hardest hit by the global economic slowdown, most notably the USA
- 'Downside' risks to this forecast significantly outweigh 'upside' risks at present

These forecasts are dependent on normal circumstances prevailing and do not factor in unexpected shocks caused by terrorism, health scares and other crises.

### **Forecast methodology**

These forecasts were prepared in late October, based on published International Passenger Survey data through to August 2008. The most recent figures released by the Office for National Statistics for September suggest that, if anything, our central estimate for 2008 may be too optimistic.

Monthly IPS data from 1978 to 2007 has been analysed to understand the percentage of full-year visits and spend that has accrued by each month of the year. These figures show that, on average, by August 69% of visits and 66% of spend has accrued. Looking at the "minimum and maximum" amount of visits and spend to have accrued by August shows ranges of 66%-71% and 65%-69% respectively (2001 is excluded as an outlier).

With only four more months of data due to be published at the time of preparing the estimates the forecast full-year figure adopted was the mid-point between the 'most likely' and 'worst case' options, reflecting the balance of risks at present which weigh heavily on the 'downside' as confirmed by the September figure of an 11% year-on-year drop.

Based on IPS data the average annual growth rate for the period 1994-2008 (with the 2008 figures based on our forecast values) specific to visits and spend has been used to produce forecasts for 2009. The growth rates have been weighted, with the weight applied to 'year t' being twice that applied to 'year t-1' and so on.

Due to the current global economic slowdown the forecast adopted here has been reduced by 1.5% compared with the 'central' statistical forecast. This adjustment reflects the latest available traffic figures from carriers and sharp downward revision made by the International Monetary Fund in relation to global economic prospects.

### **What will shape 2009?**

Twelve months ago the 'credit crunch' was very much in the news, but nobody foresaw the global financial crisis that would arise in September 2008. This reinforces the message that although we can look ahead to some of the trends and events that will help to shape the UK's inbound tourism prospects throughout the coming year with a degree of certainty, it is sometimes the unpredicted events that have by far the largest impact. Below we describe some of the 'risks' to the forecast, both those that may result in the situation being more favourable than forecast, and those which could result in 2009 being gloomier than predicted.

## Upside forecast risks for 2009

On 1<sup>st</sup> June 2009 the US government will implement the full requirements of the land and sea phase of the Western Hemisphere Travel Initiative (WHTI). The proposed rules require most US citizens entering the United States at sea or land ports of entry to have a passport, passport card, or WHTI-compliant document. This should result in further growth in the proportion of US adults owning a passport, currently estimated at 31%.

Throughout much of 2008 Sterling has been weak against the Euro, and in more recent months also against the US Dollar, making Britain more affordable to Eurozone and American citizens. As with all global markets at present the currency markets are highly volatile, and until a fuller picture emerges about the nature and consequences (for public finances) of government backed recovery plans for the banking sector and possible fiscal stimuli becomes apparent it is difficult to forecast whether further Sterling weakening is on the cards.

The price of oil has fallen sharply from a peak of near \$150 per barrel in June 2008 to under \$55 in late November trading. If oil prices continue to fall airlines will be in a stronger financial position and able to reduce 'fuel surcharges', with airlines such as BA and Virgin Atlantic having already done so. However, if the price of oil falls markedly due to global economic stagnation then this is not perhaps as good a piece of news as it would first appear.

New opportunities continue to emerge thanks to new air routes being developed, for example Hyderabad is now linked to London by British Airways, and enhanced flight frequencies (notably between the Middle East and London). Airlines including Qantas, Singapore Airlines and Emirates are all in line for deliveries of Airbus A380s during the next year which will help make best use of the available capacity at Heathrow.

After an inauspicious first few weeks the new Terminal 5 at Heathrow is now said to be working well, and, over time, should enhance the impression overseas visitors to Britain (who fly with British Airways) have of our major hub airport. Elsewhere permission has recently been granted for an expansion in passenger movements at both London City and Stansted airports, but with aviation demand currently in the doldrums 2009 is not likely to see rapid growth in passenger numbers.

From early in 2009 the main West Coast Main Line railway will operate a 'Very High Frequency' train service, thereby opening up new journey opportunities between London, the Midlands, North West England and Glasgow.

Easter fell early in 2008, and a return to an April date in 2009 should help encourage more inbound tourism over this period, with the prospect of warmer weather and longer hours of daylight, plus the clocks having been put forward by an hour.

With the Beijing Olympic and Paralympic Games now over, London is the official host city of the next Summer Games, and the four-year Cultural Olympiad is set to provide a varied palette of cultural events across the entire country thereby helping to attract inbound visitors to Britain.

On a sporting theme England will play host to both the World Twenty20 Cricket Cup and the Ashes Test series during the summer of 2009, along with more regular sporting fixtures attracting international visitors including Wimbledon, The Open and of course hundreds of Premier League football matches.

Continued delivery of additional visitor spend through VisitBritain and partner activity across our Overseas Network, especially in emerging markets such as China and India where, despite a potential economic slowdown, substantial long-term growth potential exists.

One of the major themes running through 2009 will be 'Homecoming Scotland', an initiative created by the Scottish Government to celebrate Scotland's great and unique contributions to the world. The vision is for Homecoming to appeal to the extended Scottish family around the globe. It will motivate people of Scottish descent as well as those who simply love Scotland, to 'come home' in 2009 and take part in an inspirational celebration of Scotland's culture, heritage and the many great contributions Scotland has given the world.

### **Downside forecast risks for 2009**

The starkest downside risk to inbound tourism during 2009 at present is clearly the prospect of a prolonged, and potentially deep, global economic slowdown. Although governments across the globe have been taking action to prop-up the ailing banking system it now looks inevitable that the 'real' economy will suffer a more significant dip in activity than was forecast only a few months ago.

Despite the Bail Out Bill in the US the problems on Wall St are clearly impacting on Main St, with the jobless total in the US rising and consumer confidence exceptionally low. Until the US housing market bottoms out there seems little prospect of an upswing in wider US economic activity or consumer sentiment.

In the Eurozone the three largest economies (Germany, France and Italy) officially entered recession in the second half of 2008, and both Spain and Ireland have witnessed a housing bubble burst and contraction in wider economic activity.

In Asia the big concern is that if the US economy does contract significantly there will be a sharp tailing-off in American's need to buy Asian exports, which for many countries in the region (for example China and South Korea) has been the main locomotive of economic growth in the past few years.

Business tourism, in particular that related to the Financial and Business Services sector, is at risk of a slowdown as companies search for ways of reducing their outgoings, including the amount spent on business travel and the number of events and conferences that are held. This weakness may manifest itself through an actual decline in the number of business trips and/or through companies opting for cheaper travel and accommodation options. As such this may result in a further weakening of the aviation sector as it becomes harder for legacy airlines to fill the front end of the plane.

In terms of inbound holiday tourism growing global inflationary pressures are placing a squeeze on household disposable incomes, and this may result in holidaymakers searching out destinations that are perceived to offer the best 'value for money'. This is an area in which Britain does not perform strongly, and the emergence of new holiday destinations with a relative price advantage, for example Morocco, Turkey and in the longer term even Libya, represents a significant risk.

There has been a sharp slowdown in applications recoded by the Worker Registration Scheme from the eight Eastern European 'Accession Countries' according to official figures, and

although the IPS only records visitors who do not undertake paid employment in the UK, it is likely that fewer economic migrants will result in declining numbers of 'VFR' visitors from Eastern European countries.

There remains a risk that the UK government will extend the number of countries that require a visa in order to visit Britain from early in 2009, including Malaysia, Brazil and South Africa. A related risk is that the price of a UK visa may rise further, thereby increasing the current differential between UK and Schengen visas.

Although potentially lower oil prices (discussed above) should help, there remains a real risk of further airline bankruptcies in the months ahead as demand remains weak. If the US dollar should weaken significantly oil prices may in fact revert to an upward trend (as the international trading currency for oil is the US dollar) thereby exacerbating the difficulties faced by airlines.

A number of airlines are offering fewer flights than at this time last year, and further route cuts are in the offing, with JAL to withdraw its Osaka to Heathrow route, British Airways axing one of its daily Tokyo to Heathrow flights and Virgin Atlantic dropping one of its many daily flights from New York to London.

The Irish government plans a new airport tax which would increase the cost of air travel and may further weaken the Ireland to UK mainland air market during 2009.

Although far less in the media spotlight than a year or two ago, H5N1 'avian flu' is still a potential risk to global travel trends, with the number of human cases in Asia and Africa during the first nine months of 2008 being 36, of which 28 were fatal. A more realistic short-term threat is not that there will be a human pandemic, but that avian flu will re-emerge in birds in the UK and thereby deter or disrupt travel.

National political instability may impact on outbound travel from a small number of countries during 2009, with ongoing tensions in Thailand worthy of note in this regard. Additionally, the risk of acts of terrorism remains a global risk to tourism.

### **A challenging environment**

It looks as though a co-ordinated global effort has prevented the financial crisis of summer 2008 from becoming a calamity of unimaginable proportions for the world's economy, but the outlook remains thoroughly downbeat, with virtually every country, and every economic sector facing tough times in 2009. Tourism is not immune from what takes place in the real economy as businesses and consumers alike reconsider travel plans.

The good news is that holidays are increasingly fundamental to people's lives, and Britain is a top-notch destination; the sixth most visited country worldwide and ranked 4<sup>th</sup> in the Anholt-GfK Nations Brand Index in terms of Tourism. However, it would be a brave strategy to forecast 2009 being a year in which the volume and value of inbound tourism is set to increase.

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