



TOURISM
ECONOMICS

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What Does the Economy Tell Us About Tourism Performance in 2008?

Prepared for:

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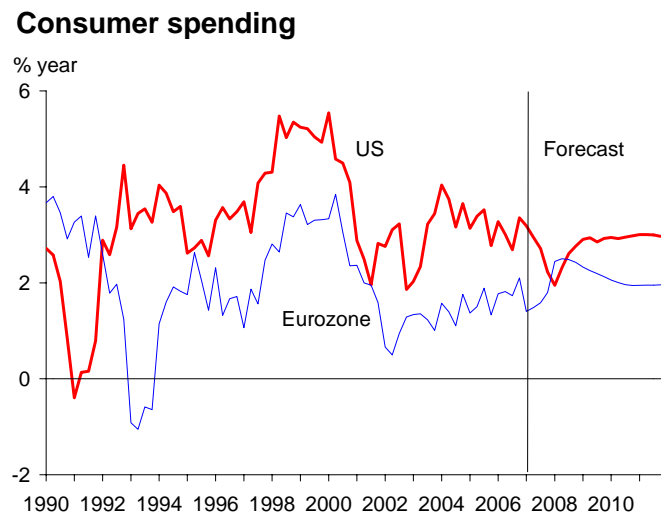
The Risks and Opportunities Facing US Tourism

Our perspective on demand for hotel services finds its footing in the economic fundamentals affecting consumers—both business and leisure. Historically, this has been an effective way of predicting growth and flagging risks. This brief article focuses on some of the key economic factors to watch in the coming year which will affect your business. More detail is available by request.

1. The US consumer is going to retrench

The tourism sector in the US has enjoyed robust consumer demand over the past few years. However, employment growth has been slowing significantly which will, in turn, constrain income growth. Meanwhile, persistently high energy prices are cutting further into real income. With credit conditions tightened, homeowners will find it harder to use home equity to finance current spending.

There are also concerns about consumer confidence. Gasoline prices and sluggish payroll growth will weigh on consumer attitudes, and volatile financial markets will also take a toll. Although financial wealth has been hit only slightly at the time of writing, falling housing wealth may have a more significant effect. Main implications in 2008: performance in hotel, transport, and recreation sectors will soften moderately in the US.



2. The dollar will remain weak

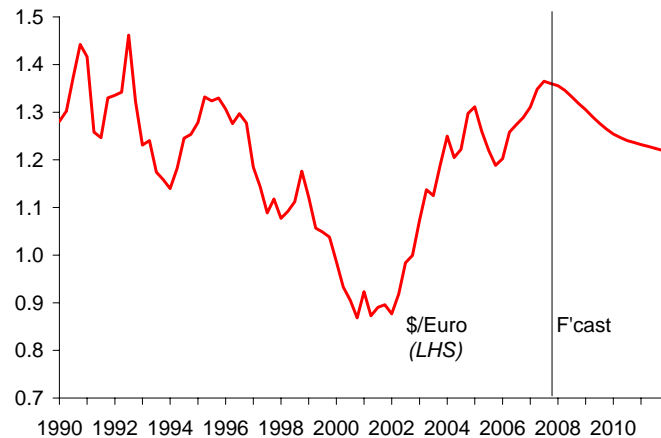
A \$1,000 US vacation package cost 1,146 euro in 2001. It now costs 735 euro, implying a 35% discount. The discount for Japanese travellers is 14% since 2002. For the United Kingdom, the discount is 28%. The reasons for these currency realignments are not speculative. US dollar has lost value since the beginning of the millennium because US interest rates have remained low and risks have gone up with the budget and trade deficits. Although the dollar will drift upward, its current “weakness” is its true value. Main implications in 2008:

- The US remains an attractive target for new investment from abroad
- International travel to the US continues its bounce from 2007 as an extremely

price attractive destination. Add to this that select countries will gain “visa waiver” status in 2008. This will have huge implications on inbound travel to the US.

- US outbound travel will be soft—especially to Europe. The ongoing effect of the pending Western Hemisphere Travel Initiative compounds the problem for Canada as passports are required of US residents crossing the boarder.
- US residents' domestic travel will be buoyed as domestic holidays substitute for those abroad and to Canada.

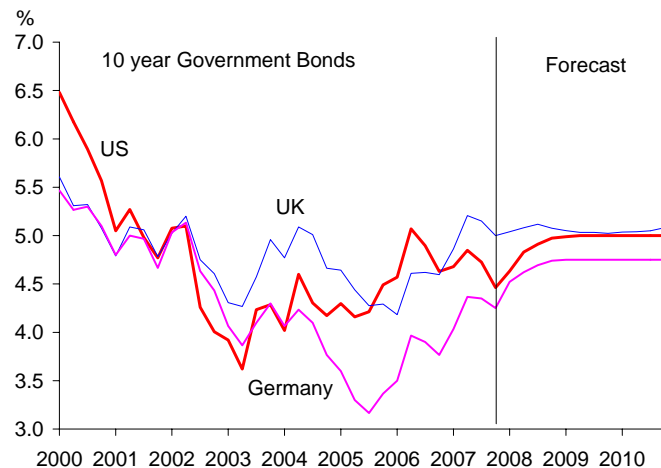
\$ / Euro Exchange Rate



3. Money will get a bit more expensive (but will be relatively cheap)

Over the past four years, impressive performance by the world economy, coupled with low interest rates, high levels of liquidity, strong growth in corporate and personal borrowing and surging M&A activity, has produced strong credit market growth and risk spreads falling to record low levels. Now, weakness in the US economy and higher bond yields in the major markets indicate that the remarkable reduction in risk spreads in recent years will start to go into reverse. Indeed, monetary conditions have become tighter in most leading economies. Tighter liquidity will cause investors switch to less risky assets, driving up risk spreads to more normal levels or even beyond should conditions deteriorate sharply. The end effect will be a modest rise in long term lending rates and tighter lending conditions—and slowing investment in new attractions.

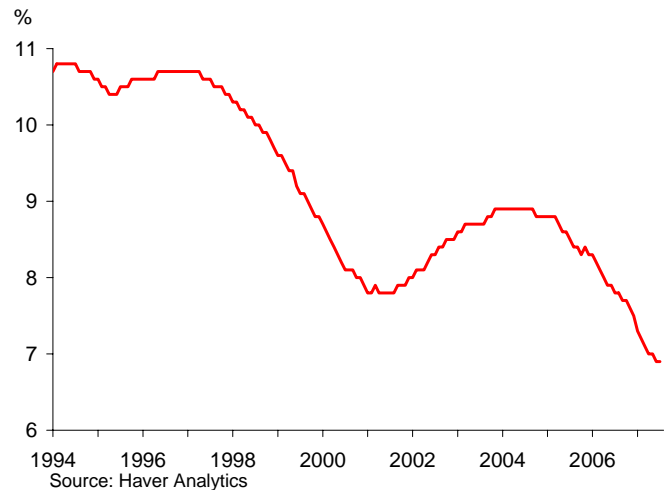
Long term interest rates



4. Western Europe is rejuvenated (although not quite a renaissance)

Despite a strong Euro, the Eurozone has been enjoying strong economic growth. Throughout Europe, we see favorable economic conditions with low unemployment and inflation. Germany has performed particularly well, backed by surging exports, strong brands in engineering products and high productivity growth. The biggest economic risks exist for the UK as it will be hit hardest by financial markets turmoil due to the importance of financial services (London); one of the biggest housing market bubbles in the world; a high proportion of mortgages at variable rates; high share of equities in household wealth; and high levels of consumer debt. Still, we expect a continued rebound of travel from Europe with the combined effects of the strong euro and steady economic performance.

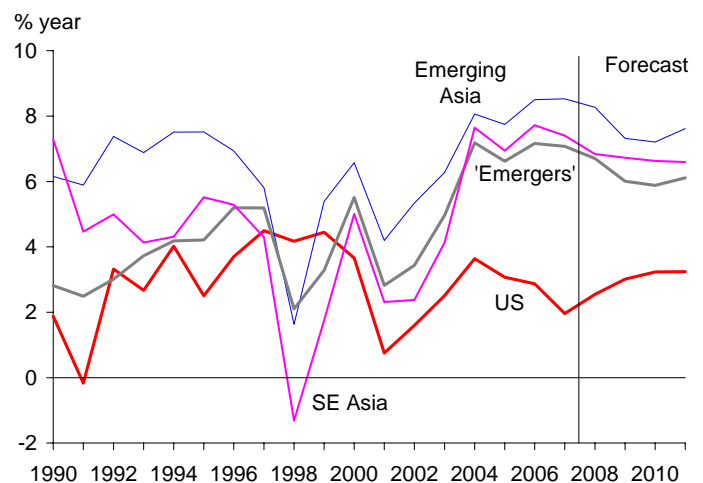
Eurozone: Unemployment rate



5. Emerging markets are still the growth markets

Within the emerging markets, the pace is still being set by China and India, two of the so-called BRIC countries (the others being Brazil and Russia) and the prevailing winds are still positive. Double-digit growth in China looks set to continue and may even be accelerating to around 11% this year on the back of very strong investment. And India, also one of the fastest growing economies in the world, shows little sign of slackening given the broad-based nature of its strength. There are also hopes that the pace of growth in Latin America may prove a little stronger than initially expected, amid some signs that Brazil might be set for a period of faster expansion as inflation remains subdued and interest rates are now declining faster than before. And although the Russian economy remains at the mercy of world oil and gas prices, in the near term at least it will continue to benefit from high energy prices and growth looks set to be maintained at around 7%. Outbound travel

GDP Growth



demand to be brisk from these markets. However, US visa policy will constrain the benefits to the US tourism industry.

Conclusion: Economic fundamentals still support that we are in the right industry

Those sectors of the economy associated with travel, including the hotel sector, have grown more quickly than the global economy over the past thirty years. This will continue. In addition to the growth experienced as a function of income increases, the number of households with the means to travel also increases, thereby compounding the growth effect. Business travel is also increasing at a faster rate than the economy in tandem with global trade and the transition of developed economies to services. Travel-related sectors will experience their ups and downs but, on average, the ups will prevail.

For more information on Tourism Economics and Oxford Economics, contact Adam Sacks at adam@tourismeconomics.com.

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