

Expect Small Victories in 2011

Solving a Paradox

Recovery is upon us. However, I have noted two contradictory features of the recovery as we monitor the economic and travel outlook for the world. The first is that our view of economic prospects (in developed economies) is quite subdued compared with the extent of the downturn we have experienced. The second is that travel has rebounded more quickly than most forecasters would have expected.

How do we reconcile these two seemingly contradictory features of the recovery and what do they mean for 2011?

Why so dismal? Headwinds for the economy in 2011

The media has given particular voice to economic forecasters predicting a double-dip recession or at least a new normal for the world economy. As sister companies, Tourism Economics and Oxford Economics believe this both overstates and oversimplifies the position of the economy.

Here's why... First, although the world's developed economies are vulnerable to another recession in their weakened state, it would take another yet unseen shock to the world economy for this to materialize. Second, we would be wise to note that after every recession (and how much more after the Great Recession!) pundits are prone to what we might call "irrational despondence".

This is not to say that significant headwinds do not remain for the developed economies of the world. In fact, our latest forecasts are far from bullish and note a number of downside risks. As governments exhaust stimulus funds and move decisively toward austerity, we will see a drag on growth next year. Further, the consumer sector will continue to battle the effects of high unemployment and a housing market which is still staggering. And companies remain risk averse, affecting the outlook for both investment and hiring. As a result, economic growth in the US and Europe is expected to be slower in 2011 than in 2010. We assign a 45% probability to this scenario of slowing growth in 2011.

More telling, however, is that when we begin to run scenarios using the Oxford global economic model, the odds of an even weaker outcome in 2011—what we would consider anaemic growth—are relatively significant with a 25% probability.

So what are the other options? Turning first to the upside, it is possible that recent encouraging investment and M&A signs are a precursor to a renewed global boom in 2011, as strong corporate liquidity feeds into a new investment boom. To this upside risk, we only attach a 20% probability.

These leaves 10% for the scenario in which a recurrent sovereign debt or banking crisis leads to a fresh fall in asset prices, triggering sovereign defaults/reschedulings and/or bank failures.

Weighting these possible outcomes, our outlook 2011 is for decidedly muted growth in the developed economies.

Then how is travel V-shaped?!

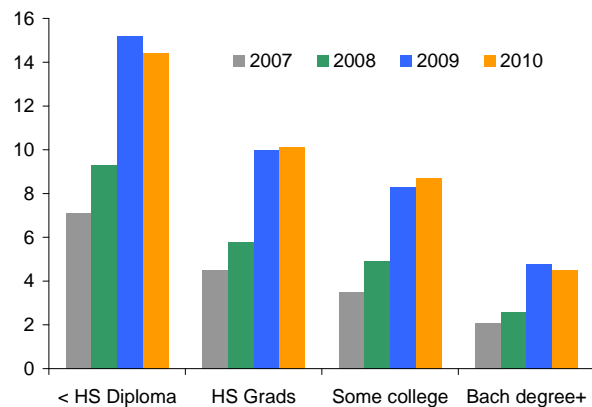
The paradox to all this is that travel has experienced a true “v-shaped recovery”. We can look at this in terms of air passengers or room nights sold, but the conclusion is the same: travel is back. Businesses have loosened travel purse strings, meetings are rebounding from their lows, and leisure travel is also posting modest growth after relatively modest declines. (Of course in the US and in Europe rate has suffered significantly and is not close to returning to pre-recession peaks. But this is more a feature of the natural response of the industry to the downturn and the unfortunate reality that it is easy to cut rates but hard to raise them. But demand is back.)

We might ask how this is possible with unemployment close to 10%. The answer relates to the structure of unemployment. The unemployment rate among those with college degrees is a mere 5% and is falling. Meanwhile, those without a high school diploma are enduring 14% unemployment and those with no more than a high school diploma are experiencing 10% unemployment. The implication is clear: the lodging sector’s customer base has been relatively unaffected!

Also, even though income growth has been tepid and we hear so much talk about the indebted consumer, the cost of that debt has been incredible stable over the past thirty years.

Unemployment Rate by Education

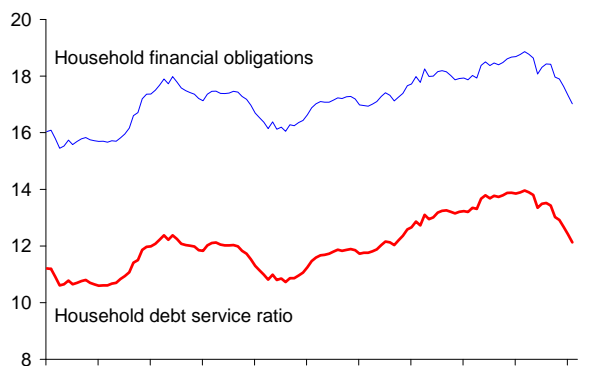
Q3 Seasonally Adjusted



Source: BLS

US : Household debt measures

% of disposable income



Source: FRB

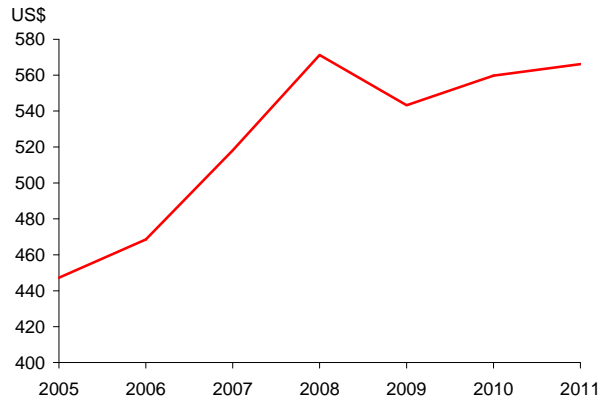
What does this mean for 2011?

The paradox of a weak and risk-filled economic outlook alongside relatively strong travel leads us to several conclusions about the coming year. We call each of these small victories because none of them takes us to the position of strength of a few years ago. However, each of these mini-conquests marches the industry forward toward full recovery.

1. Demand growth will soften overall as the upward swing part of the cycle ends. Note, we are talking about demand *growth*, not absolute demand. So room demand will grow in 2011 but at a slower pace than seen in 2010. This is partly due to the softening economic environment but more a function of comparisons to a higher base.

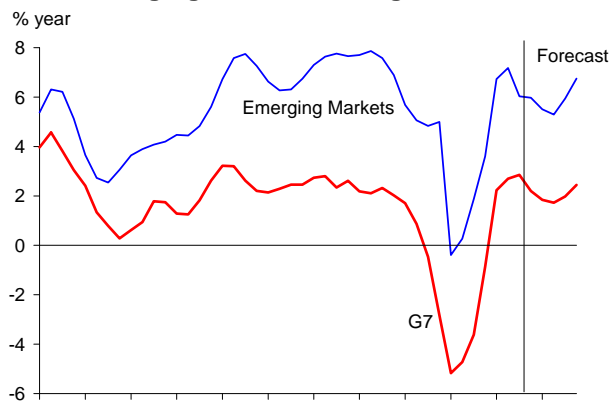
2. Business travel will continue its recovery in both transient and group as companies shift toward an investment mentality. Businesses are flush with cash. Although companies may remain conservative about large scale investments, there will be a strengthening appetite to participate in trade shows, conventions, and to meet with clients and prospects.
3. Leisure travel will hold its own due to low debt service costs and a skew of unemployment toward low income households. In fact, as confidence improves in 2011, we might even be surprised on the upside.
4. Average Daily Rates will edge upward as supply growth is subdued and demand continues to grow. We are already seeing glimmers of this but the industry will be increasingly emboldened to increase rates as demand rises into 2011 and supply growth slows. This is in line with our overall forecasts on spend per trip, driven largely by a return to more historic average length of trip.
5. Finally, we give a nod here to emerging markets. There is not enough space here to detail our view of individual market and their respective opportunities. However, suffice to say the global economic outlook is more dependent upon the strength of these economies than ever before. Therefore, we look to the BRICs economies and to others around Asia to be drivers of world economic growth as well as dynamic growth markets for the lodging industry in 2011.

Spend per trip - global travel



Source : Tourism Economics

G7 & Emerging Markets: GDP growth



Source: Oxford Economics

In conclusion, we face tempered economic prospects with real downside risks. However, the industry enters 2011 poised to make incremental steps towards full strength.