GCA tourism analysis note no. 1

November 2008

TOURISM PROSPECTS AS WALL ST. CRUNCHES MAIN ST.

HOW WILL WA TOURISM FARE AS THE GLOBAL BOOM GOES BUST?

GEOFF CARMODY & ASSOCIATES

TABLE OF CONTENTS

EXECUTIVE SUMMARY

This report has been commissioned by Tourism Western Australia and prepared by Geoff Carmody & Associates (GCA).

The stimulus for this project has been the dramatic financial disruption and credit crunch sourced initially in the USA (and in particular rooted in the 'sub-prime' mortgage lending fiasco there). That fiasco has rapidly spread into a global financial market contagion that is now – quite quickly – dragging the real economy down as well.

All economies will be affected. The developed world faces recession. Developing economies face much slower growth, at best.

World tourism will be affected too. The health of tourism depends more on the health of the global economy than vice versa. The 'knock on' effects of global recession are likely to be magnified as they emerge in tourism economic performance. The tourism industry has no choice but to deal with these effects.

This is not an optimistic report.

It is perhaps the most down-beat report Geoff Carmody has prepared on tourism since he first began analysing tourism in 1984, despite the fact that, since that time, he has prepared reports covering, amongst other things:

- The 1989 Pilots' Dispute.
- The fall-out from September 11, 2001.
- The effects of the First Gulf War and the SARS threat.
- The 1997 Asian financial crisis.

However, GCA believes that the analysis is realistic. We are neither trying unduly to cheer the reader up, nor to be excessively pessimistic.

The essential points can be summarised as follows:

The economic & financial conjuncture

- The world economy is slowing sharply.
- Most, or all, of the developed Western world is either in, or about to enter, recession.
- Financial, business and consumer confidence has been shattered.
- Unemployment is rising sharply, businesses are collapsing, and investment and consumer spending is being reduced.
- Inflation is slowing rapidly, commodity prices have collapsed, and there is some talk of possible deflation.
- The $A has tumbled nearly 40% against the $US, and by nearly 30% more generally.
- Attempts to halt the economic slide by policy stimuli are having mixed results, so far.
- This recession may last some time – possibly all of 2009 and even beyond.
- The fall-out on China and India is not yet clear, but could be much worse than expected at present.
- These and other emerging economies are slowing very rapidly already.

The implications for tourism generally

- Consumer spending generally is slowing (or falling) faster than overall economic output.
- Tourism spending, as part of discretionary consumer spending, can be expected to slow (or fall) even more than consumer spending on average.
- The reduction in peoples' wealth, slowing or falling incomes, rising unemployment, and shattered consumer confidence, can be expected to be a powerful negative influence on tourism spending.
- World tourism spending is likely to slow, and, given the weighting applicable to Western economy tourism spending, could well contract, even in nominal dollar terms.
- The falling price of oil is a partial offset, but this fall is a reflection of, and induced by, the slowing in aggregate demand. It will nowhere near counteract the drag of lower demand and output on tourism spending.
- Early signs of a tourism demand downturn may already be appearing in the latest available inbound visitor numbers statistics for September 2008.

The implications for tourism in Australia

- In Australia, too, we can expect consumer spending generally to slowing (or falling) faster than overall economic output. As to the latter, recession cannot be ruled out.
- Unemployment will increase.
- Accordingly, a downturn in Australian tourism spending – even a contraction in nominal dollar terms – is quite possible.
- This applies to (i) inbound tourism, (ii) outbound tourism, and (iii) domestic tourism.
- The fall in the $A will help, but only partially, to buffer Australian tourism.
- On the other hand, the fall in the value of the $A has also reduced the fall in the price of oil in $A terms, reducing transport system benefits from lower world oil prices.
- It is too early to discern anything like the full fall-out from the global economic collapse from available official statistics.

The implications for tourism in Western Australia

- In Western Australia, too, we can expect consumer spending generally to slowing (or falling) faster than overall economic output. As to the latter, recession cannot be ruled out.
- Why?
- Western Australia was amongst the biggest beneficiaries of the commodities boom and burgeoning growth in China, and the rest of the world. Symmetry would suggest that Western Australia is therefore likely to be hit hardest within Australia by the collapse in commodity prices and slower growth in China and more generally.
- Accordingly, a downturn in Western Australian tourism spending – even a contraction in nominal dollar terms – is quite possible.
- This applies to (i) inbound tourism, (ii) outbound tourism, (iii) interstate tourism, and (iv) even intrastate tourism.
- To a point, this would ease pressure on capacity in Western Australia (especially in Perth). But it seems likely that the tourism demand downturn will go beyond that point, lowering yields for tourism related businesses in Western Australia.

Appropriate tourism investment strategy

- The short investment message is simple.
- If thinking about expanding tourism capacity in Australia, or in Western Australia at the present time: *don't*.
- If thinking about maintaining or improving the quality of existing capacity to move up the yield curve, that's worth seriously considering.
- Where there is a good case for governments getting involved in investment – such as in improving and extending needed transport system infrastructure (a crucial element in Western Australia) – then governments can and should get involved, including with Commonwealth Government financial support. The key here is to improve the productivity of the Australian (and Western Australian) infrastructure system.
- More generally, public sector investment in 'community infrastructure' may have both counter-cyclical and longer term merits in the current and prospective environment, provided its social return justifies the use of taxpayer funds involved.

Appropriate tourism marketing strategy

- Forget setting absolute tourism performance marketing targets: marketing is not the only determinant of such performance anyway. Marketing is important and useful, but it will be swamped by the huge adverse forces now building. (it *will* need more Government funding to compete in a much tougher environment.)
- Using such targets, National and State Tourism Organisations will get blamed for failure that probably wasn't marketing's fault.
- Consider maintaining or increasing WA's ***share*** of total tourism spending in Australia as an appropriate target, perhaps with a particular emphasis on high-yielding tourism.
- Market share benchmarks mean that the focus is (or should be) on out-resourcing and out-performing other States & Territories. Whether or not this is feasible will depend on the WA Budget situation and WA Government Budget priorities (as well as industry support).
- As a relatively remote destination for many potential customers anyway, this strategy seems especially appropriate for Western Australia, especially in a sustainable tourism yield maximisation sense over time. In GCA's opinion, it is consistent with the yield maximisation focus of Tourism Western Australia as well.

1. INTRODUCTION

This report has been commissioned by Tourism Western Australia and prepared by Geoff Carmody & Associates (GCA).

The stimulus for this project has been the dramatic financial disruption and credit crunch sourced initially in the USA (and in particular rooted in the 'sub-prime' mortgage lending fiasco there). That fiasco has rapidly spread into a global financial market contagion that is now – quite quickly – dragging the real economy down as well.

This conjuncture is having major adverse economic consequences for financial markets, for financial liquidity, and for economic activity and employment. These latter effects have been strongly evident in the Western developed economies, and, via export demand and financial capital linkages, are spreading also to the developing world, including the BRICs (Brazil, Russia, India and China). Especially as a supplier to the BRICs, Australia will not escape these effects.

This is likely to prove to be the worst global economic and financial downturn seen since the 1930s. To put this in perspective, in part it is a severe reaction to one of the strongest, sustained (but ultimately unsustainable), global growth surges (in the 1990s-2000s) ever recorded. This surge also included unsustainable asset price 'bubbles' that eventually had to be burst.

All economies will be affected. The developed world faces recession. Developing economies face much slower growth, at best.

World tourism will be affected too. The health of tourism depends more on the health of the global economy than vice versa. The 'knock on' effects of global recession are likely to be magnified as they emerge in tourism economic performance. The tourism industry has no choice but to deal with these effects.

1.1 FOCUS OF ANALYSIS

This report does *not* attempt a quantitative analysis or forecast of tourism prospects, globally, in Australia, or for Western Australia. Such forecasts are likely to be out of date the minute they are released.

Rather, the focus of this report is on the *channels* or *linkages* through which the financial and economic crisis will affect tourism demand, investment and supply, with particular reference to Western Australia.

The purpose of the report is to convey a broad *qualitative* impression of likely global developments and how these might translate into tourism performance over the period ahead.

At the outset, four key points should be kept in mind:

- Things are changing fast. Views held today could well be modified next week or next month.
- Financial markets are likely to be much more volatile than the real economy. It is possible that financial market recovery could begin to emerge in the next six months or so. However, the real economy might soften very rapidly (eg, due to dramatic losses of business and consumer confidence, and less financial liquidity) but then take much, much longer to fully recover.
- At the present time, we really do not know precisely how the global economy will perform in the period ahead: uncertainties are very high.
- Government policy responses to this situation around the world are still evolving. At this stage, we do not know precisely how governments will react, and what the effects of their reactions might be. The election of Senator (President-Elect) Barak Obama as President of the USA changes the game there as well.

In short, the purpose of this report is to give the reader a feel for *mechanisms* linking tourism and other economic activity. As economic conditions evolve, an understanding of those mechanisms will help the reader come to a view about how tourism activity might fare as a result of these conditions.

1.2 STRUCTURE OF THIS TOURISM ANALYSIS NOTE

The remainder of this report is structured as follows:

- Section 2 provides an overview of economic conditions and prospects overseas, at least as presently understood. This covers both developed economies and developing economies, with particular reference to key tourism source markets for Australia in general and Western Australia in particular. It also covers key reasons for current difficulties, likely flow on effects for Australia and Western Australia, and how these can be expected to affect tourism activity.
- Section 3 provides an overview of Australian economic conditions and prospects, at least as presently understood. This covers all states and territories. It also covers likely flow on effects to tourism activity, especially in Western Australia.
- Section 4 summarises risks and uncertainties surrounding the assessments presented in sections 2 and 3, and how these might affect margins of error ('forecast spreads') around various economic and tourism forecasts.
- Section 5 attempts to pull together the foregoing sections into an overview of prospects for tourism demand (by purpose of travel) and realistic marketing targets, with particular reference to Western Australia.
- Section 6 considers prospects for tourism investment and supply in the light of the foregoing demand summary. This covers accommodation, transport (including aviation) and other elements in the supply chain. A financial market focus, emphasising competitive risk-adjusted expected rates of return, is emphasised.
- Section 7 offers some general comments about 'sustainable tourism'. This covers financial sustainability, but also addresses economic and environmental sustainability, especially given the longer term challenges likely to be thrown up by climate change policies, the possibility of a 'peak oil' price crunch as the world slowly recovers from the current downturn, and related price and other environmental initiatives.
- Section 8 presents some concluding observations.

2. OVERVIEW OF OVERSEAS ECONOMIC CONDITIONS AND PROSPECTS

Forecasting economic prospects is easy when economies are moving steadily along growth paths driven by population, productivity growth and generally non-volatile economic conditions.

In these circumstances, 'forecasting' is not a lot more than careful extrapolation.

But there are times when other, more unsustainable but immediately insistent, pressures push economies off such predictable growth paths. For a time such pressures can continue. They can even feed on themselves. But then they can collapse catastrophically. Again, when they do, they feed on themselves. They produce quite sharp economic turning points. Around such points, forecasting becomes very difficult if not impossible.

The world – and Australia, and possibly even more so Western Australia – currently faces one of the most significant such turning points seen since the 1930s. Pity the economic forecasters in such conditions. Just when they're most needed, they're least able to do their job!

The most honest forecast that an economic forecaster can make at present is: 'I don't know'. Few if any get paid for making that type of forecast. That may well be the scarcest commodity on the market at present.

It has never been more true than today that the best joke about economists is as follows:

> *Q. What do you call an economist making forecasts? A. Wrong!*

Economists have thick skins, however. Having given the crucial caveats just noted, section 2 of this report reviews current economic forecasts for the world economy.

These are key drivers for world tourism prospects.

October 2008 IMF World Economic Outlook Update

The October 2008 official global economic forecasts have been released by the International Monetary Fund (IMF).[1]

Before reviewing these forecasts, three comments are worth noting:

- These forecasts are already out of date: their underpinning assumptions (eg, on oil prices) seem off the mark at present at least.
- At least for the next few years, these forecasts are probably optimistic, for reasons set out below. The IMF itself notes the existence of 'downside risks' (see below).
- As this becomes evident, the error margin (downwards) might well increase, for reasons set out below.

The key points made in October 2008 by the IMF are as follows:

- *The world economy is entering a major downturn in the face of the most dangerous financial shock in mature financial markets since the 1930s.*
- *Many advanced economies are close to or moving into recession. Growth in emerging economies is also weakening.*
- *Global growth is expected to slow substantially in 2008, and a modest recovery would only begin later in 2009.*

---

[1] *World Economic Outlook, October 2008: Financial Stress, Downturns, and Recoveries* International Monetary Fund, as part of the *World Economic and Financial Surveys* series.

- *Inflation is high, driven by a surge in commodity prices, but is expected to moderate.*
- *The situation is exceptionally uncertain and subject to considerable downside risks.*
- *The immediate policy challenge is to stabilise financial conditions, while nursing economies through a period of slow activity and keeping inflation under control.*
- *The situation remains highly uncertain as this report goes to press.*
- *In hindsight, lax macroeconomic and regulatory policies may have allowed the global economy to exceed its 'speed limit' and may have contributed to a build up in imbalances across financial, housing, and commodity markets.* [2]

As to global economic prospects, in October 2008, the IMF concluded that:

- *Financial conditions are likely to remain very difficult, restraining global growth prospects.*
- *The required 'de-leveraging' will continue to be a protracted process, implying that limits on the pace of credit creation – and on activity – will be present at least through 2009.*
- *Against this backdrop, the baseline growth projections have been marked down significantly relative to the July 2008 World Economic Outlook Update.*
- *On an average annual basis, global growth is expected to moderate from 5% in 2007 to 3.9% in 2008 and to 3% in 2009, its slowest pace since 2002.*
- *The advanced economies would be in or close to recession in the second half of 2008 and early 2009, and the anticipated recovery later in 2009 will be exceptionally gradual by past standards.*
- *Growth in most emerging and developing economies would decelerate below trend.*
- *On inflation, rising slack and stabilising commodity prices are expected to bring inflation back below 2% per annum in advanced economies in 2009. In emerging and developing economies inflation would ebb more gradually.*
- *There are substantial downside risks to these forecasts.*
- *These stem especially from (i) the possibility of worse financial stress due to the consequences of 'de-leveraging', and (ii) the possibility of a deeper and more prolonged USA housing market deterioration than forecast, plus a more broad-based weakening in European housing markets. Inflation risks to growth are now more balanced.*
- *Risks of rising protectionism represent additional risks to the recovery.* [3]

With implications for Australia, two particular risks are noted:

- *Countries with sustained large current account deficits may face particular stress as global de-leveraging reduces the availability of external financing.*
- *They may face a much greater impact from financial market turmoil than those with small current account deficits or surpluses.* [4]

---

[2] *World Economic Outlook, October 2008: Financial Stress, Downturns, and Recoveries* International Monetary Fund, Executive Summary, page xv.

[3] *World Economic Outlook, October 2008: Financial Stress, Downturns, and Recoveries* International Monetary Fund, Executive Summary, pages xv-xvi.

[4] *World Economic Outlook, October 2008: Financial Stress, Downturns, and Recoveries* International Monetary Fund, Executive Summary, page xvii.

6 November 2008 IMF World Economic Outlook Update

Barely had the ink dried on the IMF's October 2008 World Economic Outlook when an update was released on 6 November 2008.

This shows a significant deterioration in economic prospects within just one month.[5] This underlines the point made in section 1.1 above: things are changing fast.

The key points in the IMF's 6 November 2008 release are as follows:

- Prospects for global growth have deteriorated over the past month, as financial sector de-leveraging has continued and producer and consumer confidence have fallen.
- World output growth is projected to slow from 5% in 2007, to 3 ¾% in 2008 and down to 2.2% in 2009, this last forecast being down 3/4 of one percentage point of GDP compared with the October 2008 WEO projections. The slow-down is being led by the developed economies.
- In the developed economies, output is now forecast to *contract* by ¼% in 2009, down ¾ of a percentage point from the October 2008 WEO projections, and the first annual contraction during the post-war period. A recovery is projected to begin late in 2009.
- In emerging economies, growth is projected to slow appreciably, to about 5% in 2009. The downward revisions to growth for these countries average 1 percentage point. Downwards revisions are larger for commodity exporters and countries with acute financial and liquidity problems.
- Countries in East Asia – including China – generally have suffered smaller mark-downs because their financial situations typically are more robust, they have benefited from improved terms of trade from falling commodity prices, and they have already begun easing macroeconomic policies.
- Weakening global demand has depressed commodity prices. Oil prices have dropped over 50% since their peak. The IMF's baseline projection for 2009 has been revised down from $US100/bbl in October 2008 to $US68/bbl in November 2008. Metals and food prices have also fallen from their peaks.
- 'Headline' inflation in developed economies should decline to below 1 ½% by the end of 2009. In emerging economies, inflation should also moderate, albeit more gradually.
- Markets have entered a 'vicious cycle of asset de-leveraging, price declines, and investor redemptions'. Consumers and firms are re-assessing income prospects. Cut-backs are affecting consumption (notably of durables) and investment as confidence is hit.
- These forecasts are based on current policy settings.
- The economic outlook is exceptionally uncertain, and financial conditions 'continue to present serious downside risks'. The process of de-leveraging could be more intense and protracted than currently forecast. There is a growing risk of deflationary conditions in developed economies, albeit still small.

The foregoing snapshots of world economic forecasts prepared by the IMF, less than one month apart, demonstrate how uncertain economic prospects are at the present time.

If downside risks are larger than upside risks – as seems to be the case at present – then there is one forecast about economic growth that may be more valid than most.

That forecast is:

---

[5] *World Economic Outlook Update: An update of the key WEO projections,* International Monetary Fund, 6 November 2008.

- Current world economic growth forecasts are likely to be revised downwards.

2.1 Economic growth forecasts (gross domestic product – GDP)

The breakdown of the IMF's 6 November 2008 forecasts by country is summarised in Table 2.1 below.

Table 2.1. IMF WEO Updated Output Projections, 6 November 2008 (year on year change - %)

	2006	2007	2008	2009
World output growth	**5.1**	**5.0**	**3.7**	**2.2**
Advanced economies	3.0	2.6	1.4	-0.3
European Union	3.3	3.1	1.5	-0.2
Emerging and developing economies	7.9	8.0	6.6	5.1
Selected individual economies:				
USA	2.8	2.0	1.4	-0.7
Euro area	2.8	2.6	1.2	-0.5
Of which:				
Germany	3.0	2.5	1.7	-0.8
France	2.2	2.2	0.8	-0.5
Italy	1.8	1.5	-0.2	-0.6
Spain	3.9	3.7	1.4	-0.7
Japan	2.4	2.1	0.5	-0.2
UK	2.8	3.0	0.8	-1.3
Canada	3.1	2.7	0.6	0.3
Other advanced economies	4.5	4.7	2.9	1.5
Newly industrialised Asian economies	5.6	5.6	3.9	2.1
Developing Asia	9.8	10.0	8.3	7.1
Of which:				
China	11.6	11.9	9.7	8.5
India	9.8	9.3	7.8	6.3
Russia	7.4	8.1	6.8	3.5
Brazil	3.8	5.4	5.2	3.0
Mexico	4.9	3.2	1.9	0.9
Middle East	5.7	6.0	6.1	5.3

The pattern is clear:

- Around the world, economic growth is forecast to slow – dramatically.

- In the developed world, recession is expected.
- In the newly industrialised Asian economies, growth is expected to halve (or worse).
- In the developing world, a major growth slow-down (at best) is expected.

Major stimulus packages are being introduced around the world.

In China, a $US855 billion stimulus has been announced to shore up domestic demand in the face of rapidly weakening export demand in an attempt to bolster economic growth at around 8% or so (a target already lower than forecast in table 2.1 above). Time will tell how effective that package will be.

Similar policy stimuli, either via large cuts in official interest rates (eg, in the UK) and/or via tax cuts and public spending increases have also been announced or are in contemplation.

The IMF is exhorting most countries to consider such measures as an internationally coordinated policy response intended to slow the global decline in economic growth now emerging.

2.2 TOTAL DOMESTIC DEMAND AND CONSUMER SPENDING GROWTH FORECASTS

The forecasts presented above are for real aggregate output, or gross domestic product (GDP).

For tourism, forecasts for total domestic demand, and private final consumption expenditure (PCFE), in constant price terms, are at least as important, especially as a guide to recreational tourism demand prospects.

The IMF's 6 November 2008 update does not present total domestic demand or PFCE forecasts.

However, such forecasts are presented in the IMF's October 2008 *World Economic Outlook*.

The relationships between the October 2008 GDP, total domestic demand, and PFCE forecasts for 2009 provides a guide to the likely total domestic demand and PFCE forecasts underpinning the 6 November 2008 GDP forecasts.

These are shown in table 2.2 below for selected country groups.

Table 2.2. IMF WEO October 2008 projections for 2009 (year on year change - %)

	GDP	Total demand	PFCE
Advanced economies	1.0	0.4	0.0
Of which:			
USA	0.4	-0.3	-0.9
Euro area	0.6	0.5	-0.1
Japan	0.9	1.0	0.6
UK	0.7	0.3	0.0
Canada	1.7	1.5	2.2
Newly industrialised Asian economies	5.4	3.5	2.1

As table 2.2 shows, in most cases:

- Real total domestic demand growth forecasts are lower than GDP growth forecasts.
- Real private final consumption expenditure growth forecasts are lower than both total domestic demand growth forecasts, and, even more so, GDP growth forecasts.

As noted below, it is likely that *discretionary* private final consumption expenditure growth will be lower than *total* PFCE growth. Holiday, business and VFR travel all fall into this category to some extent.

Accordingly, the 6 November 2008 GDP growth forecasts are likely to be very much an upper limit to likely growth in real expenditure on travel and tourism.

8 November 2008 World Bank Economic Outlook

Hot on the heels of the 6 November 2008 IMF WEO update, the World bank prepared its own forecasts for the G20 Finance Ministers' meeting in Sao Paulo, Brazil on 8 November 2008.

The key points made in the World Bank report[6] are:

- Consensus growth projections for developed countries in 2009 are being slashed and world trade volumes may fall for the first time since the 1982 recession.
- The consequent downturn in developing country exports will be the most widespread shock generated by the crisis and private capital flows to developing countries are likely to fall significantly in 2009, led by pull-backs in portfolio flows and international bank lending.
- Investment is expected to suffer as it bears much of the direct impact of the financial crisis.
- Investment was the main driving force for developing country growth over the past 5 years, contributing almost half of the increase in domestic demand.
- There is a risk that investment in developing countries may be headed for a 'perfect storm' with a convergence of slowing world growth, withdrawal of equity and term lending from the private sector, and higher interest rates, with a further risk that lower commodity prices in the medium term will deter new investment in natural resource sectors.

14 November 2008 OECD Economic Outlook

On 14 November the OECD issued a statement saying that the developed world is already in recession, as the latest figures confirmed that reality for one of the world's largest exporting countries, Germany (its output having fallen by 0.4% in the June quarter 2008, followed by 0.5% in the September quarter of 2008).

The key points made by the OECD in its latest assessment are as follows:

- The world's developed economies have probably tipped into a recession that will last at least through the first half of 2009, implying a slump in growth of at least nine months.
- In the December quarter of 2008, the OECD member countries will see their output contract by 1.4%, and it will keep contracting until the middle of next year.
- For 2009 as a whole OECD member countries' output will contract by 0.3%.
- The USA's output is expected to contract by 2.8% in the December quarter of 2008 (after contracting by 0.3% in the September quarter). It will contract by a further 0.9% in 2009.
- Japan's economy is expected to contract by 0.1% in 2009.
- The Euro area is expected to contract by 0.5% in 2009.
- This will be the first time since the 1974-75 that the USA, Europe and Japan have fallen into recession around the same time, and the first time that the entire OECD membership will see an aggregate shrinkage in members' output since record were first kept in 1970.

---

6 *Global Financial Crisis and Implications for Developing Countries* World Bank, Report for the G20 Finance Ministers' meeting, Sao Paulo, Brazil, 8 November 2008.

2.3 INFLATION FORECASTS

The sombre growth prospects outlined above – for advanced economies, the worst since the early 1980s – carry major implications for commodity prices (including oil), and inflation more generally.

These are summarised in Table 2.3 below.

The main message is that generalised inflation as measured by consumer price indices is likely to be subdued in advanced economies and slowing in emerging economies.

In addition, commodity prices are expected to fall substantially.

Table 2.3. IMF WEO Updated Inflation Projections, 6 November 2008 (year on year change - %)

	2006	2007	2008	2009
Consumer prices				
Advanced economies	2.4	2.2	3.6	1.4
Emerging and developing economies	5.4	6.4	9.2	7.1
Commodity prices ($US)				
Oil ($US/bbl)	20.5	10.7	40.2	-31.8
Non-fuel	23.2	14.1	9.4	-18.7

2.4 EXCHANGE RATE CHANGES

The value of the $A, and other currencies, relative to the $US, have changed dramatically in the last several months, in many case reversing trends in evidence over recent years.

Table 2.4 below summarises these developments based on the latest available Reserve bank of Australia (RBA) data.[7]

Table 2.4. Selected exchange rates, $A, end-October 2006 – to date*

	2006	2007	Latest*
US dollar (cents)	76.92	92.16	67.24
Japanese yen	90.39	105.74	65.63
Pounds sterling	0.4050	0.4455	0.4284
Euro	0.6051	0.6384	0.5271
$NZ	1.1565	1.2049	1.1379
South Korean won	725.70	830.07	879.84
Chinese renminbi	6.0598	6.8806	4.5884
New Taiwan dollar	25.57	29.87	22.05
Singapore dollar	1.2013	1.3358	1.0036
Indonesian rupiah	7011	8385	7504

[7] Reserve bank of Australia, *Statistical Bulletin*, statistical table updated to 8 October 2008. Latest data from weekend newspapers, 8 November 2008.

Hong Kong dollar	5.9811	7.1428	5.2112
Malaysian ringgit	2.8064	3.0789	2.3894
Trade-weighted index (May 1907=100)	**64.0**	**72.2**	**55.3**

* As at 7 November 2008.

The message from table 2.4 is clear enough:

- At present, the value of the $A against other currencies has lost all of the gains recorded since end-October 2006 against most other currencies (pounds sterling, the won, and the rupiah being exceptions).
- Overall, as measured by the trade weighted index (TWI), the $A has lost all of the gains recorded since end-October 2006, and is now about 13.5% below that level, 23.4% below the end-October 2007 level, and almost 25% below its recent peak.

This is bad news for Australian tourism imports (Australians travelling overseas), but a small ray of sunshine for Australian tourism exports (non-Australians travelling to Australia).

2.5 UNDERLYING CAUSES OF THE PROBLEMS LEADING TO RECESSION OR SLOW GROWTH

It's worth summarising briefly *why* things have developed as they have. This can help tourism industry businesses appreciate what they are facing and how economies, consumer spending, and tourism demand are likely to evolve.

It's possible to go into a lot more detail, but a broad-brush summary of causes (with the wisdom of hindsight) is as follows:

- *Lax macroeconomic policy*. In the USA, and more generally, arguably monetary policy has been too loose. In the USA Federal Reserve Chairman Alan Greenspan was 'on watch' at the time. By using official cash rates to target inflation defined primarily with respect to the CPI, monetary policy allowed excessive growth in the money supply, and did nothing to 'lean against' emerging asset price bubbles (such as housing, especially in the Anglo-Saxon developed economies). In addition, in some countries (eg, the USA) fiscal policy was also lax, summarised by large budget deficits even as economies grew strongly.
- *Increasingly poor prudential regulation*. The best example of this is the 'sub-prime' mortgage lending fiasco in the USA. This was compounded by the practice of 'securitising' dodgy sub-prime loans into pieces of paper that were purchased by institutions (including banks) around the world, buttressed by lax ratings agency assessments of their riskiness, and increasingly opacity about the underlying risks as large numbers of loans were bundled together. For as long as asset price bubbles (eg, for property) continued to grow, this process was masked as paper profits grew.
- *Very poorly-conceived social policy measures.* Again the best example of this is in the USA, where 'Fannie Mae' and 'Freddie Mac' dominated housing lending, driven by government policy and incentives (both Democrat, under President Bill Clinton, and Republican, under President George W Bush) that led to housing loans being offered (on initial low-rate 'honeymoon' terms) to people who were poor, had bad credit records, and no real prospect of repaying long term mortgages (increasingly on 100% or more of then current 'valuations'), and fuelled by commission agents interested only in selling the loans and not in their longer term viability.
- *As a result of all this, an emerging 'pyramid'-type scam*. In combination, and for a time, the three preceding elements seemed to be a 'win-win' situation. For as long as asset prices (eg housing) continued to rise, the situation seemed viable. Even those facing debt-servicing stress could sell out at a profit, and the longer they could hold on, the bigger the profit.
- *Failure to take the tough political decision to lean against the growing asset price bubble*. This is a difficult issue. In democracies, inflation of house prices (and indeed share prices) is strongly welcomed by the owners of those assets. These owners represent the majority of the

electorate. Governments attempting to dampen such price increases face resentment from the asset owners, whose wealth (and current living standards as measured by spending out of such wealth) is reduced or weakened by such initiatives. But not acting is a poor choice: it just makes the ultimate crash larger when it inevitably occurs.

- *Increased global financial and economic interdependence.* The world is more inter-connected than ever. For example, dodgy USA ‘sub prime’ mortgages have been ‘securitised’ and purchased by financial institutions around the world. The fall-out from collapsing house prices in the USA (and then the UK, etc) has affected financial institutions everywhere. Banks in Australia are less exposed than some others, but they are still affected.

The world partied while the music played. Then the music – quite suddenly – stopped.

2.6 BROAD REMEDIES FOR CURRENT FINANCIAL/ECONOMIC PROBLEMS

The broadest-brush summary of what the factors outlined above have caused is two-fold:

- Individuals and businesses have borrowed too much (they have ‘over-leveraged’).
- Through debt-fuelled demand, they have driven asset prices – for shares, houses, other property – unsustainably high. At the same time they have boosted consumption spending as saving ratios fell.

This diagnosis of the symptoms also points to the broad solutions needed to wean the world economy away from recent excesses and restore conditions for sustainable growth in future:

- Individuals and businesses need to ‘de-leverage’ – that is, reduce debt.
- Asset prices need to fall to more sustainable levels (where ‘sustainable’ means prices reflecting capitalised sustainable investment yields).

In short, the world needs to save more, consume less, and accept wealth reductions as asset prices fall. Shattered consumer and business confidence is delivering all three right now. Indeed, governments are mainly concerned in the short term that this adjustment may be so rapid as to cause undesirably sharp reductions in output, investment and employment (‘overshooting’).

This is a toxic cocktail for tourism businesses globally.

Demand for their products and services is at the discretionary end of consumer demand. When consumers are forced, or decide, to rein in their consumption, a disproportionate amount of that will fall on discretionary items, such as consumer durables and tourism spending (holiday and VFR).

Business travel, to some extent also discretionary, will also be disproportionately affected as businesses move into cost-control mode.

2.7 KEY TOURISM ‘DRIVERS’.

The empirical research over many years has confirmed two key drivers of tourism demand:

- Income (or proxies for income).
- Competitiveness of destinations (or proxies for competitiveness).

At present, the ***income driver*** can be considered under at least three broad mechanisms:

- Changes in real disposable income, which, in aggregate, can be affected by real wage changes, changes in real profits, and changes in employment (as well as changes in population as a ‘scaling’ factor, which is affected by net natural increase and net migration).
- Changes in real net wealth (or perceptions thereof).
- Changes in consumer and business confidence.

I have *not* forgotten the role of marketing, but under current conditions especially, it can only play a small role – albeit a statistically significant and useful role – at best.

Typically, data series are available to allow quantification of changes in real disposable income, aggregate real income, employment and net population and migration. There are also some series that can provide data on changes in net wealth. But changes in consumer and business confidence are less easily quantified. There are various *indices* compiled that attempt to show changes in confidence, but these do not provide the same linkages to demand as do series for income and wealth.

The ***competitiveness driver*** can be considered under at least two broad mechanisms:

- Changes in the value of the destination country currency against other currencies.
- Differences in general inflation between the destination country and other countries.

These two factors are frequently combined, using broad trade weightings, and reported as *real effective exchange rates*.

Quantitatively, the income driver is usually found to have a large, significant and positive effect on tourism demand (spending).

In the economist's jargon, the *income elasticity of demand*[8] is usually positive and larger than +1 (sometimes being estimated as high as +2 to +3).

These findings are widely held to reflect the hypothesis that tourism spending is a 'superior good' – that is, we consume proportionally more of it as our real incomes rise.

Quantitatively, the competitiveness driver is usually found to have a significant and negative effect on tourism demand (spending). That is, the lower a destination's competitiveness (the higher its relative cost structure), the lower will be tourism spending.

In the economist's jargon, the *price elasticity of demand*[9] is usually negative but often smaller than -1 (in absolute terms).

It might be concluded that income effects will swamp competitiveness effects. In terms of estimated demand *elasticities* this is empirically the case. However, the drivers: changes in output, inflation, employment, and net population/migration etc., which dominate changes in real incomes, produce smaller *changes* in real incomes – and even wealth – than some of the drivers of competitiveness.

For example, compare the percentage point reductions in real growth of economic output, demand, and consumption, on the one hand (Tables 2.1 and 2.2 above), with the changes in exchange rates for the $A, on the other (Table 2.4 above). The latter are much larger.

But that's not the end of the story, either:

- The estimated income elasticities cited above are averages, derived from analysis over a long run of years. They do not allow adequately for sharp shocks reducing consumer and business confidence, as we are experiencing at the present time. Economic slow-downs or recessions, building as sharply as is currently the case, are likely to increase the negative effect on tourism spending from the measured slowing in economic growth.

---

8 The income elasticity of demand is defined as: the percentage change in (constant price) spending on product X – in this case tourism – divided by the percentage change in real per capita income (both expressed in constant price dollars).

9 The price elasticity of demand is defined as: the percentage change in (constant price) spending on product X – in this case tourism – divided by the percentage change in the relative price of that product in the destination country compared with alternative destinations (both expressed in constant price dollars). Strictly speaking, this concept combines both own-price elasticity and substitution elasticity concepts.

- These confidence effects are likely to be particularly pronounced for discretionary spending such as tourism.
- The sharp increase in Australia's competitiveness against our major trading partners as a result of the decline in the value of the $A might appear to offer a major buffer against adverse tourism spending effects. During the 1997 Asian financial crisis, this was in fact the case. Much of the adverse growth impact of that crisis on Australian exports, including tourism, was offset by increased Australian competitiveness as a result of a decline in the value of the $A.
- However, part of the reason for that was that much of the developed Western world (notably the USA, the UK, and to a lesser extent the Euro area) continued to grow solidly, so that its spending capacity was maintained as its currencies rose in value (and these countries switched to Australian-produced goods and services). The Asian financial crisis *did* reduce growth in Japan, and much of non-Japan Asia, but even here China and India were less affected.)
- This time, the Western world as a whole – the repository of the highest per capita incomes (which drive tourism demand) – is leading the world into recession. We will have to rely much more on China and other Asian economies to increase their demand for Australian tourism products. But even these economies are forecast to slow down (see table 2.1 above), and the latest World Bank warnings suggest the 'knock on' effects from the shock to developing country exports will have important adverse effects on growth for many developing countries as well.

In short, there is good reason to expect that, on this occasion, the negative income/wealth effects on global tourism demand will dominate, and Australia will not be fully insulated from this by the drop in the value of the $A. The net effect on inbound tourism spending is likely to be adverse.

2.8 LINKAGES VIA KEY DRIVERS TO TOURISM CONDITIONS AND PROSPECTS.

The effects of the foregoing analysis on international demand for Australian tourism products are set out more fully in section 5 below.

For now, suffice it to note that:

- We should expect growth in international tourism spending in Australia (our tourism exports) to slow dramatically. It may well decline in real, absolute terms.
- Against that, imports of tourism (Australians spending on overseas travel) are also likely to grow much more slowly, or even to decline in absolute terms.
- It is by no means clear that the slow-down in tourism imports will translate dollar-for-dollar into increased tourism spending by Australians within Australia. Many of the dollars saved are likely to be used for other purposes (eg, debt reduction, other forms of saving, non-tourism spending, etc).
- Given current economic conditions, prospects, and the current state of consumer and business confidence, it seems realistic to expect that only a proportion (possibly a small proportion) of the reduction in tourism imports will re-appear as domestic tourism spending. After all, Australia may well go into recession as well (see section 3 below).

Tourism is a volatile industry. When general conditions are good, it can perform strongly. When conditions are very bad and expected to get worse, it is likely to perform well below average. We face such bad conditions today, and the tourism industry should plan on the basis that it will be disproportionately affected by these bad conditions.

2.9 FLOW-ON EFFECTS FOR AUSTRALIA

The broader flow-on effects for Australia from weak world growth, falling commodity prices, weak or falling Asian exports to Western economies, and rising unemployment overseas, comprise several elements:

- Australia's terms of trade are likely to drop sharply, especially from April 2009 as new minerals exports contracts are re-negotiated. This will remove an important stimulus to domestic spending.
- In part, at least, this will be counteracted by a lower value for the $A as noted above.
- Export volumes growth might slow or even fall, as overseas importers of Australian output scale back their expansion plans in response to their own weaker export prospects.
- Investment and employment expansion plans in Australia may be reviewed, cancelled, put on hold, or slowed. While there is a 'pipeline' of committed projects already underway, that 'pipeline' can be shortened dramatically if sentiment turns down sharply.
- Lower investment in turn affects construction, transport and other industries, contributing to slower Australian demand and output growth.

2.10 FLOW ON EFFECTS FOR WESTERN AUSTRALIA

The flow-on effects for Western Australia are similar to those just outlined.

If anything, they may be more marked for Western Australia because of its relatively high exposure to the recent mining industry investment and export boom, and (until recently) the associated high Australian terms of trade. Much will depend on how China and India fare in the years ahead, and in particular on how effective Chinese measures to support Chinese domestic growth are.

All of these flow-on effects feed into Australian economic prospects more generally.

These are covered in section 3 below.

3. OVERVIEW OF AUSTRALIAN ECONOMIC CONDITIONS AND PROSPECTS

By historical standards, the Australian economy has had a dream run since the recovery from the 'recession we had to have' in the early 1990s. Since then annual real GDP growth has fluctuated within a 2% - 5% range. Domestic demand – as measured by growth in real Gross National Expenditure (GNE) – has generally been growing even more strongly, supported by rising terms of trade.

But the story is about to change:

- Investment, as a share of GDP, is likely to begin a long decline, starting some time in 2009-2010 (if not earlier).
- Australian consumer spending is already sliding, after being a growth mainstay, and now looks like slowing faster than anything seen since 1993.
- Net exports, on the other hand, are likely to move to a relatively more supportive growth role than in the past (although a lot of that might be imports crashing rather than export volumes soaring).
- Government sector demand is about to be pumped up as C*ommonwealth* policy responds to the slow-down, although even here cash-strapped state governments might well be tightening their belts even as the Commonwealth opens its wallet.
- Unemployment will reverse recent benign trends and begin to increase. The unemployment rate will increase, albeit as a lagging indicator of economic conditions.
- Policy will shift towards a more protectionist slant. By itself this might *appear* to help (some industries, such as cars) in the short term. But other countries will be doing the same: watch for Obama announcements on Detroit. Collectively, these sorts of policy shifts (eg, on motor vehicles) could add a further contractionary twist to the global downwards spiral.

The Australian growth party's probably over – for a few years at least.

3.1 AN AUSTRALIA-WIDE VIEW

The October 2008 IMF forecasts for Australia are summarised in table 3.1 below.

Table 3.1. IMF WEO Projections for Australia, October 2008 (year on year change - %)

	2006	2007	2008	2009
Real GDP	2.7	4.2	2.5	2.2
Unemployment rate	4.8	4.4	4.3	4.8
Consumer price inflation	3.5	2.3	4.6	3.6
Current account deficit (% of GDP)	-5.3	-6.2	-4.9	-4.3

Since the release of the IMF's October 2008 forecasts, Australian growth prospects have been revised downwards along with those for most of the rest of the world. The IMF now expects the Australian economy to grow by 1.8% in 2008-09 (less in calendar 2009 over 2008?). This is slightly lower than the recently released Commonwealth Government's mid-year economic and fiscal outlook forecasts for Australia of around 2% (but well within forecast error margins, especially at the present time).

On 10 November, in its latest quarterly statement on monetary policy, the Reserve bank of Australia forecast Australian GDP growth to decline from 2.7% over the year to June 2008, to 1.5% over the year to December, and the pace of growth is not expected to pick up until the end of 2009 (annual growth over the year to December 2009 of 2.5%).

The basic message is clear: demand is expected to grow less strongly, production will follow, pressure on capacity limits will ease, and unemployment will increase.

The main question worrying politicians and the rest of us is whether Australia will slide into recession. In GCA's opinion this is at least an even-money prospect.

As is the case for the world economic forecasts reviewed in section 2 above, perhaps the most robust forecast is that economic prospects in Australia may well be revised down more in the period ahead.

3.2 A STATE/TERRITORY BREAKDOWN

The 'mix' of growth prospects between Australian States and Territories is diverse.

Based on GDP annual growth (in 2007-08, and 2008-09 as forecast by Access Economics[10]), the *relative* performance of Australian States and Territories can be summarised as follows:

- NSW is the 'basket case', especially in 2008-09 (GDP growth of about 2.3%, followed by about 1% in 2008-09).
- SA and Victoria come next (GDP growth of about ±3%, followed by about 1.6% in 2008-09).
- The ACT and Tasmania come next, around the Australia-wide average (GDP growth of about 3.4%, followed by about 2.25% in 2008-09).
- The Northern Territory is next, above the Australia-wide average (GDP growth of about 4+%, followed by about 4.25% in 2008-09).
- Topping the list are Western Australia and Queensland, although Queensland falls off sharply in 2008-09 (GDP growth of about 5%, followed by about 5.2% in 2008-09 for WA and, for Queensland, GDP growth of about 5.1%, followed by about 3.4% in 2008-09).

These relativities are based on Access Economics' forecasts produced some weeks ago. If they hold true, Western Australia is the strongest growth state in 2008-09 (above 5%). To be sure, there's a lot of growth momentum still building in WA, even if Australia's terms of trade take a dive.

But in GCA's opinion, the risks associated with the resource states' forecasts are larger than for the other states.

3.3 FOCUS ON WA

As the firm I co-founded, Access Economics, puts it (and I acknowledge the words of Chris Richardson here):

> *…. it isn't financial markets that Western Australia need fear, it is commodity markets. Our long held mantra (that the State is fine while China is fine) remains true in spades (let alone in diamonds, gold, iron ore, and gas) ….*
>
> *As we've said before, if China cools enough, WA might not merely get a cold, but flirt with Asian flu. Today's commodity prices can't last. Whether they are brought to heel sooner rather than later remains to be seen. ….*[11]

WA is deeply involved in a high-risk, high-stakes economic game at present. It will win if the world economy, or at least domestic demand in the emerging economies like China and India, hold up well despite the current financial crisis. It may lose big time if these large importers of its exports also slide into very weak growth.

---

10 See *Business Outlook: Will the China domino fall?* Access Economics, September 2008, page 94.

11 *Business Outlook: Will the China domino fall?* Access Economics, September 2008, pages 107 and 108.

The call is very finely balanced at present, and depends much on the effectiveness of Chinese attempts to boost demand in the domestic sector of their economy.

3.4 KEY DOMESTIC TOURISM 'DRIVERS'

For domestic tourism spending, the key drivers are:

- Australian income (or proxies for income).
- Competitiveness of destinations (or proxies for competitiveness).

At present, as for overseas, the ***income driver*** can be considered under at least three broad mechanisms:

- Changes in real disposable income, which, in aggregate, can be affected by real wage changes, changes in real profits, and changes in employment (as well as changes in population as a 'scaling' factor, which is affected by net natural increase and net migration).
- Changes in real net wealth (or perceptions thereof).
- Changes in consumer and business confidence.

Again, I have *not* forgotten the role of marketing, but under current conditions especially, it can only play a small role – albeit a statistically significant, and useful role – at best.

Typically, data series are available to allow quantification of changes in real disposable income, aggregate real income, employment and net population and migration. There are also some series that can provide data on changes in net wealth. But changes in consumer and business confidence are less easily quantified. There are various *indices* compiled that attempt to show changes in confidence, but these do not provide the same linkages to demand as do series for income and wealth.

The ***competitiveness driver*** can be regarded as:

- Distance-related: longer travel means more cost, and more time.
- Destination cost-related: more remote destinations may face higher costs for construction and consumables (partly due to transport costs).

Quantitatively, the income driver is usually found to have a sizeable, significant and positive effect on tourism demand (spending).

These findings are widely held to reflect the hypothesis that tourism spending is a 'superior good' – that is, we consume proportionally more of it as our real incomes rise.

Quantitatively, the competitiveness driver is usually found to have a significant and negative effect on tourism demand (spending). That is, the lower a destination's competitiveness (the higher its relative cost structure), the lower will be tourism spending.

3.5 THE DOMINANCE OF INCOME EFFECTS: PURPOSE OF TRAVEL

When considering Western Australian tourism prospects, visitors from other States and Territories constitute the State's tourism exports, while travel by Western Australians to other States and Territories involve imports of tourism by Western Australians.

There's a mixed prospective story here:

- In general, forecasts for Australian real output growth (based on GDP) – weak though they are – may be still higher than real consumption spending growth, and, at least, higher than real *discretionary* consumption spending growth (including on tourism).

- This Australia-wide story comprises relative weaker output and consumer spending growth for most of non-WA Australia (based on current forecasts WA, Queensland and the NT are increasing their shares of the Australian totals; the others' shares are declining).
- Slower income and spending growth implies slower WA tourism export income.
- Any slow down in WA income and spending growth also implies slower growth in WA tourism import spending too (although, in a severe downturn for the mining industry, it may also lead to some reversal of the inter-state migration into WA seen in recent years).
- These observations apply mainly to holiday and business travel, especially the former.
- They are likely to apply less strongly to VFR travel.

3.6 THE SIGNIFICANCE OF RELATIVE PRICE EFFECTS: PURPOSE OF TRAVEL

The relative price effect for Western Australia is largely a distance/cost related issue.

- As a relatively remote destination for non-WA Australian travellers, WA may suffer from the distance/cost impediment for east coast customers.
- Against that, oil prices have fallen, and airlines will need to price their services keenly in an increasingly tough aviation market. The airfare/transport cost disadvantage for WA has been reduced significantly, compared with the situation only a few months ago.
- Perhaps VFR travel will be less affected than other purposes of travel.

These matters are taken up in more detail in section 5 below.

3.7 LINKAGES TO TOURISM PROSPECTS

The effects of the foregoing analysis on domestic demand for Australian tourism products are set out more fully in section 5 below.

For now, suffice it to note that:

- We should expect growth in interstate tourism spending in WA (its tourism exports) to slow dramatically. It may well decline in real, absolute terms.
- Against that, imports of interstate tourism (WA residents spending on interstate travel) are also likely to grow much more slowly, or even to decline in absolute terms.
- It is by no means clear that the slow-down in tourism imports will translate dollar-for-dollar into increased tourism spending by WA residents within WA. Many of the dollars saved are likely to be used for other purposes (eg, debt reduction, other forms of saving, non-tourism spending, etc).
- Given current economic conditions, prospects, and the current state of consumer and business confidence, it seems realistic to expect that only a proportion (possibly a small proportion) of the reduction in WA tourism imports will re-appear as WA domestic tourism spending.
- Given weak confidence, rising unemployment, and the possibility of an Australian recession, a disproportionate reduction in tourism spending relative to the reduction in total WA consumer spending seems plausible.

The WA tourism industry should plan on the basis that it will be disproportionately affected by these bad conditions.

4. RISKS AND UNCERTAINTIES

As can be seen by the descriptions in sections 2 and 3 above, economic forecasts at present are surrounded by much more than the usual degree of uncertainty.

As a result, error margins around forecasts are also likely to be much larger than usual, even for forecasts out over a period of one year.

There are plenty of ‘known unknowns’, but probably just as many ‘unknown unknowns’.

A healthy degree of humility is required of those claiming to be able to forecast future developments.

The old forecaster’s mantra:

> *Forecast frequently and change your mind often!*

Is more relevant than ever.

There are also good reasons for judging that, on balance, there are downside risks to current forecasts (even after recent downwards revisions):

- Consumer and business confidence has taken a severe beating in recent months, and this is feeding into a ‘vicious circle’ of bad news further reducing confidence leading to reduced demand leading to more bad news, and so on.
- On the investment front, many investment plans may be mothballed, delayed, reduced or cancelled, further adding to the downwards demand spiral.
- These effects feed into lower demand both within economies and, via reduced demand for exports and imports, between economies.
- The very fact that governments around the world are moving to implement major fiscal and monetary policy stimulus packages is a clear manifestation of official concern about net downside risks.
- More ominously, the emergence of subtle and not-so-subtle protectionist measures in various economies could reinforce this downwards vicious circle. Australia has not been immune from such measures, either.

All of this simply reinforces the points made in sections 2 and 3 above.

If things can get worse, there’s probably a better than even chance that they will, for a while yet.

It goes without saying that tourism globally, in Australia, and in Western Australia is particularly exposed to such downside risks.

5. PULLING IT ALL TOGETHER: TOURISM DEMAND

The early evidence of tourism performance in Australia associated with the global economic slowdown is already coming in. To date, this is more evident in inbound visitor numbers than anywhere else.

5.1 HOW IS TOURISM IN AUSTRALIA AND WESTERN AUSTRALIA PERFORMING SO FAR?

The following is a brief summary of the latest available statistics for tourism performance in Australia.

Chart 5.1 below shows recent monthly trend movements in total short term visitor arrivals to Australia, from October 1996 to September 2008 (the latest data available).

The main features shown in Chart 5.1 are as follows:

- After the September/December 2000 peak associated with the Sydney Olympic Games, inbound visitor numbers fell for a few years, affected by September 11, 2001, SARS, and the second Iraq war. (Note also the modest downwards shift in 1997-1998 as a result of the Asian financial crisis. This showed up more in numbers than in spending.)
- From mid-2003 to early 2005 visitor numbers grew, surpassing the second half of 2000 Sydney Olympics peak.
- From mid-2005 to mid-2006, inbound visitor numbers plateaued, before rising until early 2007, after which they plateaued again until early 2008.
- As 2008 has unfolded, a downwards trend has emerged. Monthly numbers are back to 2005 levels. Other countries have led the world into recession: inbound visitor numbers show it.
- The seasonally adjusted data series (not shown in Chart 5.1) shows a much sharper decline in visitor numbers since mid-2008.

Chart 5.1. Short term visitor arrivals, total, Australia – trend.

Source: *Overseas arrivals and departures, Australia, Sep 2008,* ABS Cat. No. 3401.0.

Looking at Australia's top ten source markets, the changes in the year to September 2008 are as shown in Table 5.1 below:

Table 5.1. Change in short term visitor arrivals, top ten source markets, September 2008 over September 2007 (%), based on trend series*.

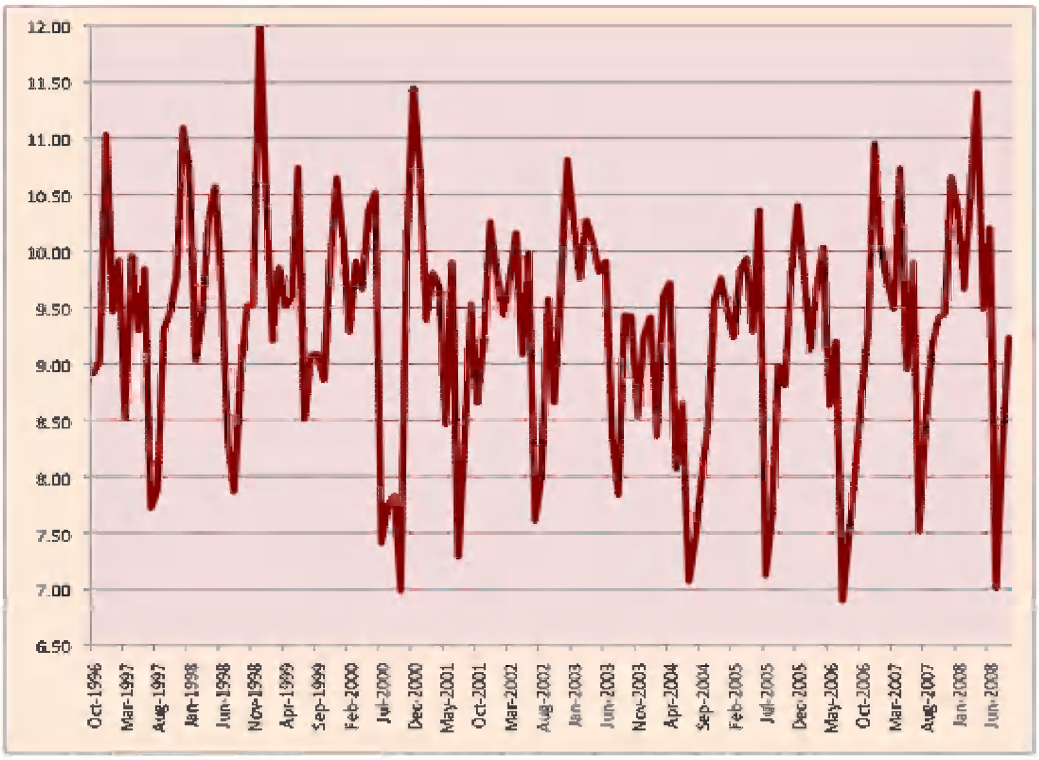
New Zealand	-6.1
UK	-2.1
Japan	-19.3
USA	-3.2
China	-16.4
Singapore	+6.8
Korea	-4.5
Germany	0.8
Malaysia	-1.6
Indonesia	18.5

* Top ten source countries based on original estimates.

Source: *Overseas arrivals and departures, Australia, Sep 2008,* ABS Cat. No. 3401.0.

Chart 5.2 below shows changes in the proportion of inbound visitors spending most time in WA relative to the total number of visitors.

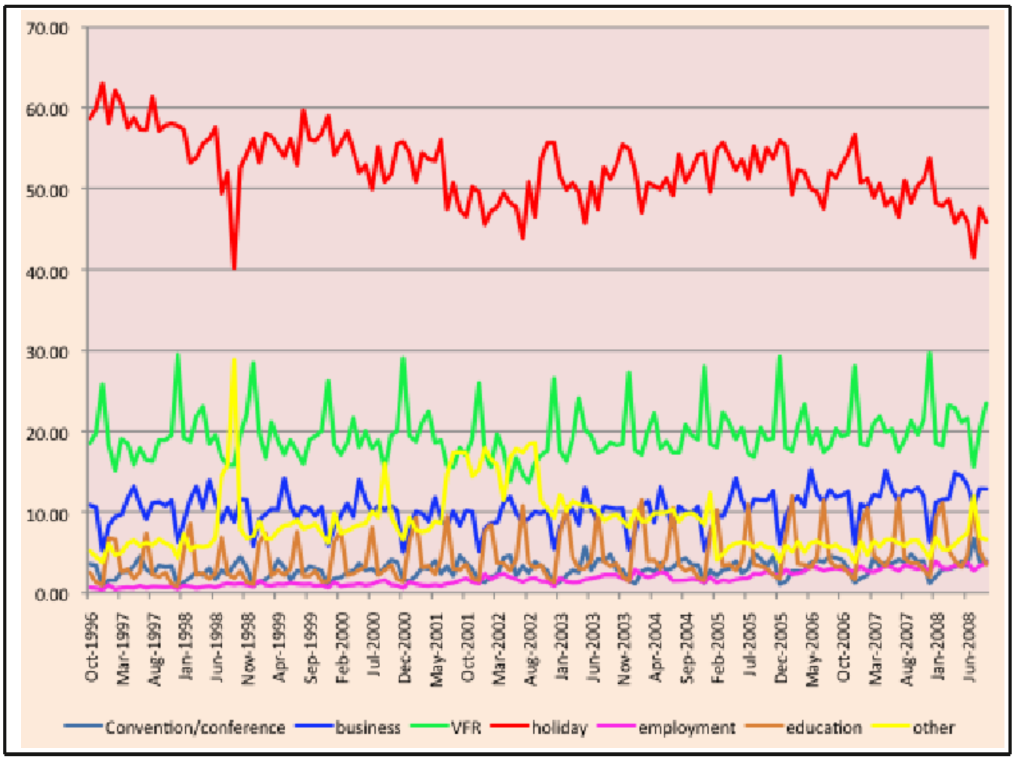
Chart 5.2. Short term visitors spending most time in WA (%) – original data.



Source: *Overseas arrivals and departures, Australia, Sep 2008,* ABS Cat. No. 3401.0.

The seasonal variations are very marked, but, if anything, the increase from around 2003 to early 2008 may be showing early signs of going into reverse.

Chart 5.3. Short term visitors to Australia by purpose of visit (% of total) – original data.



Source: *Overseas arrivals and departures, Australia, Sep 2008,* ABS Cat. No. 3401.0.

Chart 5.3 above shows variations in the proportions of total inbound visitors to Australia classified by main purpose of visit (based on original data).

The main points shown in this chart are as follows:

- For Australia as a whole, the ‘holiday’ reason for travel to Australia has tended to decline.
- The ‘VFR’ proportion, if anything, has increased slightly, while travel for ‘business’ purposes has also been increasing somewhat as a share of the total. So have travel for ‘employment’, for ‘convention/conference’ (slightly), and for ‘education’ (slightly).
- Travel for ‘other’ purposes has tended to decline.

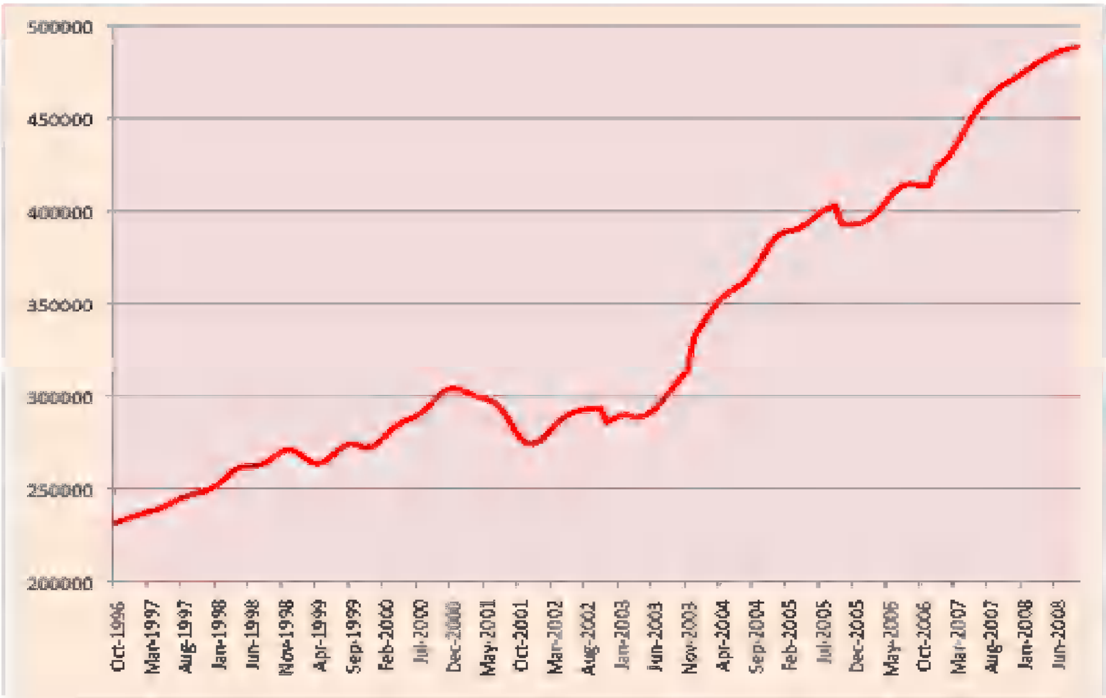
Chart 5.4 below shows recent monthly trend movements in total short term resident departures from Australia, from October 1996 to September 2008 (the latest data available).

The main features shown in Chart 5.4 are as follows:

- After the September/December 2000 peak associated with the Sydney Olympic Games, outbound Australian departure numbers fell for two years or so, affected by September 11 2001, SARS, and the second Iraq war.
- From mid-2003 to late 2005 short term departure numbers grew, easily surpassing the Sydney Olympics peak in the second half of 2000.
- After a pause late in 2005, Australian departures continued to rise.
- As 2008 has unfolded, a slowing in this upwards trend might be emerging, but so far it is slight.

- The seasonally adjusted data series (not shown in Chart 5.1) shows a somewhat sharper decline in departure numbers since mid-2008.
- Australia has been lagging the growth slow down experienced overseas. The drop in the value of the $A has been relatively recent. These effects are likely to be reflected in slower growth, or a fall, in outbound traveller numbers in coming months.

Chart 5.4. Short term visitor departures, total, Australia – trend.



Source: *Overseas arrivals and departures, Australia, Sep 2008,* ABS Cat. No. 3401.0.

Looking at Australian outbound traveller top ten destination markets, the changes in the year to September 2008 are as follows:

Table 5.2. Change in short term visitor departures, top ten destination markets, September 2008 over September 2007 (%), based on trend series*.

New Zealand	-1.3
USA	7.1
UK	-3.7
Indonesia	34.3
Thailand	6.5
China	-8.3
Fiji	12.7
Italy	10.5
Singapore	-3.6
Malaysia	4.9

* Top ten destination countries based on original estimates.

Source: *Overseas arrivals and departures, Australia, Sep 2008,* ABS Cat. No. 3401.0.

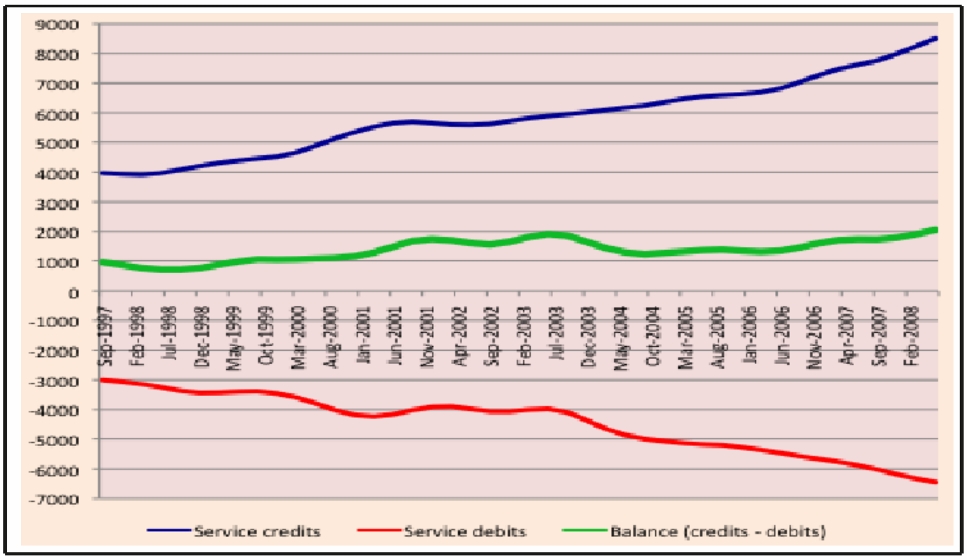
Australian balance of payments statistics provide quarterly snapshots of proxies for tourism export earnings and import spending in recent years as well. These are more out of date, only being available up to the June quarter of 2008.

Chart 5.5 below shows recent trends in the current dollar value of tourism related service exports (credits) and imports (debits) from 1997 to the June quarter of 2008.

The main features shown in Chart 5.5 are as follows:

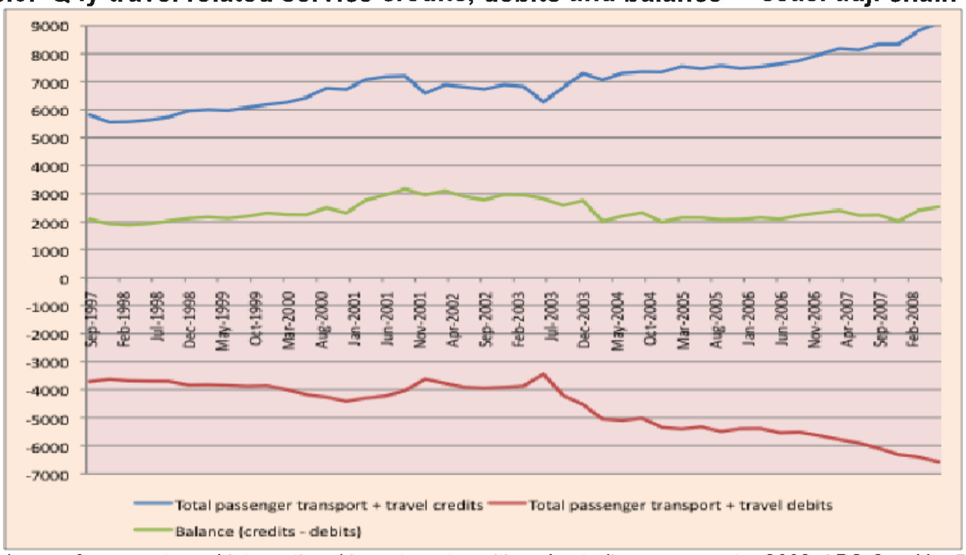
- Both tourism related exports and imports have grown over the last decade or so – each more than doubling, in current dollar terms at least.
- But the net exports balance between the two has not really changed as much, and currently stands no higher than it was in mid-2003.
- This data does not allow for inflation over the period. Volume measures are shown in Chart 5.6 below.

Chart 5.5. Quarterly tourism related service credits, debits and balance – trend.



Source: *Balance of payments and international investment position, Australia, June quarter 2008*, ABS Cat. No. 5302.0.

Chart 5.6. Q'ly travel related service credits, debits and balance – seas. adj. chain volumes.



Source: *Balance of payments and international investment position, Australia, June quarter 2008*, ABS Cat. No. 5302.0.

Chart 5.6 shows that, in volume terms, travel and international transport related exports and imports (seasonally adjusted) have grown much less – up about 50% for exports and more than 50% for imports – and the balance between the two has changed little in absolute terms over the period shown.

As to domestic tourism, amongst the most reliable performance indicators is the data from the ABS tourism accommodation survey. Some of the key measures are summarised in Table 5.3 below.

Table 5.3. Tourist accommodation, Australia (June quarter 2008)*

	Mar qtr 08	Jun qtr 08	Jun/Mar qtr	Jun 08/Jun 07
Trend				
Accommodation takings ($m)	1,969.0	2,014.2	2.3%	9.3%
Room occupancy rate (%)	65.1	65.1	0.0pts	-0.8pts
Seasonally adjusted				
Accommodation takings ($m)	1,966.9	2,023.3	2.9%	10.6%
Room occupancy rate (%)	64.8	65.5	0.7pts	0.1pts

* Accommodation with 15 rooms or more.

Source: *Tourist accommodation, Australia, June quarter 2008.* ABS Cat. No. 8635.0.

Other points made in the latest tourist accommodation release are as follows:

- Over the two years to June 2008, the room occupancy rate for Australia rose (to early 2007) but subsequently has been falling in trend terms.
- Occupancy rates have been higher for the higher star grading establishments (as have average takings per room night occupied).
- Accommodation takings have grown steadily.

The situation in Western Australia is significantly stronger than for Australia as a whole – at least measured over the year up to the June quarter 2008. The main details are shown in Table 5.4 below.

Table 5.4. Tourist accommodation, Western Australia (June quarter 2008)*

	Mar qtr 08	Jun qtr 08	Jun/Mar qtr	Jun 08/Jun 07
Original data				
Accommodation takings ($m)	205.7	208.5	1.7%	20.8%
Room occupancy rate (%)	69.6	67.5	-2.1pts	+1.4pts

* Accommodation with 15 rooms or more.

Source: *Tourist accommodation, Australia, June quarter 2008.* ABS Cat. No. 8635.06.

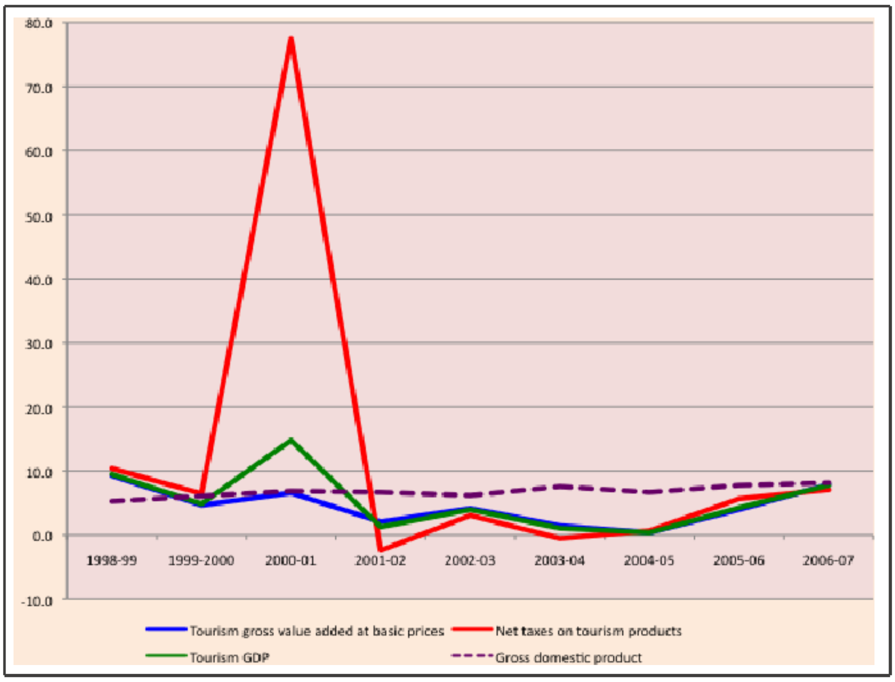
It's too soon to be sure, but there may be very early signs of a softening in demand, even in (the relatively over-heated) Western Australia, but this will only become clearer in the period ahead.

Finally, the ABS *Tourism Satellite Accounts* (TSA) data can be used to obtain a national account-consistent overview of the tourism industry's performance.

Unfortunately, tourism data on this basis is only available up to 2006-07, and so it does not give us any insight into developments in 2007-08 or beyond.

The TSA data shows a growing tourism contribution to Australia's GDP, tax revenues, and value-added over the period from 1997-98 to 2006-07. This is shown in Chart 5.7 below.

Chart 5.7. Growth in GDP, tourism GDP, tourism value added, and net tourism taxes*

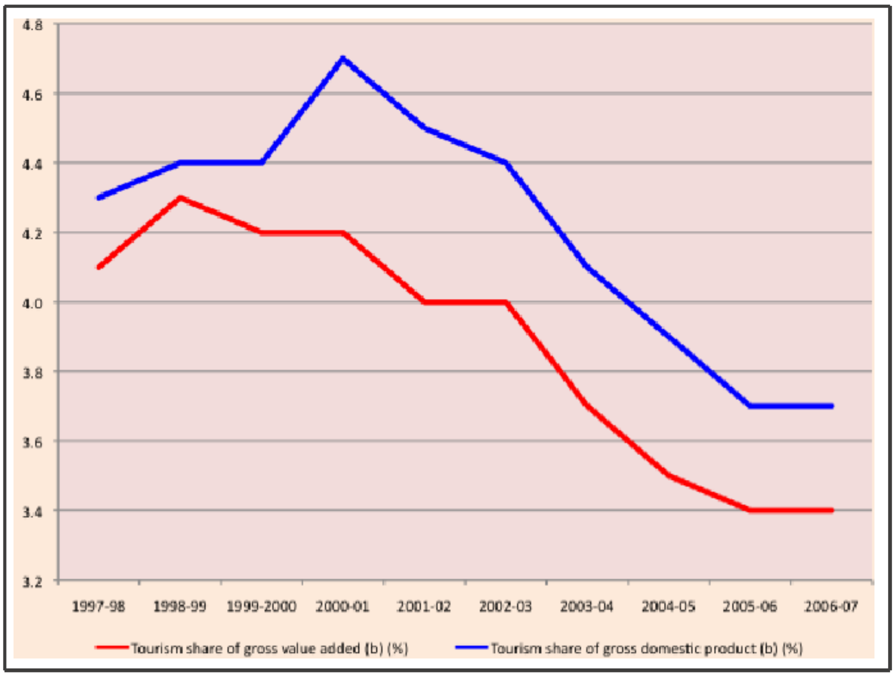


Source: *Australian National Accounts: Tourism Satellite Account* ABS Cat. No. 5249.0.

* Spike in 2000 due to Olympic Games and sale of broadcast rights thereto.

However tourism has been making a declining contribution to Australian GDP (as measured by its *direct* share of GDP and value added) since the Olympic Games year. See Chart 5.8 below.

Chart 5.8. Tourism share in Australian GDP and value added



Source: *Australian National Accounts: Tourism Satellite Account* ABS Cat. No. 5249.0.

(b) Only the direct tourism shares are shown here.

The story in Western Australia is probably similar, although its value added performance *relative to tourism* in other parts of Australia is probably superior:

- Based on the analysis undertaken in 2007 by GCA and Access Economics[12], over the four years from 2001-02 to 2005-06, Western Australia's share of national tourism, as measured by direct value added, increased from 8.5% to 9.6%, but its share of total Western Australian value added decreased from 3.2% to 2.7%.

- This latter result reflected the doubling of value added in the Western Australian mining and construction industries over this period, during which time the value added of tourism increased by 29%.

- Clearly, Western Australian tourism did better than the national average over this period. It grew both in nominal and real terms, whereas *national* tourism grew by 14% in nominal terms, but hardly changed in real terms.

- Over the same period, primarily as a result of demand pressures associated with the mining boom, direct tourism employment in WA declined by 1%, even though value added increased by 29% in nominal terms. These results are consistent with tourism industry employers having difficulty in finding labour because there were greater employment opportunities in the mining sector.

The *International Visitor Survey* (IVS) and the *National Visitor Survey* (NVS) results for the June Quarter 2008 have been released by Tourism Research Australia.[13] These are not recent enough to show big effects from the global economic crisis.

For what they are worth, however:

- The IVS shows no change in inbound visitor numbers in the year to June 2008 compared with the previous year. Total visitor nights increased 1% in the year to June 2008 compared with the previous year. Total expenditure in Australia in the year to June 2008 was about $16 billion, up 9% on the previous year.

- The NVS shows total domestic trips fell 2%, and nights away from home fell 3% in the year to June 2008 compared with the previous year. Expenditure by overnight visitors amounted to $44.7 billion in the year to June 2008, up 4% on the previous year.

5.2 REALISTIC TOURISM EXPECTATIONS

What are the prospects for Australian tourism demand?

These can be considered under four headings:

- Inbound tourism (and WA's share thereof).

- Outbound tourism.

- Domestic tourism (and WA's share of interstate tourism).

- Intrastate tourism in WA.

These are considered below.

---

12 *The Economic Contribution of Tourism to Western Australia in 2005-06: A Tourism Satellite Account-based Analysis*, Report by Access Economics for Tourism Western Australia, 10 August 2007.

13 See *International Visitors in Australia*, June 2008, Quarterly results of the International Visitor Survey, and *Travel by Australians*, June 2008, Quarterly results of the National Visitor Survey, Tourism Research Australia.

Note that no numerical forecasts are presented. Aggregate economic forecasts are in a state of flux. Without steady forecasts for these drivers of tourism demand, and given shattered banking, consumer and business confidence, past econometric relationships are probably almost useless at the present time.

Prospects for inbound tourism to Australia and WA's share of that

The key drivers of inbound tourism – the income/wealth/confidence driver and the competitiveness driver – are pulling in opposite directions. The former is dragging inbound tourism down. The latter is making Australia a more competitive destination. Which will dominate?

We do not have a precedent to look back on. The current world situation is worse than anything since the 1930s.

If we look back to the 1997 Asian financial crisis (see Chart 5.1 above) we can see that there was a drop in *visitor arrivals* of about 20,000 per month between the second half of 1997 and early 1998.

Balance of payments data showed that *spending* was less affected, however.

We are already seeing a drop in inbound visitor numbers (see Chart 5.1 above) of almost 20,000 per month from mid-2007 to September 2008. But these are early days. The Western economies went into recession first, and (allowing for lags of up to one year) the early effects of that are starting to show up in the Australian inbound numbers.

But these *are* only the early effects.

In GCA's opinion, there's a lot more to come.

Consider Australia's top ten source markets and how they are currently faring:

- The [redacted] – already in recession and going deeper (and for longer) than expected earlier.
- [redacted] – already in recession.
- [redacted] – mixed domestic demand indicators.
- [redacted] – already in recession.
- [redacted] – believed to be in recession and dropping fast.
- [redacted] – already in recession.
- [redacted] – already in recession.
- [redacted] – hoping to hold growth at 8-8.5% p.a., but demand indicators dropping fast. Already talk of growth slipping below 7%, depending on effects of major stimulus package.
- [redacted] – growing reasonably well at present, but consumption and exports are weakening.
- [redacted] – growth slowing more sharply than expected, inducing large cuts in interest rates.

In short, of these, 6 are already in, or believed to be in, recession (all of the developed economies), and the other four (emerging economies) are slowing – fast, in the cases of China and India.

So the income-related drivers are already signalling a sizeable drop in inbound visitor numbers. Spending (in $A terms) might drop less, but still seems likely to fall.

What about the countering effects of a drop in the value of the $A, and the dramatic fall in the price of oil?

There is no doubt that these will buffer Australia from the full fall-out from Western economy recession and a major slowing in emerging economies' growth rates.

But can this buffer be a 100% offset?

In GCA's opinion, the answer is 'no', for several reasons:

- The drop in the value of the $A, and the fall in the price of oil, are themselves *induced* by the rapidly slowing world economy. Such induced effects are unlikely to 'bootstrap' Australian inbound tourism back to the growth path predicated on no such growth slow down.
- Large as the fall in the $A has been, it also acts to buffer Australia from the full benefits of a falling world oil price: in part, the two cancel out.
- The adverse confidence and wealth effects – not well measured in assessments of economic growth – will be particularly powerful in the case of consumer spending in general, and discretionary spending on items like tourism.

In net terms, GCA expects to see a *reduction* in Australian inbound visitor numbers, and tourism export income (nominal and real terms) in the next year or so.

Whatever happens to total inbound visitor numbers and spending for Australia as a whole, there seems no strong reason why WA's share should rise in the period ahead:

- With the world economy slowing, and WA subject to distance/cost disadvantages relative to other Australian states, and recreational tourism's share assumed to continue to decline, the WA share of holiday travel might be expected to be steady, at best, or fall, at worst.
- For business travel, the reversal of the mining boom of recent years might have the same effect.

In net terms, GCA expects to see either no change, or, if anything, a reduction, in WA's share of Australian inbound visitor numbers and tourism export income (nominal and real terms) in the next year or so.

Prospects for outbound tourism from Australia

In contrast with the situation for inbound tourism, the key drivers of outbound tourism – the income/wealth/confidence driver and the competitiveness of overseas destinations – are likely to be working in the same direction:

- The Australian economy is slowing. The current debate is about whether or not it will go into recession. Banking, business and consumer confidence are low. Asset prices – shares and houses and other property values – are falling, reducing wealth.
- The $A has fallen substantially, making imports – including tourism imports – more expensive.

Together, these two key drivers should induce a slower growth in, and probably a reduction in outbound tourism. Because the slowing of the Australian economy has come later than those in other countries, and allowing for the usual lags, this is not showing up strongly in outbound traveller numbers – yet.

As Chart 5.3 above shows, outbound traveller numbers are still growing, but the growth is slowing.

Nevertheless, GCA expects that outbound traveller numbers in the year or so ahead will grow much more slowly, and probably decline, as will total Australian spending on tourism imports.

The next question is: will this reduction generate a 100% switch to Australian spending on tourism within Australia?

In GCA's opinion, the answer is 'almost certainly not':

- The income/wealth/confidence effects are likely to fall disproportionately on discretionary spending in general, and possibly tourism spending in particular.

- As in past episodes of crisis (9/11, SARs, etc), there will be a degree of travel spending ‘cocooning’. Depending on how small the ‘cocoon’ is, some of this spending will not be recorded as tourism spending at all, because it is undertaken within the relevant travel distance limits.

On balance, therefore, GCA expects a reduction in Australian tourism import spending, but with substantially less than 100% of this reduction switched to domestic tourism spending.

Prospects for domestic Australian tourism and WA’s share of that

Domestic Australian tourism is likely to be dragged down:

- The growth in Australian output will slow, and may go negative for long enough to qualify for a ‘recession’ tag.
- Australian wealth is falling, as share prices tumble and housing and super investments also lose value.
- Consumer and business confidence has been shattered.

Together, these factors are likely to reduce Australian resident spending on tourism products (retail sales for cafes and restaurants are amongst the leaders in the downturn in retail sales already).

As a partial offset, a lower value for the $A will switch some Australian tourism spending from imports to local demand. A lower oil price (even after the fall in the value of the $A) will help ease the transport cost component.

But for tourism, confidence and cash are king, and there’s a shortage of both at present.

VFR might hold up best. Business travel might be next. But holiday travel is likely to suffer most.

Regionally, GCA expects that ‘cocooning’ phenomena will mean tourism operators closest to the major Australian population centres will fare best amongst the Australian tourism industry.

On balance, therefore, GCA expects a reduction in Australian domestic travel, domestic visitor nights, commercial accommodation, and domestic tourism spending. This may be concentrated most amongst more distant Australian destinations and holiday travel.

For WA, the foregoing comments suggest that east coast custom, on balance, will slow or fall.

Distance, absolute cost, lower incomes and wealth, lower confidence, and ‘cocooning’ effects are likely to work against interstate travel to WA. The bursting of the minerals boom is likely to have the same effect on business travel.

On balance, GCA expects a reduction in Australian resident travel, domestic visitor nights, commercial accommodation, and domestic tourism spending in WA. This may be concentrated most amongst more distant WA destinations and holiday travel in WA.

Prospects for intrastate tourism in WA

The key drivers of outbound tourism – the income/wealth/confidence driver and the competitiveness of overseas destinations – are likely to be working in the same direction.

Intrastate tourism demand might behave a bit like Australia-wide tourism demand:

- Some interstate WA tourism imports are likely to be reduced as WA residents travel less interstate.
- But not all of this reduction is likely to translate into increased intra-WA demand.
- The slowing in the WA economy is likely to reduce intrastate tourism demand.

- 'Cocooning' effects might well shrink that demand closer into the major population centres.

On balance, GCA expects a reduction in WA resident travel, WA domestic visitor nights, WA commercial accommodation, and WA resident tourism spending in WA. This may be concentrated most amongst more distant WA destinations and holiday travel in WA.

How long might this down period last? We don't know. We think it could be at least a year, possibly more.

Is there any good news? The lower $A value is one key bit of good news. We can at least hope that China and India will surprise on the growth upside. But only time will tell on that score.

5.3 SENSIBLE MARKETING TARGETS

For marketing organisations such as Tourism Australia and State Tourism organisations, it's important to get the balance right:

- Such organisations should not claim credit for all of the goods news when tourism is performing strongly.
- Equally, they should not be expected to shoulder all of the blame when things go bad.

Studies have been done of the effectiveness of tourism marketing organisations such as the ATC (now Tourism Australia) and State organisations, including Tourism Western Australia.[14]

In general, these studies show that:

- The proxy for income or economic growth has a statistically significant and large positive effect on tourism spending, with income elasticities of greater than +1 – sometimes much greater.
- The proxy for destination competitiveness has a statistically significant, but usually smaller effect on tourism spending, with price elasticities of -0.8 or (in absolute terms) smaller. (This means that a loss of competitiveness of 1% as measured by the relevant price/cost index leads to a reduction in tourism spending of 0.8% or less.)
- The proxy for marketing spending is also statistically significant, but the relevant (positive) elasticity is usually small – around +0.1 or so. This does not mean that such marketing activity is not valuable. It's just a smaller valuable contribution than strong income growth.

Given these results, it's important to remember that Australia and the world are facing very large shifts in income and wealth and confidence (all downwards), and large changes in the $A value.

These drivers will swamp likely changes to marketing spending, even though the latter can have useful effects.

Accordingly, realistic marketing targets in the present situation would comprise objectives like the following:

- Minimise the adverse fallout on inbound and interstate tourism spending in WA from the global financial crisis (correct in principle, but hard to measure 'adverse effects' without a solid 'counterfactual' benchmark scenario).
- Hold WA's share of total Australian inbound, interstate and intrastate tourism spending at least constant at, say, 2007-08 percentages (this will be fairly readily measurable).

---

[14] See, for example, *The Economic Value of Tourism for Australia: A Post-September 2001 Stock-take & Update*, Report commissioned by the Australian Tourist Commission and prepared by Access Economics, May 2002. See also *Impact of Additional Tourism Marketing Funding on Western Australia*, Report by Access Economics for Tourism Western Australia, December 2007.

- More ambitiously, seek to increase WA's share of total Australian (i) inbound tourism spending, (ii) interstate tourism spending, and (iii) intrastate tourism spending, relative to shares recorded in, say, 2007-08 (again this will be fairly readily measurable). (We think this may be ambitious if WA suffers disproportionately from the commodity price crunch.)

- As a variant of this third suggestion, seek to increase WA's share of high-yielding tourism spending by inbound visitors, interstate visitors and intrastate visitors. (This will require some definition of 'high yielding' to allow measurement of performance.)

But do *not* benchmark performance against absolute spending increases or similar targets. That seems unrealistic if much larger forces are likely to drive a tourism spending downturn.

Market share benchmarks mean that the focus is (or should be) on out-resourcing and out-performing other States & Territories. Whether or not this is feasible will depend on the WA Budget situation and WA Government Budget priorities (as well as industry support).

6. Pulling it all together: Tourism investment and supply

The tourism market is properly viewed as one (like most/all others) where demand conditions and supply conditions jointly determine market outcomes.

But GCA believes that tourism demand is more dependent upon strong overall demand and economic prosperity than vice versa. We also believe that tourism supply follows (or should, at least, follow) demand, disciplined by some sort of focus on required returns on investment. That focus may not be all that precise in the short term, especially if ‘build it and they will come’ sentiment prevails, but eventually it becomes dominant.

That said, the supply side is subject to very different degrees of flexibility in responding to fluctuations in demand.

Some parts cannot respond quickly – especially in terms of contraction – while others are more flexible:

- The commercial accommodation sector is probably the least flexible: it takes longer to bring more capacity on line in the face of strong growth in demand, and even longer to balance demand and supply in the face of a protracted, deep, demand downturn.

- Aviation capacity can be a fair bit more flexible. Routes can be changed, capacity can be shifted (within Australia or between Australia and overseas). Older assets in the fleet can be retired sooner or later. But even this flexibility is limited in the face of a *global* economic slow down.

- Smaller businesses – local cafes & restaurants – may be even more flexible, especially in terms of employment. Part of their flexibility comes via adjustments in working hours and pay rates. Part comes via expansion (in good times) and closure (in bad times).

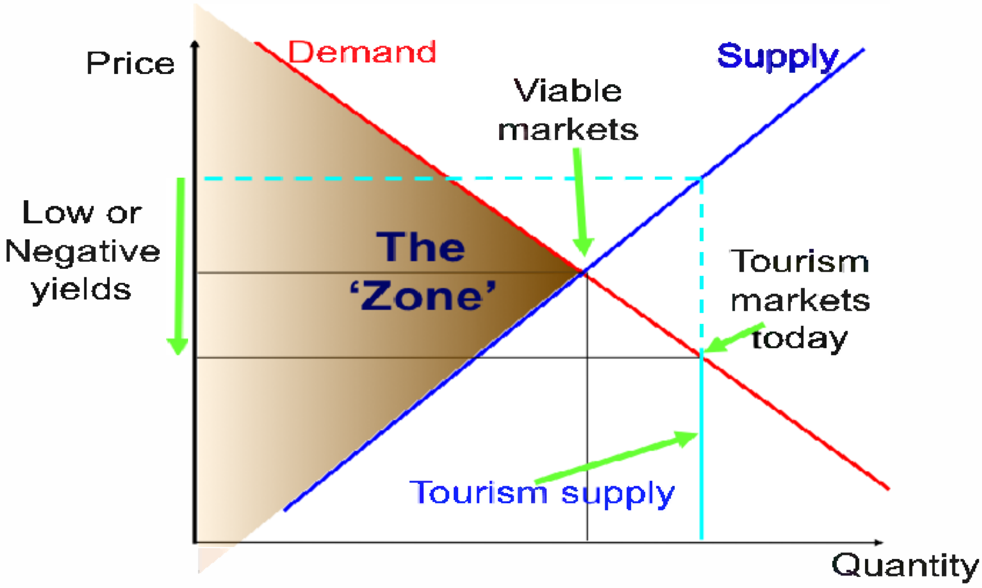
But for all parts of the tourism industry, getting the demand/supply balance right – and generating competitive investment yields is part of that – is essential for economic sustainability.

This is not rocket science – it’s ‘economics 101’. What follows is a bit more of that inexact ‘science’.

6.1 Realistic tourism expectations about demand-supply balance

The tourism market in the early 1990s – and probably until the last few years – could be summarised by the following diagram.

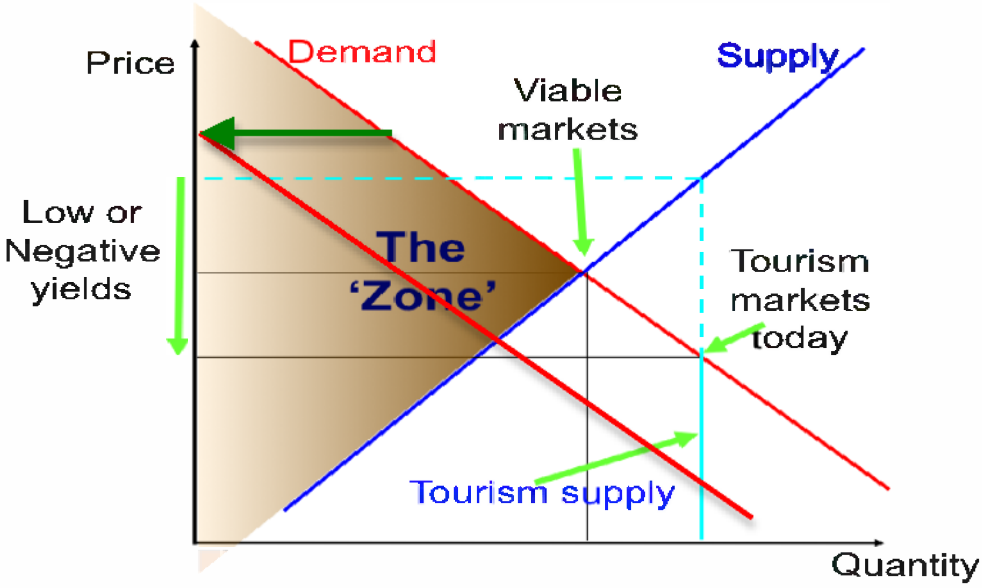
Diagram 6.1. Stylised tourism market in Australia



This sort of market requires a period where demand growth catches up with available supply – and supply stops expanding. This was happening, and in WA (especially in Perth?) the case for new investment in capacity was rapidly strengthening – until this year.

However, with a dramatically slowing world economy, the demand line in Diagram 6.1 can be expected to shift to the left, as shown in Diagram 6.2. This places downwards pressure on tourism industry yields as prices are forced down because available capacity sits higher above demand.

Diagram 6.2. Stylised tourism market in Australia as the world economy slumps



This is the sort of market shift we can expect. It will put downwards pressure on the viability of available supply in the tourism industry.

The message is clear.

Capacity expansion, as opposed to quality improvement, is really risky at the present time, whether we are talking about Australia or WA.

6.2 REALISTIC RETURN-ON-INVESTMENT EXPECTATIONS

The supply side of the tourism industry includes the following key sectors:

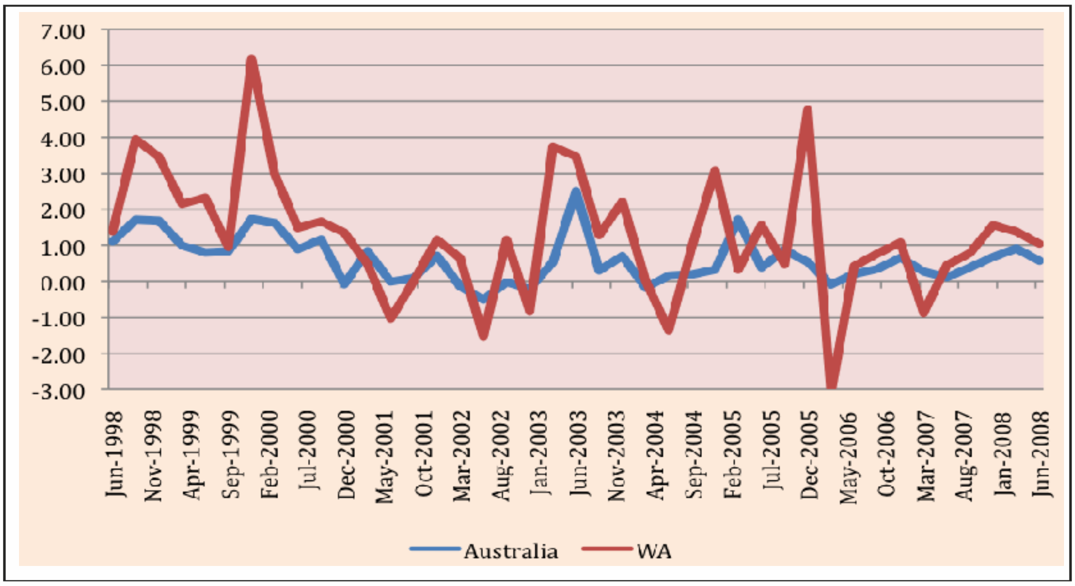
- Commercial accommodation.
- Cafes and restaurants.
- Commercial aviation.
- Other transport.
- Other (attractions, convention centres, package accumulators, etc.)

For some of these GCA can make some observations about current conditions and likely prospects.

Commercial accommodation

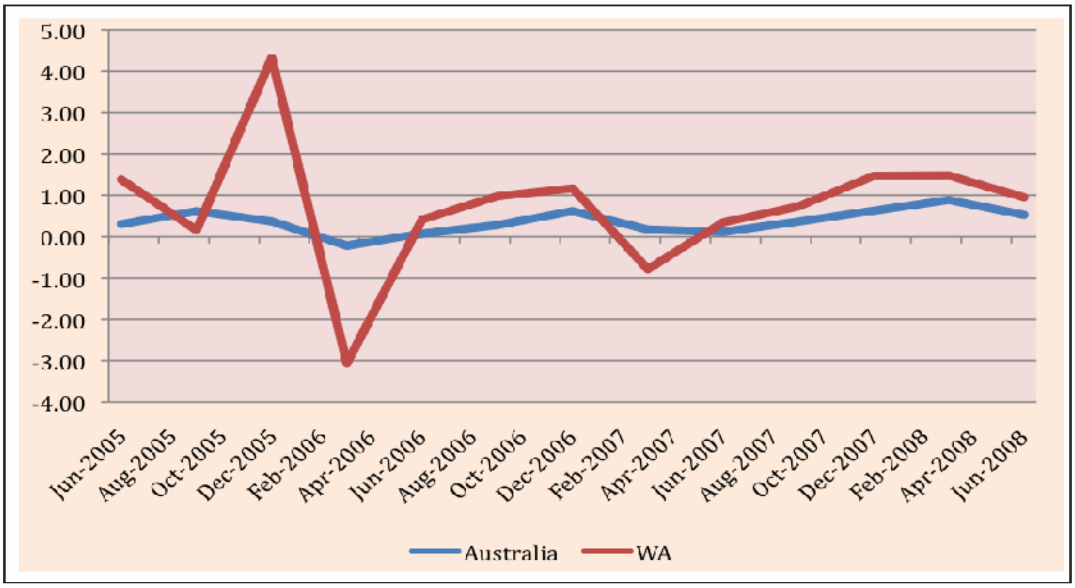
Based on ABS data up to the June quarter of 2008, commercial accommodation establishment capacity, as measured by rooms, has continued to grow.

Chart 6.1. Tourist accommodation: hotels, motels, serviced apartments with 15 rooms plus, percentage growth (quarter-on-quarter)



Source: *Tourist accomodation, Australia*, ABS Cat. No. 8635.0

Chart 6.2. Tourist accommodation: hotels, motels, serviced apartments with 5 rooms plus, percentage growth (quarter-on-quarter)



Source: *Tourist accomodation, Australia*, ABS Cat. No. 8635.0

As Charts 6.1 and 6.2 show, commercial room numbers have been growing over the past decade (establishments with 15+ rooms), or over the past three years (5+ rooms), with few interruptions.

If anything, growth in capacity has been a little stronger in WA than for Australia as a whole, especially recently. This is not surprising, given stronger demand pressures as measured by occupancy rates and growth in accommodation takings (see Tables 5.3 and 5.4 above).

But if demand turns down, as GCA expects, then occupancy rates for existing capacity will also ease, possibly especially in WA.

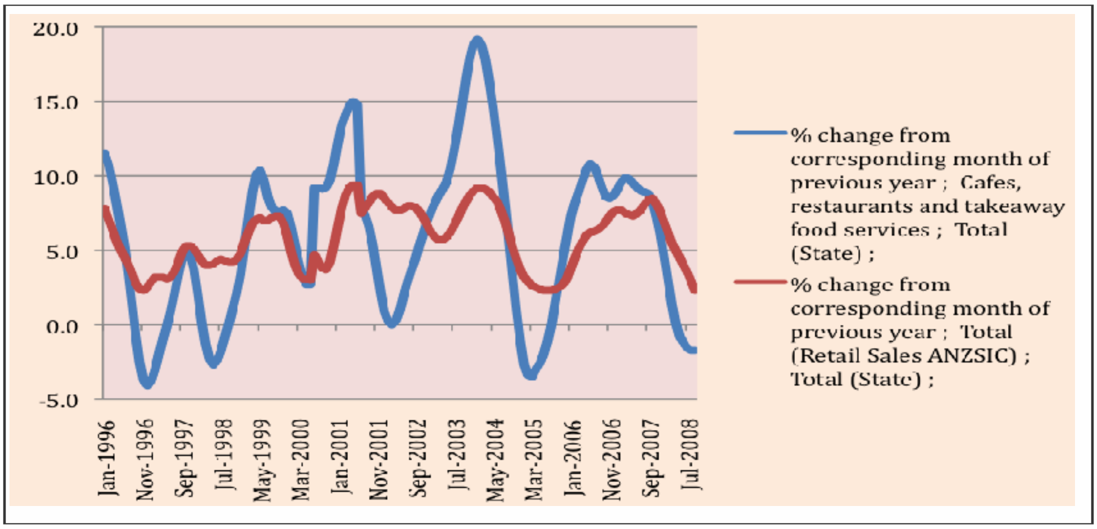
In part, and perhaps especially in Perth, this may be a welcome easing of pressure on capacity. But beyond a point it will reduce returns on investment in commercial accommodation, Australia-wide and in WA. *This part of the industry is probably the least flexible in terms of downwards adjustments*.

The coming year or more may not be a good time to consider new investment expanding commercial accommodation capacity in Australia in general or in WA in particular.

Cafes and restaurants

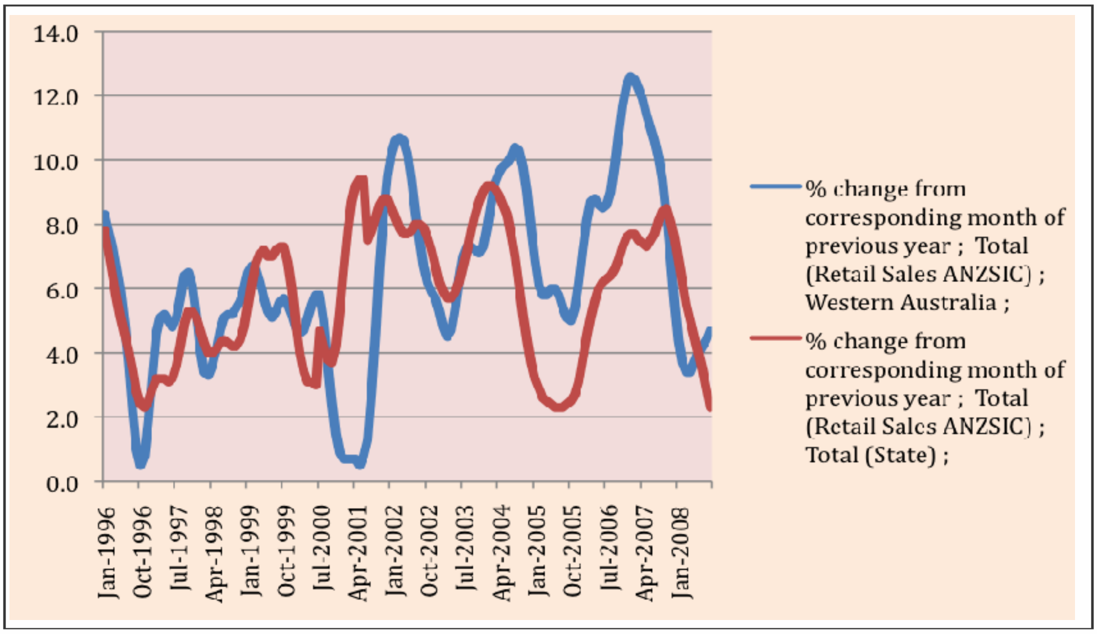
ABS retail trade data up to September 2008 shows falling sales values in recent months.

Chart 6.3. Retail sales trends, Australia: total retail sales; sales from cafes, restaurants and takeaway food services (%change on year earlier)



Source: *Retail trade trends, Australia*, ABS Cat. No. 8501.0

Chart 6.4. Retail sales trends, Australia: total retail sales, Australia and Western Australia (%change on year earlier)



Source: *Retail trade trends, Australia*, ABS Cat. No. 8501.0

As Charts 6.3 and 6.4 show, while retail trade is obviously fairly volatile in terms of fluctuating growth rates, in recent months:

- Sales value growth has dropped sharply for total Australian retail sales, but even more so for cafes, restaurants and takeaway food services, which have been *contracting* in dollar value terms in the five months to September 2008.
- The size of the decline has been larger for total retail sales in WA than in Australia, albeit from higher growth rates earlier in 2007.
- Not all of this can be attributable to tourism demand, of course, but the decline is consistent with the view that discretionary spending (of which tourism is a part) is likely to be most affected by the expected economic slowdown.

Given that we were still very much in the early days of the downturn in September 2008, the sharpness of the growth slowdown is of concern as a harbinger of much worse to come.

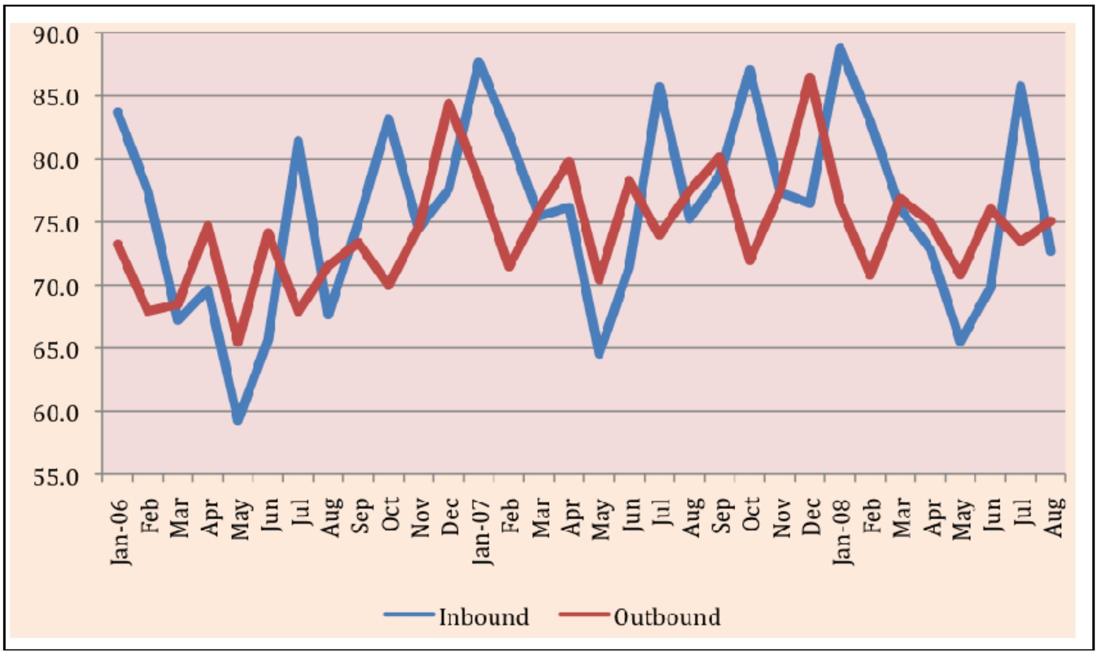
The coming year or more may not be a good time to consider new investment expanding capacity in cafes, restaurants and takeaway food services in Australia in general or in WA in particular.

Commercial aviation

Chart 6.5 below provides one indication of capacity utilisation for international aviation to and from Australia (inbound and outbound travel) from June 2006 to August 2008. This measure is dominated by short term travel. The main features are:

- Inbound seat utilisation has dropped recently, but it's hard to separate seasonal from other effects.
- Outbound seat utilisation is holding at levels established by end-2007.
- It's probably too early to be definitive on international aviation effects, although the drop in inbound seat utilisation might be suggestive of the early effect of overseas recession/slowdown.

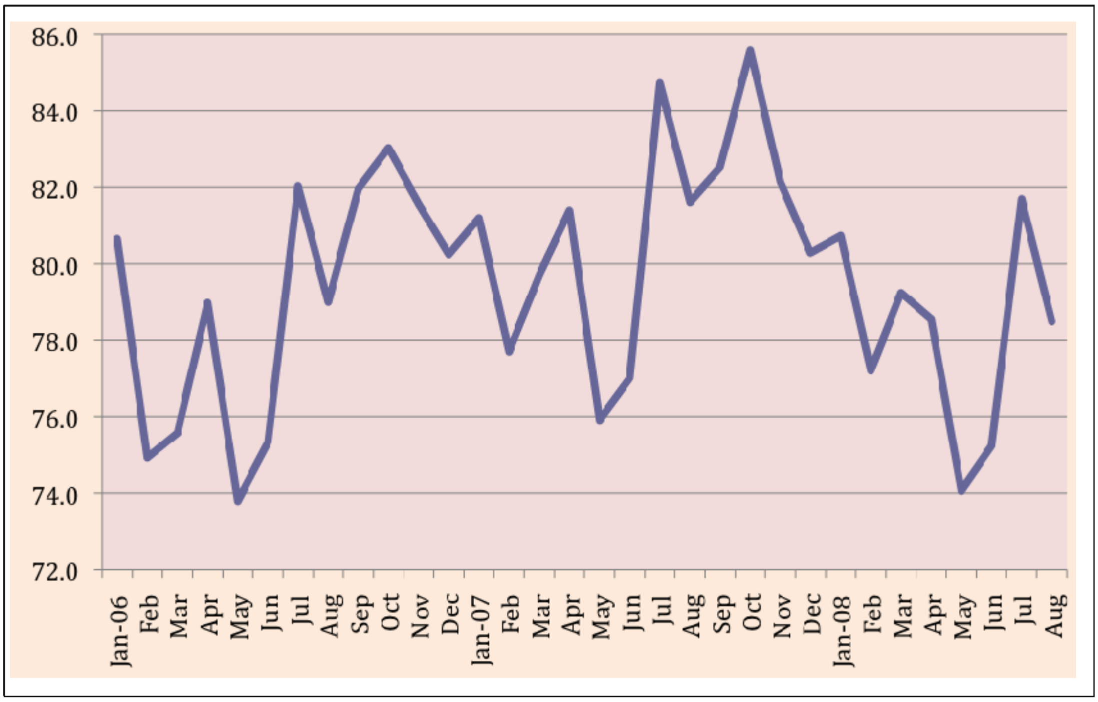
Chart 6.5. Seat utilisation (%), International aviation



Source: *Transport & regional economics, monthly international airline performance*, Department of Infrastructure, Transport, Regional Development and Local Government.

Chart 6.6 below presents the corresponding picture for domestic aviation.

Chart 6.6. Seat utilisation (%), domestic aviation



Source: *Transport & regional economics, monthly international airline performance*, Department of Infrastructure, Transport, Regional Development and Local Government.

It's hard to tell from the data available (to August 2008) whether or not load factors are declining, but the trend from the second half of 2007 is suggestive of some easing of demand relative to capacity.

The anecdotal evidence about aviation – international and domestic – is sombre:

- Overseas, airlines are going into receivership, 'Chapter 11' status in the USA, or consolidation and takeover arrangements, as they confront the slowing world economy
- Domestically, some regional routes have been cut, and staff layoffs are beginning to replace earlier periods where there was a pilot shortage.
- Major carriers have signed on to major longer term fleet upgrades (the Airbus A380 and Boeing 787 are featured aircraft). This capacity expansion has generated media talk about earlier retirement of older fleet assets as a capacity adjustment.
- Airline share prices have not been star performers lately
- Lower oil prices will help, but falling demand may well dominate.

The coming year or more may not be a good time to consider new investment expanding capacity in commercial aviation anywhere around the world. Industry consolidation, route rationalisation, and staff reductions seem the main items on aviation business agendas.

6.3 REALISTIC INVESTMENT AVENUES

The foregoing discussion suggests capacity expansion is not likely to be a good investment proposition for the next year or so. In some cases, contraction of currently available capacity may be needed. Where that is difficult to effect, existing businesses will have to 'sweat out' a period of low returns.

This may well be the case for accommodation, cafes and restaurants, convention centres, existing attractions, commercial aviation and the like.

This is not to say there is no case for new investment. It *is* to suggest that such investment should be confined to depreciation repair and quality upgrades, without expanding capacity. Targeting hi-yield tourism business means having high quality facilities to cater for such customers.

7. SUSTAINABLE TOURISM

There are at least two notions of 'sustainable tourism':

- The first is economically viable tourism, where all businesses involved in supplying goods and services to travellers operate with sufficient profitability to justify the investment of scarce resources in the products required, to ensure viable employment and training and careers for those working in the businesses, and, as well, meet that part of tourism demand able to pay the prices required to make supply financially viable.
- The second takes a wider view of resource availability and renewability, and seeks to extend the first notion to an inter-generational concept. This concept involves having a tourism industry operating so as to ensure that the same tourism related goods and services can be enjoyed by future generations as are enjoyed by the current generation.

The first of these concepts seems hard enough for the tourism industry in Australia to achieve for any length of time.

Demand is volatile and supply generally is not that flexible (absent layoffs and business closures) to adjust. The industry generally does not have a high reputation within the investment community. Required risk premia make 'hurdle' rates of return so high that savvy investors relatively rarely see good investment opportunities.

Arguably, in WA, conditions for new investment were building quite nicely until just a few months ago. Then the world economic boom suddenly went sharply into reverse, and the prospects for the next year (probably much more than that) now seem bleaker and bleaker.

Economically viable tourism is likely to recede as an achievable industry objective for a while.

Ironically, this period might be an opportune time to consider adapting the industry to the challenges of the longer-term requirements of inter-generationally sustainable tourism.

These challenges include:

- Resource conservation (especially for those resources fast running low).
- Environmental conservation (crucial for a country, much of whose appeal relates to its natural endowments).
- Climate change threats.

Some comments on each of these follow.

Resource conservation

Perhaps the best illustration here is oil supply. It may seem strange to be concerned about this when the price of oil has dropped from about $US150/bbl to $US50/bbl or less, and with some forecasts of $US40/bbl next year.

But there is good reason to be concerned about this in the tourism industry over the longer term:

- 'Peak oil' is a very real issue. How will the transport sector cope as oil prices rise in the longer term? How will mass tourism fare? Estimates vary, but we're either at 'peak oil' or will get there within a relatively few years.
- The current economic collapse has greatly reduced demand for oil, but when the recovery comes, and especially as China and India and the other BRICs resume strong growth, the pressure of demand against dwindling supplies will resume.
- Just as the oil price fell by two-thirds in a few months, it could easily quadruple (to $US200/bbl+) in a few years or less.

- Tourism is especially exposed to high oil prices, not least aviation.
- There are policy-related threats to oil prices and tourism services more generally as well, partly related to climate change (see below).

Environmental conservation

Mass tourism can inexorably damage and even destroy some of the natural attractions on which it depends.

Tourism tends to gravitate to resource-intensive, price competing, volume based tourism. This low yield emphasis is itself more likely to be both economically and environmentally unsustainable.

The strategy of moving up the customer yield curve is a logical consequence of being concerned about environmental conservation. A corollary is more rationing by price, not less.

- Minimising footprints on the ecology, for example by using access pricing as a rationing mechanism, is a path that the industry should consider. Chances are that governments increasingly will impose such rationing devices in sensitive areas anyway.
- While such initiatives have merit, they move the destination away from price-based competition towards more durability of attraction supply.
- There is a market for this type of supply, but it is likely to be a lower volume market – but with a higher destination yield.

Climate change threats

Climate change abatement policies might be placed on a slow track while the world economy slows, but presumably they will come back on the agenda as recovery occurs.

These policies also directly challenge the tourism industry, and –relative to the status quo – possibly disproportionately, especially via transport costs and for international tourism:

- The EU is already levying/threatening to levy charges ostensibly related to greenhouse gas emissions on flights into/out of member countries.
- The centrepiece of broad-based greenhouse gas abatement policies – whether delivered via an Emissions Trading Scheme (ETS) or, more simply, via a carbon tax – is to put a price on anthropogenic carbon emissions (including those from burning petroleum products such as diesel, petrol, avgas and avtur.
- Especially for aviation, finding substitutes for the last two is difficult *and current low oil prices greatly reduce the incentives to try, so that a sudden resurgence in oil prices could leave the aviation sector exposed, and with no choice but to pass the costs on to price-sensitive travellers*.
- Linked to the second point above, we could well see an unwinding of the 'special treatment' afforded international transportation under various international agreements (Warsaw Convention, Hague Convention, Carriage by Air Act) as a result of which such services are currently value added tax-free. Reversing these concessions will further increase the relative price of international transport.

What does all this mean?

It's hard to be precise, but GCA believes that these 'sustainable tourism' issues, both economic and inter-generational, point to a strategy of weaning the industry away from low cost, high volume mass tourism, and towards higher cost, lower volume, higher yield, more sustainable tourism.

As a relatively remote destination for many potential customers anyway, this strategy seems especially appropriate for Western Australia. In GCA's opinion, it is consistent with the yield maximisation focus of Tourism Western Australia as well.

8. CONCLUDING OBSERVATIONS

This is not an optimistic report.

It is perhaps the most down-beat report Geoff Carmody has prepared on tourism since he first began analysing tourism in 1984, despite the fact that, since that time, he has prepared reports covering, amongst other things:

- The 1989 Pilots' Dispute.
- The fall-out from September 11, 2001.
- The effects of the First Gulf War and the SARS threat.
- The 1997 Asian financial crisis.

However, GCA believes that the analysis is realistic. We are neither trying unduly to cheer the reader up, nor to be excessively pessimistic.

The essential points can be summarised as follows:

The economic & financial conjuncture

- The world economy is slowing sharply.
- Most, or all, of the developed Western world is either in, or about to enter, recession.
- Financial, business and consumer confidence has been shattered.
- Unemployment is rising sharply, businesses are collapsing, and investment and consumer spending is being reduced.
- Inflation is slowing rapidly, commodity prices have collapsed, and there is some talk of possible deflation.
- The $A has tumbled nearly 40% against the $US, and by nearly 30% more generally.
- Attempts to halt the economic slide by policy stimuli are having mixed results, so far.
- This recession may last some time – possibly all of 2009 and even beyond.
- The fall-out on China and India is not yet clear, but could be much worse than expected at present. These economies are slowing very rapidly already.

The implications for tourism generally

- Consumer spending generally is slowing (or falling) faster than overall economic output.
- Tourism spending, as part of discretionary consumer spending, can be expected to slow (or fall) even more than consumer spending on average.
- The reduction in peoples' wealth, slowing or falling incomes, rising unemployment, and shattered consumer confidence, can be expected to be a powerful negative influence on tourism spending.
- World tourism spending is likely to slow, and, given the weighting applicable to Western economy tourism spending, could well contract, even in nominal dollar terms.
- The falling price of oil is a partial offset, but this fall is a reflection of, and induced by, the slowing in aggregate demand. It will nowhere near counteract the drag of lower demand and output on tourism spending.

- Early signs of a tourism demand downturn may already be appearing in the latest available inbound visitor numbers statistics for September 2008.

The implications for tourism in Australia

- In Australia, too, we can expect consumer spending generally to slowing (or falling) faster than overall economic output. As to the latter, recession cannot be ruled out.
- Unemployment will increase.
- Accordingly, a downturn in Australian tourism spending – even a contraction in nominal dollar terms – is quite possible.
- This applies to (i) inbound tourism, (ii) outbound tourism, and (iii) domestic tourism.
- The fall in the $A will help, but only partially, to buffer Australian tourism.
- On the other hand, the fall in the value of the $A has also reduced the fall in the price of oil in $A terms, reducing transport system benefits from lower world oil prices.
- It is too early to discern anything like the full fall-out from the global economic collapse from available official statistics.

The implications for tourism in Western Australia

- In Western Australia, too, we can expect consumer spending generally to slowing (or falling) faster than overall economic output. As to the latter, recession cannot be ruled out.
- Western Australia was the biggest beneficiary of the commodities boom and burgeoning growth in China, and the rest of the world. Symmetry would suggest that Western Australia is therefore likely to be hit hardest within Australia by the collapse in commodity prices and slower growth in China and more generally.
- Accordingly, a downturn in Western Australian tourism spending – even a contraction in nominal dollar terms – is quite possible.
- This applies to (i) inbound tourism, (ii) outbound tourism, (iii) interstate tourism, and (iv) intrastate tourism.
- To a point, this would ease pressure on capacity in Western Australia (especially in Perth). But it seems likely that the tourism demand downturn will go beyond that point, lowering yields for tourism related businesses in Western Australia.

Appropriate tourism investment strategy

- The short investment message is simple.
- If thinking about expanding tourism capacity in Australia, or in Western Australia: *don't*.
- If thinking about maintaining or improving the quality of existing capacity to move up the yield curve, that's worth seriously considering.
- More generally, where there is a good case for governments getting involved in investment – such as in improving and extending needed transport system infrastructure (a crucial element in Western Australia) – then governments can and should get involved, including with Commonwealth Government financial support. The key here is to improve the productivity of the Australian (and Western Australian) infrastructure system.
- More generally, public sector investment in 'community infrastructure' may have both counter-cyclical and longer term merits in the current and prospective environment, provided its social return justifies the use of taxpayer funds involved.

Appropriate tourism marketing strategy

- Forget setting absolute tourism performance marketing targets: marketing is not the only determinant of such performance anyway. Unless you do, National and State Tourism Organisations will get blamed for failure that probably wasn't marketing's fault.

- To be sure, marketing is important and useful, but it will be swamped by the huge adverse forces now building. (it *will* need more Government funding to compete in a much tougher environment.)

- Consider maintaining or increasing WA's ***share*** of total tourism spending in Australia as an appropriate target, perhaps with a particular emphasis on high-yielding tourism.

- Market share benchmarks mean that the focus is (or should be) on out-resourcing and out-performing other States & Territories. Whether or not this is feasible will depend on the WA Budget situation and WA Government Budget priorities (as well as industry support).

- As a relatively remote destination for many potential customers anyway, this strategy seems especially appropriate for Western Australia, especially in a sustainable tourism yield maximisation sense over time. In GCA's opinion, it is consistent with the yield maximisation focus of Tourism Western Australia as well.