



making business sense

Will the UK consumer be able to afford to travel?

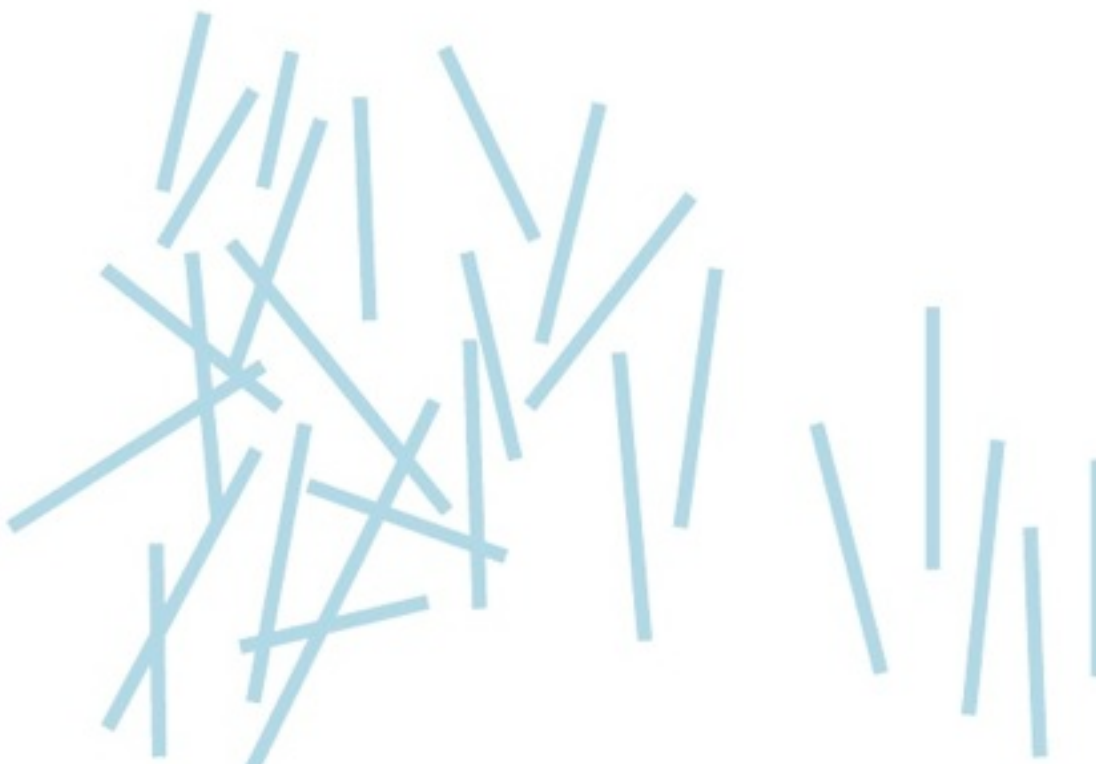
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5 October 2011

Objectives

- To look at how the changing world will affect UK consumer patterns and travel spending



Outline

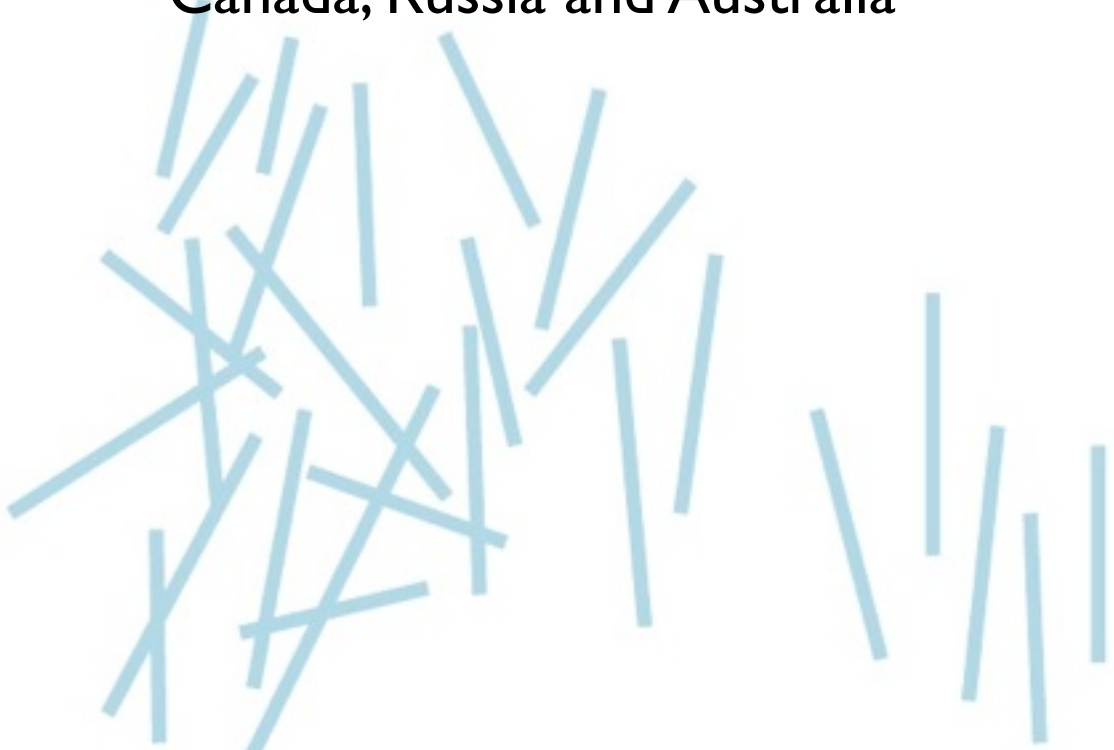
- **A multispeed world**
- **New spending patterns**
- **A squeeze on household incomes**
- **Currencies are going to adjust**
- **So what does this mean for travel?**

The six big shifts

- The East grows, the West falls back
- The real price of primary commodities like energy, minerals and food rises – inflation becomes increasingly a commodity price based phenomenon
- World growth becomes much more volatile
- It's a good time to be a capitalist – in the East you will benefit from growth, in the West from cheaper labour
- While Westerners who are used to a high standard of living by global standards will find this increasingly hard to sustain as wages are squeezed while commodity prices push up inflation
- The world's wealth is moving towards countries which traditionally have high savings - while debt will restrain borrowing in the older economies – does this produce a growth problem?

The winners

- Not only the emerging economies like India and China
- But even more so, the commodity economies like Brazil, Canada, Russia and Australia

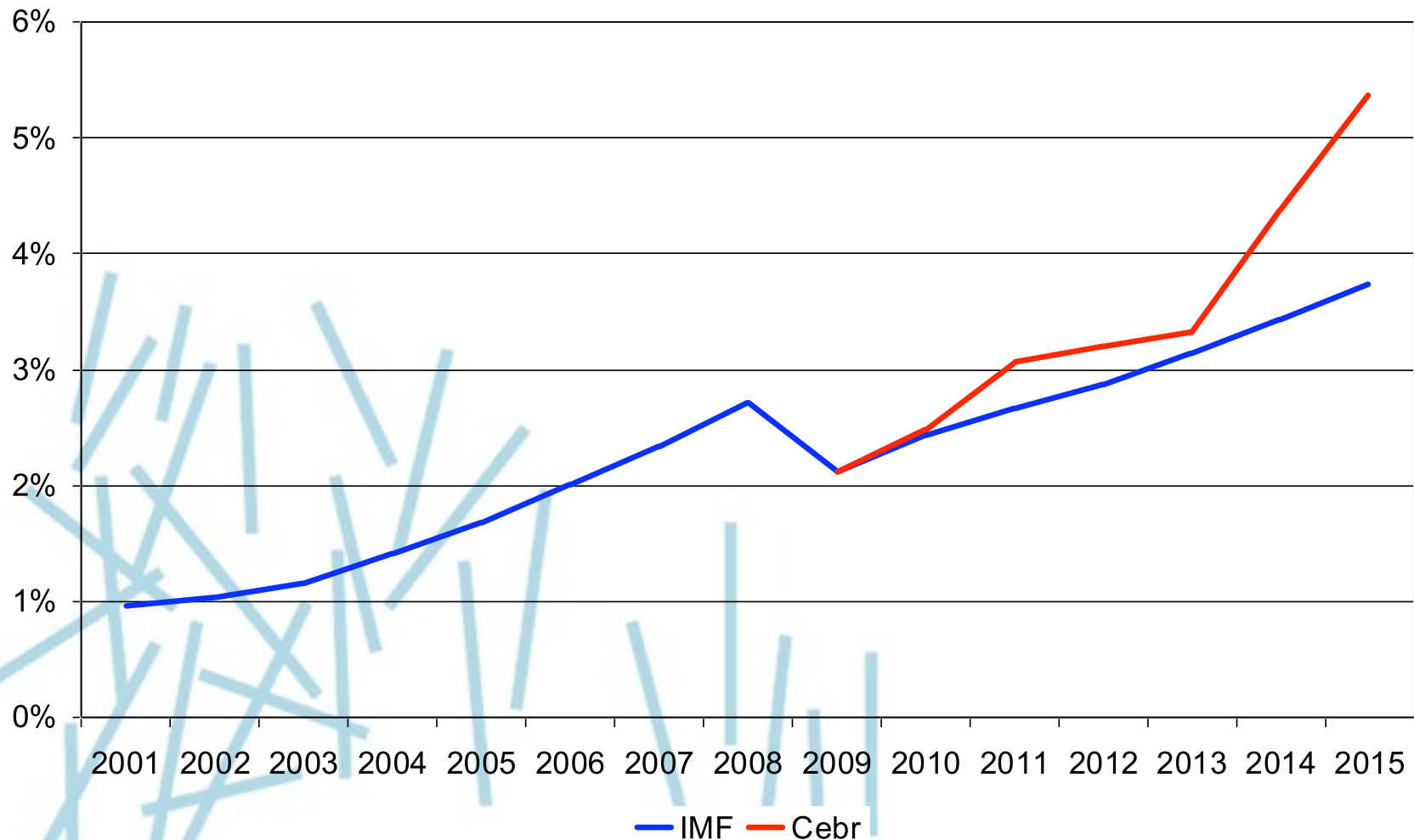


Russian position in the world economic league table (according to the IMF)

Year	1992	1997	2000	2009	2015
GDP \$ billions	86	405	260	1229	3061
Position	35	16	19	13	6
Countries with similar GDP	Poland Thailand Hong Kong	India Australia Holland	Argentina Turkey Switzerland	India Canada Spain	Germany France

...and the Cebr forecast is even higher than the IMF forecast

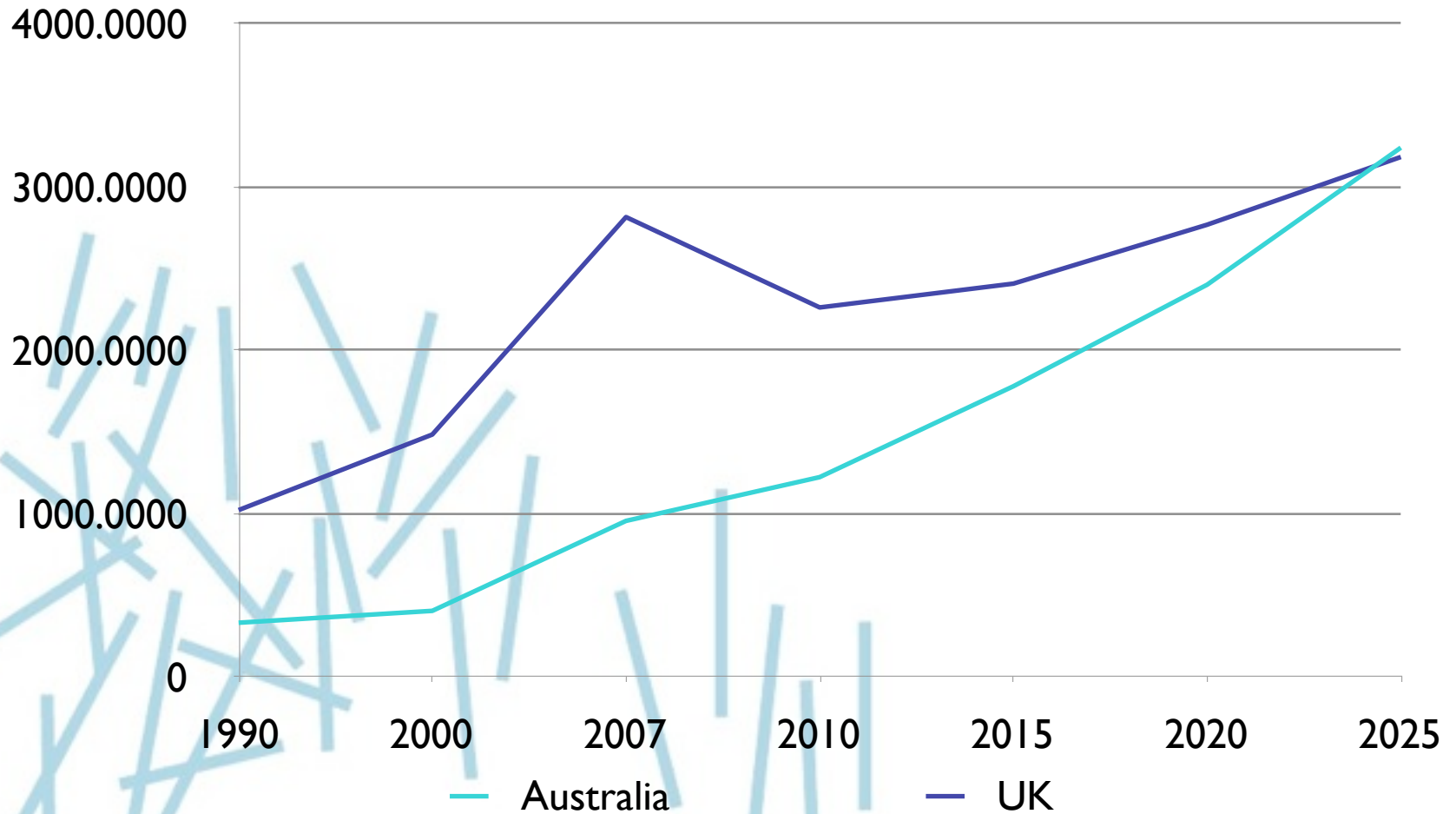
Russian GDP as %age of world GDP at nominal prices



Source: IMF World Economic Outlook Oct 2010, Cebr Global Economic Prospects August 2011

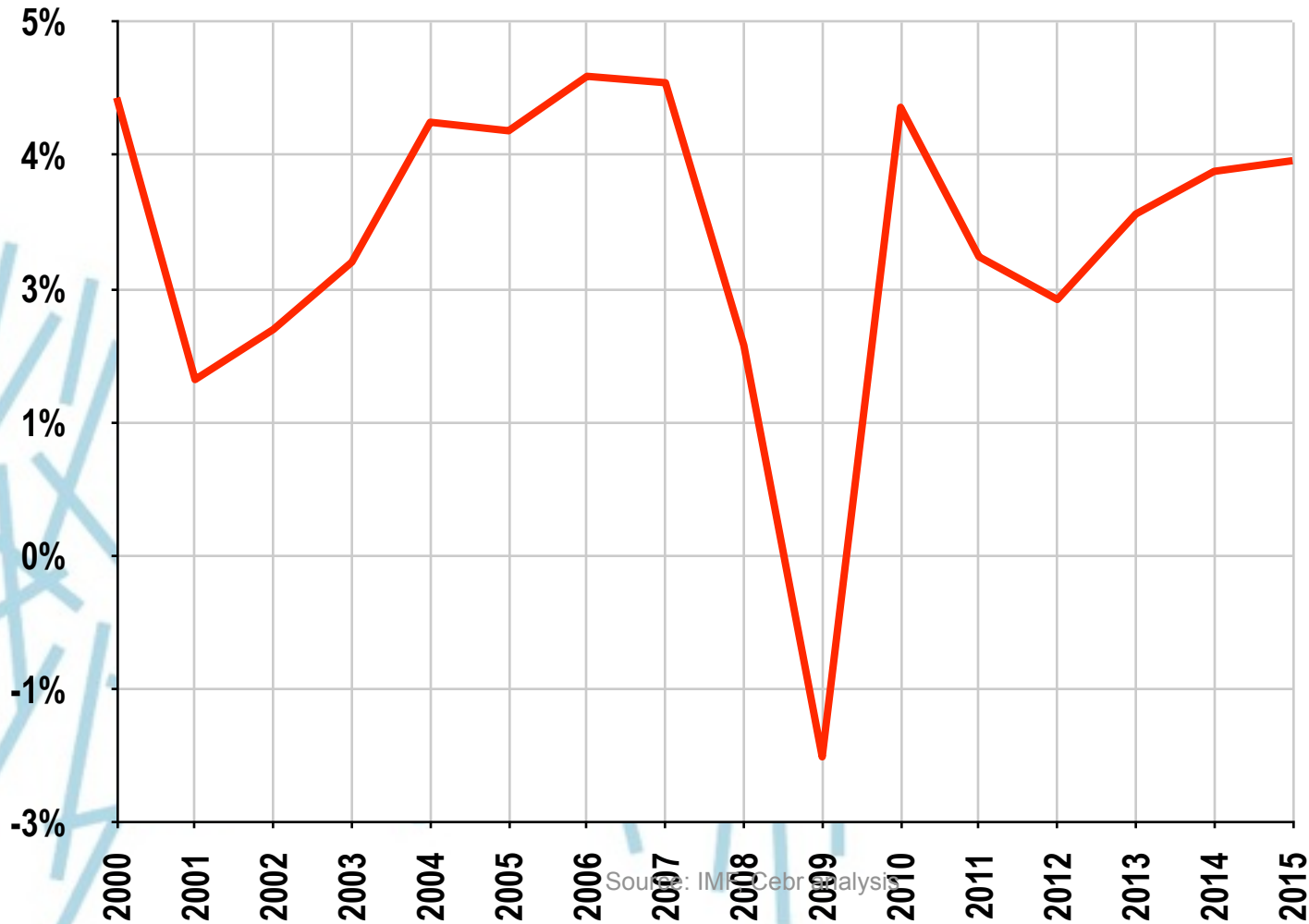
By 2025, the Australian economy is likely to have caught up with

GDP in \$ billion



We now look to be in a world mini-cycle

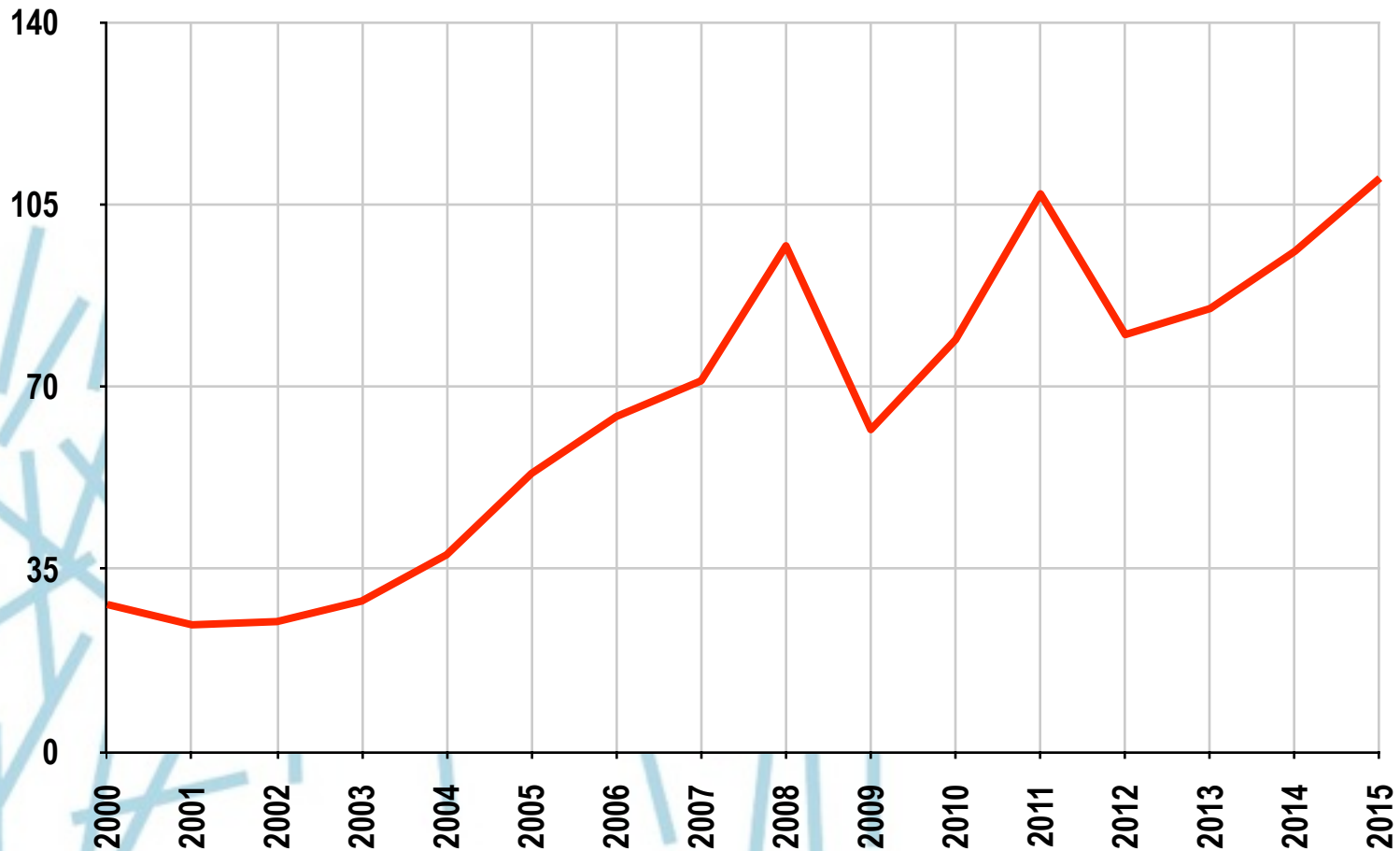
World real GDP growth, annual percentage change



Source: IMF, Cebr analysis

Oil to average around \$80 next year, before gradual recovery but is likely to hit \$200 in this decade

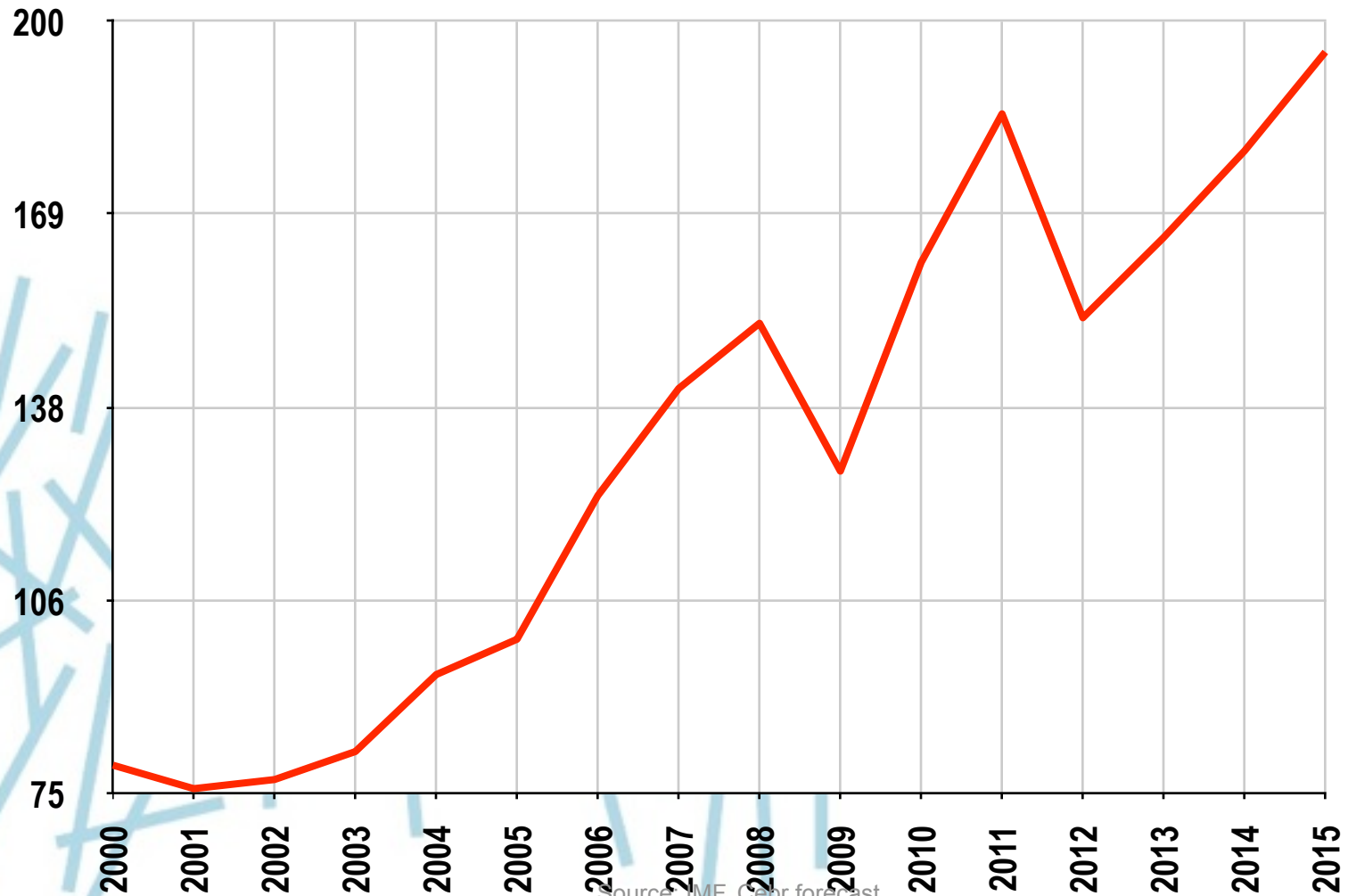
Average of Brent, WTI & Dubai Fateh crude oil spot price, \$/barrel, average across calendar year



Source: IMF, Cebr forecast

Commodity prices to correct before recovering

IMF non-fuel commodity price index (2005=100)



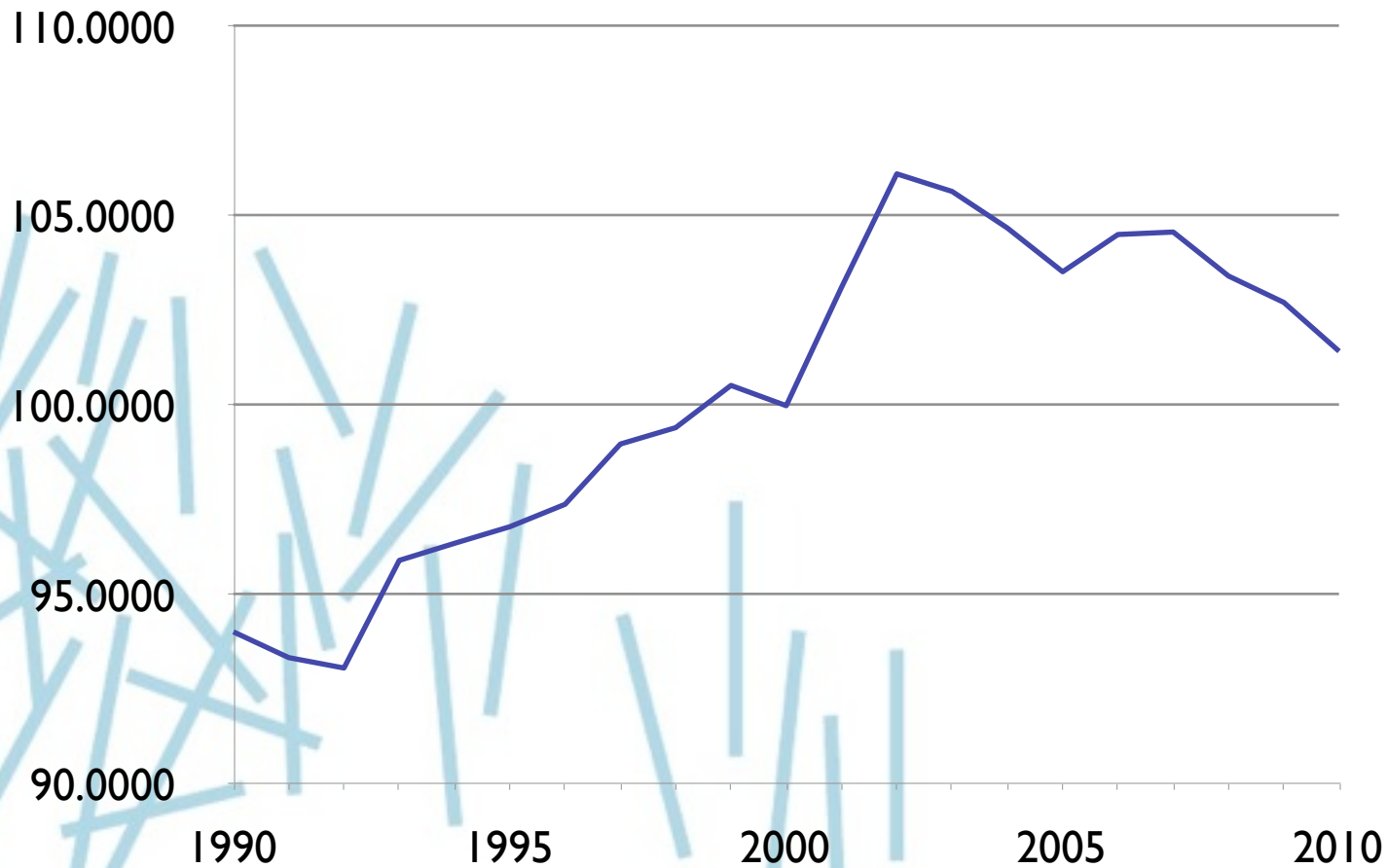
Source: IMF, Cebr forecast

The new paradigm

- More sluggish growth in economic activity generally
- Depressed real income growth in countries like the UK which have traditionally sustained much higher real incomes than those in emerging economies
- Increased use of IT and other solutions to enhance productivity and reduce cost.
- Rising real costs of materials and energy leading to changing consumption patterns away from energy intensive uses. One of these energy intensive areas where consumption is likely to grow more slowly is transport.
- Some reductions in hours worked and an increasing unwillingness to spend time and effort in difficult and stressful activities

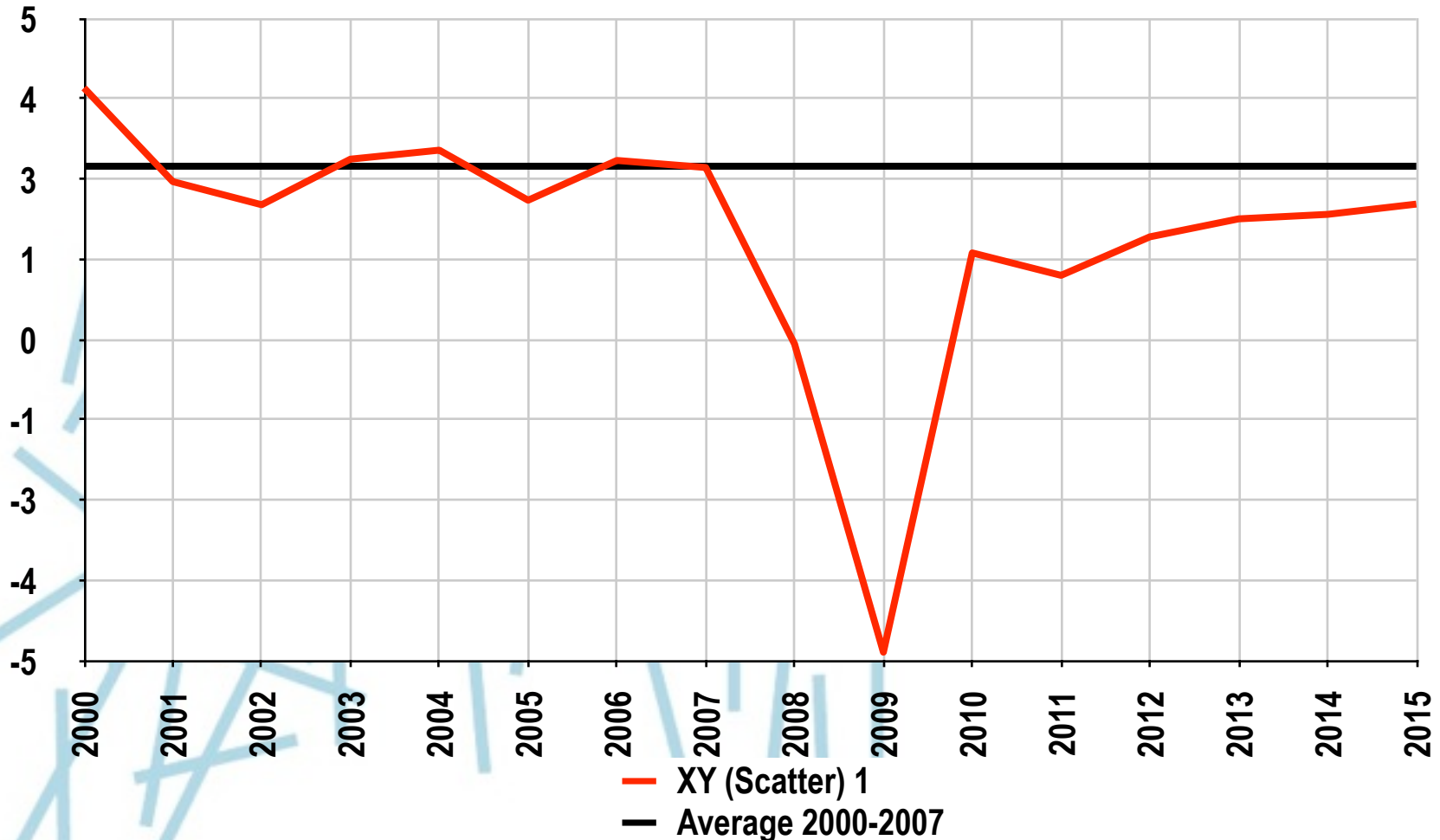
People are not travelling as much as they once did

Index of annual distance travelled by British people per capita per year – 2000 = 100



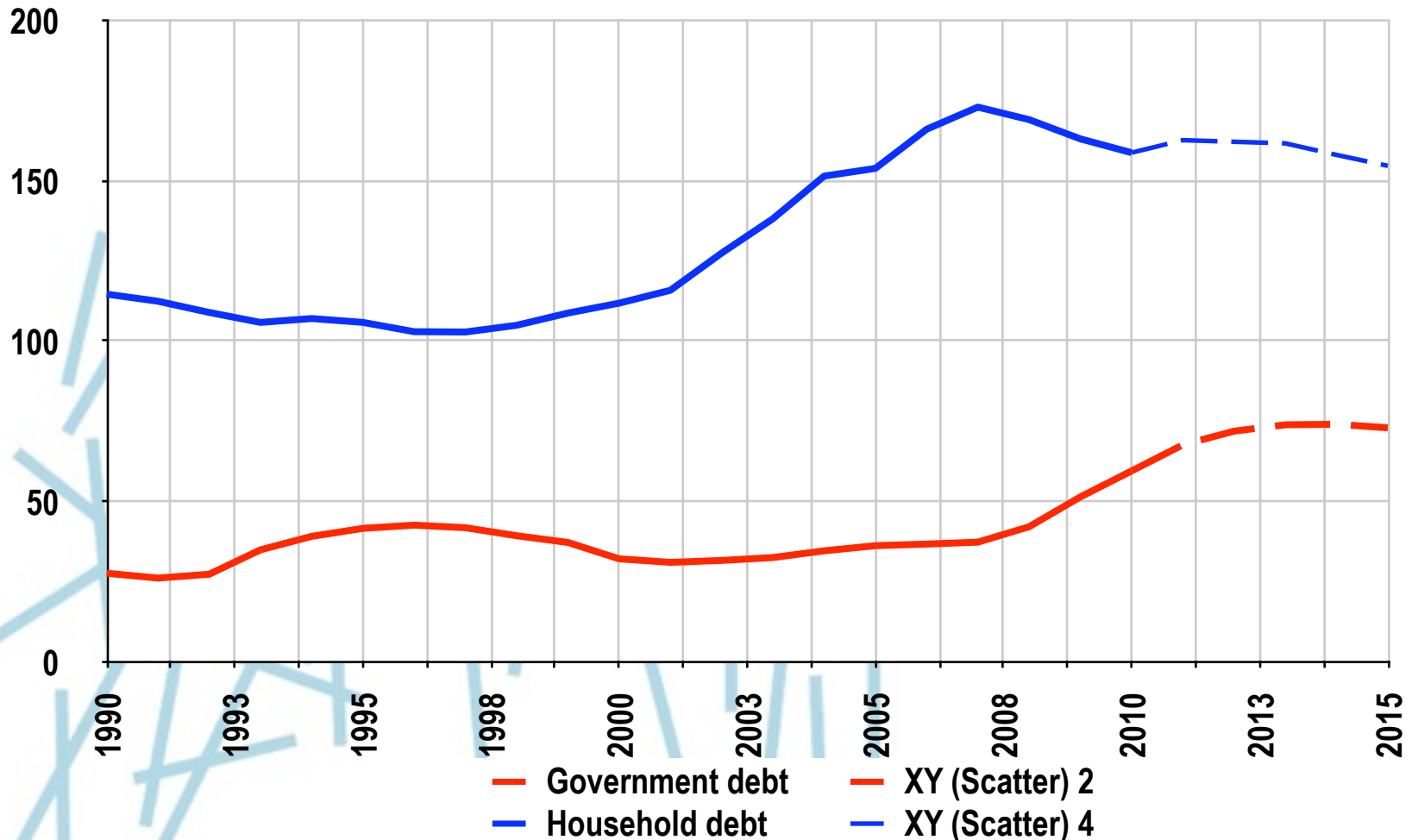
Following the financial crisis, we expect a sustained period of weak growth in the UK

UK real gross domestic product, annual percentage change



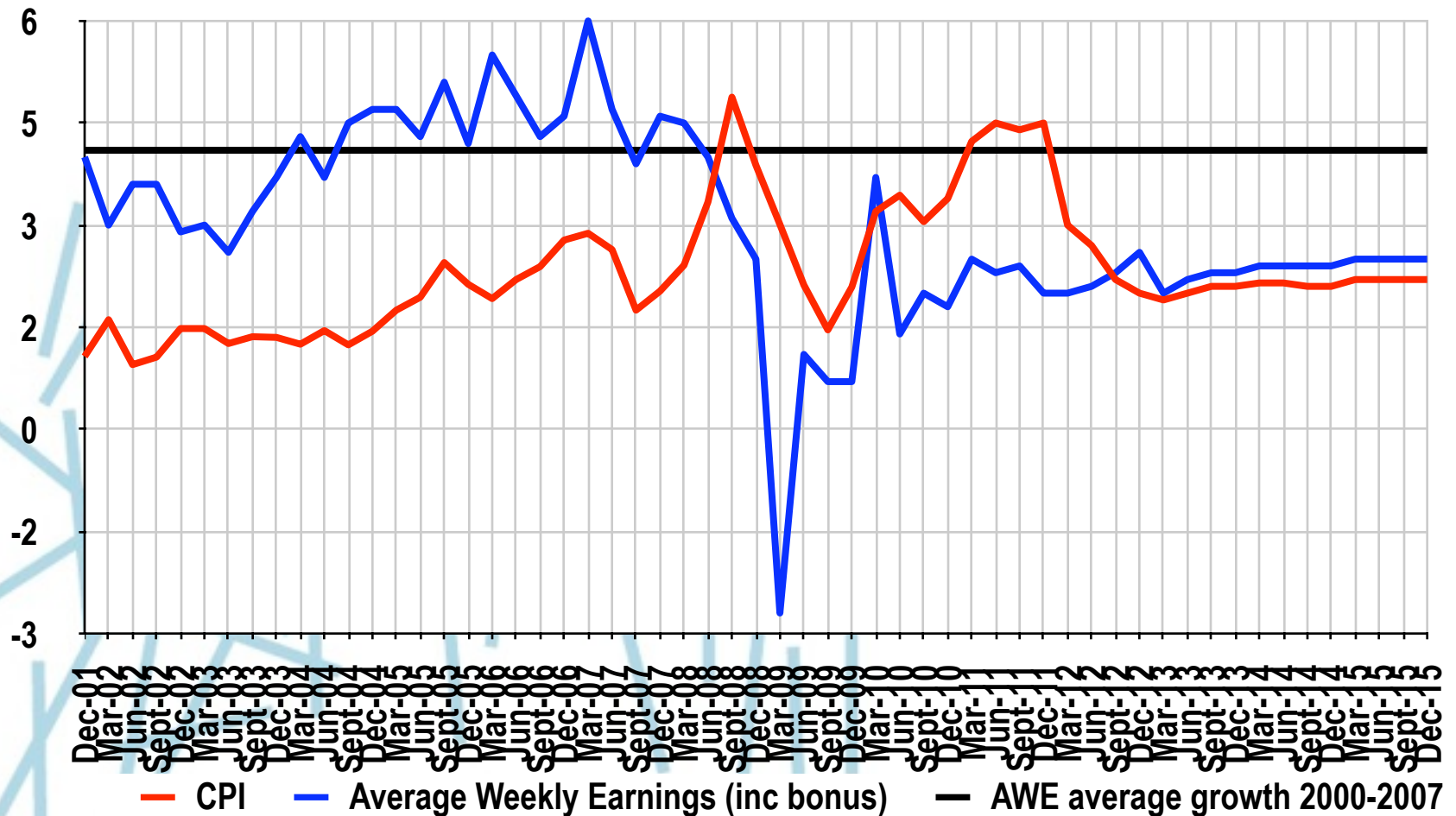
We enjoyed an unsustainable boom, driven by debt

Household and government debt as a share of GDP



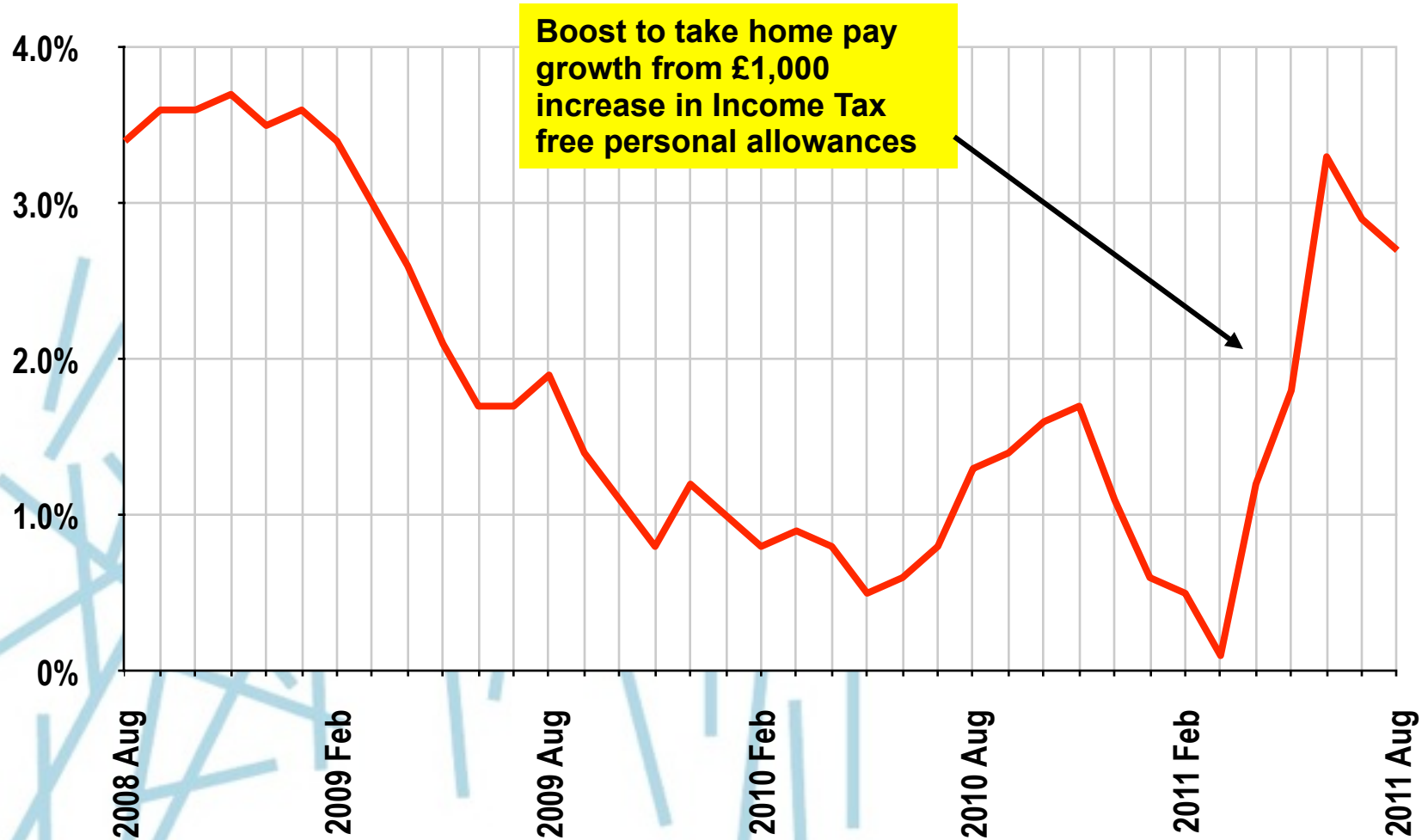
Earnings growth is trailing behind inflation

CPI and earnings growth (including bonuses), annual percentage change



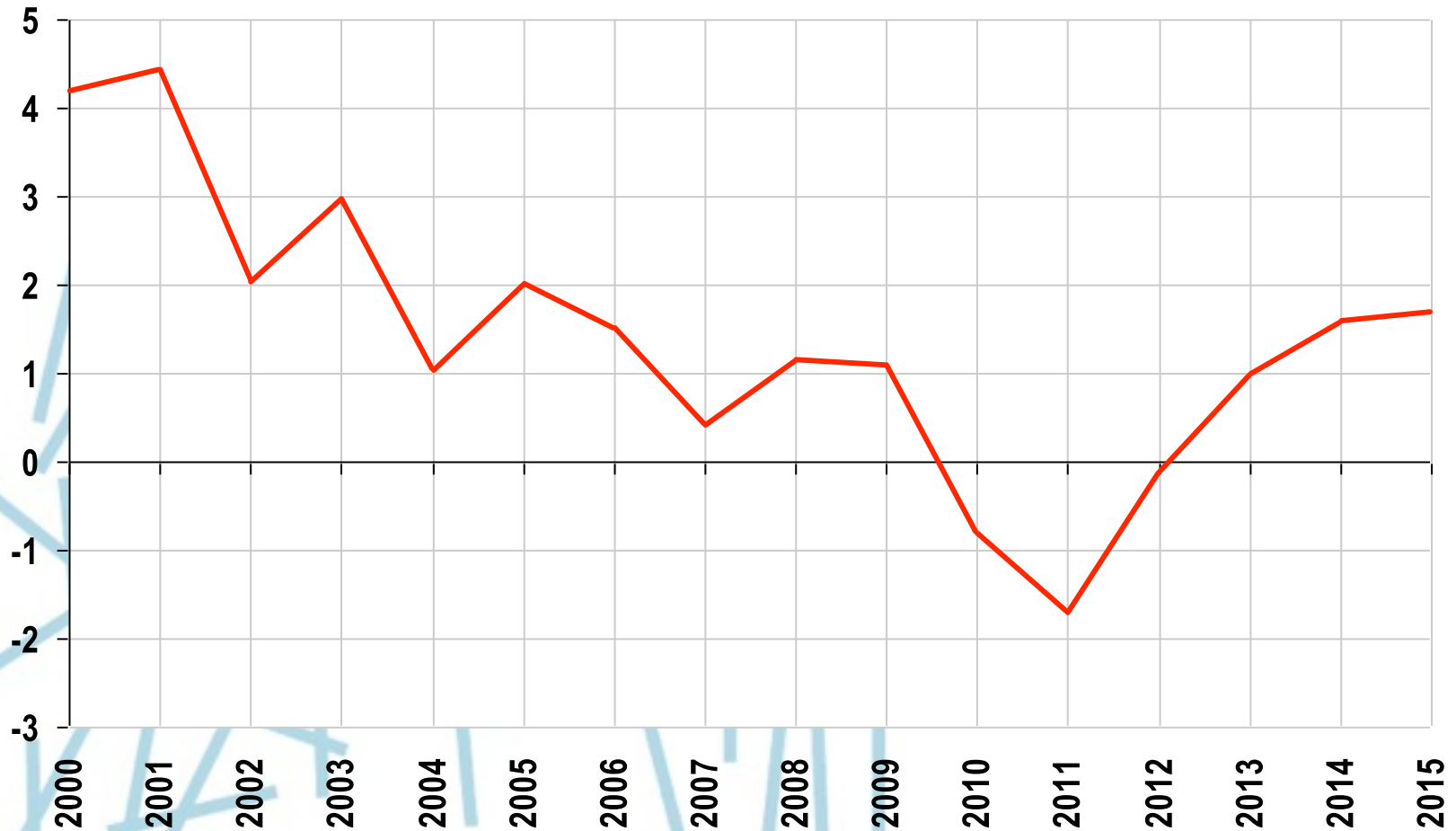
Rising personal allowances will provide some respite for low-to-

VocaLink FTSE 350 Take Home Pay Index, annual % change



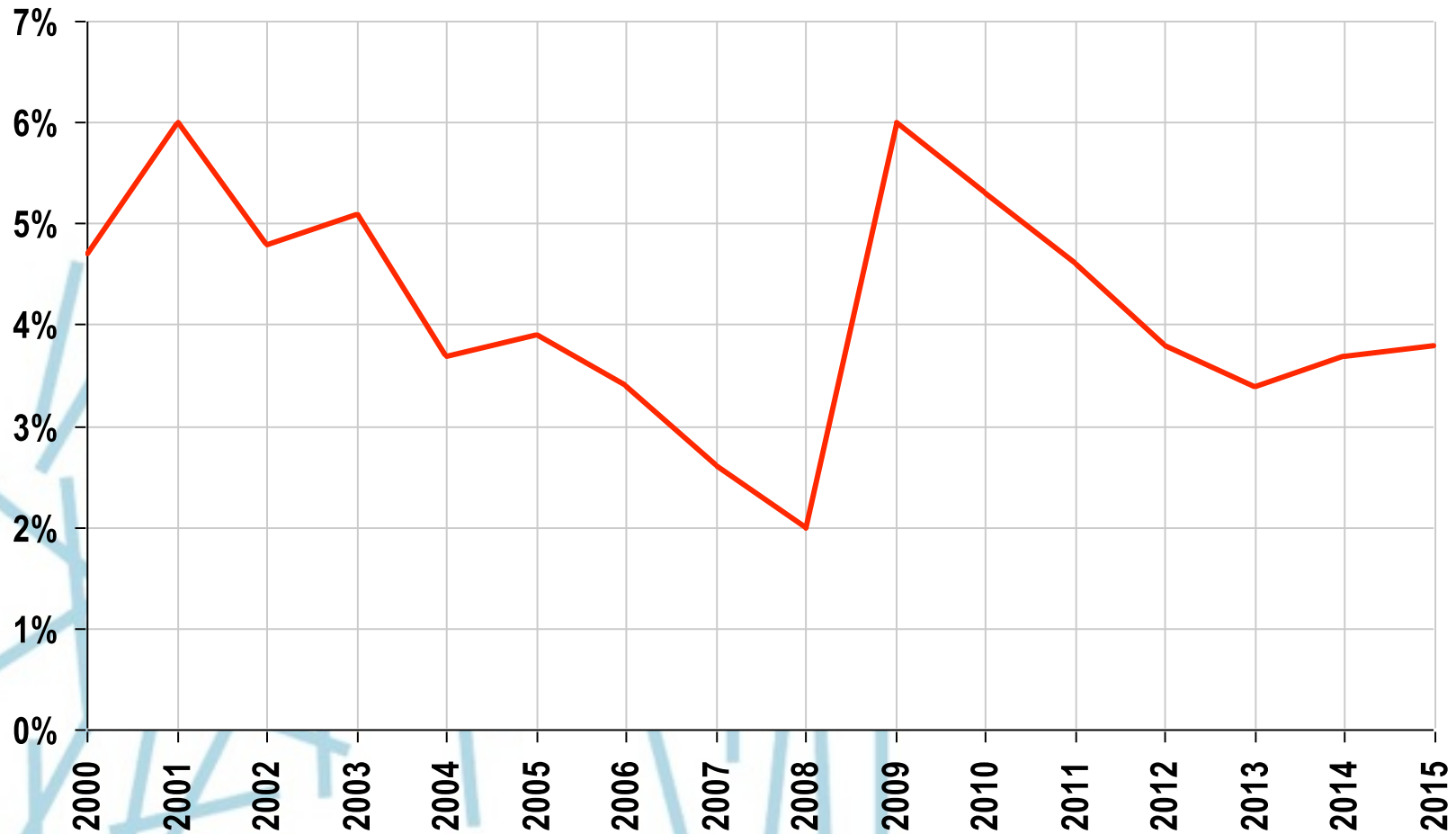
Overall real incomes will fall this year and be broadly flat in 2012

Real household disposable incomes, annual % change



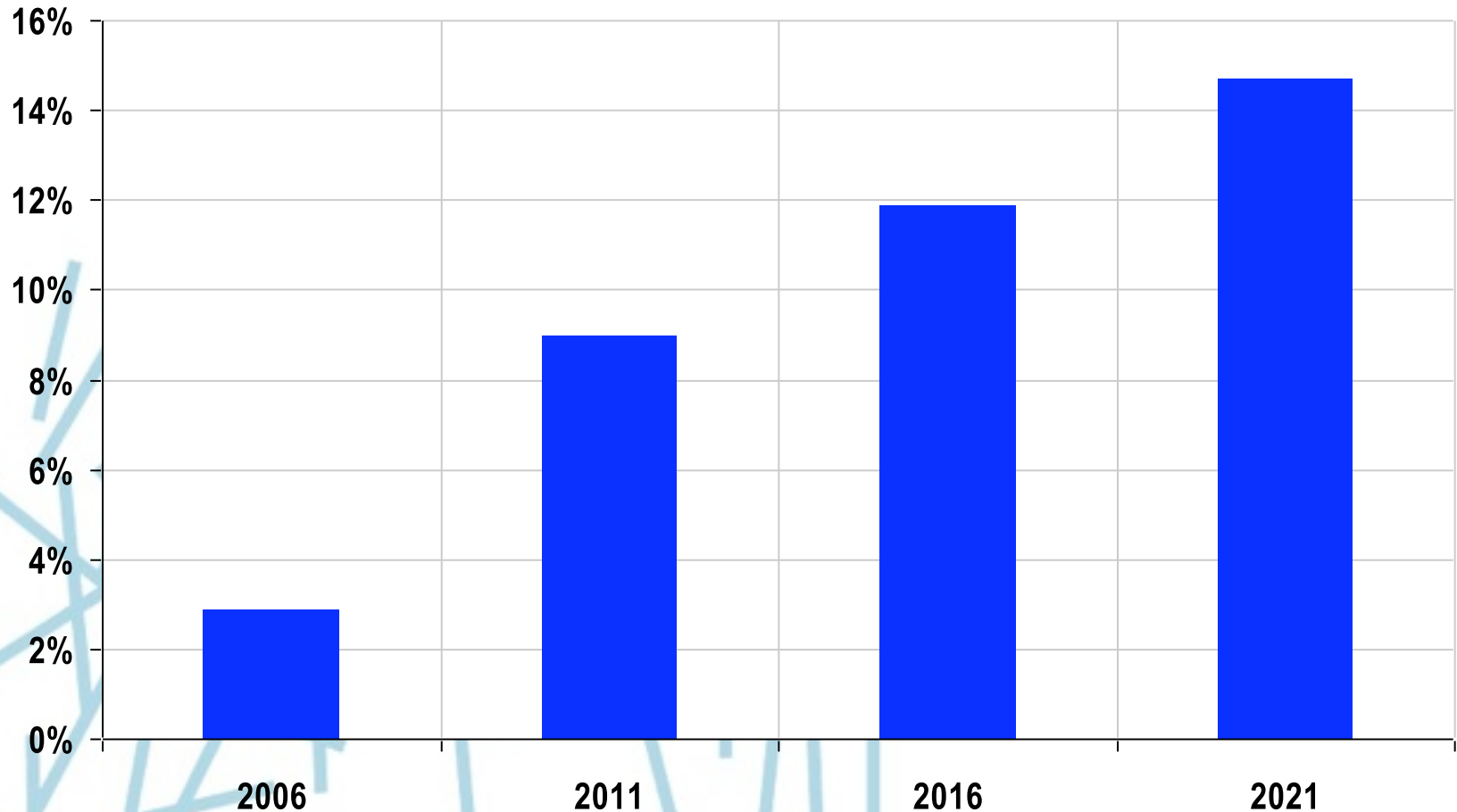
The savings ratio will decline as households try to maintain their

Household savings ratio



Internet retail sales to grow by 63% over the next ten years

% of total retail sales via the internet

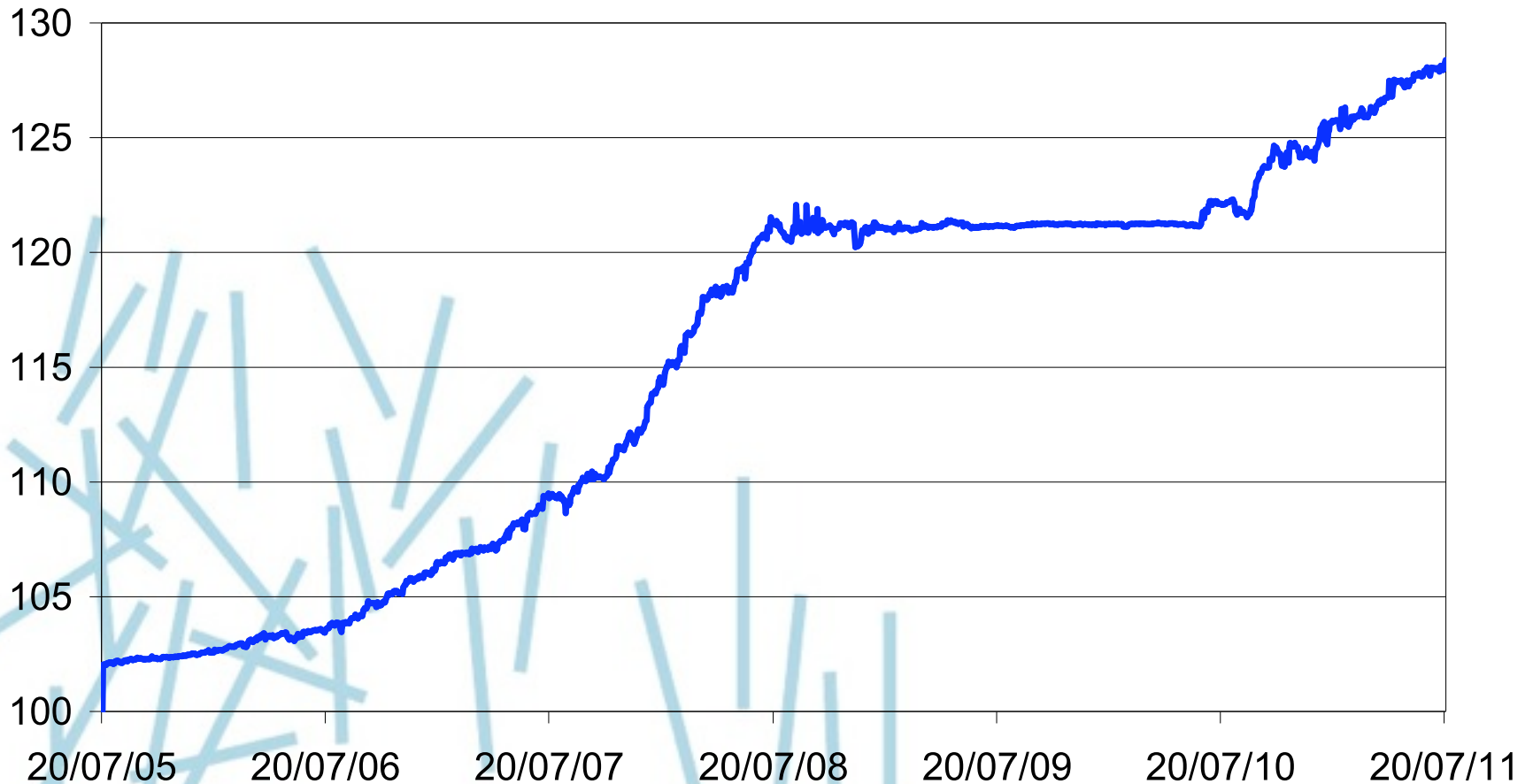


Currencies are going to adjust sharply over the next ten years

- Emerging economy currencies will stop being as undervalued
- Commodity currencies will rise with the real value of their underlying commodities
- The Euro is unlikely to survive in its current format
- Western currencies will fall in real terms relative to those in the East
- Part of the Osbourne recovery plan is to keep sterling weak and possibly let it fall further

The Chinese are revaluing gradually

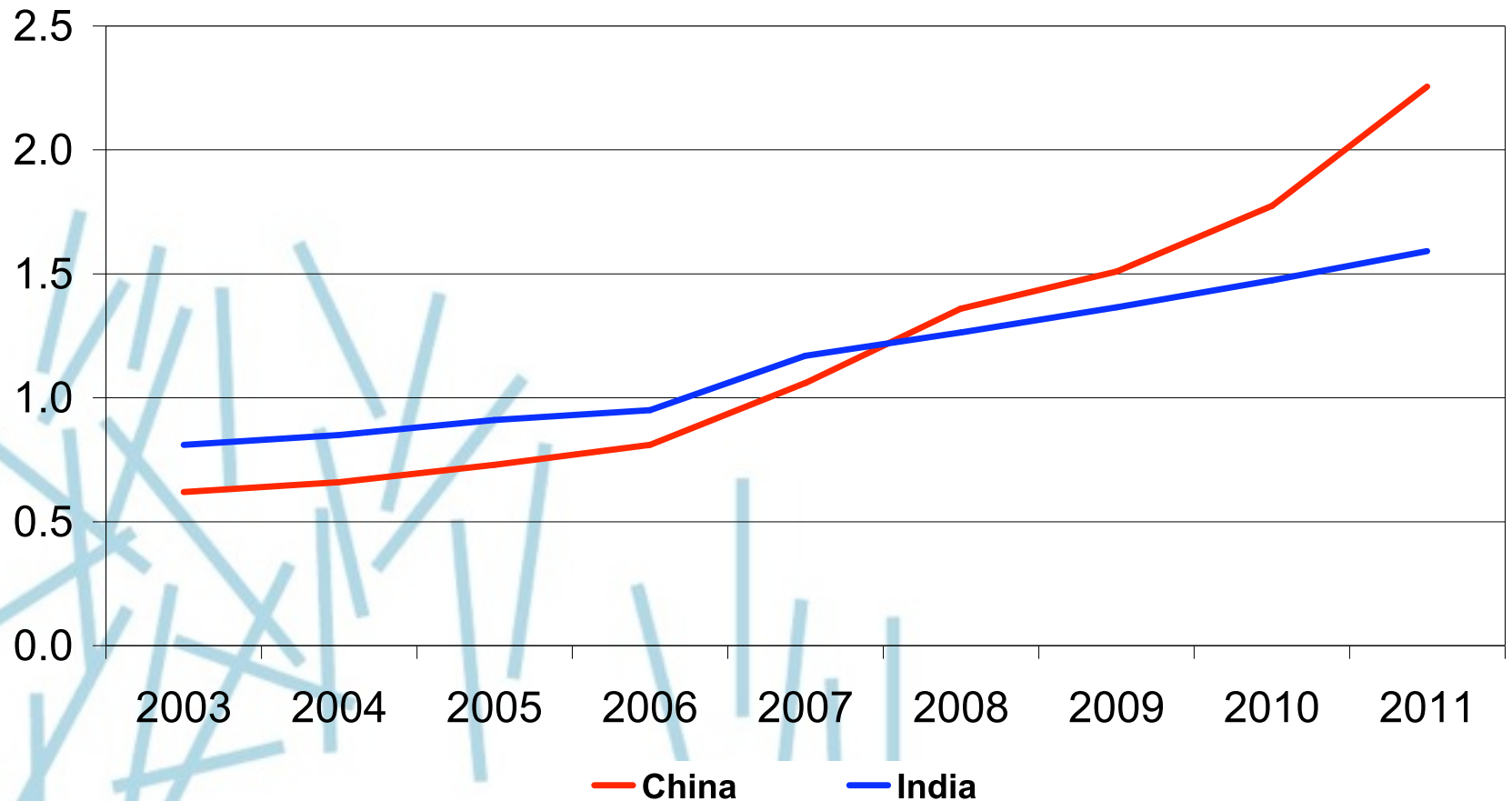
The Yuan v the Dollar since uncapping



And their \$ labour costs are rising rapidly

Chinese and Indian hourly compensation costs

\$ per hour



The collapse of the euro – which is more likely than not – will be a second ‘Lehmans

- It will be very hard for the euro to survive the strains placed on it
- There are three crises – property, debt and competitiveness
- The euro may survive 2011 ‘known unknowns’ but it is unlikely to survive the ‘unknown unknowns’ over the next 10 years
- The breakup of the euro is likely to create a second banking crisis in Europe with another requirement to recapitalise the banks
- It will probably be less painful than the Lehmans crisis in 2008 because at least governments know what to do now

Three scenarios for the euro:

- The IMF/EU bailouts of Greece, Portugal and Ireland work, averting the breakup of the Eurozone.
- However, the fallout from the bailouts is that European policymakers work towards some unification of fiscal policy in the EU.
- Large-scale European Central Bank purchases of sovereign debt would also be likely.
- The effect of the quantitative easing implied by the policy is that it boosts economic growth in the stronger economies which in turn permit the weaker economies to export themselves back to growth, despite weak consumer spending growth in the weaker economies.
- The property and construction markets in the stronger economies are boosted by the effect of the monetary easing, especially in the early phases in 2012 and 2013
- Anatole Kaletsky, Principal Economics Editor of The Times, sees this scenario as a likely outcome (or at least did so in March when I discussed this with him).

Three scenarios for the euro:

- Greece or Portugal (or possibly both) leave the euro, though none of the other PIGGs leave.
- Ireland is under pressure but its competitive strength sees it through
- Spain's reserve funds in the banking system as a result of 15 years of dynamic provisioning allow it to withstand financial market speculation.
- Italy's low deficit (but high debt) allows it to avoid a debt crisis.
- Cebr sees Greek exit from Eurozone as a likely scenario, given the country's inability to devalue its way to recovery at a time when domestic demand is suppressed by austerity measures
- In this scenario there is less monetary easing than in Scenario 1 because the extreme pressure to generate growth to bail out weaker economies disappears. Also the extent of the bailing out (which itself is a source of monetary easing) is limited.
- So growth is lower on this scenario than on the others.
- Simon Johnson (MIT) is associated with this scenario

Three scenarios for the euro:

- The bailout of Greece, Portugal and Ireland eventually leads to the creation of a two-tier euro system.
- We have called these currencies the hard and soft euros.
- In the hard euro zone, Germany, Netherlands Austria, Finland and possibly a few smaller countries. France is marginal but we have assumed that it will be in the hard zone for this piece of analysis
- Portugal, Ireland, Italy, Greece and Spain are definite members of the soft zone, probably also with a few smaller economies.
- This scenario means considerable disruption and it is likely that the key European economies will have to refinance their banking systems. We believe that they would be willing to do this however, although there would need to be more fiscal integration in the hard euro countries to ensure that this refinancing was not expected against an open chequebook.
- This scenario has frequently been referred to in the Financial Times Lex column and is Cebr's most likely scenario though our subjective probability is no more than 40%.

Implications for travel

- **Squeezed real incomes are with us for some time**
- **Meanwhile, others will have the spending power to pay premium prices in traditional British destinations – not just emerging economies but also commodity producers**
- **The cost of travel will probably rise in real terms**
- **So consumers will have to be more selective**
- **The pound will generally be a weak currency**
- **But other currencies are likely to change dramatically**
- **And the Euro is likely to break up**

How the travel industry

- **The industry will have to compete much harder for the consumer spending pound – not only will spending power be squeezed but the relative cost of the industry will rise**
- **With transport costs rising in real terms, super cheap travel is likely to disappear**
- **Southern Europe is likely to become cheap again – either the euro will break up or they will have to cut their wages drastically as the Irish have already done**
- **Customer service is going to rise up the agenda – the industry must move from its Primark stage to its M&S stage**
- **Parts of the industry need to get away from the ‘rip-off’ image where hidden charges are slipped through – ultimately customers will not put up with this when they are paying more in real terms**



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