

Hospitality industry forecasts for 2009

Gary Akehurst

Rotterdam School of Management, Erasmus University, The Netherlands. Previously of Greene Belfield-Smith Division, Deloitte & Touche Consulting Group, London

2008 was such a traumatic, roller-coaster year that making sense of it all is not easy. Back at the end of 2007 we said it had never been more difficult to make realistic 2008 forecasts for the hospitality industry. Well, this year it is doubly difficult to produce robust forecasts but if consumers cut their spending in response to tightening credit (which is likely), and disposable incomes are severely constrained, then 2009 will truly be a difficult but not impossible year for the hospitality industry. We believe that the hospitality industry is still reasonably well-placed to secure modest increases in revenues in the face of general economic adversity. There is undoubtedly now an economic slowdown in the UK and across the world but moderate hospitality industry growth is still possible in 2009 provided hospitality businesses provide good value for money and excellent quality services for discerning, value-conscious customers.

Hospitality industry predictions for 2008

This article considers what happened to the UK economy and the hospitality industry during 2008, reviews the "moderate growth" forecasts prepared this time last year, examines medium-term trends for the British economy and hospitality industry, and makes forecasts for 2009.

Back in December 2007 we said that 2008 would be a year of slower economic growth, falling from 3% in 2007 to 2% in 2008 (based on Deloitte forecasts), and consequently somewhat slower growth for the hospitality industry outside of London. The Deloitte growth forecast assumed interest rates would fall by 0.75% to 5%, whereas we believed, because of growing inflationary pressures, the Bank of England would reduce interest rates to no more than 5.25% by the year end. In the light of tightening financial constraints we nevertheless forecasted a relatively modest overall hospitality growth provided interest rates fell by 0.5% by the third quarter and consumer real disposable incomes did not fall too drastically. This meant:

- ◆ A relatively small increase, on average and in real terms, in the demand for hospitality services but this would again be variable according to sector and region; customers would continue to seek perceived value for money, good accommodation, good cuisine and excellent service
- ◆ Acquisitions, especially by venture capital companies, would be few and far between as attitudes to risk hardened, although a mega-merger or buy-out could not be ruled out as bargains would be available. Hotel and restaurant groups would continue to adjust property portfolios to sustain better performing brands, by selling off under-performing properties while investing in high margin, good-performing units with even better future potential under new ownership
- ◆ Investment in refurbishment and capacity expansion would continue at a more moderate pace (and not at the rate experienced in recent years) primarily in businesses with a considerable turnover and profits track record or potential
- ◆ Business and property values would be static across the UK but might fall by 2 to 5% outside London; this in itself offered business opportunities
- ◆ Lenders would be very cautious and more risk averse during 2008 and would continue to lend only on projects which could demonstrate clearly above average revenue and discounted profits streams; cash flows would be watched even more closely than usual
- ◆ Business planning and marketing, as always, would continue to need to be very focused paying particular attention to underlying market trends, keeping a level head and establishing a very clear market positioning

Generally this forecast was, against all the odds, reasonably accurate, given a violently turbulent global economy and mega instabilities in the banking world. The “credit crunch” has shown us how truly fragile the global financial economy really is, how bankers have taken considerable risks in search of higher returns, and how ill-prepared the world financial regulatory systems were to supervise these wayward and irresponsible financial institutions. The result has been the partial nationalisation of large chunks of the banking industry in the USA, UK, and Europe and even now, the nationalisation of the entire banking industry is not ruled out. Free markets may have been the driver of the developed economies for the past century but there is a growing realisation that these markets, particularly in key sectors, are frankly not mature enough nor responsible enough to remain unregulated. It therefore, comes as a shock to realise that for the foreseeable future governments will be controlling even larger proportions of national GDP (in the case of the UK more than 45% of GNP).

The economy last year

The economy has markedly slowed down during the second half of 2008 with a growth rate of around 0.8% for the whole year, significant falls in house prices, rising inflation, which peaked in September, rising unemployment and consequently severely constrained real incomes. These factors together with the extraordinary global financial turmoil have clearly hit domestic demand hard, especially since September. The Chancellor of the Exchequer forecast in his Pre-Budget Report presented in November that the economy would suffer a pronounced but short-lived slowdown, which he believed would end by the middle of 2009. Growth expectations have therefore, been revised drastically downwards from 2% to 0.8% for 2008, although Britain has probably been in recession since the autumn (defined as two consecutive quarters when output has fallen).

Inflation has been rising during 2008 and in October stood at 4.5% using the consumer prices index (or 4.2% using the all items retail prices index), which is considerably above the government's 2% target. As inflation, particularly of food, gas, electricity and fuel costs, has risen sharply during the year this has had a major impact on households' real disposable incomes. Real household incomes will have been static during the first half of 2008 and for the whole of 2008 may have actually fallen by 0.6%. It is estimated that house price falls have much further to go (on top of the average price falls of 15% during 2008) and as the housing sector stagnates, so will consumer spending. The reduction in VAT from 17.5% to 15% for 13 months starting from December 2008 is thought unlikely to stimulate consumer spending but time will tell.

Interest rates have fallen to 3.0% after an unprecedented 2% cut in November and Deloitte expects rates to fall to as low as 2.5% in 2009 but unfortunately this will not prevent the economy continuing in a downturn cycle. GDP during 2009 is expected fall by at least 1%. How long that downturn will last is not clear – commentators are divided, with some saying conditions will not pick up for several years while others feel that the downturn will be relatively short-lived. In truth no-one knows.

For a long time sterling has been overvalued but during 2008 the sterling exchange rate fell. This will help UK companies who export their products, including tourism, and help them to compete more aggressively once global demand picks up; sadly however, with the global financial crisis global demand will stay muted during the next 12 to 18 months at least.

Of the many industrial sectors, construction has had a bad year as had the financial sector and unemployment is now rising (and may increase by 1.5 million by 2010). Average earnings growth however is slowing, having dropped in 2008 to 3.5% (compared with 3.9% in 2007). Meanwhile public finances are in a very poor state and now even more so since the huge government financial support for the UK banking sector and partial nationalisation of several banks. Weaker corporation tax receipts and a sharp slowdown in income tax receipts compound the problem of worsening public finances during the second half of 2008. The UK government budgetary position continues to give real cause for concern, raising questions about chronic government over-borrowing. Government borrowing now stands at £118 billion.

The hospitality industry last year

During the 9 months ending September 2008, overseas visitor numbers were roughly the same as the same period in 2007, while overseas visitor earnings increased by 3.6% according to the International Passenger Survey. In the

same nine month period to September 2008 UK residents' visits overseas stayed the same when compared with 2007, while UK residents' expenditure on visits overseas increased by a remarkable 6%.

Comparing the three months to September 2008, seasonally adjusted, with the previous three months, total spending by overseas visitors to the UK (that is, earnings) decreased by 6% (£4 billion) and expenditure by UK residents overseas increased by 1% to £9.2 billion. The estimated number of overseas residents' visits to the UK, seasonally adjusted, in the three months to September 2008 decreased by 4% to 7.8 million compared with the previous three months and decreased by 3% when compared with the three months to September 2007. The estimated number of UK residents' visits abroad, seasonally adjusted, in the three months to September 2008 decreased by 3% to 17.0 million compared with the previous three months, and decreased by 5% when compared with the three months to September 2007.

Visits and Spending by overseas residents to the UK 2008

	Overseas visitors to UK all visits	Overseas visitors to UK all visits	Overseas visitors to UK Earnings	Overseas visitors to UK Earnings
	(000) not seasonally adjusted	(000) seasonally adjusted	£ million at current prices not seasonally adjusted	£ million at current prices seasonally adjusted
January 2008	2,348	2,740	1,049	1,370
February 2008	2,249	2,930	995	1,370
March 2008	2,596	2,880	1,084	1,360
April 2008	2,704	2,670	1,341	1,410
May 2008	3,048	2,810	1,463	1,450
June 2008	2,672	2,670	1,457	1,400
July 2008	3,320	2,680	1,775	1,330
August 2008	3,390	2,640	1,885	1,380
September 2008	2,550	2,510	1,475	1,270
Year to date	24,877	24,530	12,524	12,340
% change 2007-2008	0%		+3.6%	

Source: monthly series derived from the International Passenger Survey (IPS) 2008

Visits and Spending by UK residents abroad 2008

	UK residents going abroad all visits	UK residents going abroad all visits	UK residents going abroad Expenditure	UK residents going abroad Expenditure
	(000) not seasonally adjusted	(000) seasonally adjusted	£ million, current prices not seasonally adjusted	£ million, current prices seasonally adjusted
January 2008	4,697	5,900	2,667	3 290
February 2008	4,530	6,090	2,414	3,050
March 2008	5,056	5,930	2,681	3,060
April 2008	5,720	5,680	2,734	2,880
May 2008	5,824	5,990	2,913	3,120
June 2008	6,846	5,850	3,577	3,070
July 2008	6,740	5,780	3,670	3,120
August 2008	8,460	5,780	4,805	3,010
September 2008	6,970	5,430	3,920	3,040
Year to date	54,843	52,430	29,381	27,640
% change 2007-2008	0%		+6%	

Source: monthly series derived from the International Passenger Survey (IPS) 2008

During the first nine months of 2008 UK hotels generally saw reductions in occupancy but room rates and RevPAR improved.

UK Hotels Performance, 2007-2008 (nine months to September)

	2007	2008	% change 2007-2008
Occupancy (%)			
UK hotels	75.7	75.0	-0.7 points
London	82.2	82.0	-0.2 points
Provinces	72.1	71.2	-0.9 points
Room rate (£)			
UK hotels	87.08	89.97	+3.3
London	110.71	116.89	+5.6
Provinces	72.42	73.22	+1.1
Revenue per available room (£)			
UK hotels	65.91	67.49	+2.4
London	90.98	95.83	+5.3
Provinces	52.25	52.16	-0.2
Total revenue per available room (£)*			
UK hotels	30,097	30,685	+2.0
London	35,522	37,157	+4.6
Provinces	27,166	27,187	+0.1

* eight months to August

Source: TRI Hospitality Consulting, HotStats, September 2008, based on a sample of up to 509 hotels, mostly 3 and 4-star hotels, averaging 177 bedrooms.

Forecasts

2009 will be a year of probably negative economic growth, falling from 1% growth in 2008 to a 1% *decrease* in 2009 according to Deloitte. This is within the range as outlined by the Treasury in the Pre-Budget Report on 24 November 2008, where it is estimated that economic growth came to a halt in spring 2008 and for the whole of 2008 GDP is expected to have grown by just 0.8% before falling by between 0.75% and 1.25% in 2009. This would mean:

- ◆ A decrease, on average and in real terms, in the demand for hospitality services throughout 2009 but this will again be variable according to sector and region; restaurants and pubs will have a particularly difficult time but hotel groups will continue to offer good value special packages and customers will continue to seek perceived value for money, good accommodation, good cuisine and excellent service but there is a danger that widespread discounting of hospitality prices will be counter-productive
- ◆ Acquisitions will be again be few and far between as attitudes to risk harden further, although some bargains may become available as some businesses unfortunately get into cash flow difficulties. Venture capital companies will be conspicuous by their absence in the acquisitions market. Hotel and restaurant groups will continue to adjust property portfolios at the margins to sustain better performing brands, by attempting to sell off under-performing properties while modestly investing in high margin, good-performing units with even better future potential under new ownership
- ◆ Investment in refurbishment and capacity expansion will be held back partly by a continued reluctance of banks to lend to businesses in the first half of 2009 and partly by a natural but short-term reluctance of business managers to invest in times of difficult trading conditions

- ◆ Business and property values will fall by 5 to 12% outside London; this offers business opportunities for astute investors who take a medium-term view (that is, beyond 2010)
- ◆ Lenders will be very cautious and even more risk averse during 2009 and will continue to lend only on projects which can demonstrate clearly well-above average revenue and discounted profits streams; cash flows will be watched even more closely than usual
- ◆ Business planning and marketing, as always, will continue to need to be very focused, paying particular attention to underlying market trends and consumer reluctance to spend by keeping a level head and establishing a very clear market positioning based on value for money offerings

The following table summarises the key economic indicators and forecasts. This year we use again the Deloitte Economic Review, Fourth Quarter 2008, which has proven to be relatively reliable over a number of years.

UK Economy Key forecasts - % change over previous year

	2006	2007	2008 estimate	2009 forecast	2010 forecast
Demand					
GDP	2.8	3.0	1.0	-1.0	-0.5
Consumer Spending	2.0	3.0	1.9	-1.5	-1.0
Government Consumption	1.6	1.8	2.1	2.0	2.0
Fixed Investment	6.0	7.1	-1.9	-2.5	-3.0
Stockbuilding (% of GDP)	0.4	0.5	0.3	0.1	0.0
Domestic Demand	2.6	3.6	1.1	-1.0	-0.7
Exports ¹	11.0	-4.5	1.2	1.5	3.0
Imports ¹	9.6	-1.9	1.2	1.2	2.0
Output and Profits					
Manufacturing Output	1.9	0.6	-0.1	-3.0	-1.0
Services Output	3.7	3.7	1.7	-0.6	-0.3
Company Profits ² (nominal)	5.1	9.7	-0.5	-10.0	-4.5
Labour market					
Unemployment (claimant millions)	0.9	0.9	0.9	1.2	1.7
Unemployment (%)	2.9	2.5	2.8	3.7	5.1
Employment (%)	0.5	0.6	1.2	-1.0	-2.0
Productivity (output per worker)	2.1	2.2	0.1	0.0	1.5
Income and Saving					
Average earnings ³	4.1	3.9	3.7	3.2	2.9
Real Disposable Income	1.5	0.1	-0.6	1.8	2.5
Saving Ratio	4.2	2.5	-0.4	2.8	6.1
Prices					
RPI	3.2	4.3	4.3	1.1	0.7
RPIX Retail Prices	3.0	3.2	4.5	2.4	1.3
Nationwide House Prices	9.3	6.9	-6.7	-15.3	-10.3
Balance of Payments and Public Finances					
Current Account (Ebillion)	-45.0	-52.6	-44.3	-55.0	-50.0
% of GDP	-3.4	-3.8	-3.0	-3.7	-3.3
Public sector net borrowing (Ebillion, financial year) ⁴	30.4	35.8	60	80	110
PSNB as % of GDP	2.3	2.6	4.1	5.4	7.4

¹ includes VAT fraud distortion

² gross trading profits of non-financial corporations

³ including bonuses

⁴ a positive PSNB figure indicates a budgetary deficit, negative PSNB indicates a surplus

Source: Deloitte Economic Review, Fourth Quarter 2008, pages 12-13.

2008 was a year when the UK government and others around the world narrowly avoided a complete collapse of the banking and financial systems. Despite governments across the world pumping in billions to shore up the banking system there has been in the UK a major slowdown in bank lending to companies and households. This is worrying. The forecasters are predicting a decrease in GDP growth during 2009 of about 1%, with falling house prices, falling inflation and rising unemployment. Inflation is thought to have peaked at around 5% in September 2008 and Deloitte predicts inflation will fall to around 1% by the autumn of 2009 or even negative inflation if food and oil prices fall further. Interest rates look set to fall to 2.5% (the lowest level since 1951) but some commentators expect rates to fall even further towards 1%.

But all is not lost. Deloitte predict that household real incomes will start growing again in 2009 due to falling commodity prices and low interest rates may boost demand. The continued fall in the pound will boost exports, and improve competitiveness, and as Deloitte say in their latest Economic Survey – the financial sector will be in a better state to contribute to future progress and prosperity.

Taking all available evidence PriceWaterhouseCoopers forecast the following average room rates, occupancy levels and revenue per available room for the UK, London and Provinces in 2008 and 2009:

UK Hotel Forecasts 2008-2009

	2006	% change 2005-2006	2007	% change 2006-2007	2008*	% change 2007-2008	2009*	% change 2008-2009
Average Room Rate (£)								
UK	77.12	+3.0	80.78	+4.8	82.58	+2.2	81.09	-1.8
London	103.02	+5.8	112.4	+9.1	118.5	+5.4	118.11	-0.2
Provinces	63.25	+1.8	65.03	+2.8	65.48	+0.7	63.82	-2.5
Occupancy (%)								
UK	77.9	+2.0	77.9	+0.1	76.2	-2.3	74.2	-2.6
London	80.5	+7.9	81.1	+0.8	79.5	-1.9	70.2	-11.8
Provinces	70.4	+0.3	70.2	-0.2	68.6	-2.4	68.8	+0.3
Revenue per available room (£)								
UK	60.14	+5.1	62.99	+4.8	62.97	-0.1	60.19	-4.3
London	83.04	+14.3	91.27	+10.0	94.28	+3.4	82.92	-11.9
Provinces	44.56	+2.1	45.69	+2.6	44.96	-1.7	43.93	-2.2

* forecast

Source: PricewaterhouseCoopers Forecasting Model, Issue 18, November 2008.

With a deteriorating economy the PricewaterhouseCoopers baseline scenario (based on 1% GDP growth in 2008 and a 0.5% GDP decline in 2009) anticipates UK hotel occupancy falling by 2.6%, a massive 11.8% drop in London and a very modest 0.3% increase in the provinces. Corporate hospitality demand is expected to fall as budgets are cut and London will experience the greatest fall. UK RevPAR is forecast by PricewaterhouseCoopers to fall by 4.3% as room rates fall for the first time since 2003. RevPAR in London is forecast to fall by 11.9% although London average room rates will stay roughly the same as 2008.

The PricewaterhouseCoopers downside scenario (based on 0.9% GDP growth in 2008 and a 1.9% GDP decline in 2009) would see UK occupancy fall by 1.9% and fall 8.7% in London, with average UK room rates falling by 7.7%, 3.7% in the provinces and a massive 15.9% in London. RevPAR under this scenario would fall by 23.3% in London and 9.4% in the UK. In all probability the actual results will be closer to the baseline scenario but we cannot be sure.

Conclusions

2008 was a truly shocking year on the economic and financial front. We still firmly believe that the hospitality industry should hold its nerve during 2009, concentrating on providing excellent value for money and be alive to the needs of very discerning customers who will be feeling very hard-done by, while at the same time keeping costs under constant scrutiny. We forecast unfortunately a decrease in demand for hospitality services with London bearing the brunt but there is a possibility that business will pick up in the final quarter of the year.