

A Look Back Over 2008

2008 was a year when the economic and financial world turned upside down. It will go down in history as the year when the global economy and the associated banking systems nearly failed.

We forecast back in October 2007 that things would slow down during 2008 and this has indeed happened but with a vengeance and rapidity which is awesome. What no forecaster could have predicted was the demise and nationalisation or partial nationalisation of so many banks and financial organisations across the world as governments stepped in to try to halt an economic catastrophe – the roll call is simply astounding: Freddie Mac, Fannie Mae, AIG and Lehman Brothers in the USA, HBOS, Royal Bank of Scotland, Barclays, Lloyds TSB, Bradford & Bingley and Alliance & Leicester in Britain, Fortis in Belgium and France, Kaupthing, Landsbanki and Icesave in Iceland and others in Germany, Japan and other countries. In just one week ending 10 October an extraordinary turmoil in the world's stock markets wiped off £2.7 trillion from the value of global shares.

Remarkably the hospitality industry did not do as badly as some had predicted, indeed many parts of the industry did rather well, as demand generally held up, and although profitability started to fall in the last quarter nevertheless the year as a whole was not a trading disaster. 2009 may however, be a different story as economic recession becomes a distinct reality.

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Industry fortunes during 2008

Back in October 2007 we said that 2008 would be a year of slower economic growth, falling from 3% in 2007 to 2% in 2008, according to Deloitte, and consequently somewhat slower growth for the hospitality industry outside of London. But 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 perceived 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 harden, although a mega-merger or buy-out cannot 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

In the event interest rates fell to 4.5% following an emergency 0.5% cut in October, demonstrating an overwhelming Bank of England concern to spark up the economy in the face of a growing recessionary threat – so this forecast prepared in November 2007 was broadly right for the first eight months of the year when for example, hotel occupancy levels in London hotels were slightly up on 2007 (by 0.3%) while room rates increased by nearly 7%, but in provincial hotels occupancy fell by nearly 1% but room rates increased by 1.4%. Since August however, hospitality demand has faltered in some areas particularly in the pub and restaurant sectors and it can be anticipated that in the final quarter of the year hotel occupancy levels will have fallen on average across the UK by 1.5% - not it must be said, a huge drop, given the financial mayhem currently being experienced. Our forecast was spot on as far as acquisitions were concerned and although final figures for 2008 are not available as yet, business property values will have fallen but not by as much as some commentators were predicting because basically, there will still be a demand for good business properties. Certainly lenders are very risk averse indeed as the global financial crisis has really taken a hold and this reluctance to lend on anything but the very best projects will continue well into 2009.

The UK economy in 2008

The economy has markedly slowed down during 2008 to a growth rate of around 1.7%, with significant falls in house prices, real incomes being severely constrained and the global financial turmoil has clearly hit domestic demand particularly since September. The Chancellor of the Exchequer was forced in his March Budget to revise downwards growth expectations to a range of 1.75 to 2.25% but even back in March this was considered by many economic commentators to have been over-optimistic.

Inflation has been rising during 2008 and currently in October stands at 4.8% using the RPI index (Retail Prices) – nearly 3% above the government’s 2% target and thus generating several explanatory letters from the Governor of the Bank of England to the government. As inflation, particularly of food, gas, electricity and fuel costs, has taken off during the year this has had a major impact on household real disposable incomes. Real household incomes will have been static during the second half of 2008 and for the whole of 2008 may have risen by just 0.5%. Clearly house price falls have much further to go and as the housing sector slows down so will consumer spending.

Interest rates have fallen to 4.5% and Deloitte expects rates to fall to as low as 3.5% in 2009 but unfortunately this will not prevent the economy going into a “deep downturn”. GDP growth during 2009 is expected to be just 0.5% although in reality it may actually fall to zero.

For a long time the British pound has been overvalued but during 2008 the sterling exchange rate fell. This will eventually help UK companies which export their products (including, of course, 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 months at least.

Of the many industrial sectors, construction has had a bad year as had the financial sector and unemployment is starting to rise (and may increase by 1 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. The problem of worsening public finances is compounded by weaker corporation tax receipts and a sharp slowdown in income tax receipts during the second half of 2008.

The industry during 2008

PriceWaterhouseCoopers forecast the following average room rates, occupancy levels and revenue per available room for the UK, London and Provinces in 2008 (but note these forecasts were published in June 2008, the latest figures available and unfortunately a lot has happened since June): Almost certainly when the figures are published in January 2009 Britain will have been found to have been in recession between September and December 2008 and possibly since July 2008. For the first time in many a year service sector growth was arrested during the second half of 2008.

UK Hotel Forecasts 2008

	2005	% <i>change</i> 2004- 2005	2006	% <i>change</i> 2005- 2006	2007	% <i>change</i> 2006- 2007	2008*	% <i>change</i> 2007- 2008
Average Room Rate (£)								

UK	74.23	+3.5	77.02	+3.8	80.99	+5.2	83.97	+3.7
London	97.43	+2.9	103.33	+6.1	112.92	+9.3	118.92	+5.3
Provinces	62.34	+3.9	63.39	+1.7	65.20	+2.9	66.55	+2.1
Occupancy (%)								
UK	71.7	-0.5	73.6	+2.7	73.6	-0.1	73.0	-0.8
London	74.9	-1.3	80.9	+8.0	81.5	+0.7	81.4	-0.1
Provinces	70.1	-0.1	70.3	+0.3	70.2	-0.2	69.1	-1.6
Revenue per available room (£)								
UK	53.21	+3.0	56.70	+6.6	59.58	+5.1	61.26	+2.8
London	72.99	+1.5	83.62	+14.6	92.02	+10.0	96.82	+5.2
Provinces	43.72	+3.8	44.58	+2.0	45.76	+2.6	45.97	+0.5

* forecast

Source: PricewaterhouseCoopers Forecasting Model, June 2008.

The key indicator of UK average room rate, according to PricewaterhouseCoopers, shows an increase of 3.7% although it must be noted that this is based on a June forecast and the actual rate of increase for the whole year is likely to be nearer 1.4%, but nevertheless this is an increase in pretty constrained trading conditions. As always, London average room rates increased by more than the UK average. Occupancy levels universally fell during the year but not by nearly as much as some commentators were predicting in September. Back in June PricewaterhouseCoopers were predicting a UK occupancy drop of 0.8%, with a far smaller drop in London but a higher drop in the provinces. Latest figures suggest a fall in UK average occupancy levels of 1.5%, which given the financial and economic conditions is far better than could be expected and suggests that there is cause for greater optimism for hotel prospects in 2009. Revenue per available room (RevPAR) was for the whole UK up by around 3%, London by 6% and the provinces lagging far behind at around 0.5%.

Looking at the very latest figures available from TRI Hospitality Consulting - during the eight months to August UK occupancy levels were broadly static, slightly up in London but down by nearly 1% in the Provinces. Liverpool however, saw increased average occupancy to 73.1% due to City of Culture events including an international music event starring Paul McCartney. Room rates were up by nearly 7% in London, which is a very credible result and room rates in provincial hotels nevertheless grew by 1.4%. Total revenue per available rooms was correspondingly up in London by 6% and all UK hotels by just over 3%. Profitability however, has according to TRI Hospitality Consulting been dropping since July in provincial hotels as demand slows down (particularly corporate demand and conference room lets).

UK Hotels Comparative Performance, Eight Months to August 2007 and August 2008

	August	August	% change
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	2007	2008	2007-2008
Occupancy (%)			
UK hotels	74.9	74.5	-0.4 points
London	81.6	81.9	+0.3 points
Provinces	71.3	70.6	-0.7 points
Room rate (£)			
UK hotels	86.23	89.77	+4.1
London	109.38	116.74	+6.7
Provinces	71.85	72.88	+1.4
Revenue per available room (£)			
UK hotels	64.60	66.92	+3.6
London	89.23	95.60	+7.1
Provinces	51.23	51.44	+0.4
Total revenue per available room (£)			
UK hotels	26,207	27,022	+3.1
London	30,807	32,700	+6.1
Provinces	23,711	23,933	+0.9

Source: TRI Hospitality Consulting, HotStats August 2008, based on a sample of 508 hotels, mostly 3 and 4-star hotels, averaging 178 bedrooms

During the 12 months to July 2008, the number of visits by overseas residents to the UK, not seasonally adjusted, remained broadly the same when compared with the 12 months to July 2007, at 33.0 million. Visits from residents of Europe increased by 1% to 24.1 million, but from North America they decreased by 6% to 4.3 million. Visits from other parts of the world increased by 4% to 4.7 million.

Overseas visitors to Britain: to the end of July 2008

	<i>12 months ending July 2007</i>	<i>12 months ending July 2008</i>	<i>% change 2007/2008</i>	<i>Year to date (to August 2008)</i>	<i>% change Jan-August 2007/2008</i>
From	Visits (000)	Visits (000)		Visits (000)	
North America	4,558	4,270	-6	2,472	-5.0
W. Europe	23,894	24,090	+1	13,814	+1.6
Rest of World	4,501	4,690	+4	2,598	+8.3
Total visits	32,953	33,050	0	18,863	+1.4
Total spend (£million)	16,030	16,255	+1	8,986	+3.3

Source: International Passenger Survey, September 2008; data is not seasonally adjusted

Bearing in mind that we are not reviewing the whole year's data nevertheless the number of overseas visitors to the UK from January up to and including July 2008 continued to increase albeit by just 1.4%. The number of visitors from North America fell by 5% in the year to August 2008 while visitor numbers increased by 1.6% from Western Europe and by 8.3% from the rest of the world. Total spend by overseas visitors to the UK increased by 3.3% in the year to August 2008 to nearly £9 billion.

In the 12-month period to July 2008, the number of visits abroad by UK residents, not seasonally adjusted, increased by 2% compared with the 12 months to July 2007, from 69.2 million to 70.7million. Visits by UK residents to Europe increased by 2% to 56.0 million and to North America increased by 2% at 4.8 million. Visits to other parts of the world rose by 2% to 9.9 million.

During May to July 2008, the seasonally adjusted number of visits to the UK by overseas residents decreased to 8.2 million - a 4% fall when compared with the previous three months, according to the latest September published figures from the Office for National Statistics (ONS).

Over the same period May to June 2008, the seasonally adjusted number of visits abroad by UK residents remained broadly the same at 17.8 million when compared with the previous three months, while the associated spending increased by 4% to £9.4 billion.

The figures for the year to August 2008 (not seasonally adjusted) tell an interesting story of continued growth in UK residents going overseas and their spending - basically total overseas visits by UK residents increased by just over 3% to 39.5 million while total spending increased by roughly 8% to nearly £21 billion. It seems that a poor summer and declining economic fortunes at home led to precisely what we had predicted a year ago, that is, "go and have a good time and blow the consequences". Surprisingly, UK visits to North America increased by nearly 8% as well, although the growth in visits to Europe stabilised at just fewer than 31 million.

UK residents' visits abroad: to the end of July 2008

	<i>12 months ending July 2007</i>	<i>12 months ending July 2008</i>	<i>% change 2007/2008</i>	<i>Year to date (to August 2008)</i>	<i>% change Jan-August 2007/2008</i>
To	Visits (000)	Visits (000)		Visits (000)	
North America	4,693	4,780	+2	2,732	+7.8
W. Europe	54,806	55,950	+2	30,907	+2.5
Rest of World	9,746	9,940	+2	5,873	+4.5
Total visits	69,244	70,670	+2	39,523	+3.2
Total spend (£billion)	34.86	36.48	+5	20.77	+7.6

Source: International Passenger Survey, September 2008; data is not seasonally adjusted

During the year there were as usual mixed results for Britain's hospitality companies. J.D. Wetherspoon is perhaps typical of many as the eating out market becomes more competitive – although J.D. Wetherspoon continues to open new pub restaurants it suffered large falls in its share price in September but recently the share price has been slowly climbing back. In the year to 27 July 2008 revenue was £907.5 million (up 2.1% from £888.47 million in the year to July 2007) but pre tax profits fell from £62.02 million to £54.16 million in the same 12 month period. Revenue for the year ending July 2009 is forecast to increase by 2.6% to £931.15 million while pre tax profits are forecast to fall a further 5.6% to £51.13 million.

Conclusions

Generally once every century there is a truly momentous economic upheaval which fundamentally changes the economic landscape – 1929, for example, in the last century, which was followed by nearly a decade of prolonged depression (more severe than recession), ended only by a terrible world war. History is not repeating itself – 1929 is not the same as 2008 although the financial services industry has a lot to answer for. One difference is that the global economy is so much more interdependent and the speed of information exchange is so much quicker.

The year 2008 will go down in history as one in which the global banking industry went into virtual meltdown and one country's economy (Iceland) came close to complete bankruptcy (to be bailed out by the IMF – International Monetary Fund), and ending in eye watering government bailouts involving hundreds of billions of pounds, euros and dollars and nationalisations. At the time of writing (mid-October) there is no indication that the bottom of the crisis has yet been reached although there are signs that these massive government bail outs across the world are thankfully having longed-for stabilising effects. Many banks threw caution and banking reserve to the winds and over-reached themselves in making unwise, indeed reckless loans, and in turn these “sub-prime” loans were repackaged and sold on to other banks. The end result is that the banks began to mistrust other banks and refused to lend money to each other; no one knew how much “toxic” debt was washing around the system, and we still don't know. The end result is a banking industry which is now partly nationalised and which may in time be wholly nationalised – a case of the free market system failing in a spectacular way.

Although it has been a worrying time nevertheless, people still need to eat, drink and stay in accommodation when away from home. Inevitably there will be in the months ahead some hospitality casualties in the UK and often this will be the end result of a poor business model, poor product and poor service but some will fail, not because of poor product but because their bank refused to lend much-needed capital. That is much more serious.