



EUROPEAN TOURISM 2011 – Trends & Prospects

Quarterly Report - Q3/2011

EUROPEAN TRAVEL COMMISSION



EUROPEAN TOURISM in 2011: TRENDS & PROSPECTS

Quarterly Report (Q3/2011)

A quarterly insights report produced for the Market Intelligence Group
of the **European Travel Commission (ETC)**
by **Tourism Economics (an Oxford Economics Company)**

Brussels, October 2011
ETC Market Intelligence Report

European Tourism in 2011: Trends & Prospects (Q3/2011)

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on behalf of the ETC Market Intelligence Group

Photo ©: iStockphoto/Rubén Hidalgo.

View of Guggenheim Museum, Bilbao, Spain.

Foreword

Travel in Europe continues to move toward full recovery even as growth is slowing

Aviation and hotel results indicate a broad rebound

The recovery now faces a renewed economic slowdown with notable downside risks.

Recent indicators of European travel have been encouraging. The pace of growth is slowing but nearly all destinations have posted growth and the region is on track to fully recover to prior peaks in 2011. International visits are on track to expand 5.6% for the year.

Aviation passenger demand has expanded 8% through September and capacity has nearly kept pace, improving accessibility and controlling prices. Hotel performance has also been solid. Occupancy rates through August have jumped 3.7% while rates have also increased 3.2%.

The recovery has been broad based. The Baltics and other destinations in Eastern Europe are enjoying a surge in visits. Occupancy rate data support this observation with 10.4% growth in Eastern Europe through August. Southern Europe is also performing well, led by Spain, Cyprus, and Malta. Occupancy rates are 5.2% higher this year in Southern Europe.

However, European travel faces multiple external risks which are addressed in this report. Most significantly, the Eurozone debt crisis has yet to be contained. Financial market contagion could drive the European economy back into recession. In addition, risks to the US and emerging market economies present a near term outlook with more downside than upside.

As a result, the baseline Tourism Economics forecast for Europe includes a marked slowdown of growth in 2012. Visits to all of Europe are expected to expand 2.3% in 2012. Two points of clarification are necessary to this projection. First, the core Eurozone countries are most exposed to the downturn and will likely post lower growth than the rest of the region. Second, the downside alternative scenarios to this outlook appear to be as probable as the baseline forecast.

Nevertheless, our experiences over the past few years have taught us how to operate within volatile markets. May we continue to challenge ourselves to greater focus, innovation, and cooperation as we face this next round of challenges.

We trust you will find the analysis in this report helpful as you track your own destination's performance and seek to anticipate future trends.

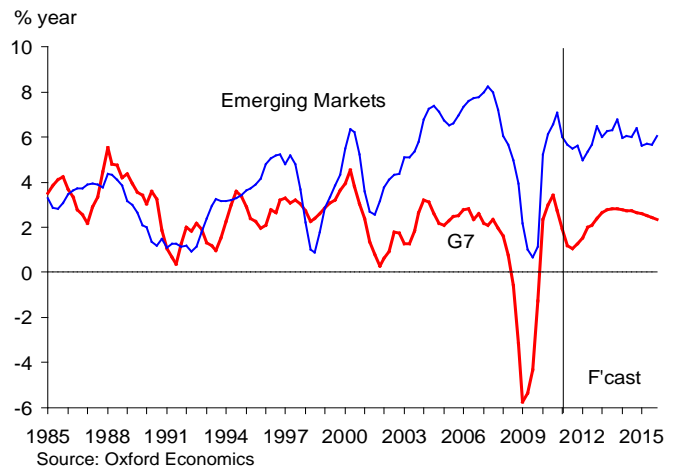
Best wishes,

Leslie Vella
Chairman
ETC Market Intelligence Group

Executive Summary

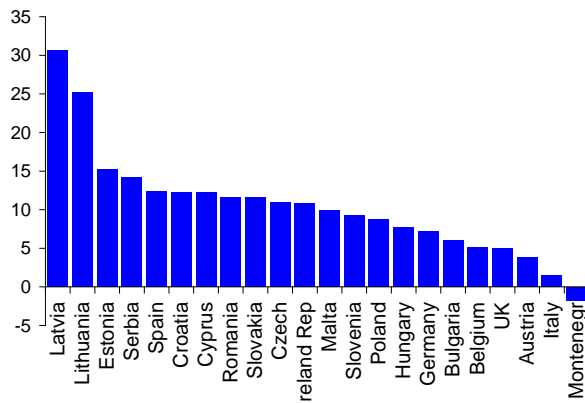
- Signs of economic weakness have led us to revise down our global economic growth forecast to 2.8% in 2011 and 3.1% in 2012 (at market exchange rates).
- And risks to this forecast are skewed to the downside, coming from three different fronts: i) an escalation of the Eurozone debt crisis including financial contagion, ii) the possibility that the US falls back into recession, and iii) a hard landing in the emerging economies and China in particular. Each of these three scenarios could be sufficient to tip the world back into recession.
- On the whole, the travel recovery is continuing. However, the rate of expansion is slowing with few exceptions.
- European airlines have experience robust demand growth through September. With only one exception, weekly growth rates have been above 6% and have averaged a rate of nearly 8% over this period. And seat capacity has nearly kept pace with demand, producing stable load factors.
- Through August, room demand has grown nearly 4% and been especially strong in Eastern and Southern Europe, with occupancy rates up 7.3% and 5.2%, respectively. Although occupancy growth has been relatively weak in Western Europe (2.4% YTD), room rates have performed well above average, growing 4.8%.
- By the end of 2011, we expect international visits to Europe to have surpassed records set in 2008.
- However, the economic landscape presents a challenging environment for travel. We expect European inbound travel to slow markedly, to 2.3% in 2012 from 5.6% in 2011. The core Eurozone countries are most exposed to the downturn and are projected to experience marginal growth in 2012.

G7 & Emerging Markets: GDP growth



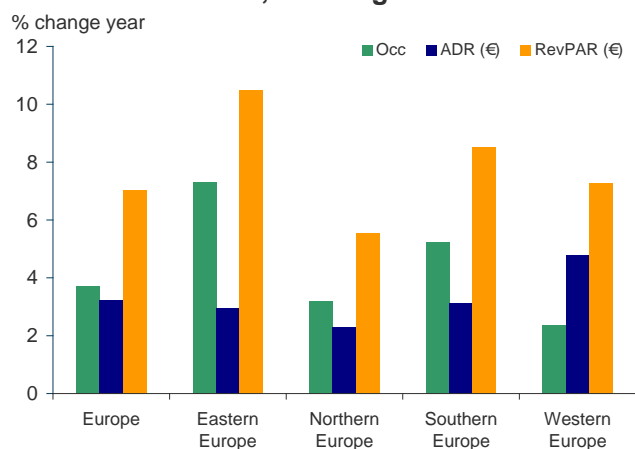
Foreign Visits to Select Destinations

2011, year-to-date*, % change year ago



Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

Hotel Performance, Jan-Aug 2011



2011 Tourism Performance Summary

On the whole, the travel recovery is continuing. However, the rate of expansion is slowing with few exceptions. Visits, nights, and hotel occupancy data tell a consistent story of strong performance that is tapering off as the year progresses. Occupancy rates have increased 3.7% through August while visits have grown roughly 6% through the first half of the year. By the end of 2011, we expect international visits to Europe to have surpassed records set in 2008.

2011 Performance, Year to Date									
Tourist Arrivals and Nights					Hotel Performance, Jan-Aug				
International Arrivals			International Nights		Hotel Occupancy			Hotel ADR (LCU)	
Country	% ytd	to month	Country	% ytd	to month	Country	% ytd	Country	% ytd
Latvia	30.6	Jun	Lithuania	23.1	Jun	Estonia	18.1	Turkey	29.4
Lithuania	25.2	Jun	Latvia	21.9	Jun	Iceland	17.8	Estonia	12.3
Estonia	15.2	Jul	Bulgaria	18.1	Jun	Lithuania	15.2	Lithuania	11.9
Serbia	14.2	Aug	Serbia	17.7	Aug	Slovakia	10.8	France	9.0
Spain	12.4	Aug	Estonia	17.2	Jul	Czech Republic	9.6	Iceland	6.6
Croatia	12.2	Jun	Spain	14.7	Aug	Romania	9.1	Netherlands	5.9
Cyprus	12.2	Aug	Cyprus	13.0	Apr	Malta	7.6	Greece	5.1
Romania	11.6	Jul	Portugal	13.0	Jul	Ireland	6.9	Ireland	4.9
Slovakia	11.6	Jun	Czech Rep.	11.9	Jun	Spain	6.6	Belgium	4.6
Czech Rep.	11.0	Jun	Croatia	11.5	Jun	Hungary	6.5	Sweden	4.6
Malta	9.9	Jul	Romania	10.4	Jul	Greece	5.9	United Kingdom	4.1
Slovenia	9.3	Jul	Finland	9.7	Jul	Italy	5.7	Russia	4.0
Poland	8.7	Apr	Slovenia	9.5	Jul	Norway	5.5	Poland	4.0
Ireland Rep	8.3	Jul	Poland	7.5	Apr	Russia	5.4	Austria	3.8
Hungary	7.7	Jun	Germany	7.3	Jul	Poland	5.2	Romania	3.5
Germany	7.2	Jul	Malta	7.3	Jul	Denmark	4.2	Denmark	3.4
Bulgaria	6.0	Jul	Slovakia	7.2	Jun	Finland	4.0	Portugal	3.1
Belgium	5.1	Jun	Sweden	5.0	Jul	Germany	3.5	Italy	3.1
UK	5.0	Jul	Belgium	4.1	Jun	Belgium	2.9	Finland	2.5
Austria	3.8	Jul	Hungary	4.1	Jul	Portugal	2.7	Malta	2.2
Italy	1.5	Mar	Denmark	3.9	Aug	Netherlands	2.6	Germany	2.0
Netherlands	0.0	May	Norway	2.8	Aug	Sweden	2.2	Slovakia	1.8
Montenegro	-1.8	May	Montenegro	2.4	May	United Kingdom	1.8	Spain	1.6
			Netherlands	2.0	May	Switzerland	1.2	Switzerland	0.5
			Austria	0.2	Jul	France	1.2	Norway	0.4
			Switzerland	-1.6	Jul	Austria	0.7	Czech Republic	-0.3
						Turkey	-0.7	Hungary	-1.7

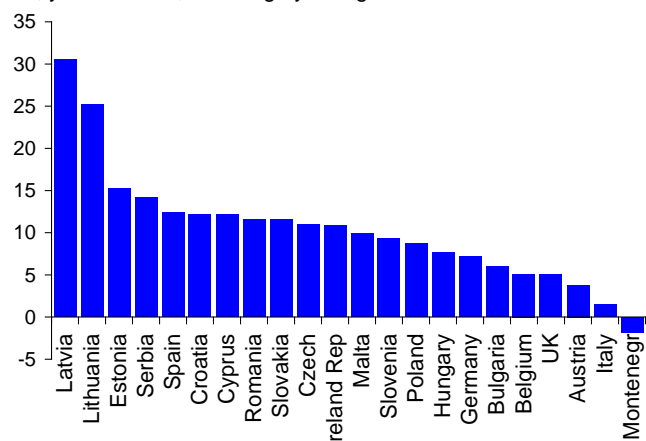
Sources: TourMIS, ETC, STR Global

Measures used for nights and arrivals vary by country

Based on data available through 4 October, 2011.

Foreign Visits to Select Destinations

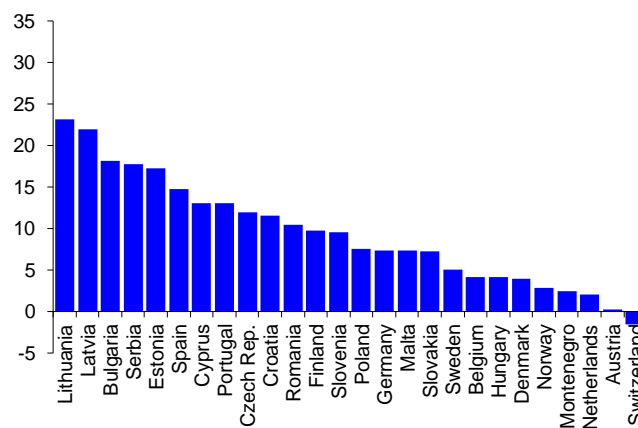
2011, year-to-date*, % change year ago



Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

Foreign Visitor Nights in Select Destinations

2011, year-to-date*, % change year ago



Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

Global Outlook: Dangerous Times

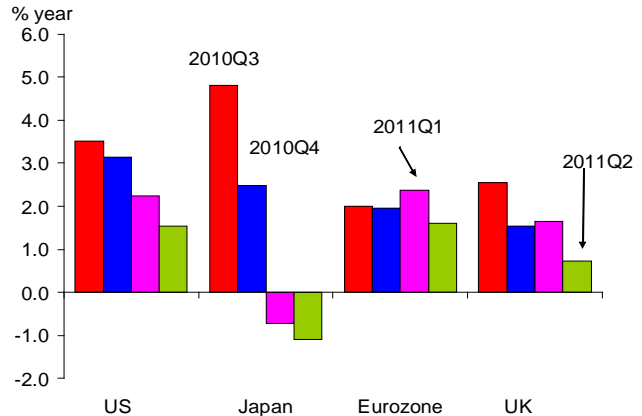
The global economic outlook has worsened since our last report. The latest data point to a loss of momentum across a wide range of countries following the post-crisis recovery in 2010. We estimate that world GDP growth (at market exchange rates) slowed from 4% year-on-year in 2010Q4 to 3.2% in 2011Q1 and further to 2.7% in Q2 on the back of a slowdown in economic activity in the advanced economies. The Eurozone and the US nearly stagnated in Q2, with growth at 0.2% and 0.3% quarter-on-quarter respectively. Growth was similarly weak in the UK, while Japan's GDP was down in the aftermath of the disasters that hit the country in March.

And data available for Q3 show few signs of a rebound. The manufacturing ISM and PMIs in the US, Europe and China have fallen to or below the 50 threshold that separates expansion from contraction.

In addition, August figures show that US unemployment continues to linger at 9.1% while net job creation has ground to zero. Elsewhere, the latest labour market data tells a similar story; in Europe and Japan unemployment has yet to recede.

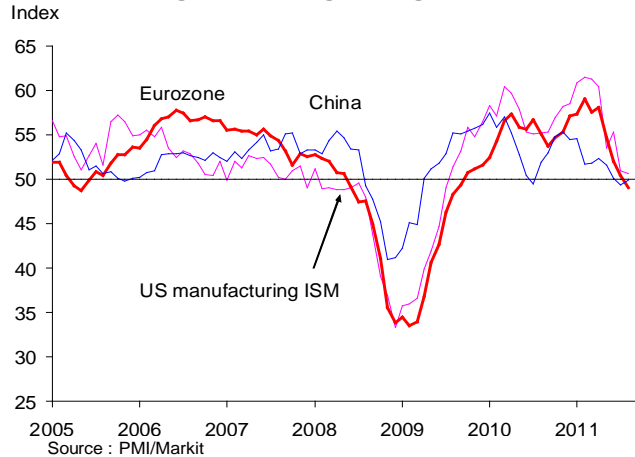
The evident slowdown in global economic activity, combined with a series of events (protracted negotiations on the US debt ceiling, the risk rating downgrade of Italian and US debt, rumours about French banks' ability to access funding and the Italian government's U-turn on a draft austerity package), have sent financial markets into a tailspin since July. By mid-September, share prices in the US were down almost 15% from their early July peak, while European stocks were down 25-30%. The sell-off has also hit financial markets in emerging economies; Brazil and Malaysia's equity markets fell by more 18% during August for example. And risk aversion increased across all instruments. For instance, the spread between BB and AAA corporate bond yields has increased by about 200 bps since mid-July. Stress is also visible in Eurozone interbank markets, with the spread between Euribor and overnight swap rates rising to around 80 basis points, compared to around 20-30 basis points earlier this year.

GDP growth



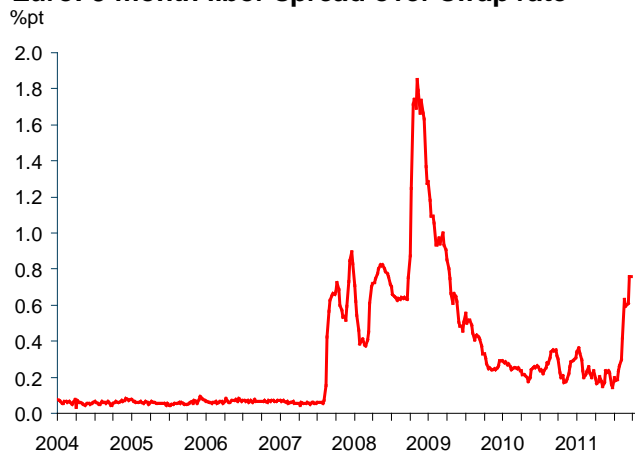
Source : Oxford Economics/Haver Analytics

Manufacturing Purchasing Managers' Index



Source : PMI/Markit

Euro: 3 month libor spread over swap rate

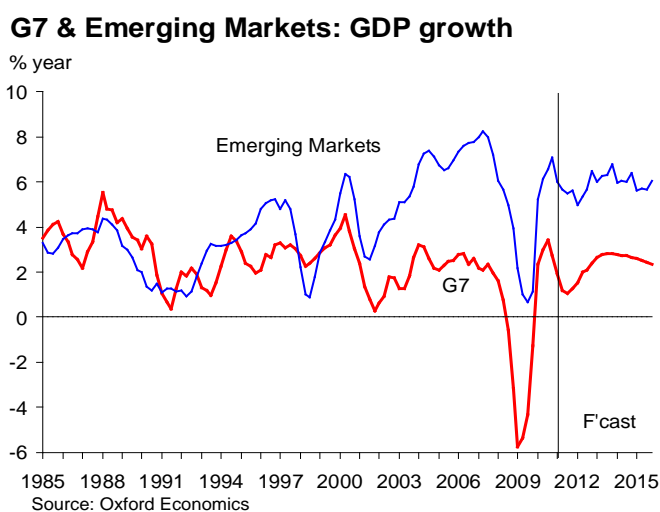


Source: Oxford Economics; Haver Analytics

One factor accounting for the slowdown in economic activity is the change in policy stance across most countries and regions. In particular, following the period of fiscal expansion that took place during the 2008/09 recession, fiscal policy was broadly neutral in 2010 and has turned restrictive this year. Fiscal tightening is particularly sharp in the UK and the peripheral Eurozone countries. But it is also taking place in core Eurozone countries and, to a lesser extent, in emerging markets.

Baseline forecast revised down

We have revised down our global economic growth forecast to 2.8% in 2011 and 3.1% in 2012 (at market exchange rates). Advanced economies are forecast to grow by 1.5% this year and 2.1% in 2012, while emerging markets growth is expected at just under 6% in both years.



Risks to this forecast are skewed to the downside, coming from three different fronts: i) an escalation of the Eurozone debt crisis including financial contagion, ii) the possibility that the US falls back into recession, and iii) a hard landing in the emerging economies and China in particular. Each of these three scenarios could be sufficient to tip the world back into recession. Combined, the downside scenarios are now viewed to be as 'likely' as the central baseline scenario, while the probability of the upside scenario has been reduced to just 10%.

Global macroeconomic scenarios	
	Probability
Central baseline	45%
Downside	45%
Disorderly Eurozone debt default	20%
US recession	15%
China hard landing	10%
Upside	
Corporate re-awakening	10%

Source: Oxford Economics

i) Eurozone debt crisis unabated

We have long argued that the most likely scenario is that the Eurozone 'muddles through' the current debt crisis, avoiding messy defaults and remaining intact as a currency area. In particular, we have taken the view that even if debt defaults do take place, the weaker countries would engage in a very risky path by also leaving the Eurozone as this would result in major financial disruption. The stronger countries would also have a lot to lose in a very likely sharp appreciation of their currency that would wipe out previous, painful, competitiveness gains. Realising this, policy makers would take appropriate decisions to keep the Eurozone in its current form.

However, developments in recent months are raising doubts that policymakers will act quickly and effectively to resolve the crisis and head off the risk of worst-case outcomes such as a fracturing of the Eurozone. Risks lie with national and Eurozone-wide decisions. First, at the national level, there is a risk that the successive rounds of fiscal austerity become self-defeating. Austerity packages are already facing stiff opposition in Greece and Italy for instance. The combination of massive expenditure cuts and tax increases is putting significant pressure on business and households.

With no sign of improvement in economic conditions, governments in peripheral countries will find it increasingly difficult to implement the austerity measures. Commitment to redress public finances could also waver at the government level as hinted by the U-turn by Italy's Prime Minister attempting to water down the draft of the latest set of austerity measures. Fiscal targets are likely to be missed, fuelling pressure on bond markets and possibly triggering a negative spiral of ever higher bond yields, ever tighter fiscal policy and lower growth.

Eurozone: Bond spreads

% spread of 10-year bonds over German bunds



Source : Oxford Economics/Haver Analytics

At the Eurozone level, political will to 'do what it takes' to effectively tackle the crisis seems to be lacking. Finland's insistence on getting collateral from Greece in exchange for its share of funding for the July bailout package is just one sign that a common view on shared responsibility to ensure the future of the Eurozone is still missing.

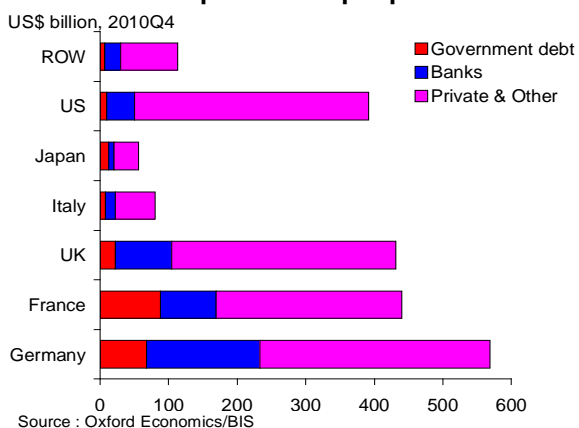
Furthermore, some of the tools available at the disposal of Eurozone policymakers have limited efficiency and adjusting them requires a consensus that currently does not exist. First, while the European Financial Stability Facility (EFSF) should be able to rescue one of the 'small' peripheral economies if needed, it cannot support Italy or Spain. At the moment, there is no agreement

on extending the size of the EFSF to cope with an escalation of the crisis that would engulf Spain and Italy.

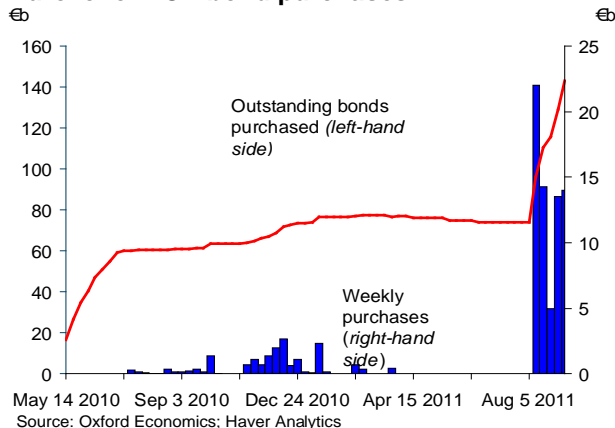
Overall, there is a significant risk that political or economic accidents tip the Eurozone into a less favourable path than our baseline forecast assumes. Disappointing fiscal developments or awkward communication from some Eurozone governments could make financial markets conclude that the current crisis will ever be brought under control. Greece would be pushed into a disorderly default that would quickly spread to other Eurozone countries. In addition, significant holdings of peripheral government debt by banks in core Eurozone countries imply that the whole region would quickly be drawn down to a much weaker growth path than assumed in our baseline forecast. Investor sentiment would slump, causing equity markets to do likewise. This, coupled with the loss of business and investor confidence, would drive the Eurozone into recession.

Policy-makers in the Eurozone are ill-prepared to cope with the fall-out from a disorderly default. A taxpayer bail out of banks and financial institutions, similar to that witnessed after the collapse of Lehman Brothers, would carry a hefty political cost – not to mention a massive financial burden. In terms of monetary policy, the ECB's bond buying programme can only be a stop gap measure. In the five weeks to 9 September, the ECB bought €68.8 billion worth of Eurozone bonds, more than it had bought since the start of this programme in May last year. But Italian and Spanish debt, which totals around €2.3 trillion, is larger than the ECB's total balance sheet. Expansion of the latter would, quite likely, be sterilised i.e. offset by sales of other (short-term) assets, given the ECB's reluctance to expand the monetary base. But even if the ECB could find enough short-term paper to sell, this could push up short-term borrowing cost, affecting regional growth.

World: Bank exposures to peripherals



Eurozone: ECB bond purchases



Given the size of the Eurozone economy, such a scenario would significantly affect growth in other parts of the world. Beside trade linkages, there would be a flight to low-risk assets (US dollar, the Swiss franc and German bonds), similar to what has been observed in recent weeks, although far more severe. The US dollar would likely appreciate which would exacerbate unresolved imbalances in the US.

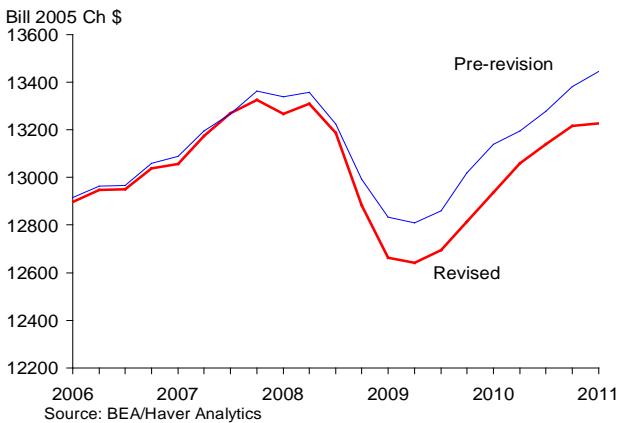
We estimate that there is a 20% probability of disorderly default unfolding. The level of world GDP would be cut by 3% by 2012 compared with our baseline forecast, with the Eurozone in recession and the US very close to it.

ii) US teetering on recession

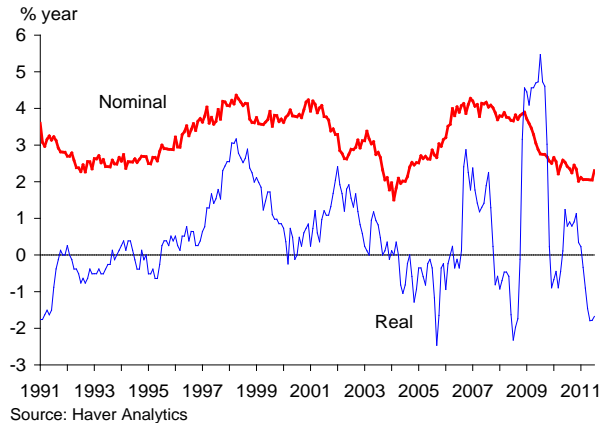
Independent from developments in the Eurozone, the risk of recession in the US has increased in recent months.

First of all, large revisions to historical data now show that the recession was worse than originally thought. More importantly, economic activity has picked up at a very moderate pace. As mentioned above, net job creation has come to a halt in recent weeks. Furthermore, households' purchasing power has been hit hard; nominal wage growth was 1.7% on the year in August, lagging well behind inflation.

GDP



US: Hourly earnings growth



In addition, fiscal cuts have been biting. On average, Federal outlays shrank by 11% on an annual basis from May to July, and only recovered in August (although this was expected due to a sharp decline a year before). Also, the debate on the debt ceiling added to the uncertainty among businesses and consumers about the stance of future fiscal policy.

The upshot is that weak labour conditions, exacerbated by fiscal cuts, have taken their toll on consumer confidence, which plummeted in August to lowest level since April 2009.

If these conditions persist, and growth is too weak to induce a significant improvement of labour conditions, then households' consumer spending could be more subdued than we currently expect, tipping the US economy into recession. We estimate that there is a 15% probability to this scenario.

If GDP growth falls into negative territory, US policymakers' room for manoeuvre would be limited. In terms of fiscal policy, the political deadlock between Democrats and Republicans would cause any aid package to be delayed, at best, given the degree of polarisation and entrenchment of the two parties before a presidential election year.

In terms of monetary policy, the Fed would respond with another wave of quantitative easing (QE). But, with the central bank having already tried a vast and wide-ranging expansion of its balance sheet, the efficiency of yet more QE is in doubt. More QE would also put downward pressure on the US dollar which could drive commodity prices upwards in the short term.

The size of the US economy in the global context means a recession would have a significant impact on world growth. Overall, by 2012 world GDP would fall by more than 1% vis-à-vis our baseline scenario.

iii) Hard landing in emerging economies

So far emerging economies have performed well. However, there are a series of risks that could change that, deteriorating the global economic outlook.

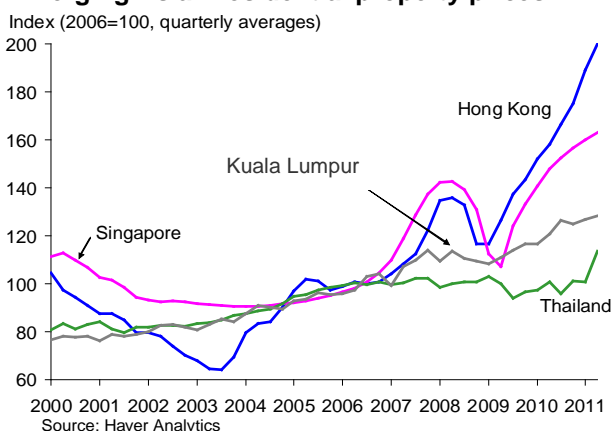
The first of these risks comes from inflation rising beyond acceptable levels to monetary policy makers. Admittedly, inflation has eased in recent weeks but upside risks still exist, for example related to developments in commodity prices. A sudden deterioration of political stability in large oil-producing countries could cause commodity prices to rise again, which would unavoidably drive inflation upwards. A similar assumption can be made in case of a severe drought affecting the production of grains such as corn, wheat or soy beans. Given large weights for energy and food in emerging markets' consumer baskets, such developments would drive inflation up sharply in these countries.

When inflation was at the top of the agenda, central banks responded aggressively to increases in inflation across emerging markets. Since January 2010, the central banks of India and China have raised their reference rates by 325 bps and 125bps, respectively. Although Brazil and Russia's central banks have cut rates by 50bps as economic activity has slowed down in recent quarters, in Brazil the move was unexpected and came after the central bank had increased rates by 375bps during the previous 18 months. And, in many emerging markets, reserve requirements have been increased sharply as well. For instance, China has raised the reserve requirements for large banks by 600 basis points

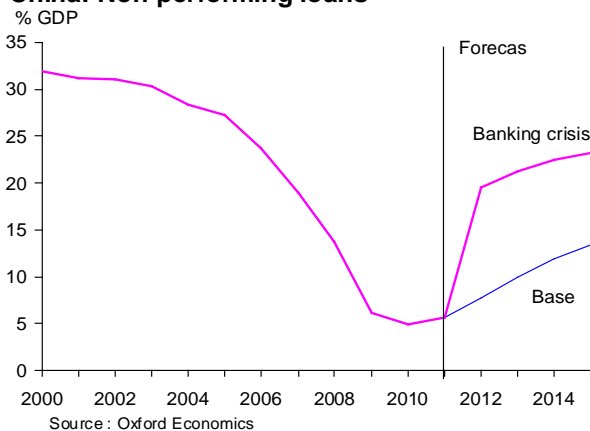
With economies operating near or at capacity, the risk that commodity-driven inflation spills over onto increases in core inflation and wage growth persists. A surge in inflation would force an even more rapid tightening of monetary policy.

The second threat to emerging economies comes from subdued global demand; weaker than currently expected growth in advanced economies would put export-reliant companies in emerging markets under significant pressure. In addition, as global demand softens, a surge in risk aversion could reverse capital flows, drying up credit markets. This would hit some emerging markets such as Turkey, which are heavily reliant on external financing to fund large current account deficits.

Emerging Asia: Residential property prices



China: Non-performing loans



Furthermore, the flight from risk could see a correction in asset prices with sharp falls in equity and property prices. Asian markets would be particularly affected as residential property prices have been raising steadily since the

recession in 2009. Accordingly, investment in the Chinese construction sector could dry up, affecting employment and hence consumption.

Reduced revenues from abroad and weaker domestic demand could lead to a sharp increase in non-performing loans (NPLs), which would undermine banking systems. This is a risk for China in particular because of the scale of the credit stimulus implemented by the Chinese authorities during 2009 and 2010 that has raised concerns regarding the robustness of the banking sector. Accordingly, a surge in NPLs would deteriorate banks' balance sheets, constraining credit available for investment.

Such banking sector stress could lead Chinese GDP to expand by only 4.9% in 2012. Growth would be weaker in all global regions and we estimate that by 2012, world GDP would be nearly 2% below our baseline forecast.

Of the downside risks discussed, we think that the probability of a Chinese or emerging market hard landing is lowest, around 10%. This is because policymakers in emerging markets (unlike their peers in advanced economies) would be in a position to offset some of the negative growth developments with looser fiscal and monetary policy.

But there is hope

While the last four years have been disappointing in terms of growth and economic development, one positive change has been in businesses' cash balances that have risen to sizeable surpluses.

If tensions in the Middle East ease, allowing oil prices to continue to fall, and the fiscal and financial consolidation in advanced economies takes place successfully, business confidence could improve rapidly enabling firms to invest their reserves. Accordingly, growth would be driven by the G7 members with clear benefits spilling over to emerging markets.

We estimate that there is a 10% probability to this scenario, in which world GDP would surpass our baseline scenario by nearly 1.5% in 2012.

Conclusion – Caution, turbulence ahead

After the recovery from the economic crisis caused by global financial turmoil, the world economy is threatened with another possible recession. In our view, global economic growth and stability face clear and present dangers from at least three fronts. The most worrying is the Eurozone debt crisis, an escalation of which could be triggered by policymakers not responding quickly and decisively enough to stem a disorderly default. Similarly, a US recession would dampen world growth. Like their European counterparts, US policymakers have used much of the arsenal at their disposal and would have limited policy options to contain a recession. Another source of downside risks lies in emerging markets and in particular China where a hard landing, possibly triggered by a stiff policy response to rising inflation, is a possibility. In these countries however, the authorities arguably have more tools at their disposal to offset negative growth developments.

We also continue to think that a corporate reawakening is possible but it depends on the ability and commitment of policy makers to deliver the reforms needed in order to restore business confidence. Companies that have been building up reserves could then lead the way to growth through investment.

Recent Industry Performance

Reverting to the mean or slowing down?

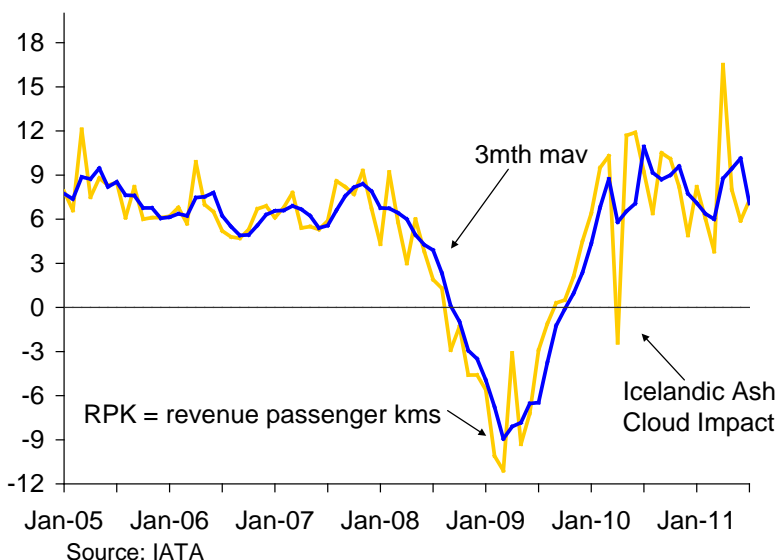
- Both the hotel and airline industries posted data showing a strong rebound from the ash cloud shutdowns of April 2010, inflating year to date numbers in the early part of the year.
- Unsurprisingly, recent data show slowing from these peak numbers as the year-to-date trend reverts to the mean. The question becomes is the industry really slowing down or is it just an appearance given by the data?
- The trend of the most recent data relative to the months prior to April and the first months after April do show some signs of rather moderate slowing which we expect to continue through the end of the year. Still, the pace of expansion is relatively strong in both the hotel and airline sectors even when discounting for the April rebound.

Air Transport

Global air passenger traffic has been a strong, although sporadic, performer over the last several months – consistent with the trends of global visitor movements. After somewhat volatile gains in the spring, Revenue Passenger Kilometres (RPK) growth has slowed in the three months since May, on average, bringing year to date growth down to a still robust 7.8% through July. Load factors are on average lower for the year as the industry has added capacity at a higher rate, according to data from IATA.

International air passenger traffic growth

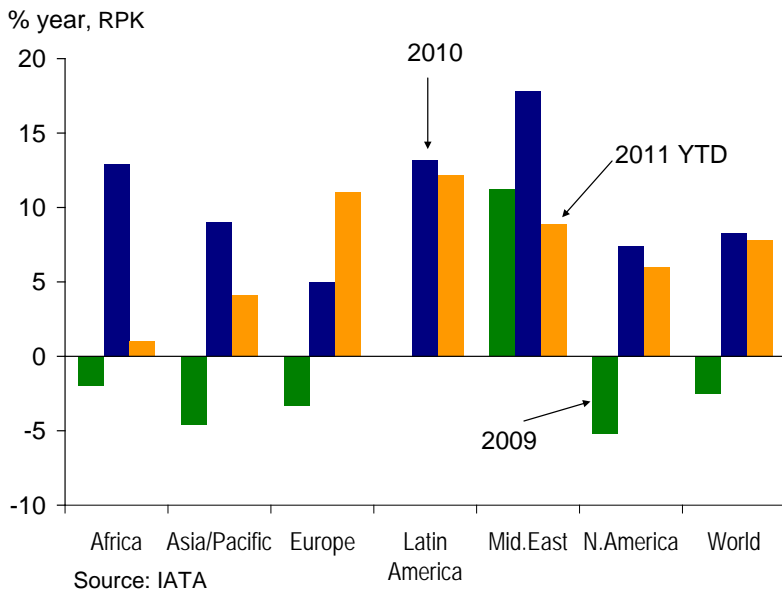
% year, RPK



Every region of the world is posting growth over last year, although with varying levels of strength. Growing at only 1% for the year through July, Africa is the only region to post a year over year decline in any of the first seven months—driven largely by political upheaval in North Africa. Latin American routes have experienced the strongest growth this year, growing in double digits every month

through July and averaging over 12% for the year. Europe is just behind, averaging 11% for the year, largely aided by favourable comparisons to last April.

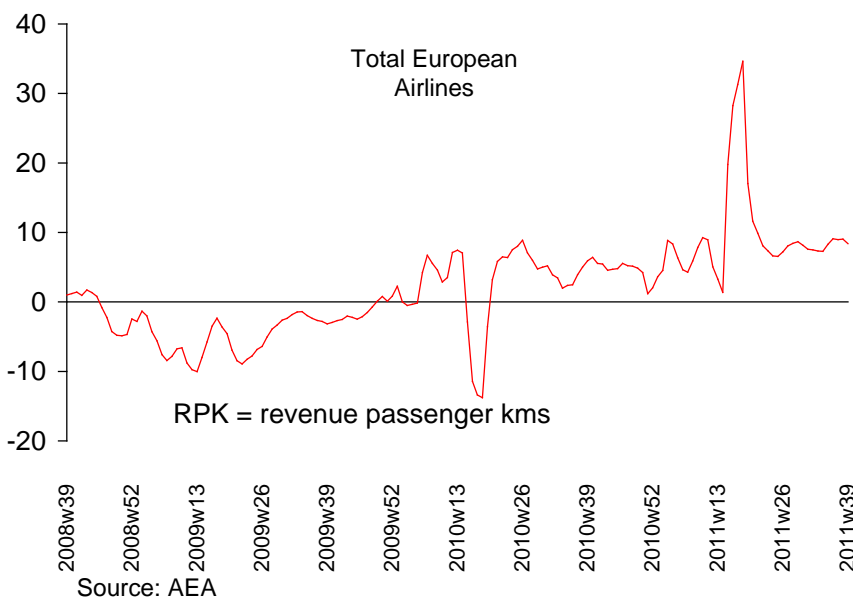
International air passenger growth by region



Data from the Association of European Airlines show the same effect. European airlines have posted robust RPK growth even in the weeks outside those compared to the air space closures of April 2010. Since April, RPK growth has been relatively stronger than the weeks prior to April. With only one exception, weekly growth rates have been above 6% and have averaged a rate of nearly 8% over this period.

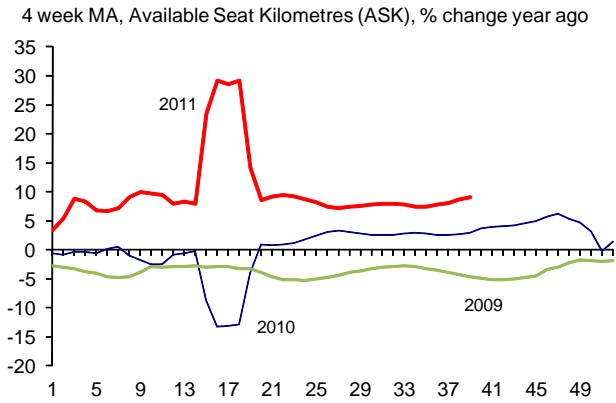
European airline passenger traffic growth

RPK, 4 week moving average, % change year ago



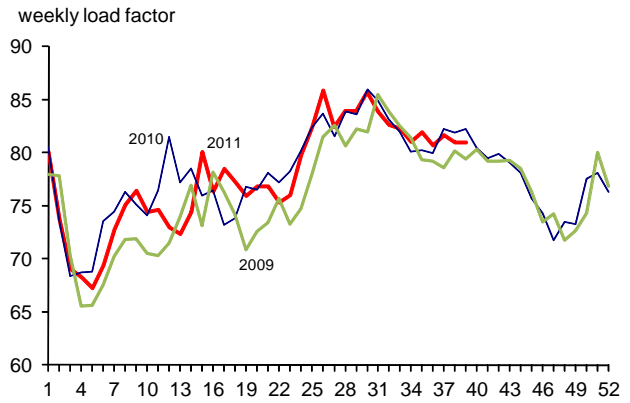
Capacity has nearly kept pace with demand. Available Seat Kilometres (ASK) grew at an average rate of 7.9% over the last 16 weeks (through September) compared to an 8.1% increase in RPK. Load factors averaged just 0.1 percentage points above the same period a year ago. Load factors have

European airlines capacity



Source: AEA

European airlines passenger load factor



Source: AEA

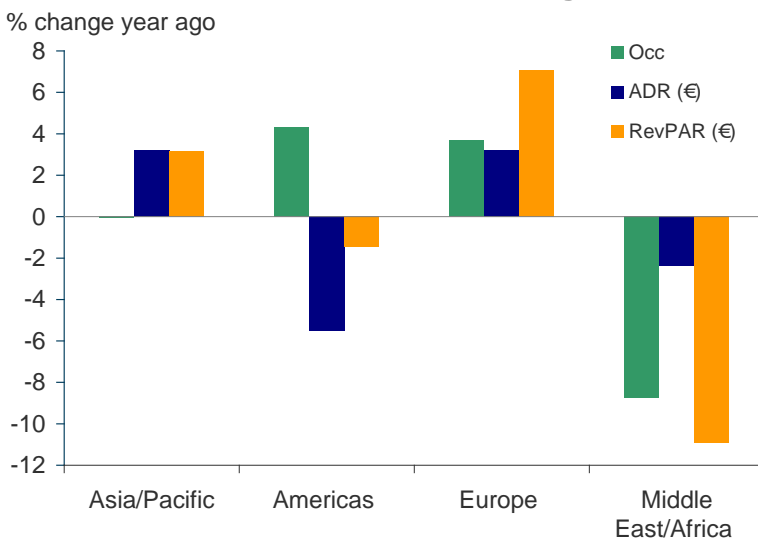
remained above 80% over the last 15 weeks.

Accommodation

The global hotel recovery shows further signs of softening but growth does continue. Recent data show that global hotel demand and occupancy are growing at a slower rate than earlier in the year. Growth slowed in both Europe and the Americas in the year to August partly due to comparison with the strong rates of a year earlier but also influenced by the economic slowdown. Further slowdown is also evident in Asia/Pacific, excluding North Eastern Asia, which has been heavily affected by events in Japan. The Middle East and Africa continue to experience large falls in occupancy due to ongoing civil unrest.

Average Daily Rate (ADR) growth remains solid if not spectacular, especially given high commodity prices and broader inflation. Rates remain well below previous peaks and further growth should allow continued growth in Revenue per Available Room (RevPAR) even as demand softens.

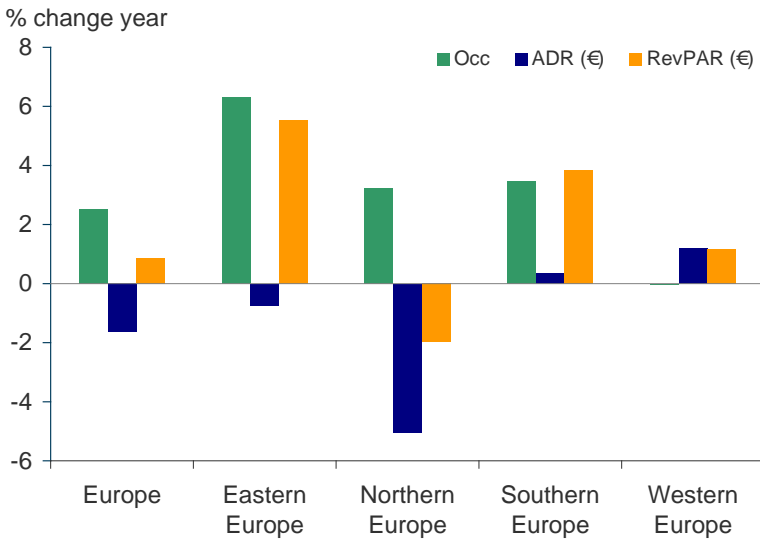
Global Hotel Performance, Jan-Aug 2011



Source : STR Global

Within Europe, recent data exhibit slower demand growth in all sub-regions, notably in Western Europe where occupancy rates in August were only fractionally higher than in 2010. More worrying, ADR slowed significantly and even fell in the month for the Eastern and Northern European sub-regions. However, this is thought to be a one-off shock rather than the start of a trend. These sub-regions have performed well in terms of occupancy growth for the rest of the year and should not require lower rates to maintain competitiveness.

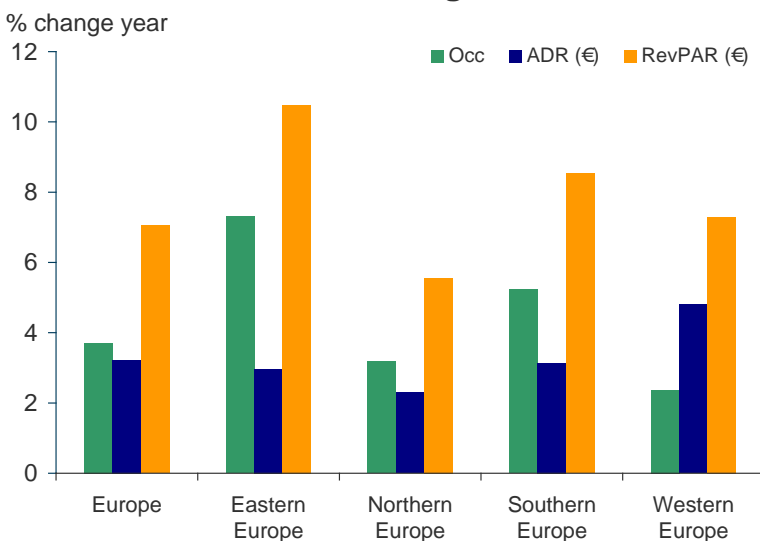
Hotel Performance, Aug 2011



Source : STR Global

Through August, room demand has grown nearly 4% and been especially strong in Eastern and Southern Europe, with occupancy rates up 7.3% and 5.2%, respectively. Although occupancy growth has been relatively weak in Western Europe (2.4% YTD), room rates have performed well above average, growing 4.8%.

Hotel Performance, Jan-Aug 2011

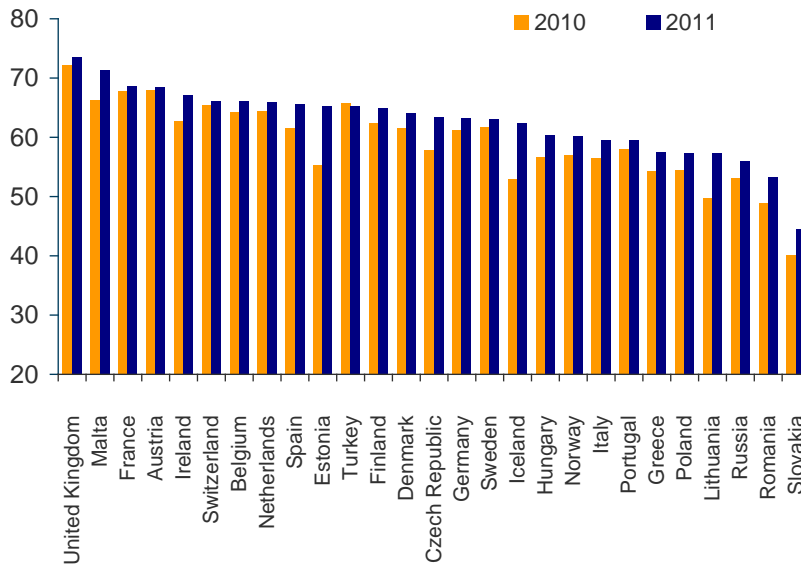


Source : STR Global

For the year through August 2011, pan-European occupancy was 3.7% higher than the year before, including some slowdown from the first part of the year. Slowing has been most noticeable in Western Europe, but occupancy remains higher than in 2010 for all countries in the region. ADR also remains higher than in 2010 for the year to August for all countries except the Czech Republic and Hungary.

Hotel Occupancy Rates

Jan-Aug, occupancy, %



Source : STR Global

Key Source Market Performance

Long haul and regional markets shine

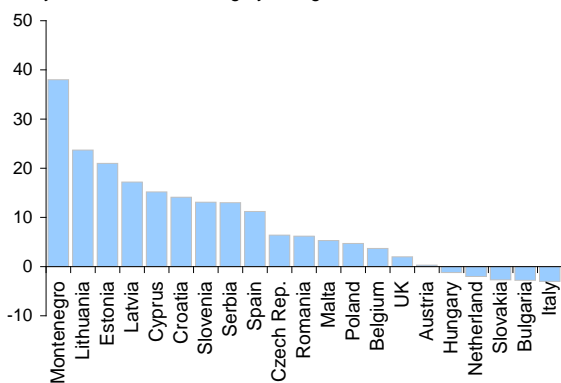
- Russia remains the best performing source market, well ahead of other markets
- Japanese travel is recovering to Western Europe
- Travel activity from other key source markets remains relatively robust overall, despite some softening in arrivals due mainly to trend reversion

Key intra-European markets

German travellers have moved back into their core markets as trends to both Austria and the Netherlands have improved. More than three-quarters of reporting destinations have welcomed more German visitors this year and 80% are reporting an increase in nights. Of comparable destinations, more than half are reporting an increase in the length of stay.

Visits from Germany to Select Destinations

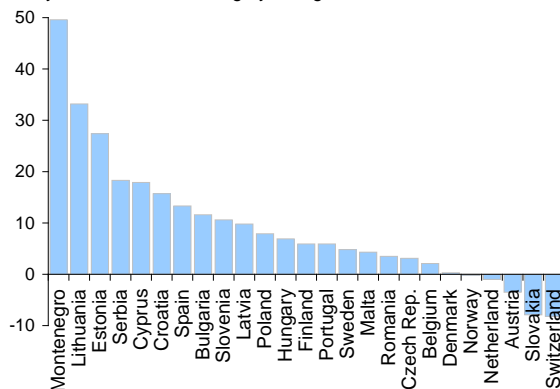
2011, year-to-date*, % change year ago



Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

German Visitor Nights in Select Destinations

2011, year-to-date*, % change year ago

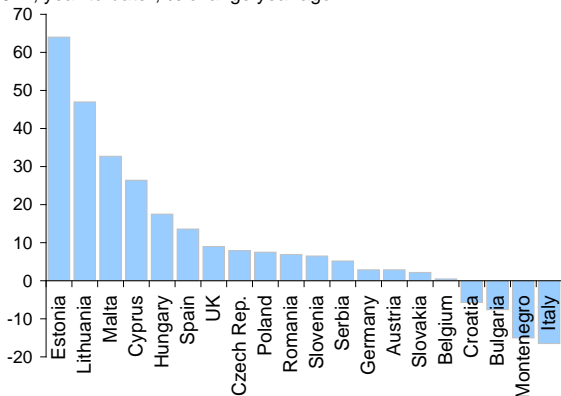


Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

European destinations also continued to experience growth in arrivals of Dutch travellers with three-quarters of the reporting destinations indicating growth in arrivals. Nights spent by travellers from the Netherlands have increased in 10 of the 18 destinations reporting both nights and arrivals.

Visits from Netherlands to Select Destinations

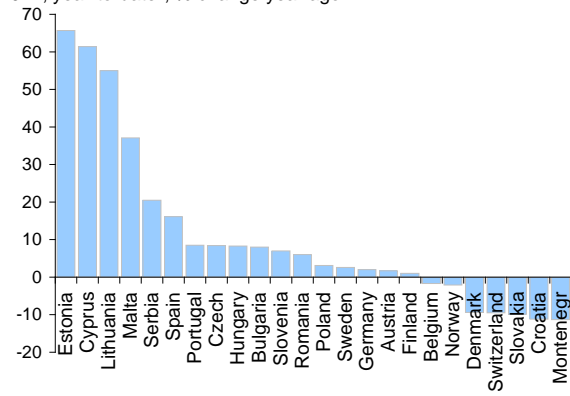
2011, year-to-date*, % change year ago



Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

Netherlands Nights in Select Destinations

2011, year-to-date*, % change year ago

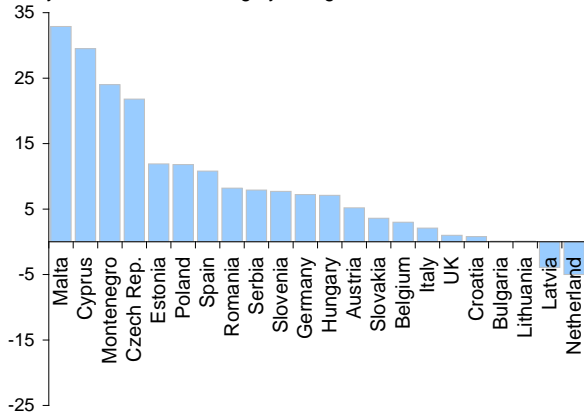


Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

Nearly every reporting destination has benefited from an increase in arrivals from France (20 of 22 destinations). While many destinations have experienced reversion to the mean in growth, French visits to some higher volume destinations have expanded since our last report. However, for a majority of destinations reporting both arrivals and nights, the length of stay has decreased.

Visits from France to Select Destinations

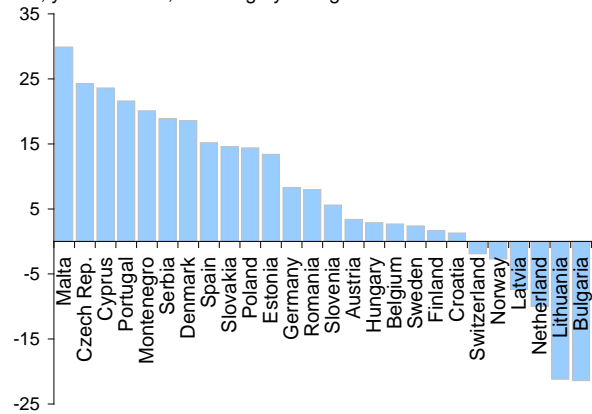
2011, year-to-date*, % change year ago



Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

French Visitor Nights in Select Destinations

2011, year-to-date*, % change year ago

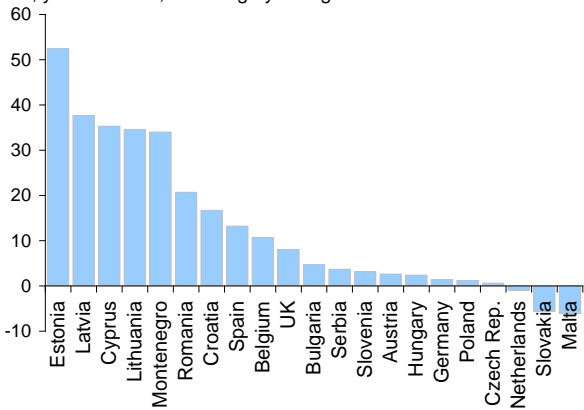


Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

The increase in Italian travellers to European destinations continues to be strong, with 18 of 21 destinations reporting increases for the year. However, only 15 of 26 destinations recorded more nights thus far in 2011. Only one quarter of reporting destinations are reporting longer visits from Italy.

Visits from Italy to Select Destinations

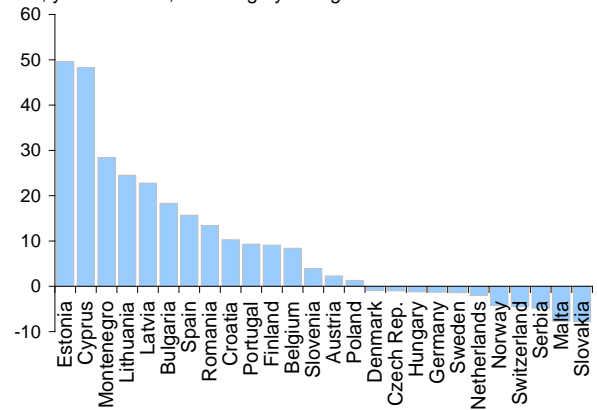
2011, year-to-date*, % change year ago



Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

Italian Visitor Nights in Select Destinations

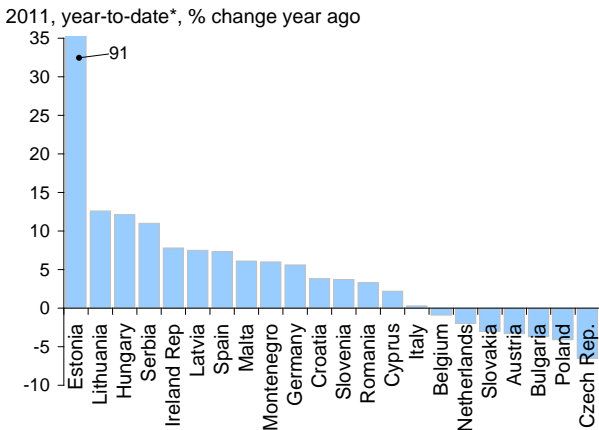
2011, year-to-date*, % change year ago



Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

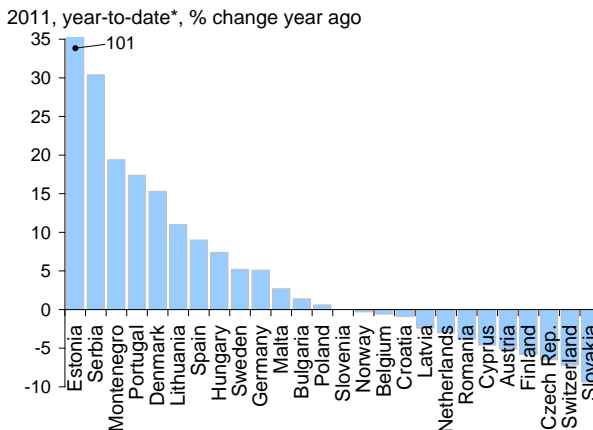
Travel from the UK is mixed but positive on the balance. Of reporting destinations, 15 have welcomed more UK visitors in 2011 while 7 have reported fewer. The majority (12 of 20) of destinations are reporting weaker nights than visits, indicating a shorter length of stay.

Visits from UK to Select Destinations



Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

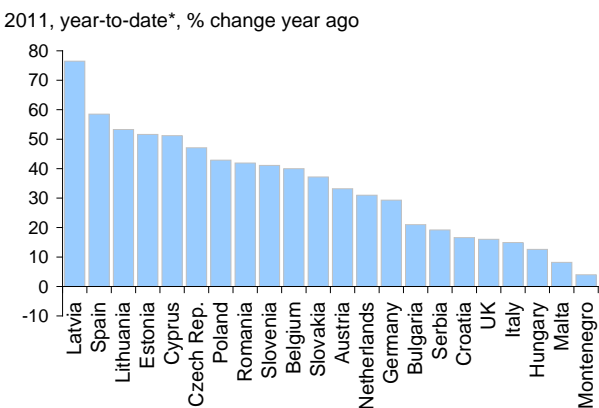
UK Visitor Nights in Select Destinations



Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

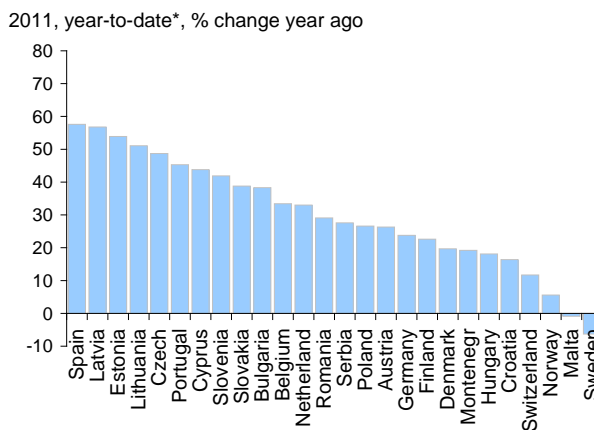
Russia remains the top performing source market for European destinations. Growth in Russian arrivals is reported in every destination for 2011. More impressive is that all but two destinations have hosted at least 10% more Russian visitors in 2011. On balance, length of stay appears slightly lower for the year, but 24 of 26 destinations do report an increase in the number of nights.

Visits from Russia to Select Destinations



Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

Russian Visitor Nights in Select Destinations



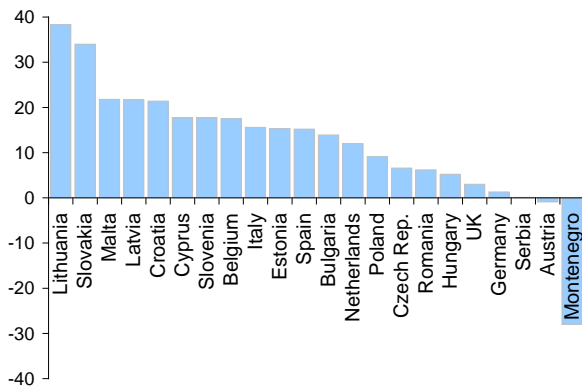
Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

Non-European markets

Travel from the US has increased for nearly every destination in Europe and strongly for more than half of reporting destinations. All but two destinations have reported growth in either or both arrivals and nights from the US. However, US travellers continue to spend less time in their destinations in Europe than last year.

Visits from US to Select Destinations

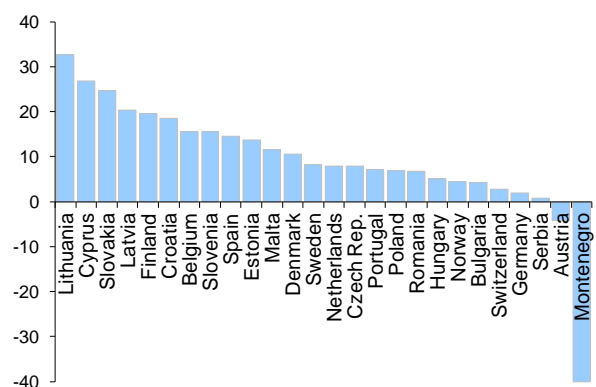
2011, year-to-date*, % change year ago



Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

US Visitor Nights in Select Destinations

2011, year-to-date*, % change year ago

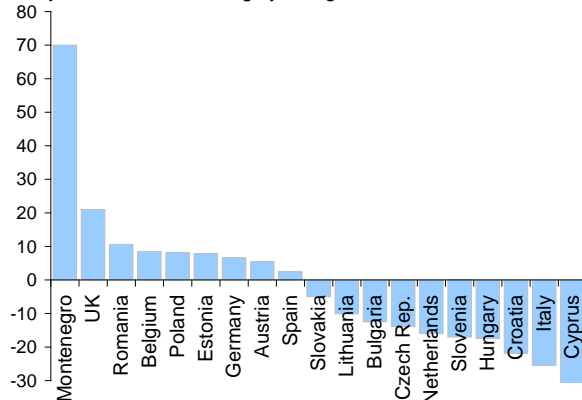


Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

Despite the catastrophic earthquake, tsunami, and nuclear disaster in Japan earlier in the year, travel to many destinations from Japan has expanded in the intervening months. However, this phenomenon has largely been enjoyed by destinations west of the Danube. Destinations in Central and Eastern Europe have experienced quite heavy declines in Japanese visitors.

Visits from Japan to Select Destinations

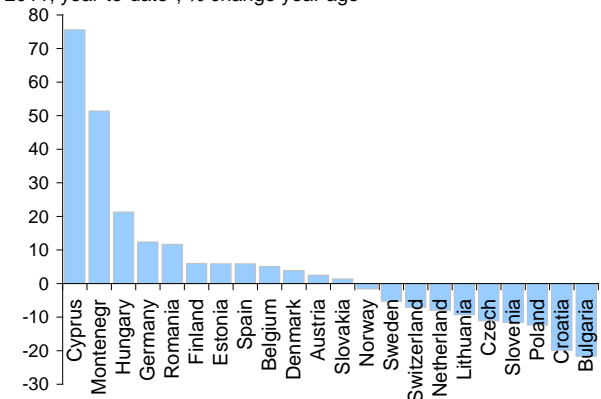
2011, year-to-date*, % change year ago



Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

Japanese Visitor Nights in Select Destinations

2011, year-to-date*, % change year ago



Source : TourMIS, ETC, *date varies (Mar-Aug) by destination

Global Tourism Forecast Summary

Tourism Economics' global travel forecasts are shown on an inbound and outbound basis in the following table. These are the results of the Tourism Decision Metrics (TDM) model, which is updated in detail three times per year. Full origin-destination country detail is available online to subscribers.

TDM Visitor Growth Forecasts, % change													
	Inbound*						Outbound**						
	2008	2009	2010	2011	2012	2013	2007	2008	2009	2010	2011	2012	2013
World	1.7%	-4.2%	6.8%	4.2%	3.3%	3.9%	7.0%	2.9%	-3.6%	6.5%	3.9%	3.3%	4.4%
Americas	2.9%	-4.8%	6.4%	4.5%	3.2%	4.4%	4.7%	1.0%	-2.8%	6.7%	4.3%	3.1%	4.4%
North America	2.6%	-5.4%	6.7%	3.3%	3.2%	4.1%	3.9%	0.7%	-3.6%	5.5%	2.5%	2.1%	3.7%
Caribbean	0.9%	-3.5%	2.6%	3.9%	3.1%	3.7%	0.6%	-12.3%	2.9%	6.1%	5.4%	4.8%	5.5%
Latin America	5.3%	-3.6%	8.1%	8.4%	3.5%	5.5%	10.2%	6.8%	-0.9%	11.6%	10.7%	5.7%	6.5%
Europe	0.3%	-5.7%	3.6%	5.6%	2.3%	2.9%	4.7%	0.0%	-6.7%	4.1%	4.5%	2.9%	3.7%
EU15	-1.6%	-5.2%	3.0%	4.1%	1.5%	2.0%	2.6%	1.0%	-3.3%	2.7%	4.1%	1.9%	2.4%
Eastern Europe	3.3%	-8.9%	4.6%	8.9%	4.4%	5.4%	8.0%	-2.4%	-12.9%	6.1%	5.9%	4.9%	6.0%
Asia	-0.5%	-1.5%	12.8%	5.7%	5.3%	5.1%	10.1%	3.5%	-0.8%	10.9%	3.9%	4.3%	5.2%
North East	-3.1%	-2.9%	13.8%	2.9%	6.6%	5.6%	8.8%	1.9%	-0.9%	7.9%	2.5%	4.7%	5.2%
South East	3.7%	0.8%	12.5%	9.9%	3.4%	4.3%	12.0%	8.7%	-0.5%	19.0%	6.5%	3.6%	5.0%
South	3.6%	-3.5%	13.0%	11.9%	6.1%	5.5%	18.0%	0.4%	-4.2%	12.4%	7.2%	5.1%	7.7%
Oceania	-1.2%	-0.7%	4.7%	2.2%	2.6%	5.5%	8.5%	5.2%	6.3%	9.0%	4.9%	0.3%	0.7%
Africa	7.3%	1.1%	10.6%	-4.9%	5.5%	6.0%	21.8%	7.2%	-10.7%	16.3%	-0.7%	6.4%	6.9%
Mid East	16.7%	-4.2%	12.1%	-2.8%	2.5%	5.3%	14.5%	27.5%	10.5%	2.6%	0.9%	0.8%	4.7%

* Inbound is based on the sum of the country overnight tourist arrivals and includes intra-regional flows

** Outbound is based on the sum of visits to all destinations.

Economic Outlook for Key Markets

Can policymakers rise to the current challenges?

- A large default of Greek state debt now appears to be unavoidable and is expected as part of our central forecast.
- Financial stress is rising accordingly within the Eurozone and globally leading to tighter borrowing conditions and weaker expected growth.
- There remain significant downside risks to the lowered central forecast if Eurozone policymakers do not take decisive action. This should include a larger EFSF and greater willingness to intervene in capital markets, as well as lower interest rates.
- There are some encouraging signs within recent US data but only modest growth is expected within our baseline and even this will require some cooperation between political parties.
- Some strong growth is expected in Japan but this is largely limited to a rebound from the natural disaster induced slump and the outlook has deteriorated.
- Growth is still expected for Emerging markets but at a slower pace than in previous forecasts amid investor concerns of export demand

Global Overview

Growth forecasts have been downgraded again due to a combination of weak data and rising concerns regarding the manageability of sovereign debt. Recent data show that recession in the US and the subsequent recovery were weaker than previously reported. However, the current situation within the Eurozone is of greater concern for the outlook.

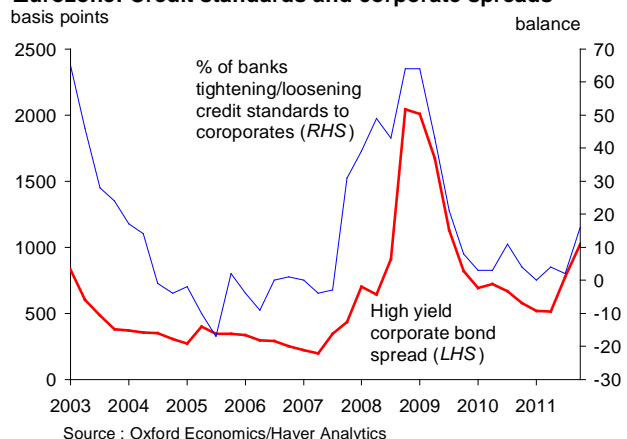
We now see GDP growth in the Eurozone at just 0.5% next year, down from an expected 1.6% last quarter. The main reason for this is our view that a large default in Greece – involving a face value writedown of state debt of around 50% - cannot now be avoided.

We expect this to prompt a further increase in financial stress, which has risen sharply in recent weeks to the highest level since September 2009. This will also mean weaker stock markets and rising borrowing costs, damaging

US: Financial stress indicator



Eurozone: Credit standards and corporate spreads



consumption and investment.

The impact on the Eurozone economy of these forces is already visible. The PMI surveys pointed to declining output in September while the latest ECB lending survey showed tightening credit conditions. The 'negative feedback loop' between weaker growth and tighter financial conditions may again be materialising.

Conditions elsewhere in the global economy are less severe but policymakers are acutely aware of how precarious even the current modest recovery might be in the face of another major financial shock.

The Fed acted in late September with 'operation twist', a policy package designed to drive down long-term borrowing costs. With US activity and monetary indicators still signalling moderate growth, this fell short of renewed quantitative easing (QE), but a 'QE3' nevertheless remains a possibility. In the UK, meanwhile, the Bank of England went further, adding £75 billion extra QE in early October.

But it is the Eurozone authorities who need to act most. A credible plan to manage and contain a Greek default is essential quickly, and this may also involve the ECB taking unprecedented actions like large-scale QE and purchases of sovereign debt.

Summary of International Forecasts						
	2010	2011	2012	2013	2014	2015
Real GDP						
North America						
United States	3.0	1.7	2.1	3.2	3.5	3.1
Canada	3.2	2.2	1.8	2.6	3.0	2.8
Europe						
Eurozone	1.7	1.6	0.6	1.8	2.0	2.0
Germany	3.6	3.0	1.1	2.0	2.1	2.0
France	1.4	1.6	0.7	1.8	2.0	2.0
Italy	1.2	0.6	0.2	0.9	1.3	1.7
UK	1.8	0.9	1.1	2.6	2.8	2.7
EU27	1.8	1.7	0.9	2.2	2.4	2.4
Asia						
Japan	4.0	-0.6	2.2	3.0	2.4	1.5
Emerging Asia, excl Japan	9.0	6.9	6.8	7.8	7.5	7.1
China	10.3	8.8	8.3	9.2	8.8	8.3
India	8.9	7.1	7.7	9.6	9.2	8.3
World	3.8	2.8	2.8	3.9	4.0	3.7
World 2005 PPPs	4.5	3.7	3.7	4.7	4.7	4.5
World trade	14.2	6.7	5.7	7.8	7.7	7.2

Eurozone

A default on Greek government debt, with a haircut of around 50%, now seems unavoidable. We assume it will happen around the turn of the year.

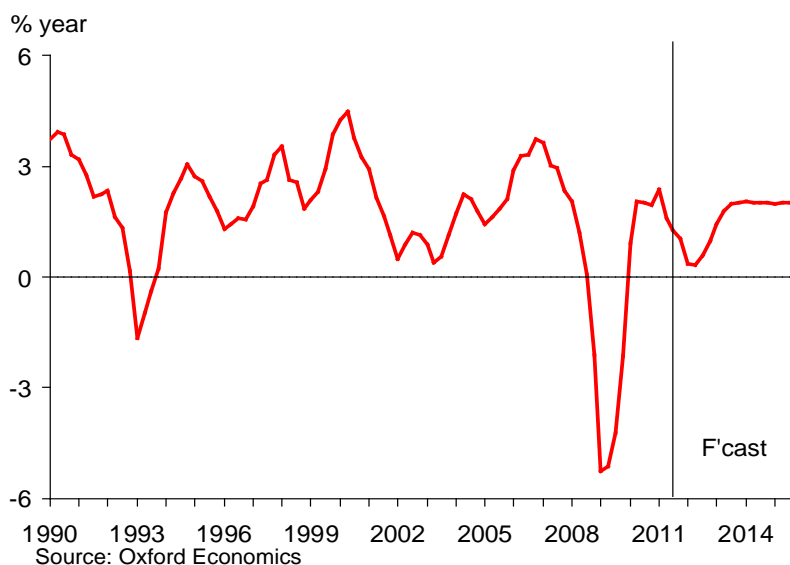
Our baseline forecast assumes an orderly default, which is contained to Greece. In the baseline, we forecast Eurozone GDP to grow by only 0.5% in 2012 with the economy very close to recession in the first half of next year.

To contain the default Eurozone policymakers (and the IMF) need to ensure that enough funds are available to recapitalise the Greek banking system as well as other European banks significantly affected. A much beefed-up EFSF and a willingness by the ECB to engage in potentially very large liquidity operations also look essential.

If the default process became disorderly, with rapid contagion, government bond yields could increase dramatically across the Eurozone and credit markets would freeze. Investment and employment would be hit, plunging the region into a deep recession.

In the October press conference the ECB announced a series of measures aimed at providing extra liquidity support to the financial system during the next two years. The ECB left rates unchanged at 1.5%, but we feel that the slowdown in economic activity will cause inflation risks to subside, allowing rates to be cut by 50 bps by the end of the year.

Eurozone: GDP



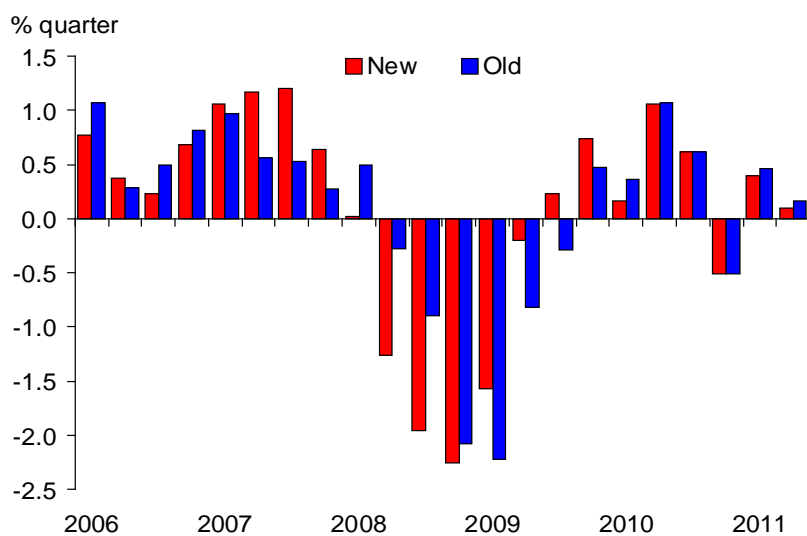
UK Economy

The publication of the Quarterly National Accounts saw significant revisions to the historical data amidst the introduction of a series of changes to methodology and coverage. The latest data shows that the recession was deeper than previously thought – a decline in GDP of 7.1% from peak-to-trough – but also one quarter shorter. Growth in both 2011Q1 and 2011Q2 was revised down by 0.1 percentage points.

The unwinding of temporary factors, which had dampened growth in Q2, should ensure reasonable growth in Q3. However, the economy is likely to slow thereafter, with the on-going volatility in financial markets continuing to erode confidence and the global outlook having deteriorated further. The forecast hangs on how the Eurozone crisis is resolved. We have assumed that Greece defaults in an orderly fashion and that the fallout is contained. On this basis we expect GDP to grow by 0.9% this year and by 1.1% in 2012. However, a less orderly default would yield a weaker outcome.

The MPC reacted to the weakening in the outlook by restarting its programme of asset purchases. It will buy £75bn of gilts over the next four months, but while the MPC has been upbeat about its potential benefits, we are more sceptical given the very low level of gilt yields. We think that it may provide less of a boost than in 2009, meaning that further stimulus may be required and that the MPC may have to look to other types of asset.

UK: GDP revisions



US Economy

Recent economic reports have been moderately positive, including the ISM indexes, orders, auto and chain store sales, and employment. But these have not been robust enough to signal a strong acceleration in the economy. And the near-term outlook for consumer spending remains subdued.

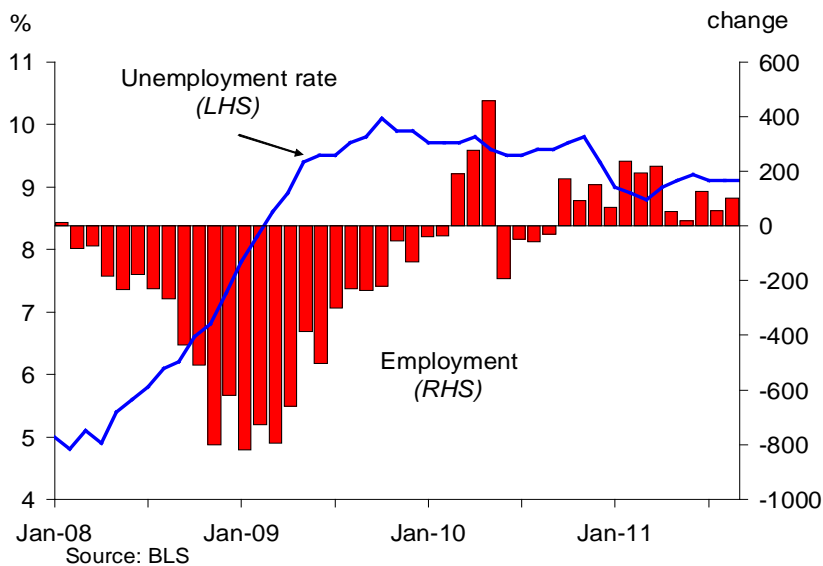
We continue to expect better growth in the second half of 2011 than in the first half and a better outcome in 2012 than 2011, but growth will be modest at best – an annual rate of about 1.8% in 2011H2 and 2.1% for 2012.

This outlook is dependent on events in Europe – right now we assume that though Greece will be forced into a large default, the fallout from this will be contained. If an uncontrolled default process gets under way instead, then the US economy is in for a much rockier road.

In addition, our forecast assumes that US fiscal policy will be less constrictive than current law prescribes. That will require cooperation between the two political parties in Congress and between Congress and the Administration, by no means a sure thing.

The Federal Reserve continues to support the economy. Its latest program of selling short-term securities in order to purchase long-term debt is designed to put further downward pressure on long-term interest rates. The Fed will also be reinvesting its holdings of mortgage-backed securities to try to shore up the housing sector.

Employment and unemployment



Japan

Growth figures for the third quarter are likely to be strong, as a result of the rebounding of activity from the natural disaster induced slumps of the previous two quarters. But despite this, we are once again downgrading our growth forecasts this month.

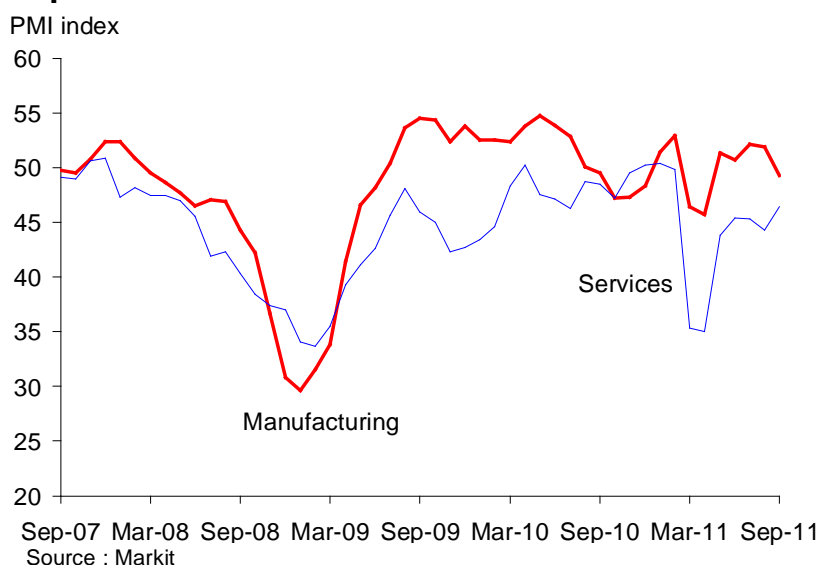
While industrial output has regained much of the losses induced by March's earthquake and tsunami, the prospects for further sustained expansion have worsened. The September PMI implied flat production levels, with export orders weakening – including from China – as the global growth outlook weakens.

On the domestic demand front, the latest evidence also points to some stalling in the recovery seen in previous months. Retail sales fell in July and August and real consumption was essentially flat. And although the unemployment rate dipped in August, employment fell for the second straight month.

Industry also continues to suffer from the strength of the yen, a by-product of global financial stresses. The real effective exchange rate is around 5% above its ten-year average, and is close to the peak levels seen at the worst point of the 2008-2009 global financial crisis.

We now forecast a 0.6% decline in GDP in 2011 and 2.2% growth in 2012. This forecast partly reflects an expected lack of action by policymakers, but options do exist – especially on the exchange rate side.

Japan: PMIs

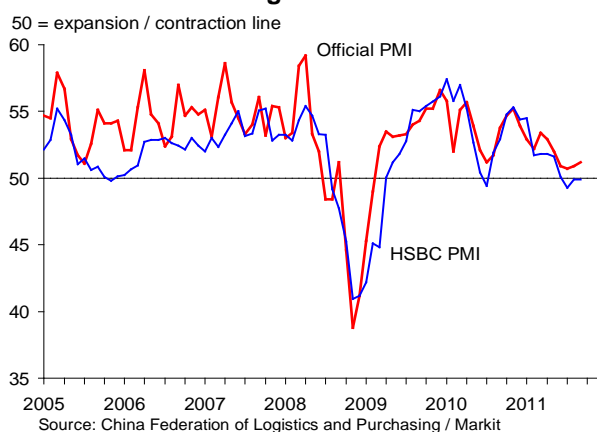


Emerging Markets

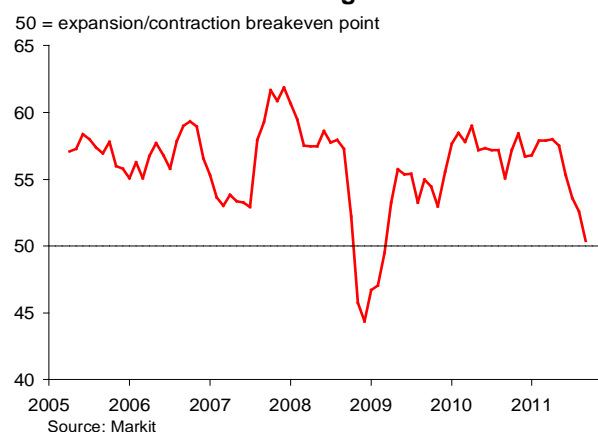
Compared with developments in other parts of the world, the latest surveys and data paint a fairly reassuring economic picture in China. The September manufacturing PMIs were broadly stable for the second consecutive month at around the 50 level, while the HSBC services index bounced in September after a weak August. Meanwhile headline CPI inflation fell to 6.2% in August and the last month's fall in global oil and food prices should help to push it significantly lower over the next six months, which will support consumers' purchasing power. In addition to the fears about the repercussions of major weakness in the country's key export markets of the EU and the US, there are also concerns about the state of the domestic property market, but it remains the case that China still has huge resources to respond in the event of an economic emergency.

Of the other BRICs, the September PMI surveys for India showed a further marked deceleration in the pace of expansion, dropping to their lowest levels in two and a half years – with the global turmoil adding to the pressures from rising interest rates and a prolonged period of high inflation. And although this is still likely to be consistent with a very rapid rate of growth by western standards, it seems very likely that official forecasts of near 8% GDP growth in 2011/12 will not be achieved. We have lowered our near-term forecasts again and now think that only 6.7% growth will be achieved in the current fiscal year. Although the rupee has also weakened significantly since end July (down around 10%), we think it probable that the Reserve Bank will be increasingly concerned about the growth outlook rather than sanctioning any further rises in interest rates.

China: Manufacturing PMI



India: HSBC Manufacturing PMI



Elsewhere in Asia, the other important signal from the September round of surveys was the further move into contractionary territory of Korea's manufacturing PMI, given the broad-based nature of the sector. Companies were over-optimistic about the global outlook in H1 and as a result have been left with excessive inventories now that demand has slowed. This, together with a generally weak electronics sector across Asia, will dampen industrial output over the next six months. As a result we have cut our Korean GDP growth forecasts for 2011 and 2012 to 3.4% and 3.9% respectively (three months ago they were 3.7% and 5.0%). Importantly, the country's domestic sectors continued to show steady growth in August.

Affected by the increasingly gloomy outlook in the Eurozone, both the Polish and Czech manufacturing PMIs slipped further in September – albeit remaining

just in expansion territory. Surprisingly, Turkey's PMI bounced, echoing other of its recent manufacturing indicators. But this pattern is unlikely to last – despite the benefits of a much more competitive currency – given weak EU demand and a much less attractive environment for investment now that lending interest rates are at a much higher level than earlier in the year. Meanwhile in Russia, the surveys point to a slowing in already fairly modest growth but September's fall in CPI inflation to 7.2% from 9.5% in H1 should help support consumer spending. However, Russia's equity market has dropped more than any other leading emerger since end July and interbank lending rates have risen.

The increasing level of concern about the scale of the Eurozone debt crisis has prompted global investors to withdraw from emerging market assets, with stock markets being hit severely in early August and then a more general slide over the last month (including heavy selling of emerger domestic government bonds – previously a favourite of investors). Out of 19 major emerging currencies, only China's has not weakened against the US\$ since the end of July, while those of Brazil, India, Russia, Korea, Mexico, South Africa and Chile have fallen 10% or more, and Poland's and Hungary's have dropped by nearly 10% against a weakening euro.

In more normal times, such sharp drops would have implications for monetary policy but if the threat to growth prospects intensifies then the latter risk is likely to take precedence, particularly as in this situation the downward pressure on global oil and food prices already evident over the last month would probably continue. However, while the risk of a move to a general easing of monetary policy has risen, provided the US and Eurozone avoid outright recession most emerger central banks are likely to keep interest rates on hold for the next couple of quarters (awaiting further global developments and a sustained fall in inflation) rather than going for an early cut.

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