

## **What are the economic prospects for Scottish tourism 2007/09? Will it be a 'Steady State' or a 'Middle Class Squeeze'.<sup>1</sup>**

Study team

Prof. Ian Yeoman,  
Scenario Planner,  
VisitScotland  
Ocean Point One  
94 Ocean Drive  
Edinburgh EH6 6PL  
Email: [ian.yeoman@visitscotland.com](mailto:ian.yeoman@visitscotland.com)  
Tel: 00 44 (0) 131 472 2388

Mr Chris Greenwood,  
Research Analyst,  
VisitScotland

Mr Dougie Adams  
Economist  
Oxford Forecasting

### **Introduction**

A day doesn't go by without a media story about the mortgage sub prime market or where you one of those people that stood in the queue to withdraw your savings from Northern Rock? Whatever the situation, there seems to be more uncertainty in the financial markets and many business sectors of the UK economy are predicting a slow down in 2008. What does this mean for Scottish tourism? The scenario planning team at VisitScotland has constructed two scenarios about the prospects for 2007 through to 2009 called 'Steady as it Goes' and 'Middle Class Squeeze'. The two scenarios were constructed considering a number of variables including:

- Propensity to travel to Scotland
- Relationships of inbound / outbound tourism traffic
- Transport links
- Disposable income and wealth
- Oil prices
- Inflation
- Exchange rates
- Weather

---

<sup>1</sup> *This research bulletin has being prepared for VisitScotland and the Scottish Tourism industry. No representation or warranty is given (expressed or implied) as to its accuracy or correctness of the information and opinions contained in this report. The material should not be regarded as specific advice and no action should be taken in reliance on it. Neither the authors nor VisitScotland accepts any liability whatsoever for any loss or damage in any way of or reliance placed upon the material. All of the events and portraits referred to within the scenarios are fictitious or viewed in context. Publication date: November 2007*

The purpose of the research project is to:

- Provide an analysis of the present economic environment and short-term prospects
- The construction of two economic scenarios about Scottish tourism 2007/09
- Measurement of the likelihood of the occurrence of each scenario using an expert panel and industry barometer
- What does this all mean for the industry's 50% growth ambition?

## The Economics

### Has the “credit crunch” danger passed?

Over the late summer the fall in equity prices, along with the very public run on Northern Rock were perhaps the most visible signs of the ‘credit crunch’. The crunch was largely attributed to changing attitudes to risky lending (beginning with the sub-prime US lending markets). The sharp reversal in stockmarket fortunes caused consternation across global markets and many column inches were dedicated to the discussion of the causes and likely extent of the difficulties. However, at the time of writing, stock markets have recovered most of their late summer losses and further problems in the banking sector have not surfaced. Nonetheless it would be unwise to surmise that we are definitely ‘out of the woods’. Oil prices have begun to climb again, reaching over \$90 per barrel, and the US economy continues to report mixed signals across the corporate sector. Looking forward, the concern that borrowing remains too high and that lenders will get even more discerning with their cash remains very real.

### UK still strong

In addition to the recovery in stock markets many of the mid / late 2007 indicators continue to suggest a steadily growing UK economy. Employee job levels continue to climb and output continues to grow, albeit at an unspectacular pace. Unemployment has fallen to historically low levels and inflation has fallen back to target after a long period of overshooting.

**Table 1: UK key economic indicators, Oxford economics base forecast**

	2005	2006	2007	2008	2009	2010
Inflation (%)	2.05	2.33	2.36	1.91	2.00	1.98
Interest rates (%)	4.63	4.69	5.60	5.38	5.00	5.00
Total employment (000's)	30876	31274	31540	31785	32068	32311
Unemployment (000's)	862	945	864	921	992	1003
GVA growth (%)	2.2	3.0	3.2	2.5	3.0	3.1
Imports	359626	401614	378992	398505	420115	442783
Exports	323749	361541	338656	355996	377347	399539

With 3.3% growth recorded in the year to Q3 (the latest data) the UK is likely to be the strongest of the G7 economies, with growth above initial expectations. Looking at 2008 there is undoubtedly going to be some effects from the recent problems in 2007. These effects are likely to be felt through the following mechanisms:

- **Bank lending** – with a re-pricing of risk, borrowing has become more expensive.
- **Credit tightening** – the corporate sector will find borrowing conditions more difficult, as will house purchasers seeking high loan-to-value products.
- **Consumer spending effects** – consumers may be more reluctant to take on debt or to withdraw equity from their homes to support spending.

- **Trade** – UK exports will fall if world demand weakens, but the strength of China and other emerging markets is likely to offset any particular problems experienced in the US.
- **City jobs** – jobs in so-called ‘city jobs’ may be at risk if problems persist – in the UK this would affect London and the South East most significantly though Scotland would also be impacted. The effects of this form of contraction would be significant, reducing government tax takes, causing knock-on effects on other sectors, with city bonuses thought to be particularly important in driving house prices in and around the capital.

There are a number of reasons to support the interpretation that the UK economy will remain strong in 2008.

- **Corporate liquidity and profitability:** Both are very strong and this should cushion any adverse effects from credit problems.
- **Interest rates:** There is scope for rates to fall (with inflation and wage growth subdued) as they have done in the US.
- **Consumer confidence** – there is little evidence of this to date but a fall in confidence would have significant effects not just on the retail sectors but more widely on the economy.

## The Scenarios

### Scenario 1: Steady as it Goes

#### *Economic Environment in 2007/09*

- The UK economy remains stable through the second half of 2007 and 2008, although growth projections have been scaled back in light of the Credit Crunch.
- Inflationary pressure and interest rate hikes in the UK, US and Europe continue to erode household budgets but remain manageable.
- Borrowing becomes more difficult for the consumer.
- The housing market remains stable with only marginal house price inflation.
- Europe’s economy remains flat but stable as the strong Euro impacts exports and manufacturing.
- Oil prices float between \$65 and \$75 per barrel
- In North America, the baby boomer generation is less effected by the slow down in the economy than any other socio-economic group.
- 2009 is a year of recovery and growth.

**Table 2 Scenario 1: Steady as it goes**

<b>Visits/Trips (million)</b>								
To Scotland :Trips (m)	2005	2006	2007 est.	% Change	2008 proj.	% Change	2009 proj.	% Change
Scotland	6.75	6.35	6.64	4.65%	6.72	1.20%	6.98	3.81%
Rest of UK	8.13	6.93	7.20	3.80%	7.30	1.50%	7.53	3.11%
Europe (EU15)	1.46	1.61	1.61	3.20%	1.66	3.10%	1.73	4.38%
N America	0.53	0.62	0.62	1.00%	0.61	-0.80%	0.63	2.89%
Rest of World	0.41	0.46	0.47	2.44%	0.48	2.88%	0.49	2.55%
<b>Total</b>	<b>17.27</b>	<b>15.97</b>	<b>16.54</b>	<b>3.57%</b>	<b>16.78</b>	<b>1.49%</b>	<b>17.37</b>	<b>3.49%</b>
<b>Spend/Expenditure (£ million)</b>								
To Scotland :Expenditure (£m)	2005	2006	2007 est.	% Change	2008 proj.	% Change	2009 proj.	% Change
Scotland	897.00	829.99	882.35	4.20%	898.23	1.80%	932.45	3.81%
Rest of UK	2109.00	1890.03	2058.81	6.10%	2102.04	2.10%	2167.41	3.11%
Europe (EU15)	534.35	630.83	661.11	4.80%	680.28	2.90%	695.25	2.20%
N America	389.44	464.10	469.67	1.20%	464.03	-1.20%	477.44	2.89%
Rest of World	293.48	343.78	352.16	2.44%	361.32	2.60%	370.53	2.55%
<b>Total</b>	<b>4223.27</b>	<b>4158.73</b>	<b>4424.09</b>	<b>6.38%</b>	<b>4505.90</b>	<b>1.85%</b>	<b>4643.09</b>	<b>3.04%</b>

### *Impact on Scottish Tourism*

- Holidays still remain priority for many households, therefore driving slight growth, through 2008 and 2009.
- Annual growth in visits and spending for 2008 is 1.5% and 1.9% respectively.
- In Scotland and Rest of the UK, a squeeze on disposable income impacts upon UK tourism spending, with 2.0% growth in 2008 and 3.3% in 2009.
- EU15 visitors in 2008 slow down due to inflationary pressures, consumer credit and competition.
- North American in 2008 experiences slight decline due to poor exchange rates for the US\$, housing market deflation and growing consumer debt.
- Inbound travel from India and China remains strong but a relatively small market

### **Scenario 2: Middle Class Squeeze**

#### *Economic Environment in 2007/09*

- Economic slow down in the second half of 2007
- The hallmark of consumer spending in 2008 is described at best as 'thrifty' and at worst 'stretched'
- Oil prices float between \$80-\$90 in 2008
- Realignment in the UK housing market as a result of a credit squeeze and falling house prices
- Food prices, council taxes and utility bills continue to restrict spending for the Middle Class consumer
- Risks from agricultural diseases continue to be a potential threat throughout the UK impacting on the rural economy (e.g. Blue Tongue Disease).
- Flood risks persist throughout 2008/09.
- In 2008 the US economy goes into recession, resulting in rising unemployment.
- Lack of confidence in the US economy sees further weakening of US\$ against Sterling and Euro making Scotland more expensive for both Europeans and the US consumer.
- The emerging economies of Brazil, India, China and Russia continue to grow.
- 2009 is a year of recovery

**Table 2 Scenario 1: Steady as it goes**

<b>Visits/Trips (million)</b>								
To Scotland :Trips (m)	2005	2006	2007 est.	% Change	2008 proj.	% Change	2009 proj.	% Change
Scotland	6.75	6.35	6.37	0.31%	5.92	-7.00%	6.14	3.70%
Rest of UK	8.13	6.93	6.95	0.30%	6.47	-7.00%	6.71	3.70%
Europe (EU15)	1.46	1.61	1.61	-0.16%	1.56	-3.00%	1.62	3.70%
N America	0.53	0.62	0.62	1.00%	0.56	-10.00%	0.59	5.00%
Rest of World	0.41	0.46	0.46	1.00%	0.46	0.00%	0.47	2.55%
<b>Total</b>	<b>17.27</b>	<b>15.97</b>	<b>16.02</b>	<b>0.31%</b>	<b>14.97</b>	<b>-6.51%</b>	<b>15.53</b>	<b>3.71%</b>
<b>Spend/Expenditure (£ million)</b>								
To Scotland :Expenditure (£m)	2005	2006	2007 est.	% Change	2008 proj.	% Change	2009 proj.	% Change
Scotland	897.00	829.99	832.60	0.31%	774.32	-7.00%	802.97	3.70%
Rest of UK	2100.00	1890.03	1895.70	0.30%	1763.00	-7.00%	1828.24	3.70%
Europe (EU15)	534.35	630.83	629.81	-0.16%	610.92	-3.00%	633.52	3.70%
N America	389.44	464.10	468.74	1.00%	421.87	-10.00%	442.96	5.00%
Rest of World	293.48	343.78	347.21	1.00%	347.21	0.00%	356.08	2.55%
<b>Total</b>	<b>4214.27</b>	<b>4158.73</b>	<b>4174.07</b>	<b>0.37%</b>	<b>3917.32</b>	<b>-6.15%</b>	<b>4063.76</b>	<b>3.74%</b>

*Impact on Scottish Tourism*

- Sharp decline in tourism spending across all main markets in 2008
- Domestic and rest of the UK spending falls by 7% in 2008 but grows by 3.7% in 2009
- North American markets fall by 10% in 2008.
- Stabilizing conditions in 2009 show market recovery and growth across all sectors.

**How does the economic evidence fit the scenarios?**

Taking the factors outlined in the two scenario's, 'Steady as it Goes' and 'Middle Class Squeeze' scenarios, how does the economic evidence fit the scenarios? This is what Oxford Forecasting thought:

- **UK economy remains stable:** Current evidence suggests this is likely with positive third quarter 2007 data in labour market and output terms. Though, for the reasons discussed above there is likely to be some moderation of growth in 2008, at 2.5% this is far from a recessionary outlook. **On balance the outlook is close to that set out in the 'steady as it goes' scenario.**
- **Inflation and interest rates:** Inflation is below target, though recent oil price inflation may push it upwards in the near future and reverse recent improvements in utility bill costs. With respect to interest rates the US has already made aggressive cuts and, though no corresponding cut has occurred in the UK, the expectations are no longer for any further rises. Pressures on the consumer are coming more from availability and attitudes to borrowing. **On balance the outlook is slightly more favourable than outlined in the steady as it goes scenario for interest rates and, though risks are increasing, the inflation outlook remains relatively benign.**
- **Borrowing becomes more difficult:** This is very likely for 2008, though reduced rates may help offset the impact somewhat. A reduction in the number of mortgage products and scaling back of high loan-to-value products will reduce borrowing levels. However some offsets will come from interest rate cuts. **The outlook is as expressed in the 'steady as it goes' scenario.**

- **Housing market:** Third quarter 2007 data shows some contraction in the north of England and Northern Ireland and a sharper correction in 2008 cannot be ruled out. However, the shift in the likely direction of interest rates and an economy that is still growing should make for a stable housing market in 2008. **On balance the 'steady as it goes' outlook is the most probable but a price realignment cannot be ruled out.**
- **Oil prices:** These are very difficult to predict, but with prices, at the time of writing, reaching over \$90 a barrel, 50% higher than at the start of the year, the outlook for prices under \$75 looks unlikely. The possibility of \$100 a barrel is looking more and more plausible with tensions between the US and Iran and between Israel and Syria. This does cast some concern over the 2008 outlook. **On balance the 'middle class squeeze' outcome appears more probable at the time of writing.**
- **US economy:** Though the housing market remains in recession the overall economy continues to grow, with export demand remaining high. **Prospects are delicately balanced, but the 'middle class squeeze' outlook of a US recession is not the most likely outcome at this time.**
- **Disease, floods and other risks:** This is impossible to predict but the continued instability in the Middle East provides a further risk that could adversely affect growth. **At the time of writing the conditions outlined under the middle class squeeze scenario have not worsened but cannot be discounted.**
- **2009 is a year of recovery and growth:** With the economic fundamentals remaining strong and world growth continuing to be bolstered by the Chinese economy and other emerging markets the longer term prognosis remains good. **This outlook is the same in both scenarios.**

**Table 4: Impact of the scenarios on 50% growth ambitions**

<b>Real Prices</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2015 Target</b>	<b>2009-2015 Annual Growth</b>
Steady as it goes (Domestic)	2997.00	2720.03	2941.15	3000.27	3099.86	4495.50	6.20%
Steady as it goes (International)	1217.27	1438.71	1482.94	1505.64	1543.23	1825.90	2.80%
Steady as it goes (Total)	4214.27	4158.73	4424.09	4505.90	4643.09	6321.40	5.14%
Middle Class Squeeze (Domestic)	2997.00	2720.03	2728.30	2537.32	2631.20	4495.50	8.93%
Middle Class Squeeze (International)	1217.27	1438.71	1445.76	1380.00	1432.56	1825.90	4.04%
Middle Class Squeeze (Total)	4214.27	4158.73	4174.07	3917.32	4063.76	6321.40	7.36%
Ambition (Domestic)	2997.00	3130.39	3259.92	3394.82	3535.29	4509.00	4.05%
Ambition (International)	1217.12	1257.99	1310.04	1364.25	1420.70	1812.00	4.05%
Ambition (Total)	4214.00	4388.37	4569.96	4759.07	4956.00	6321.00	4.05%
<b>Nominal Prices (incl inflation)</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2015 Target</b>	<b>2009-2015 Annual Growth</b>
Steady as it goes (Domestic)	3065.93	2720.03	3058.80	3210.29	3378.85	5799.20	9.00%
Steady as it goes (International)	1245.27	1438.71	1542.26	1611.03	1682.12	2355.42	5.61%
Steady as it goes (Total)	4311.20	4158.73	4601.06	4821.32	5060.97	8154.61	7.95%
Middle Class Squeeze (Domestic)	3065.93	2720.03	2837.43	2714.93	2868.01	5799.20	11.74%
Middle Class Squeeze (International)	1245.27	1438.71	1503.59	1476.60	1561.49	2355.42	6.85%
Middle Class Squeeze (Total)	4311.20	4158.73	4341.03	4191.53	4429.50	8154.61	10.17%
Ambition (Domestic)	3065.93	3130.39	3390.32	3632.45	3853.47	5816.61	6.86%
Ambition (International)	1245.11	1257.99	1362.44	1459.75	1548.57	2337.48	6.86%
Ambition (Total)	4310.92	4388.37	4752.76	5092.20	5402.04	8154.09	6.86%
CPI Multiplier (2005 CPI from ONS) (Forecast from OEF)	1.02	1.00	1.04	1.07	1.09	1.29	

It is the ambition of Scottish tourism to grow by 50% by the year 2015 in real terms, from £4.2bn in 2005 to £6.3bn in 2015; this represents an extra £2.1bn in revenue at a growth rate of 4.05% p.a. However if you include inflation in this figure, the value of Scottish tourism in 2015 would have to be £8.1bn, changing the growth rate to 6.86% p.a. Table 3 examines the impact of the two scenarios on this 50% ambition and growth rates. We can see from table 3, that the 'steady as it goes' scenario changes the growth rate to 5.14% in real terms or 7.95% in nominal terms, whereas the 'middle class squeeze' scenario changes the growth rate to 7.36% in real terms or 10.17% in nominal terms.

What does industry think about the scenarios and prospects for 2008?

The most frequently expected increases are in customers from around the UK (not Scotland) and mainland Europe

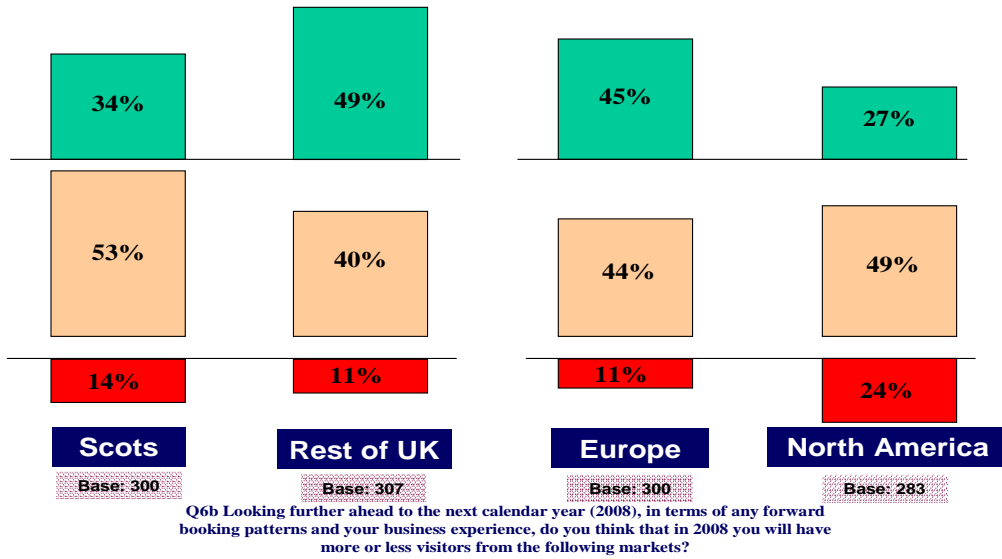


Figure 1: Prospects for trips in 2008

Visitors from mainland Europe are those most frequently expected to be spending more in 2008 than this year

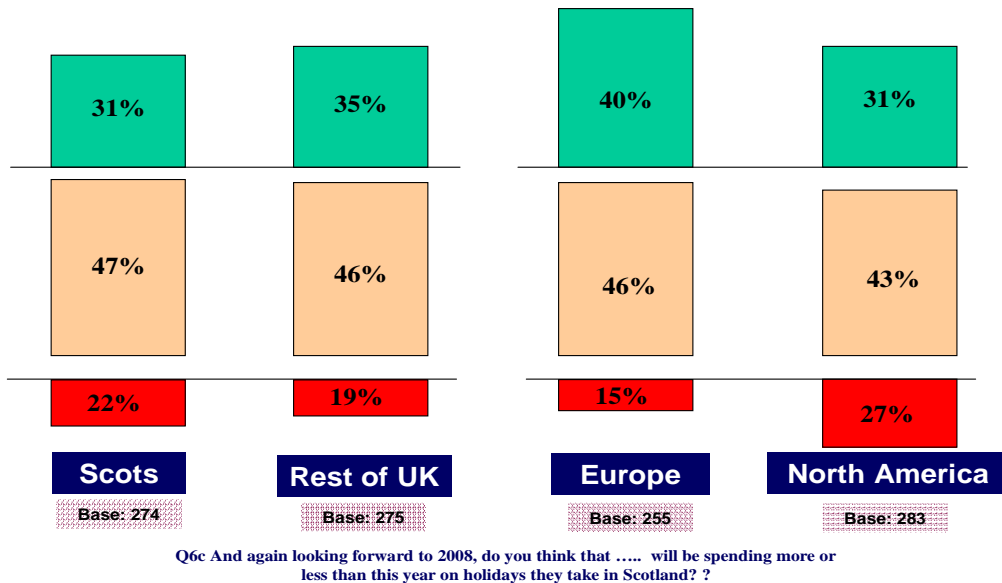


Figure 2: Prospects for expenditure in 2008

The industry barometer of 400 business tells us that the vast majority of business see a decline in spending and visitors from North America as a result of the weak US\$. The most frequently expected increases are in customers from around the UK (but Scotland) and mainland Europe, whereas the majority of visitors see little change in spending in the markets respectively.

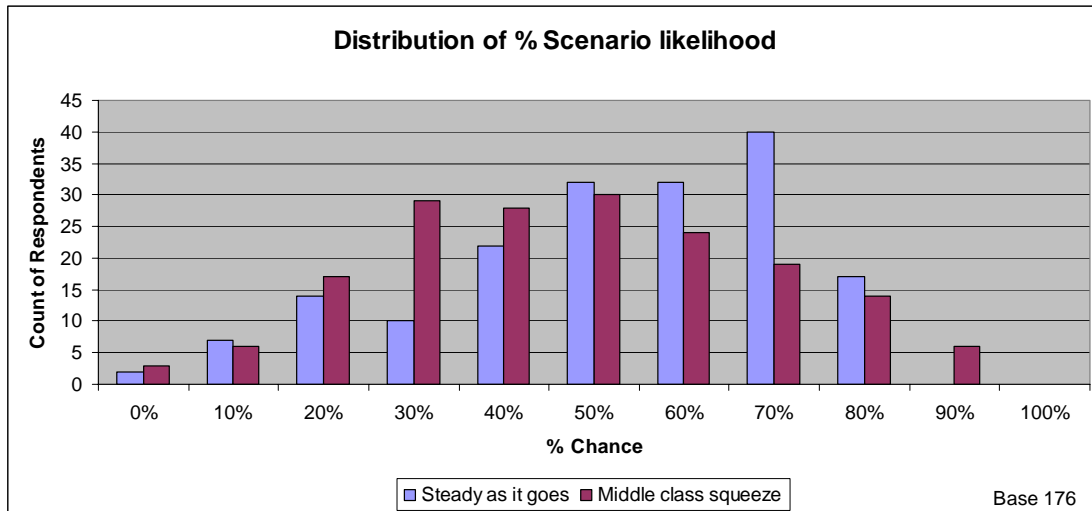


Figure 3: Probability of scenario occurrence distribution

From figure 3 we can see that from the opinion poll of industry operators and experts about the two scenarios, the probability of the *Steady State* scenario occurring is clustered between the 50-70%, whereas the Middle Class squeeze is clustered between 30-50%. What the poll suggests is that **respondents are more confident with the steady state scenario.**

### Concluding remarks

It is the considered opinion of the VisitScotland scenario planning team, backed up by the survey and opinions stated in this study, that 2008 will be a modest year for Scottish tourism. Overall we think the UK economy is strong enough to weather the storm, however the possibility of tighter consumer spending; uncertainty in the housing markets; the US slipping into recession and rising oil prices increase the downside risks. Tourism in Scotland is not as dependent on US tourism as it was in the past. In 1985, revenues from US visitors accounted for 46% of all international receipts whereas in 2005 they only accounted for 16%. During those intervening years we have seen a large increase in visitors from Europe and the south east of England. In addition we are seeing more visitors from further afield, including South America and China. Many of these emerging nations have more sophisticated macro and fiscal policy frameworks and thus less volatile economies. As such the outlook for 2008 remains reasonably robust.

**Therefore our probability assessment for the steady state scenario occurring is 50-70%, whereas the middle class squeeze scenario has a probability of 30-50% occurring.**

**However, both of the scenarios have clear implications on the prospects for growth and achieving an extra £2.1bn in tourism revenues in real terms. This would now require growth rates of 7.95 and 10.17% per annum to 2015 depending on the prevailing scenario**