23 Jan 2023

Travel & Tourism | United States

Will the travel industry prevail through a potential global recession?

Economists

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Executive Summary

- **Our baseline economic outlook now assumes a mild US recession beginning in the second quarter of 2023.** Despite recent moderation, core inflation remains stubbornly persistent and broad-based across goods & services. The Federal Reserve has indicated it will continue to raise interest rates until inflation is brought down. The Oxford Economics baseline 2023 GDP forecast now sits at 0.1% for the year, while our growth expectations for 2024 stand at a modest 0.8%.
- **Softening labor markets and a weaker economic environment will slow consumer spending.** Some early signs of trouble are evident in recent weakening in retail sales, increases in consumer debt, and a housing market reeling from high borrowing costs. This will slow growth in travel, especially in 2023 as the US economy goes into reverse in the second quarter of 2023.
- **However, recessionary impacts on leisure travel will be modest compared to past economic downturns.** Consumers are well-positioned to weather a downturn. Household finances and steady job creation will continue to support leisure travel. Pent-up demand and a continued prioritization of travel will endure into 2023, especially for higher income households who travel more frequently. However, inflation's regressive impact will increasingly bite into household finances for lower income households who spend a greater portion of their income on essential goods and services.
- **A mild recession in 2023 will slow but not reverse the trend of the business travel recovery cycle.** Corporations are still in the process of rebuilding business travel activity to more normal levels. Additional pent-up demand remains for conventions and trade shows as well as other meeting types.
- **Global weakness and a strong US dollar could slow the recovery of inbound international travel.** The economic outlook has been downgraded across many major international feeder markets and a strong dollar is further adding to the cost of international travel to the US. Meanwhile, US outbound travel is recovering more quickly, resulting in a slight pullback in domestic travel.

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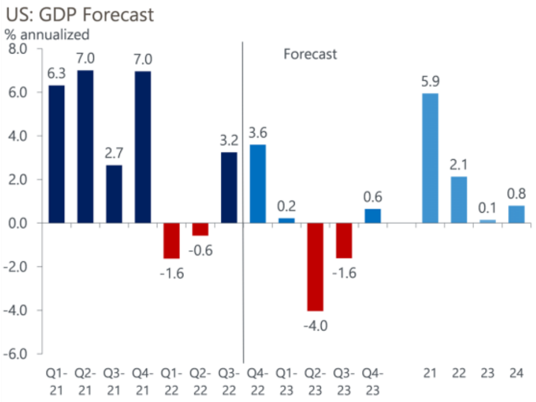
Mild US Recession in 2023

Stubborn inflation, a forceful response by the Fed, and global economic weakness will push the US economy into recession in the middle of 2023.

The combination of persistently high inflation, aggressive Fed monetary policy tightening, negative spill-over effects from slower global activity, and weaker corporate earnings will weigh on consumers' and businesses' willingness to spend and likely push the economy into a mild recession. We anticipate a peak-to-trough decline in GDP of around 1%, beginning in 2023Q2, and roughly a 1ppt increase in the unemployment rate.



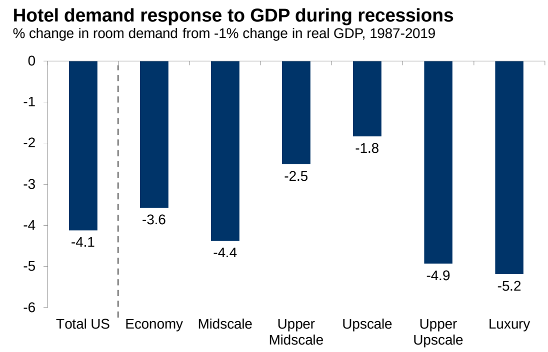
We expect the recession to be mild because there are no glaring imbalances in the economy's balance sheet. Currently, household balance sheets in aggregate are in great shape, nonfinancial corporate balance sheets are also healthy, and state and local governments are flush with cash. In addition, the labor market and job openings indicate the impact of a recession on unemployment and income would be relatively modest.

This weakening economic environment would typically imply a significant downturn in travel. Tourism Economics research has determined that travel demand is highly elastic to economic activity. For example, hotel room demand in the US has fallen by 4.1% for every 1% drop in GDP during the three recessions before 2020. The mild recession of 1991, which is in the range of our expectations for 2023, would imply a 6% fall in hotel revenue.

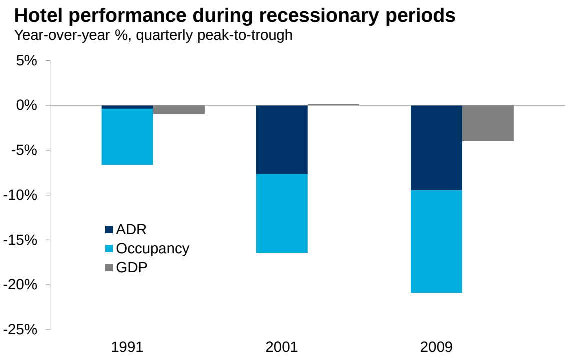
Hotel demand has fallen dramatically in previous recessions; however, a variety of factors may mitigate this effect.

However, evidence is building that travel activity will be more resilient amidst an incoming economic downturn and, in fact, may continue to grow. This idea was picked up by Delta CEO Ed Bastian during the carrier's third quarter-earnings call: "While we are mindful of macroeconomic headwinds, the travel industry is experiencing a countercyclical recovery. Global demand is continuing to ramp as consumers shift spend to experiences, businesses return to travel, and international markets continue to reopen."

This paper examines recent economic data, industry data, and survey research to explore the plausibility of travel continuing to grow, even in the face of an economic downturn in 2023.



Source: Tourism Economics



Source: STR, BEA

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Excess savings provide a bulwark for travel spending in the face of a 2023 recession.

We expect excess savings in the top income brackets to sustain travel spending in the coming year.

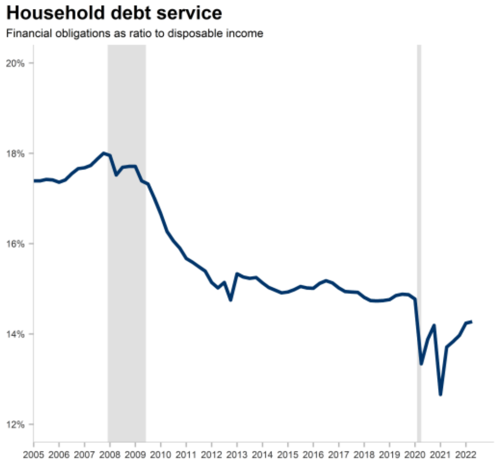
The Case for Leisure Travel Resilience

We see four distinct, but inter-related, drivers of leisure travel in the coming year. Collectively, these will sustain formidable forward momentum while the economy falters.

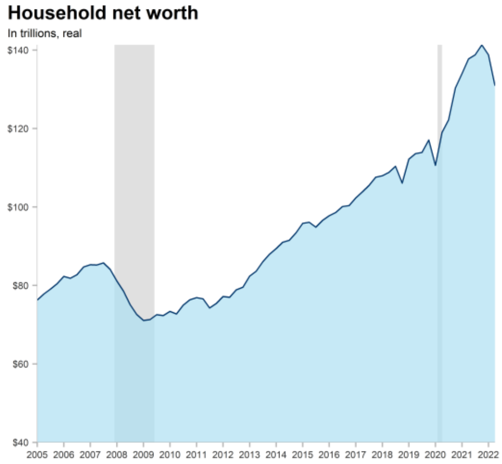
1. Household balance sheets remain strong.
2. International capacity is being restored.
3. Traveler sentiment shows continued pent-up demand.
4. Remote work is allowing for more travel.

Households amassed substantial savings during the pandemic and much of these savings remain available for travel. This is true for nearly all developed markets and especially pronounced in the US. While these savings have been drawn down to some degree, the majority remains as a consumer war chest. In the US, about $1.7 trillion in excess savings remains of the $2.5 trillion saved during the initial year of the pandemic. Host noted this in their November 3 earnings call: "While macroeconomic concerns continue to dominate the headlines, we are not seeing any signs of weakness in our business. In contrast to 2008, the banking system is in good shape, leverage levels are reasonable, and consumers still have $1.7 trillion in excess savings, with the majority concentrated in the top income brackets which gives us confidence the recovery in the lodging industry is sustainable."

Balance sheets remain strong overall, with debt service at low levels and net worth still historically elevated.



Note: Quarterly data through 2022Q2. Financial obligations ratio is the ratio of household debt payments, and payments such as rent and auto leases, to disposable income. Source: Federal Reserve, NBER



Note: 2020 dollars. Quarterly data through 2022Q2. Net worth of households and nonprofit organizations. Measures assets such as housing and financial assets, minus liabilities. Source: Federal Reserve, NBER

Furthermore, US income growth has exceeded the rate of inflation (measured as the PCE deflator) over the past two years. This is providing added purchasing power, even amidst rising prices.

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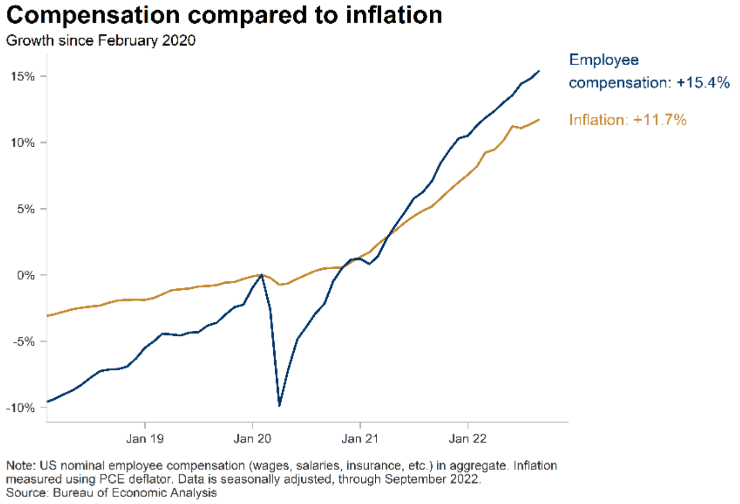
A solid labor market, pent-up travel demand, and the shift of spending towards experiences will provide continued tailwinds in 2023.

Consumer spending data present an interesting picture of households in the US prioritizing services while weakness is evident in goods. Marriott noted in their August earnings call, “we have yet to see signs of a slowdown in global lodging demand. On the contrary, the pent-up demand for all types of travel, the shift of spending towards experiences versus goods, sustained high levels of employment and the lifting of travel restrictions and opening borders in most markets around the world are fueling travel.” This theme continued in their November 3 earnings call: “We currently think 2023 global RevPAR could increase nicely year-over-year, driven by gains in both the U.S. and Canada and internationally.”

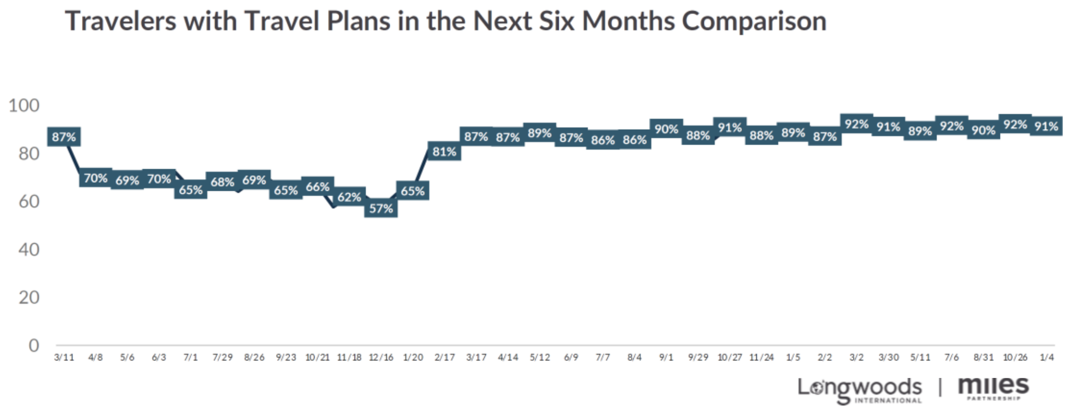


Survey data from Longwoods add to the picture of sustained leisure travel demand. In fact, 92% of US travelers indicated they have travel plans in the next six months. This is as high a reading as this survey has registered in nearly three years.

Travel intentions remain high.

Planning Leisure Travel Within the Next 6 Months

% of American Travelers

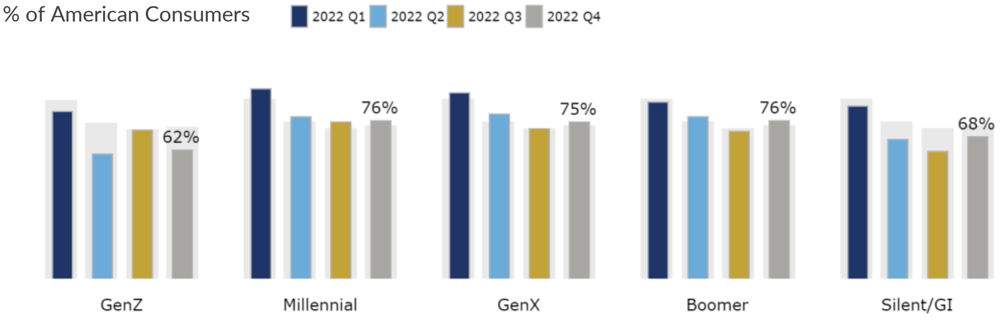


Data from MMGY's latest Portrait of the American Traveler show a similar picture with increased in intent to travel across most income categories with a notable exception: households earning less than $50,000 per year.

The latest data from MMGY indicate an increase in leisure travel planning across all generations except GenZ.

Planning Leisure Travel Within the Next 12 Months

% of American Consumers



Source: MMGY

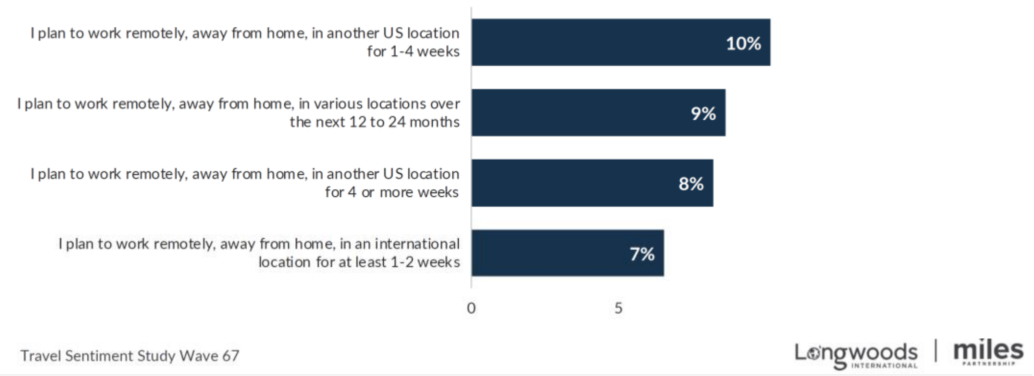
International travel also remains suppressed, partly by limited air service. However, plans for resumption of service are in place across the airline industry. Delta noted in their October 13th earnings call, "Demand for transatlantic travel is extending well into the fall. Starting in October, we anticipate flying more transatlantic capacity than 2019, making it the first geography to exceed 2019 capacity levels."

Lastly, leisure travel will benefit from the ongoing flexibility afforded by remote work. In United Airlines' October 19 earning call, executives noted, "There's been a permanent structural change in leisure demand because of the flexibility that hybrid work allows. This is not pent-up demand. It's the new normal." This is evident in the latest Longwoods data for US travelers, 34% of respondents indicated they planned to travel while still working remotely in the coming 12-24 months. This share has risen significantly over the past four months; just 26% planned to travel while working in early July.

The flexibility of remote work has introduced a new travel market with 34% of travelers indicating they planned to travel while working remotely in the coming 12-24 months.

Remote Work Plans Within the Next 12-24 Months

% of American Travelers



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The Case for Business Travel Resilience

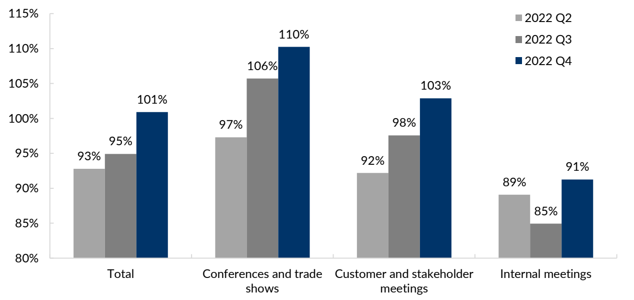
Business travel continues to rebuild to pre-pandemic levels. From United's October 19th earnings call, "Regardless of what you think demand for business travel will ultimately return to 100% or something less, it almost certainly is going higher from here."

Business travel intentions rose sharply in the fourth quarter of 2022 across all purposes.

Third quarter data from JD Power, conducted on behalf of the U.S. Travel Association show that business travelers increased their travel expectations in the fourth quarter of 2022, with expectations reaching 101% of 2019 business travel volumes for the coming six months. Business travelers expect both conferences and customer meetings to exceed 2019 levels.

Average expected trips versus 2019

Average monthly trips expected in next six months relative to pre-pandemic (2019=100%)



[q1&q2] How many times do you travel on average for business purposes?

Business Travelers Survey BASE: Q4 = 790; Q3 N = 1641; Q2 N = 2545

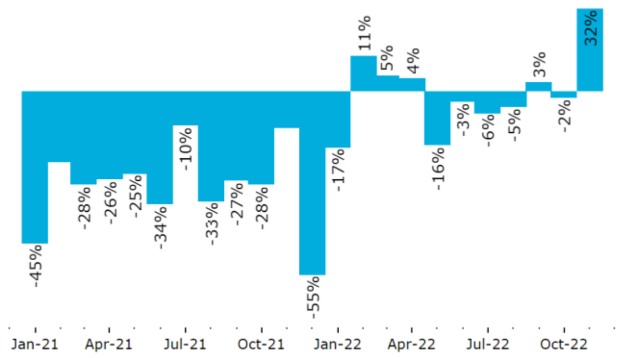
Group hotel bookings and the outlook of meeting planners continue to exhibit strength.

Group hotel bookings are also gathering strength. Across more than 250 destinations in the US, group bookings for future events have been gradually increasing and for the last half of 2022, were only down single digits relative to 2019. Bookings in December registered 32% ahead of 2019 room nights booked.

DMO/CVB Group Bookings

Hotel room nights contracted during most recent months

% change from 2019

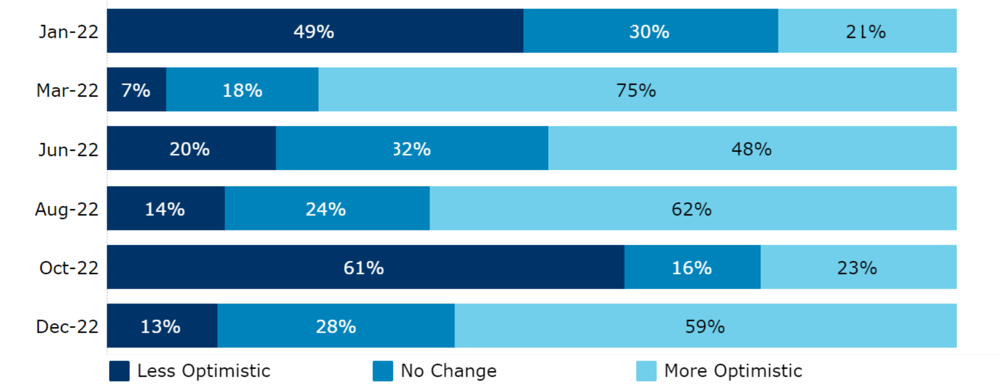


Source: Simpleview CRM (250+ U.S. DMOs)

The latest meeting planner outlook from Northstar Meetings Group also shows strengthening expectations with 59% of planners feeling more optimistic

Meeting Planner Outlook

How the outlook for recovery has changed among meeting planners the past six weeks



Source: Northstar Meetings Group and Cvent (Meetings industry PULSE survey)

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On October 26, Hilton conveyed a consistent perspective on its earnings call, saying “We expect business transient RevPAR to continue to see gradual recovery, primarily driven by rising demand as companies encourage their people to get back on the road.”

And Marriott, during their September earnings call, noted that “group bookings <for future dates> are up 30% compared to 2019, and we expect it to perform better than prior recessions.”

Conclusions

A US recession seems increasingly likely, affecting both businesses and consumer demand. The travel industry will not be unaffected by these headwinds. However, current data support our view that travel is on an upward swing and that this momentum will prevail through a recession. As a result, the travel industry will defy the typical dynamic of falling to a greater degree than the broader economy. That is, while the economic tide recedes, the travel tide may still rise in 2023.

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