Canada's Tourism Industry: Industrial Outlook

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Prepared for:
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By:
The Conference Board of Canada
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Background

The Canadian Tourism Industry: Industrial Outlook analyzes the profitability of Canada's tourism sector by projecting revenues and costs. The tourism sector is broken down into four industries: transportation, accommodation, food and beverage services, and "other" tourism.

These industries are based on spending, employment, price and gross domestic product (GDP) data derived from the N*ational Tourism Indicators* – a quarterly publication developed by Statistics Canada in partnership with the Canadian Tourism Commission. The financial data is based on the Q*uarterly Financial Statistics for Enterprises*, published by Statistics Canada. The data in all of these categories include only travel-related activity, and the forecasts are available quarterly to the year 2011.

Key Issues

[🡅] Domestic Travel

After two consecutive years of robust growth, growth in real spending on domestic travel will decelerate this year. However, the slowdown is best characterised as a return to more normal conditions.

[🡅] New Markets

Double digit gains in visitors from new markets like India and Brazil are helping the tourism sector to weather the downturn in visitors from more traditional markets.

[🡇] Increased Global Competition for Travellers

The combination of more and more countries developing their tourism industries, growing investments in marketing and improving air access will continue to draw an increasing number of travellers to international destinations other than Canada.

[🡇] Western Hemisphere Travel Initiative (WHTI)

The border between Canada and the United States will be tightened in the coming years. The WHTI will reduce the number of visitors entering Canada from the United States, particularly in the short-haul travel segment.

Highlights

Despite significant challenges, the Canadian tourism sector had another solid year in 2006. Once again, the domestic market proved very strong and carried the sector throughout the year. In contrast to the domestic market, foreign markets proved to be a challenge with growth in overseas markets falling short of expectations and overnight travel from the United States dropping for the second year in a row.

Lead by the transportation and "other tourism" industries, real spending in the tourism sector grew by an estimated 3.6 per cent last year[1]. Growth in domestic spending was very strong, with an estimated gain of 6.1 per cent in 2006. However, real foreign spending on tourism declined for a second consecutive year, falling by 3.3 per cent. The decline was the result of fewer foreign visitors arriving in Canada.

The tourism sector is now entering a period of more subdued growth. The slower growth will be the result of two factors: first, a slowdown in the growth of the domestic market; and second, the continued erosion of foreign spending due to the high value of the Canadian dollar and the implementation of the Western Hemisphere Travel Initiative (WHTI) in the United States. Continued high energy prices and slower global economic growth will also detract from foreign spending. However, the slowdown in spending is best characterized as a moderation of growth to more sustainable levels. Overall, total real tourism spending growth will average 3.2 per cent per year over the forecast period.

Given the challenges of declining foreign spending and rising operating costs, mainly in the form of increased labour and energy costs, the financial performance of the tourism sector deteriorated in 2006. Although the sector remained profitable, dollar profits declined by 25 per cent last year. Profits in the transportation industry, food and beverage services industry and the "other" tourism industries all fell in 2006. The transportation industry accounted for the largest portion of the decline in profits.

Looking forward, sector profits will improve this year, but decline again in 2008. One of the main reasons for the decline has to do with the implementation of the land and sea portions of the WHTI, which is expected to further reduce visits from the United States. However, because of increasing yields from United States visitors and continued strength in the domestic market, profit margins are expected to remain above their 2006 average, even during the implementation phase of the initiative. During the outlying years of the forecast, a gradual recovery from the

1 Note that all tourism spending numbers referenced are on a seasonally adjusted basis and expressed in 1997 dollars.

effects of the WHTI, rising travel spending from new markets and the 2010 Olympics will all contribute to rising profits. As such, sector profits will reach a new high of $1.2 billion in 2011.

Domestic — Current Spending: Strong

After two years of posting above average growth, the expansion in real domestic spending will ease somewhat. However, growth in real domestic spending will remain healthy over the next five years, averaging 3.7 per cent, which is on par with the average growth rate over the previous decade of 4 per cent.

The health of the domestic market continues to reflect the increased propensity of Canadians to travel. By 2003, a combination of factors including 9/11, the war in Iraq, SARS, and a housing boom, had caused the share of disposable income Canadians spend on travel to fall to its lowest level since 1996. However, since 2003, the share has been steadily rising again and it surpassed its previous peak in 2005.

The increased propensity to travel reflects a renewed focus on travel, as well as demographic changes in the population. The renewed focus on travel is part of a cycle that is seeing the pendulum swing towards more spending on travel and away from spending on homes and durable or semi-durable goods. Meanwhile, demographic changes include the rising share of baby boomers whose children have left home, leaving them with the time and means to travel in increasing numbers.

Foreign — Current Spending: Weak

Growth in real foreign spending will remain subdued in the near term but will begin to improve after 2008, once the WHTI has been fully implemented and U.S. travellers obtain the required documents. If the implementation date of the WHTI for land and sea crossings is delayed, the timing of the sector's recovery will be different, but the effects of the WHTI will be similar. As a result, real foreign tourism spending will increase by 1.4 per cent between 2007 and 2011. Spending growth will be strongest in 2010 because of a boost from the Vancouver Olympics, and if policymakers are able to successfully leverage the Vancouver Olympics in order to encourage growth in tourism activity, growth in foreign spending could be even stronger than expected in 2010 and beyond.

One factor that is causing international visitors to look at other destinations is Canada's price competitiveness. Driven by the rise in the Canadian dollar over the past few years, Canada has become more expensive as a destination compared to virtually all of its international competitors. To once again attract international visitors and drive growth in foreign tourism spending, the industry is working to redefine the value proposition of tourism in Canada. In the meantime, the easing of the dollar this year should make the transition a little easier.

The upside of a global tourism market is that foreign spending in Canada is getting a boost from non-traditional tourism markets. Indeed, growth in spending is expected to come more and more from emerging markets going forward. For instance, Mexico is rapidly becoming an important driver for the Canadian tourism industry. Other countries, such as Brazil and China, also present good opportunities for growth. In fact, even without approved destination status, visits from China to Canada grew by over 20 per cent last year.

Transportation Current Spending: Strong Current Profits: Declining

The transportation industry experienced the strongest gains in spending last year, at 4.9 per cent in real terms. Much of this growth occurred in the air transportation segment of the industry. However, despite the healthy growth in spending, profits in the industry fell in 2006 because of large increases in all types of costs, but high oil prices were of particular concern for this industry. Looking forward, growth in real tourism spending on transportation will decelerate, but remain healthy, averaging 3.8 per cent per year between 2007 and 2011. Competitive pressure will keep margins thin in the industry, but lower oil prices and healthy demand growth will be sufficient to allow profits to improve steadily over the forecast, reaching $560 million by 2011.

Accommodation Current Spending: Modest Current Profits: Negative

Despite strong growth in domestic spending, total real spending in the accommodation industry rose by only 2.1 per cent for the year. Ongoing weakness in foreign spending combined with rising labour and capital costs resulted in the industry reporting a net loss for the second consecutive year in 2006. Looking forward, growth in domestic spending is expected to moderate and foreign spending conditions will only gradually improve, as a result growth in real spending on accommodation will be only modest averaging 1.6 per cent per year between 2007 and 2011. However, cost control efforts and reduced depreciation charges are expected to allow the industry to return to profitability in 2007, but margins will remain thin. By 2011, profits are expected to reach $186 million, but this is still below the peak they reached in 1999.

Food & Beverage Services | Current Spending: Weak | Current Profits: Declining

In the food and beverage services industry healthy growth in real domestic spending was offset by a decline in foreign spending, and as a result, total tourism related expenditures in the industry rose by a weak 1.6 per cent in 2006. The combination of weak growth in spending and rising labour costs led to a decline in industry profits in 2006. Looking forward, real tourism spending on food and beverages will average increases of 2 per cent between 2007 and 2011, with growth in foreign spending expected to improve in the outlying years of the forecast, and domestic spending growth expected to remain modest. Competitive pressure will keep margins thin in the industry, but profits are expected to gradually improve as food services companies are expected to pass their higher wage and food costs onto customers. As a result, profits will reach $85 million by 2011.

Other Tourism[2] | Current Spending: Healthy | Current Profits: Declining

Thanks to strong growth in pre-trip expenditures, total real tourism spending in the "other" tourism industry rose by an estimated 4 per cent in 2006. However, weak price appreciation and rising costs led to a decline in profits. Looking forward, between 2007 and 2011, growth in real domestic spending will decelerate, averaging 2.4 per cent. But, stronger price appreciation and cost control efforts by industry firms will allow profits to gradually improve, surpassing their record high and reaching $321 million by 2011.

2 "Other" tourism includes recreation and entertainment, travel agency services, convention fees and pre-trip expenditures.