2017 Tourism Update

Making the most of surging demand

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Tourism Outlook 2017: Key Points

- **Best visitor growth in 20 years – up 12% in 2016 – to continue**
- **Less to do with global growth – low airfares, higher tourist wealth/incomes and NZ factors lift growth**
- **Expect double-digit visitor growth in 2017 with stay-days and spend to follow - visitor growth averages 8.8% to 2019**
- **Key risk is not demand but managing capacity to ensure sustainable long-run outlook**
- **Emphasizes the need for continued coordination of efforts across industry, government and TNZ**

Global Economic Outlook

Moderate global economic conditions fail to dampen visitor growth to New Zealand

- **Global economic growth moderate in 2016 with most advanced economies a little below trend growth**
- **Asset prices have recovered but inflation is low, and oil prices are very low**
- **No ‘shot in the arm’ for activity from 2015 fall in oil price but airfares were much lower**
- **Global tourism outpaces headline economic growth New Zealand outperforms most destinations**

There are many risks to the global outlook

- **Global economy moving sideways – US a little better**

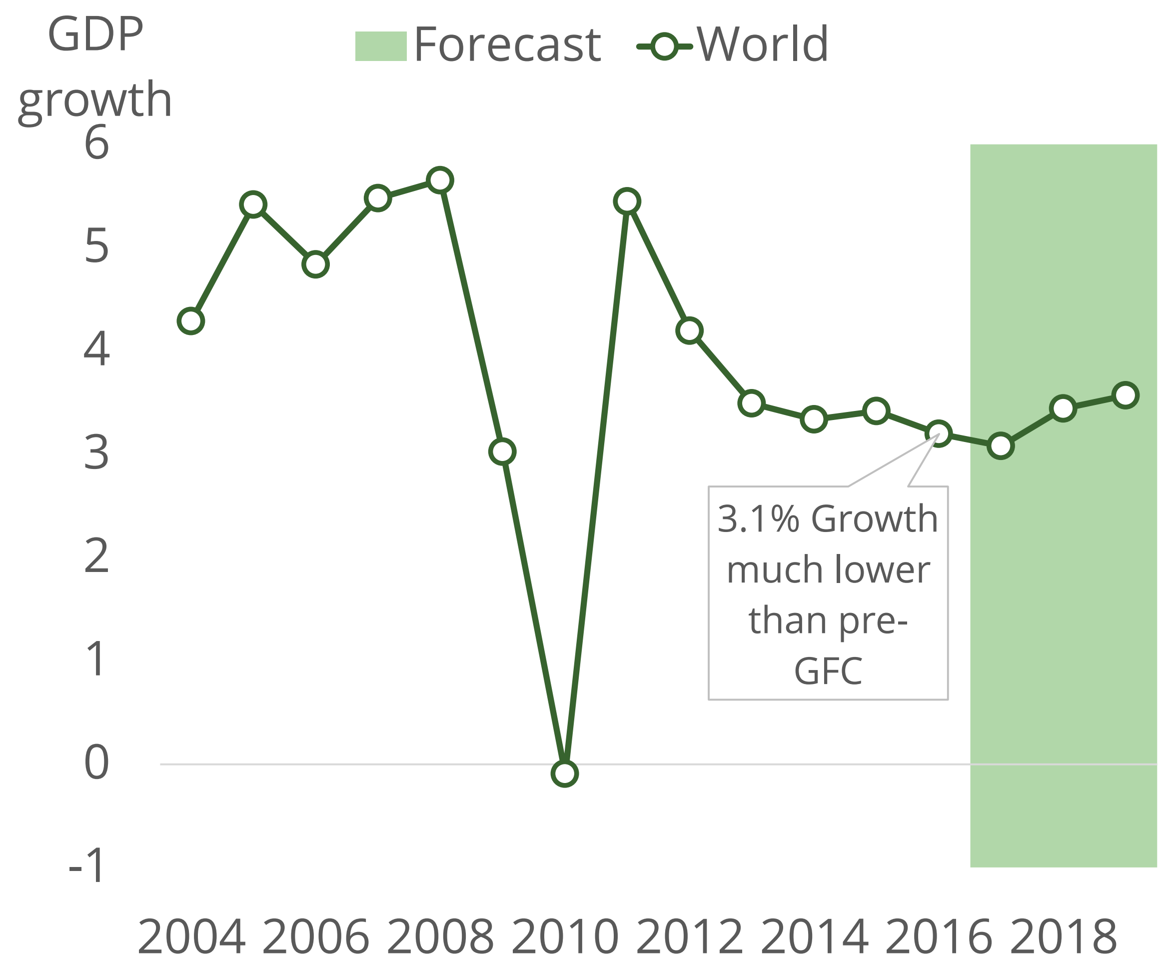
- **Brexit and the US election shock yet to play out in 2017 but political uncertainty dampens investment**

- **Possibility of trade retaliation – Chinese authorities could react to any US tariffs by devaluing yuan**

- **Challenge for governments to boost incomes when debt constrains what is possible**

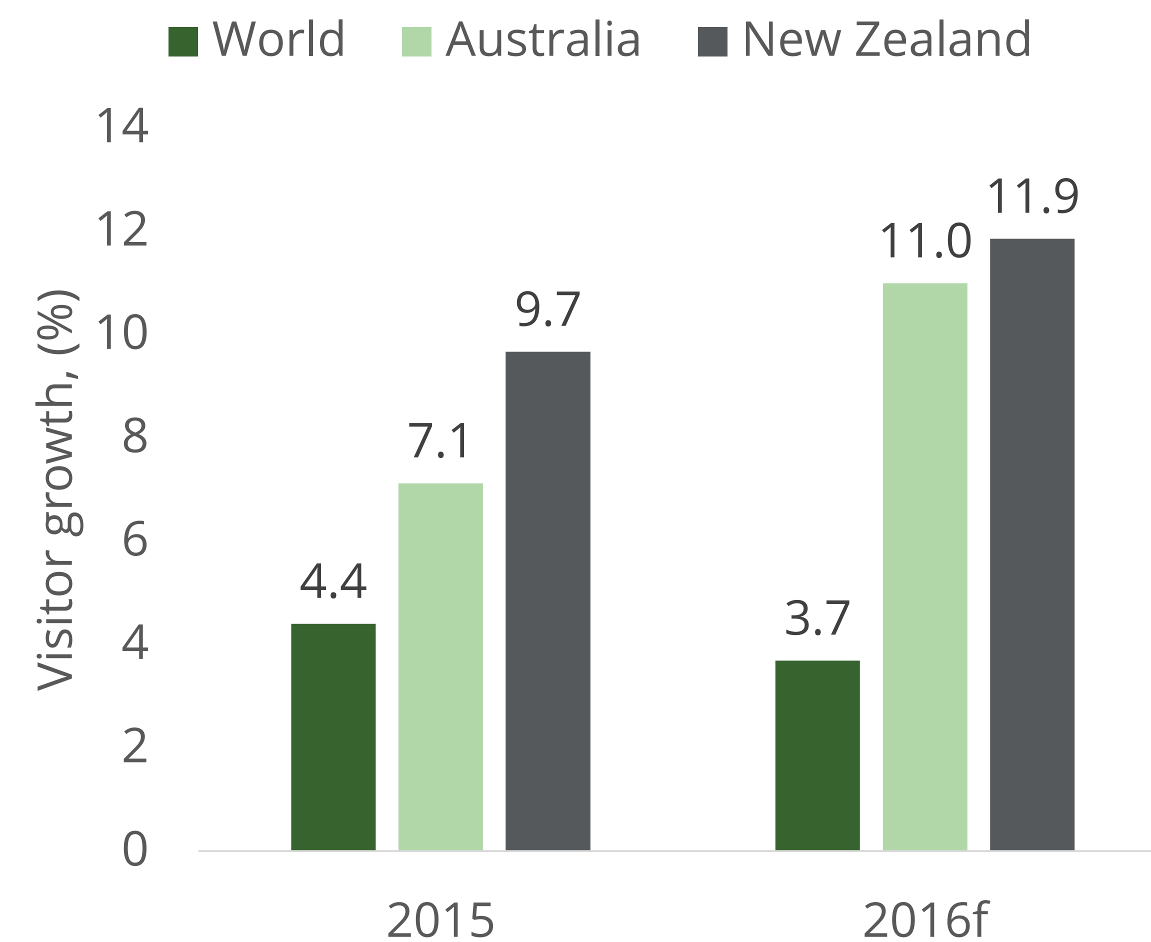
Growth is low but visitor growth super strong

FIG 1: Global growth lower than pre-GFC highs
Global GDP growth (real, annual %)



Source: International Monetary Fund

FIG 2: New Zealand is experiencing a growth surge
Visitor growth, 2015 and a forecast for 2016, selected regions

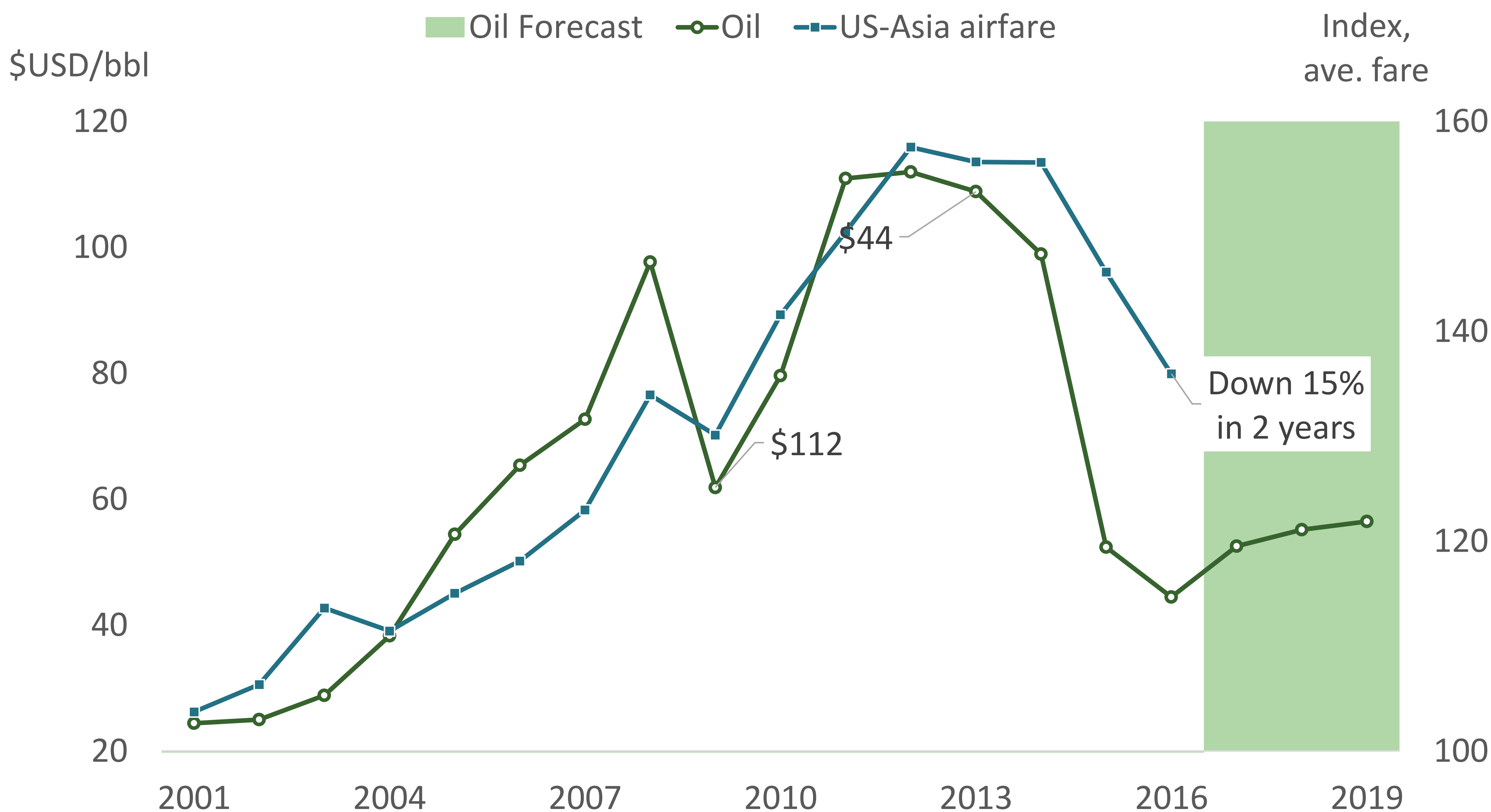


Source: ABS, Statistics New Zealand, UNWTO

Low oil prices brought fares down lifting demand

FIG 3: Low oil prices reduced long-haul airfares, competition also helped

USD Brent crude oil price vs Index of US airfares to Asia



Source: International Monetary Fund, US Dept. of Transportation

Debt and slowing global trade risk the outlook

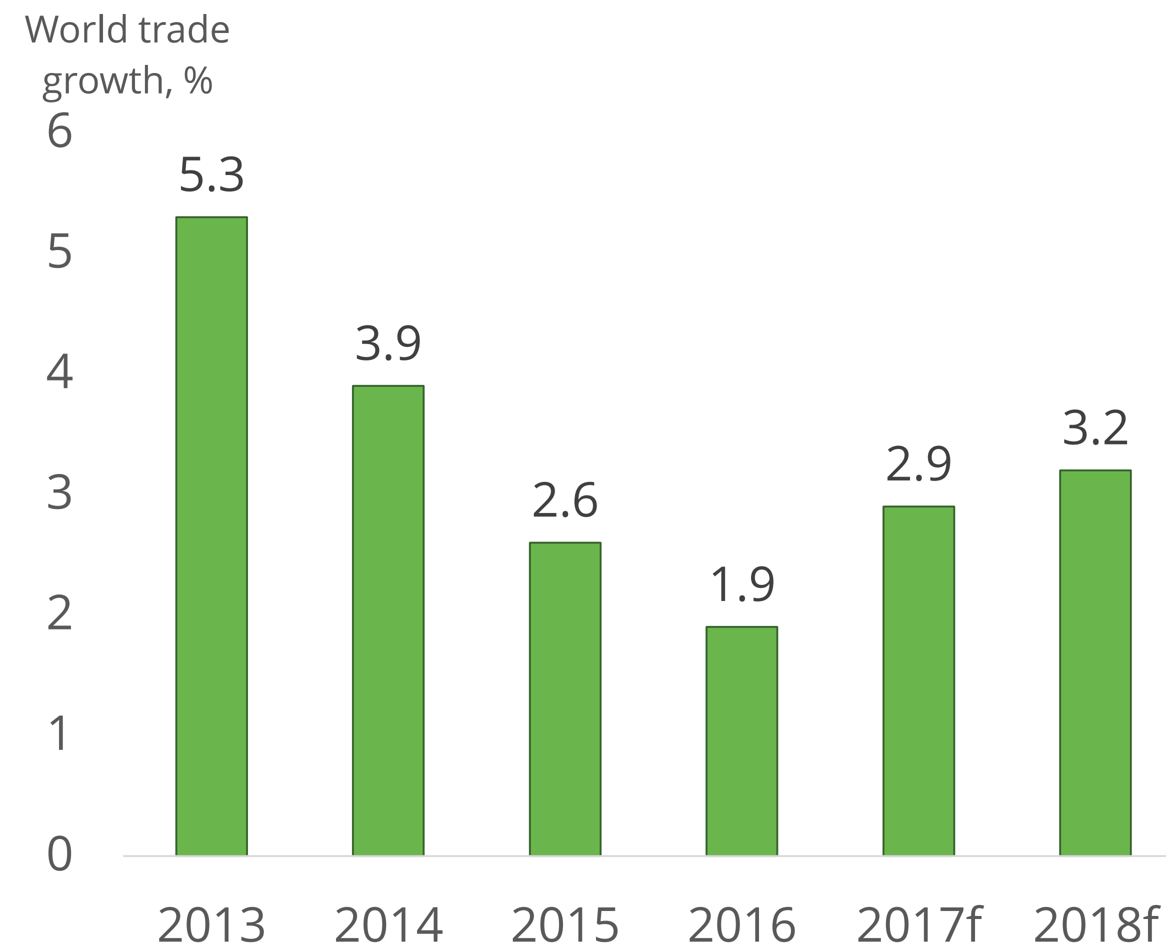
FIG 4: Debt elevated even after the GFC

Non-financial Debt/GDP ratio, advanced economies and China (percent)

Source: Reserve Bank of New Zealand

FIG 5: Growth in world trade has slowed

World trade growth, goods, real (%)

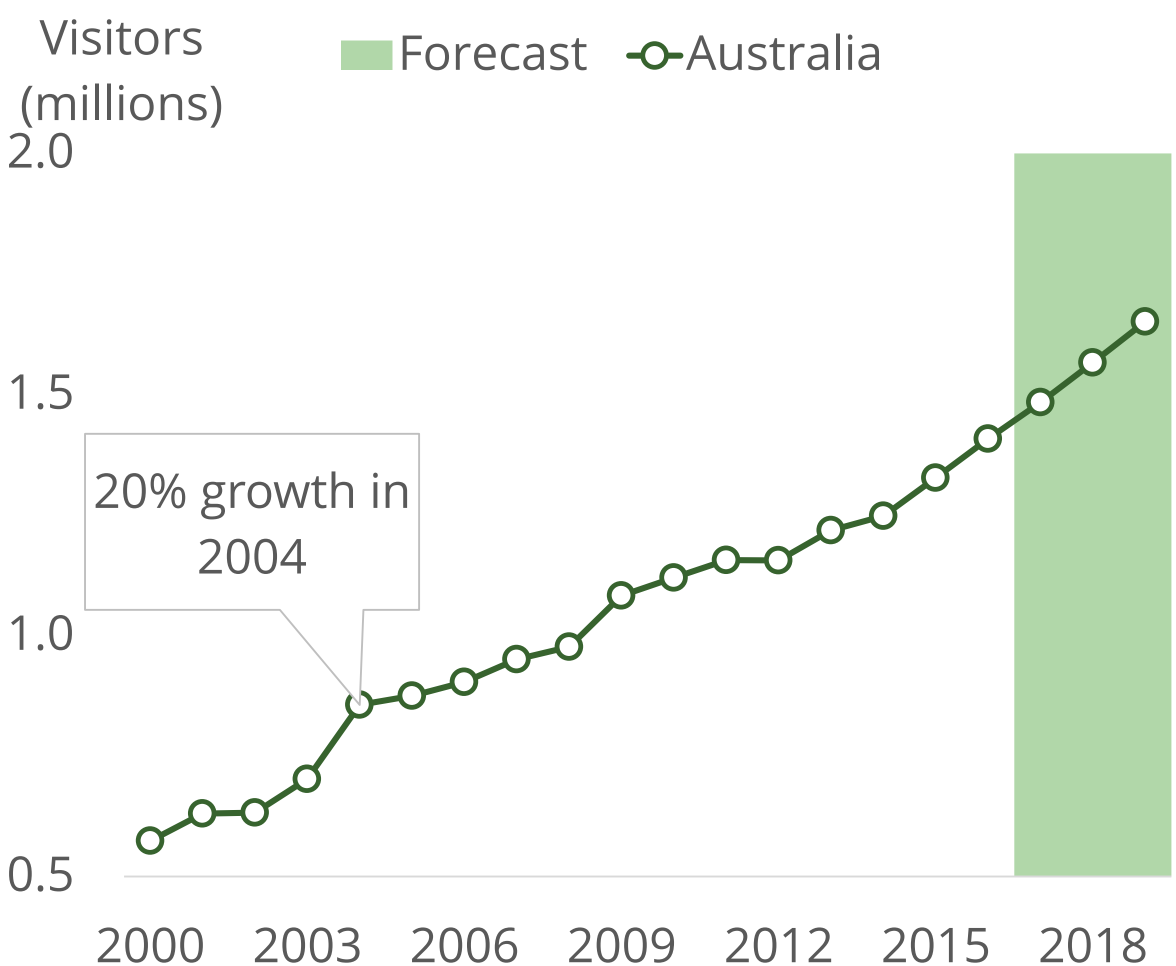


Source: OECD

Outlook market-by-market: Australia

Visitor growth outpaces Aussie economy

FIG 6: But expect strong visitor growth
Visitor arrivals (Annual)



Source: Sense Partners

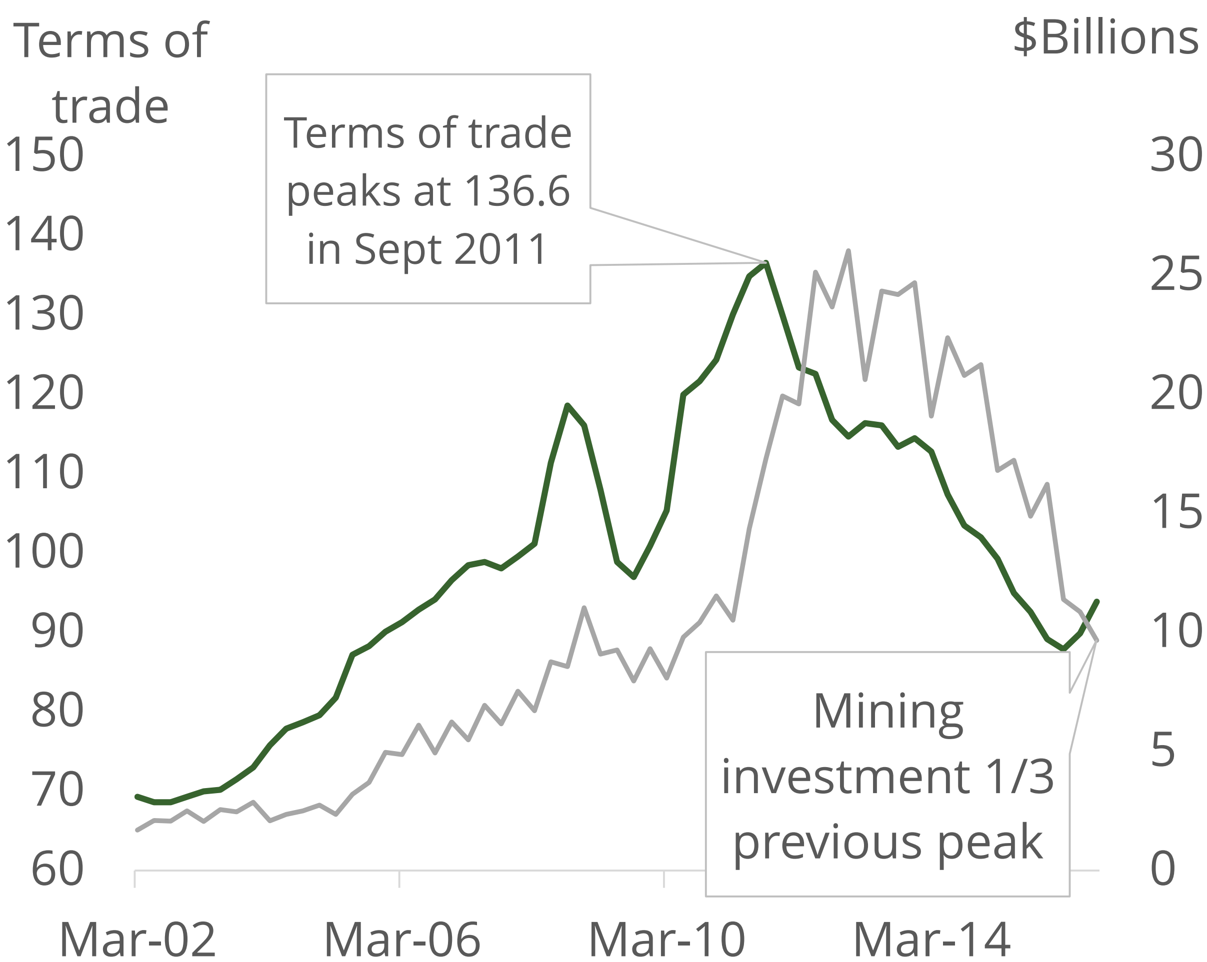
Key takeaways - Australia

- **End of commodity super-cycle reducing incomes-Aussie down**
- **New Zealand less exposed NSW and Victoria doing OK**
- **Our forecast models arrivals with GDP growth and IMF growth and oil forecasts – add/subtract for tourism factors like capacity**
- **We expect volume if not spend growth to continue – we expect 5.5 CAGR over the next 3 years**

Aussie mining fall means less spending power

FIG 7: Terms of trade fall drives mining bust

Terms of trade vs mining investment



Source: International Monetary Fund

FIG 8: Nominal wage growth has declined

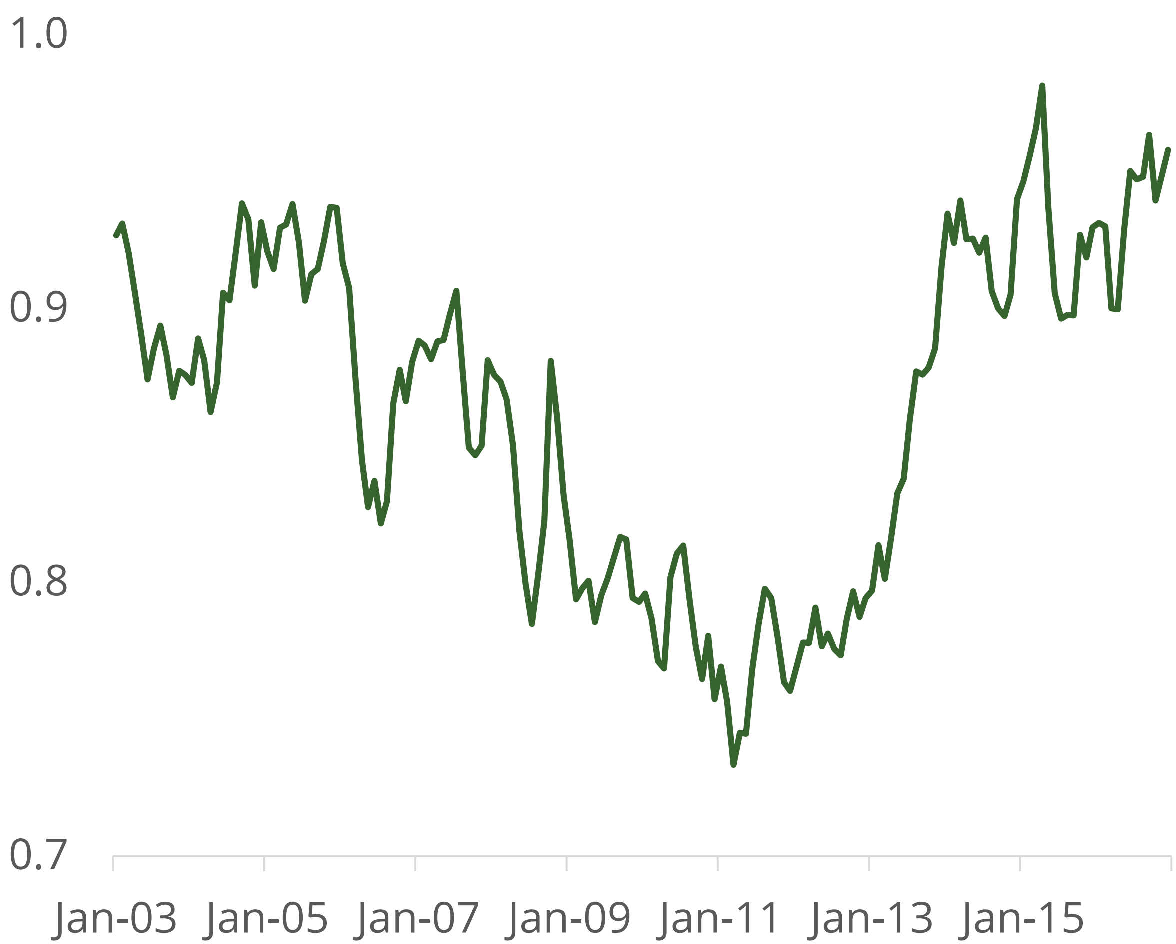
Nominal wage growth, percent

Source: Australian Bureau of Statistics

NZ a little less exposed but Aussie remans low

FIG 9 Don't expect Aussie to appreciate soon

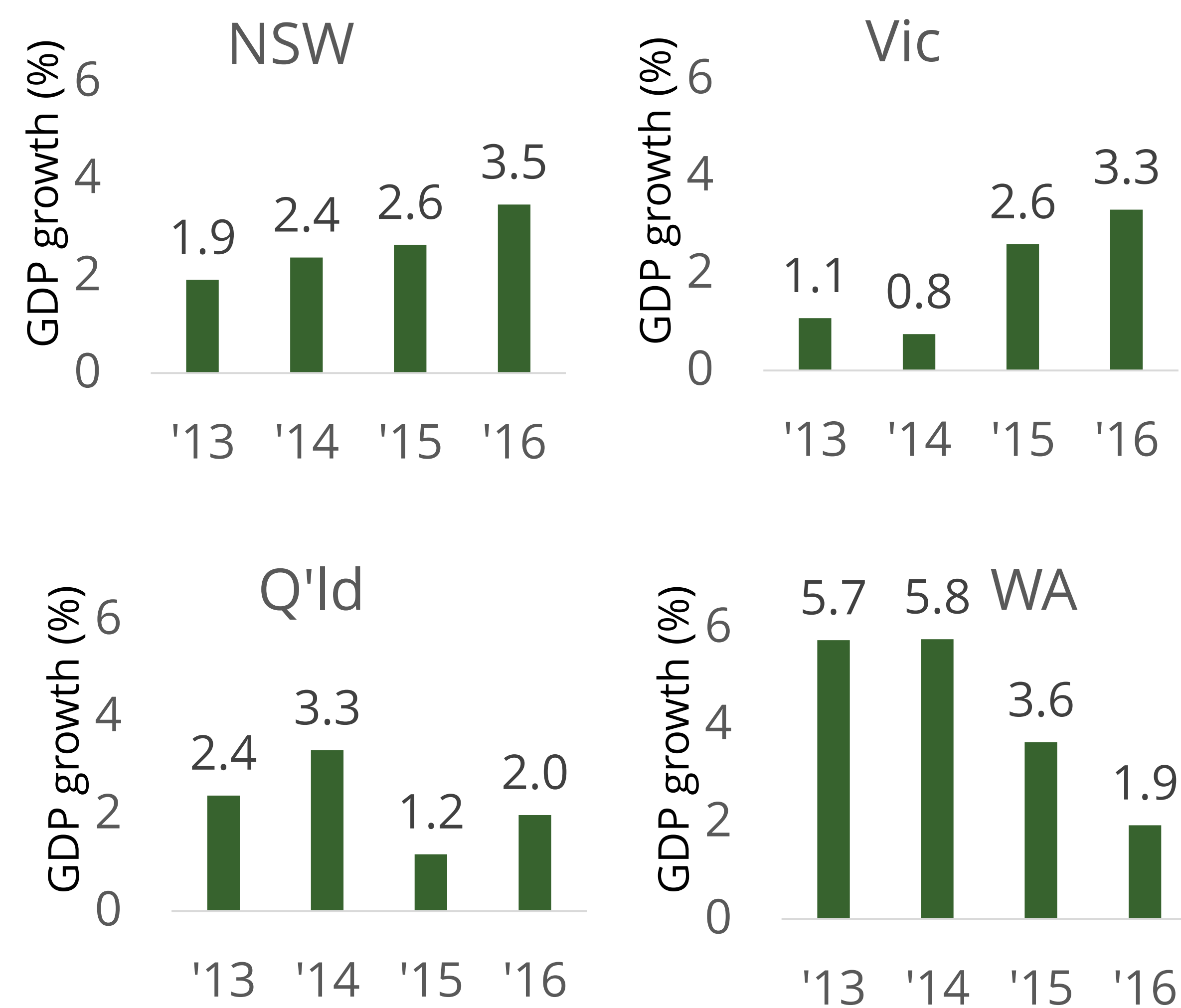
NZD/AUD cross rate, (increase is a depreciation of the Aussie)



Source: Reserve Bank of New Zealand

FIG 10: State level growth better for NZ tourism

GDP growth by selected states (percent)



Source: Australian Bureau of Statistics

Outlook market-by-market: Asia

Demographics, income growth and New Zealand specific attraction continue to lift visitor growth

FIG 11: But expect strong visitor growth
Visitor arrivals (Annual)

Source: Sense Partners

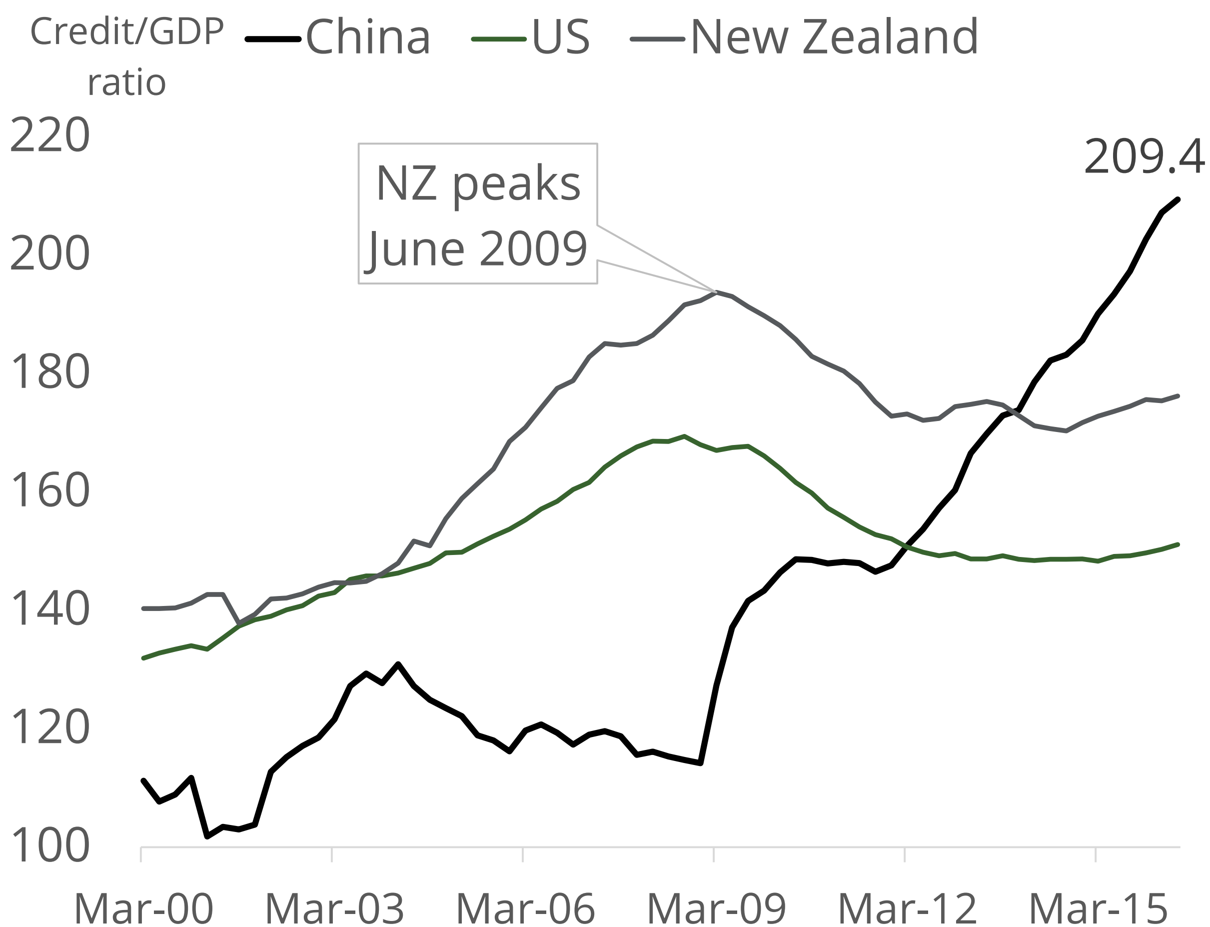
Key takeaways - China

- **Headline growth is slowing with transition to consumption economy**
- **Many firms and local authorities are highly leveraged needing monitoring**
- **Demographics, urbanisation and connectivity support outbound**
- **New Zealand continues to outpace most, expect 22% CAGR to 2019**

Leveraged firms, households risk China's growth

FIG 12: Credit/GDP ratio up sharply...

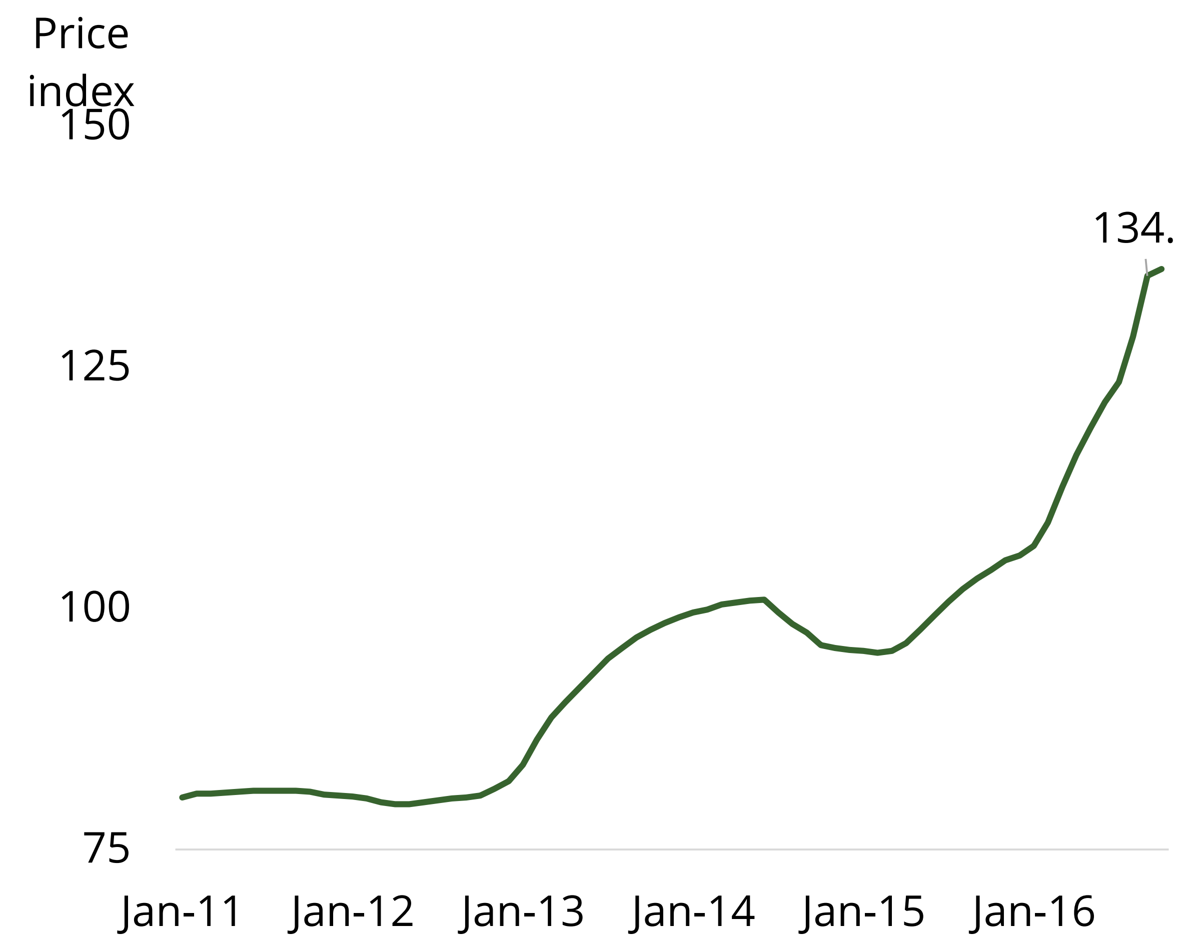
Credit/GDP ratio, quarterly, percent, selected countries



Source: Bank of International Settlements

FIG 13: Property prices now need monitoring too

Index of average dwelling price (including apartments)

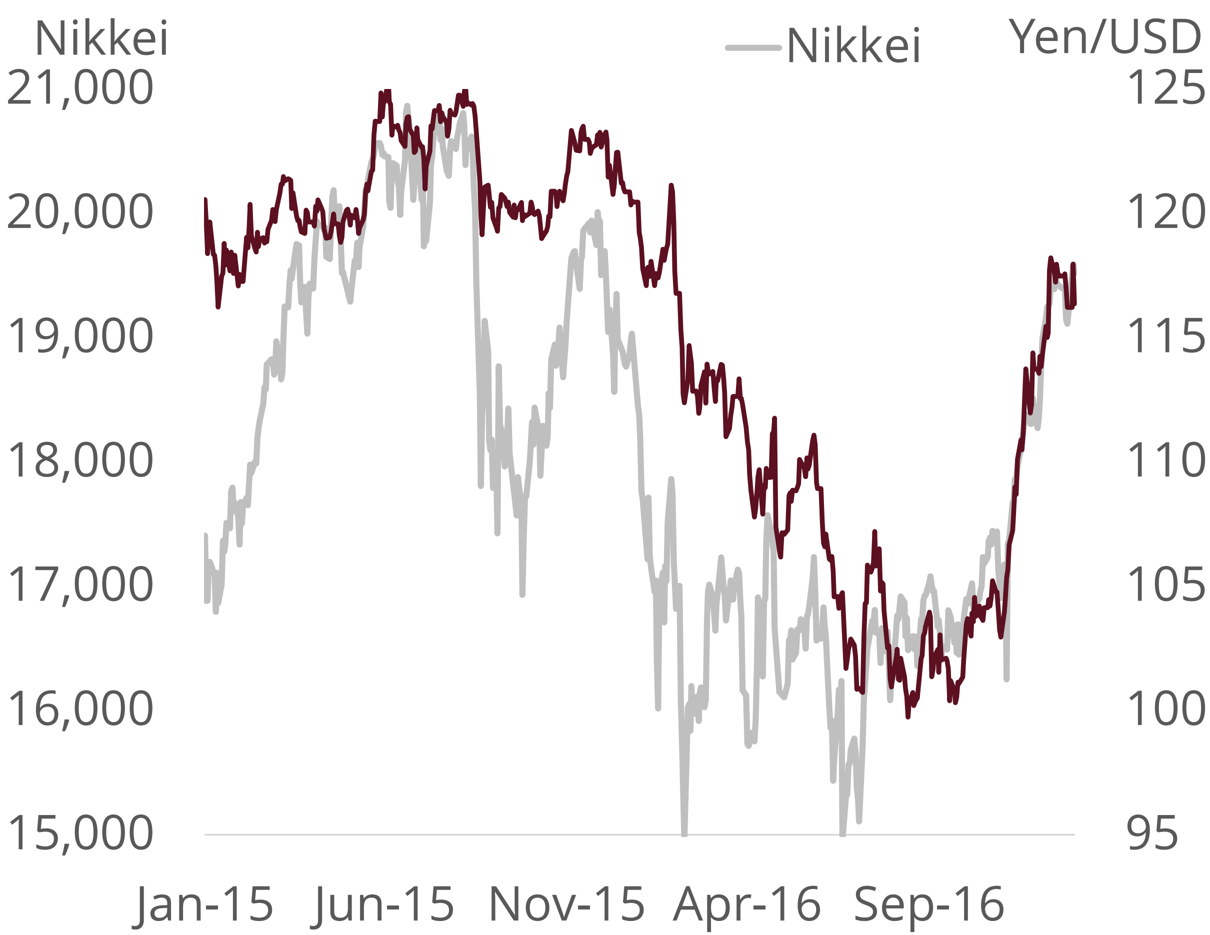


Source: Bank of International Settlements

Weak yen, US recovery boost Japanese economy

FIG 14: Weak Yen lifts returns to many firms

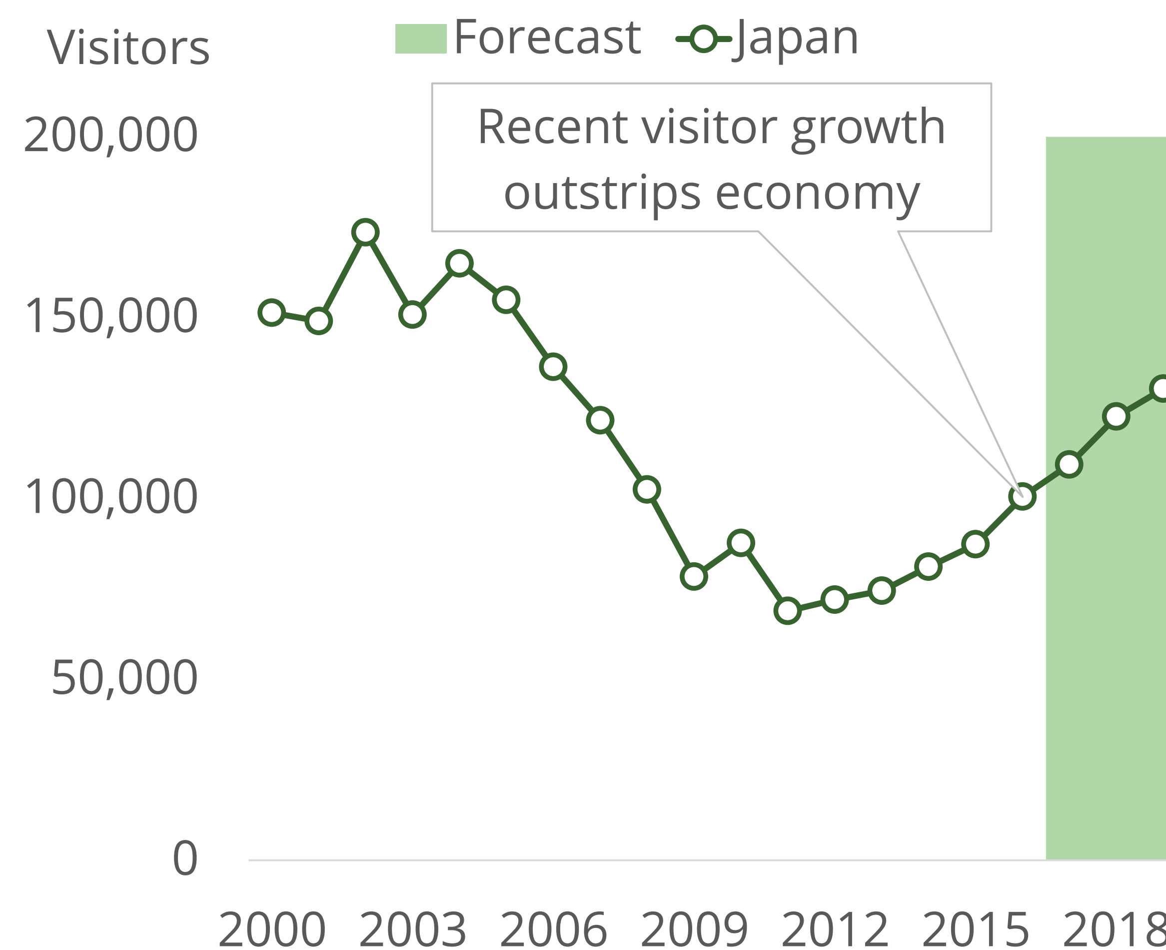
Nikkei vs USD-Yen exchange rate



Source: Federal Reserve, Reserve Bank of New Zealand

FIG 15: Expect strong growth – 9% CAGR to 2019

Annual visitor growth,

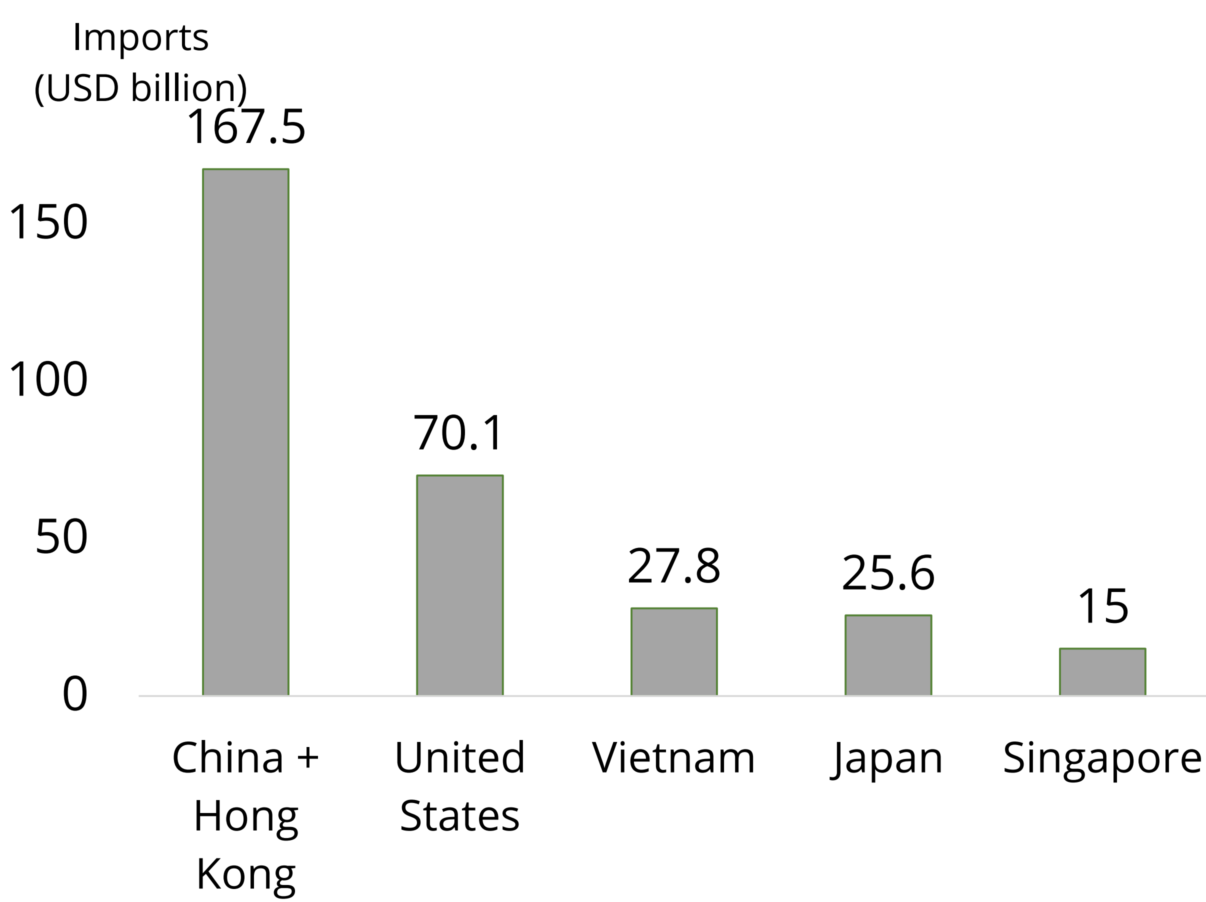


Source: Sense Partners

China link risk to Korean outlook but often volatile Korean visitor growth strong for now

FIG 16: China largest share of Korean exports

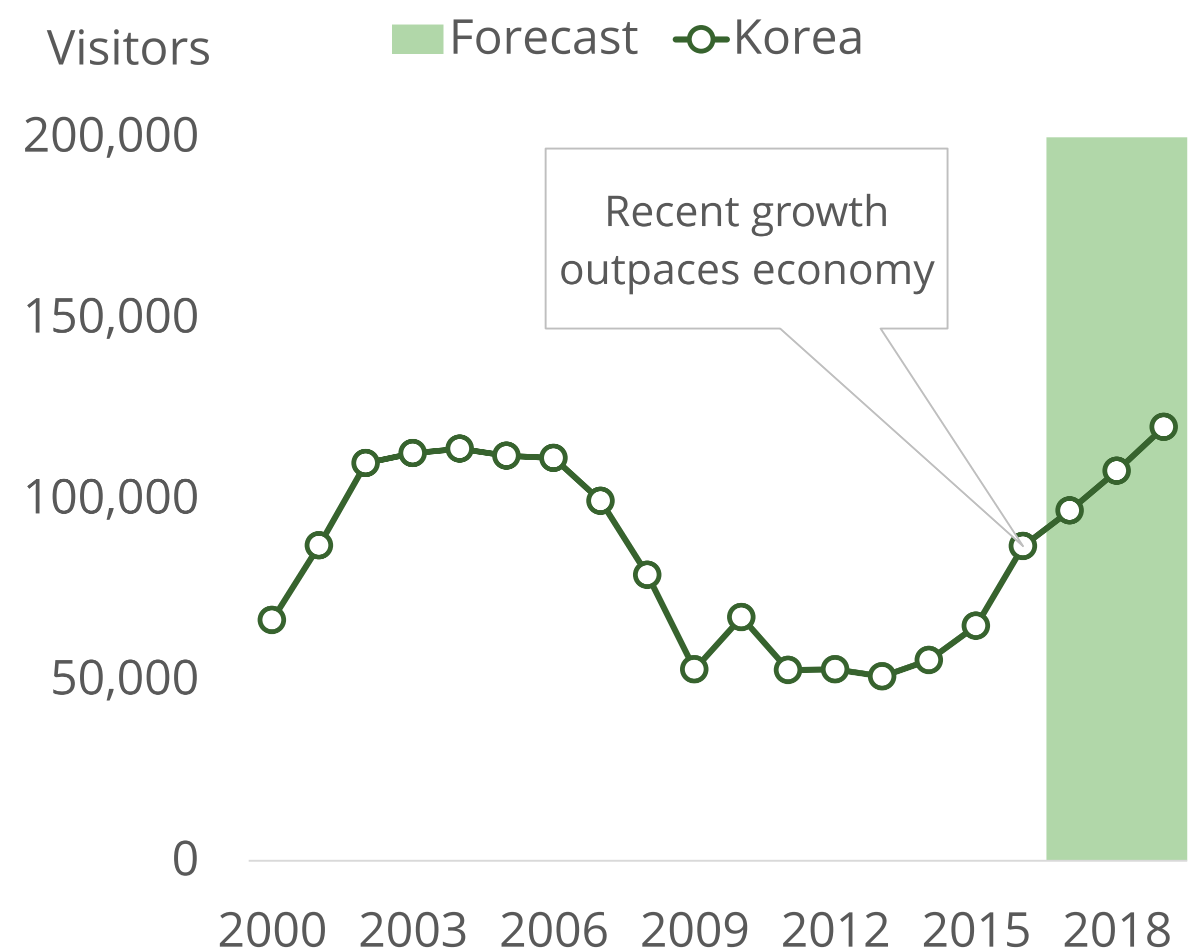
5 largest importers of Korean products



Source: OECD

FIG 17: Expect strong growth – 9% CAGR to 2019

Annual visitor growth,

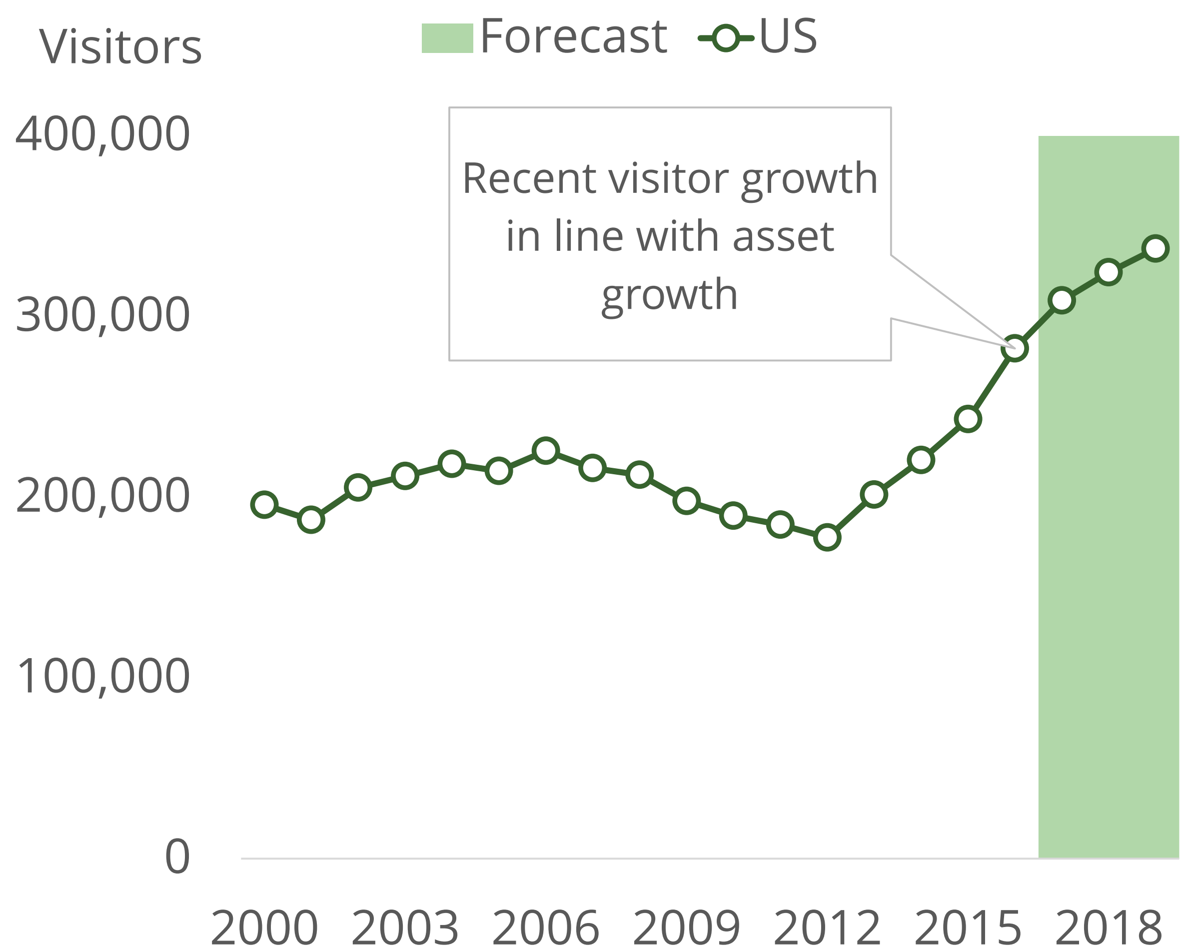


Source: Sense Partners

Outlook market-by-market: Western markets

Recovering US economy brings more visitors, New Zealand benefits more than elsewhere

FIG 18: But expect strong visitor growth
Visitor arrivals (Annual)



Source: Sense Partners

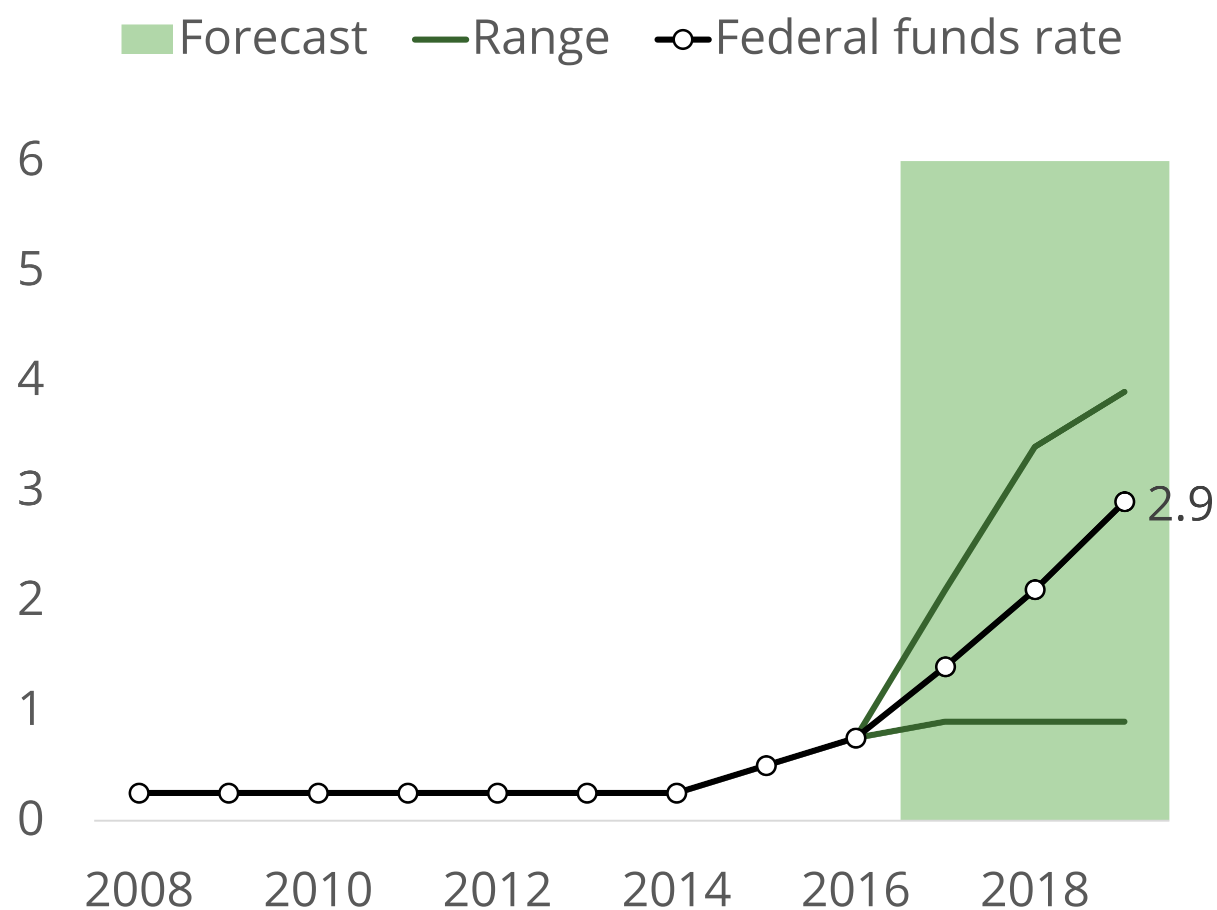
Key takeaways – United States

- **US economy has recovered from the GFC, asset prices up strongly boosting visitor arrivals**
- **Fed is hiking interest rates (finally), lifting the US dollar**
- **Markets read US election shock as lifting demand and inflation**
- **Capacity puts upside risk on our forecast of visitor growth to moderate from 16% in 2016 to 9% in 2017. We have 6% in 2018.**

US recovery pushes global interest rates higher, expect strong US dollar to persist in 2017

FIG 19: Fed expects to hike rates further…

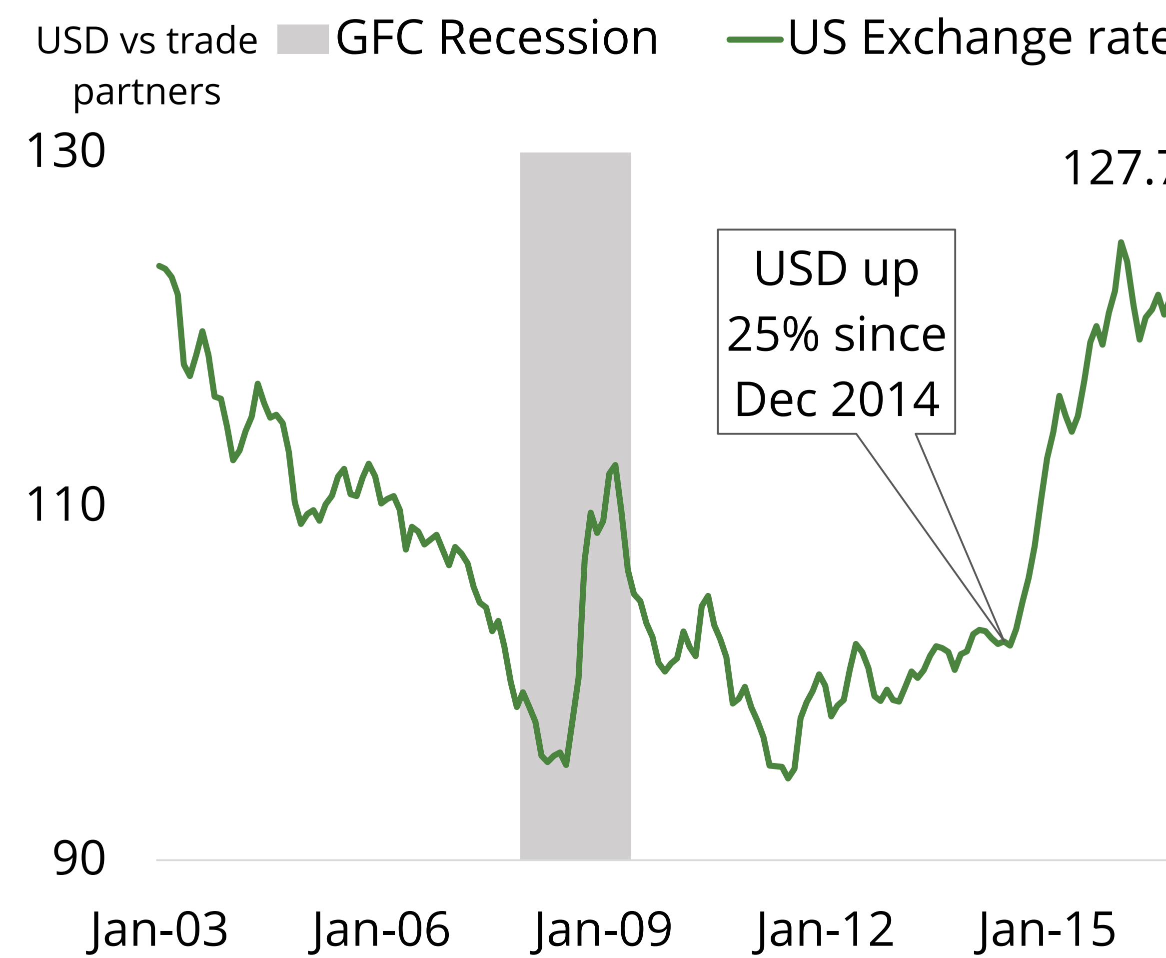
Federal funds rate and Federal Reserve Board forecast (Dec 2016)



Source: Federal Reserve Board of Governors

FIG 20: Strong economy also lifting the US dollar

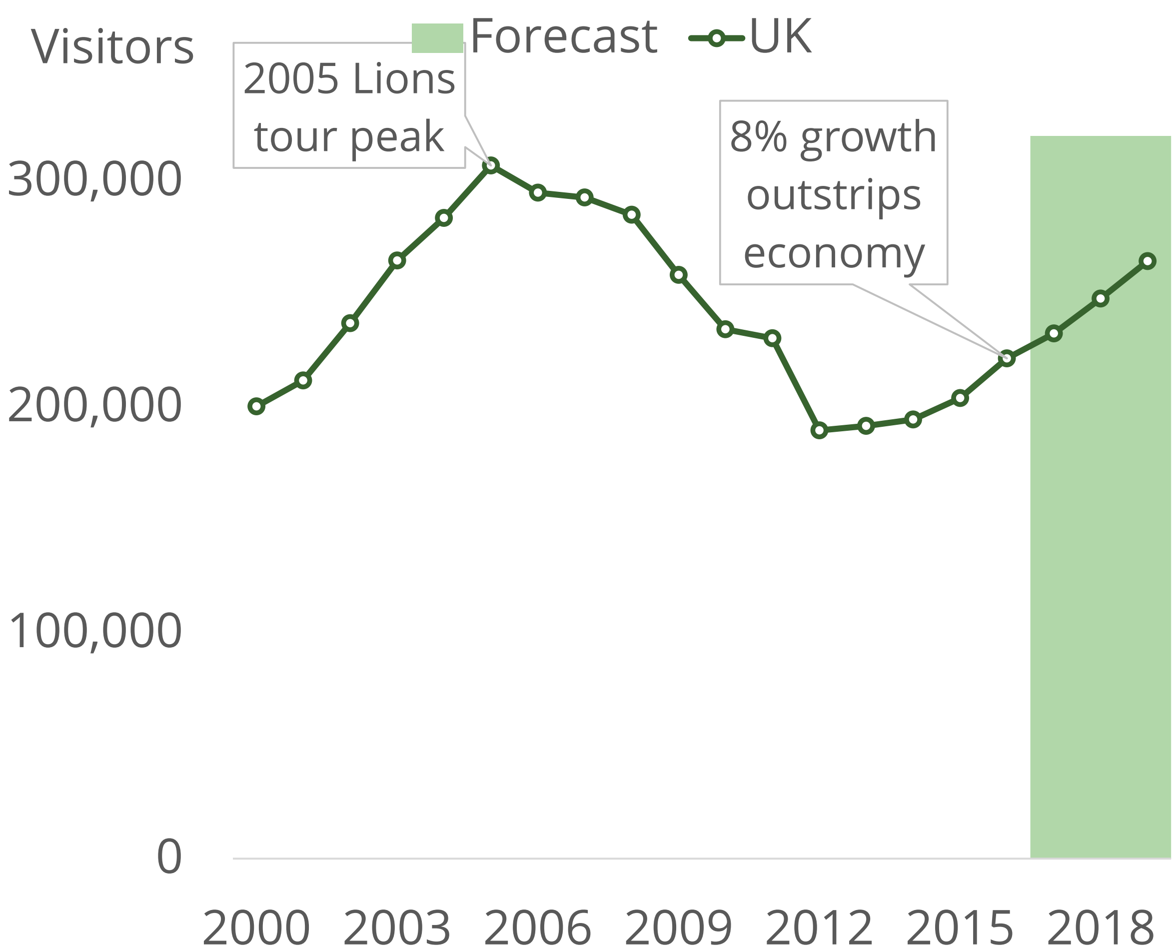
Trade Weighted U.S. Dollar Index: Broad, monthly



Source: Federal Reserve Board of Governors

UK economy faces challenges but visitor growth holds up, at least for now

FIG 21: But expect strong visitor growth
Visitor arrivals (Annual)



Source: Sense Partners

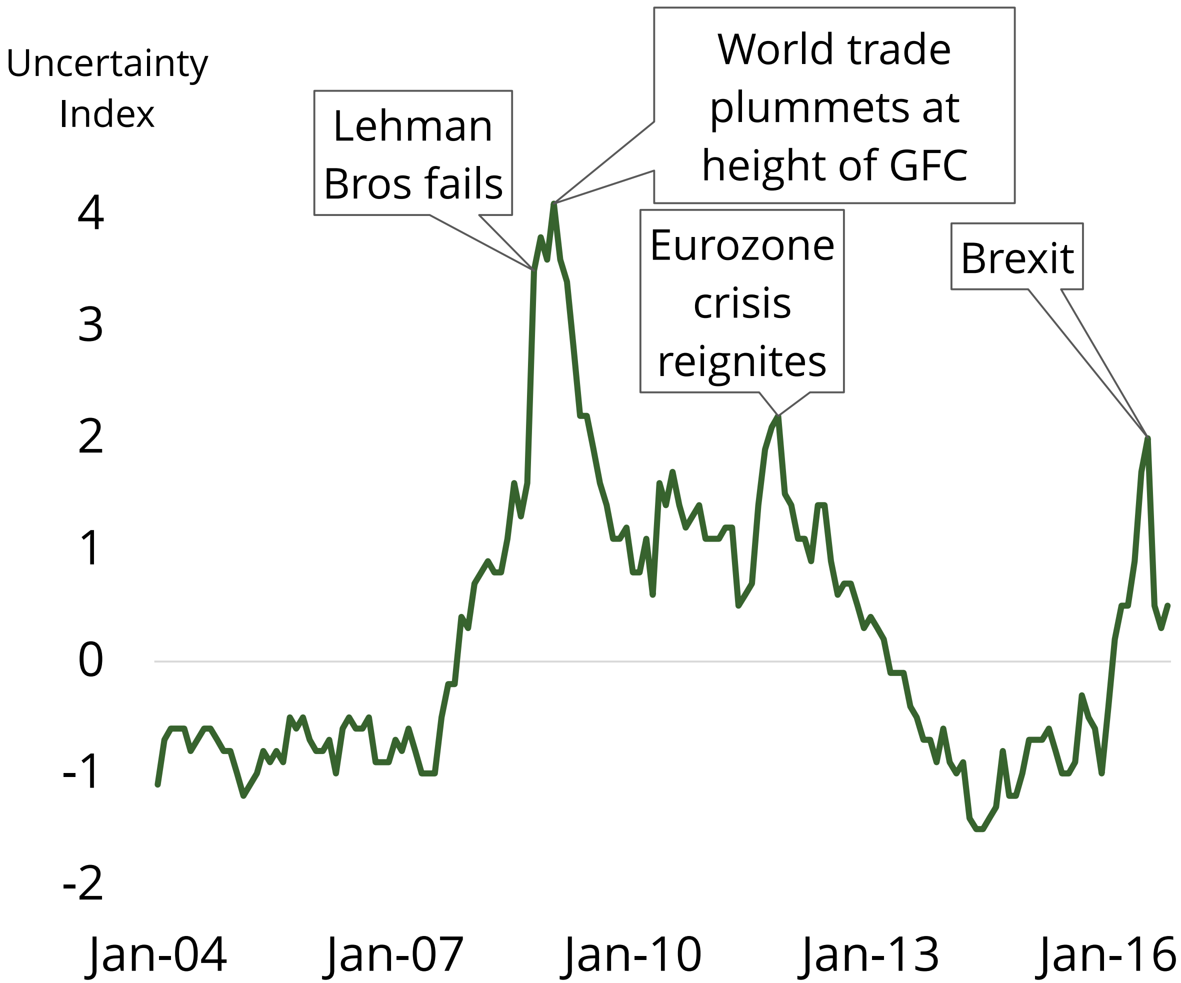
Key takeaways – United Kingdom

- **UK economy recovering more slowly than the US economy**
- **Brexit weakens growth outlook but moderate impact to date**
- **Pound has depreciated and tough for govt to build incomes**
- **We expect 8% growth in 2016 to ease to a CAGR of 6.1% to 2019**

Pound down but post-Brexit growth OK for now

FIG 22: Brexit expected to be seismic shock

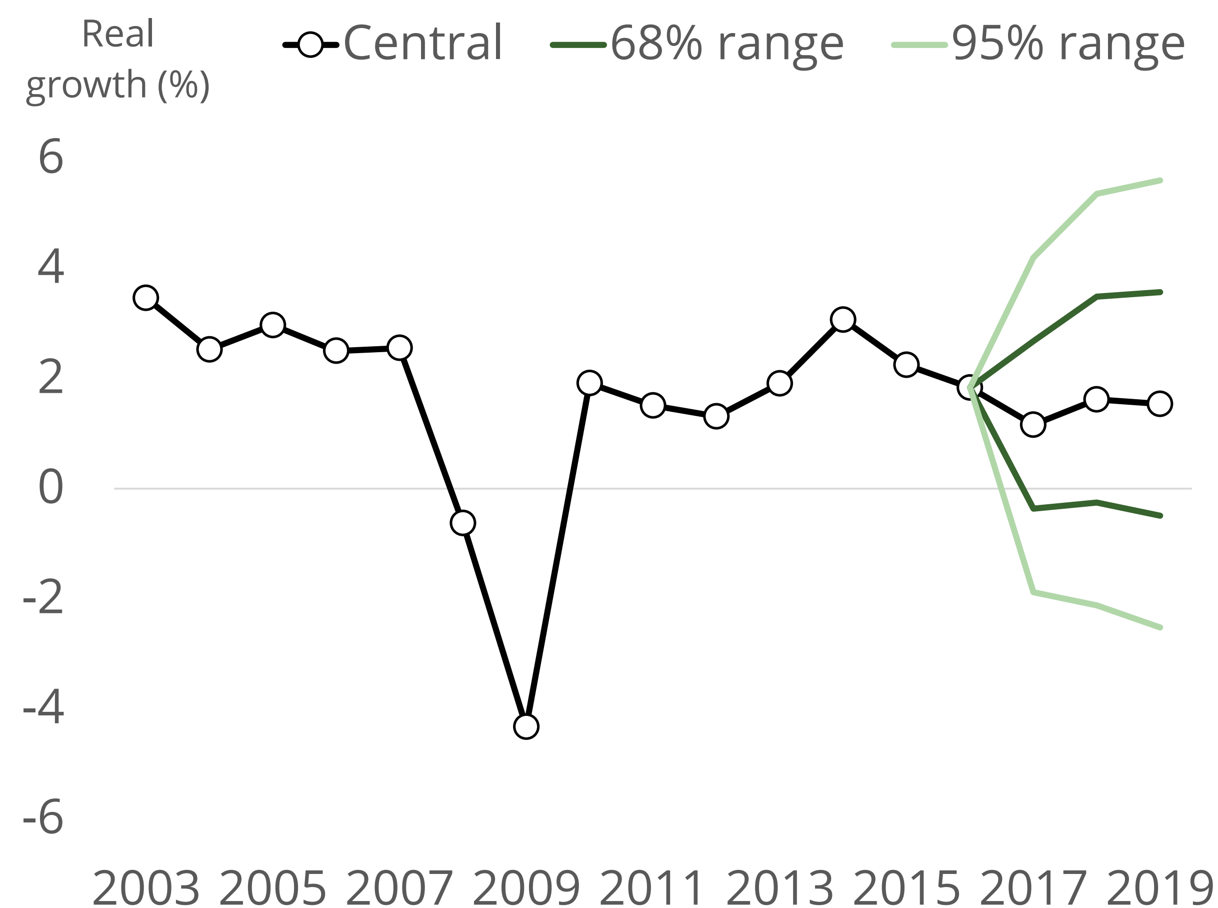
BoE *Inflation Report*, Nov. 2016, Principal component of uncertainty measures



Source: Bank of England

FIG 23: But growth only mildly muted near-term

BoE *Inflation Report,* Nov. 2016, economic growth forecasts

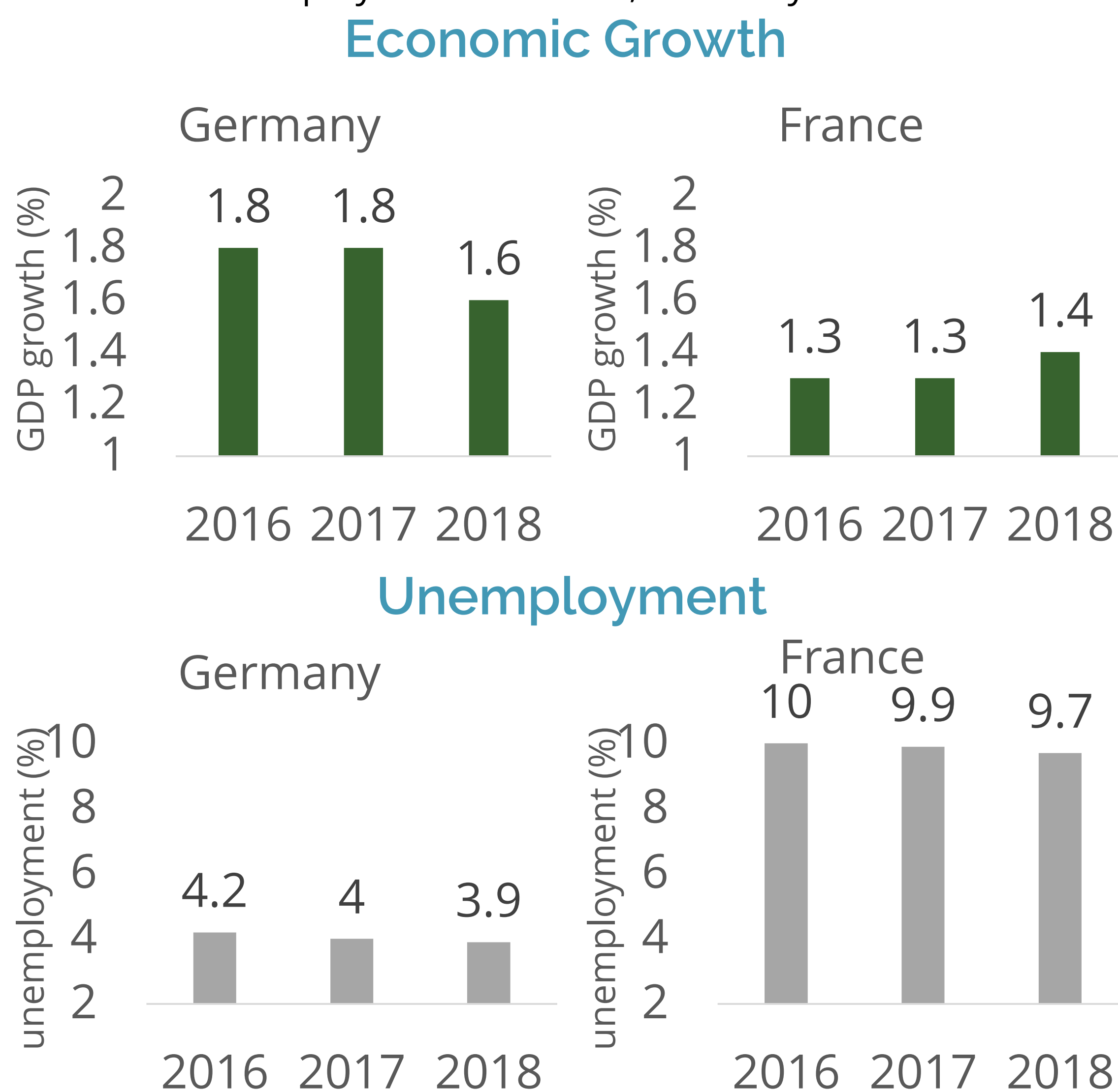


Source: Bank of England

Germany economy weak but outstrips EU peers, expect visitor growth to ease from 2016 high

FIG 24: German economy better than EU peers

Growth and unemployment forecasts, Germany vs France



Source: OECD

FIG 25: Expect strong growth – 9% CAGR to 2019

Annual visitor growth,

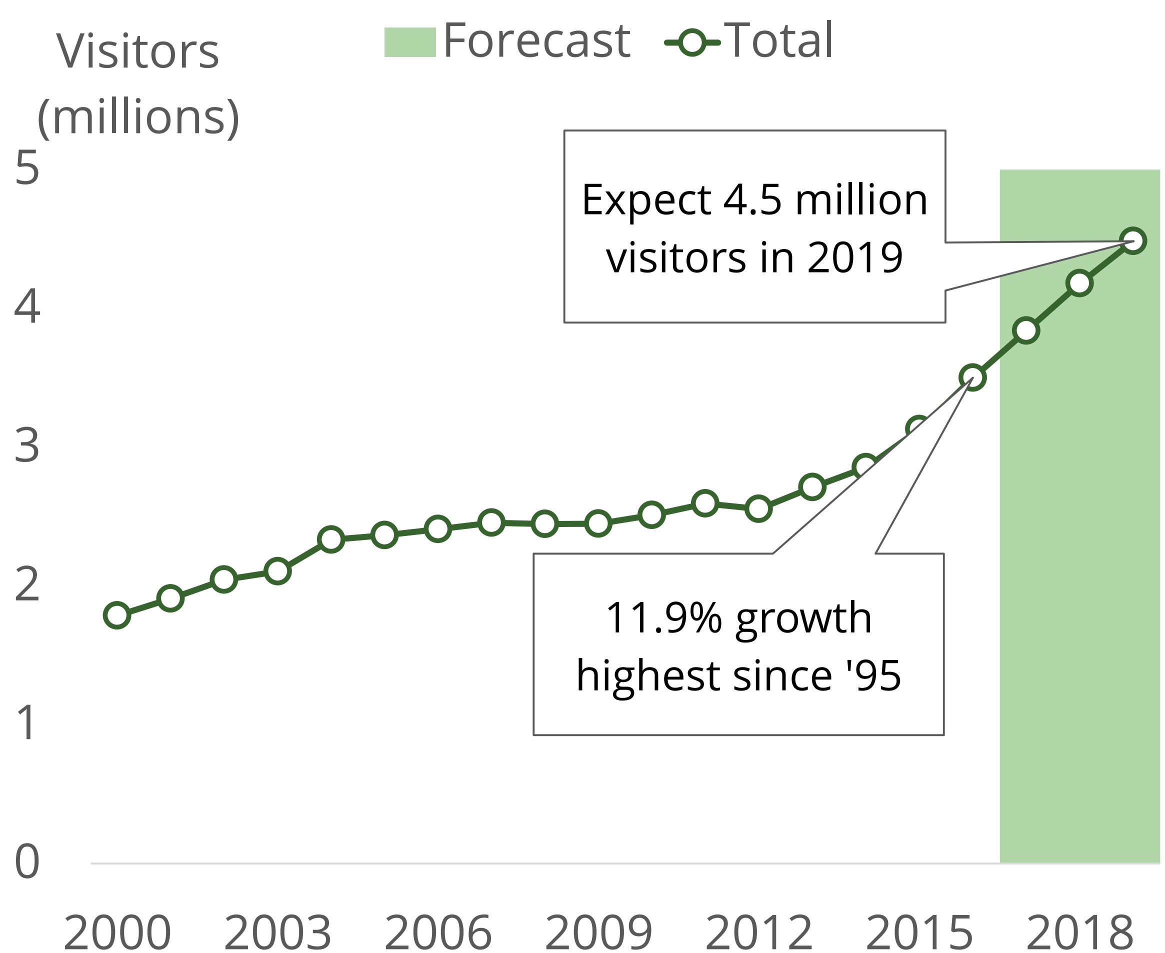
Source: Sense Partners

What this means for New Zealand

Risks and uncertainties but pace of growth strongest in a generation, plan on continuation

FIG 26: No problem generating enough demand

Visitor arrivals (Annual) to 2019



Source: Sense Partners

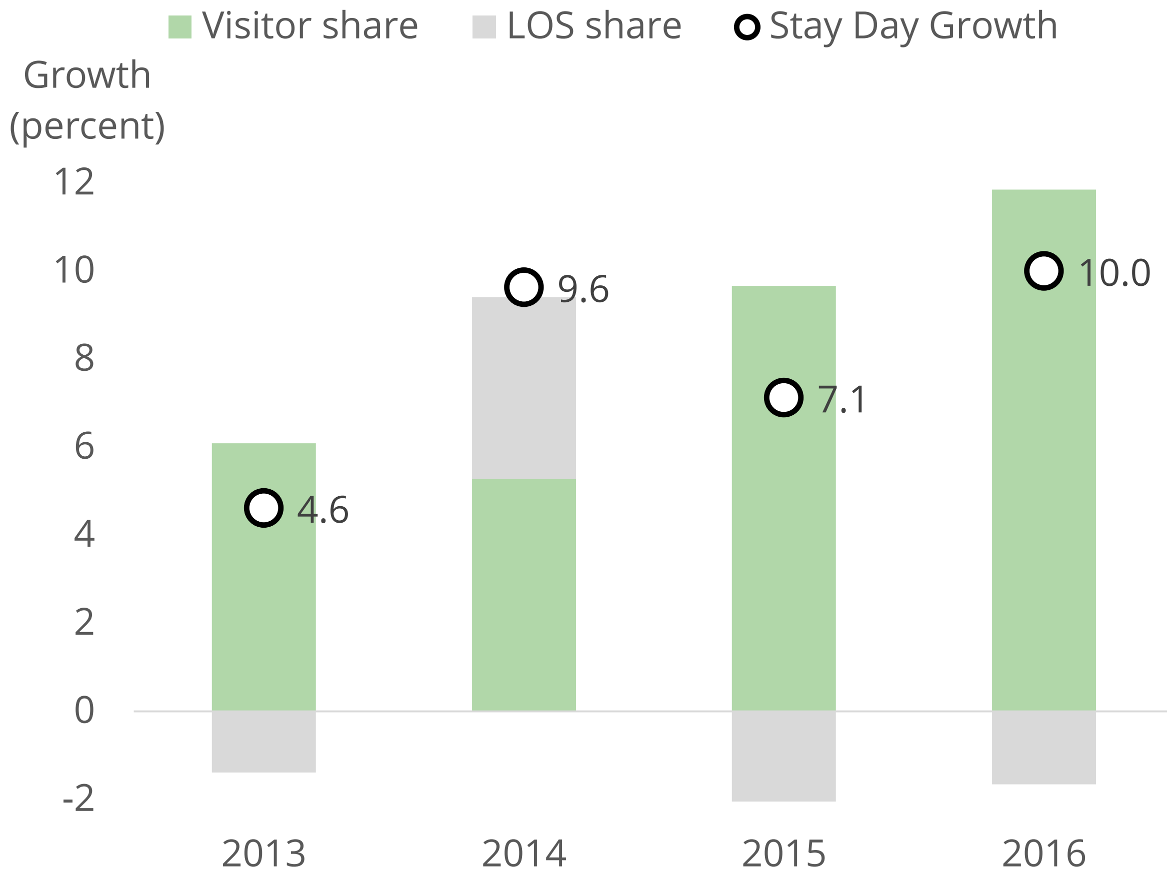
Key takeaways

- **Headline growth strongest in generation – all markets outstrip 20-year averages**
- **China effect continues to bring many more visitors**
- **Government in advanced economies challenged but tourists defy the economic cycle**
- **We expect growth to ease a little and average 8.6% to 2019**

Pace of growth drives need for infrastructure and management of bottlenecks

FIG 27: Likely to need double digit room growth to accommodate rising stay days

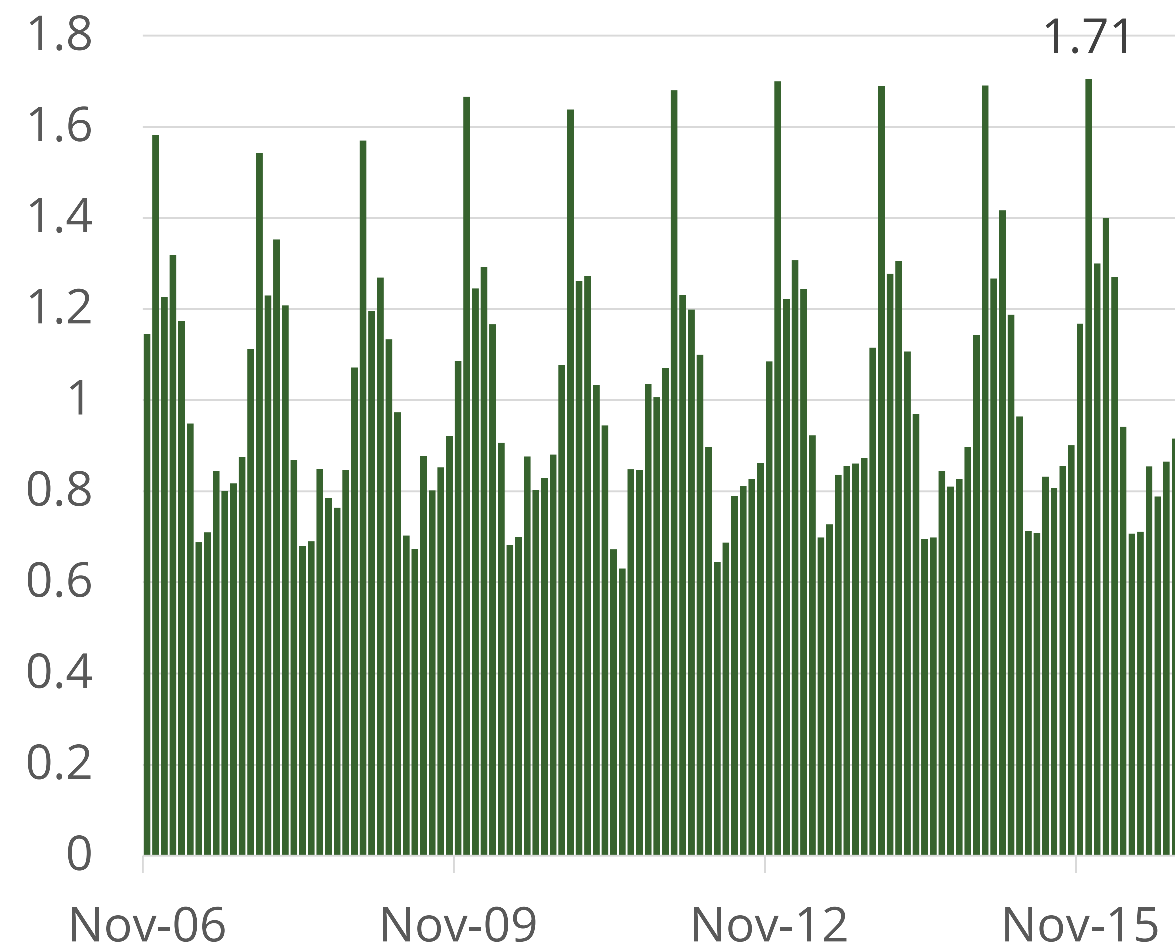
Contributions to growth in international stay days



Source: Statistics New Zealand

FIG 28: Don't expect seasonality to change much

Ratio of month arrivals to monthly average



Source: Statistics New Zealand

Economic framework for thinking on supply

- **First diagnose the problem: do you need infrastructure or is congestion the issue?**
- **Firms will deal with many infrastructure decisions based on expected returns and risk appetite – govt will not do this better**
- **Could be case for government money if networks are involved but many other industries face supply chain/capacity issues too**
- **Right to expect Government investment decision is relative to other priorities that compete for government dollars: no hypothecation**

Averaging is evil – Price the peak!

- **Congestion issues are not directly hard infrastructure issues – can't directly build more iconic destinations need a pricing solution**

- **Price is the most efficient means of allocating access – people don't like this so the politics is difficult, but current quotas don't work**

- **Border control tax too blunt - if the problem is congestion, price the access as closely as possible, eg Tongariro crossing charge**

- **Can think of risks to natural tourism assets just like any network asset where access is rival eg brownouts in electricity network**

None of which is easy but risks to not acting – continuing coordination will be critical