

Impact of the Fall in Tourism on Asia

Fullerton Market Updates
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Executive summary

- International tourist numbers to Asia are expected to fall off a cliff in 2020, with the adverse economic impact reflecting each country's dependence on tourism, and the composition of its domestic and international visitors.
- International tourist receipts account for about 4% of GDP across Asian economies on average, but the economic impact is amplified when taking into account spill-overs to employment.
- The recovery in tourism will likely be much slower than the SARS outbreak experience because the containment costs of COVID-19 are so large, and the global economy is sliding into a painful recession.
- Investors will have to be cautious and selective given the likelihood that the post COVID-19 environment is fundamentally different. At least until a COVID-19 vaccine is discovered, social distancing will be sustained - resulting in weaker performance from risk-assets linked to tourism and transport, but stronger performance from utilities, healthcare, and technology.
- China seems well-placed to lead the global recovery while other countries more dependent on global trade, like South Korea and Taiwan, will lag. Other Asian countries, like Thailand, Hong Kong, Malaysia, and Singapore, will suffer a 'double-whammy' of stress because trade and tourism are very important to economic activity.

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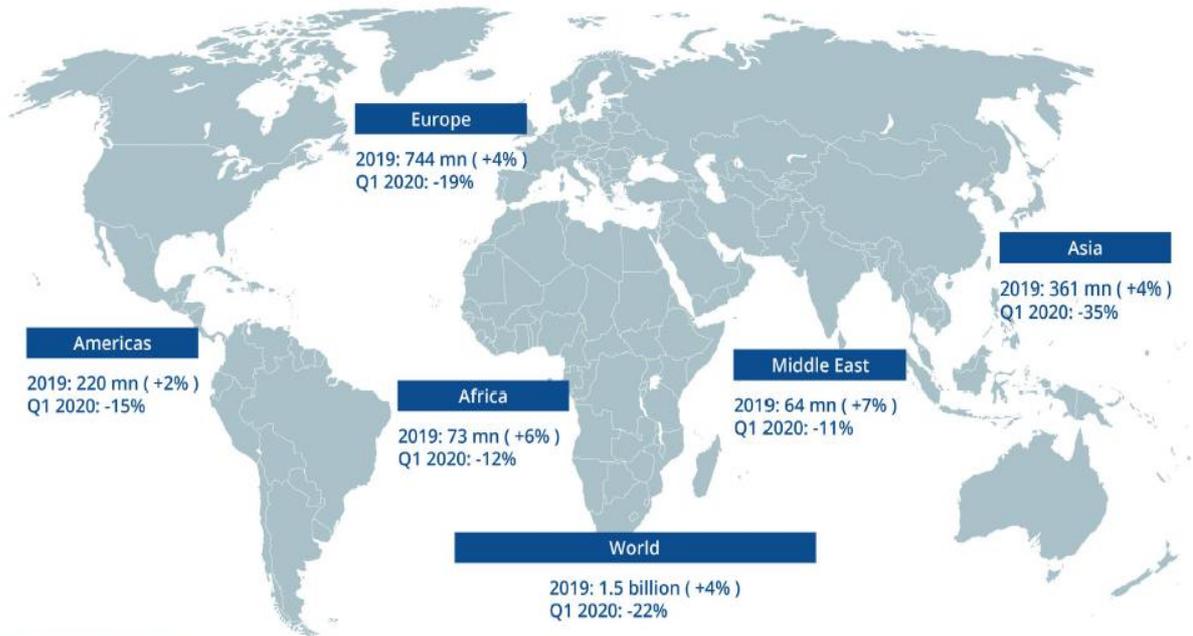
“Significantly lower tourism receipts in Asia will affect growth, unemployment, and current account balances, but the extent of the impact will differ across the region.”

To what extent will COVID-19 impact tourism?

Travel and tourism are among the most affected sectors by the COVID-19 driven recession, with airplanes on the ground, hotels closed and travel restrictions put in place in virtually all countries around the world. The United Nations World Tourism Organisation (UNWTO) World Tourism Barometer (May 2020) reported a 22% fall in global tourist arrivals over Q1 2020 (see Chart 1). By regions, Asia and the Pacific, the first region to suffer the impact of COVID-19, saw a 35% fall in arrivals in Q1 2020 (13% pts worse than the global average fall). The second-hardest hit region was Europe with a 19% decline, followed by the Americas (-15%), Africa (-12%) and the Middle East (-11%).

The UNWTO World Tourism Barometer suggests that declines of 60% to 80% in global international tourist arrivals, and global tourism export receipts (equating to falls of \$900bn to \$1,200bn USD), is possible for 2020. The degree of contraction depends upon the speed of the COVID-19 containment, and the duration of travel restrictions and shutdown of borders. Such outcomes would put 100 to 120 million global tourism jobs at risk.

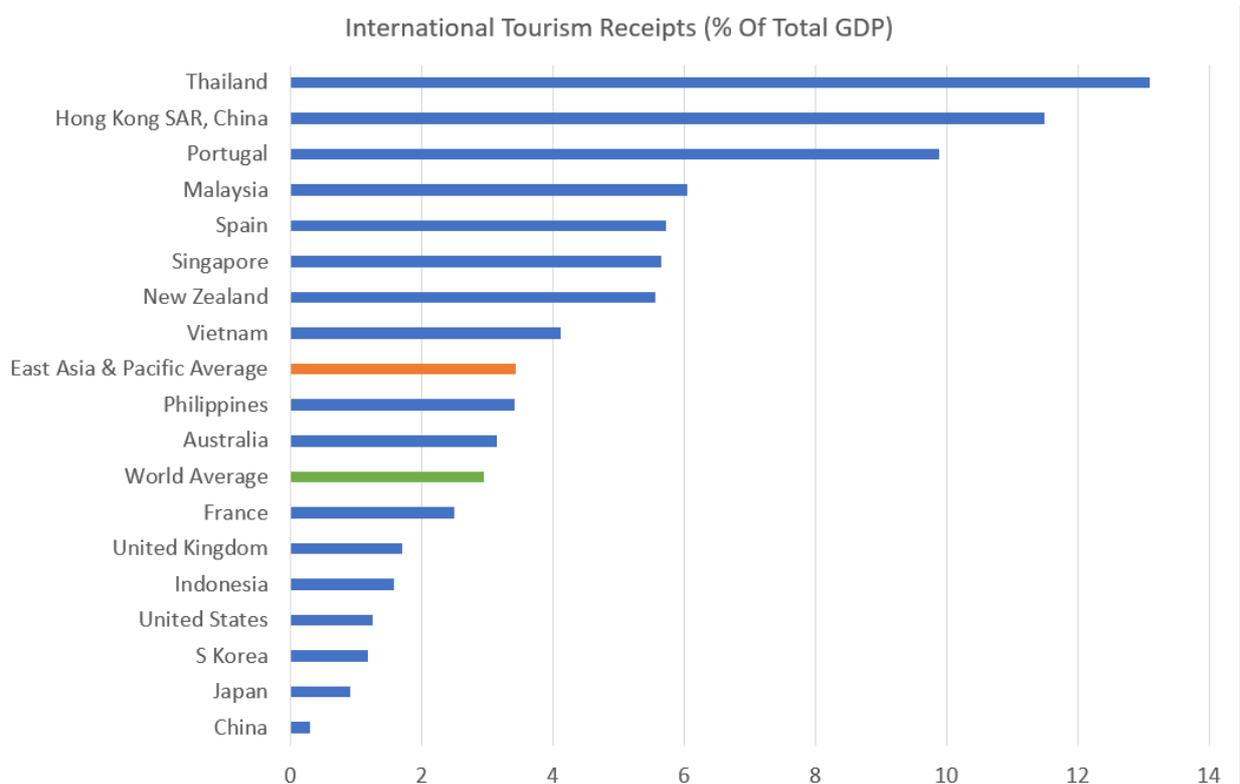
Chart 1: Global tourist arrivals by region 2019 versus Q1 2020



Source: UNWTO World Tourism Barometer (May 2020)

Within Asia, the countries that will suffer the most are those where tourist export receipts are large shares of GDP e.g. Thailand, Hong Kong, Malaysia, Singapore, New Zealand, Vietnam, and Philippines (see Chart 2). European countries that will likely suffer by more than Asia are those across Southern Europe, especially Portugal and Spain. In contrast, the US, the UK, and Japan, are all likely to suffer relatively less because international tourism is only a small share of their GDP.

Chart 2: International tourism receipts as a share of GDP



Source: World Bank (2018, or latest data available)

Which countries across Asia will be impacted the most?

The collapse in tourism will affect growth, unemployment, and current account balances, but the extent of the impact will differ across Asia. Asia's international tourist receipts as a share of GDP is about 4% (and higher than the global average. See Chart 2). However, the World Travel and Tourism Council (WTTC) notes that if indirect impacts are fully measured, such as spill-overs to other entertainment and service industries, then the total share could be as large as 10% of GDP. This means that the collapse in tourism will have an amplified effect on unemployment and consumption spending more generally.

Across Asia, Thailand and Hong Kong stand out as the countries most sensitive to falls in international tourism (see Chart 2). Countries which are least impacted would be the more domestically-driven economies such as China and India.

While Thailand and Hong Kong are likely to be significantly impacted by the collapse in international tourism, they have current account surpluses and fiscal resources to help economic activity recover. Conversely, countries with current account deficits, and that are also reliant on tourism revenues, are likely to suffer more. Most of these countries are outside of Asia (such as Morocco, Egypt, and Turkey. See Chart 3).

Adverse impacts on employment from the tourism slump are likely to be much worse for many countries across Asia because tourism tends to be labour intensive (i.e. tourism's share of employment is much larger than its share of GDP). For example, in Japan, tourism accounts for almost a 10% share of total employment, which is around 5 times greater than the share of tourism activity in GDP. Thailand, the Philippines, and India, are also likely to be impacted significantly by potential layoffs as a result of falling tourism activity (see Chart 4).

Chart 3: Current account balance and net tourism inflows

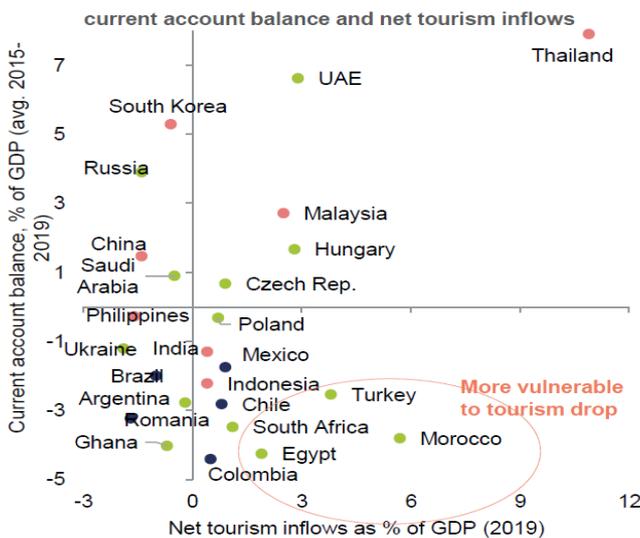
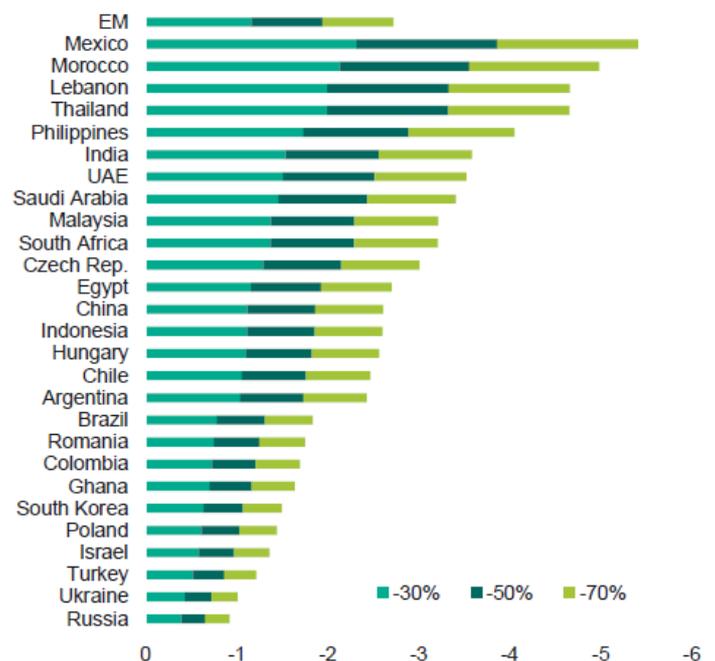


Chart 4: Employment losses under different tourism activity scenarios (as % of total jobs)



Source: BNP Paribas, May 2020

When will tourism recover?

Looking back at past epidemics, such as during the SARS outbreak in 2003, it took about 12 months for Asia ex Japan tourist arrival growth to return to where it was beforehand. Unfortunately, this gives limited guidance because the containment costs of COVID-19 are so large, and the global economy is sliding into a painful recession. The UNWTO Panel of Experts Survey (May 2020) shows that most respondents do not expect a recovery in international tourism to start until 2021 (see Chart 5).

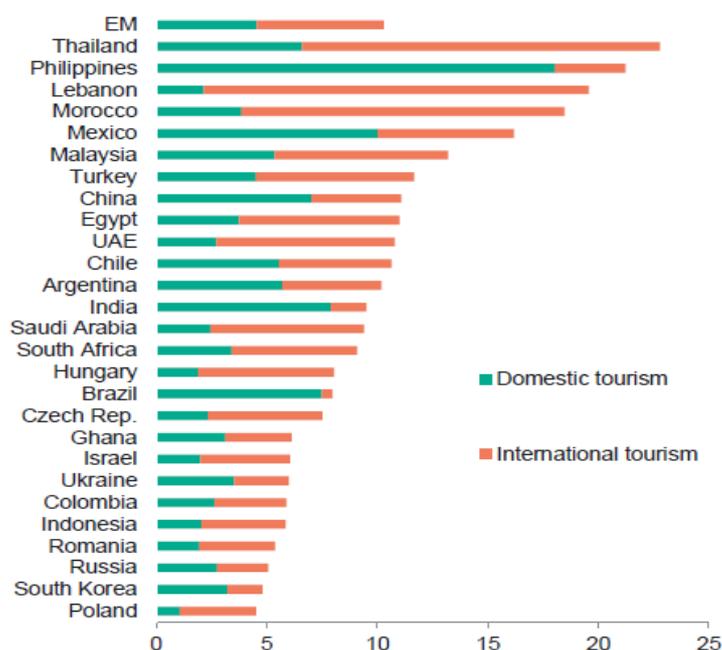
Chart 5: UNWTO survey expectations on when tourism will recover



Source: UNWTO Panel of Experts survey responses (May 2020)

If domestic tourism can recover faster than international travel, as the UNWTO Survey suggests (see Chart 5), then that could be a key supporting factor for some Asian economies. For example, domestic tourism is a key contributor to economic activity across the Philippines, India, and China (see Chart 6). In addition, intra-Asian tourism is also important to many regional economies and has coincided with China’s rising middle-class and its greater demand for travel. It has had a positive impact on various sectors across Asia, such as gaming in Macau and Singapore, retail in Hong Kong, and cosmetics in Korea. Given COVID-19 containment is more advanced across Asia, intra-regional travel may rebound faster than otherwise.

Chart 6: Total economic impacts from tourism - by international and domestic visitors (2019, in % of GDP)



Source: WTTC, World Bank, BNP Paribas, May 2020. Accounting for both direct and indirect impacts of tourism on overall economic activity.

Given the collapse in tourism, and the painful global recession unfolding, how should investors adjust their strategy?

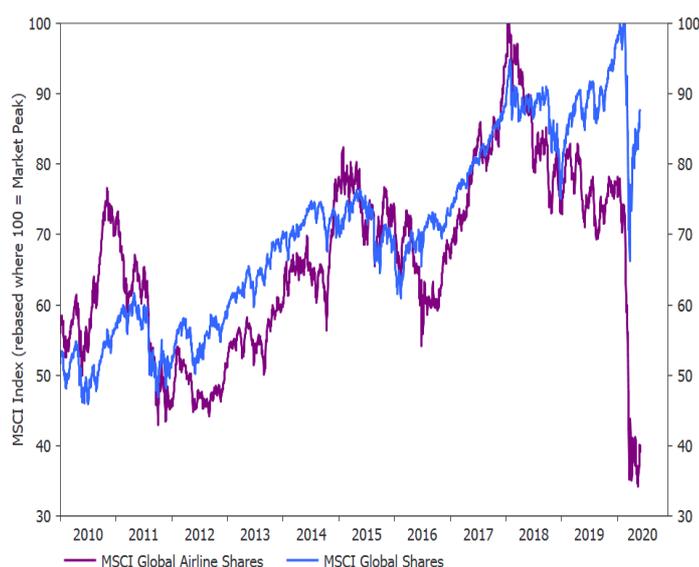
Some sectors, like tourism, will suffer long-lasting demand destruction

A key uncertainty from the COVID-19 driven global recession is when the recovery comes will tourism, in particular, still suffer from structurally weak demand? This is possible because:

- the surge in global unemployment means that households will have less disposable income to spend on recreational travel for quite a while.
- the 'new-normal' Work-From-Home (WFH) environment is likely to keep business travel depressed.
- similarly, the cruise sector and MICE (Meetings, Incentives, Conferences, and Exhibitions) sectors may take a long time to recover.

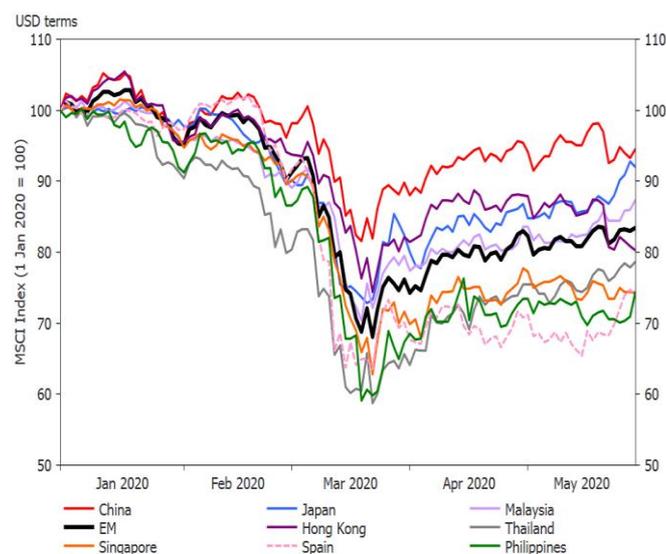
Because tourism and its related activities are so dependent on social interactions it faces the risk of much lower demand post-recession - at least until a COVID-19 vaccine is discovered. In the meantime, significant demand destruction will inevitably lead to sector consolidation (especially across airlines and hotels which tend to be asset/debt heavy sectors). These concerns are already playing out in global equity markets as global equities have rallied with expectations that the end of the global recession is on the horizon, but, in contrast, global airline shares are still struggling (see Chart 7).

Chart 7: Global equities and global airline shares



Source: Refinitiv, May 2020

Chart 8: Select equity markets



Source: Refinitiv, June 2020

China and Japan equities are outperforming the Emerging Market average (YTD) while Hong Kong, Thailand, Singapore, Spain, and the Philippines are all underperforming the Emerging Market average (see Chart 8). A common link across the relative underperforming markets is their sensitivity to global trade but also the importance of tourism. However, this is not a strong inference because Malaysia is outperforming the Emerging Market average even though it is quite dependent on tourism.

Implications for equities

A key takeaway for investors is that the broad market impact of the dramatic fall in travel and tourism on Asian equities is likely to be limited. Other significant factors are important drivers, and the huge policy stimulus and demand recoveries will support rebounds in Asian markets even if travel and tourism sectors lag (NB travel and tourism related sectors make up less than 3% of the MSCI Asia ex Japan Index. This includes hotels, restaurants, leisure, airlines as well as transport Infrastructure companies such as ports and airports, etc.).

Nevertheless, equity investors need to continue to focus on sound 'bottom-up' stock selections, driven by fundamentals. Some sectors are likely to suffer from depressed earnings growth for quite a while - such as tourism,

transportation, recreation, and consumer discretionary spending (especially big-ticket items). Other sectors like technology, on-line services, utilities, and consumer staples should perform strongly.

We are more positive on global equities given the rally since March and because markets seem to have 'priced-in' much of the recession risk ahead. Asian equity markets will get support from the recovery in China, but more export dependent markets, like South Korea, Taiwan, much of ASEAN, and India, may struggle for a while.

China's risk assets are well-positioned to flourish in the post COVID-19 environment – its equity market has outperformed most other countries as its domestic demand has rebounded. But, at the same time, geopolitical risks have increased significantly with the deterioration in US-China relations, and that could cause investors to pause. However, the more significant longer-lasting risk is that China's on-going liberalisation of its financial markets, and its rebalancing of the economy, does not feed-through to better returns, especially for long-term equity investors.

China is still an investment destination that provides great opportunities to access higher value-added consumer sectors (with strong brands and market share), as well as global leaders in technology, e-commerce, and healthcare.

Implications for fixed-income and FX

Because many Asian economies are dependent on external demand, investors should position cautiously on currencies and allocate risk via duration, curve and credit-beta plays. As China seems well-positioned to lead the global recovery, its currency is attractive with solid yield and modest volatility, while lower yielding currencies, such as HKD, are less attractive.

With significant policy stimulus underway there is the case to overweight duration, favouring countries across Asia, such as South Korea, Malaysia and Singapore. Increased bond supply will be needed to fund larger fiscal deficits, so investors should expect yield curves to steepen slowly over time, and focus on exposures up to the 10-year tenor.

Default rates will also rise significantly with the recession, and lag the recovery, so investors should remain selective about High Yield credit exposures and consider Investment Grade credits (which tend to have stronger balance sheets and fundamentals).

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