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Research Briefing | Eurozone

A rebound in Mediterranean tourism is likely, not assured

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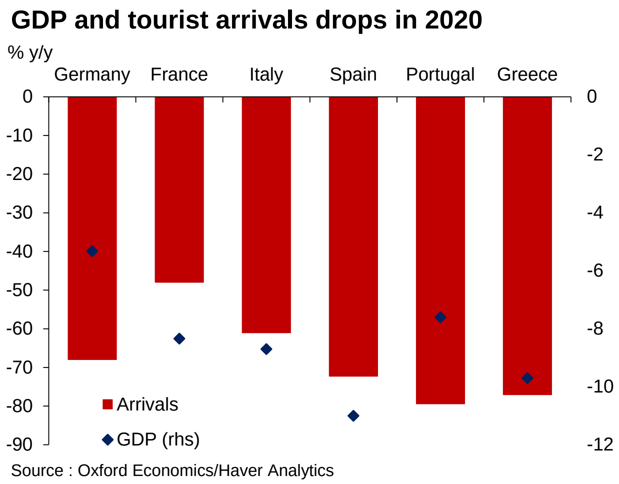
- **Mediterranean countries suffered some of the largest GDP losses experienced in the eurozone last year, due in part to the collapse in tourism. In our baseline forecast, we envisage a partial recovery in 2021 as travel restrictions are gradually eased this year, but this outlook is very uncertain. Should tourism experience another lost year, the damage to the Mediterranean countries' economies would widen the GDP gap with the core eurozone countries.**
- **The tourism sector has been one of the worst hit by the coronavirus crisis, with tourist arrivals to Mediterranean countries down 60%-80% y/y in 2020. Activity recovered partially during summer 2020 as some restrictions were eased. Although activity recovered somewhat in summer 2020, the collapse in tourism contributed to massive GDP drops of 8%-11% in Italy, Spain, Portugal, and Greece in 2020. This was well above the eurozone average decline of 6.8%.**
- **We anticipate a level of tourism in summer 2021 similar to or higher than that of last year. Tourism will continue to be supported by a stronger than usual domestic share of travellers, as international restrictions will be the last to be removed and people will remain reluctant to travel abroad. But we don't expect a full recovery of services exports, including tourism, to pre-crisis levels until at least early 2023, behind the recovery in GDP and domestic demand.**
- **Further delays in production and distribution of vaccines, as well as the spread of more transmissible virus variants, pose large downside risks to our baseline forecast for the Mediterranean countries. We expect a more gradual recovery if international tourism in 2021 is similar to last year, with a negative impact on GDP. In this downside scenario, economic effects would be very light for Italy, but take -1% off GDP for Spain and Portugal, and -6% for Greece.**

Figure 1: Mediterranean countries recorded massive falls in GDP and tourism arrivals



2020 was an unprecedently weak year for international arrivals, which fell by around 60%-80% in the Mediterranean countries. The tourism industry contributes a considerable part to the general economic activity in these countries, so GDP losses were massive.

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Tourism: A brief history of a lost year

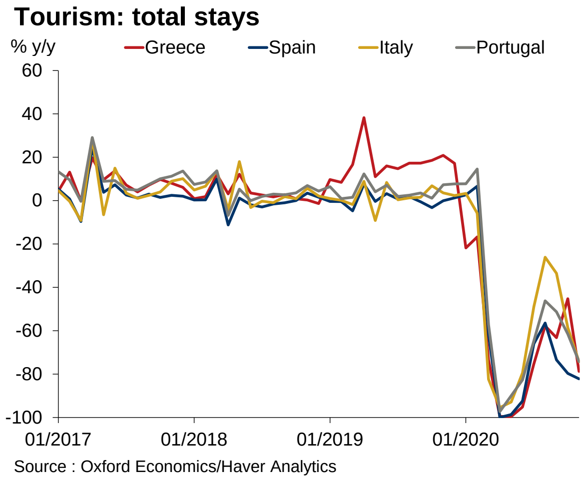
International arrivals took a massive hit in 2020 as a consequence of tight mobility restrictions

Tourism activity represents a considerable part of the economy in Italy, Spain, Portugal, and Greece. The sector accounts for between 6% and 8% of these countries' GDP directly and for further 8% to 13% indirectly, representing a major component of services exports.

Countries have been forced to take restrictive measures to halt the rapid spread of the coronavirus since the outbreak of the global pandemic. As a consequence, travel activity and demand plummeted in the first half of 2020, with tourist stays almost at zero year on year in April and May (**Figure 2**). The hospitality industry has been one of the hardest-hit sectors, with the plunge in demand causing many hotels and accommodation sites to remain closed throughout most of 2020. The Mediterranean countries benefited from a brief up-tick in demand as governments eased the most stringent restrictions during the summer and borders gradually re-opened, although annual levels remained well below those of 2019.

However, the health situation deteriorated rapidly in autumn and the tourism rebound came to a halt. Overall, last year's tourist arrivals are expected to have fallen between 60% and 80% in the four most affected Southern European countries and to have contributed significantly to the countries' GDP contractions (**Figure 1**).

Figure 2: Tourism activity froze completely in Q2 2020



Since the outbreak of the crisis, mobility restrictions have been undertaken to halt the rapid spread of coronavirus. This caused tourism arrivals and stays to plunge in March and April, and to recover only partially during the summer months of 2020.

What will the tourism recovery look like in the Southern countries?

Tourism outlook for 2021 is expected to improve, but risks remain titled to the downside

We expect some rebound in tourism activity from late Q2 and early Q3 2021 as restrictions are gradually eased, allowing mobility to pick up, but the recovery outlook for the tourism sector remains clouded. According to Oxford Economics' Tourism service, we expect substantial yearly growth in international arrivals to Europe during 2021, which are very relevant for the Mediterranean countries, but total nights in the region will continue to remain over a third below 2019 levels.

Confidence in the accommodation and travel industries in the Mediterranean region recovered only partially during the summer due to reduced infections rates, but then deteriorated again (**Figure 3**) due to further spread of the virus and the general health situation. The availability of a vaccine gave a clear boost to confidence at the end of 2020, but initial delays in production and distribution led to slow vaccine rollouts in many European countries.

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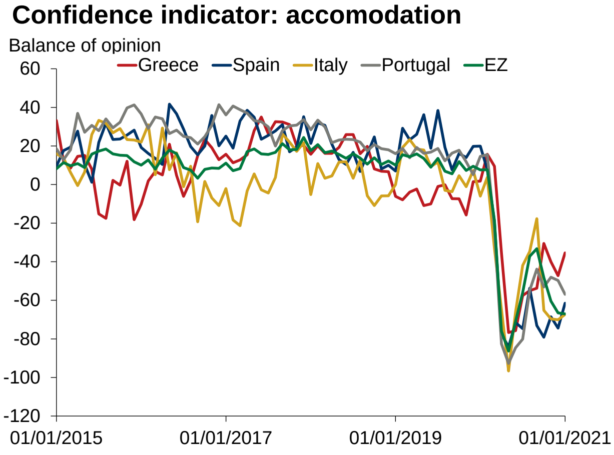
Vaccination progresses and tourism sentiment are closely connected

We think sentiment will take some time to restore completely as current travel restrictions have been extended and uncertainty about the future economic situation remains high. Expected demand for accommodation over the next three months is slowly improving following the second yearly plunge recorded in November and the new round of lockdowns that were reimposed in most European countries. However, hiring intentions remain very weak in the sector.

The boost to confidence from a smoother vaccine distribution and improved health conditions will be a key element for the economic recovery of these Mediterranean countries, especially the tourism sector. The level of restrictions and travellers' perceptions about inbound and outbound travel will shape the recovery of international and domestic travel.

Figure 3: Confidence deteriorated sharply in 2020, and is only recovering slowly



Source : Oxford Economics/Haver Analytics

Confidence in accommodation services recovered only partially during the summer and took another major hit in November. Vaccinations will be critical in facilitating a return to a normal travel activity by allowing more substantial easing of restrictions.

Domestic travels will recover first and support the sector recovery

Domestic demand for travel is expected to be steady in 2021

As we highlighted in a recent analysis, the domestic component of travel will be an important element of the 2021 tourism recovery. Indeed, countries with higher domestic resilience (measured by the importance of domestic tourism as a share of total tourism - based on an average of visits, nights, and expenditures) are likely to be more buoyant in 2021 and 2022.

Consumers preferences towards travels once restrictions are eased will also play a large role in the tourism spending recovery. We expect consumption patterns to quickly normalise after an initial bounce back and savings rates, which soared in 2020 as lockdowns shut off spending opportunities, will reduce.

Encouragingly, the home bias since the outbreak of the crisis and the change in behaviour led by long-lasting international mobility restrictions and quarantine requirements already made domestic travel more popular in 2020, although for the Mediterranean countries there is limited opportunity for growth this year. Indeed, the domestic share of travel increased significantly from January to November 2020 compared to previous years' average in the four Mediterranean countries (**Figure 4**).

However, Mediterranean countries are more vulnerable as they have lower than average resilience scores (**Figure 5**). They have a higher than average share of inbound tourism and therefore face greater risks, as their tourism industries would be highly impacted by prolonged restrictions on international travels.

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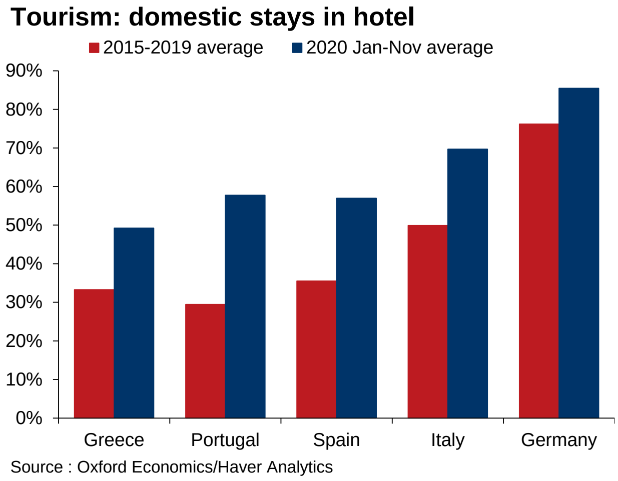
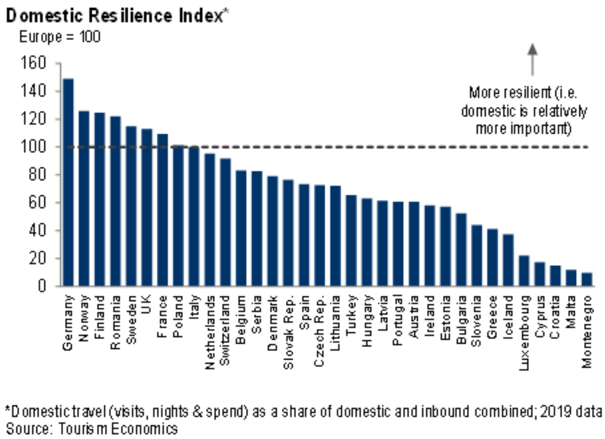
Figure 4: Domestic component of travel became more important in 2020 compared to previous years



The relative share of domestic stays during January-November 2020 was well above the average registered in the years 2015-2019. This supported tourism activity.

Although Italy is less likely to experience a large decline in domestic tourism (with above average Resilience Index score), there is limited opportunity for faster domestic growth as residents already have a high propensity for domestic travel. Spanish, Portuguese, and Greek residents also have limited opportunity to switch to domestic travel, resulting in a more challenging outlook for their travel sectors.

Figure 5: The Domestic Resilience Index measures how relevant domestic tourism is as a share of the total tourism activity



Countries with large domestic tourism markets will be favoured in the recovery, as well as those which can more easily convert from the outbound to domestic market.

The international travel outlook remains subdued

International tourism outlook for 2021 is expected to improve more gradually, with risks titled to the downside

Even if we expect the Mediterranean countries to experience a significant recovery in their tourism industries during 2021, levels will remain below that of 2019. In our baseline, we expect a full recovery of services exports to pre-pandemic levels to be achieved by early 2023, and pent up demand for international travel will boost tourism spending in the Mediterranean countries.

The recovery of the travel sector could be much slower if the health situation does not improve significantly in the coming months, meaning infection rates remain high and the vaccine rollout in Europe faces further delays and logistical issues. If so, the losses felt in the travel sector would be more significant. In this scenario, the Mediterranean countries that rely on high shares of inbound tourism would likely perform much worse than under our baseline scenario for recovery. We consider the evolution of the tourism sector to be perhaps the most important downside risk to our forecasts for Southern Europe.

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A prolonged global health crisis will further challenge the recovery of the travel and tourism sectors

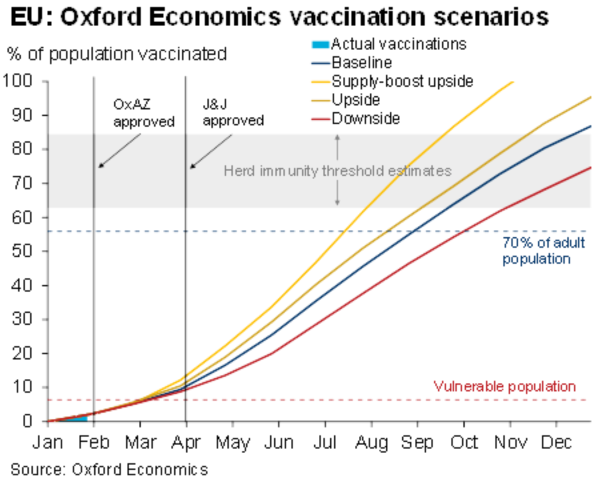
We assume in a simple 'what-if' analysis that the balance of services in the second half of 2021 will remain at the same level as the second half of 2020, and we keep the other GDP components endogenous in our Global Economic Model. With this set-up, we implicitly assume that domestic travel will not increase this year and will not result in higher national consumption. Therefore, this simulation can be seen as a stylized scenario where both domestic and international travel activity is stagnant. Starting from our February baseline, this would result in a negative 2021 GDP impact on the Mediterranean countries. The GDP decline would be very light for Italy, and take around 1% off GDP for Spain and Portugal, but have a larger effect of -5.8% for Greece. The different in the magnitude of GDP impact is mainly due to the dynamics of the Q3 2020 balance of services. Indeed, Greece didn't record any significant bounce back, leading to a bigger loss in the what-if scenario. Importantly, the ranking of the negative economic effects replicates the Mediterranean countries' scores in the Domestic Resilience Index reported above.

In this what-if scenario, the pandemic would also have additional scarring effects on the labour market, given the relative size of the sector. In Italy, Spain, Portugal, and Greece, the tourism industry accounts directly for between 5.3% and 7.9% of total employment.

In conclusion, we think the rate and scale of recovery in the tourism sector is contingent on widespread vaccination, which is not expected until summer 2021 at the earliest (**Figure 6**). We expect some improvement in travel activity this summer and at the end of 2021, relative to 2020, but a full recovery to pre-pandemic levels of activity will take at least another full year. Moreover, domestic and international travel will experience different paces of recovery. Domestic travel demand will pick up earlier as internal restrictions will be withdrawn first, while the international travel will take some time to rebound and will remain very linked to the outcome of the vaccination campaigns and travel restrictions.

Finally, while new virulent virus variants represent a major downside risk to our baseline, 'vaccine passports', which would allow people to move between countries after being inoculated, could help travellers deal with restrictions and support the tourism recovery in the Southern European countries. Indeed, countries highly dependent on tourism activity are pushing for this kind of solution, and will be soon discussed at the EU levels.

Figure 6: We expect the 70% vaccination target to be achieved by end August, which could boost tourism activity in H2



Our baseline forecast for the EU's vaccination programme expects the target of vaccinating 70% of the adult population to be met by the end August, with the estimated herd immunity threshold surpassed in Q4.

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