

The Tohoku Pacific Earthquake and Tsunami

Impact on Japan Travel & Tourism

March 2012 Update

Twelve months ago, in March 2011, the devastating Tohoku earthquake and tsunami struck northeast Japan. The most serious natural disaster to hit the country since the 1995 Kobe earthquake, it also triggered Japan's worst ever nuclear crisis – indeed, the world's worst ever nuclear emergency since Chernobyl. Significant Travel & Tourism impacts were inevitable, and were immediately evident as Japanese travellers remained at home and international visitors stayed away.

The World Travel & Tourism Council (WTTC), which has been tracking the performance of Japan's Travel & Tourism since the disaster, commissioned Oxford Economics to prepare scenarios for the recovery of the industry. In this fourth report – the third update – we look at trends and developments since March 2011 and review current performance.

- The initial impacts were dramatic as international inbound arrivals fell by 62% in April 2011 (over the same month in 2010) – a greater impact than had been observed with other previous natural disasters in Japan.
- There was also greater initial uncertainty regarding the path of recovery due to the nuclear emergency and operations at Fukushima. Failure to contain the situation quickly and successfully could have affected Travel & Tourism confidence for many years.
- Domestic demand rebounded more quickly than anticipated, and had fully recovered by the second half of 2011. The emerging trend of increasing travel intensity among young Japanese actually strengthened and is now reportedly higher than under original baseline assumptions.
- After the initial large falls, international demand also began to rebound in 2011, evolving in line with our initial low impact scenario. Full recovery in international tourism demand should be evident in the first half of 2012. However, while some origin markets have already fully rebounded, further external disruptions are muddying the waters,
- It is clear that Travel & Tourism demand overall fully recovered in late 2011, ahead of activity in the wider economy and despite recent disruptions – boosted in no small part by the strength of the yen. Travel & Tourism is clearly set to make an increasing contribution to the wider economy in 2012.

Japan's Travel & Tourism: one year on

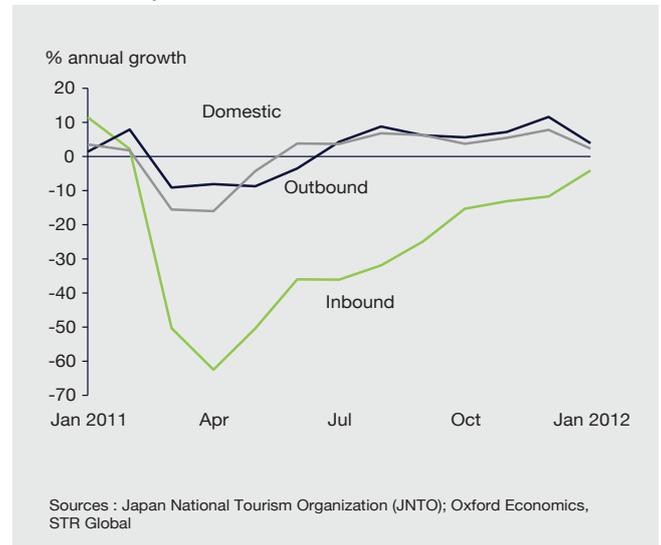
Overview

The immediate impacts of the earthquake and tsunami on Japan's Travel & Tourism were extremely stark as international arrivals were down 50% in March and then 62% in April. Inbound leisure tourism fell by an estimated 90% in the two months, according to the Japan Tourism Agency (JTA), with domestic travel down almost 20% over the period. The disruption to demand was felt across the country, not just in the northeastern regions that were directly affected by the earthquake and tsunami.

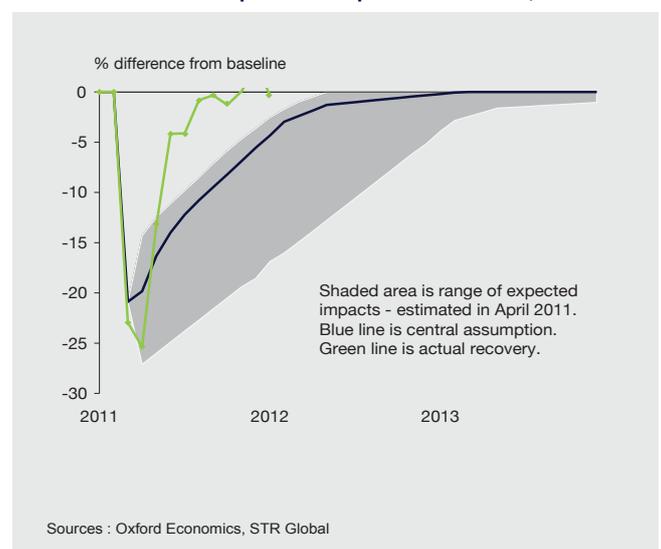
These initial impacts were apparently larger than the disruption witnessed in 1995 in the aftermath of the Kobe earthquake, and a wider set of events was considered as benchmarks for potential outcomes. Research by Oxford Economics into the recovery of Travel & Tourism after Hurricane Katrina, hurricanes in Central America and the Caribbean, and the Indian Ocean seaquake and tsunami in 2004, as well as terrorist attacks, shows that the average duration of an impact (excluding some outlying incidents) lies in the range of 8-26 months. This is the length of time taken for visitor spending to return to baseline levels.

The length of time taken for recovery has historically varied according to the extent of the damage, the political support to rebuild infrastructure and promote Travel & Tourism and, crucially, the perceptions left on the travelling public by the disaster. Recovery following hurricanes, and even following the 2004 Indian Ocean disaster, has tended to take roughly a year, with a longer period required following terrorist attacks and oil spills. The clear outlier has been New Orleans following Katrina, hampered by the slow rebuilding of both physical capacity and public confidence.

Japanese tourism demand, Jan 2011 - Jan 2012



Total estimated impact on Japanese tourism, 2011-2013



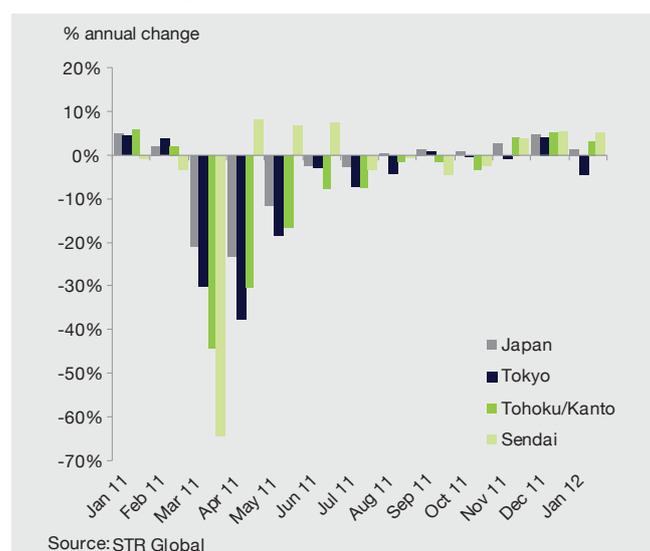
Domestic travel

In the case of Japan we expected the recovery to take over a year, given the large-scale destruction of infrastructure and fears among travellers as a result of the nuclear emergency, with the distinct possibility that full recovery would require up to two years. However, resurgent domestic demand in 2011 ensured that the recovery was actually achieved even more quickly than under our best-case 'low impact' scenario. International inbound demand is consistent with the low impact scenario, and we expect full recovery even in this segment of the market over the next few months. Outbound travel demand, meanwhile, is firmly back on track to achieve new highs in 2012.

Resurgent domestic Travel & Tourism demand has been key to the rapid recovery of the industry in Japan and should ensure that the sector is poised to make a positive contribution to the wider economy in 2012.

Domestic travel demand initially fell sharply, by more than outbound demand, but it recovered rapidly – to levels higher than in 2010 by as early as June. It has since remained higher than under original baseline assumptions in each subsequent month. Hotel demand fell by almost 24% in April but recovered rapidly to levels higher than in 2010 by August, according to data from STR

Hotel occupancy trends in Japan, Jan 2011 - Jan 2012



Global. Since domestic demand comprises roughly 90% of total hotel demand, we can estimate its contribution by deducting the international growth contribution. Our estimates of domestic travel demand are consistent with the recovery trend in sales by major travel agencies, as reported by JTA.

Recovery in demand appears to be broadly based, benefiting all Japanese regions – those areas directly affected by the earthquake and tsunami, as well as the rest of the country.

For 2011 as a whole, Japan Travel Bureau (JTB) Foundation points to an even stronger recovery, predicting last December that the rebound in late 2011 would largely offset the initial fall. It attributes the rebound partly to reconstruction efforts, but also to an increase in visits to friends and family (VFR travel) as “the disaster motivated people to strengthen the family bond... [because] travel is something very essential in life.”

More importantly, JTB Foundation suggests that holiday demand also picked up since “people have recognised again that travel is something very essential in life”, according to senior researcher Hiroshi Kurosu. This change in attitude is also reflected in the outbound travel data.

Outbound travel

Outbound Travel & Tourism has followed a similar path to that of domestic tourism as Japanese travellers quickly regained confidence, and recovery was more rapid than under any of the original scenarios. For 2011 as a whole, departures were 2% higher than in 2010 – to just under 17 million from 16.6 million in 2010 – with growth evident from as early as July. This means that outbound travel has not only recovered back to previous levels, in terms of trips, but has also fully recovered losses from the period during and immediately after the disaster. However, outbound travel expenditure was still more than 8% down on 2010's level after the first ten months of the year.

Key factors in this quick recovery from the post-earthquake/tsunami slump were that the affected region in Japan accounted for only a very small share of the outbound market, there was no risk in travelling abroad as in past crises, flight capacity had only fallen slightly, and the yen had strengthened in value. Moreover, according to JTB Foundations' Kurosu, one surprising factor was that stress concerning the disaster had motivated people to travel rather than stay at home.

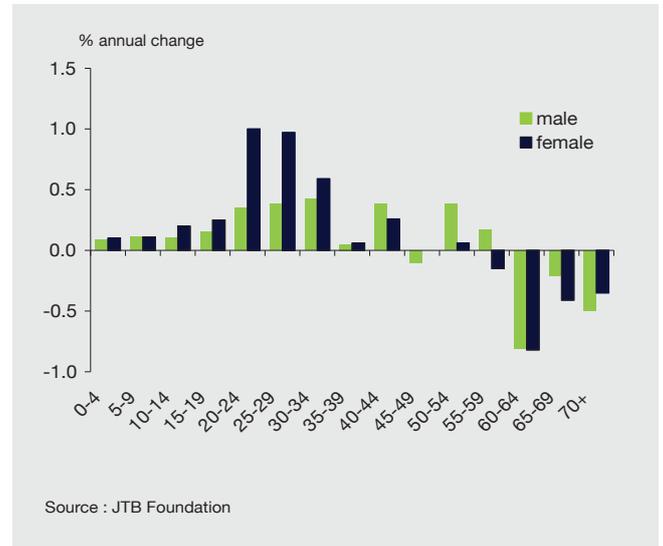
“There was also a change of mindset among the Japanese population following the March disasters,” he said. “People are modifying their lifestyle – and they are thinking seriously about how to change their lives. This includes less mass consumption, more energy saving, more social and volunteer work, and a shift from spending on assets to spending on experiences, including travel.”

Oxford Economics’ models suggest the strengthening of the yen may also have added as much as 4% growth to departures over baseline forecasts. But the increase in outbound departures averaged roughly 7% in the last six months of 2011, suggesting that other factors are also having a significant impact.

Recovery in outbound travel is being led by young travellers, following a long period of stagnation. A notable change in trend is that young males as well as females have started to travel, following a long period when Japanese leisure travel was dependent on female demand and a typically older demographic profile. The initial fall in departures and uncertain prospects were clearly a concern for destinations such as Hawaii, South Korea and Taiwan for which Japan provides a significant proportion of visitors. In the case of Hawaii, JAL suspended a significant proportion of flights in April. Outbound travel from Japan to each of these destinations fell for 2011 as a whole but, for all three destinations, there was a complete recovery to baseline levels towards the end of the year. Japanese arrivals in the USA were down an estimated 3% in 2011, while several countries in Europe – including leading destinations such as Germany and Spain – recorded double-digit growth in arrivals and/or overnight volume from Japan.

JTB Foundation is currently forecasting a 4% increase in Japanese outbound travel, with a continuation of the trend to more short-haul and less long-haul travel.

Japanese departure trends by age and gender, Apr - Sep 2011



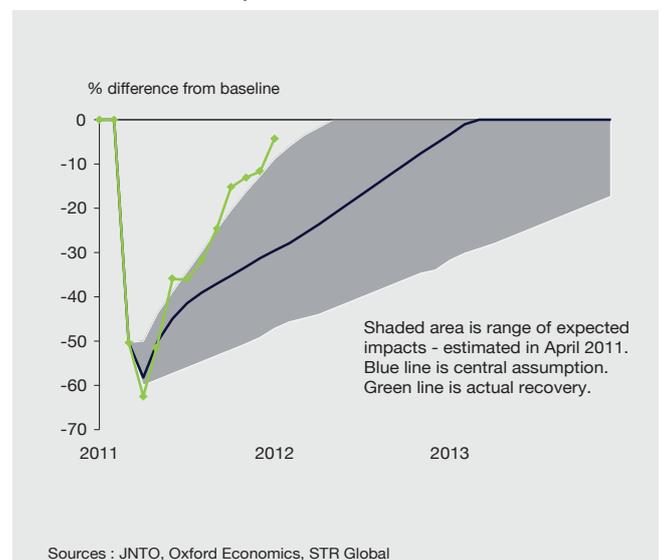
Inbound travel

The Travel & Tourism impacts of the Tohoku earthquake and tsunami have been most dramatic for Japan’s inbound tourism, with arrivals falling for the ninth consecutive month in December 2011. However, since the sharp falls of the first few months following the disaster, there has been a progressive recovery in inbound tourism demand. For 2011 as a whole, inbound arrivals were 28% down on 2010’s level – to 6.2 million from 8.6 million in 2010 – with January 2012 showing only a 4% down on the same month of the previous year. By contrast, visitor exports were an estimated 28% below 2010’s level through the first ten months of 2011.

The arrivals figures compare favourably with the scenarios that we considered in April 2011 – indeed, arrivals have been closely aligned with the low impact scenario of inbound impacts for much of the past year. The trend is also broadly in line with the previously observed path of recovery following other natural disasters such as hurricanes, as well as the 2004 Indian Ocean tsunami.

Results for the first three months were aligned with the central scenario, which expected a greater overall impact and a longer

Estimated impact on inbound tourism, 2011 - 2013



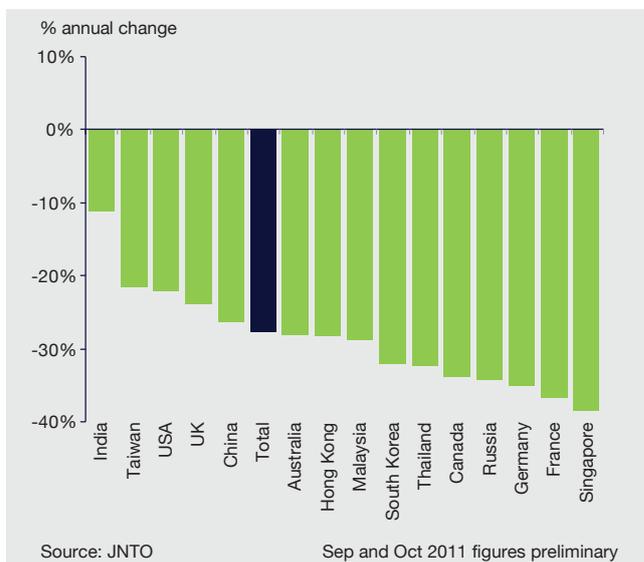
recovery period consistent with a more pessimistic set of assumptions and closer to the profile in recovery from terrorist attacks. This central case seemed plausible given the scale of the impact and the fears prevalent among potential travellers. At the same time, we also established a high impact scenario, under which full recovery would be unlikely within the space of three years. This was considered an extreme case involving severe complications with nuclear clean-up operations at Fukushima and minimal government support. However, it became clear by mid-2011 that this was not a plausible outcome given the actual government policy response, including the quick restoration of vital infrastructure and few complications in the nuclear clean-up operations.

Business travellers have been quickest to respond to the reality that Japan remains a safe and attractive destination, with inbound arrivals approaching 2010 levels during the second half 2011. But leisure traveller volumes were still significantly lower than a year earlier in October, the latest month for which a breakdown of arrivals data is available.

The differences in performance by purpose are not immediately evident by origin market. Leisure-intensive markets such as Hong Kong have rebounded more quickly, implying that market-specific factors are more important. For some markets trends are affected by additional external events, such as the Thai floods and the ongoing eurozone debt crisis, which means that arrivals have been weaker than would otherwise have been the case. But the continued falls in arrivals from several markets cannot be entirely attributed to these factors.

By way of example, South Korea – Japan’s leading market source – was down 32% over the year, with just under 1.7 million visitors as against more than 2.4 million in 2010. Arrivals from number two market China slipped by 26%, although the last couple of months saw strong double-digit growth, thanks in large part to a major year-end promotional drive and an easing of visa requirements for Chinese.

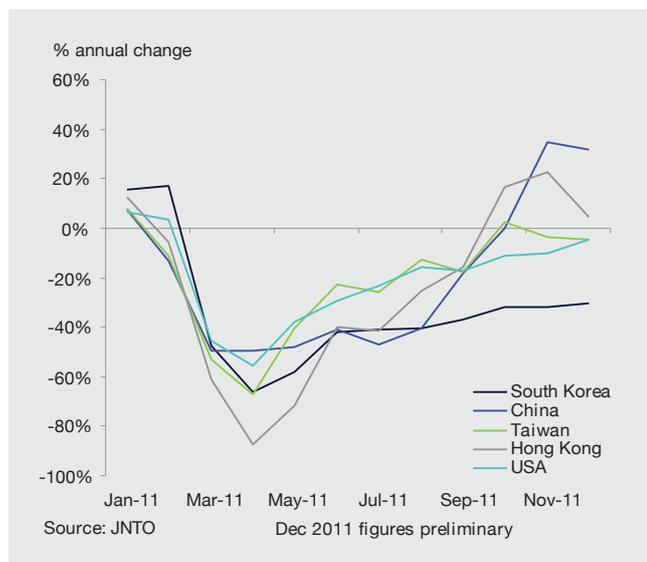
Japan’s inbound visitor arrivals by market, 2011



Japan’s inbound visitor arrivals by purpose, 2011



Japan’s top 5 inbound visitor markets, 2011



The worst performing markets have generally been the smaller, secondary markets and further promotions may be required to improve travel confidence and understanding that Japan remains a safe destination. We remain optimistic that this message will become clear throughout 2012 with continued forecast growth in tourism arrivals. The Japan National Tourism Organization (JNTO) is aiming to top 2010’s record 18.6 million arrivals count.

2012 and beyond

Current outlook

Despite less than rosy prospects for the Japanese economy overall in 2012, the outlook for Travel & Tourism is much better than might have been expected given the events of the past 12 months.

As already indicated, outbound travel prospects are more bullish than they have been for some years, driven both by the strong yen and a desire for lifestyle change among Japanese, especially young people. Domestic tourism demand has held up extremely well, and anecdotal evidence – as well as some recent statistical trends – points to a recovery from most important tourism source markets for Japan. This may well result in new records in 2012.

Japan's Travel & Tourism is expected to make an increasing contribution to the national economy and, albeit to a lesser extent, job creation. Following the serious shock to Travel & Tourism demand in the aftermath of the March 2011 earthquake and tsunami, exacerbated by the nuclear crisis, international confidence in the safety of the destination has clearly picked up, and motivation for travel among Japanese has been strengthened rather than weakened.

Macroeconomic developments

The earthquake and tsunami directly hit the two Japanese prefectures of Miyagi and Fukushima which account for approximately 4% of Japanese GDP. A large proportion of this production was disrupted during March, while the disaster also damaged national infrastructure such as power plants and water supplies with significant knock-on effects on the broader Japanese economy. Indeed, even where industrial plants in the immediate area have escaped relatively unscathed, the initial dislocations to transport infrastructure, compounded by rolling power cuts and unreliable water supplies – especially critical to several key electronics and chemical plants – have resulted in extended shutdowns.

Industrial production in March 2011 was 13.1% lower than a year earlier followed by a further 12.3% fall in April. Production was restarted through April, albeit with some delays, and there was rapid recovery by the middle of the year, helped by some intelligent rationing of power. Both GDP and industrial production grew strongly in the third quarter, suggesting that the economy would return to 2010 levels by the end of the year.

However, GDP fell by 0.6% in the final quarter of 2011, resulting in a 1% drop over 2011 as a whole and leaving real GDP more than 4% below its peak of 2008 Q1. The Q4 slump can be attributed, at least in part, to further external shocks, including the flooding in Thailand, and manufacturers' forecasts suggest some rebound from these setbacks in 2012 Q1. Industrial output fell 0.4% in the final quarter of the year, export volumes declined almost 4%, and retail sales dropped by 1.3%

The underlying fundamentals point to growth remaining subdued over the next year. Consumer spending remains weak with wage growth stagnant, and the investment outlook is still also downbeat, including for residential investment.

This leaves Japan heavily dependent on external demand to pull the economy along, but here too recent trends have been discouraging. Japan's export growth has been lagging behind growth in its key export markets, with further downside risks in the shape of the eurozone financial crisis and a possible sharper slowdown in China.

Low-cost airlines enter the market

Demand for airline travel will unarguably be boosted by the arrival of the low-cost airline (LCC) model in Japan in 2011. The country's first LCC to enter the market is Peach Aviation, but it will be joined by established LCC brands AirAsia and Jetstar, in August and December respectively, with their AirAsia Japan and Jetstar Japan subsidiaries.

While passengers and Japan as a whole will benefit from lower cost travel – which will stimulate demand for domestic, inbound and outbound trips – the growth could well be at the expense of Japan's incumbent full-service carriers. Japan Airlines (JAL), which emerged from bankruptcy last year is, however, wisely preparing to de-emphasise its mainline domestic market, which will be most exposed to LCCs, and concentrate on two areas which LCCs will not reach in full force in the medium term: domestic regional flights and, more especially, long-haul markets.

JAL and the International Airlines Group (IAG) have agreed plans for a new joint operation between JAL and British Airways on flights between Europe and Japan. This will benefit customers by providing better links between Europe and Japan, a greater choice of flights, enhanced frequent flyer benefits and the potential to launch new routes. JAL has also announced its first codeshare agreement with another (soon-to-be) OneWorld alliance member, airberlin, Germany's second biggest carrier. Flights by airberlin between Frankfurt and Berlin (six times weekly) are now codeshared with those of JAL.

WTTC remains reasonably bullish about Travel & Tourism prospects ...

Reflecting the current operating environment, WTTC's latest annual research, carried out in collaboration with Oxford Economics, is reasonably bullish for Japan this year, as well as for the coming decade. After an 27% estimated decline in 2011, visitor exports are forecast to make a strong recovery in 2012 – increasing by more than 21% to ¥1,066.90 billion – and to achieve continued growth averaging 4% a year from 2012 to 2022.

Admittedly, the growth in other measures is less spectacular, but Travel & Tourism's contribution to GDP in 2012 is set to increase by a healthy 4.4% (directly) and 3.4% (total contribution, taking into account its indirect and induced impacts). The growth for its contribution to employment, meanwhile, is projected at a lower 1.3% and 0.6% respectively – to 1.4 million jobs directly in the industry and 4.4 million direct, indirect and induced jobs. The longer-term prospects are even more modest – an annual increase of 0.5% in direct industry jobs and stagnation (+0.2%) in total Travel & Tourism-related employment over the period 2012-2022 – which may well prove inadequate to cater to the forecast rise in visitor exports and arrivals.

... but weak growth in employment and investment could be cause for concern

As is the case with employment, the outlook for capital investment in Travel & Tourism remains rather bearish, with a modest 1.3% growth forecast for 2012, and just 1.6% annual growth over the coming ten years. The trend could well become a serious source of concern to the industry and government in the short to medium term and, together with the employment issue, will certainly require additional policy focus if Japan is to retain its position on the world tourism stage.

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Tel: +44 (0) 1865 288900; email: jrgaster@oxfordeconomics.com



1-2 Queen Victoria Terrace,
Sovereign Court,
London E1W 3HA
United Kingdom
Tel: +44 (0) 207 481 8007
Fax: +44 (0) 207 488 1008
email: enquiries@wttc.org

www.wttc.org