NATIXIS

SPECIAL REPORT

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Alicia Garcia Herrero, (852) 3900-8680, alicia.garcia-herrero@ap.natixis.com
Kohei Iwahara, (81) 3-4579-2144, kohei.iwahara@ap.natixis.com

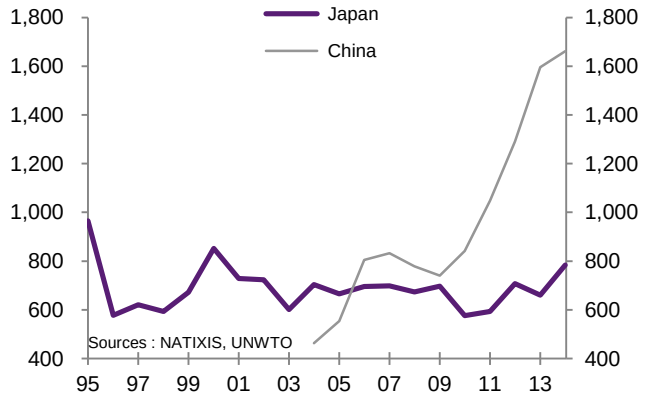
Chinese Outbound Tourism Resembling Japan in the 1980s?

Introduction

While some of us may still remember the floods of Japanese tourists into Europe, it so happens that Chinese tourists are now the ones flooding the globe. In particular, Chinese tourists have already outnumbered Japanese ones into major tourist destinations, such as France **(Chart 1)**.

The acceleration of China's outbound tourism during the last few years reminds us of Japan's overseas travel boom in the 1980s. Because of the rapid growth, the sustainability of Chinese outbound tourism could be questioned and this issue has important implications to the tourism sector globally. This is even true for Japan where Chinese travelers to Japan have been reshaping the country's tourist sector[1].

Chart 1
Tourists Visiting France By Countries ('000)



One would argue that China's outbound tourism has a potential to increase further since it is supported by a growing middle class with the world's largest population. In fact, Chinese are expected to increase expenditures on discretionary items, such as leisure and luxury[2]. Because of this structural shift in consumers' behavior and the strong RMB, demand for overseas traveling from China could have further room to expand.

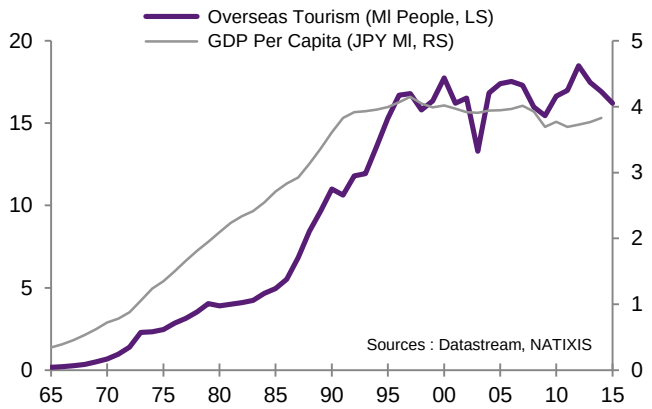
Notwithstanding the wonderful prospects, the experience of Japan in the 1980s may cool them down somewhat. In fact, Japan's travel boom lasted about 10 years until the middle of 1990s to an extent that overseas tourism has actually fallen since the 2000s.

This report analyzes Japan's overseas travel boom in the 1980s focusing on the factor which turned the tide of Japanese tourists travelling overseas. After comparing the development in both countries, we conclude that Chinese outbound tourism could moderate in the short run but its potential in the long run is high and certainly higher than the one in Japan during the 1980s.

Overview of the Japanese Outbound Tourism

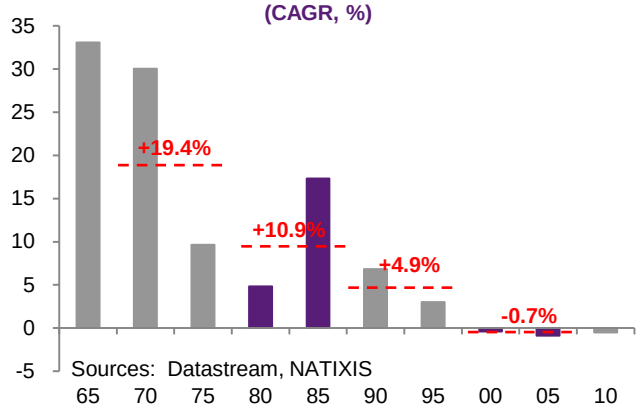
Since the post-war period, the Japanese consumers have been climbing up the Maslow's ladder. As income expanded, they initially purchased manufactured goods, such as TVs, air conditioners and cars. Once those needs were fulfilled, they turned their interest to consuming services including tourism. In fact, overseas travelling grew close to +20% in the 1970s from a very low base and notwithstanding the capital controls that made it hard for Japanese households to obtain the foreign currency to go abroad. Only in 1978, Japanese Yen could be converted to foreign currencies without restrictions, which probably was one of the reasons behind the still very rapid growth in outbound tourism in the 1980s **(Chart 2 & 3)**. As mentioned, this boom ended in the 1990s, and the number of traveler has even fallen from the 2000s. Below we explore the reasons behind the boom and bust.

Chart 2
Japan: Income & Overseas Tourism



[1] Special Report: "Japan: China Reshaping the Tourist Industry?" Dec 8th, 2015.
[2] Special Report: "From Old to New China: Tectonic shifts for Asia in 2016?" Dec. 15th, 2015.

Chart 3
Japan: Overseas Tourism
(CAGR, %)



The 1980s - Let's Explore the World!

Japanese households gradually shifted the emphasis in their lives to leisure **(Chart 4)**. Initially, "housing" and "eating" were listed on the top of the priority list until "leisure" became the top priority in 1983 according to existing surveys. At the same time, the Yen appreciated significantly after the G5 governments signed the Plaza Accord in September 1985 to weaken the US Dollar, which strengthened under Reaganomics to contain inflationary pressure. Furthermore, air fares fell steadily as competition in the airline industry intensified. One could argue that, other than the evolution of Japanese own preferences, a rapid appreciation of the Yen and lower air fares also supported the rapid growth of outbound tourism **(Chart 5)**.

Chart 4
Japan: Public Opinion Survey
-Future Emphasis (%)

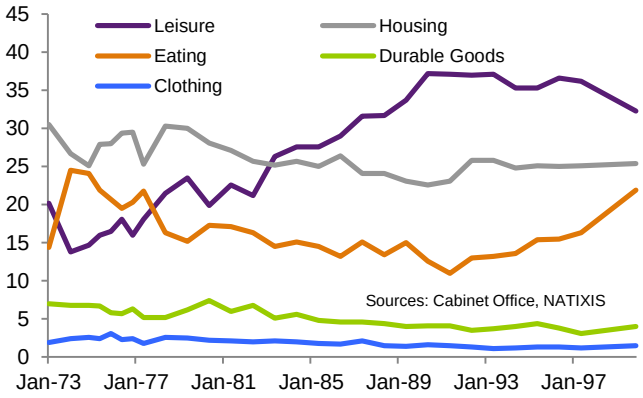
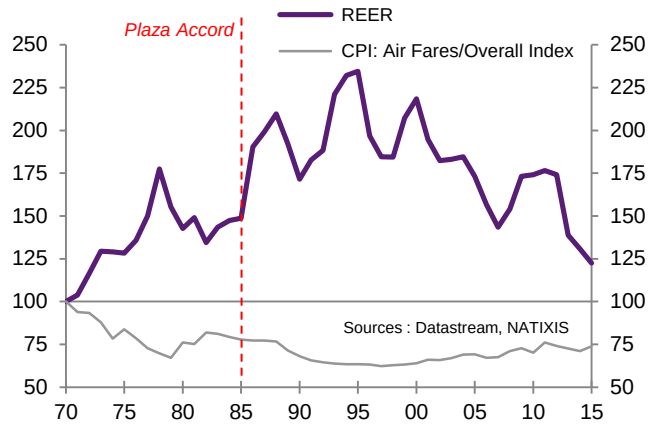
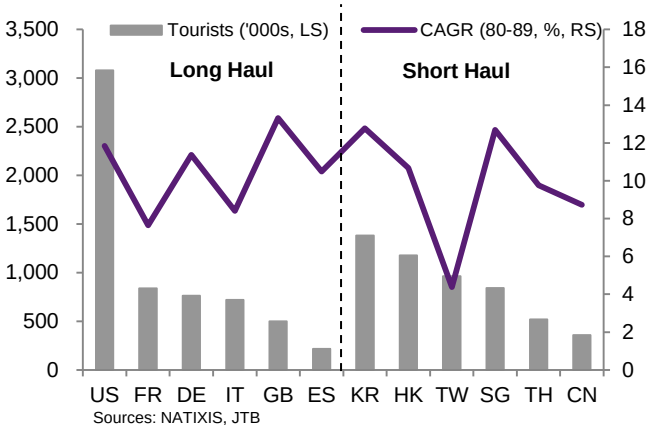


Chart 5
Japan: REER & Air Fares (1970=100)



While the Japanese travelled extensively to neighbor Asian countries, the US was the most preferred destination **(Chart 6)**. This development could reflect the strong political and economic ties with the US after the World War II. In fact, Japan has been strongly influenced by American culture, and the young generation enjoyed their movies, music and food. At the same time, the Japanese enjoyed travelling in Europe, with France being the top destination. All in all, as they became affluent, overseas travelling accelerated for both close and distant destinations.

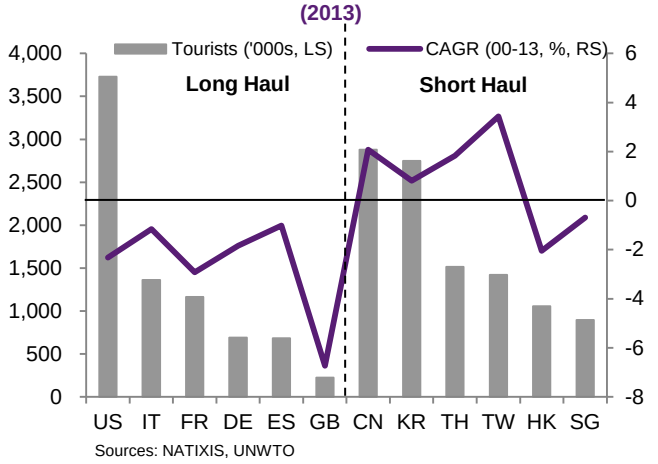
Chart 6
Japan: Outbound Tourists
(1989)



The 2000s – Maturing Japanese?

After the growth of international travelers slowed to +4.9% in the 1990s, it declined by -0.7% in the 2000s **(Chart 3)**. At the same time, Japanese have become more sensitive to long distance flights. In fact long haul, especially Europe, has fallen while short haul has continued to expand. Interestingly, the US has remained the most preferred destination together with China **(Chart 7)**.

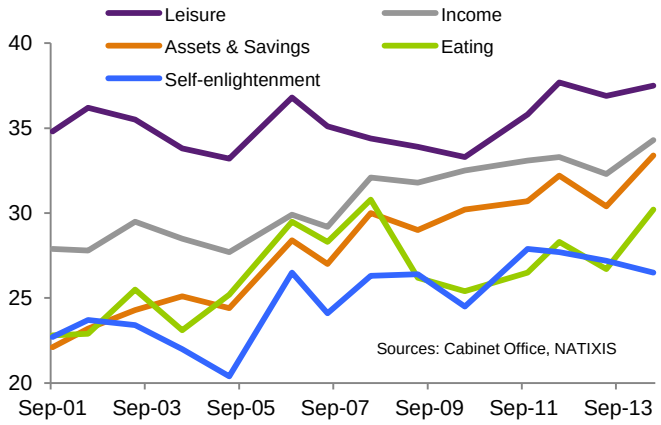
Chart 7
Japan: Outbound Tourists (2013)



Sources: NATIXIS, UNWTO

One of the important reasons for the shift in tourist behavior is arguably economic. Although "leisure" has remained the highest priority for the Japanese, its relative importance has fallen over the past decade **(Chart 8)**. As the economy struggled with a prolonged deflation, the public has put more emphasis on "income" and "assets & savings." In other words, the Japanese have become more cost cautious in developing their travel plans.

Chart 8
Japan: Public Opinion Survey -Future Emphasis (%)



Because work life balance has generally become more important in the work place, "cannot take time off" has become less of an issue to take vacation **(Chart 9)**. However, "costs" have become an important reason for travelling less, possibly because of weak income growth over the past decade and the falling Yen **(Chart 5)**. Furthermore, "security" issues may have also discouraged travelling. Going forward, "health concerns" could become increasingly important to travel less as the Japanese population ages.

Chart 9
Japan: Reasons for not Traveling Overseas (%)

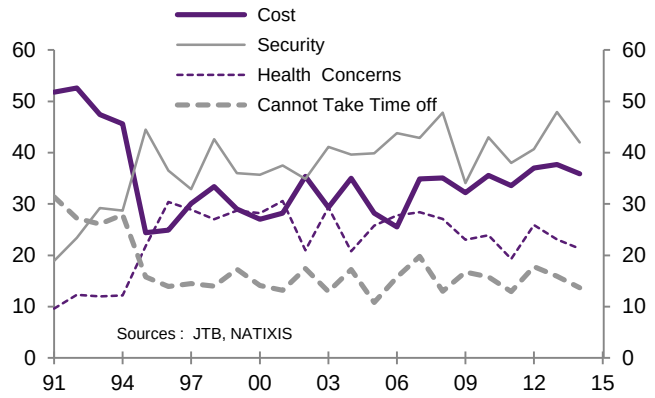
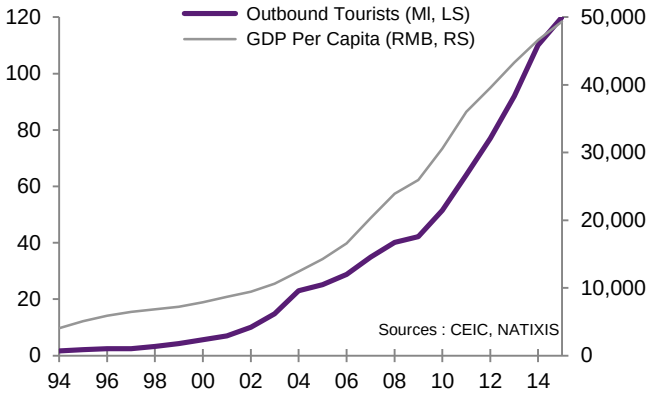


Chart 10
China: Outbound Tourism & GDP Per Capita



Chinese Tourists - The "Japanese" of the 21st Century?

As discussed above, China's outbound tourism has accelerated over the past decade. The driving forces are quite similar to the Japan's boom in the 1980s. As personal income expands, Chinese have increased their expenditures on discretionary items and the strong RMB has also supported overseas tourism **(Chart 10)**. Therefore, it is very tempting to extrapolate Japan's experience and conclude that the travel boom in China can end soon, after expanding for about ten years. However, this projection misses important differences between Japan and China, which have important implications for the tourism outlook globally.

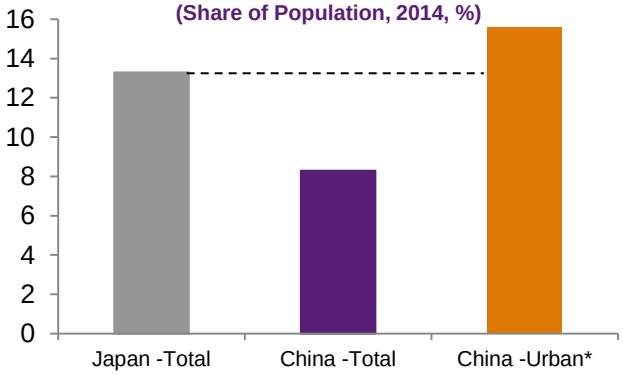
Differences in Economic Development Models

Firstly, the ideology behind economic policies between the two countries has been quite different. On the one hand, Japan attempted to promote equal economic growth throughout the nation. For example, public work projects were extensively used to ensure that the country side would not fall behind from the urban areas. Through these policies, a large portion of the Japanese enjoyed the fruits of rapid economic growth. In fact, the majority of the Japanese saw themselves as part of the middle class in the 1980s. Consequently, most of the Japanese were able to experience overseas travelling in a similar period.

In China, however, income distribution has remained clearly more unequal than Japan. Urban households have enjoyed a significantly higher share of income than the rural ones so that the bulk of the tourists (virtually all) are urban citizens. Because of that, **the ratio of outbound tourist to the population in the urban area is already higher for China**

than for Japan (Chart 11). A simple extrapolation of the Japanese experience would, thus, indicate that the growth in China's outbound tourism could moderate. Although there is a general expectations that Chinese tourists will continue to flood shopping malls everywhere, the Japanese experience should not be dispelled totally. In fact, according to a survey by FT Confidential Research, experienced tourists are travelling less frequently, with the number of trips in the past 12 months falling from 1.97 in 2014 to 1.92 in 2015 and 1.76.

Chart 11
China: Outbound Tourism
(Share of Population, 2014, %)



*Elites, Middle Class, Low Middle, Urban Poor
Sources : Datastream, CEIC, NATIXIS

The real question, thus, seems to be whether the rural population – or at least those in Tier 3-4 cities - will ever enjoy overseas tourism. According to FT Confidential Research, overseas tourism is driven by first time travelers living in lower tier cities. In fact, application for passports in these cities grew by more than 20% YoY in 2014.

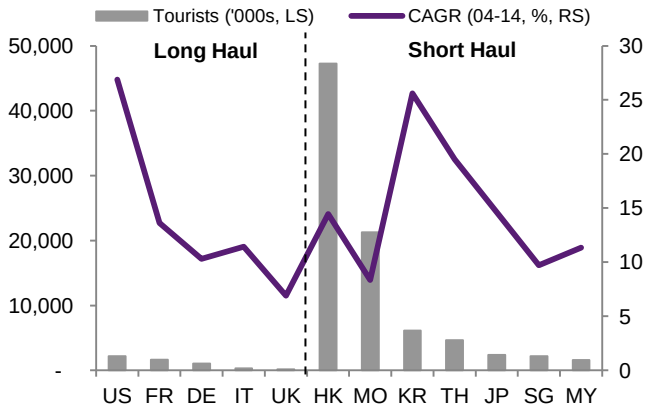
Overall about half of the Chinese population is classified as "poor" with an annual income between USD 0 and USD 3,000 [3], largely residing in rural areas. Through the government's initiatives, additional 81 million people are expected to join the urban class by 2020. While they may currently have limited financial resources to go abroad, these new urban citizens should be able to give an additional push to overseas tourism. This means that, while there may be some slowdown in the short term given the current economic slowdown and the already high level of urban tourists, the push for additional urbanization levels should help push the numbers further. Consequently, the expansion in Chinese outbound tourism is anticipated to last longer than the Japanese boom during the 1980s.

Two Dynamics in Chinese Outbound Tourism

China's outbound tourism has largely focused on short haul trips **(Chart 12)**. In particular, the most popular destination was by far its close neighbor: Hong Kong and Macao. This is a big contrast with Japan's experience in the 1980s, as the largest tourist destination was the US, and the Japanese also travelled extensively to Europe **(Chart 6)**. We are already starting to see Chinese tourism becoming increasingly interested in traveling further away. With the numbers expected to continue to grow. The reality is that such growth starts from a large base given China's massive population. Already now, the number of Chinese visitors to France is twice as large as Japan's tourists **(Chart 1)**.

[3] Special Report: "From Old to New China: Tectonic shifts for Asia in 2016?" Dec. 15th, 2015.

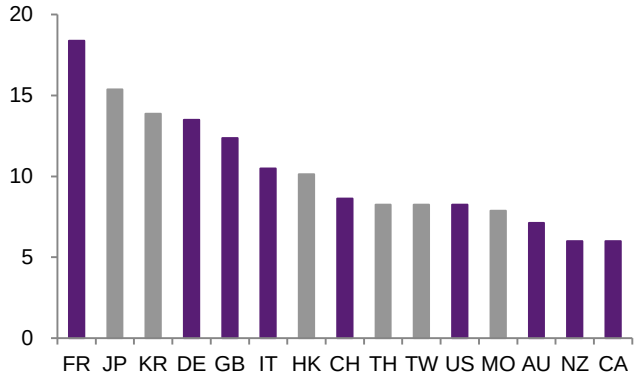
Chart 12
China: Outbound Tourists
(2014)



Sources: NATIXIS, UNWTO

Within the long haul, Europe appears to be the largest potential beneficiary of Chinese tourism with France, Germany and the UK on the top list of countries planned for the next twelve months **(Chart 13)**. The fact that the holiday entitlement is growing in China to attract talent also expected to support this development. In fact, the survey from FT Confidential previously mentioned reveals that travelers spending more than seven days on their recent international trip recently rose from 32.6% in 2015 to 34.4%.

Chart 13
China: Popular Overseas Destination
Plan for the Next 12 Months (%, 2016)



Sources : FT Confidential Research, NATIXIS

The second relevant dynamic is for the growing number of tourists expected from rural or newly urbanized areas. Regarding the second trend, Chinese explore neighboring Asian countries first.

Risks to Chinese Tourism

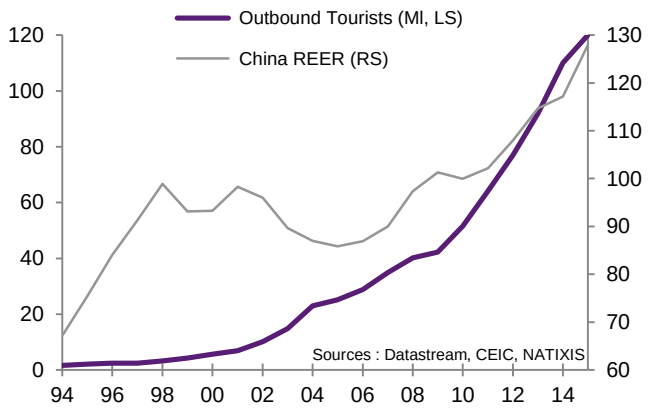
The irony of Japanese overseas tourism is that it was exactly when holiday entitlement increased that the number of tourists slowed down **(Chart 9)**. Will the same happen with Chinese tourists? .

While it is obviously hard to predict, we could argue that the current economic slowdown could slow down the flow of Chinese tourists in the short-term. In addition, security issues related to terrorist attacks and the refugee crisis could also discourage Chinese traveling to Europe notwithstanding the preferences expressed in the surveys mentioned above.

However, if economic growth stabilizes, the flow should continue supported by the Chinese leadership recent push

for additional urbanization in the next five years as well as the prospects for a strong currency as purchasing power continues to grow **(Chart 14)**. In the longer term though, aging should have a negative bearing on overseas tourism, especially long haul. In fact, all of these negative developments were actually realized in Japan **(Chart 9)**.

Chart 14
China: Outbound Tourism & REER



Conclusion

It seems interesting to compare the international travel boom in Japan during the 1980s and the current expansion in Chinese outbound tourism. In both experiences, the expansion of households' income led to a shift in preferences and, thereby, expenditure from essentials to more sophisticated goods and services, with overseas tourism being one of the preferred ones. A strong currency has also supported these developments.

While the outlook continues to be positive for Chinese overseas tourism, the experience of Japan shows that we should not be over-complacent. There are a number of risks which could derail the expansion in Chinese tourism. In short run, the economic slowdown is especially relevant but also external factors, such as terrorist attacks and refugee crisis in the case of Europe which happens to be a preferred destination among long haul ones. In the long run, aging can constitute a real drawback, especially for long haul destinations.

Still, as opposed to Japan, the Chinese tourism boom may last longer as there still is a large population which is fully underserved, namely the rural one. As urbanization continues, the pie (i.e, the number of targetable tourists) should continue to grow.

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