Group Economics

Ulster Bank

'Our Time Our Place' but where's our profitability?

Contact: Richard Ramsey
Chief Economist, Northern Ireland
02890 276354 or 07881 930955

Richard.ramsey@ulsterbankcm.com

www.ulsterbank.com/economics

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With Northern Ireland's burgeoning tourism industry in recent years - think MTV Awards, World Police & Fire Games, Titanic Belfast and the UK City of Culture - hoteliers must have been making a killing, right? Indeed, record visitor numbers in 2012 and record hotel income in that year too would suggest that this might well be the case. But the reality is that profitability in the hotel industry in 2012 was actually well down relative to 2007. The record highs in visitor numbers have simply not translated into record profitability. So what it going on?

To explain this, we need to look at what has been happening within our nearest rival market, the Republic of Ireland, and, related to this, what has been happening within the cost base of Northern Ireland's own tourism industry.

In recent weeks, the tax differential between Northern Ireland and the Republic of Ireland in relation to VAT and Air Passenger Duty (APD) has hit the headlines. The Republic's tourism & hospitality industry currently benefits from a VAT rate of just 9% which compares favourably with 20% for the UK. Meanwhile last month's Irish Budget saw the temporary VAT reduction *(from 13% to 9%)* extended beyond the end of this year. In addition, the €3 APD charge on each flight entering or exiting the RoI will be scrapped next April. Again this compares favourably with a current rate of £12 per flight in the UK / Northern Ireland.

Whilst the tourist industry has focussed on the tax differentials between the UK/NI and the RoI as influencing price competitiveness, little attention has been paid to the more shocking and significant consumer prices index (CPI) differential. The UK has experienced one of the highest cumulative rises in CPI within the EU-28 economies over the last 6 years (+21%). Conversely, the Republic of Ireland has experienced the lowest cumulative rise in inflation (+3%) of any EU-28 economy over the same period. Therefore the reality is that one of the most inflationary economies and the least inflationary economies within the EU-28 are bordering each other and competing within a single All-Island market. A look at some of the hotel deals south of the border compared to Northern Ireland gives some insight into the price competitiveness this has helped bring about.

Looking at the CPI index provides an indication of the cost pressures being experienced by the tourist industry's customer base (households) in Northern Ireland and also the cost base of the tourist industry itself. Remember 2007 was a record year for hotel income and profitability. But how have consumer prices and average earnings of UK households changed over the last 6 years? It is noted that UK CPI has risen by 21% since August 2007 whilst average weekly earnings have risen by less than 11%. With this ongoing squeeze on disposable incomes, this makes it difficult for consumer sensitive sectors, such as the hotel industry, to pass on price rises.

Meanwhile food prices have increased by 36% since August 2007 with gas (+76%), domestic heating oil (+84%) and electricity (+47%) posting even larger price rises.

Due to market conditions, hotels have been unable to pass on all of these costs to customers. Indeed, when inflation is taken into account, the average room rate and revenue received per available hotel room in Northern Ireland has fallen by 14% in real terms between 2007 and 2012. Part of this fall in the room rate is linked to the changing hotel mix in Northern Ireland and the increased supply in the number of budget hotel rooms. In turn, this is adding downward pressure on the non-budget hotel room rates. Given that costs are rising, the net result is profitability is being squeezed.

According to Michael Williamson of ASM Chartered Accountants, an oracle on the tourism industry, the RoI has seen room rates slashed by 20% in recent years. This can partly be explained by an oversupply of hotel rooms in the RoI, and the fact that 300 out of 800 hotels in the RoI are in financial difficulties, according to a recent report highlighted. This has given rise to the term 'zombie hotels', with prices slashed for firms to stay afloat and in some cases in order to keep the tax breaks entitled to those hotels that stay open for 7 years. RoI hotels have simply not had the inflationary pressures that their counterparts north of the border have had to endure. Startlingly, food prices in the RoI are no higher than they were 6 years ago which compares with +36% for the UK/NI. Meanwhile energy costs in the RoI (+29%) have risen by half the rate in the UK (+61%).

So overall, whilst Northern Ireland's tourism industry has certainly fared better than many other local sectors of the economy, visitor numbers and income don't tell the full story. So the next time you're sitting in a hotel Jacuzzi or in a well-lit dining room in a Northern Ireland hotel, spare a thought for how the rise in energy costs and food prices has been preventing the owner from fully reaping the benefits of all of our big events.

Richard Ramsey
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