The Baltic Hotel Market Update

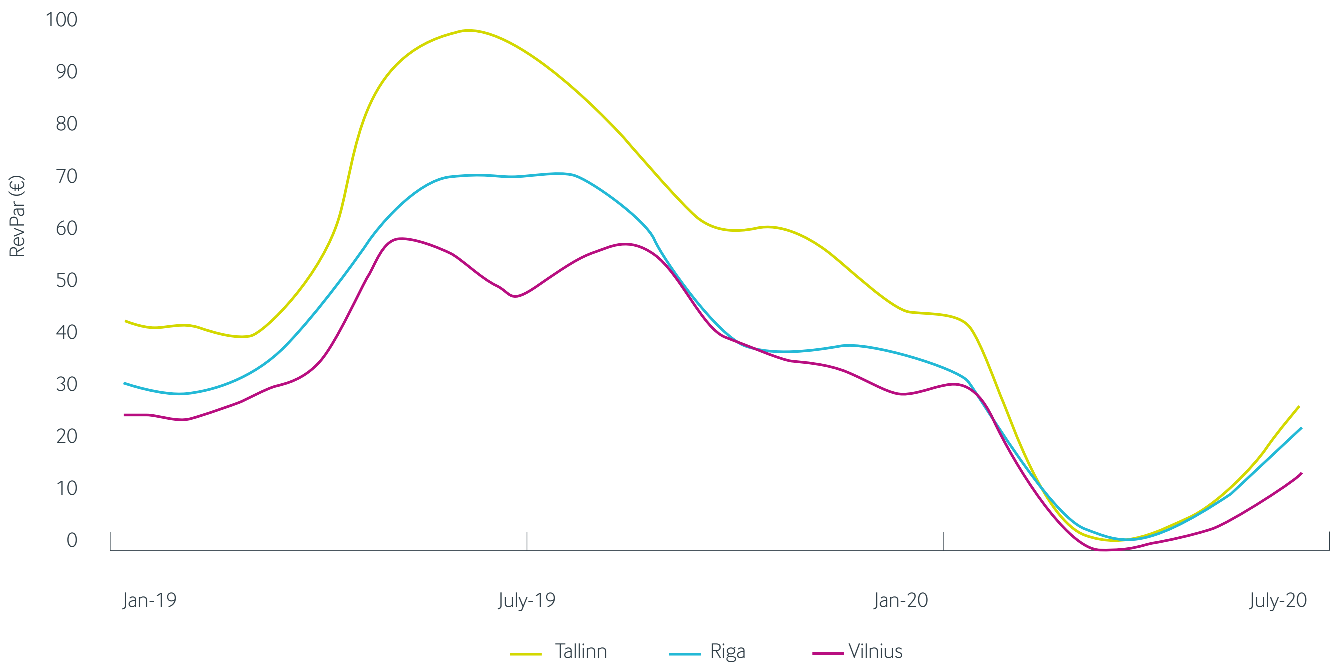
CHRISTIE & CO

The ongoing Covid-19 pandemic has placed the hotel industry into an unprecedented situation. The pandemic that started in Wuhan, China, at the end of 2019 and spread globally, has significantly limited all forms of travel, reinforced by government-imposed restrictions on mobility and border closures.

As has been widely recognized, the effects of these developments have been steep and immediate for hotels globally, with no exception in the Baltic markets. While hotels in the Baltics had not been obligated to close by the respective governments, many hotels closed business temporarily due to a radical collapse in demand that started in mid-March and escalated further in April. With most of the hotel rooms in the capitals of the Baltic States (Tallinn, Riga and Vilnius) being closed in April, the recorded occupancy levels dropped below 5% mark in all three markets. The effects of such a steep demand drop on hotel performance have been unparalleled; RevPAR declined by almost 2/3 in March compared to the previous year before almost fully collapsing in April.

Since the steep drop in March and April, the arrival of the holiday season combined with pandemic related safety measures being relaxed, the hotel markets across all three capitals have demonstrated some signs of recovery. While the recorded RevPAR levels are still nowhere near the previous year's levels, the RevPAR direction, encouragingly, is upward trending.

Fig. 1 – RevPAR 2019 – YTD 2020

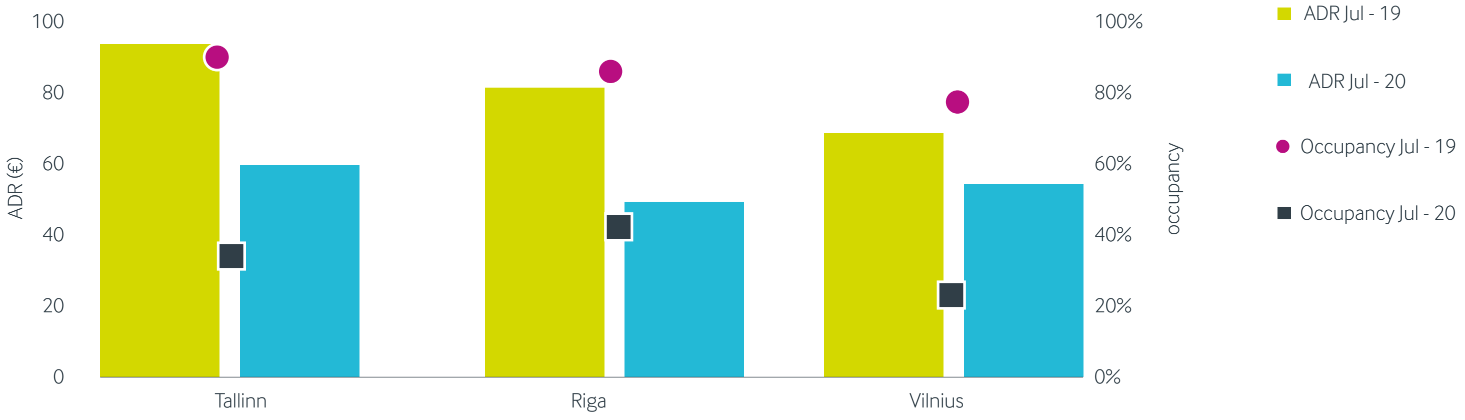


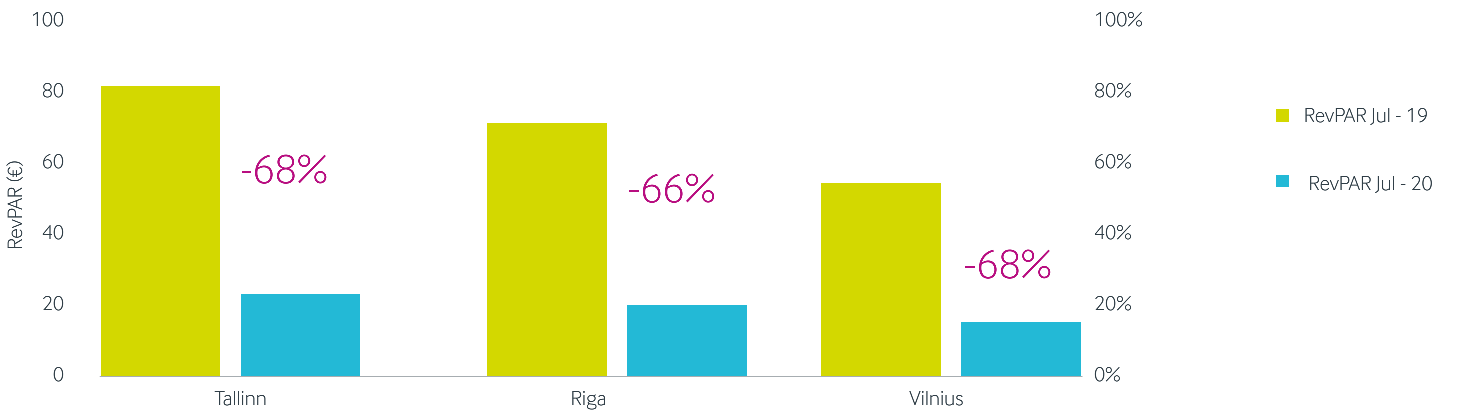
Source: Benchmarking Alliance

Despite the positive performance signs recorded in the recent months, July's 2020 RevPAR level in all three markets was still just 1/3 of that in the previous year. Note that this is still a significant improvement from the near single-digit RevPAR performance levels recorded in the April-June period.

The drop in RevPAR was a result of both a decrease in ADR and occupancy. While the latter dropped by more than half compared to the same month in the previous year, ADR decrease was milder with approximately 30% decrease across all three markets.

Fig. 2 – Hotel KPI's July 2019 vs. 2020





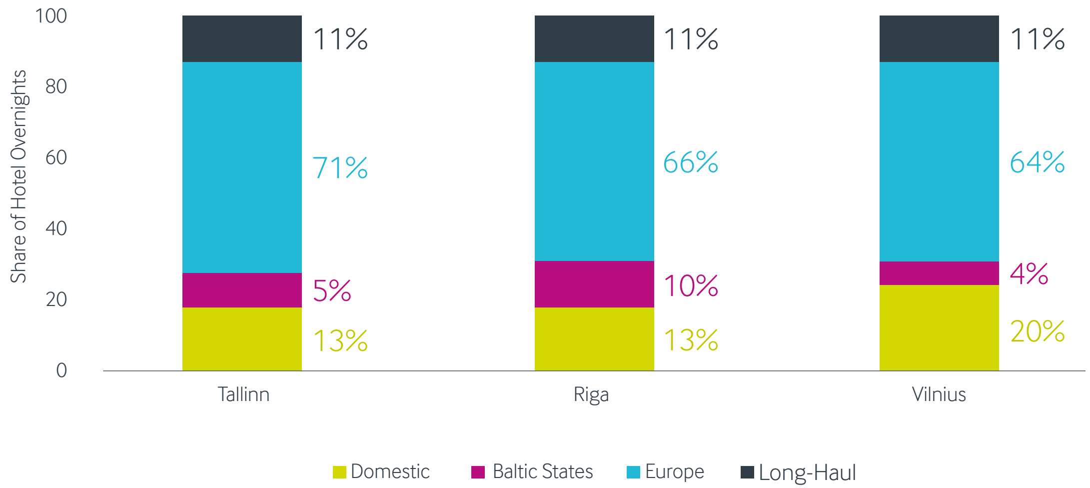
Source: Benchmarking Alliance

While the recorded hotel markets' KPIs are highly alarming and utterly unsustainable for hotel chains, even on a short-term basis, positive signals are conveying that the worst could be behind us, and that recovery for hotels is ahead as most of the economies have re-opened. Furthermore, as the Baltic States are among the least affected countries in Europe, there are few restrictions left in place. The most notable restrictions affect travelling to and from countries with a relatively high amount of new Covid-19 cases and mass gatherings and include other more minor safety measures.

With the positive signals for an increase in overnight accommodation demand, the temporarily closed hotels had been gradually re-opening for business. We estimate that in July, around 90% of the hotel room stock in the capitals of the Baltic States were open.

As economies and borders continue opening, we anticipate the Baltic hotel markets to be better positioned for recovery compared to other markets in Europe. The key to this view lies in the demand structure of the Baltic markets. While domestic demand share is relatively low, the Baltic states profit from low reliance on long-haul demand, which is expected to take the longest to recover. As Figure 3 illustrates, European overnight demand accounts for close to 90%, with long-haul demand accounting only for approximately 10% of total overnight demand in all three capital markets.

Fig. 3 – Hotel Demand by Source Region (2019)



Source: National Statistics Centres

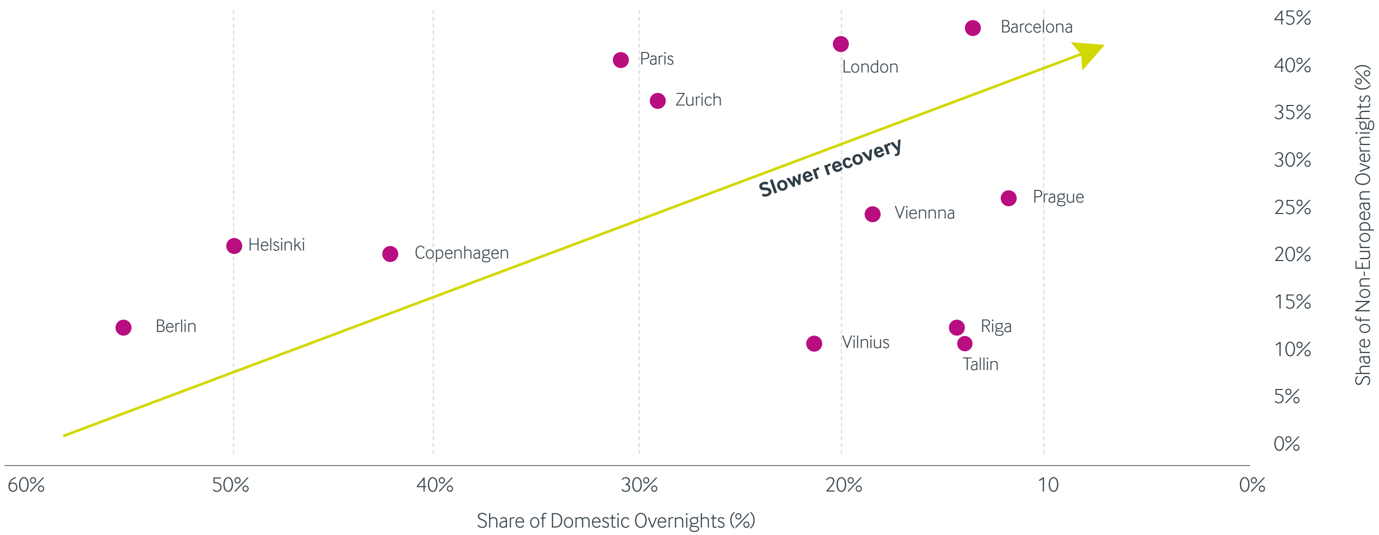
As travel restrictions within Europe are eased, having a relatively low reliance on long-haul demand puts the Baltic States in a favourable position for a faster recovery to sustainable performance levels. Furthermore, short-distance travel is perceived to be safer than long-distance travel, as it can conveniently be conducted by a private transportation, without being exposed to the public. Short-distance travel can also be more flexible than long-distance travel, which is an essential factor, given how fluidly the pandemic scene is changing.

The pandemic and ensuing government measures have had, and probably will continue to have, a significant negative economic impact. While the largest setbacks to company earnings and bankruptcies might be behind us, there is still a growing number of layoffs across industries, evident from the surge of unemployment benefit applications throughout the region. Whether a longer-lasting recession is ahead or not, many families and individuals have already seen their disposable income diminished. In economically uncertain times travel spending tends to be one of the first areas to cut back on, this is likely to drive many consumers to choose more budget-friendly closer-distance travel destinations.

Potential challenges with air travel, including flight availability, price increases, and safety concerns are likely to support the faster recovery of relatively short-distance travel. Since the crisis began, many airlines have grounded a significant part of their fleets and are currently operating only on limited vital routes. Therefore, air travel supply has diminished just as much as demand, if not more, which appears to have led to recent price increases. Airbus airline-data subsidiary Skytra reports that airfares have risen in all major regions as travel restrictions eased and people are conducting essential travel on limited flights. This was especially true for long-haul flights, as flight tickets between Asia-Pacific and Europe, as well as Asia-Pacific and North America, saw a price hike of around 33% on average - which could represent a new norm in price levels according to Skytra.

With these key drivers in mind, it is reasonable to expect hotel markets with relatively low dependency on long-haul demand to recover faster from the current crisis, than markets that rely more heavily on long-distance inbound travel. As Figure 4 below illustrates, the demand structure of the Baltic states' capital markets may be better positioned for recovery compared to many other European capital markets.

Fig. 4 – Demand Structure Comparison (2018)



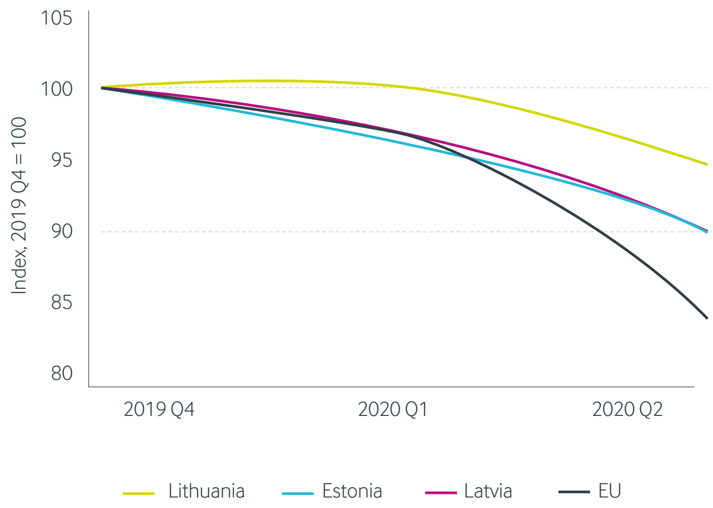
Source: National Statistics Centres

Naturally, hotel demand, whether domestic or international, is positively correlated with the state and growth of the overall economy. In this regard, the economies of the Baltic States appear to have favourable conditions for economic recovery and the resulting hotel demand compared to other economies within Europe. Three factors to consider are:

First, the Baltic States benefit from low constraints to mobility. The three countries were among the first to allow travel by creating their Baltic states travel bubble, as early as May 15, 2020, without needing to self-quarantine. Since then, the three countries have collectively allowed inbound travel without self-quarantining from countries with a relatively low number of new cases. With the critical airlines for the region, including airBaltic and Finnair, being saved through refinancing and government financial aid packages, air connectivity to the area is also secured in the medium-term, supporting economic activity and facilitating recovery.

Second, the Baltic economies are relatively stable and balanced on a macro level, providing a solid base for recovery. The countries have among the lowest public debt/GDP ratios in Europe. Estonia at 8%, has the lowest proportion among EU countries, while Lithuania and Latvia at around 35% are among the top 8 in the EU, which has the average ratio at c. 80%. Moreover, the Baltic State countries' economies are less dependent on tourism than many southern European countries are. While for Estonia tourism contributes still a notable c. 15% to the GDP, the ratio is significantly lower in Latvia (c. 8%) and Lithuania (c. 5%). Therefore, on average, the three Baltic States tourism industries' contribution is still below that of the EU average (c. 10%). Besides, approximately 1/3 of Estonia's visitors stem from Finland, and travel between the two countries is still relatively active. Furthermore, 2020 first and second-quarter GDP growth demonstrates that the Baltic State countries' GDPs have decreased by notably less than the average GDP of the EU, signalling a relatively lower negative impact on the Baltic States from the pandemic.

Fig. 5 – GDP growth

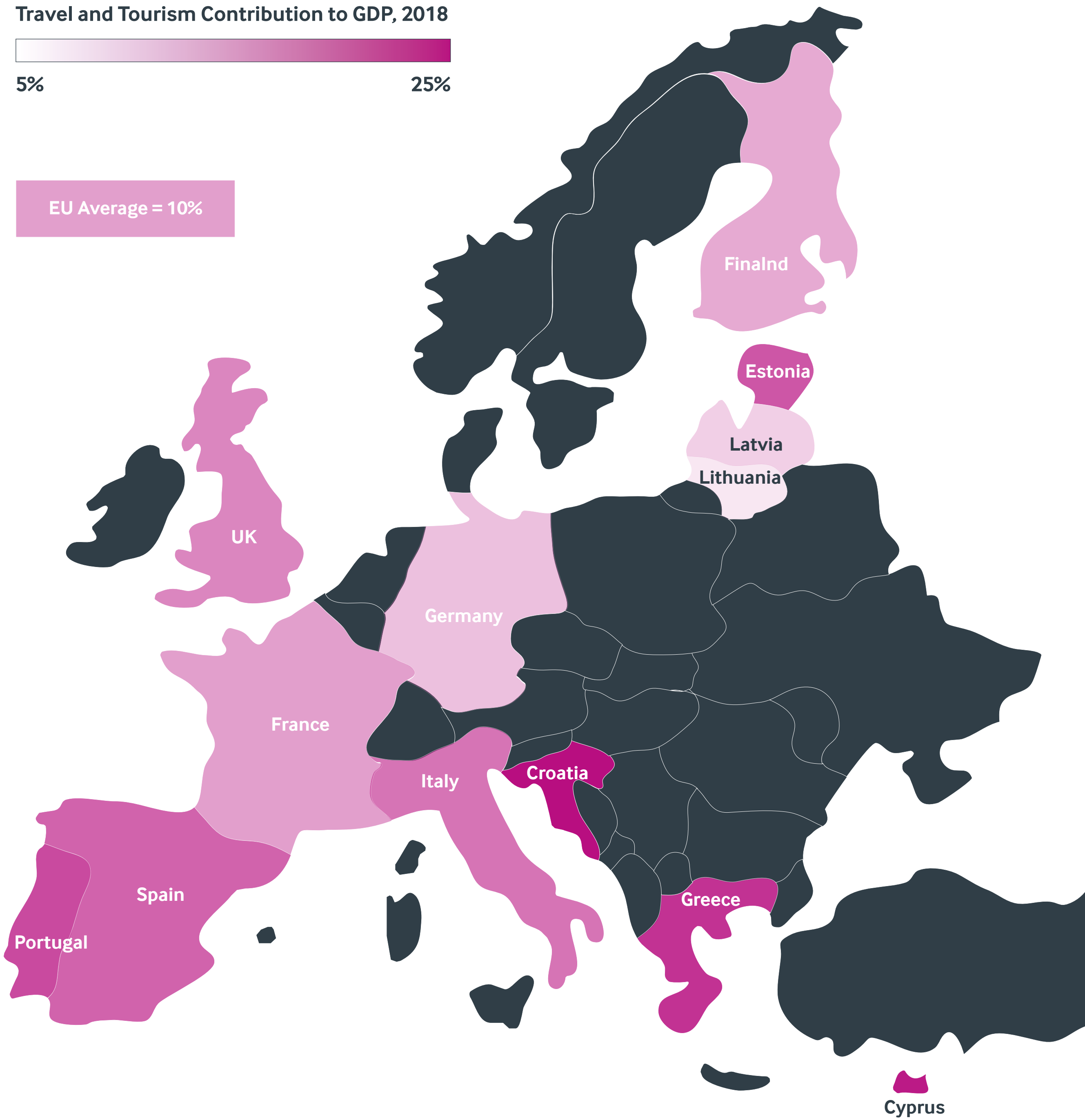


Source: Eurostat

Third, we anticipate that the Baltics States will benefit from less negative consumer sentiment compared to other regions. Negative news has a substantial impact on consumer confidence and usually shorten the planning horizon for spending. The overall Covid-19 infection rate, hospitalisations and deaths are among the lowest in Europe, which instils trust in consumers and allows for more rapid resumption of ordinary life and consumption. More open economies and less wary consumers are, thus, also anticipated to support faster economic recovery.

In summary, while the situation for the past several months has been dire for hotels, the opening of economies and borders in the Baltic States seems to have initiated recovery. With the relatively low dependency on long-haul arrivals, the Baltic states hotel markets should recover faster to sustainable performance levels compared to many other European markets. The Baltic State countries' economies are also well positioned to deal with the aftermath of the pandemic, supported by unrestricted mobility, relatively healthy macro-economic conditions, and a sound basis for resumed consumption, which in turn drives hotel demand. Nevertheless, it remains to be seen exactly how long it will take before hotel demand and performance in the Baltic states are back to pre-pandemic levels.

	Public Debt to GDP, 2019	Covid-19 Related Death per 1M population, Aug, 2020
Croatia	73%	46
Cyprus	96%	17
Greece	177%	26
Portugal	118%	179
Estonia	8%	48
Spain	96%	622
Italy	135%	587
UK	85%	611
EU Average	79%	354
France	98%	469
Finland	59%	61
Germany	60%	112
Latvia	37%	18
Lithuania	36%	32



Source: Eurostat, WTTC, Worldometers

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For questions, comments and further discussion on the topic, please do not hesitate to get in touch with us.

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