Tourism Dynamics in a Low-Growth, High-Cost environment

By

Andrea Saayman and Ilsé Botha

Abstract

Recent years have witnessed a number of shocks to the tourism industry, caused by natural disasters, health disasters and political instability, with the COVID-19 pandemic the most recent profound shock to the industry. While the recent pandemic had a profound impact on tourism, the lockdowns and loss in economic activity lead to an economic breakdown, described by the World Bank (2022) as the largest economic crisis in more than a century. Large shocks to the economy have shown to influence tourism behaviour; for example, Lu, Chen and Kuo (2018) revealed that tourism demand for seven major destinations changed after the 2008/9 financial crisis

The COVID-19 pandemic also significantly impacted global inflation through disruptions in supply chains, labour markets, and currency exchange rates, leading to rising input costs. Additionally, increased government spending contributed to demand-pull inflation. As a result, inflation surged to levels not seen since 2008 in developed economies and since 2011 in developing nations. The subsequent Russian-Ukrainian war further exacerbated inflationary pressures by driving up energy and food prices, leading to widespread shortages. This economic environment created a cost-of-living crisis, where stagnant wages failed to keep pace with rising prices, pushing many households into financial hardship.

Within this context of high inflation and low economic growth, the recovery of international tourism—especially to long-haul destinations—has been sluggish. This study examines the behavioural responses of tourists in the face of rising travel costs by applying Kahneman and Tversky's (1979) Prospect Theory, which explains how individuals make decisions under uncertainty. Specifically, the research investigates how changes in income and price levels influence tourism demand and how travellers adjust their behaviour during economic downturns. By employing a Markov-Switching model, the study estimates the marginal effects of price and income under different economic conditions, distinguishing between high-income versus low-income states and high-price versus low-price states. This allows for a nuanced understanding of how inflationary pressures and economic uncertainty shape international travel decisions.

The study focuses on three countries across different continents—Canada (North America), South Africa (Africa), and Australia (Oceania). An analysis of tourism recovery trends in 2023 relative to 2019 levels reveals that total international arrivals stand at 83.5% for Canada, 82.6% for South Africa, and 79.5% for Australia. The study also explores disparities in recovery rates across key tourism source markets.

The findings highlight significant behavioural shifts in tourism demand in response to inflationary pressures. The results suggest that travellers are becoming more risk-averse, opting for destinations with lower relative costs or favouring regional travel over long-haul destinations. Additionally, income constraints and increased travel costs are leading to a preference for shorter stays and budget-conscious travel choices. Understanding these dynamics is crucial for policymakers and tourism industry stakeholders seeking to accelerate recovery and adapt marketing strategies to evolving consumer behaviour.

This research contributes to the literature on tourism economics by incorporating behavioural finance theories into travel decision-making analysis. By utilizing a Markov-Switching framework, the study provides empirical insights into how different economic states influence tourism demand, offering valuable implications for managing tourism recovery in the post-pandemic era.