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Tourism in Israel: Significant Untapped Potential

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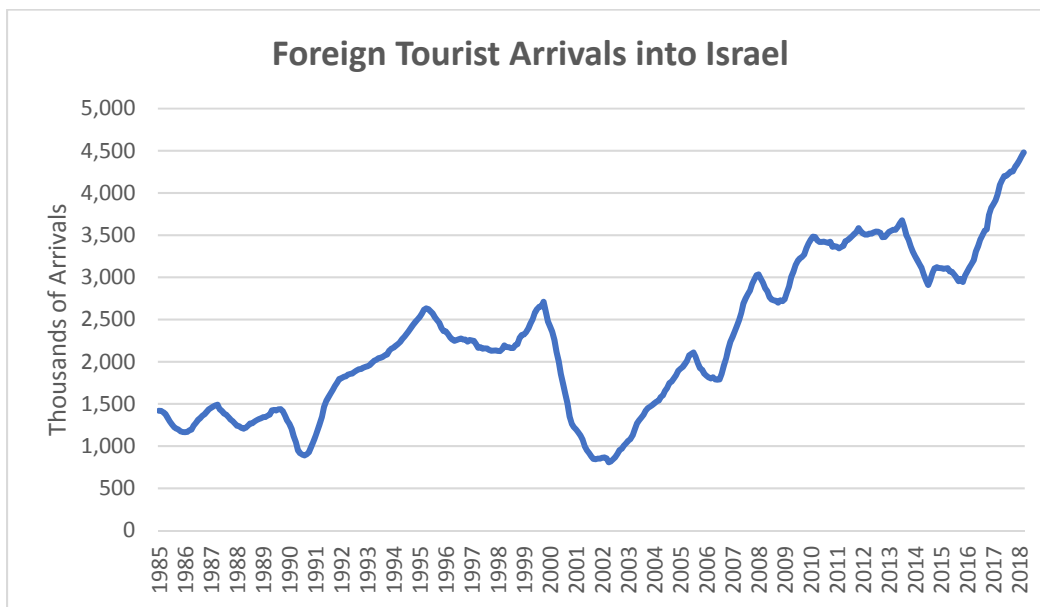
Tourists battling summer heat, crowds, lines, and high prices might be surprised to learn Israel is not a very popular tourist destination by global standards. Israel welcomed a record 4.3 million international tourists in 2018. During the same period, 82 million foreign tourists visited Spain, 58 million visited Italy, 27 million visited Greece, and Egypt hosted 8 million. Mediterranean beaches and rich archaeological treasures are very popular with European travelers. Like Spain, Italy and Greece, Israel has both.

European travelers account for 51% of international tourism (i.e. excluding domestic-only tourism), which explains why a more distant destination like Australia only received 8.8 million visitors in 2018. By contrast, Barcelona is a 1½-hour flight from London and a 2½-hour flight from Berlin.

Israel, with its religious heritage, temperate weather, beautiful beaches, and lively nightlife, is a bit further. Perhaps the five-hour flight from London and the four-hour flight from Berlin are deterrents for the weekend traveler.

Terrorism Can Scare Tourists Away

Throughout periods of terrorism or military conflict, foreign tourism to Israel fell sharply (chart 1). During the First Gulf War in 1991 when Saddam Hussein fired Scud missiles at Tel-Aviv, foreign tourist arrivals plummeted 37%, taking two years to recover. When the Second Palestinian Intifada raged in the early 2000s, tourism dropped 66%, only returning to its year 2000 peak in 2008. Similarly, following the Operation Protective Edge conflict with Gaza in 2014, foreign tourism dropped 20%, regaining its former high three years later. Regardless of these conflicts, foreign tourists in Israel nearly tripled over the past 30 years.

Chart 1

Source: Israel Central Bureau of Statistics (CBS)

Geopolitical Risks Make Hotel Development Risky in Israel

Hotel occupancy rates in Israel dropped precipitously and without warning when armed conflict escalated. As a result, Israeli real estate developers were reluctant to build new hotel projects given the potential financial risk. Over the past 8 years, the number of hotel rooms available in Israel rose by just 10%, from 60,100 in 2010 to 66,100 in 2018, despite a 27% increase in foreign tourist arrivals (CBS). Predictably, with demand growth outstripping supply, hotel room prices jumped nearly 20% during the same period. However, some supply constraints are starting to ease.

Ongoing geopolitical threats include military conflict with Hezbollah in Lebanon, Hamas in Gaza, newly-established Iranian military bases and militia forces in Syria, and potential Palestinian terrorism. Regardless, a record number of hotel projects are either under construction or planned. Hotel occupancy rates remained fairly stable in recent years, even when foreign tourists stayed away following Operation Protective Edge. Strong demand from domestic Israeli tourists bridged the gap, potentially reducing development risk.

Most Tourists in Israel are Israelis

From the outbreak of the Second Palestinian Intifada in 2000 through 2018, Israeli GDP per capita doubled, while middle-class disposable income more than doubled. Israelis increased their spending on domestic hotels by 4.4% per year since 2010, while foreign tourists' annual hotel spending grew 3.1%. More importantly for hotel developers, Israeli domestic demand growth was stable. Israeli spending growth on hotels accelerated to 5.3% per year in 2014 and 2015, even as foreign demand dipped following the Gaza conflict. Domestic demand now accounts for 59% of total hotel revenues in Israel (CBS).

Another reason for the uptick in hotel construction is the success of web-based apartment rental services, such as AirBnb. The 50/50 ratio of short-term apartment rentals to available hotel rooms in Tel-Aviv is estimated to be the highest in the world (www.haaretz.com). Investors are converting residential apartments into AirBnb-type accommodations, exacerbating supply shortages in the housing market. To combat the shortages while recognizing the reality of geopolitical risks, the Israeli government recently enacted financial subsidies for hotel developers.

Security is Not the Only Crucial Measure for Tourism Growth

Foreign tourists come to Israel when they feel it is safe. With effective terrorist deterrence, foreign tourist growth could continue. Meanwhile, other measures are likely to increase foreign tourist arrivals. Israel signed an “Open Skies” agreement with the European Union, granting landing rights to more budget airlines. The new Ramon Airport in Eilat opened this year and is specifically built to handle larger volumes of direct flights from Europe.

Israel’s potential as a tourist destination is immense, but the possibility of armed conflict always lurks in the background. Stable domestic demand, however, is reducing some of the risk and encouraging needed investments in tourist infrastructure. While the primary goal of the Israel Defense Forces (IDF) is to protect human lives in Israel, protecting economic prosperity is also quite important. If terrorism or war can be deterred for extended periods, Israel could realize more of its tourism potential.