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India Lodging Industry: Economic Headwinds Likely to Impact Performance of the Sector in 2020

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The outlook for the Indian lodging industry is one of caution due to the decline in demand growth and economic headwinds shrouding the benefits accrued over the recent years, largely attributed to the increasing demand-supply gap.

Indian Economy Growing at a Slower Pace

The Indian economy grew at an abysmal rate of 4.5% in the second quarter (July through September) of fiscal 2019, lower than the 5% rate of the previous quarter, among economic headwinds, a weakening financial sector, lower industrial production, depressed consumer demand, and declining private investment. The only major sector to have grown during that period was the services sector, albeit at a slower rate than previous years.

In response, The Government of India (GoI) is in the process of implementing a reform-based agenda as a way to revive economic growth. As part of this effort, it has announced several measures, including the reduction in corporate taxes, withdrawal of higher taxes on foreign investors, recapitalization of banks, interest rate cuts, and a massive public-sector disinvestment plan. India's central bank, the Reserve Bank of India (RBI), has reduced the repo rate (the interest rate at which it lends to commercial banks) five times this calendar year by 135 basis points to 5.15%. The current interest rate levels are expected to remain in place, maybe even soften through 2020, with the combined initiatives of the GoI anticipated to improve business confidence.



Indian Hotel Market Dynamics

At the start of the current year (2019), the prescribed view of many industry pundits, including ours at HVS, was that of optimism due to the strong performance witnessed in 2018 that was propelled by the ongoing widening of the demand-supply gap. Surely so, the first quarter of 2019 beat market expectations, and later in the year, the sector benefited from easing of Goods & Services Tax (GST) rate on hotel room tariffs across the board. But successive negative impacts on the sector drained much of the enthuse. The closure of Jet Airways, India's largest airline by market share, led to a severe crunch in availability of airline seats, which, combined with the impact of general elections in the country, led to a temporary softening in demand growth. While multiple airlines quickly filled the void by increasing capacity, and as the incumbent government returned to power with thumping majority, the ongoing economic headwinds have continued to negatively impact the sector.

Hotel supply growth in India has been successively declining since 2012, with the current year an aberration to the long-term trend, as it has grown above 5% (compared to 3% in 2018). Based on the number of projects currently under construction and in the pipeline, coupled with the ongoing economic uncertainty, HVS anticipates that the long-term trend of declining supply growth will continue to remain well into the first half of the next decade.

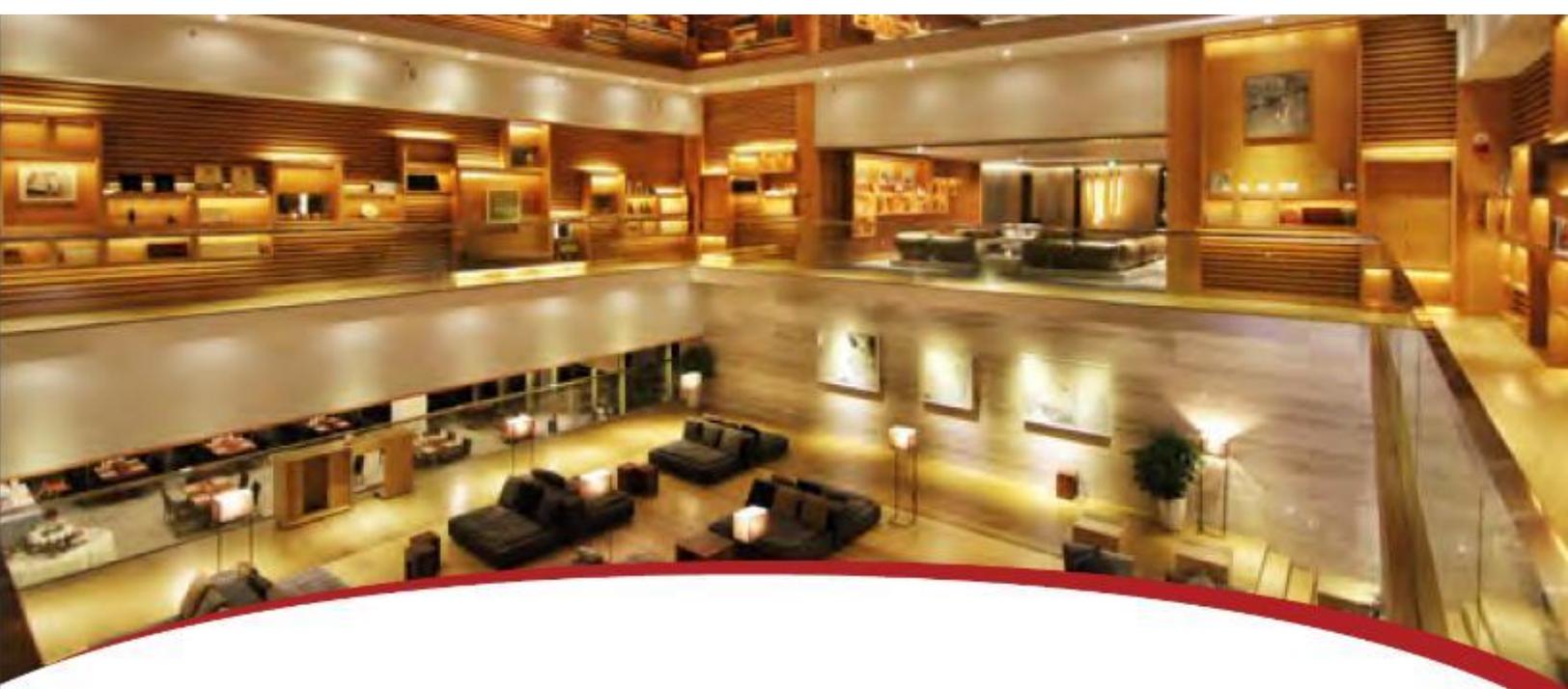
According to STR, as of the year-to-date period ending October 2019, occupancy registered 65%, with average daily rate recorded at INR 5,845, respectively. These figures equate to a RevPAR of INR 3,800, which reflects 3.1% growth based on the strong increase in ADR. The outlook for November and December is positive; thus, we anticipate overall RevPAR growth for 2019 to increase higher than the 3% registered through October 2019.

Prior to hardening of the ongoing economic headwinds, hotel demand in 2020 was expected to grow on a strong base of 2019, which in our view is now unlikely to happen. At best, we anticipate the sector to perform at similar levels of growth as witnessed in 2019. Should the ongoing reform plan of the GoI result in revival of the economy, the impact will only show credible results in the second half of 2020.

Hotel Real Estate Transactions

Increasing interest of institutional investors to acquire distressed real estate assets, including hotels, is another growing trend, though volumes in the hotel sector continue to remain low, and the average time taken to consummate them remain long. The successful completion of the Brookfield acquisition of Leela Hotels bodes well for the Indian hospitality sector and is likely to improve the market sentiment for more hospitality M&A activity in the country. The coming year will also witness one of the largest hotel IPOs (USD 300 million), with Goldman Sachs and Equity International-backed SAMHI Hotels expected to list in January 2020. Apeejay Surrender Park Hotels is also anticipated to enter the equity market in the first quarter of next year. The successful listings will further boost investment sentiment for the sector. The recently signed joint venture between Indian Hotels Company (Taj Hotels) and GIC of Singapore has declared an initial corpus of USD 400 million, which will become active in 2020 and add to the acquisition growth. At the beginning of the current year, we had estimated hotel transactions in India to reach USD 800 million. While the year is likely to close near USD 700 million of transactions, several deals remain active, some of which involve HVS, with closings anticipated to occur in 2020.





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