Inflation Anchoring and Behavioural Tourism Demand

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Abstract

This paper develops a theoretical model to investigate how inflation expectations — whether anchored or unanchored — affect international tourist demand. Departing from traditional models that assume tourists respond passively to observed prices, we incorporate behavioural macroeconomic insights to capture how perceived inflation risk influences travel decisions. In our framework, unanchored expectations lead tourists to overstate future destination prices, generating nonlinear declines in real tourism demand. By contrast, anchored expectations — consistent with credible inflation-targeting regimes — stabilise demand by reducing perceived price uncertainty. The model highlights the importance of macroeconomic credibility in shaping forward-looking tourism behaviour and provides theoretical support for inflation targeting as a complementary policy instrument in tourism-dependent economies.

Keywords: tourism demand; inflation expectations; forward-looking behavior; inflation targeting

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1. Introduction

The COVID-19 pandemic has reshaped global tourism patterns, introducing unprecedented volatility in both mobility and macroeconomic fundamentals. As borders reopen and travel gradually normalises, a new source of uncertainty has emerged: inflation. Across developed and emerging economies alike, the post-pandemic recovery has been accompanied by rising and unpredictable price levels, especially in services sectors such as hospitality, air transport, and accommodation — core components of tourism consumption. While traditional tourism models emphasise that relative prices and incomes are key demand drivers, far less attention has been paid to how tourists perceive and form expectations about future inflation when deciding where and how much to travel. This paper addresses the gap by introducing a behavioural macroeconomic perspective into tourism demand theory.

We developed a theoretical model in which international tourists allocate income between domestic consumption and foreign tourism. Crucially, they base their decisions not only on current prices but also on subjective expectations of future inflation in destination countries. We distinguish between two regimes: i) an *anchored* regime, where tourists perceive price levels as stable and predictable, and ii) an *unanchored* regime, where tourists expect price volatility or systematically overreact to recent inflation. Our model shows that even modest behavioural distortions in inflation expectations can lead to contractions in real tourism demand. Furthermore, countries with credible inflation-targeting regimes are shown to experience more stable inbound tourism flows.

Our study connects and contributes to several strands of literature. First, we build on the large body of empirical work analysing the determinants of international tourism demand. Classical approaches often rely on gravity models or demand system estimation to quantify the effects of income, prices, and exchange rates on tourism flows (see Crouch, 1994; Song and Witt, 2000; Lim, 1997; Eilat and Einav, 2004). However, these models typically assume tourists are perfectly informed and respond only to realised relative prices, ignoring expectation formation and behavioural distortions. Second, we draw on the behavioural macroeconomics literature, particularly models of inflation expectations under information frictions. Recent inflationary surges have exposed a critical vulnerability in tourism-dependent economies: even modest price fluctuations can deter visitors if perceived as persistent. Behavioural economics suggests that tourists, like other economic agents, rely on heuristics to forecast prices (Gabaix, 2020). When inflation expectations become unanchored — due to weak central bank credibility or extrapolative beliefs — tourists may overestimate future costs, distorting their consumption decisions. For example, a 10% inflation shock in a destination with unanchored expectations could trigger a demand drop exceeding 20% (see Section 2), a nonlinearity absent from conventional models. Yet, existing tourism demand frameworks (e.g., the almost ideal demand system of De Mello *et al.*, 2002) typically assume rational expectations, ignoring how subjective inflation risk alters behaviour. There are a number of influential contributions in monetary policy design and inflation forecasting, including the sticky information model of Mankiw and Reis (2002), the rational inattention framework of Sims (2003), and evidence on expectation biases in both consumers and professionals (Coibion and Gorodnichenko, 2015). Nevertheless, the implications of these models for real-sector behaviour, such as tourism, have not been formally explored. Third, our work complements studies on the effects of macroeconomic stability and institutional credibility on tourism performance. For instance, Tiwari *et al.* (2019) and Aloui *et al.* (2021) find that political and economic stability influence destination attractiveness, but do not model inflation credibility or expectations per se. So far, no studies have examined the effects of macroeconomic risk perception on tourists' destination choices.

In this study, we argue that macroeconomic risks, especially inflation volatility and the credibility of monetary institutions, play a pivotal role in shaping tourists' forward-looking behaviour. International travel often involves pre-booking, long planning horizons, and exposure to price risk across currencies and jurisdictions. As such, tourists form expectations about future costs at their destination, and these expectations are influenced not only by historical prices but also by macroeconomic signals, such as inflation rates, central bank communication, and perceived policy stability. Our study brings these macroeconomic elements to the forefront, positioning them as core determinants of international tourism behaviour under uncertainty.

Our paper makes three main contributions. First, we developed a theoretical model that incorporates inflation expectation regimes — anchored vs. unanchored — into tourists' decision-making. Second, we show that expectation distortion acts as an endogenous wedge on real tourism prices, generating asymmetric responses to inflation even under constant nominal conditions. Third, we use calibrated numerical simulations to illustrate the nonlinear impact of behavioural unanchoring on tourism demand and highlight the stabilising role of inflation credibility. Our model's predictions align with empirical anomalies observed during post-pandemic recovery. For instance, countries with high volatility (e.g., Turkey) experienced sharper tourism declines than predicted by income or relative prices alone (World Tourism Organization, 2023). Conversely, destinations with credible central banks (e.g., Switzerland) maintained stable inflows despite global inflationary pressures. Our work thus provides a microfoundation for macroeconomic credibility as a determinant of tourism competitiveness, urging policymakers to integrate price stability into tourism development strategies.

The rest of the paper is structured as follows. Section 2 presents the baseline theoretical model. Section 3 extends it to general equilibrium. Section 4 concludes and discusses policy implications for inflation targeting in tourism-dependent economies.

2. Model

2.1 Set up

We developed a stylised model to examine how inflation anchoring influences international tourism demand through tourists' expectations. The model features a representative tourist who allocates income between domestic consumption and a tourism good priced in foreign currency. Expectations about future prices at the destination play a central role in determining real tourism demand.

Consider a tourist residing in the home country (H), with nominal income (I), who chooses how much to allocate to domestic consumption C_H and international tourism consumption C_D. Let M denote nominal spending on tourism. The actual price level of tourism services in the destination country (D) is denoted by P_D, while the tourist forms expectations about this price, denoted P_D^e. The tourist derives utility from both types of consumption and forms expectations about the real value of tourism based on the expected price level. The utility function is:

$$U = \ln(C_H) + \theta \mathbb{E}_t[\ln(C_D)], \tag{1}$$

where $0 < \theta < 1$ captures the relative preference for international travel, and expectations are taken with respect to the foreign tourism consumption good. The tourist faces the following constraints:

$$C_H = I - M, \tag{2}$$

$$C_D = \frac{M}{P_D^e}, \tag{3}$$

We consider two regimes for inflation expectations in the destination country: i) anchored expectations that tourist believes that inflation is well-controlled, and expects the price level to remain at a known target value: $P_D^e = \bar{P}_D$; ii) unanchored expectations that the tourist perceives inflation as volatile and adjust expectations upward based on recent observed inflation: $P_D^e = P_D \cdot e^{\delta}$, $e^{\delta} > 0$, where δ captures behavioral overreaction or extrapolative beliefs.

2.2 Optimization

Substituting the constraints into the utility function yields the tourist's problem:

$$\max_{M \in (0,I)} \ln(I - M) + \theta \ln\left(\frac{M}{P_D^e}\right), \tag{4}$$

The first order condition (FOC) with respect to M is:

$$\frac{-1}{I-M} + \theta \cdot \frac{1}{M} = 0 \Rightarrow M^* = \frac{\theta I}{1+\theta}. \tag{5}$$

Substituting the optimal M^* into the consumption of the tourism good gives the equilibrium real tourism demand:

$$C_D^* = \frac{M^*}{P_D^e} = \frac{\theta I}{(1+\theta)P_D^e}. \tag{6}$$

We can now express the equilibrium tourism demand under the two expectation regimes. Specifically, for anchored expectations, we have:

$$C_D^{anchored} = \frac{\theta I}{(1+\theta)\bar{P}_D}. \tag{7}$$

While for unanchored expectation, we have:

$$C_D^{unanchored} = \frac{\theta I}{(1+\theta)P_D e^{\delta}}. \tag{8}$$

We therefore have the following propositions.

Proposition 2.1 (Inflation expectations reduce tourism demand). *Tourism demand is inversely related to expected prices:* $\frac{\partial C_D^*}{\partial P_D^e} < 0$.

Proof. From the optimal allocation derived in Equation (6), the real tourism demand is:

$$C_D^* = \frac{\theta I}{(1+\theta)P_D^e}.$$

Taking the partial derivative with respect to P_D^e yields:

$$\frac{\partial C_D^*}{\partial P_D^e} = -\frac{\theta I}{(1+\theta)(P_D^e)^2} < 0,$$

Since all parameters are positive. This confirms that expected inflation at the destination reduces real tourism demand.

Proposition 2.2 (Anchoring stabilises tourism flows). *If expectations are anchored, i.e.,* $P_D^e = \bar{P}_D$, *then tourism demand is invariant to actual inflation at the destination.*

Proof. Under anchored expectations, we have $P_D^e = \bar{P}_D$, where $\bar{P}_D$ is a fixed constant, independent of the realised price level P_D. Then the real tourism demand becomes:

$$C_D^{anchored} = \frac{\theta I}{(1+\theta)\bar{P}_D}.$$

Because $\bar{P}_D$ is constant, it follows that:

$$\frac{\partial C_D^{anchored}}{\partial P_D} = 0.$$

This implies that tourism demand does not respond to transitory inflation shocks when expectations are anchored.

Proposition 2.3 (unanchored expectations amplify volatility). *Under unanchored expectations,* $P_D^e = P_D \cdot e^{\delta}$ *with* $\delta > 0$*, tourism demand is more sensitive to inflation shocks, and the elasticity of tourism demand with respect to* P_D *increases with* δ*.*

Proof. Under unanchored expectations, real tourism demand is:

$$C_D^{unanchored} = \frac{\theta I}{(1+\theta) P_D e^{\delta}}.$$

Taking logarithms on both sides of the equation, get:

$$lnC_D^{unanchored} = ln\frac{\theta I}{(1+\theta)} - lnP_D - \delta.$$

Differentiating with respect to lnP_D and δ yields:

$$\frac{d\ lnC_D^{unanchored}}{d\ lnP_D} = -1, \qquad \frac{d\ lnC_D^{unanchored}}{d\ \delta} = -1.$$

The first derivative is the price elasticity of real tourism demand, indicating that a 1% increase in the actual tourism price P_D leads to a 1% decrease in real tourism demand.[1] The semi-elasticity $\frac{d\ lnC_D^{unanchored}}{d\ \delta} = -1$ captures the additional negative impact from behavioural inflation, pessimism, or expectation shocks.

Therefore, the effect of actual inflation on tourism demand is:

$$\frac{\partial C_D^{unanchored}}{\partial P_D} = -\frac{\theta I}{(1+\theta) P_D^2 e^{\delta}} < 0,$$

And the magnitude of this derivative increases with δ. Hence, the unanchored regime induces greater sensitivity of tourism demand to price--level movements, amplifying volatility.

2.3 Calibration

To illustrate the quantitative implications of the model, we calibrate the key parameters using plausible values from the tourism and macroeconomic literature. The goal is to demonstrate how real tourism demand responds under anchored and unanchored inflation expectation regimes. Table 1 shows the baseline parameter values we set.

From Table 1, we can get the optimal nominal expenditure on tourism is constant and given by:

$$M^* = \frac{\theta I}{1+\theta} = \frac{0.5 \times 10{,}000}{1+0.5} = 3{,}333.33.$$

Recall that the real tourism demand is computed as: $C_D^* = \frac{M^*}{P_D^e}$. We then evaluate C_D^* under both expectation regimes which is shown in Table 2.

[1] The elasticity $\frac{d\ lnC_D^{unanchored}}{d\ lnP_D} = -1$ quantifies how responsive demand is to actual price increases.

Table 1: Baseline parameter calibration

Parameter	Description	Value
I	Tourism income (home currency unit)	10,000
θ	Preference weight on tourism	0.5
$\bar{P}_D$	Anchored expected price level	100
P_D	Actual destination price level (initial)	100
$P_D{}'$	Actual price level (post-inflation)	120
δ	Behavioural overreaction parameter	{0.00, 0.10, 0.25, 0.50}

In the benchmark anchored case ($\delta = 0$), a representative tourist facing a price level of $P_D = 100$ allocates $M^* = 3{,}333.33$, generating a real tourism demand of 33.33 units. Under mild anchoring ($\delta = 0.1$), the same nominal budget results in a perceived price level of $P_D^e = 100 \times e^{0.1} \approx 110.52$, reducing real demand to approximately 30.23. With stronger unanchoring ($\delta = 0.5$), the perceived price level rises to $P_D^e = 100 \times e^{0.5} \approx 184.87$, yielding only $C_D^* \approx 20.22$.

Table 2: Real tourism demand under anchored and unanchored expectations

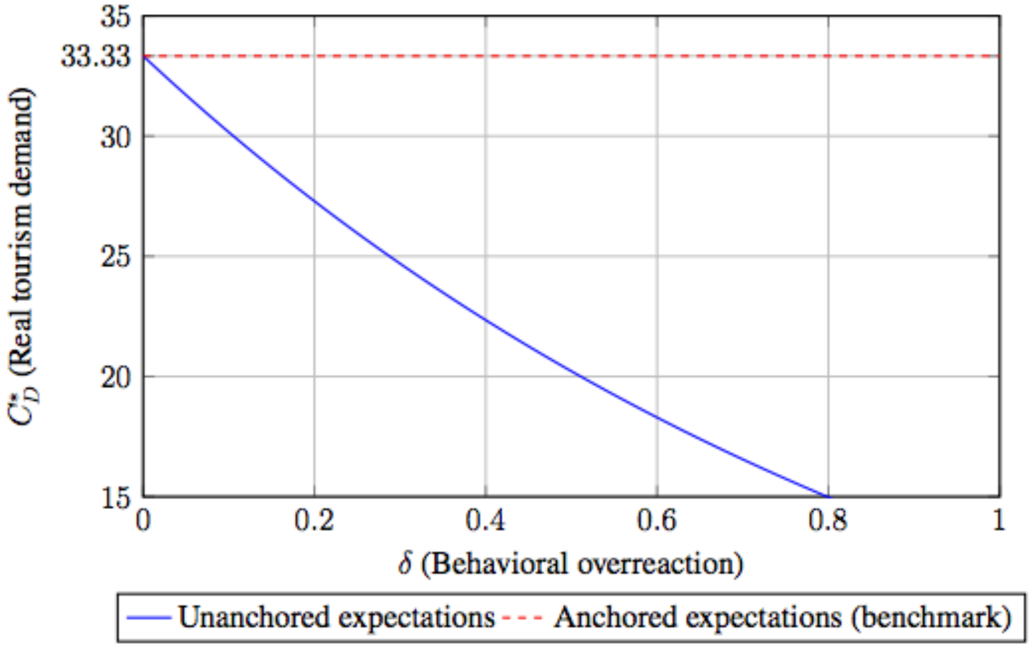
Scenario	P_D	δ	C_D^*
Anchored expectations	100	-	33.33
Unanchored (mild)	100	0.10	30.23
Unanchored (moderate)	100	0.25	26.00
Unanchored (strong)	100	0.50	20.22
Anchored (post-inflation)	120	-	27.78
Unanchored (post-inflation, $\delta = 0.25$)	120	0.25	21.67

Post-inflation, when P_D increases to 120, anchored expectations reduce demand proportionally, while unanchored expectations (with $\delta = 0.25$) cause amplified perceived inflation ($P_D^e \approx 153.95$), reducing demand to 21.67, a drop of over 35% from the baseline.

These results illustrate how inflation unanchoring introduces nonlinear declines in tourism demand even when nominal income remains unchanged. Hence, destinations with credible monetary policy regimes may thus maintain more stable tourism inflows during inflationary episodes.

Figure 1 illustrates how real tourism demand C_D^* responds to behavioral inflation expectation distortion δ, comparing unanchored expectations (blue curve) with the benchmark case of anchored expectations (red dashed line). The curve is derived from the model's core result: $C_D^* = \frac{\theta I}{(1+\theta) P_D e^{\delta}}$ with calibrated parameters $\theta = 0.5$, $I = 10{,}000$, and $P_D = 100$. The horizontal red line corresponds to the case in which tourist believes prices are fixed and predictable (i.e., $\delta = 0$), yielding a constant real tourism demand for $C_D^* = 33.33$. This represents a stable environment in which inflation expectations are well anchored by credible monetary policy.

Figure 1: Tourism demand under unanchored vs. Anchored expectations



Note: Real tourism demand C_D^* declines nonlinearly with inflation expectation distortion δ under unanchored expectations. Anchored expectations imply constant perceived prices and stable demand.

In contrast, the blue curve shows how demand evolves when tourists begin to overact to potential inflation by inflating their subjective price expectations (i.e., $P_D^e = P_D e^{\delta}$). We can see that even a modest level of expectation distortion ($\delta = 0.1$) causes real tourism demand to decline meaningfully, falling to approximately 30.23. As δ rises to 0.5 or above, the drop in demand becomes increasingly steep and nonlinear, falling below 21 units at $\delta = 0.5$.

The divergence between the two lines visually demonstrates the amplification effect of expectation unanchoring. While actual destination prices remain constant, tourists' perceived costs escalate rapidly under behavioural overreaction. As a result, unanchored expectations act as an endogenous amplifier of inflation's real effects, even in the absence of further price increases.

Overall, Figure 1 highlights a central implication of our model. Specifically, in economies where central banks fail to credibly anchor inflation expectations, even minor inflation shocks can lead to disproportionate reductions in tourism flows. Our results provide theoretical support for the macroeconomic policy objective of maintaining inflation credibility, especially in tourism dependent economies.

3. Model Extension

In this section, we extend our baseline model to allow for general equilibrium feedback effects, in which tourism demand influences destination-country inflation through a price-setting mechanism. This extension captures the endogenous interaction between forward-looking tourist behaviour and the inflationary response of the local economy.

3.1 Set up

Consider a small open economy that produces two goods: a tourism good and a non-tourism good. Foreign tourists allocate income between domestic consumption and tourism services in the destination country. Unlike the baseline model, the tourism price level is endogenously determined as a function of tourism demand. Foreign tourists maximise expected utility:

$$U = \ln(C_H) + \theta \mathbb{E}_t[\ln(C_D)], \tag{9}$$

where $C_H = I - M$ and $C_D = \frac{M}{P_D^e}$. Here, P_D^e is the expected price level of tourism services in the destination country.

We assume that the price of the tourism good responds positively to aggregate demand.

$$P_D = \bar{P} \cdot (1 + \phi C_D), \qquad \phi > 0, \tag{10}$$

where $\bar{P}$ is the baseline tourism price and ϕ captures the inflation sensitivity to tourism inflows.

Again, tourists form expectations about inflation under two regimes: i) anchored expectations: $P_D^e = \bar{P}$; ii) unanchored expectations: $P_D^e = P_D \cdot e^{\delta}$, where $\delta > 0$ represents behavioral overreaction or lack of policy credibility.

3.2 Optimization

Substituting the constraints into utility function:

$$U = \ln(I - M) + \theta \ \ln(\frac{M}{P_D^e})$$

The FOC yields: $M^* = \frac{\theta I}{1+\theta}$. Hence, real tourism demand is: $C_D = \frac{M^*}{P_D^e} = \frac{\theta I}{(1+\theta)P_D e^{\delta}}$. Using the endogenous price level, we can get:

$$P_D = \bar{P} \cdot (1 + \phi C_D) \Longrightarrow C_D = \frac{\theta I}{(1+\theta)\bar{P}(1+\phi C_D)e^{\delta}}$$

To solve for C_D, we define:

$$K = \frac{\theta I}{(1+\theta)\bar{P}e^{\delta}} \Rightarrow C_D(1 + \phi C_D) = K$$

This is a quadratic function in C_D: $\phi {C_D}^2 + C_D - K = 0$, with solution:

$$C_D^* = \frac{-1+\sqrt{1+4\phi K}}{2\phi} \tag{11}$$

This is the unique, positive equilibrium level of real tourism demand.

Proposition 3.1 (Existence and uniqueness). *A unique positive equilibrium C_D^* exists for all $\delta \geq 0$, $\phi > 0$, and $I > 0$.*

Proof. The quadratic equation : $\phi {C_D}^2 + C_D - K = 0$ has discriminant $\Delta = 1 + 4\phi K > 0$ for all $K > 0$. The positive root is: $C_D^* = \frac{-1+\sqrt{1+4\phi K}}{2\phi} > 0$. Since $\phi > 0$, the solution is real and unique.

Proposition 3.2 (Amplification through feedback). *An increase in expectation distortion δ reduces C_D^* more sharply when $\phi > 0$, due to general equilibrium price feedback.*

Proof. Note that $K = \frac{\theta I}{(1+\theta)Pe^{\delta}}$ with $\frac{dK}{d\delta} < 0$. Differentiating C_D^* with respect to δ:

$$\frac{dC_D^*}{dK} = \frac{1}{\sqrt{1+4\phi K}} > 0, \quad \frac{dK}{d\delta} < 0 \;\Rightarrow\; \frac{dC_D^*}{d\delta} = \frac{dC_D^*}{dK}\frac{dK}{d\delta} < 0$$

Compared to the decay in the baseline model, the nonlinearity introduced by $\phi > 0$ amplifies the sensitivity of C_D^* to change in δ.

Proposition 3.3 (Collapse under extreme expectations). *As $\delta \to \infty$, real tourism demand collapses to zero regardless of the income level.*

Proof. As $\delta \to \infty$, $e^{\delta} \to \infty \Rightarrow K \to 0$. Then:

$$C_D^* \to \frac{-1+\sqrt{1}}{2\phi} = 0$$

Therefore, real tourism demand vanishes when tourists anticipate extreme inflation, illustrating how behavioural unanchoring can lead to market collapse.

3.3 Calibration

To quantify the implications of the general equilibrium model with tourism-inflation feedback, we calibrate the extended model using plausible parameter values. The goal is to illustrate how real tourism demand C_D^* responds to changes in inflation expectation distortion (δ) under varying strengths of the feedback parameter (ϕ).

Table 3 presents the parameter values we set. We assume a representative tourist with income $I = 10{,}000$ (in home currency units), and assign a preference weight $\theta = 0.5$ for international tourism. The baseline price level is normalized to $\bar{P} = 100$. These values yield an optimal tourism expenditure of: $M^* = \frac{\theta I}{1+\theta} = \frac{0.5\times 10{,}000}{1.5} = 3{,}333.33$. We then evaluate real tourism demand C_D^* across a range of expectation distortion values $\delta \in \{0.00, 0.10, 0.25, 0.50\}$, and feedback strengths $\phi \in \{0, 0.005, 0.01, 0.02\}$. The key intermediate variable is: $K = \frac{\theta I}{(1+\theta)\bar{P}e^{\delta}} = \frac{5000}{150e^{\delta}} = \frac{33.\bar{3}}{e^{\delta}}$. In the no-feedback case ($\phi = 0$), tourism demand is determined by: $C_D^{*nofeedback} = \frac{33.33}{e^{\delta}}$. When feedback is introduced ($\phi > 0$), real tourism demand is obtained from the closed-form quadratic solution: $C_D^* = \frac{-1+\sqrt{1+4\phi K}}{2\phi}$.

Table 3: Calibrated parameter values for numerical illustration

Parameter	Description	Value
I	Tourism income (home currency unit)	10,000
θ	Preference weight on tourism	0.5
$\bar{P}$	Baseline price level for tourism	100
$1+\theta$	Consumption share denominator	1.5
M^*	Optimal tourism spending	3,333.33
δ	Expectation distortion parameter	{0.00, 0.10, 0.25, 0.50}
ϕ	Inflation feedback sensitivity	{0, 0.005, 0.01, 0.02}

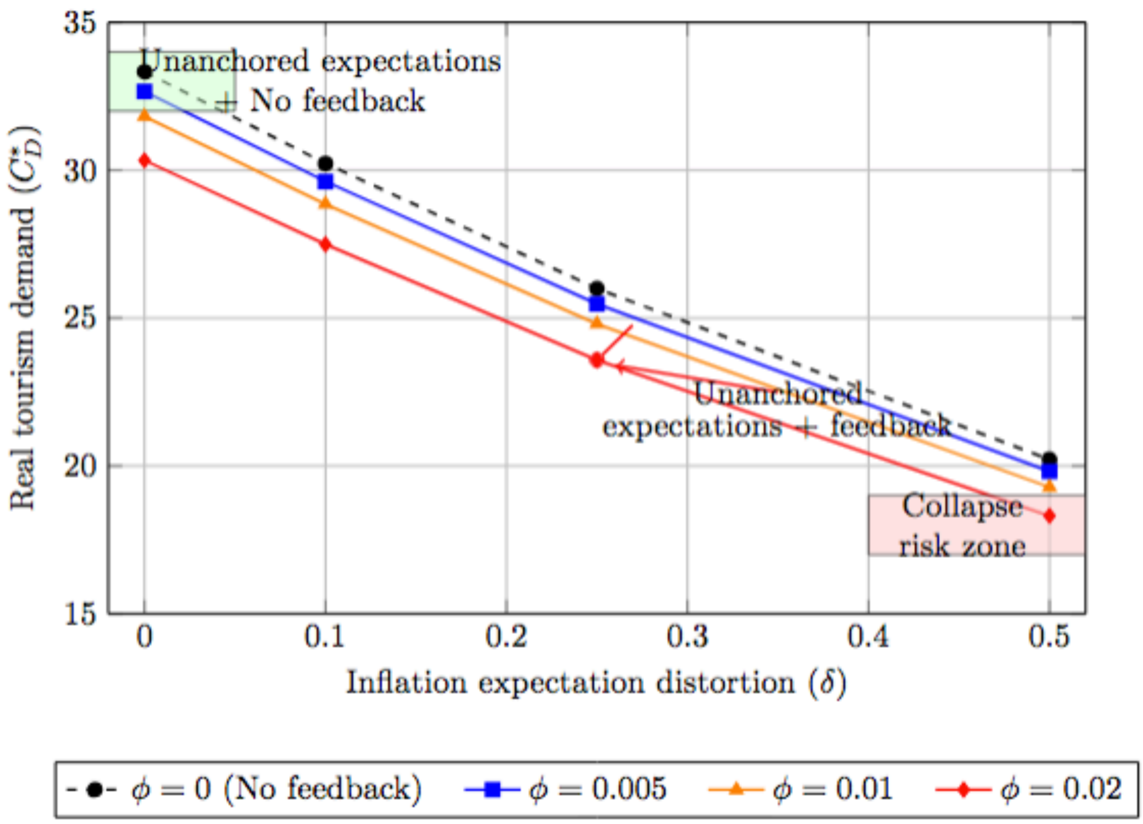
Table 4 reports the calibrated values of real tourism demand C_D^* under varying combinations of expectation distortion and price-feedback intensity. The results confirm two key insights. First, in the absence of feedback ($\phi = 0$), inflation expectation distortion leads to a smooth and proportional decline in tourism demand. For instance, increasing δ from 0 to 0.25 reduces demand from 33.33 to 26, or by roughly 22%. Second, once price feedback is introduced ($\phi > 0$), the decline in demand becomes more severe and nonlinear. At $\phi = 0.02$, the same increase in δ from 0 to 0.25 reduces demand from 30.33 to 23.58, almost a 22.26% drop from an already lower base. The convexity of the demand curve in $\boldsymbol{\delta}$ reflects the compounding effect of expectations and inflation feedback, consistent with Proposition 3.2. This highlights how inflation credibility, and the responsiveness of local prices can jointly determine the stability of tourism inflows.

Table 4: Calibrated tourism demand C_D^* under different feedback strengths and expectation distortions

δ	$\phi = 0$	$\phi = 0.005$	$\phi = 0.01$	$\phi = 0.02$
0.00	33.33	32.66	31.82	30.33
0.10	30.23	29.62	28.85	27.49
0.25	26.00	25.48	24.80	23.58
0.50	20.22	19.82	19.28	18.31

Figure 2 shows the calibrated relationship between inflation expectation distortion (δ) and real tourism demand (C_D^*) across varying levels of the price-feedback parameter (ϕ). The black-dashed curve represents the baseline case when expectations are unanchored and with no feedback ($\phi = 0$), where demand declines smoothly and proportionally as tourists anticipate higher inflation, reflecting only the direct effect of perceived inflation. In contrast, the colored curves illustrate how even modest levels of feedback ($\phi > 0$) steepen the rate of decline. Specifically, the blue curve (weak feedback) shows that demand marginally undershoots the baseline (e.g., 19.82 vs. 20.22 at $\delta = 0.5$), indicating mild sensitivity to local price adjustments. The red curve (strong feedback) illustrates that demand collapses nonlinearly (to 18.31 at $\delta = 0.5$), revealing a "vicious cycle" where unanchored expectations and endogenous price rises mutually reinforce. The 9% demand drop at ($\delta = 0.25$, red circle) highlights the critical threshold beyond which feedback effects dominate. The convexity confirms that general equilibrium price feedback amplifies the impact of expectation distortion, consistent with Proposition 3.2. Moreover, the green zone in Figure 2 confirms that anchored expectations stabilise demand, even with price feedback, whereas the red zone warns of systemic risk (when ϕ and δ interact, demand approaches collapse (Proposition 3.3)), underscoring the necessity of inflation targeting in tourism-dependent economies. Overall, Figure 2 quantitatively validates our model's core conclusion. More specifically, macroeconomic credibility is not merely complementary but essential to mitigate tourism demand fragility during inflationary shocks. The convexity of the curves emphasises that small expectation distortions can trigger disproportionately large demand declines when feedback loops exist, emphasising the critical role of inflation anchoring in maintaining tourism stability.

Figure 2: Tourism demand under inflation expectation distortion and price feedback



Note: Real tourism demand C_D^* as a function of inflation expectation distortion δ, under different levels of inflation feedback sensitivity ϕ.

4. Conclusion and Policy Recommendations

This paper develops a novel theoretical framework to examine how inflation expectations — anchored versus unanchored — influence international tourism demand. By incorporating behavioral macroeconomic elements into a micro-founded model of tourism consumption, we show that subjective price expectations can significantly distort real tourism decisions, even in the absence of large changes in actual destination prices.

The central insight of the model is that expectation formation acts as an endogenous channel of volatility in tourism flows. When inflation expectations are unanchored, tourists overreact to perceived inflation risk, leading to nonlinear and exaggerated reductions in real tourism demand. In contrast, when expectations are anchored — typically through credible and transparent inflation targeting regimes — tourists respond less to transitory price shocks, resulting in more stable tourism flows. Furthermore, when tourism demand endogenously affects local prices, unanchored expectations trigger a vicious cycle. In particular, higher perceived inflation reduces demand, which further raises prices, exacerbating the decline. These findings underscore the importance of macroeconomic credibility in shaping forward-looking consumer behavior in global tourism markets. It also highlights that macroeconomic stability is not merely a backdrop but a core pillar of tourism competitiveness. By integrating behavioral expectations into policy design, destinations can transform inflation credibility into a strategic advantage — turning volatility into resilience.

Our results have clear policy relevance, particularly for tourism-dependent economies in the Global South and emerging markets. First, our analysis provides theoretical support for inflation targeting as not only a tool of macroeconomic stability, but also as a sectoral competitiveness strategy. By reducing inflation volatility and anchoring expectations, central banks can indirectly support inbound tourism by lowering perceived price uncertainty among international travelers. Second, our results have practical implications for crisis management and central bank communications. Specifically, managing expectations is as crucial as managing fundamentals. Tourism ministries and central banks alike should recognize that perceived inflation can erode a destination's attractiveness faster than realized inflation. Third, from a broader policy coordination perspective, our findings call for stronger alignment between tourism strategy and macroeconomic frameworks. While tourism promotion often focuses on marketing and infrastructure, our model implies that maintaining inflation credibility — through credible monetary policy frameworks, forward guidance, and institutional independence — can be an equally important lever for sustaining tourism resilience in uncertain macroeconomic environments. For instance, the Reserve Bank of Australia (RBA)'s transparent inflation reports reduced tourism volatility during the 2022 price surge. Governments can modify consumer price index (CPI) calculations to assign higher weights to tourism-related sectors (e.g., hospitality, airfare, accommodation). In fact, Thailand's central bank already tracks tourism-core inflation separately to guide rate decisions. To mitigate feedback loops and smooth price volatility by preventing scarcity-driven inflation, destination governments can subsidize off-season hotel operations to maintain idle capacity or allow temporary conversion of residential/office spaces to lodging during demand spikes. Furthermore, to reduce tourists' inflation fears by guaranteeing costs, while stabilizing cash flow for businesses, tax authorities can offer tax breaks to tour operators for contracts locking in prices over 6 months ahead. For example, Maldives' "Fixed-Price Holiday Guarantee" program, where participating resorts receive value-added tax (VAT) exemptions in exchange for price ceilings.

Our study lays the groundwork for a number of promising future research avenues. First, empirical validation of the model's key predictions could be pursued using bilateral tourism flow data combined with inflation expectation surveys (e.g., surveys at airports). Comparing behavior across countries with varying degree of inflation targeting credibility would offer rich heterogeneity for analysis. Future research can also extend the framework to account for income-tiered demand (e.g., luxury vs. budget tourists). Interdisciplinary applications involving behavioral economics, international marketing, and central bank communication studies could further bridge the gap between tourism and economics and policy-oriented macroeconomics. As inflation volatility continues to characterize the post-pandemic world economy, understanding how tourists from expectations — and how policymakers can shape them — will remain a fertile ground for both theoretical and applied inquiry.

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