



# AVIATION LETTER

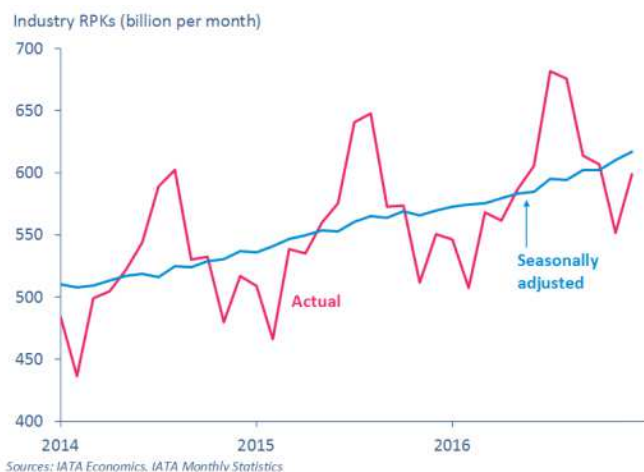
N°1 – MARCH 2017

## 2016 RPK<sup>1</sup>

# +6.3%

2016 was another good year for global air traffic, with 6.3% growth, slightly slower than in 2015 (+7.1%) but still above its 10-year average (+5.5%). This growth is being driven by international traffic (+6.7%, especially in the Middle East and Asia-Pacific), less so by domestic traffic.

The terrorist attacks only had an impact limited to local markets. Turkey was hit hardest, due not only to several dramatic events but also to considerable political instability. Generally speaking, demand was driven solidly by relatively low ticket prices, due, in turn, to low jet fuel prices.



But jet fuel has come back up somewhat since hitting bottom in early 2016, and the largest factor in stimulating demand is now past.

So global growth will play a larger role this year in traffic growth, which should be between 4% and 4.5%. The IMF forecasts GDP growth at 3.4% in 2017, up by 0.3 percentage points.

## A CYCLICAL MARKET?

Today, most industry players are wondering why the cycle is so long and when the next downturn (which is more expected than feared) will occur. Some of them (manufacturers and US airlines) have suggested that air travel market is no longer a cyclical market, which would lessen the likelihood of a coming downturn. In 2001 industry players were asking the same question, and the industry

nonetheless experienced a serious crisis a few months later, triggered by a serious exogenous event. Since then, airlines have drawn some lessons from these crises, in particular, the importance of controlling capacities, and load factors<sup>2</sup> today are at record highs. In

2016, ASKs<sup>3</sup>, i.e., the supply of seats, rose by 6.2% and load factors set a record annual average of 80.5%.

## WHAT ABOUT BREXIT?

Brexit is likely to have a limited overall impact but could be bad news for UK airlines. First of all, sterling's depreciation vs. the dollar could hit their profitability, as a considerable portion of their costs are denominated in dollars. Weaker domestic traffic (due to a negative economic climate) or international traffic (as weaker sterling hits British travellers and is not enough to draw foreigners who are balking at terrorist risks) will also have an impact on the airline. And the exit from the European Union may also lead to an exit from the European Common Aviation Area, which allows any airline from a signatory country to fly between any airport of signatory countries (including domestic flights by "foreign" airlines), and even an exit from the EU-US Open Sky agreements.

## SUSTAINABLE PROFITABILITY?

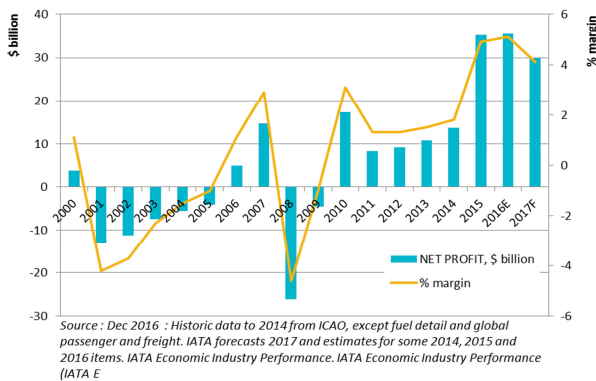
Airlines have long been known for being unprofitable but in recent years have achieved record profitability, helped along by low oil prices. Other factors are also helping to improve the sector's profitability, including more

<sup>1</sup> RPK : Revenue Passenger Kilometers : measure air traffic. Source IATA- Dec 2016

<sup>2</sup> Load Factors: the percentage of the planes that are filled.

<sup>3</sup> ASK: Available Seat Kilometres: measures airline capacity. Source IATA

### Worldwide Airline Industry - Net Profit



narrow-bodies has been stable, but the A320's value has fared better than its competitor, the B737-800, which has been subject to discounts granted by Boeing for its new version, the B737Max8. Among wide-bodies, lease returns have exceeded demand for certain models (A330-200 and B777-200ER), leading to a decline in their values. (Source: Flightglobal Ascend)

manufacturers' production rate, which will push out older aircraft that had been hanging on, thanks to low oil prices. If oil continues to move up and if the US dollar remains strong, values of both narrow-bodies and wide-bodies could slide somewhat.

### WHAT ABOUT MR. TRUMP?

Donald Trump's election as president is also raising some questions on the market. It should at first be good news for US airlines, due to improvements to airport infrastructure. They have also found a ready ear to their recurring claims of unfair competition from Middle East and European low-cost airlines. The activity of the US Export-Import Bank is also in doubt. Republicans have always considered the Ex-Im Bank as corporate welfare, but Donald Trump sees it as a way to help American industry, in accordance with his America First plan.

reasonable management of capacities, restructuring undertaken in recent years by North American airlines and wage cuts put through then, and consolidation in the sector, also in the US.

### STABLE VALUES

Whereas aircraft orders are generally correlated to airlines' financial results, over the past two years orders have shrunk from 3346 to 1579 units at Airbus and Boeing even in the midst of all-time high profits (source: aircraft manufacturers). This is also due to a historically high order backlog of 12,500 aircraft (or 8.75 years of production) and the lack of near-term delivery slots. With a backlog like this, manufacturers are able to easily absorb order postponements, which have become more frequent in recent months – a sign that airlines are paying more attention to controlling their capacities at a time when they are less optimistic on demand. In 2017, almost 750 units will be delivered by Airbus and 760 by Boeing, including the new A321Neo, B737Max8 and A350-1000. Lastly, aircraft values have been relatively stable, despite contrasts between models – interest in

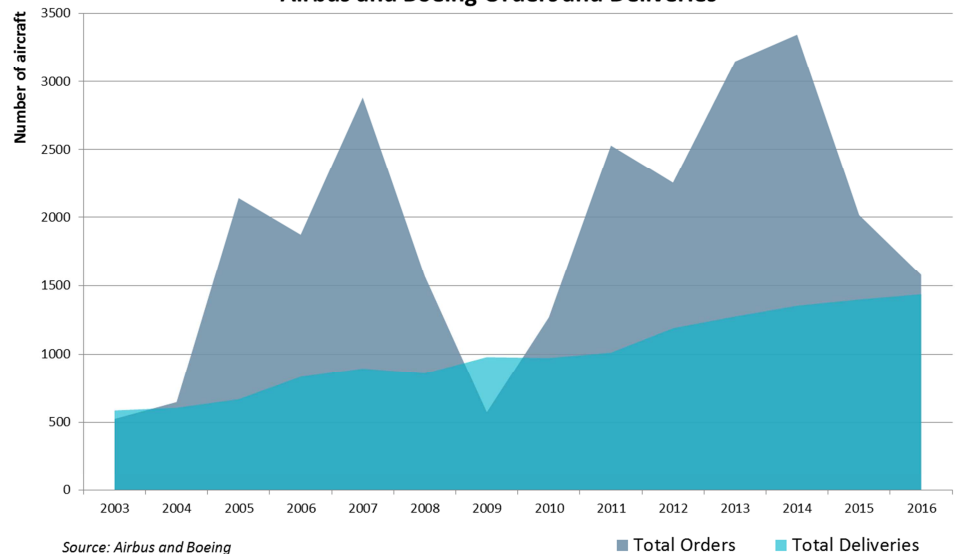
### TAKEOFF OR LANDING?

Growth in air traffic is likely to slow again in 2017, to about 5%, in line with the average growth forecast for the next 20 years.

While there are some uncertainties regarding the impact of Brexit, Donald Trump's election and protectionist trends, this growth is likely to be driven by an increase in city pairs and more frequent flights.

Aircraft values could be hit by higher

### Airbus and Boeing Orders and Deliveries



Written on 2 March 2017

Credit photo : Spooh – Istockphoto.

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