Adding value despite difficult business conditions

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June 2014
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To represent, lead and serve the airline industry
Cyclical upturn in trade, production and confidence began in late 2012. Early 2014 seems to be faltering with downturn in confidence and world trade. Most expect a resumption of upturn but this has taken a dent out of this year’s growth and shows upturn is still fragile.
We have never faced a period of such sustained high fuel costs. Little sign of much decline.
Despite relatively weak economy growth and high fuel prices, air travel growth has proved very robust. In fact while economic conditions deteriorated in Q1 air travel growth accelerated.
However, not all parts of travel are strong. Business travel on premium seats has got weaker, reflecting fall of business confidence.
Cargo has been weak ever since 2010 peak but showed signs of an upturn in the second half of last year. Since peaking in January the trend seems to be slowly down in Q1, in line with overall world trade.
There does seem to be a problem with cross-border trade. Since the recession there has been what might be a structural break, with cross border trade no longer growing faster than domestic production. Indeed in the early months of 2014 the line pointed down as trade grew more slowly than domestic industrial production. This ‘on-shoring’ could have a number of causes, including non-tariff trade barriers. Whatever the cause it is bad news for air cargo.
Airlines have been responding to the weak economy/high fuel cost environment by looking for economies of scale and scope by combining networks – in mergers where allowed and in JVs on long-haul markets. The resulting consolidation has allowed load factors achieved to move above breakeven load factors (which tend to trend higher as yields fall faster than unit cost reductions).
Airlines are also changing the structure of the airline product. The old airline product is being unbundled as telecoms and banking services were years ago. The industry is looking at adding new value added services, enabled by the NDC standard being developed.
Customers have benefited from lower fares and from new destinations. The wider economy has too. Economic development benefits come from new connections being established between cities and the cost of transport being cut. In the past 20 years the number of air connections between cities has been doubled. Over the same period the cost of transport, adjusted for inflation, has halved.
Governments have been a major beneficiary of airline activity. Employment targets have been supported by the 54.1 million of jobs supported through the supply chain and further out in the economy. We forecast that around $120 billion of payroll, social security, corporate and product taxes will be paid to governments by the industry this year.
Investors have also been seeing their returns improve this year. We forecast that the average return on invested capital will rise to 5.4% this year. That’s better than last year and better than 10 years ago. However, it still is below the cost of capital, which should really be the minimum. Returns are improving but there is further to go before the industry is really financially sustainable.
This year an estimated 1400 aircraft will be delivered, representing an investment by airlines worth around $150 billion. This investment has been driven by improving returns, but also high fuel prices making it economic to replace old aircraft with new fuel efficient versions.
High fuel prices is helping to drive further fuel efficiency gains. Last year the industry improved its fuel efficiency by 1.9%. We forecast that fleet renewal will help achieve a similar improvement this year.
With fuel costs more than tripling in the past decade there has been an intense effort to get efficiencies and keep non-fuel unit costs down. One cost area where this has been less successful has been with infrastructure (airports and ANSPs). The rise in these unit costs shows that competitive pressures are limited in this part of the value chain.
Overall we forecast that the industry will improve its net post-tax profits to $18 billion this year.
N American airlines are seeing the strongest improvement, benefiting most from consolidation and ancillaries.