

Global aviation outlook: delayed but persuasive recovery despite new turbulence

Travel will rebound strongly in 2022. Consumers are eager to travel and short-haul continental traffic will benefit from pent-up leisure demand. The closure of airspaces is a new blow for aviation and Covid is a headwind for China meaning the return to profitability may be pushed back, though the recovery is expected to continue



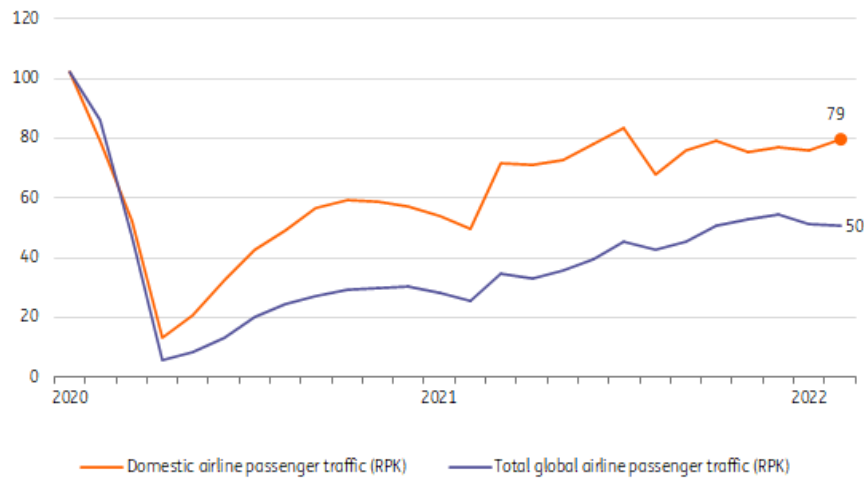
Source: Shutterstock

Recovery in aviation shifts to second stage in 2022, despite lasting volatility

The pandemic has hampered the airline industry for much longer than expected. After the recovery began in 2021, new waves of the virus and fresh travel restrictions prevented the sector from scaling up. This year, however, is meant to be the year of delayed but sustained recovery, despite new scars. Global passenger traffic (RPK) recovered to 50% of pre-pandemic levels in the first months of 2022, but intercontinental traffic still has a long way to go.

Global airline traffic recovery, while entering spring

Index global passenger revenue kilometer (RPK) (2019 = 100)



Source: IATA, ING Research

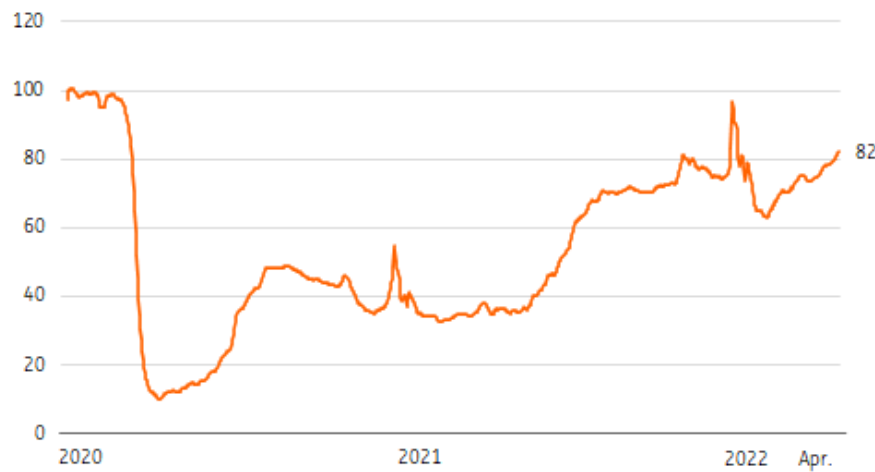
Strong rebound in leisure travel expected for the summer of 2022

What we learned from 2021 is that when restrictions are lifted, demand for travel is still there, particularly for family visits and holidays. Many air passengers have suspended trips over the last two years leading to pent-up demand. This could also lead to 'front loading' this summer as consumers may consider these travel freedoms to be temporary. This suggests the recovery could lose strength later on.

Passenger traffic showed a significant increase, up two thirds of pre-pandemic levels in March in Europe's main airports. Airlines such as [Ryanair have reported stronger international bookings](#) - especially for short-haul international flights despite uncertainty from the war in Ukraine and higher ticket fares. [Sales data on international tickets](#) also point in this direction. Following a weak 2021 - especially in Europe - [airports also expect a much better 2022](#).

European flights reach 80% of pre-pandemic levels in April

Index number of flights from and to European countries, 7 day moving average (2019 = 100)



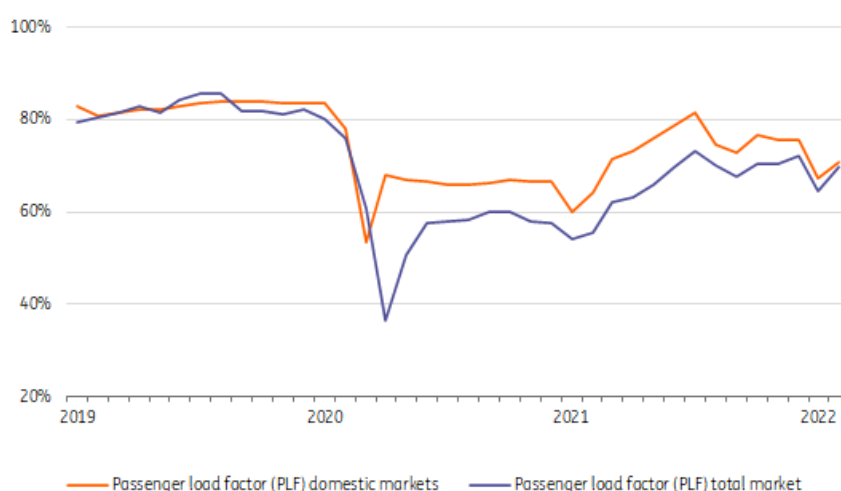
Source: Eurocontrol, ING Research

Flights still less busy than before, leading to inefficiency

Flights have returned stronger than passenger numbers (possibly also to retain slot rights). Average global passenger load factors are still hovering around 70%, which shows that occupancy rates of aircraft are still lower than the pre-pandemic levels of >80%. This means that the cost-efficiency of airlines is still suboptimal which weighs on cost-income ratios. How load factors evolve is therefore something to watch as well in 2022.

Aircraft occupancy rates still some 10%-points lower than usual

Development of passenger aircraft load factors (PLF) total market and domestic markets



Source: IATA, ING Research

Staff shortages challenge airlines in returning capacity to the market

Paradoxically, hiring staff is now a critical factor in getting aircraft frequency back online, as airlines cut their workforces over the pandemic and cabin crew staff left for other sectors. Sick leave rates are also higher than before, which is leading to operational challenges. For every restored flight additional personnel and job markets are tight. This may limit expansion, frequencies and routes, especially in the US (e.g. Jetblue).

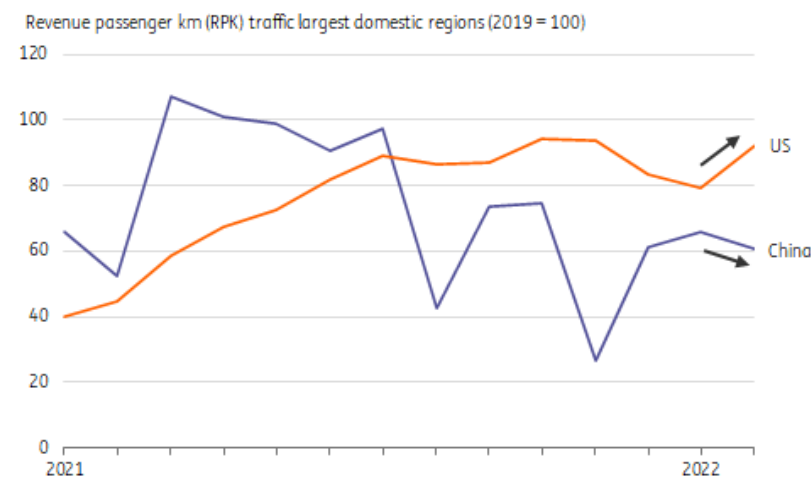
War in Ukraine affects European airline traffic, as well as airfreight capacity

- The mutual closing of air spaces has led to a **reduction of passenger traffic to and from Russia and Ukraine**. Russia accounts for 4.5% of global revenue passenger kilometres (RPK), and because of the sanctions this will undoubtedly go down as Russian holidays to European countries will fall ([Russian travelling accounted for 5.7% of European traffic in 2021](#)). Domestic travel will also suffer.
- The massive size of the Russian airspace avoidance affects some 10% of total passenger kilometres, according to IATA. Avoiding Russian airspace leads to **detours and longer flights on East-West routes** (e.g. from London, Amsterdam or Frankfurt to Tokyo, Seoul or Beijing). This will make trips less efficient and pushes up fuel costs even more, leading to higher ticket prices and extra capacity deployment.
- The war in Ukraine also leads to **direct new capacity cuts**. The grounding of Russian carriers like Airbridge cargo (approx. 20 freighters) due to the closing of airspaces and disturbed supply of spare parts for freighters reduces capacity. Lufthansa expects global air cargo capacity to consequently be [reduced by 10%](#), and global airfreight forwarder Kuhne Nagel indicated its capacity was down 30% on the Far-East Europe route following the sanctions. Due to scarce capacity, airlines are also considering re-allocating capacity to (possibly more profitable) other routes.
- In total, **hundreds of aircraft** leased to Russian operators were [still in Russian territory](#) at the end of March, but they are not in service on the usual international routes anymore. It's uncertain how many eventually will be returned to the lessors, but this will also curtail global capacity.

Full global recovery in passenger aviation not expected before 2024

Although we expect the recovery in aviation to continue this year, global passenger volume is not expected to recover in full before 2024. The war in Ukraine will temper the pace of recovery in 2022. In addition, a setback in the large Chinese airline market due to new Covid-related restrictions is slowing the return of travel volumes as well. Without these events, the recovery would undeniably have been stronger this year. For airlines based in the US, the impact will most likely be less severe than for European airlines, and the impact for low-cost carriers will also be less than for traditional intercontinental operating carriers. Despite the long haul to recovery, global passenger figures are still expected to eventually return to an annual growth trend of 3% or 4%.

Largest domestic market US on track for recovery, Chinese traffic slumps



Source: IATA, ING Research

Continued large regional differences in recovery – US in the front

On the back of a large home market, airlines in the US performed better than European airlines over the last year. Mid-April 2022 passenger checks at [US airports are back to around 90% of pre-pandemic levels](#) and bookings appeared to be relatively strong. European flight numbers returned to 80%, but passenger load factors in Europe are still below the 70-80% US figures.

A relevant difference is that the American (highspeed) rail network is less intensively developed than the European system and distances are longer, so there are fewer alternatives while airline interconnectedness is high. In Europe though, rail network connections are being extended and governments, like the French, aim to shift short-haul flights to rail on short notice.

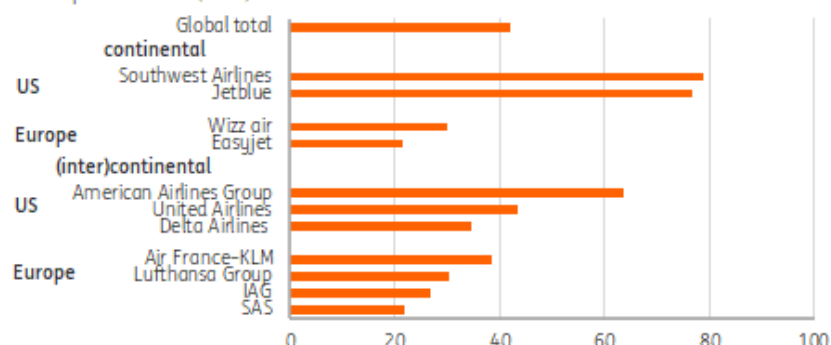
Chinese airline market struggles with return of Covid restrictions

Contrary to the US, the Chinese airline market has slumped after new Covid-related lockdowns. After an almost full return to pre-pandemic levels early in 2021, domestic airline travel figures started to decline again and were around 60% in early 2022. The risk of new measures has led to uncertainty about when the recovery might pick up again.

The other major Asian growth market, India, is also seeing a strong trend of returning domestic airline traffic, which can also be seen in India's public transport. With a growing middle class, India could be a driving force behind the global recovery in the years to come.

US continental airlines recovered stronger than European airlines at the start of 2022

Index revenue passenger km (RPK) of a selection of continental and intercontinental operating airlines in 2021 compared to 2019 (=100)



Source: Annual reports, ING Research

Global aviation entered the year with far fewer restrictions. How will travelling behaviour change once the pandemic is over?

Structural effects of the pandemic for aviation:

- Business travel won't be the same. The pandemic changed the way we perceive work and travel. Corporate travel will show a recovery in 2022 but is not expected to return to previous levels in the near future. Many typically international companies like ASML, PWC and financial institutions have indicated they will fly less and on top of this, sustainable alternatives are preferred – conscious travelling policies, for example for staff at universities and civil servants are also being introduced. For airlines, this means fewer sales of profitable business seat tickets.
- Another effect of the pandemic is the revaluation of the air cargo business. This could offer interesting complementary business opportunities.

The focus on sustainability has gained extra momentum during the pandemic. The blending of sustainable aviation has started to gain traction by flag carriers and market leaders and consequently, flying will be more expensive in the short run, at least in Europe. Europe is also considering fuel taxing and ticket taxing.

Adapting to the post-pandemic world – fewer business seats, more freighters

The dynamics of the post-pandemic world make it relevant for airlines to review their business models and strategy. Air networks may emerge smaller than previously expected and volumes could remain more volatile. With fewer business passengers, smaller aircraft may gain popularity. This will further benefit single-aisle aircraft, which are more flexible and easier to fill. Some airlines may consider changing their seat composition to include fewer business seats and more upgraded economy class seats ('economy plus').

In today's world, freighters are also becoming more structurally important. Freight cushioned the drop in results for intercontinental carriers and due to high rates, it even counted long-haul international passenger routes will take the longest to recover and these are important for belly freight.

Higher fuel costs, but this won't slash traffic in 2022

The gradual rise in oil prices in the second half of 2021 and the spike following the war in Ukraine significantly pushed up airline operational costs. Over the fourth quarter of 2021, jet fuel costs already accounted for 24% of airlines' total operating expenses and this will go up further. Even if oil prices ease in the remainder of 2022, results will be hit and [this complicates the return to profitability](#) for many airlines this year.

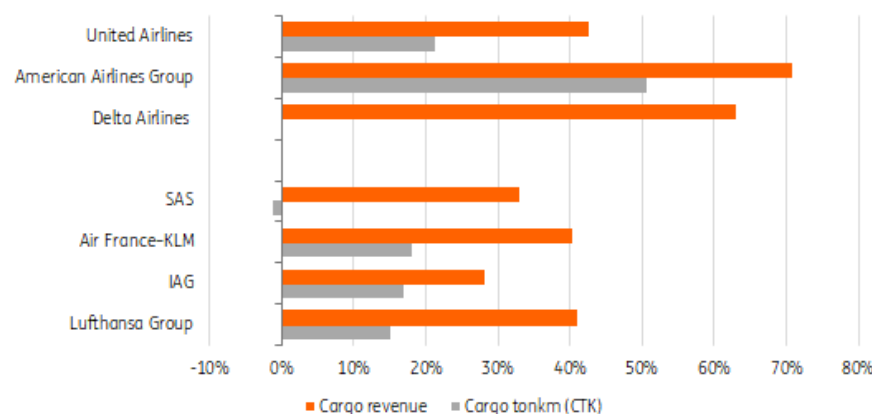
To what extent airlines are affected depends on fuel hedging strategies. In general, low-cost carriers apply hedging rates more than traditional carriers, which implies that the impact for 2022 will be mitigated. Traditional carriers usually accept more risk on the fuel side, with lower hedging rates. This means higher kerosine prices tend to affect them more.

And there is also a difference between European and American airlines as the latter tend to bear the risk themselves (Southwest airlines using hedges is an exception).

Airlines like Air France, KLM and Delta have started to raise ticket fares with fuel surcharges. A positive note is that travellers seem willing to pay extra for their tickets at this point (with oil prices just above \$100). Nevertheless, high fuel prices make fuel efficiency even more important.

Ongoing strong results in air freight attract strategic attention

Development of cargo revenue and cargo tonkm (CTK) in 2021 y.o.y.



Source: Annual reports, ING Research

Air cargo business keeps outperforming in 2022

One thing the pandemic made clear is the need for flexibility and a fast alternative in case of unexpected circumstances. Air freight is more expensive but keeps supply chains agile, although timeliness is also several days longer than the normal six days ex-works to the destination airport. After a strong double-digit rebound in 2021, market growth will significantly slow this year [with world trade flattening and a normalisation in e-commerce growth](#). Air cargo rates on the Far East-Westbound trade are still four times higher than pre-pandemic, but the competitive position for shippers remains relatively good amid disrupted supply chains.

Airfreight capacity remains tight

Capacity remains a limiting factor in airfreight through 2022 and the war in Ukraine has curtailed this further. Belly freight capacity has started to return, but not in full yet and compared to the 5-10% larger freight volume there's still a substantial deficit. The global fleet of full freighters increased by a net 40 in two years but this doesn't compensate. And this year, permission for transporting freight in passenger aircraft (e.g., for medical products during the pandemic) ends in the US as well as in the EU (from mid-2022).

Airlines, logistics players and container liners rush to set up freighter fleets

The capacity shortage on the freight side has led to various initiatives to expand among airlines, logistics services providers and remarkably also shipping companies. Among others, Emirates, [Qantas](#) and Air Canada plan to expand their fleets from 2024 by adding freighters and converting passenger jets.

On the logistics side, Amazon, DHL, [UPS](#), as well as [K+N](#) and container liners CMA CGM, Maersk and possibly MSC are expanding and setting up (chartered) freighter fleets and airlines are revaluing the cargo activities as well. Amazon, in particular, is absorbing a lot of the market growth. Its freighter fleet has grown to 88 (mostly B767 60-ton) and it explained this will continue this year.

How are major European carriers performing?

Lufthansa

In 2021, Lufthansa Group had total revenue of €16.8bn, up 24% YoY, including traffic revenues of €11.9bn, up 31% YoY, and adjusted EBITDA loss of €90mn (compared to the respective loss of €2.9bn in FY 20). In FY '21, the adjusted EBIT loss was €2.3bn (a significant improvement on the loss of €5.5bn in the preceding year), and adjusted negative free cash flow of €0.9bn (vs. negative FCF of €3.7bn in FY 20). Lufthansa's free cash flow benefited from the turnaround in the company's cash from operating activities to a positive €0.6bn, compared to the negative amount of €2.3bn in the preceding year, while gross capex remained at a similar level of approximately €1.3bn. Adjusting Lufthansa's free cash flow further by €0.8bn of the tax payments deferred from 2020, adjusted free cashflow would have been close to breakeven at negative €45mn in FY '21.

In 2021, Lufthansa benefited from the structural decrease in its personnel costs of approximately 10% relative to the pre-Covid 19 levels. Also, during the year, Lufthansa

Cargo had a record performance, almost doubling its adjusted EBIT year-on-year to €1.5bn (from €0.8bn in FY 20).

In 2021, passenger numbers reached 47mn, up 29% YoY, and the number of flights increased by 18% YoY, with available seat-kilometres up 32% YoY. The offered capacity rose from 21% of the 2019 level at the beginning of last year, to approximately 60% at the end of it, to amount to approximately 40% on average for FY '21.

Last year, Lufthansa had multiple fundraising activities, including issuing six bonds, 20 aircraft financings and an equity capital increase, leading to the repayment of the WSF (German Economic Stabilisation) funds in full. At the end of 2021, Lufthansa had access to liquidity to the tune of €9.4bn.

Lufthansa's management expects a strong travel season in 2022, with the summer capacity on short and medium-haul routes close to the 2019 levels and bookings for the Easter period and summer partially above the pre-crisis levels. The company says that it is confident there will be a strong upswing in passenger traffic this year, reflecting the pent-up demand for leisure and business travel, which was already noticeable during the prior year, while risks include the fallout from the war in Ukraine and related geopolitical uncertainties.

For the summer season, Lufthansa expects to increase available capacity to around 85% of the 2019 levels, while on short- and medium-haul routes, the figure is expected to reach around 95%. For FY '22, Lufthansa Group expects an average capacity of over 70% of the 2019 levels.

In 2022, Lufthansa anticipates further improvements in adjusted EBIT and adjusted free cash flow, despite the notable cost inflation, including traffic control and airport charges and fuel costs, partially mitigated by fuel hedges. The improvements are likely to manifest themselves more after 1Q of this year, which was still impacted by the Omicron variant of Covid-19.

IAG

In 2021, International Consolidated Airlines Group (IAG), had total revenue of €8.5bn, up 8% YoY, including passenger revenue of €5.8bn, up 6% YoY, and an operating loss before exceptional items of €3.0bn (compared to the loss of €4.3bn in FY 20). In FY 21, IAG had negative EBITDA before exceptional items of €1.0bn but managed to achieve a positive EBITDA of €0.25bn in 4Q of the year for the first time since the start of the pandemic.

The company had negative free cash flow of €0.3bn in FY21, but with the very low level of gross capex of €0.7bn, partially offset by the asset disposals of €0.5bn. IAG's net cash from operating activities for the year was negative €0.1bn, helped by the substantial positive operating cash flow of €1.0bn in 2H 21. At YE '21, IAG had liquidity of €12.0bn.

In 1Q '22, the company expects capacity to be around 65% of the 2019 levels, with the quarter expected to be loss-making at the operating profit level due to the impact of the Omicron variant, operating costs of restoring capacity and due to the normal annual seasonality. IAG noted that bookings have been strengthening for the Easter and summer periods, with the capacity in 3Q '22 expected to be at approximately 90% of the 2019 levels and planned full restoration of the North Atlantic routes for that quarter.

For FY '22, the company expects to be close to 85% of the 2019 levels and for operating profits to be positive from 2Q onwards and significantly positive for the full year of 2022. IAG guides for net cash flows from operating activities to also be "significantly positive" for FY '22.

Of note is a significant increase in the gross capex budget in FY22, to €3.9bn (compared to just €0.7bn in FY 21), driven by the need to restore the capacity to the pre-pandemic levels and due to the delay in the delivery of aircraft and deferred pre-delivery payments from 2021.

Author

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.