Bundle | 28 June 2023

ING's global transport and logistics sector outlook

Pandemic extremes have started to fade, but the transport and logistics sector is still experiencing the ripple effects of normalising consumer behaviour and prolonged capacity issues. We examine the outlook for the sector in the second half of the year going into 2024

In this bundle

Transport & Logistics

Global aviation outlook: Air fares climb higher amid the unprecedented recovery of travel

The recovery of air travel will continue this year and next. People are keen to fly despite rising ticket prices

By Rico Luman and Oleksiy Soroka, CFA

Article | 28 June 2023

Global transport and logistics outlook: normalisation in a different world

Pandemic supply shocks have faded, but the transport and logistics sector is still experiencing the ripple effects of normalising consumer behavior and prolonged capacity issues

This article provides an overview of the transport and logistics sector. In our outlook, we discuss shipping in more detail here, container shipping here, and aviation here.

A change in transport and logistics in the wake of the pandemic

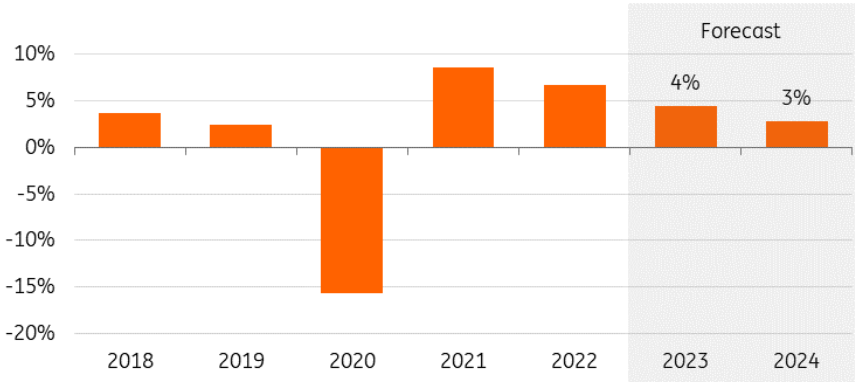
The transport and logistics sector will see growth of 4% in 2023 and 3% in 2024.

While the extremes of the Covid-19 pandemic supply shock have faded, the sector is still witnessing the ripple effects of normalisation in consumer behaviour and prolonged capacity issues. At the same time, the economy is slowing and industrial production is slumping.

The supply shock from the pandemic and the impact of the war in Ukraine have also left their mark on various parts of the transport and logistics sector. Either long because of excess capacity after a historic boom (in container shipping) or short because of lagging deliveries of aircraft and capacity-absorbing rerouting because of sanctions (in shipping).

While consumer goods logistics is facing a correction, there is a sunnier outlook for aviation which is benefiting from pent-up travel demand, while public transport is turning busier again as well.

Global transport and logistics sector slows as post-pandemic rebound fades



Source: ING Research based on Oxford Economics

Airline passenger demand outweighs the slowdown in goods

For (inland) goods transportation, 2023 will, on balance, be a year of stagnating tonnage and some segments will show declines. On the passenger side, however, it's the opposite. The pace of recovery is exceeding expectations since travel has opened up post-lockdowns and restrictions. As consumers continue to prioritise travel, the double-digit rebound of aviation is helping to push growth in the global transport and logistics sector to 4%, exceeding global GDP growth. After the unprecedented drop in 2020, the sector will exceed its pre-pandemic level by the end of the year.

After digesting the initial 'after shocks', the global economic slowdown will have a stronger impact in 2024, leading to a more challenging year for most of the sector.

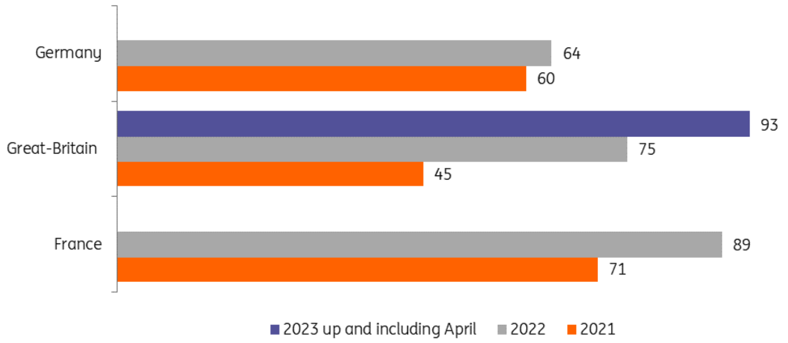
Public transport volumes continue to recover more gradually

For public transport volume, 2023 will be a year of continued recovery as well. Rail figures in European countries were still significantly below pre-pandemic levels in 2022. Full recovery won't be reached in 2023, but figures are trending up and weekends are relatively busy.

Early indicators from the UK show a strengthening recovery this year (to 93% of pre-pandemic levels). There is a similar trend in public transport figures in the Netherlands, another services-driven economy where working from home is part of the new normal. On the other side of the Atlantic – in the US – public transport is picking up at a similar rate, recovering to 72% of pre-pandemic levels in May 2023, up from 62% a year earlier.

European railway passenger transport recovery continues in 2023

Number of railway passengers transported per country, index2019 (baseline) = 100



Source: Eurostat, ONS, ING Research

2024 will be more challenging year for many logistics companies

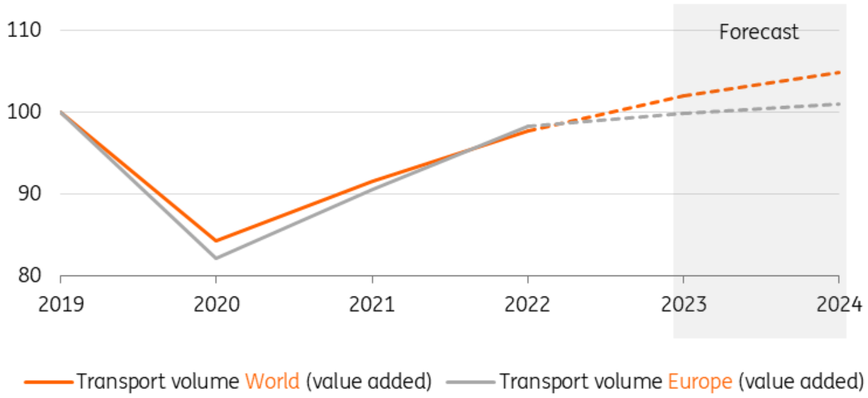
On the goods side, recent stretched and vulnerable supply is helping transport and logistics companies navigate their way through a phase of lower demand. With shortages fresh in mind, companies in road transport have managed to pass on higher costs fairly well despite a sluggish market. In container shipping and logistics, locked-in higher rates – accounting for more than half of the volume – will expire in batches over 2023, leading to falling profits into 2024.

Higher transport activity in Asia as economies catch up

While advanced economies including the US and the EU are struggling to avoid recession, China's economy is bounced back after its post-pandemic re-opening, and India is returning to trend growth. This geographical mixed picture means that transport activity in Asia will grow faster. A relevant factor here as well is that Asian airline traffic lagged for much longer in the aftermath of the pandemic, and Asian intercontinental airline passenger numbers are catching up stronger now.

Global transport and logistics sector surpasses European sector in the aftermath of the pandemic

Development value added transport, logistics and storage sector and global GDP (Index 2019 = 100)



Source: ING Research based on Oxford Economics

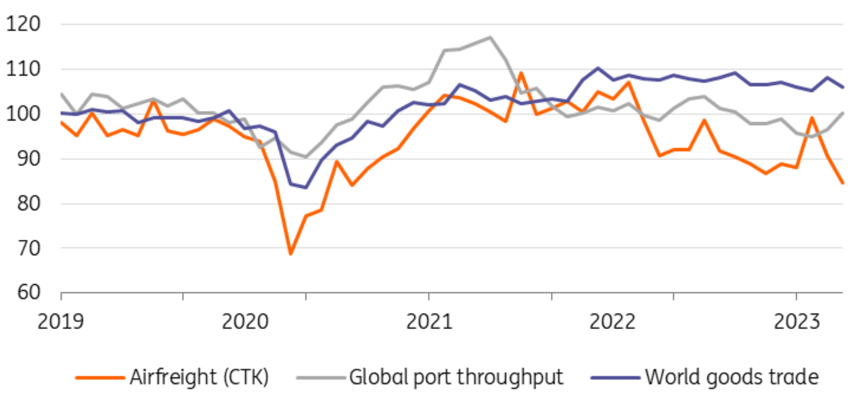
Excess inventory cuts will impact transport activity

After surging during the pandemic, container trade suffered a setback in the final months of 2022 because of a shift away from consumer spending on goods alongside the economic slowdown. Shippers had to adjust to earlier piled-up stocks in the second quarter of 2023. Effectively, this has created an accelerated slowdown (reverse bullwhip effect) across supply chains, especially in consumer products. This was most prominently felt in US logistics, but also in Europe as reflected in significantly lower container throughput in ports in the first quarter of the year.

A global wind of protectionism also hasn't helped, for instance in automotive parts. More rules and restrictions complicate trade and make it more costly and less beneficial. As outlined earlier world trade faced a correction and will only grow slightly in 2023 and 2024.

World trade flattens, air and sea freight slump on consumer products correction

Indices global trade, airfreight traffic and global ports throughput 2019 = 100



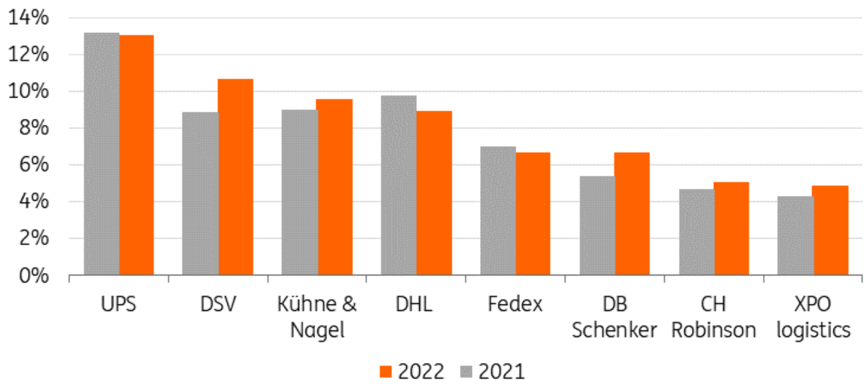
Source: CPB, IATA,RWI, ING Research, last data point: April

Air cargo slumps – signaling lingering freight market weakness

Air cargo has suffered a double blow over the last year, not only from reduced spending on higher value consumer products – which comprises the majority of its volume – but also because of the shift back to sea transport after the immediate supply chain issues were resolved and the price gap increased. Mounting working capital costs for goods in transit couldn't compensate for that.

Logistics services providers boosted margins amid rebound and disruption

Operational margins of large global logistics sercvices providers (EBIT) in % per year



Source: Annual reports, ING Research

Logistics companies have managed to keep up margins fairly well, but 2023 will be more challenging

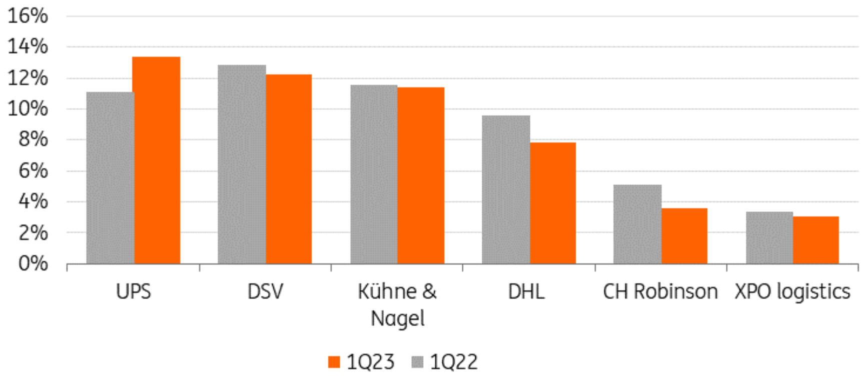
After a few strong years, the deterioration of global trade volumes will also start to impact logistics services providers. Intermediate logistics players active in sea freight, in particular, have been exposed to plummeting container rates. Spot rates on the China-Europe trade were as much as 80% lower in the first quarter of 2023 on a yearly basis. This isn't being transferred into company financials immediately, but the turnover of C.H. Robinson, DSV and Kühne + Nagel dropped by roughly a third between the first quarter of 2022 and the first quarter of 2023. Margins have kept up relatively well, but given the decline of rates in container shipping and air cargo, it seems logical to expect further deterioration going forward.

E-commerce logistics returns to lower trend growth

Another after-shock has occurred in e-logistics. After the post-pandemic reopening, the global e-commerce surge came to an end in 2022. The correction means a return to a slightly lower trend growth rather than a structural turnaround. E-commerce volumes have been picking up again in the first half of 2023.

Margins for logistics services were still solid at the start of 2023

Operational margins of large global logistics sercvices providers (EBIT) in % per year



Source: Annual reports, ING Research

Three developments shaping the future of transport and logistics

Supply chains continue to improve but are less robust than before

Global supply chains continue to stabilise in 2023, and much of the congestion in shipping and port capacity has been solved. But it will also take time to fully digest the effects of the pandemic and war-related supply shocks. Lead times of airfreight and containerised seafreight are still longer compared to pre-pandemic standards and arrival performance rates still have upward potential. In the highly regulated aviation sector, spare part supply is an ongoing constraint and consequently aircraft manufacturers are limited in ramping up production.

Global logistics will not return to the previous 'normal' due to many reasons:

- Commodity trade patterns have adjusted to sanctions on Russia. This is most visible in energy commodities trade to Europe and more indirect trade flows. On balance, this leads to reshaped routes, less efficient trade and more sea miles – which benefits tanker shipping.
- The US is attempting to ramp up regional production to move away from its dependence on China, increased with digitalisation and the shift to green technologies like electric vehicles. This is a long-term process. So far, we don't see massive deglobalisation, but rather diversification. In Europe, the Supply Chain Due Diligence Act could impact sourcing routes.
- Supply chain uncertainty probably remains higher. Structural labour market shortages are a reason for this, and an increase in climate change-related (extreme) weather events also pose a larger disruption risk. The restrictive low water levels on the Panama Canal – a crucial link on the Asia-US East Coast trade – are a recent example, and the return of El Nino could also lead to extreme weather going forward.

Logistics is higher on the agenda of shippers

Supply chain resilience remains more important for shippers in the post-pandemic world, and contract logistics can benefit from that. Shippers seem to be sticking to higher buffer stocks to increase supply chain resilience. With the lessons learned from the pandemic, supply chain management (and risks) are still high on the agenda. Logistics services are structurally more profitable than A to B transportation. This is one of the strategic drivers of the trend of integration and end-to-end supply chain management, pursued by container liners such as Maersk, CMA CGM and MSC.

Global CO_2 emissions in transport slow down, but much more is required to get on the net-zero track

Before the pandemic, the total transport sector accounted for a fifth of global CO_2 emissions, with road traffic making up three-quarters of it. From an economic and business perspective, CO_2 emission development is increasingly important. CO_2 emissions have their price and this will gradually be incorporated into business models, since shippers and operators are increasingly pushing for progress with regulatory pressure, sustainability reporting obligations and corporate ambitions. The European emissions trading system (ETS) is already introducing carbon pricing for aviation and shipping.

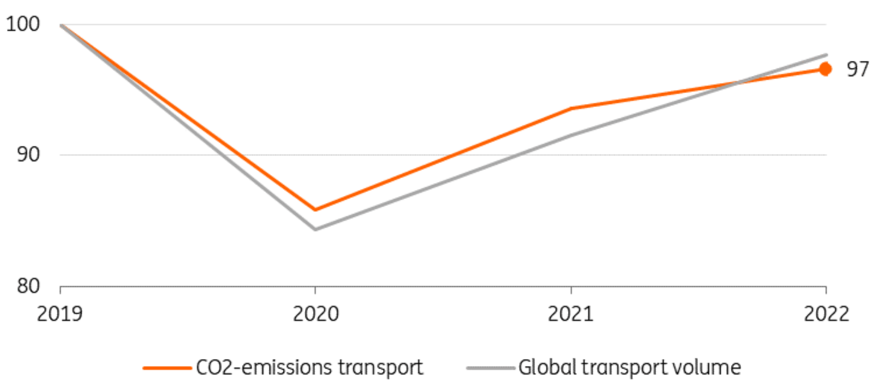
CO_2 emissions in transport (also including autos) dropped by more than 16% during the pandemic, with falling road traffic and the collapse of airline traffic. With combustion engines returning in larger quantities on motorways in 2021 and more aircraft returning to the skies in 2022, CO_2 emissions returned to 96.5% of pre-pandemic levels last year.

Given the progress in electrification within the global car fleet (in 2020, 1% of the global stock was electric, rising to 2.5% in 2022, including plug-in hybrids), but also efficiency efforts in trucking, aviation and shipping, transport CO_2 emissions are expected to continue to rise at a lower level than demand. This means the average carbon intensity of transport activity will decrease.

Electrification of the global car fleet continues, and in aviation the strong rebound in passenger numbers is likely to offset gains made by using more sustainable aviation fuels. The International Energy Agency expects oil consumption of transport to start declining after 2026.

CO2 emissions rebounded less than transport volumes in 2022

Index global CO_2 emissions from transportation and global transport volume (added value) (index, pre-pandemic base 2019 = 100)



Source: IEA, ING Research

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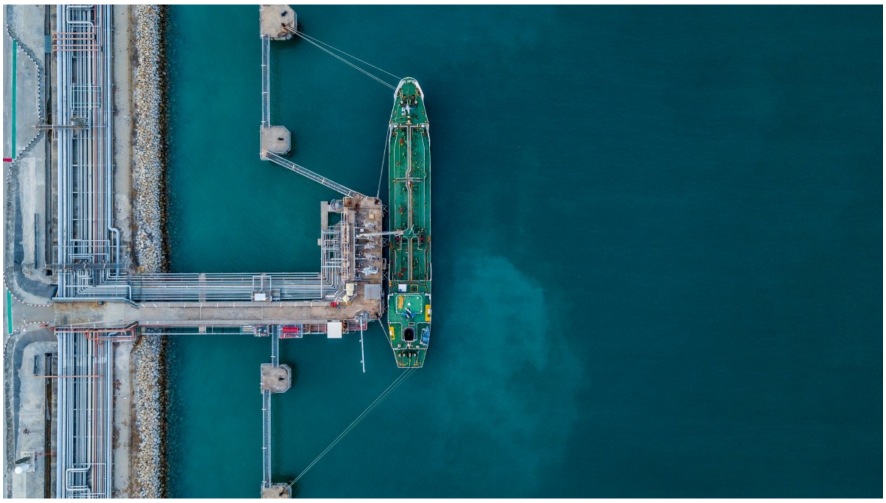
Global shipping outlook: It's all about capacity as the tide turns

We expect shipping to post a stronger second half of 2023 once consumer spending on goods picks up alongside a normalisation of spending patterns and reduced inventories

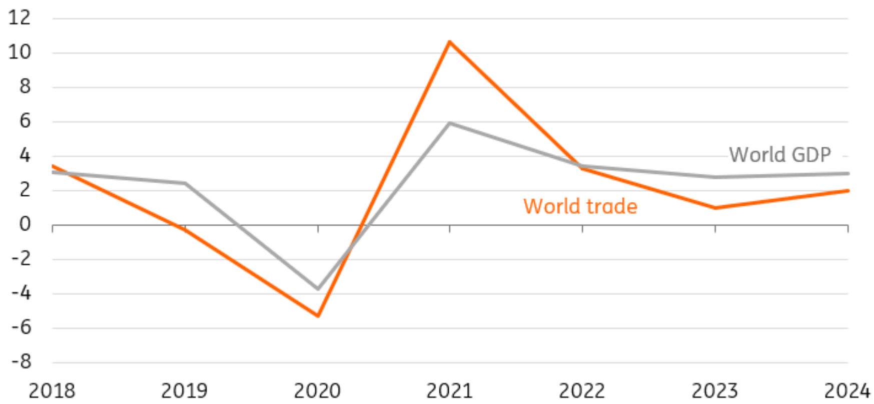


Global trade is changing and so is shipping

Global trade slipped into contraction at the end of 2022, following the rationalisation of piled-up inventories and the economic and industrial stagnation in the US and Europe. Global trade has also entered a period of lower growth due to geopolitical concerns, protectionism, and supply chain reconsiderations. Growth is therefore set to remain low into 2024 and this means that shipping tonnage is also under pressure. Nevertheless, we still expect a stronger second half of 2023 once consumer spending on goods picks up alongside a normalisation of spending patterns, reduced inventories and wage growth.

World merchant trade growth to lag GDP development in 2023-24

(Development volume in % YoY)



Source: IMF, CPB, ING research

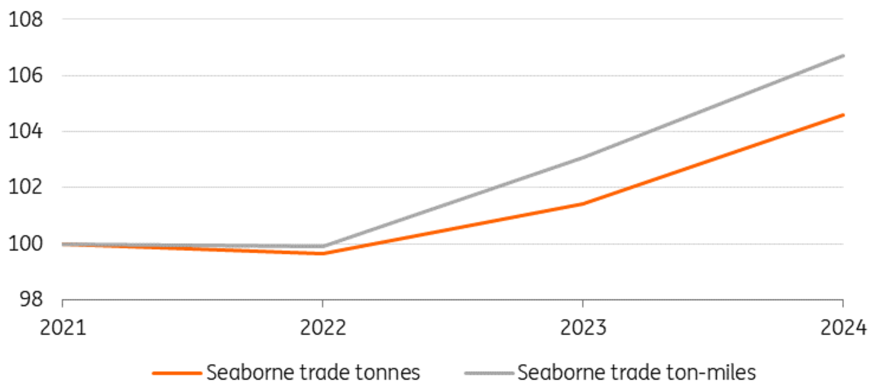
Against the backdrop of faltering economic growth in advanced economies, and emerging economies returning to their trend growth, trade activity is unequal across the world. Consequently, the development in intra-Asian traffic is likely to exceed the global average in 2023 and 2024, and the Middle East and Africa will follow suit. Therefore, regional deployment across the globe will make a difference in carrier performance.

Faltering trade isn't the full story: longer trade routes push shipping demand higher

Shipping activity is holding up better than world trade figures suggest, specifically on the (liquid) bulk side. The massive reshaping of shipping routes following Russian sanctions – which we explain in more detail here – has led to significantly longer mileages. Russian oil, gas, coal, iron ore and metals trade are still finding their way to markets, but to different buyers. With sanctions on Russian commodities coming into effect in batches, this will materialise in 2023 when seaborne ton-mileages are expected to gain more than 3% compared to a year earlier, which is more than the 1% trade growth we expect. With no signs of a reversal in policy, these extra miles will remain in place in 2024.

Trade is sailing longer distances following sanctions on Russia

Global seaborne trade growth (2021 = 100)



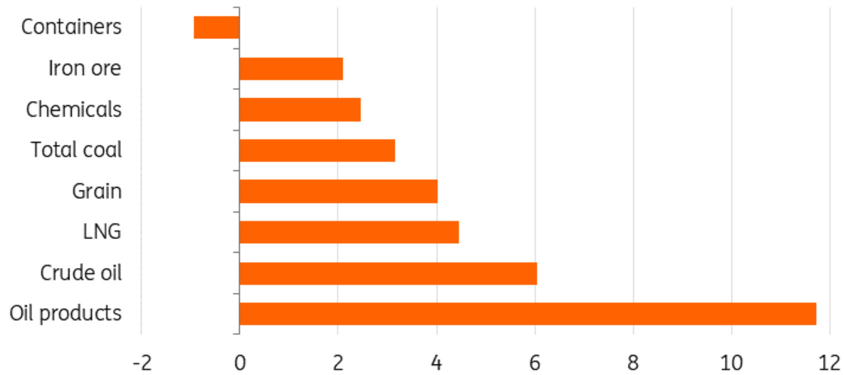
Source: Clarksons, ING Research

Tanker shipping is holding up better

The impact of longer routes is most prominent in tanker shipping, with Russian oil flowing to China and India at a discount instead of making a short haul to Europe. Western countries (G7) on the other hand have shifted away from importing Russian crude and oil products, and have started to import more crude oil from Saudi Arabia and the US and refined oil products like diesel from India. This is pushing the expected growth in global oil product shipping up to double-digit levels in 2023, while tonnage demand will increase by just 4%. Similarly, crude trade is being pushed up and to a much lesser extent this also impacts dry bulk shipping (coal, iron ore).

Oil product shipping demand will see a continued rebound in 2023

Seaborne trade growth forecast in tonne-miles (% YoY) in 2023



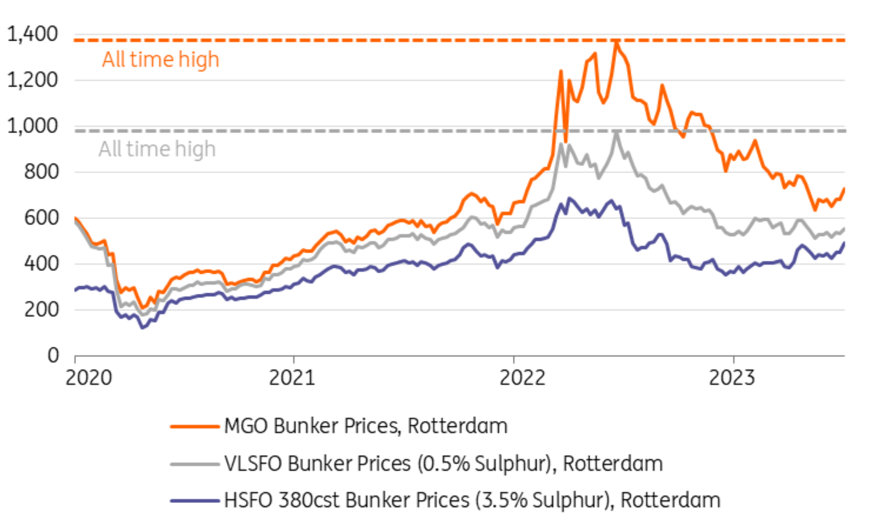
Source: Clarksons, ING Resarch

Challenging market dynamics in container shipping follow historic boom

Container shipping will leave the extraordinary pandemic years behind in 2023. A combination of high demand for consumer goods and multiple supply interruptions sent rates and profits to unprecedented levels over the last two years. But this is changing rapidly now. With a mix of demand adjustment (and a mild contraction in 2023), resolved port congestion and a range of newly-ordered vessels coming online, elevated spot rates have plummeted as the market power shifts to the buyer side. After two exceptionally profitable years, container liners are financially resilient though. Find our analysis for the container sector here.

Global bunker fuel prices in shipping have come down after 2022 highs

Bunker fuel prices (Rotterdam) in $ per tonne



Source: Clarksons, ING Research, last data point 6/9/23

Bunker prices are down against an inflationary backdrop

Shipping companies also face higher general price levels, but the costs of the most important cost fraction have come down. On most occasions, the charterer pays for the fuel, but exposure also depends on contractual arrangements, and container shipping carriers usually pay the fuel bill. So, price development does make sense. Compared to 2022, heavy fuel oil (HFO) prices (burned in combination with scrubbers) traded about 30% lower than a year earlier in the first half of 2023. Low sulphur-compliant fuels like VLSFO (very low sulphur fuel oils) and MGO (marine gasoil) have dropped more significantly compared to last year, leading to narrowed fuel spreads. This makes the case for installing scrubbers (in 2022 on 13% of the global fleet) less attractive, although pressure on results could lead to revived attention for the cheapest fuel. The oil market remains strained though and price risks remain skewed to the upside.

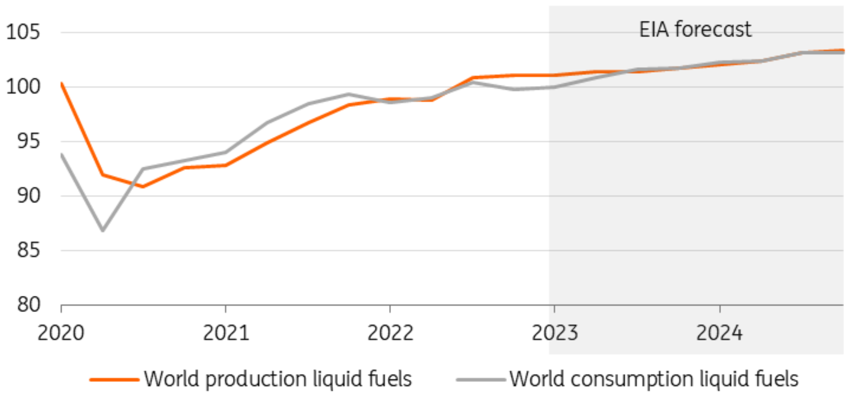
On the back of an increasing number of dual fuel vessels in the fleet, it's also relevant to look at liquefied natural gas (LNG) prices. Over most of 2022, LNG propulsion was very expensive and probably out of sight as an alternative for most companies. Prices have fallen steeply to $500 per tonne this month, but the increased global demand and the rush to attract LNG to replace piped gas in Europe still weigh on the attractiveness as a fuel and upward price risks for the rest of 2023 remain.

Tanker shipping to continue to benefit from a tight market

Contrary to container shipping, the liquid bulk market is enjoying strong fundamentals. Global oil usage is expected to grow more than 2% year-on-year in 2023, and having recovered from the pandemic global jet fuel consumption soared about 30% in the first half of this year. But the most impactful is the recalibration of trade routes following the sanctions imposed on Russia. This turned into a less efficient deployment of the fleet and the creation of a significant 'shadow fleet' of generally older tankers operated on behalf of Russia as G7 countries agreed not to ship any Russian crude oil products below the $60 cap. Find our views and forecasts for the oil market here.

Tanker trade flows expected to see ongoing moderate growth in 2023-24

Global liquid fuel production/consumption volume (mln. bbls per day)



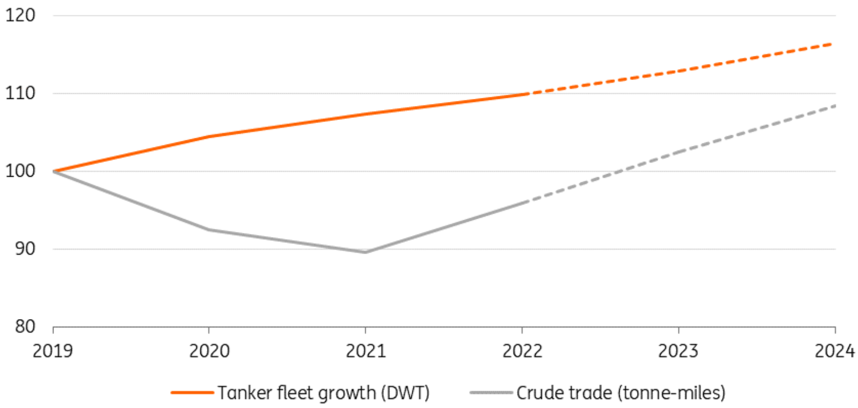
Source: EIA

Scrutiny of new tanker investments leads to structural capacity tightness

With lifecycles exceeding 20 years, potential investors in new-build tankers are increasingly wary of energy transition risks (stranded assets) and peak oil is expected for 2028, although current oil demand is still strong. The total tanker order book level in 2023 reached its lowest level since 1996. There are hardly any very large crude carriers (VLCC) on order (in June there were just 12, which is 1.3% of the total installed base). The demolition of tankers almost came to a standstill in 2023, with Russia also seeking capacity, but it will also turn relevant for market players to extend the lifecycles of existing tankers. This will probably also translate into stronger second-hand prices.

(Crude) tanker trade capacity is tightening

Index growth tanker fleet (DWT*) vs crude trade growth (tonne-miles), 2019 = 100



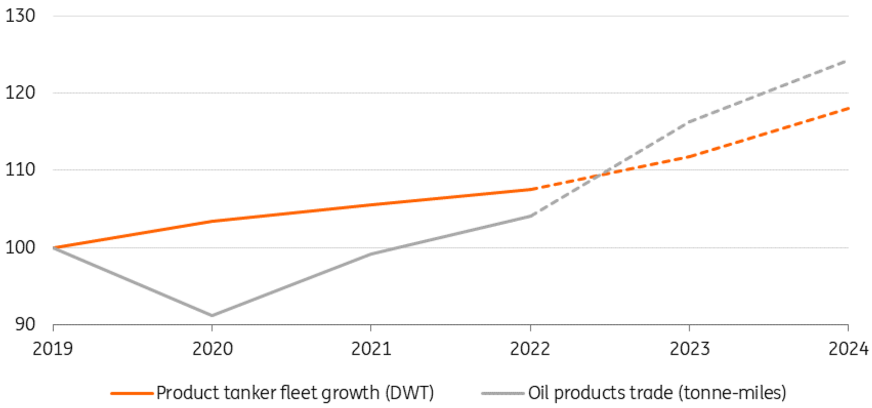
Source: Clarksons, ING Research *dead weight tonnage, tanker fleet excluding product tankers

Tanker market fundamentals remain strong

Looking at low order books, current fleet inefficiencies and the expectation that global demand for oil products won't reach a turning point over the next few years, the market will continue to be tight and profitable for tanker owners and operators. This especially holds true for product tankers. Orders of new product tankers have so far picked up in 2023, but strong shipping demand on longer journeys exceeds capacity, meaning utilisation rates and market pressure is rising.

Product tanker demand exceeds capacity growth

Index growth tanker fleet (DWT*) vs. oil products trade growth, 2019 = 100



Source: Clarksons, ING Research *dead weight tonnage

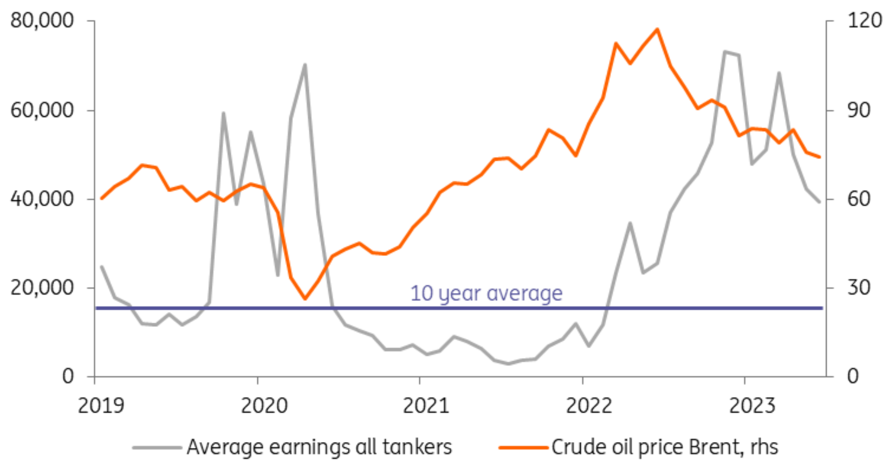
Tanker rates expected to remain elevated

In the run-up to the Russian invasion of Ukraine and subsequent sanctions, tanker rates started to rise rapidly. Despite easing since, rates remain relatively high (around $40,000 per day, over double the 10-year average). Trades to Russia (within the oil price cap) currently generate substantial premiums for shipowners. Based on the current tight market dynamics, tanker rates are set to remain strong.

Of course, the oil market always remains subject to uncertainty and volatile oil prices. New policy interventions are possible and strong sways in oil prices could lead to more or less floating storage which proved to have a strong impact on tanker market rates in 2020 when a strong contango led to price spikes.

Tanker rates still strong on tight capacity mid-2023

Average tanker earnings in $ per day and crude oil price (Brent)



Source: Clarksons, ING Research

Rush for LNG leaves tanker fleet tight, but massive inflow of new capacity is coming

The LNG tanker market has drawn quite some attention recently. Demand for LNG shipping has been strong this year and will rise again by more than 4% in 2023. Growth is being supported by the reopening of the important Freeport European countries seeking to replace Russian piped gas imports, which has pushed up demand and many new (floating) terminals are being realised and planned. In Asia, China and Japan are large importers of LNG. For exporting countries, particularly the US and Qatar, and also many African countries, production investments are made to raise production.

For LNG carriers though, there's a significant order book which exceeds 50% of the current fleet in June 2023 (330 vessels). Most of them are being delivered by a few specialised shipyards, which has pushed prices for new 170.000 M3 tankers up from around $200m to $250-260m. Most of them are set to be delivered from 2024-26, which will lead to a double-digit annual expansion of fleet capacity in those years.

Global economic slowdown tempers volume growth of ore and coal

Dry bulk shipping handles a diverse mix of cargo but generally leans heavily on global industrial activity. Production struggles will grow amid faltering consumer demand and higher interest rates curbing investment activity in the Western world. Seaborne trade of iron ore and coal is highly dependent on Chinese industrial production and the reopening of Chinese factories helped volumes to grow in 2023. But the economic rebound in China, and thus steel demand, has been weaker than expected. So production remains significantly lower in 2023 than its 2020 peak level.

But Chinese domestic demand supports bulker flows

Bulker trades are benefiting from domestic demand in China this year, which is also being stimulated by the government. Despite climate pledges, China continues to open coal-fired plants for energy purposes (no less than 50 in 2022), leading to extra thermal coal demand.

China lifted the ban on coal and iron ore from Australia, which is relevant for bulker routes, although the net impact in terms of tonnage of this is limited as trades were shifted to Indonesia and other parts of the world.

In Europe, coal has made a temporary comeback due to the energy crisis, but demand may be tempered again in 2024 if Europe is able to wean itself off Russian gas.

Moderate growth in 2023, weakening in 2024

All in all, total global coal tonnage is expected to rise by 2% with a 3% expansion of tonne-mileages on the cards. In 2024, volumes are expected to grow only slightly. The World Steel Association expects global steel demand to be flat in 2024. In the longer run, coal trade (about 10% of total tonnage) will weigh on the bulker market perspectives as demand for thermal coal will probably start to slide after 2025.

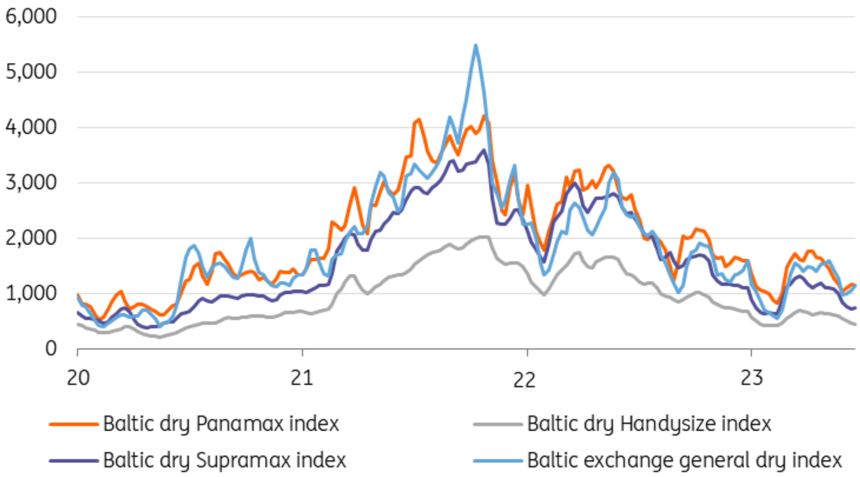
Grain trade holds up relatively well

A smaller dry bulk segment – grain – was drastically disrupted in 2022 with the blockage of Black Sea ports. Uncertainty and fragility still remain with the rollover of short-tenor agreements. Nevertheless, ports are more accessible and global grain trade is thus far better in 2023 (+4%). Without new significant interruptions, a similar increase in tonne-miles is expected for 2024.

Car carriers currently operate in an outperforming niche market in shipping. This has happened on the back of a production recovery and the rise of electric vehicles. Asian electric vehicle brands like Hyundai/Kia and BYD are gaining market share in Europe and other parts of the world, with vehicles produced in Asia. Car carriers like Höeghs and Wallenius Wilhelmsen are benefiting from rising export figures, which is also visible at Europe's largest port for overseas car imports, Bruges. These flows also have upward potential in the short run. An important factor here is that capacity can't be lifted as there are hardly any vessels on order.

Dry bulk rates softened significantly compared to 2021 and the first half of 2022

Baltic dry indices bulkers



Source: Clarksons, ING Research, last data point 06/23

Bulk rates on the weak end after a gradual decline

Bulk rates came down last year on slowing demand growth. This month, a one-year charter for a Panamax 75.000 DWT bulker was priced at $13,750 a day, which is around the 10-year average. This isn't strong when corrected for inflation. Weak expected demand growth for 2024 limits the upward potential for rates.

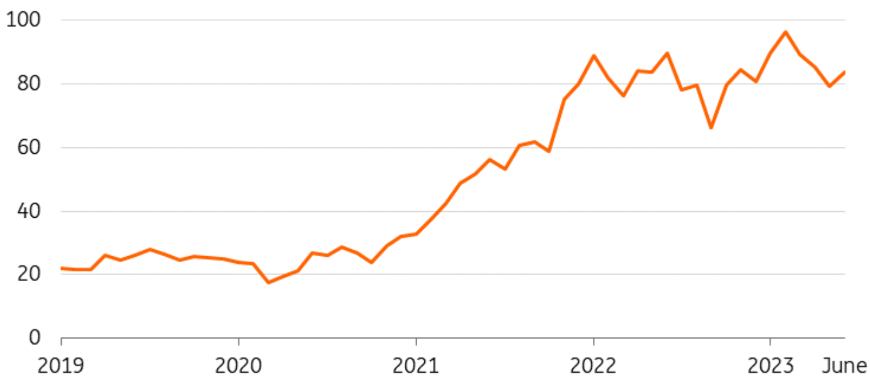
Multiple sustainability regulations are coming into force and affect existing vessels and shipping companies

	2023	2024	2025	2026	2030	2050
Europe (EU)						
FuelEU Maritime regulation Reduction of carbon intensity, compared to 2020 level			-2%		-6%	-80%
Emission Transfer System (ETS)* Share of emissions that are subjected to the Europe's carbon trading system (For vessels above 5.000 GT, Voyages and port calls within the EU are 100% exposed, extra-EU voyages count for 50%) *Find example of impact below		40%	70%	100%		
Global (IMO)						
Carbon Intensity Indicator (CII) Introduction of a carbon emission rating system (For vessels above 5.000 GT, vessels are rated and receive a carbon label A (best) to E)	start	effective				
Energy Efficiency Existing ship Index (EEXI) Introduction of a energy efficiency index for existing vessels	effective				-40%	

Source: ING Research

European carbon prices are significantly higher

Carbon spot price Europe (ETS), € per ton



Source: Refinitiv, ING Research

ETS could add 50% to fuel costs for intra-European journeys

Assuming one ton of VLSFO emits around 3.15 tons of CO_2, a CO_2 price of €80 per ton and a VLSFO price cost of $500 could push up fuel costs by more than 50%. Based on the vessel type, specific trip and port calls, as well as fuel costs and actual CO_2 prices, this could push up costs of East-West journeys by more than 20% in 2026. Operators and shipping companies will (largely) pass on these costs to charters and shippers. Carbon pricing provides a stimulus to reduce CO_2.

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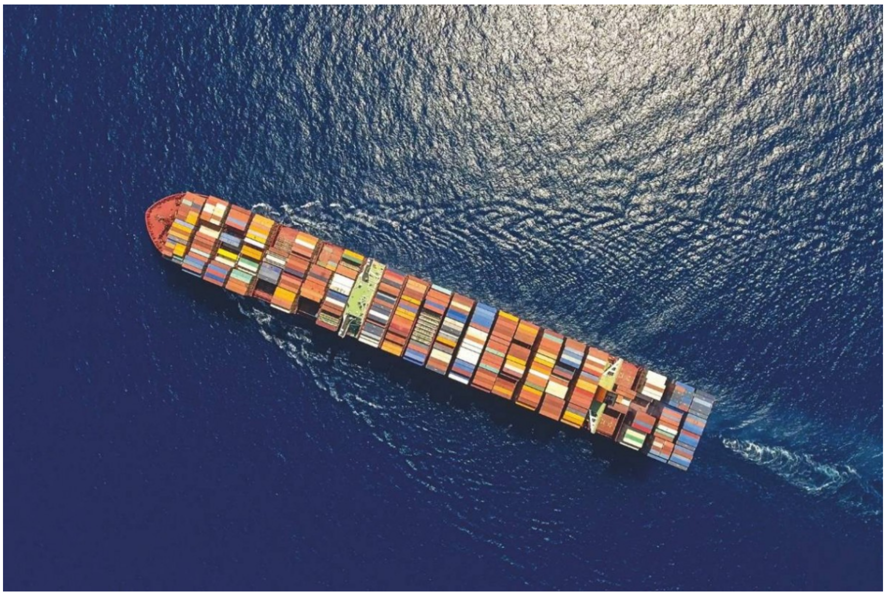
Global container shipping outlook: pressure mounts amid flood of new capacity

With consumers cutting down on their higher goods spending, the container shipping market is under pressure



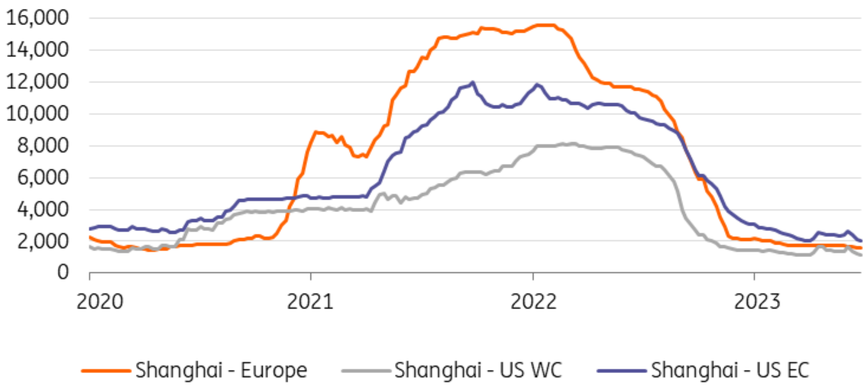
Pressure on the container market after historic boom

The container shipping market has become used to cyclicality over the decades, and it experienced an unprecedented peak in 2021 and 2022 with record rates and profits for liners.

But with consumers starting to reduce their higher goods spending, against a backdrop of a global economy reeling from an inflation shock and rapid rate increases, the demand slowdown is intense. Consequently, spot rates on major trade lanes have quickly dropped. But it's the subsequent wave of investment in new vessels that will become noticeable in the years ahead.

Container spot rates on major trades have dropped below pre-pandemic levels

Development port to port containerised freight tariffs in $ per FEU (40 ft container)*



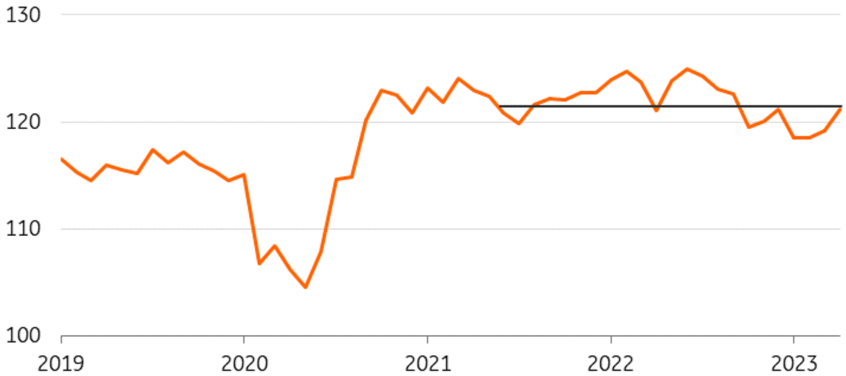
Source: Clarksons, ING Research *last data point 06/23

Container trade in contraction in 2023 but will pick up moderately in the run up to 2024

As container boxes contain food and non-food consumer products, but also capital equipment, semi-finished products and raw materials, it highly correlates with global trade. But container traffic has been more extreme recently. The empty container boom over the course of 2022 was already a signal of deteriorating market circumstances after a surge in consumers of goods and early ordering to secure deliveries. A combination of logical normalising of consumption and de-stocking led to declining volumes. European ports also faced a setback because of sanctions on Russia. Europe's largest container ports of Rotterdam, Antwerp-Bruges and Hamburg – transhipment ports to Russia – have also seen a decline in container volume and figures since the first half of 2023.

The process of normalisation is still ongoing and will leave the full year, on average, in mild contraction despite a rebound at the world's largest port, Shanghai, in the second quarter of 2023. Although the economic slowdown continues to weigh on perspectives, we do expect container trade demand to improve mildly from the second half of the year and return to about 3% growth in 2024.

Global container volume struggles to grow after pandemic surge



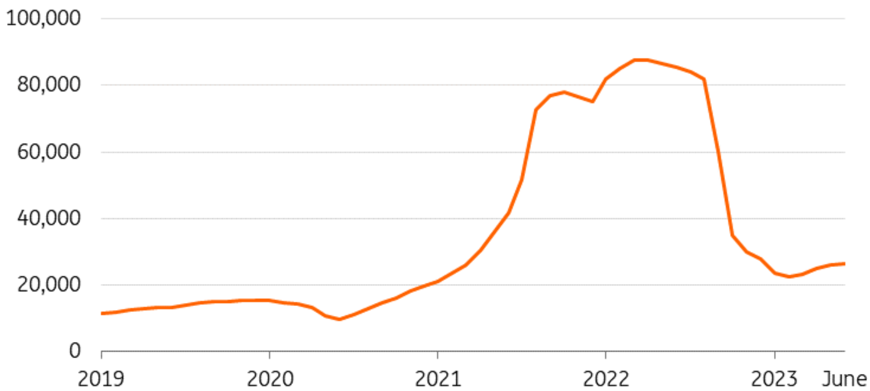
Source: RWI/ISL, ING Research. Last data point: April

Container spot rates return close to pre-pandemic levels

The composite container index CCFI continued to slide in the first half of 2023 with pre-pandemic levels close. Corrected for inflation, spot rates on the Shanghai-Europe route are trading at lower real levels in June than pre-pandemic. Spot rates are still somewhat higher than they were four years ago, but the general price level in 2023 has gone up by more than 15% in Europe, meaning $2,000 per 40ft container is now close to $1,700 in real terms. This is also the case for Shanghai-US spot rates, although East Coast rates were stimulated by a shift from West to East Coast ports and restrictions on the Panama Canal. Rates from China to other parts of the world (such as South America) also show more resilience.

Container vessel charter rates have dropped steeply, but remain above pre-Covid levels

Average container charter rates in $ per day



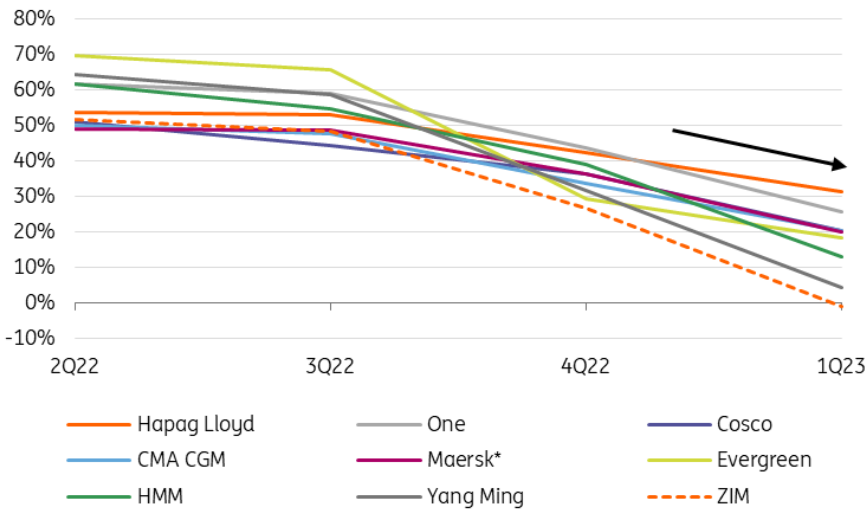
Source: Clarksons, ING Research

Six-to-12-month charter rates for container vessels and feeders in the range of 4,500-8,500 TEU have shown more resilience than spot rates and still trade significantly higher than they did pre-pandemic. And they seem to have bottomed out for now, as reiterated by the Harper-Petersen index. This may have to do with the expected recovery in the second half of the year as longer charters have shown to be weaker, but it's nevertheless remarkable.

A lower order book for this segment and diversification of production could also support demand for smaller-size vessels. For longer contracts, charter owners may also still benefit from higher rates from the past two years.

Margins for container liners are falling after record levels

Operational profits (EBIT) per container liner *container shipping activities



Source: Company reports, Linerlytica

Profitability drops steeply from peak levels

Overall container profitability level (EBIT) peaked at an exceptional 50% in 2022, similar to the year before. But that couldn't last of course. Long-term average EBIT ranges have been a mere 1% with several negative years during the last decade. EBIT levels of the largest container liners (excluding MSC) dropped from more than 55% in the second quarter of 2022 to 17% in the first quarter of this year.

Locked-in contract rates with shippers lead to a delayed profit decline in 2023

More than 50% of container volume is being shipped under term contracts with shippers. For Maersk, this was even close to 70% for the full-year 2022. Most contracts closed at peak rates expire in the first half of 2023, leading to steep declines in new rates. Consequently, plummeting spot rates will gradually feed into total transport costs in the first half of 2023. The downward pressure of supply may even lead to negative margins returning in 2024, but capacity discipline and external effects will have an impact (see more below).

Flood of new capacity is making waves in a low tide

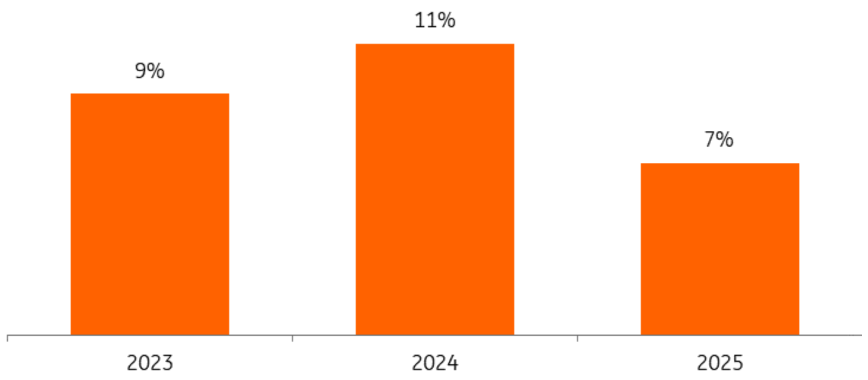
The prosperous years in container shipping sparked a surge in orders for new (large) container vessels. In March 2023, 27% of the installed fleet capacity was expected to be newly delivered between 2023-25.

Capacity on order is much lower than during peak levels before the financial crisis in 2008, but the fleet itself is also much bigger now. Given that the trend of the ongoing globalisation of supply chains is over, it may still be more challenging this time.

On the other hand, the container sector is more consolidated than it was 20 years ago. The three alliances of container liners are allowed to operate in Europe, at least until the expiry of the current block exemption in Europe and the UK on 25 April 2024 (2M will be dissolved in 2025, Ocean Alliance and The Alliance plan to continue to 2027).

Container capacity boosted in 2023-24 by inflow of new vessels

Expected capacity growth in TEU with new vessels as share of the installed fleet



Source: Drewry, ING Research

It's all about capacity in the upcoming years

The main driver of investments in new vessels is future demand, but most importantly fleet growth and more efficient (larger) vessels. More than 700 ships are expected to be delivered in 2023-24 and more than 150 in 2025. Some 45% of this is covered by Neo-Panamax size vessels (12,500-18,000 TEU) and another 20% by the largest sizes (ULCV). Feeder vessels (up to 3,000) make up just over a third of the ordered vessels and just 8% of capacity.

The push for sustainability and dual-fuel vessels have bloated the container vessel order book

The push for alternative fuels in shipping is strongest in the container segment, probably as it operates relatively close to consumers. According to shipping and trade data provider Clarksons, almost half of the total order book for new vessels consists of either LNG or methanol 'capable' or 'ready' dual-fuel vessels and these orders accelerated in 2022. Maersk ordered a range of 25 dual-fuel vessels able to run on methanol and is busy with partners creating supply in ports. Various liners including ONE-line, CMA-CGM and others will probably follow. LNG still makes up the largest fraction of alternative fuel ordered for vessels followed by methanol, but ammonia is also on the cards despite its toxicity.

Dual-fuel means that vessels are either equipped to run on alternative fuels, or that the vessel is already able to switch. In most cases, vessels can still burn fuel oil or switch to it, which provides flexibility, also in the light of price differential as a premium needs to be paid. In most cases, retrofitting vessels is not attractive. This means the surge in dual-fuel investment pushes capacity inflow up further. Find our analysis for synthetic fuels in shipping here.

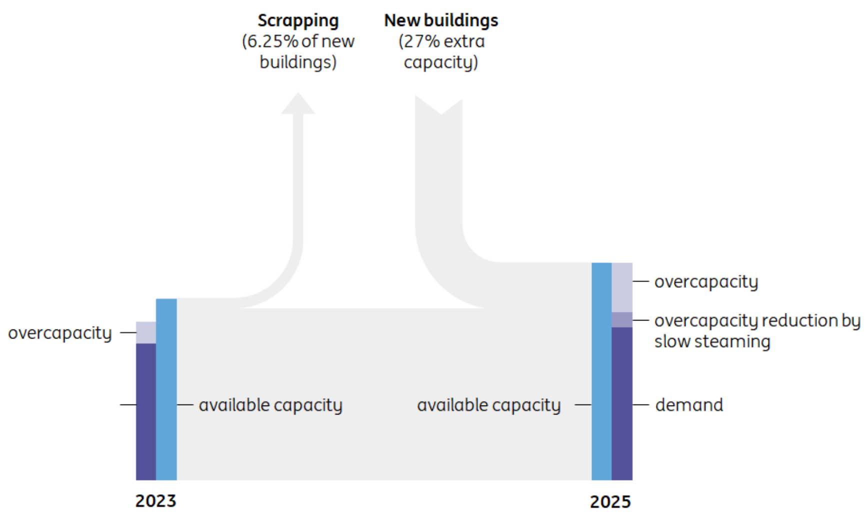
Rates are fragile and could easily go lower in 2023 and 2024

The large new capacity inflow, in combination with faltering trade growth, could spoil freight rates, as new capacity won't be absorbed by additional demand anytime soon. In addition, blocked capacity stuck around congested ports – taking out as much as 15% of capacity at its worse point in early 2022 – is increasingly being released as supply chain performance improves. Some new orders may be cancelled, but that is not expected to be massive as no one wants to lose out on efficiency progress per unit carried.

This means it all comes down to managing capacity now. The question is, how will container liners respond? So far, liners have been eager to attain market share. Occupation levels of vessels have already come down (to 75% in the first quarter) and freight rates have shown to be fragile in the second quarter and the decline could continue. Given that container liners are cash-rich, these circumstances can easily develop into a price war for a long time.

Demand growth, slow steaming and demolition will only partly offset excess capacity in the years to come

Capacity development in TEU 2023 – end of 2025



Source: ING Research

How to manage overcapacity (capacity discipline) – three options

Container liners generally have three options to stir capacity and reduce the supply overhang:

- **Scrapping:** A big question mark is how container liners will act in the demolition of older vessels. Near the end of the lifecycle, as older vessel values approach the scrapping level, shipping companies may decide to take out capacity. At the same time, liners will avoid capital losses as much as possible. Sustainability regulations could speed up demolition activity in the coming years, although it is not speeding up so far in 2023. Global shipping

branch Bimco expects scrapping to reduce capacity by about 3% in 2023-24.
- **(Super)slow steaming:** Another option to manage overcapacity is slow steaming. Sailing speed figures show that container vessels have slowed down their speeds in anticipation of new vessel inflows. In the first quarter, the average speed came down to 13.8 knots, 4% lower than a year earlier. Limited further speed reduction is still possible without suboptimality. This means for instance that one vessel can be added to the Asia-Europe loop. Slow steaming will certainly not absorb the full capacity overhang but perhaps around 5-7% of it. Part of capacity management could also be to do more sailing around the Cape of Good Hope. This extends the trip to Europe by five-to-seven days and saves around $700/k of the Suez Canal passing fare for a large container vessel.
- **Cancel (blank) sailings:** During the pandemic, carriers learned how to manage capacity (within alliances) to balance supply-demand in the short run by taking out ('blanking') sailings because of a significant slowdown. This worked relatively well, although it also affected reliability for clients. Cancelling sailings in case of sinking occupation rates is logical; about 65% of costs in container shipping are variable. The issue is, however, if carriers stick to this amid mounting competitive pressure. Figures from Lynerlitica, which provides market intelligence for the container shipping industry, suggest that this hasn't been applied that much in the first half of 2023.

Regional capacity deployment may be less impacted by overcapacity

Many ports across the world are nautically not equipped to receive the largest ULCV vessels. This is the case for ports in Brazil, India and other countries across Asia, for example. The Panama Canal isn't accessible to them either. This means that routes outside of the main trade routes could be less impacted by overcapacity, although there will be cascading. As a result, the rate picture will differ for various routes. And container liners also have various regional specialisations. MSC and Hapag Lloyd are more diversified than some other large carriers.

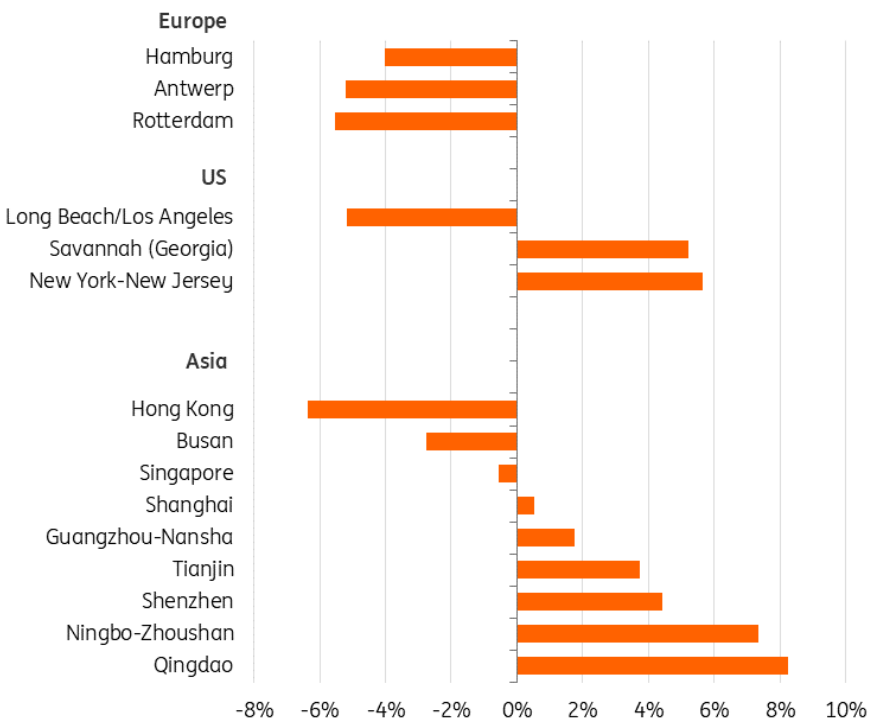
Liner investments in becoming a full supply chain services provider may cushion performance

Container liners have been using strong returns to also invest in terminals and other logistics activities such as contract logistics and aircargo to provide integrated supply chain services to clients. In that sense, they compete with logistics services providers that have traditionally fulfilled this role for a longer time.

Large container liners including MSC, Maersk and CMA-CGM have invested in terminals, but they have also created their own air cargo fleets. This will allow them to diversify their exposure. After over $300bn total profit on sector level in 2021-22, profits will sink to a fraction of the previous years' and the downward trend is expected to continue in 2023 as spot rates are back close to break-even levels and may push average profitability below par in 2024. However, the diversification strategies several large container liners including Maersk and CMA CGM, adopted may provide some cushioning for performance as margins of logistics services tend to be more stable and usally also larger than in container shipping.

European ports saw declines in 2022, while in the US there was a shift from West to East

Throughput in million. TEU in 2022 in the world's 10 largest containers ports (nine in Asia) and the largest three ports in Europe and the US



Source: Port authorities, ING Research

How have three of the largest container liners performed?

Hapag-Lloyd

In May, Hapag-Lloyd reported weak international demand for container shipping services in the first quarter of 2023 as a result of the ongoing global inventory de-stocking, leading to declining volumes transported and lower freight rates. In the first quarter, the company's shipping volumes were down 4.9% year-on-year and average freight rates were down 27.9% YoY. In the first quarter, Hapag-Lloyd reported revenue of $6bn, down 32.7% YoY, and EBITDA of $2.4bn, down 55.2% YoY. Hapag-Lloyd's management commented that the results reflected a normalisation of the container shipping market environment after the elevated levels of freight rates during the past couple of years.

Going forward, a strong inflow of new container shipping capacity is expected to be partially offset by increased scrapping activity and slower steaming. However, Hapag-Lloyd anticipates that supply will still likely outpace demand in 2023 and 2024. Furthermore, the shipping company expects demand to remain soft until the destocking cycle is completed.

Hapag-Lloyd expects a gradual normalisation of earnings during the course of 2023, with transported volumes increasing slightly during the year, bunker prices declining materially, and freight rates decreasing significantly, with the resulting EBITDA down sharply year-on-year to $4.3-6.5bn, from $20.5bn in FY22.

AP Moller-Maersk

AP Moller-Maersk (Maersk) reported a decline in revenues and EBITDA in the first quarter year-on-year, in line with the weakening sector dynamic. Specifically, during the first quarter of this year, the shipping company had revenues of $14.2bn, down 26.4% YoY, and EBITDA of $4.0bn, down 56.3% YoY. While the first quarter results were significantly down year-on-year, the company still expects it to be the strongest quarter of the year. Maersk also referred to continued destocking driving demand lower and leading to the gradual market normalisation.

In conjunction with the first quarter announcement, the company reiterated its guidance for FY23, including expected global ocean container market growth of -2.5% to +0.5% and, assuming this scenario, EBITDA of $8-11bn, down sharply from $36.8bn in FY22.

CMA CGM

CMA CGM reported first-quarter 2023 results which continued the trend seen in the final quarter of last year. First quarter revenues were $12.7bn, down 30.2% YoY, and EBITDA was $3.4bn, down 61.3% YoY. According to CMA CGM, market conditions were challenging in the transportation and logistics industry, with freight demand slowing, leading to the aforementioned "normalisation" of spot freight rates.

In the company's shipping segment, volumes transported were 5.0m TEU, down 5.3% YoY, and average revenue per TEU was $1,766, down 37% YoY. As a result, in the first quarter, CMA CGM's shipping segment revenue was $8.9bn, down 40.3% YoY, and EBITDA was $3.0bn, down 64.3% YoY. The company attributed the decline in volumes shipped to the sharp fall in household consumption of goods in Europe and North America due to high inflation and the prioritisation of leisure and travel over physical consumption. It also blamed inventory adjustment in these regions, reducing imports, in particular, from Asia, while more vibrant activity in Latin America and Africa was insufficient to offset the decline on the main East-West routes.

In terms of outlook, CMA CGM acknowledges that risks remain given the soft macroeconomic outlook, while demand may potentially stabilise later in the year. At the same time, the company notes that new capacity due to be delivered over the coming quarters is expected to weigh on freight rates. Given this backdrop, CMA CGM anticipates that the first quarter will end up being the best quarter of this year.

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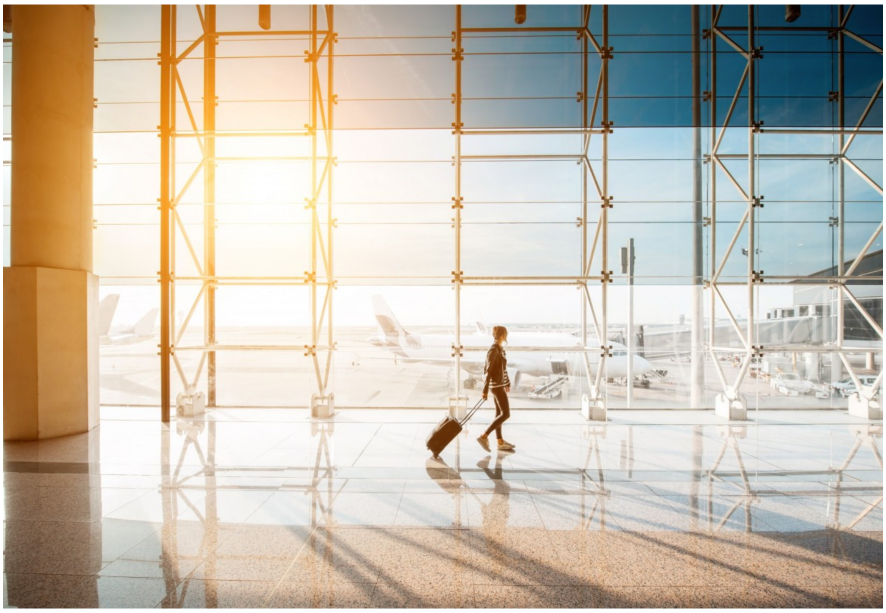
Article | 28 June 2023

Global aviation outlook: Air fares climb higher amid the unprecedented recovery of travel

The recovery of air travel will continue this year and next. People are keen to fly despite rising ticket prices



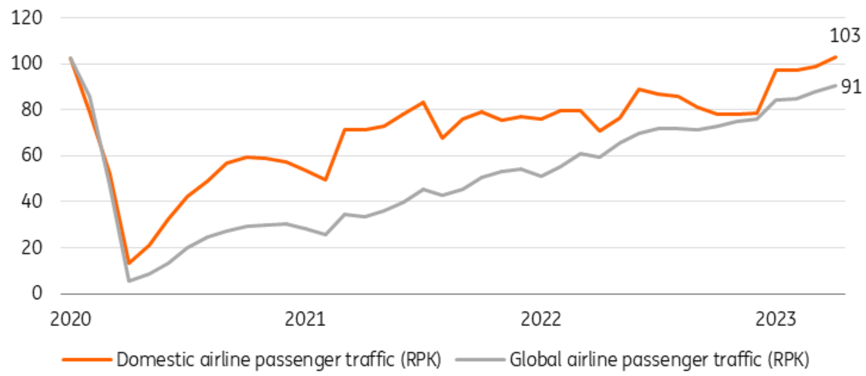
After an unprecedented drop in demand during the pandemic, the aviation sector is now witnessing a significant rebound in leisure travel

A soft landing for global aviation

After an unprecedented drop in demand for air travel during the Covid-19 pandemic, the aviation sector is witnessing a significant rebound. Travel figures for the first half of 2023 show that people are eager to fly. Despite purchasing power pressures and a global economic slowdown, people are prioritising previously postponed trips. Strong labour markets are supportive here, as just 10% of the global population in the upper middle and higher income classes are responsible for almost 90% of passenger traffic. Of course, "revenge" travel supported the recovery this year, but without restrictions and health concerns, people seem keen to resume flying more permanently, especially for leisure purposes and family visits. Domestic air travel has recovered the most so far, particularly in the US and India.

Global air traffic has recovered strongly due to pent-up demand

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



Source: IATA, ING Research, latest datapoint: April

Travel rebound relatively strong

Airlines downsized their global networks of (indirect) connections and destinations over the pandemic, and this hasn't been restored yet. For European airlines, the number of direct and indirect destinations at airports (connectivity) ended up at 71% of pre-pandemic levels in 2022. This lags behind flight activity (83% on average in 2022), which can be explained by subdued intercontinental and business traffic which is catching up more strongly in 2023.

Airlines have started to reintroduce long-haul destinations and raise frequencies at European airports, but only recently. And, of course, the war in Ukraine and the closure of Russian airspace have also had a negative impact on European connectivity.

European flight traffic continues to recover in 2023

Index flights from and to European countries* (index 2019 = 100)

Source: Eurocontrol, ING Research

*Eurocontrol area, 7dma, last datapoint 06/21

Solid double-digit recovery for aviation in 2023

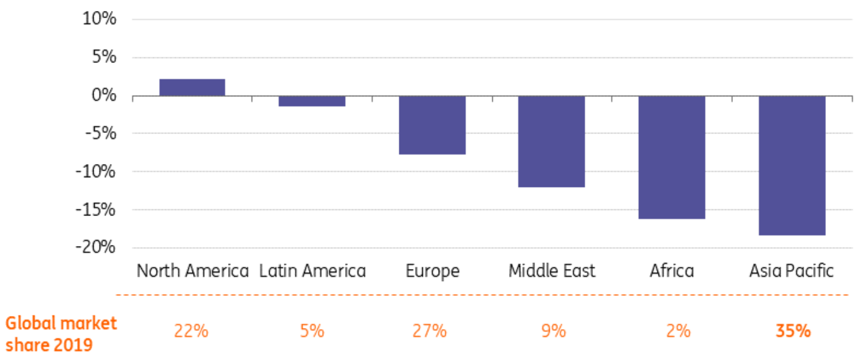
Bookings suggest that airline ticket demand across large countries and intra-Europe ("domestic") was back to around 100% of pre-pandemic levels in May 2023, while demand for international trips returned to 80% of its 2019 level. On the back of this, we expect the average annual growth for Revenue Passenger Kilometer (RPK) to hit 25% in 2023 compared to 2022. Recovery is set to naturally slow down in 2024 but will continue at a moderate pace. All in all, we expect global passenger travel volume to end up close to 90% of its pre-pandemic level in 2023, with (short haul) domestic travel at the upper end and international travelling at the lower end.

Uneven recovery across regions

Recovery isn't equal across geographies. Traffic in the US already exceeded its 2019 level in 2022, but in the Asia-Pacific, (international) traffic is just below two-thirds of its 2019 level. European flight traffic returned relatively strongly and hovered around 92% in June. Low-cost carriers make up a larger share of passenger traffic this year on the back of the leisure travel surge. This was illustrated by stronger bounceback flight activity in countries like Portugal, Spain and Greece in 2022. Ryanair even exceeded pre-pandemic passenger levels by around 15%. This shows that leisure travel has rebounded the strongest.

The world's largest airline market – Asia – has the most recovery potential

Revenue Passenger Kilometer (RPK) per region in April 2023 vs April 2019, and market shares 2019



Source: IATA, ING Research

Air travel to and from China – which finally picked up in the spring of 2023 – will strongly support the further global recovery of passenger traffic. Its global share of domestic passengers stood at 17% of RPK traffic in 2022, down from 25% in 2019. On the international side, the share was just 1% vs 9% in 2019. This implies there is ample opportunity to recover.

Other parts of Asia-Pacific, including Australia and New Zealand, show a delayed but strong recovery as well. All in all, passenger volume in the Asia-Pacific region is expected to surge more than 60% this year compared to its low 2022 base.

The Asian-Pacific market also offers the highest structural growth potential. This is not only driven by population growth but also pushed by the expanding middle class, as flying is strongly correlated with income. Flights per capita are still low compared to advanced countries. Before the pandemic in 2019, the US had 2.8 passengers per capita and the European Union 1.7, compared to 0.5 in China and just 0.1 for India.

Business travel returns, but not yet fully

Despite the cost and time benefits of the working-from-home/remote work trend, business travel has started to return as well. According to aviation analytics firm Cirium, business travel rebounded to 75% of its pre-pandemic level in 2022, with weaker recovery on shorter routes where corporates prioritised alternatives where possible. Airlines see further room for recovery.

The returning demand for wide-body aircraft from carriers is also a sign of sustained recovery in this segment. British Airways – an important airline for business travel – believes this will recover to 85% in 2023. Premium class or business seats are now also filled up by consumers willing to pay extra for more comfort.

No permanent blow for airline traffic, but lower future growth

The resilience of business travel has been underestimated, but nevertheless the pandemic will leave traces. The current rebound is being fueled by business partners seeking to catch up on physical meetings after years of restrictions, and is at least partly attributed to pent-up demand. Meanwhile, long-term growth perspectives are also tempered in the general sense, for three reasons:

- Although **business travel** is in recovery, remote working and the increase in online meetings will remain part of office work and replace part of business travel.
- **Climate awareness** is growing among consumers and there are a rising number of sustainability-linked policy measures as airlines align ambitions. Sustainable aviation fuels will start to push up ticket prices, and in Europe carbon prices (ETS) will gradually kick in more strongly the following years. Higher fares won't hold consumers back from flying, but will probably temper the pace of growth.
- **The war in Ukraine** and the closure of Russian airspace for the Western world is not likely to end anytime soon and this makes intercontinental flying less efficient. A flight between Frankfurt to Tokyo avoiding Russia is now one-to-three hours longer, which is up to 20% more fuel-consuming. European airlines also have a disadvantage here compared to Chinese airlines. In a broader sense, global **geopolitical tensions** and headwinds for international trade could drag on air cargo growth and possibly business travel.

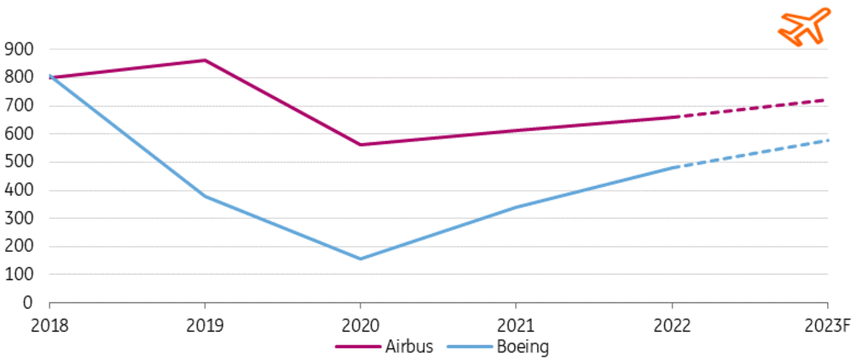
All in all, air travel is still expected to see long-term annual growth, but the figure will be closer to 3% than to the pre-pandemic 5-6% for the next two decades, with Europe probably seeing the lowest number.

Capacity is a limiting factor for airlines in 2023 and 2024

The capacity gap in aviation is quickly narrowing with the return of passengers. The load factor – a metric used in the airline industry to measure the percentage of available seating capacity that has been filled with passengers – approached its 2019 level of 82.6% in April 2023. Consequently, pressure on capacity is rising, whereas airlines face delivery delays for newly-ordered aircraft.

Deliveries of new planes is still significantly lower than pre-pandemic

Number of delivered commercial airplanes by manufacturers Airbus and Boeing



Source: Annual reports, ING Research

Manufacturers slashed aircraft production and aerospace supply chains need time to recover

Supply chain shortages have generally eased, but this isn't the case yet in the aerospace industry. Aircraft production at Airbus and Boeing has fallen sharply since 2019, while Boeing was already forced to cut production in 2018 because of the grounding of the B737 Max aircraft following software and safety issues. This turned into 1.5 years of missed output up to 2022 and production hasn't recovered yet. Delivery targets for 2023 are still around 75% of pre-pandemic numbers. Supply chains and aircraft manufacturers need 2023 and 2024, at least, to get fully up to speed. Why is this?

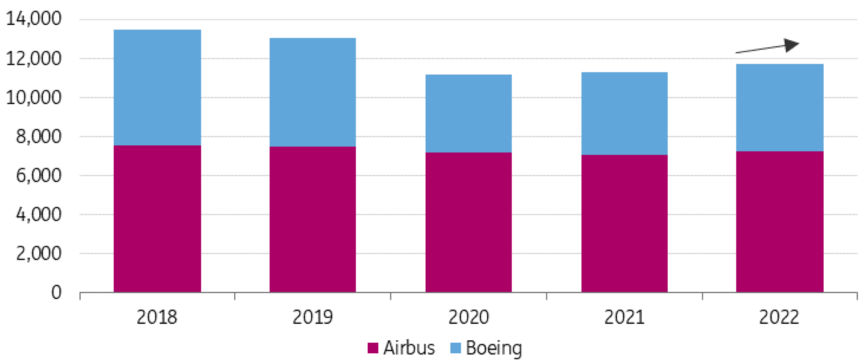
- The aircraft supply chain is complicated with large numbers of components and (certified) suppliers. Ramping up production means all the suppliers down the line need to increase production as well.
- The production of aircraft was initially reduced much more severely than the ordering intake because of interruptions and initial uncertainty about the future of travel. This had repercussions throughout the supply chain.
- Aircraft (parts) manufacturing in small series is labour-intensive and faces shortages of skilled workers.
- High safety standards and related regulations in aviation are restrictive. Components and suppliers need to be certified on behalf of the European Union Aviation Safety Agency (EASA) in Europe or the Federal Aviation Administration (FAA) in the US to comply with safety. This has become important from a legal perspective.

Order intake exceeds aircraft production increase, pushing up backlogs

Orders for new aircraft ramped up in 2021 and 2022. In these years, the total net new order intake of around 1.500 aircraft at Boeing and Airbus equalled its 2019 level. This year also shows acceleration, as the Paris airshow in June generated already orders for 1.250 aircraft. Alongside the struggle to increase production, this means order books remain packed. Based on current production levels, the backlog reaches up to 10 years. Airbus's 500-plane order by Indian budget carrier IndiGo – the largest order in history – won't be delivered until 2030-35.

Backlog of aircraft manufacturers is increasing after years of low deliveries

Airbus and Boeing order books: number of commercial planes, end of year



Source: Annual reports, ING Research

Delayed aircraft deliveries drags on fuel efficiency progress

The global commercial aviation fleet comprises about 28,000 aircraft in total and is expected to expand significantly over the next two decades. The lagging production figures result in a looming deficit of aircraft. This has revived strong leasing demand, keeping older aircraft such as B777s and A330s, with lessors – companies that lease out their fleet of aircraft to airlines – able to charge higher leasing rates. According to Cirium, parked inventory aircraft was still 5% of the total fleet above pre-pandemic levels in May, but aircraft that are good to go on short notice (an estimated 60%) are returning to service quickly. And there are also still (leased) units stalled in Russia. This means there is still some spare capacity, but this is diminishing fast and varies per aircraft type.

Several airlines have run into limitations because of postponed delivery schedules, including United Airlines, Delta Airlines and Ryanair. The cancellation of flights by airlines such as Transavia in the Netherlands illustrates the tightness of current capacity, as component delivery faces limitations as well.

The delay also has negative implications for efficiency. New generation aircraft are usually 10% to even 25% more (fuel) efficient than their predecessors. Postponed replacements slow reductions of emissions per seat/passenger km for airlines in the years ahead.

Another limiting supply factor is labour shortages in the air as well as at airports

Aircraft capacity is not the only constraint. The airline industry is also facing the challenge of staff shortages; pilots, cabin crew, as well as security, handling, and traffic control staff at airports. This has already held back traffic over the summer of 2022 and the industry still faces hiring issues. Many workers left the industry during the pandemic but vacancies are returning with the rebound. The tight labour market also poses a higher risk of labour conflicts against the backdrop of elevated inflation.

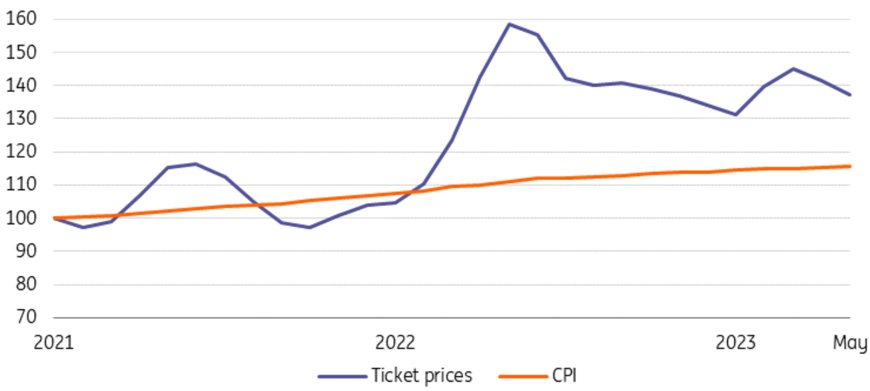
Many airlines have returned to profitability

As demand is currently not an issue and supply is limited, pricing power is with the airlines. Capacity constraints, as well as downsized networks (and frequencies), generally push up prices. US airline tickets were more than 30% more expensive in May 2023 compared to January 2022, outpacing consumer prices. Fares have dropped again over the last year, but this can be explained by significantly lower jet fuel prices (making up 20-25% of total operational costs).

The current pricing environment has been rare over the past decade due to continuous price pressures. Current market dynamics support the return to profitability. An increasing number of airlines are set to step up profitability this year. The average operational profitability of the airline sector (EBIT) is expected to recover to 2.8% in 2023, with net profits just above 1%, according to the International Air Transport Association (IATA). US airlines are expected to be the most profitable, supported by strong regional passenger volumes. Asian airlines need more time to return to profitability.

Airline tickets in the US more expensive amid post-pandemic demand rebound

Index ticket prices vs consumer price index (CPI) in the US (Jan 2021 = 100)



Source: St. Louis FED, ING Research

Flying will become more expensive

Capacity tightness currently puts upward pressure on ticket fares. But ticket prices are set to climb structurally.

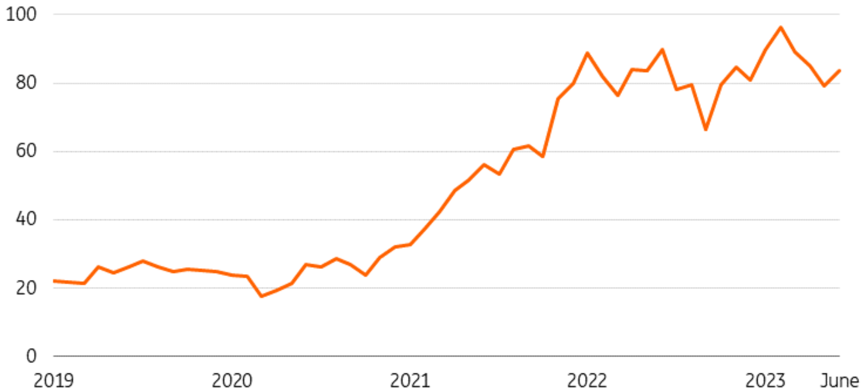
The traffic and emissions rebound in the aftermath of the pandemic also illustrate the decarbonisation challenge the sector faces. Pushed by policy and public pressure, sustainability is increasingly impacting airline markets. Airlines are investing more in efficiency measures like fleet renewal and many of them have started (joint) sustainable aviation fuel (SAF) production and blending initiatives and committed to corporate targets.

In Europe, in particular, a SAF blend mandate as well as a step up in carbon pricing (ETS) will lead to higher ticket prices in the years to come. The Refuel EU regulation requires airlines to blend 2% SAF by 2025 and 6% by 2030. Airline KLM blended a share of 0.6% SAF in 2022, but the industry average was just 0.3% and this rate will have to be raised. As BioSAF is still two-to-three times as expensive as jet fuel, this will add to total costs.

In addition, the gradual reduction in free carbon allowances from 25% in 2024 to 100% in 2027 means full carbon taxing kicks in in 2027. For a roundtrip from London to Athens (406 kg CO2), this results in a levy of €32.50 to be passed on to customers.

Carbon prices up on the back of reduction of (free) allowances

Carbon spot price Europe (ETS), € per ton



Source: Refinitiv, ING Research

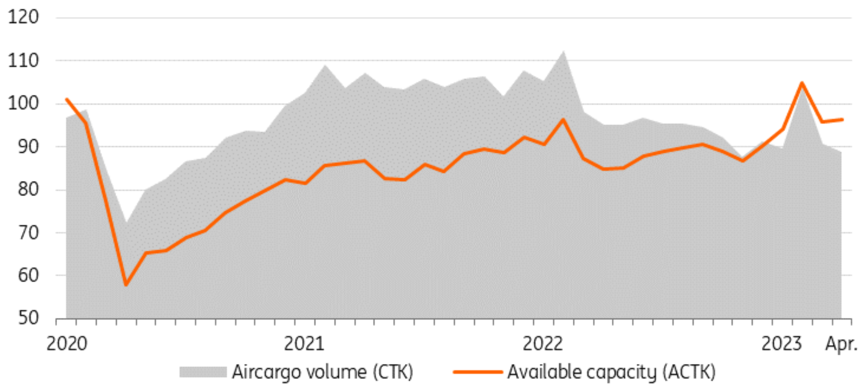
Freight market in reverse

After highly profitable years for air cargo, with global transportation over the pandemic and the circumvention of blocked supply chains, the return to normality came with a setback for airfreight. Belly capacity has returned with the gradual reintroduction of long-haul flights and a range of new freighters added by airlines, but container carriers like Maersk and CMA-CGM, and logistics services providers' capacity, has almost returned in full. At the same time, demand for high-value and time-sensitive (consumer) products has faced a correction.

Freight rates in cargo are still higher than before the pandemic, but with faltering trade growth the peak in air cargo came crashing down in 2023 and 2024. Despite dropped freight rates, cargo activities will still deliver a higher contribution to the revenue of active airlines, but rates remain under pressure. New trade routes and higher capital costs for cargo underway could provide some support for demand in due course.

Airfreight capacity returns while demand slows

Index global development of aircargo volume in ton/km (CTK) and estimated available capacity (ACTK) (2019 = 100)



Source: IATA, ING Research

How are major European carriers performing?

IAG

IAG reported a strong improvement in financial results for the first quarter of 2023, with total revenue of €5,889m, up 71.4% year-on-year, driven by higher passenger revenues of €5,041m, up 89.9% YoY, and operating profit before exceptional items of €9m, compared to the loss of €741m in the first quarter of last year. According to IAG, robust customer demand, in particular in the leisure segment, allowed the company to generate a positive underlying operating profit in the first quarter for the first time since the first quarter of 2019. The positive results were underpinned by a strong yield performance across individual group airlines and lower total costs per available seat kilometres.

IAG continued to roll out capacity in its core North Atlantic and Latin American markets, which are now back to the pre-Covid 19 levels of capacity, as well as grow Vueling's network. The company expects capacity to be around 97% of the 2019 levels for the full-year 2023.

Furthermore, the company notes that the outlook for the summer season remains positive, with customer demand remaining strong across all regions, in particular for leisure customers. At the same time, IAG noted that business travel continued to recover more slowly. The company also commented that at this stage it does not have full visibility of customer bookings for the second half of this year, with uncertainties related to the macroeconomic backdrop, including customer confidence, remaining. However, on balance, IAG currently expects its FY23 operating profit before exceptional items to come in above the higher end of the previous guidance range of €1.8bn to €2.3bn.

Lufthansa

Lufthansa Group commented that it was on track with regard to its operational objectives following the release of its first-quarter results. In the first quarter of 2023, the company had revenue of €7,017m, up 40.3% YoY, adjusted EBITDA of €272m (compared to the adjusted EBITDA loss of €32m in the first quarter of 2022) and adjusted EBIT loss of €273m (compared to the loss of €577m in the respective prior year's quarter). During the first quarter of 2023, Lufthansa Group's airlines carried 21.6 million passengers, up 64.3% YoY. The company also said that demand for the coming months is looking very good, and on the short and medium-haul tourist-focused routes customer demand is already exceeding 2019 levels. For the second quarter, Lufthansa expects capacity of around 82% of the 2019 levels and yields up to 25% above the 2019 levels, with an adjusted EBIT exceeding that of 2Q19 (of €754m).

Based on capacity offered between 85% and 90% of the 2019 levels for FY23, Lufthansa expects a significant increase in adjusted EBIT year-on-year. According to the company, this improvement is underpinned by strong bookings, elevated yields and lower fuel costs.

From a strategy perspective, Lufthansa continues to pursue its multi-airline, multi-hub and multi-brand approach. At the end of May, the company announced an agreement to acquire a 41% stake in Italy's ITA Airways, expected to be completed by the end of this year.

Ryanair

In May, Ryanair reported results for the financial year ending 31 March 2023. During the reported year, the airline's revenue was €10,775m, up 124.4% YoY, and operating profit before exceptional items was €1,573m, a major improvement from the loss of €470m in the prior year. Ryanair carried 168.6m passengers in the 12 months to 31 March 2023, up by 73.6% YoY. In terms of outlook, the airline aims to grow the number of passengers carried to approximately 185m in the year to 31 March 2024 (+10% YoY) As is the case with its peers, Ryanair noted that current demand remains robust and peak fares are trending ahead of last year.

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