

Key points

- Global economic growth is expected to decelerate in 2016, expanding at its slowest pace since the financial crisis
- World trade remains fragile and expected to grow slower than GDP, but air cargo outperforms
- Sluggish trade outlook but expansion in export orders and strong consumer confidence may boost air cargo demand
- Flooding-in of capacity, weak trade, lower yields and rising fuel costs are key risks for air cargo profitability outlook

Economic Outlook & Traffic Performance

The drivers behind the global economic outlook point to a moderate deceleration in the growth rate for 2016 (1), expanding at its slowest pace since the financial crisis.

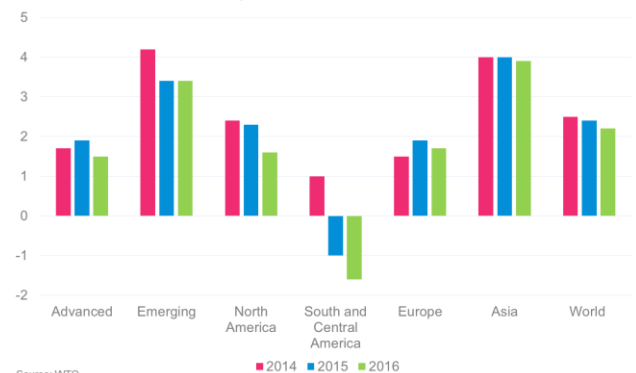
The stage of the economic cycle, together with the pace of growth, is an important driver for assessing the demand environment for air freight. Typically during upturn phases, FTK growth averages 3-5% points more than growth in world trade in goods, as firms replenish inventory and source components to build up production schedules. In downturns, the declines in FTKs average 5-7% points lower than world trade. Moderate pick-up in economic activity is expected in 2017, driven by emerging economies (2). However, the slow expected pace of acceleration in growth combined with a flattening economic cycle in advanced economies point to weak mid-term tailwinds for air freight demand growth.

Despite lower than expected growth performance, the underlying drivers in the US economy remain favorable with strong household spending, jobs growth and initial signs of rising nominal wages (3). The “Brexit” vote marks a realization of a downside risk. Although preliminary data suggests that European business and consumer sentiment has generally remained resilient, even in the UK. A key priority for European policy makers needs to be an orderly way to deal with “Brexit” vote so as to avoid large scale adverse spillovers and reduce uncertainty.

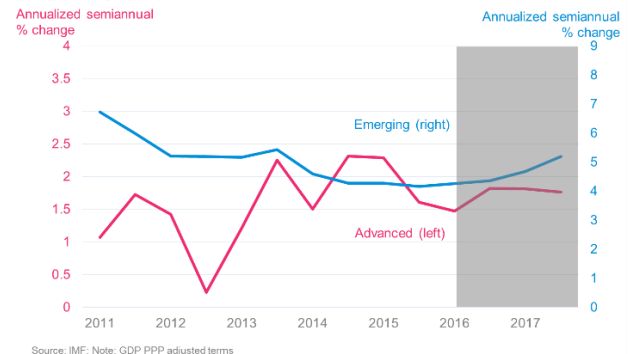
The air cargo market had a weak first quarter but recovered and grew in the second and third. September levels point to year-on-year growth of 6.1% in FTKs. However, monthly growth momentum decelerated in September, largely due to weaker performance in domestic FTKs. Compared to 2015, year-to-September FTK volume growth was 2%. The YtD growth in 2016 is compared with a period when demand for air cargo saw a one-off boost from the US west coast port backlog.

European and Asian carriers’ FTKs explain 77% of growth seen in Q3 while North American carriers were the third largest contributors. In contrast, Middle East carriers experienced a contraction in the volume of traffic handled in Q3 compared to Q2 in seasonal adjusted terms (4).

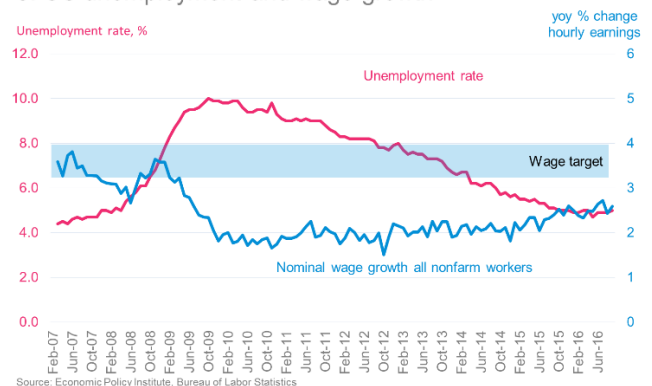
1. Forecast for GDP growth



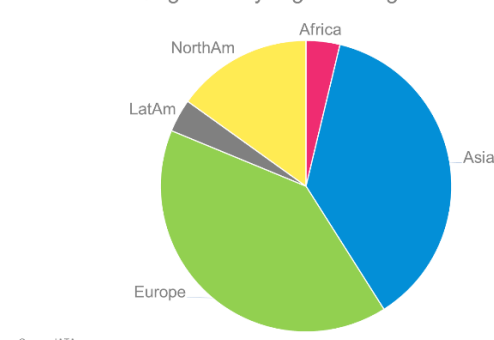
2. GDP Growth



3. US unemployment and wage growth



4. Share of Q3 growth by region of registration



Demand Environment and Drivers

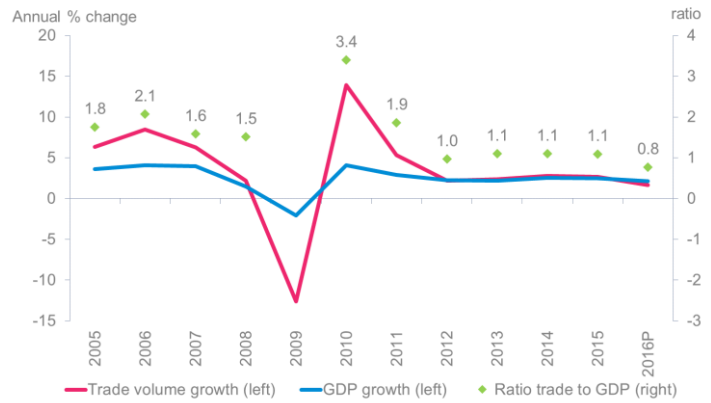
For the first time since the financial crisis, world trade in 2016 is expected to grow slower than GDP (5). YtD volumes in global merchandized trade have been flat. Although there was an uptick in August in level terms trade volumes were still lower by 0.7% compared to the 2015 year end level. It is too early to say whether the August uptick in trade marks a turning point for trade performance but leading indicators, such as FTK growth, may give room for cautious near-term optimism. The IMF explains the trade slowdown since the financial crisis through changes in composition of economic growth, lower levels of activity and restrictive trade policy combined with other factors (6).

International FTK growth has fared better. In seasonally adjusted terms, air cargo had a weak first quarter with the market shrinking by 1.4% at the end of March compared to the 2015 year end level. In the second quarter it recovered and grew, the level in June was up by 2.5% and at the end of the third quarter it was up by 5.6% compared to the 2015 year-end level (7). Growth momentum in international FTKs has been sustained, with global product launches like iPhone 7 supporting to shore up demand.

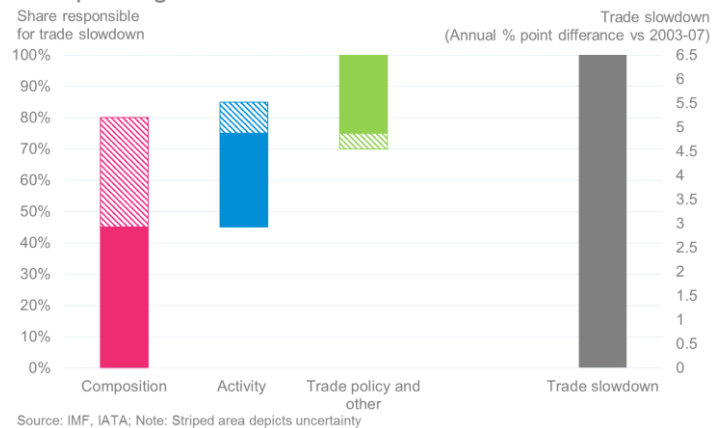
The Hanjin disruption does not appear to have had a material impact on demand for international air freight but this may be lagged as cargo 'stranded' at sea becomes offloaded. A portion of the higher-value and time sensitive goods may end-up being served by air, but no evidence of this is yet apparent.

Global PMI for export orders improved and is in expansionary territory (8). The improving trend, is a positive short-term indicator for air freight performance. Consumer confidence has continued to stay strong over the last quarter and remains resilient (9). In the EU it does not seem to have been significantly impacted by the "Brexit" shock. Strength in consumer confidence and favorable lagged impact of lower oil prices are supporting consumer spending, particularly in advanced economies.

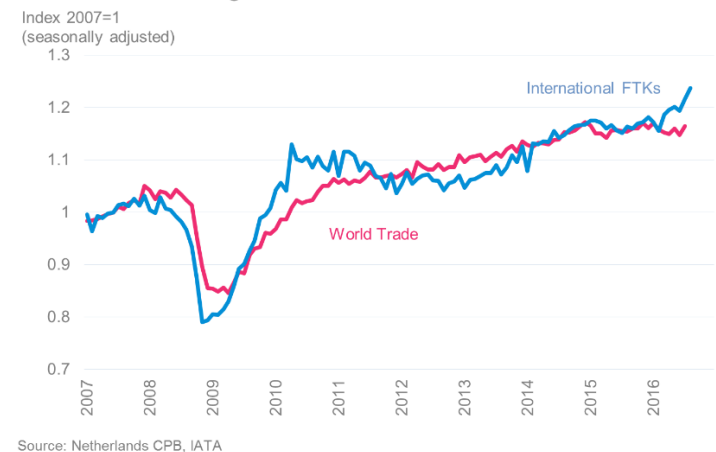
5. Ratio of trade volume vs real GDP growth



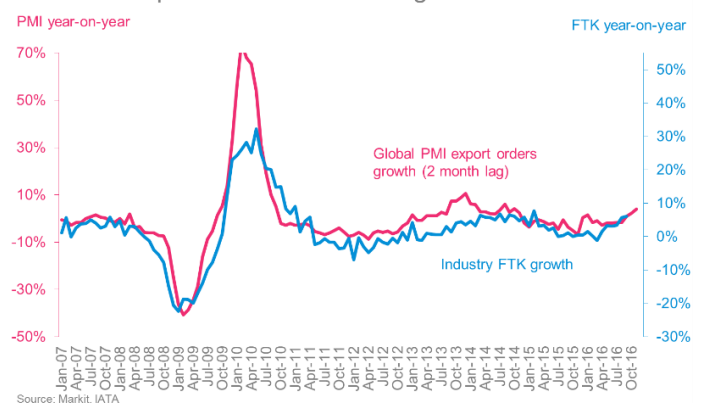
6. Explaining the trade slowdown



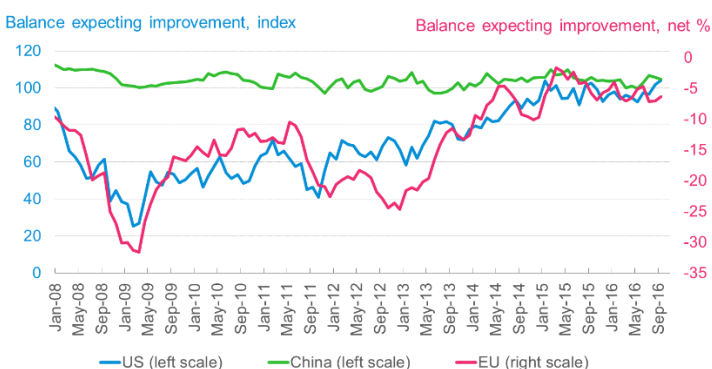
7. World trade in goods and international FTKs



8. Global export orders and air freight



9. Consumer confidence



Capacity and Competition

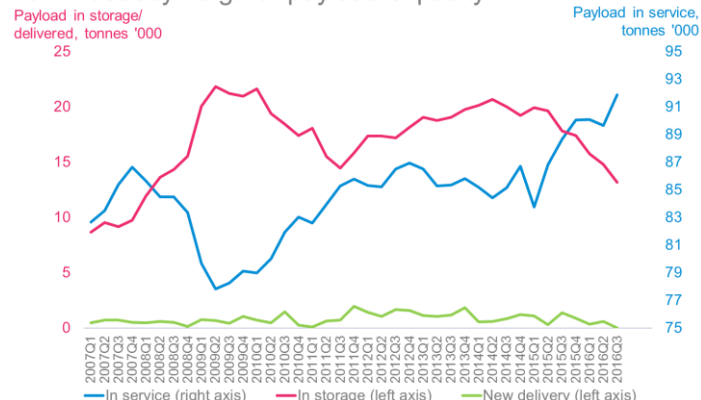
Expansion of in-service payload capacity for widebody freighters has continued on an upward trajectory for the sixth consecutive quarter. The increase in Q3 is explained by a reduction of in-storage capacity and deferral in retirements. However, payload capacity available in storage remains high at 14% of in-service payload capacity, significantly above pre-crisis levels of Q1 2007 when it was 10.5% despite an environment of higher fuel prices in 2007. In-service widebody freighter payload capacity in 2016Q3 grew by 3.6% compared to 2015Q3 (10).

The capacity challenge is further exacerbated by the strong growth in demand in the passenger business (11). Deliveries of wide-body passenger aircraft have led to the addition of significant levels of belly capacity (12). The new widebody passenger aircraft entering the fleet have on average more payload belly capacity available compared to their predecessor. Therefore, despite a marked decrease in the number of widebody passenger aircraft expected to be delivered in 2016, the decrease in widebody payload belly capacity being delivered will not be material. On some trade lanes the continued addition of widebody payload belly capacity has had a significant impact on dynamics in the air cargo market.

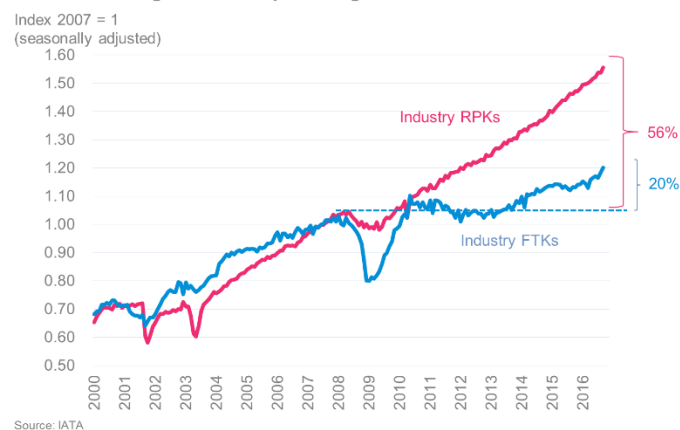
AFTKs grew 4.9% in 2016Q3 compared to 2015Q3, approximately on par with FTK growth of 5.1%. However, readily available widebody payload capacity is likely to have eroded the benefits of this marginal improvement in balancing air cargo supply and demand.

Widebody freighter aircraft utilization has improved significantly from the recent lows reached in September 2013. Since this time period, the increase in utilization has also served to boost capacity. However, in Q2 both freighter utilization and freight load factors were falling. While the decreasing aircraft utilization serves to cushion the capacity rise it also makes it more difficult for airlines to keep aircraft in service profitably. In Q3, load factors have improved but it remains to be seen whether this has occurred at the expense of lower freighter aircraft utilization (13).

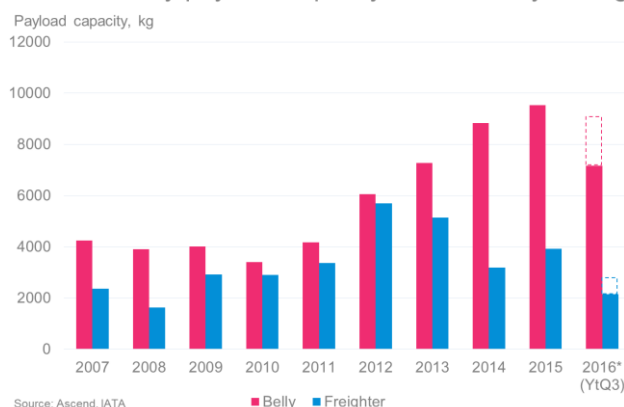
10. Widebody freighter payload capacity



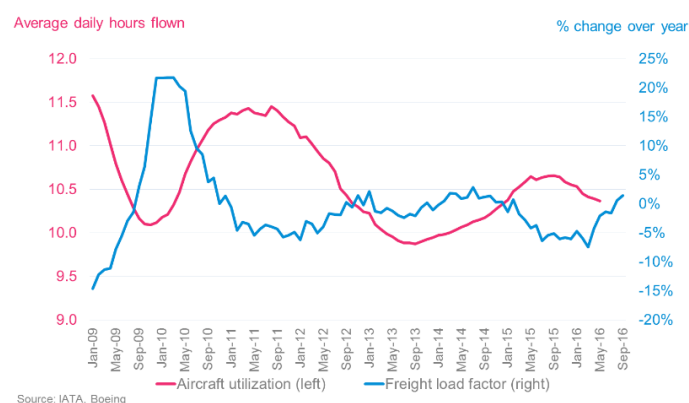
11. Passenger outstrips cargo



12. Widebody payload capacity added - belly & freighter



13. Freight load factor & freighter aircraft utilization



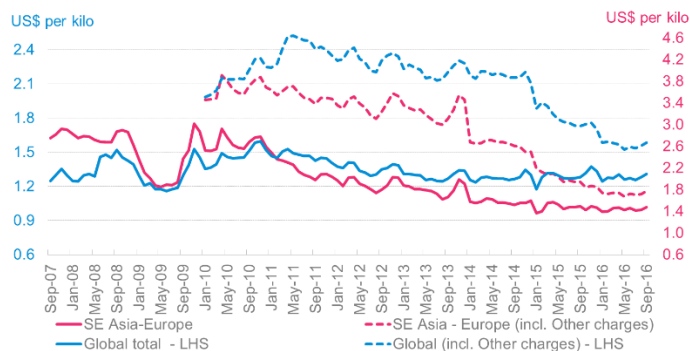
Revenues, costs and profits

Downward yield trajectory started to accelerate in the second half of 2014 as lower fuel prices were sustained. At an industry level total international air cargo yields have continued to deteriorate in 2016 but the latest deterioration is likely to be particularly damaging to profitability (14). Seasonal variability in yield performance and fuel price developments do not explain the worsening yield environment. Yields in September of 2016 were 9% lower than they were in September of 2015.

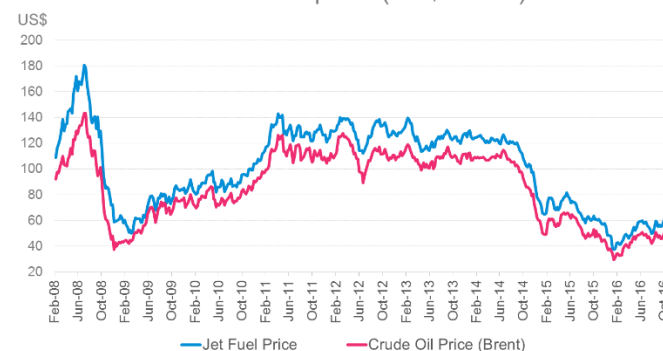
In contrast, average jet fuel prices were only 8% lower over the same time period, explaining less than half the fall in yield (15). Fuel prices have continued to rise since the second half of September, aided by an OPEC agreement to cut production. The short term implication of successfully coordinating output among oil producers makes it unlikely that fuel prices will drop to levels seen in January. Although analysts are also not expecting a price spike as the market continues to be oversupplied. In the event there is a price spike, analysts do not expect it to be sustained over an extended period of time at price levels observed between 2011 and 2013. Nevertheless, the OPEC agreement effectively marks the abandonment of its two year free market policy and reinforced market expectations of a gradual rise in the oil price.

Flooding-in of capacity (discussed in previous section) amid a weak global trade backdrop are key risks for air cargo profitability outlook. IATA survey of heads of cargo confirms concerns over yield performance for the year ahead (16).

14. Air freight yield (US\$ per kilo)



15. Jet fuel and crude oil price (US\$/barrel)



16. IATA survey of heads of cargo



Air Freight Routes and Direction

Table 1. International Freight Tonne Kilometer Growth by Route Area (Source: IATA statistics)

Route Area	% Growth in Freight Tonne Kilometers, year-on-year					
	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16
Africa - Europe	-5.9%	-4.7%	-11.7%	-9.0%	-10.7%	-6.6%
Africa - Far East	19.8%	18.0%	18.5%	21.8%	20.7%	31.8%
Africa - Middle East	8.2%	15.5%	4.5%	3.4%	1.8%	-3.4%
Central America / Caribbean - South America	1.0%	3.2%	-7.6%	-6.5%	0.3%	-0.4%
Europe - Central America / Caribbean	-5.4%	5.0%	-0.7%	2.0%	2.9%	-2.8%
Europe - Far East	-4.7%	5.9%	1.5%	2.4%	3.0%	2.3%
Europe - Middle East	-3.9%	7.8%	2.7%	0.8%	4.7%	3.8%
Europe - North America	-5.0%	-0.7%	-1.2%	0.2%	4.1%	2.9%
Europe - South America	-13.3%	5.8%	3.6%	-2.3%	1.6%	1.7%
Far East - North America	-11.7%	-6.3%	-2.7%	1.8%	2.4%	4.7%
Far East - Southwest Pacific	3.4%	4.4%	-1.5%	-5.1%	1.9%	2.9%
Middle East - Far East	6.1%	7.8%	3.3%	3.8%	0.5%	-3.6%
Middle East - North America	10.1%	21.4%	20.1%	44.1%	24.9%	8.6%
North America - Central America / Caribbean	5.3%	7.1%	-4.1%	-14.2%	-11.2%	-2.3%
North America - South America	-6.7%	-11.4%	-10.2%	-8.8%	-2.0%	-3.5%
North / South America - Southwest Pacific	-3.9%	14.2%	10.9%	9.9%	27.8%	25.6%
Within Central America	-7.8%	4.0%	-11.1%	-6.5%	-2.4%	-4.7%
Within Europe	13.7%	13.7%	8.6%	12.3%	14.1%	16.9%
With Far East	5.1%	4.6%	4.5%	9.8%	6.5%	7.2%
Within South America	-16.9%	-18.6%	-23.9%	-24.3%	-24.7%	-14.0%

Table 2. Outbound CASS Market Revenues (incl. fuel and other surcharges)

Origin Region	US\$m	% Growth in Air Freight Revenues, year-on-year					
	2016 Q3	2015 Q2	2015 Q3	2015 Q4	2016 Q1	2016 Q2	2016 Q3
Africa	82	8.9%	4.4%	-7.6%	-3.9%	-4.1%	-4.1%
Asia Pacific	1426	-8.2%	-13.2%	-16.1%	-27.5%	-5.6%	3.0%
Europe	2134	-21.5%	-20.1%	-16.6%	-9.1%	-5.7%	-6.0%
Latin America & The Caribbean	352	-11.6%	-9.0%	-10.5%	-3.5%	-5.0%	-4.2%
Middle East & North Africa	123	-4.1%	-14.8%	-10.1%	-7.0%	-4.5%	-3.2%
North Asia	1285	-11.2%	-14.0%	-19.3%	-26.0%	-22.4%	-12.4%
North Atlantic & North America	941	-8.8%	-16.4%	-20.0%	-23.9%	-18.0%	-12.7%

Table 3. Inbound CASS Market Revenues (incl. fuel and other surcharges)

Destination Region	US\$m	% Growth in Air Freight Revenues, year-on-year					
	2016 Q3	2015 Q2	2015 Q3	2015 Q4	2016 Q1	2016 Q2	2016 Q3
Africa	314	-16.8%	-21.2%	-22.7%	-20.1%	-17.6%	-19.5%
Asia Pacific	1433	-13.5%	-17.1%	-17.6%	-15.2%	-9.8%	-6.8%
Europe	1294	-15.1%	-14.4%	-14.7%	-16.1%	-11.5%	-10.3%
Latin America & The Caribbean	566	-17.6%	-17.2%	-19.9%	-19.2%	-14.8%	-7.9%
Middle East & North Africa	516	-9.7%	-6.6%	-5.3%	-3.4%	-5.3%	-8.5%
North Asia	677	-21.6%	-22.1%	-15.4%	-10.8%	-2.0%	5.1%
North Atlantic & North America	1450	-5.6%	-13.8%	-19.5%	-30.8%	-15.6%	-2.5%

Glossary and definitions

- ACI: Airports Council International
- AFTK: Available Freight Tonne Kilometers
- ECB: European Central Bank
- EIU: Economist Intelligence Unit
- CASS: Cargo Accounts Settlement System
- FTK: Freight Tonne Kilometers
- GFC: Global Financial Crisis
- PMI: Purchasing Managers Index
- Netherlands CPB: Netherlands Bureau for Economic Policy Analysis
- ODS: Origin-Destination Statistics
- SIA: Semiconductors Industry Association
- US BTS: US Bureau of Transportation Statistics
- M-o-m: Month over month percentage change
- Y-o-y: Year over year percentage change
- YtD: Year to date
- The traffic data refer to total scheduled traffic, including new model airlines, non-IATA member airlines, dedicated cargo carriers, regional carriers and others.



26th October 2016

George Anjaparidze
IATA Economics
anjaparidg@iata.org

Terms and Conditions for the use of this IATA Economics Report and its contents can be found here:
<http://www.iata.org/economics-terms> *By using this IATA Economics Report and its contents in any manner, you agree that the IATA Economics Report Terms and Conditions apply to you and agree to abide by them. If you do not accept these Terms and Conditions, do not use this report.*

FURTHER ANALYSIS AND DATA

Access data related to this briefing through the
Monthly Statistics publication:

<http://www.iata.org/publications/Pages/monthly-traffic-statistics.aspx>

NEW RELEASE ALERTS

To receive email notification of new analysis from
IATA Economics, select 'Economic Briefings' from:

www.iata.org/optin