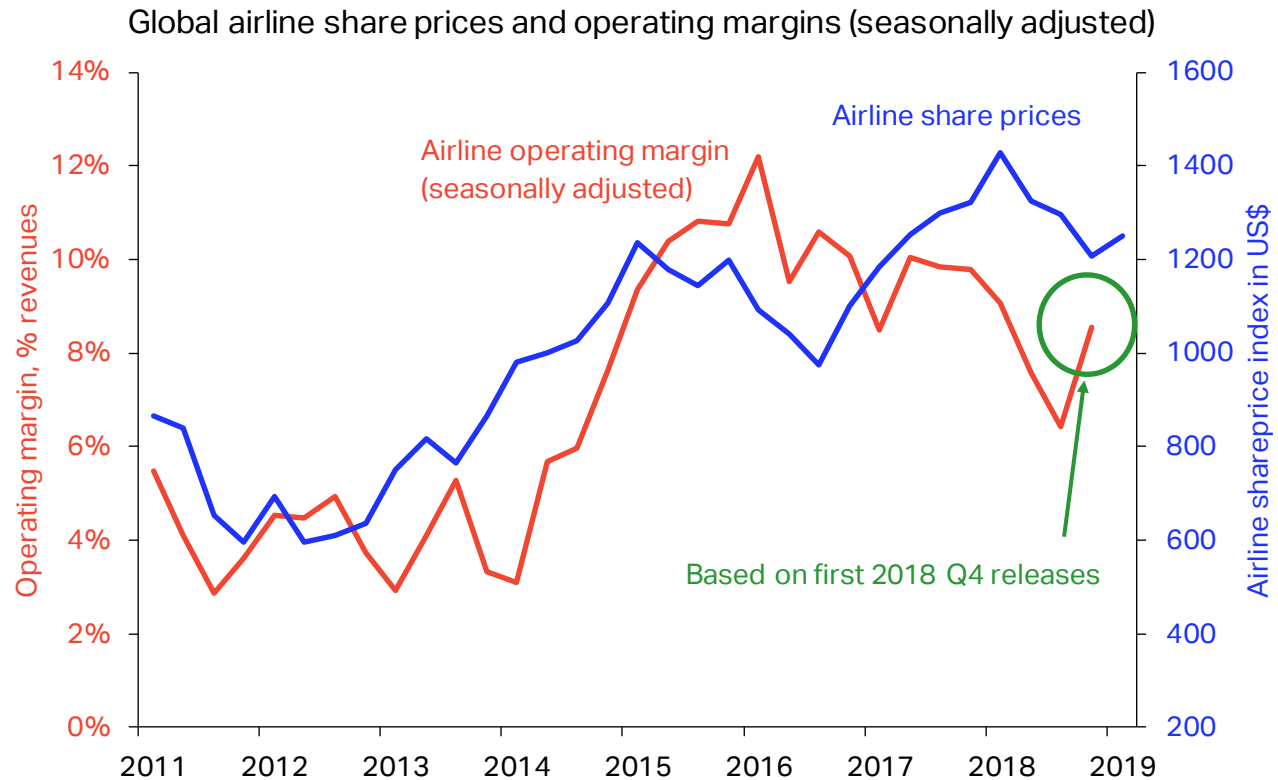




IATA Economics' Chart of the Week

22 February 2019

Have financial markets priced in the improvement in airline profits?



Source: IATA Economics using data from Datastream and the Airline Analyst

- First reports on 2018 Q4 financial results (see this week's [Airlines Financial Monitor](#)) showed a significant slowdown in the year-on-year declines in industry-wide operating margins, with a fall of 1.2% points in the year to 2018Q4 compared to declines averaging 3% points in the second and third quarters. That implies that the level of profits, seasonally adjusted, was higher in the fourth quarter than in Q2 or Q3, which we show in the chart above. There was a clear peak in airline profitability at the industry level in early 2016, after which the acceleration of unit cost pressures started to slowly reduce margins. This pressure intensified in the middle of 2018, partly as airlines' ability to recover those costs faltered under the pressure of accelerating capacity growth. Q4 was considerably better.
- That improvement was led by the substantial fall in jet fuel prices. US airlines – which formed the majority of the first Q4 releases – have little fuel hedging, so the benefit of lower spot fuel prices was felt immediately. Other regions, such as Europe, will not have seen an immediate benefit, so the Q4 industry improvement may be exaggerated by the chart above. Nevertheless, profitability has improved after the mid-2018 squeeze. Announced capacity plans have been reduced in some major markets and guidance on unit revenues in 2019Q1 has been mostly positive.
- Airline share prices are up so far this year, but only in line with the wider equity market. As the chart shows, financial markets successfully anticipated the 2014 improvement in profitability and the 2016 decline, in both cases by around a year. But the optimism shown by rising share prices in 2017 was not supported by improved airline earnings. The fall in airline share prices last year was partly a correction and partly due to the mid-2018 profits squeeze. After this experience investors are taking a cautious view of airlines' earnings outlook. It may take another quarter or two of better or at least stable profits before any improvement is fully reflected in airline share prices.

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