



Macro-economic risk and the outlook for aviation

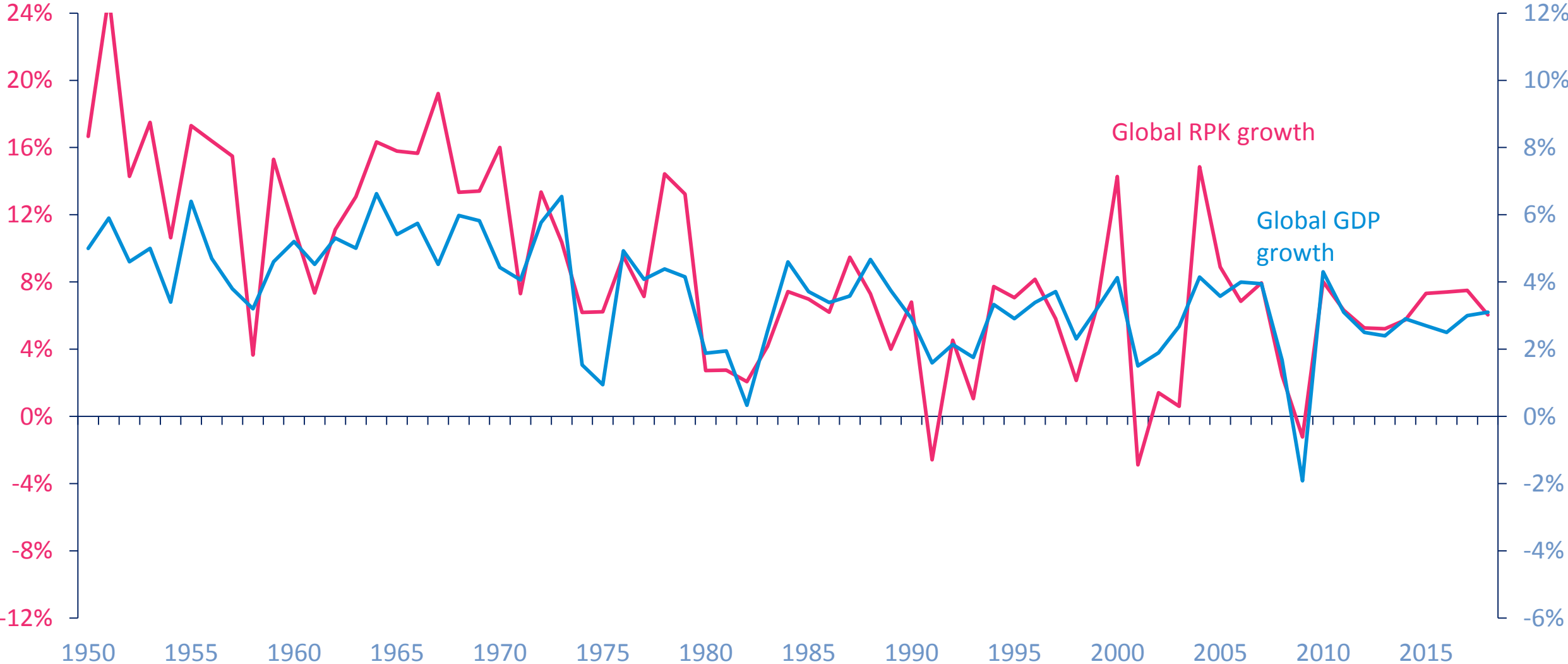
25th January 2018, Dublin

Brian Pearce,
Chief Economist,
IATA

www.iata.org/economics

Macro matters

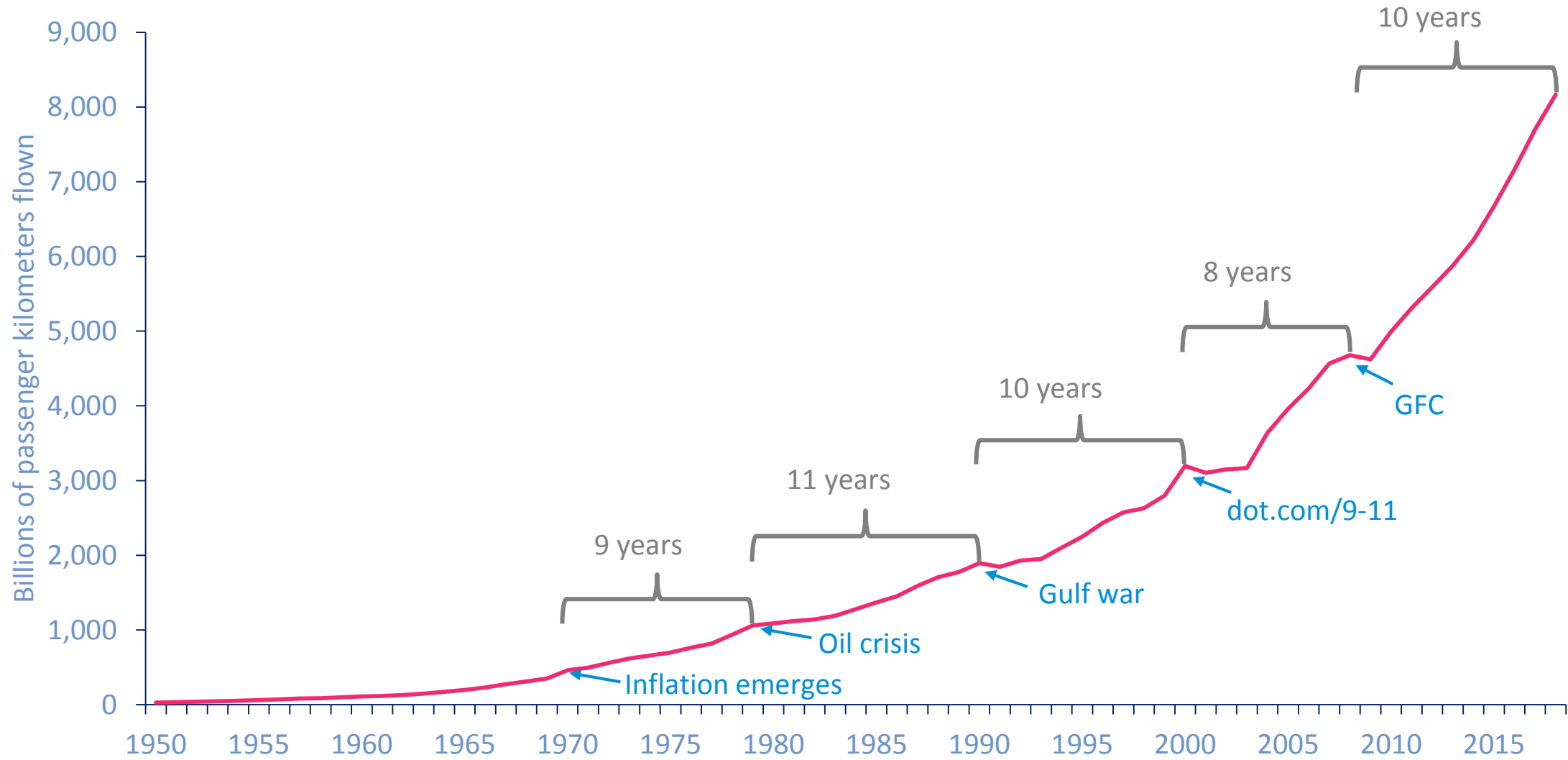
Global GDP and RPK growth



Source: IATA Economics using data from ICAO, IATA Statistics, IMF and our own forecasts

Peak-to-peak cycles lasted 8-11 years; but are downturns predictable?

Global passenger kilometers flown (RPKs)



Source: IATA Economics using data from ICAO, IATA Statistics and our own forecast

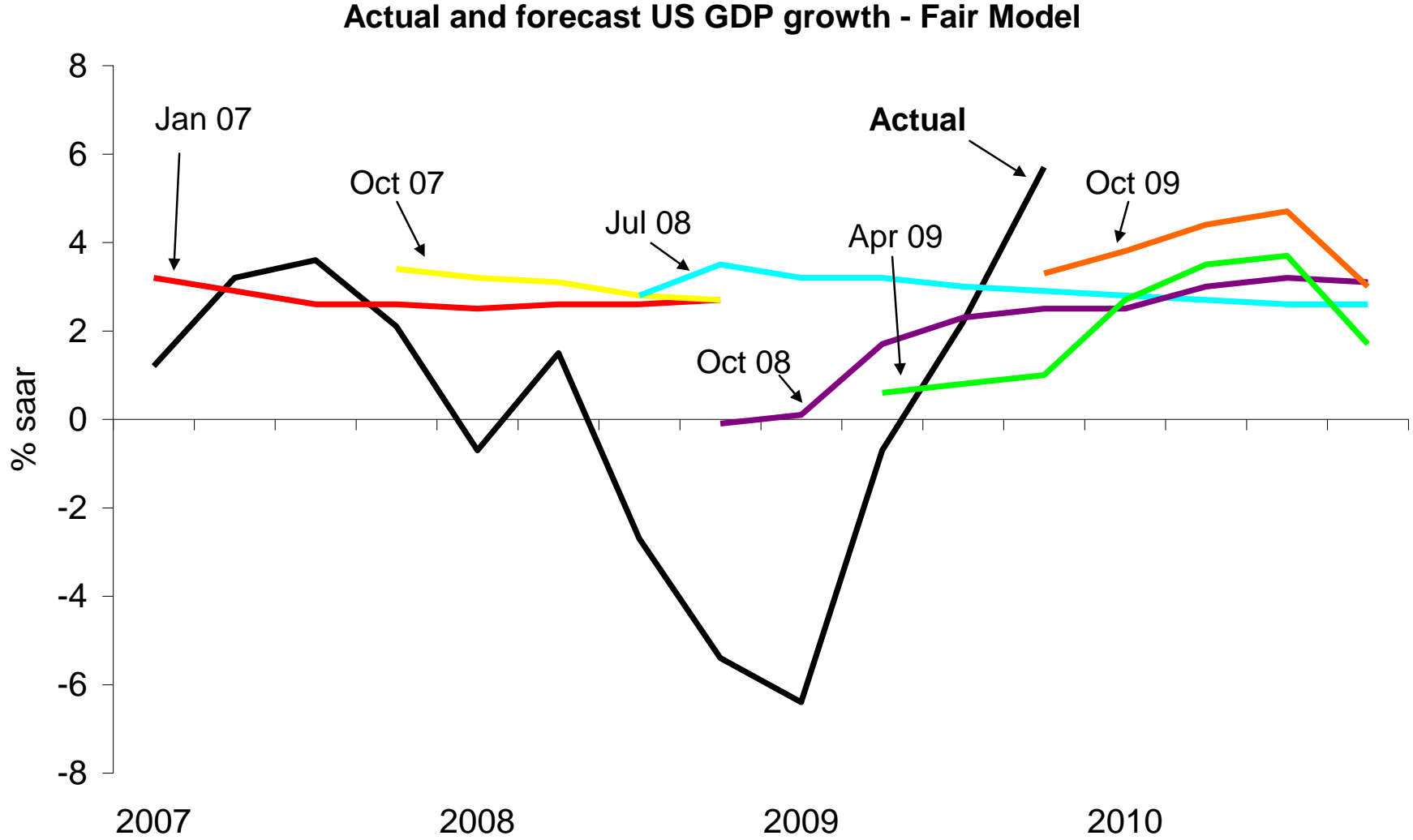
MATT

WEATHER CENTRE



*'I used to be an economic forecaster
but it was all so hit and miss'*

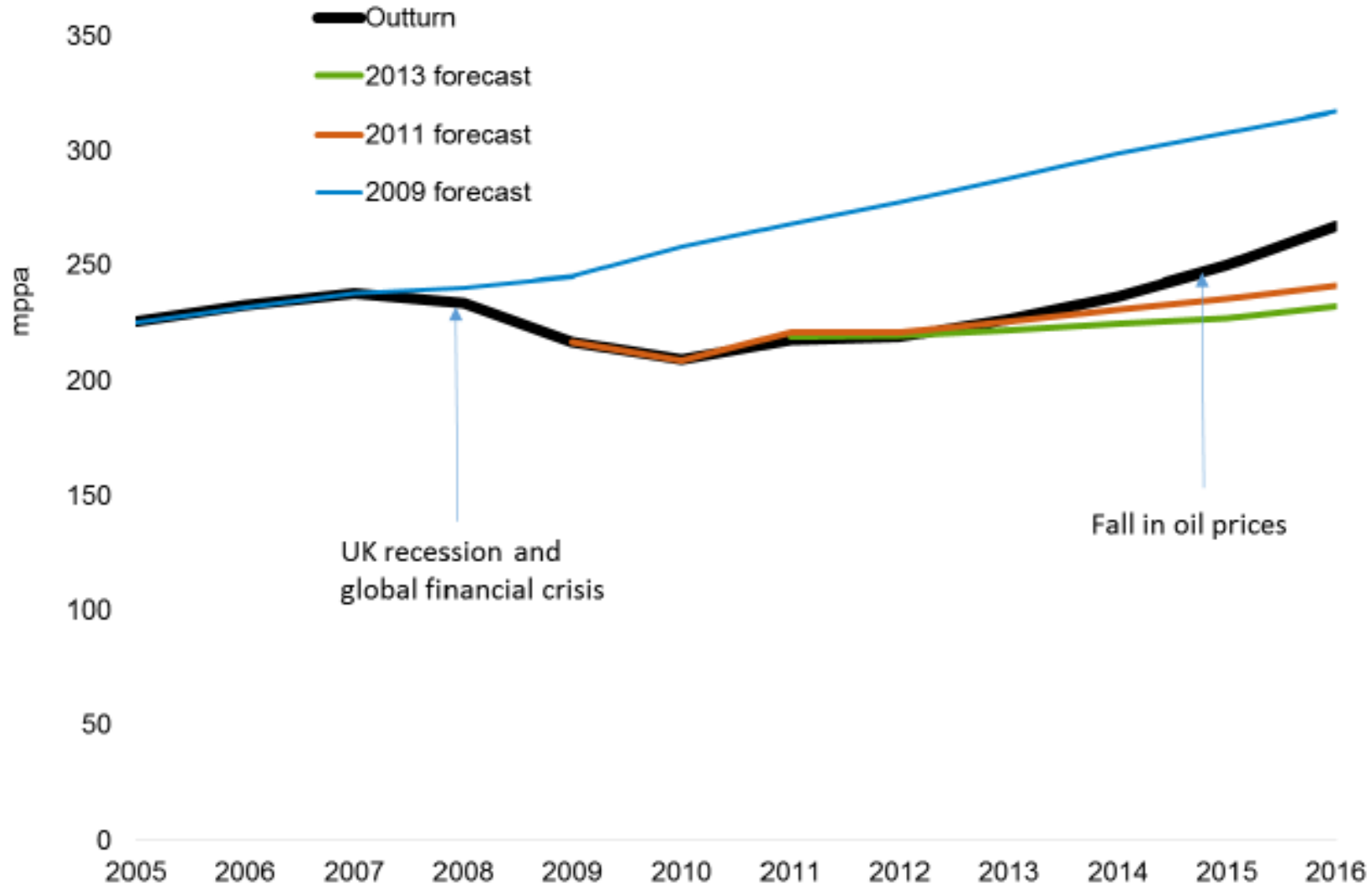
Macro-economic forecasts fail just when you need them



Source: IATA Economics using data from the US Fair Model and Datastream

The same is true in forecasting air travel

UK DfT forecasts of terminal passengers at UK airports



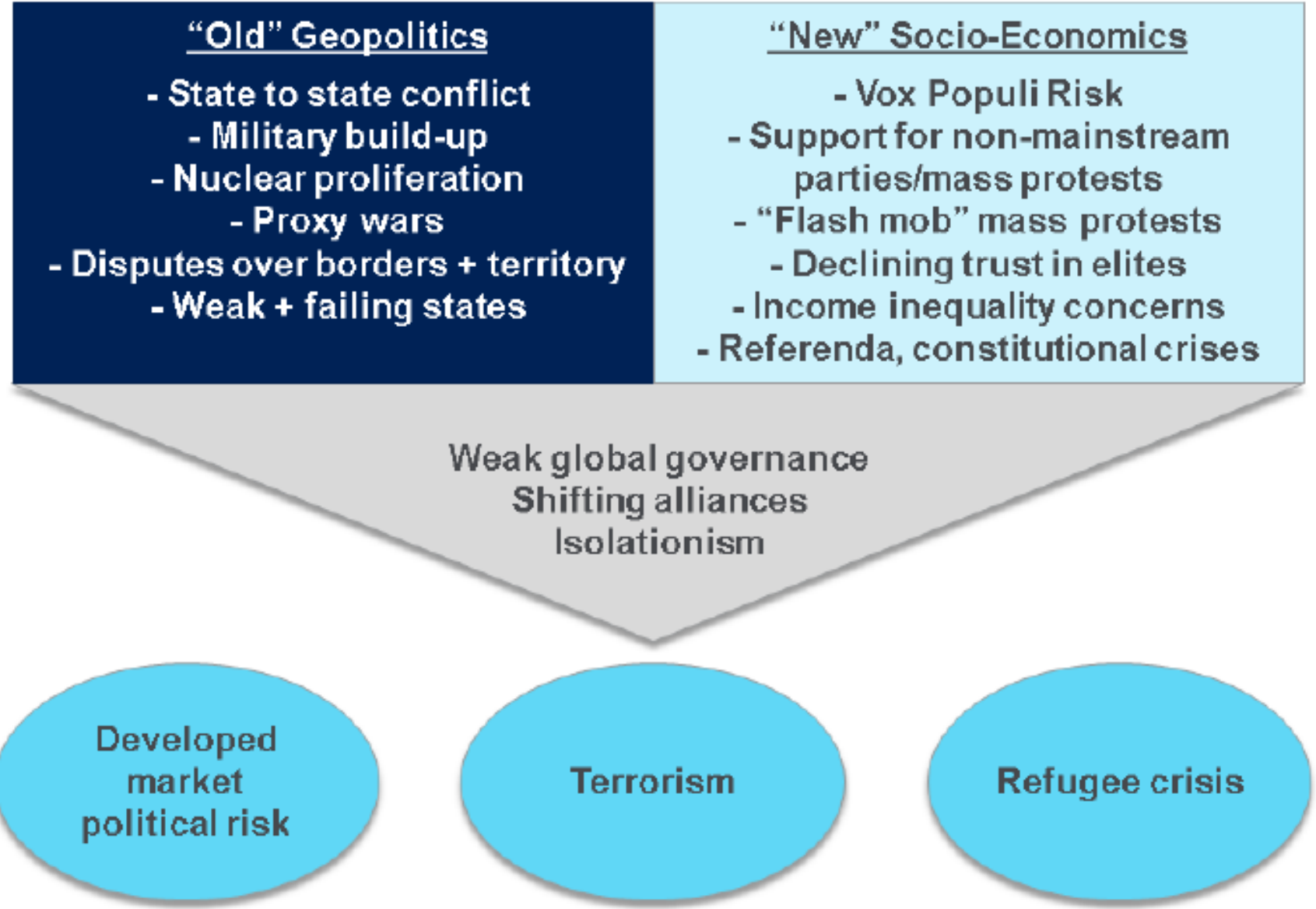
Source: UK DfT, UK Aviation Forecasts, October 2017

What can be done?

- Turning points can't be forecast consistently
 - Too many unknown unknowns
 - We don't even try
 - We focus on how the trend is evolving
 - ...but listen to Adam
 - Consider the known unknowns
 - Stress-test with scenarios
 - Build flexible, robust, business models
- Long-term trends may be predictable for some aviation variables
 - IATA/TE 20-year country-pair passenger forecast service



What are the known unknowns? 1. Geopolitical risk is at a 25 year high



Source: Tina Fordham, Chief Political Strategist, Citi

But political shocks of 2016 did not end the cycle



Donald Trump Vows to Rip Up Trade Deals and Confront China

The New York Times
28 June 2016

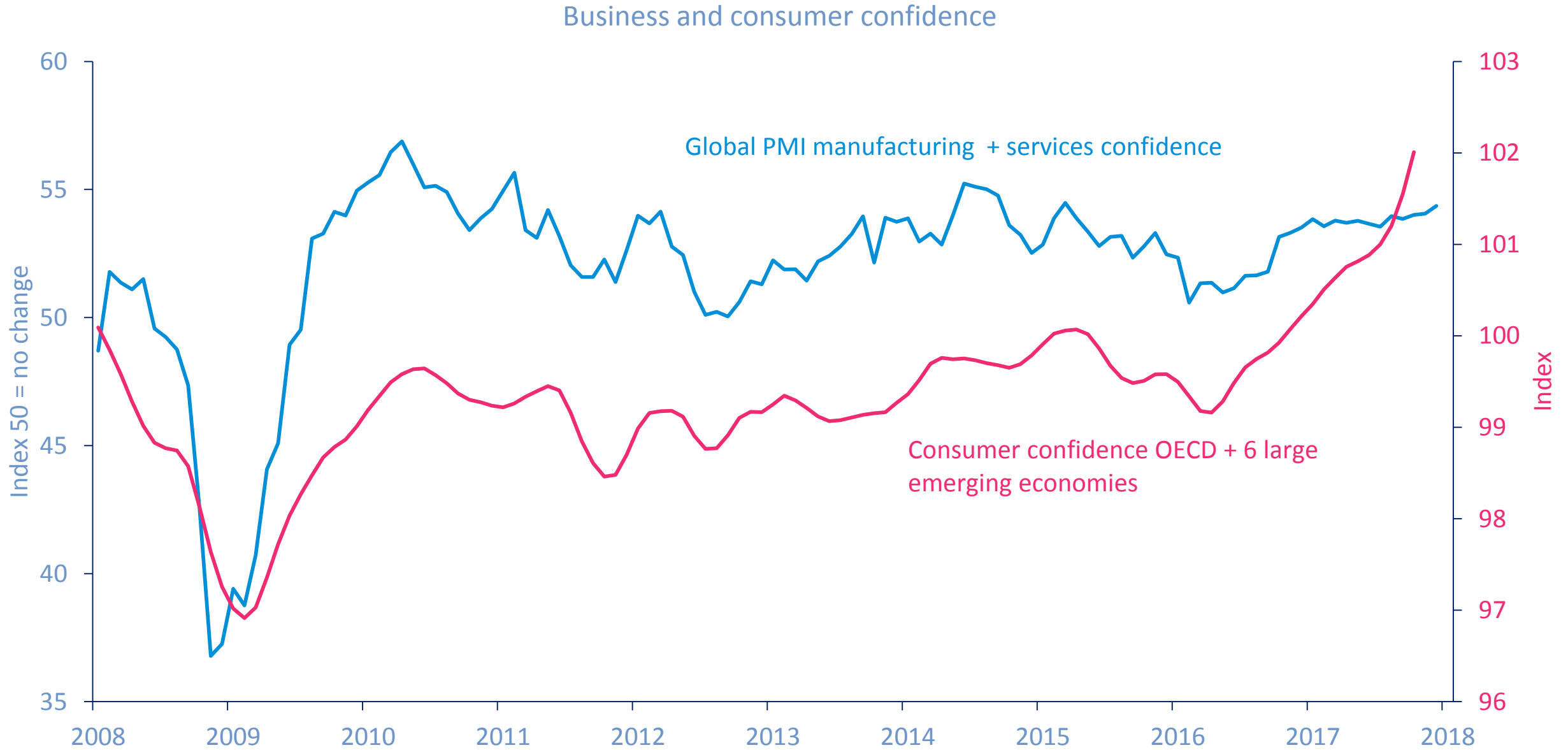
Across Europe, distrust of mainstream political parties is on the rise

Guardian
25 May 2016

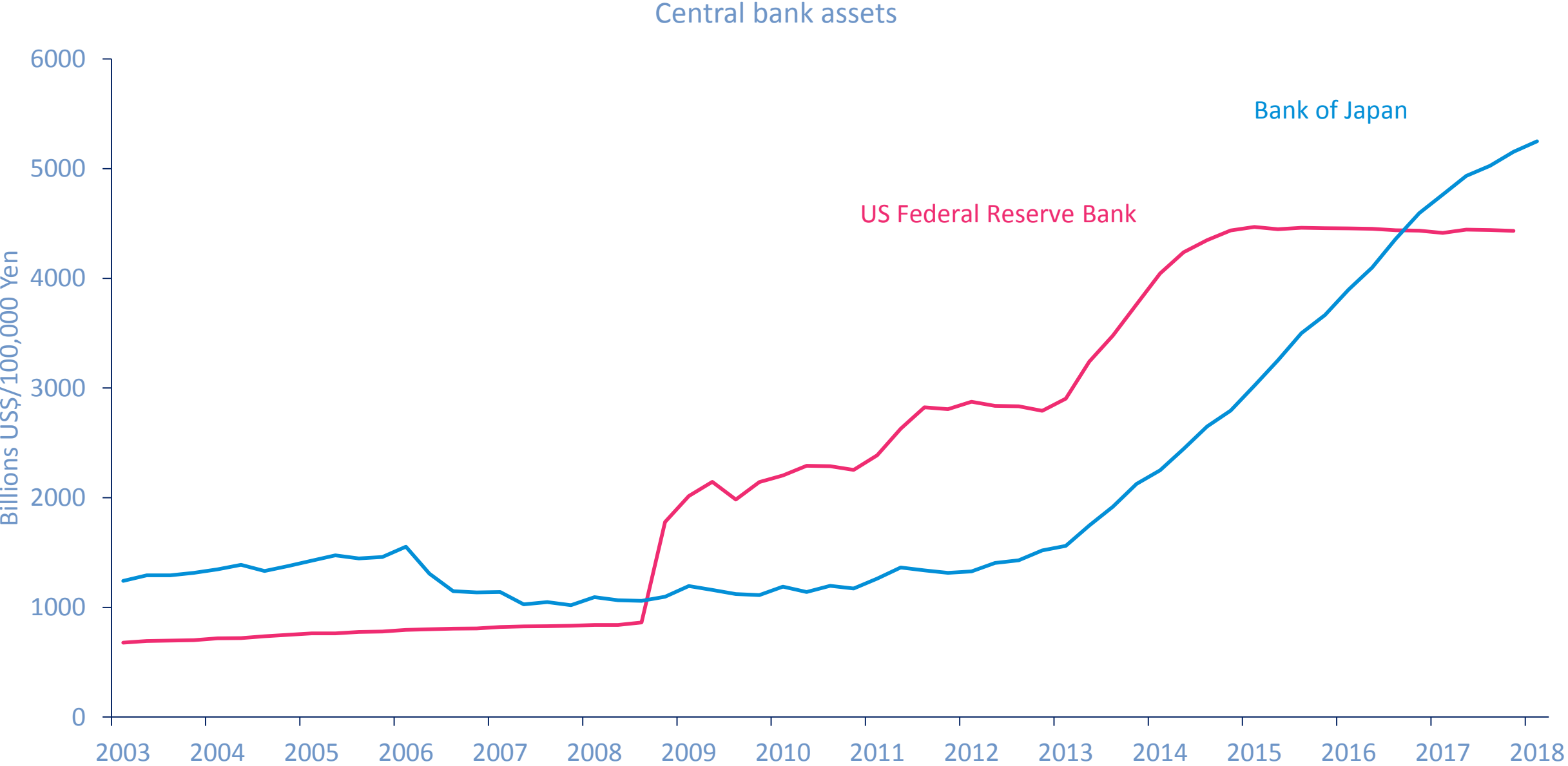
Clamour for trade protectionism on rise: Arun Jaitley

CNBC
13 October 2016

In fact confidence rose to new highs

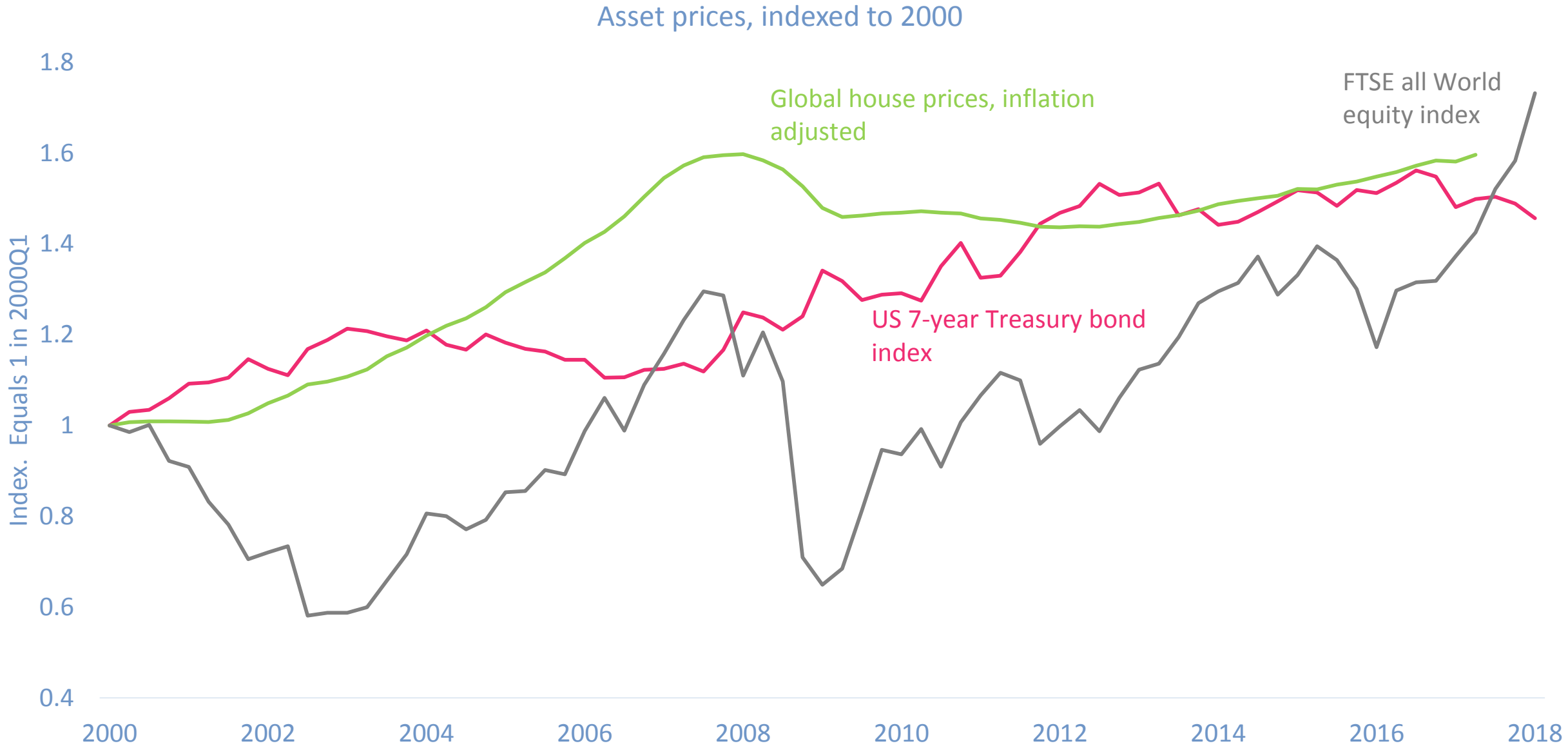


Liquidity helps; central banks have not yet started to unwind QE



Source: Datastream

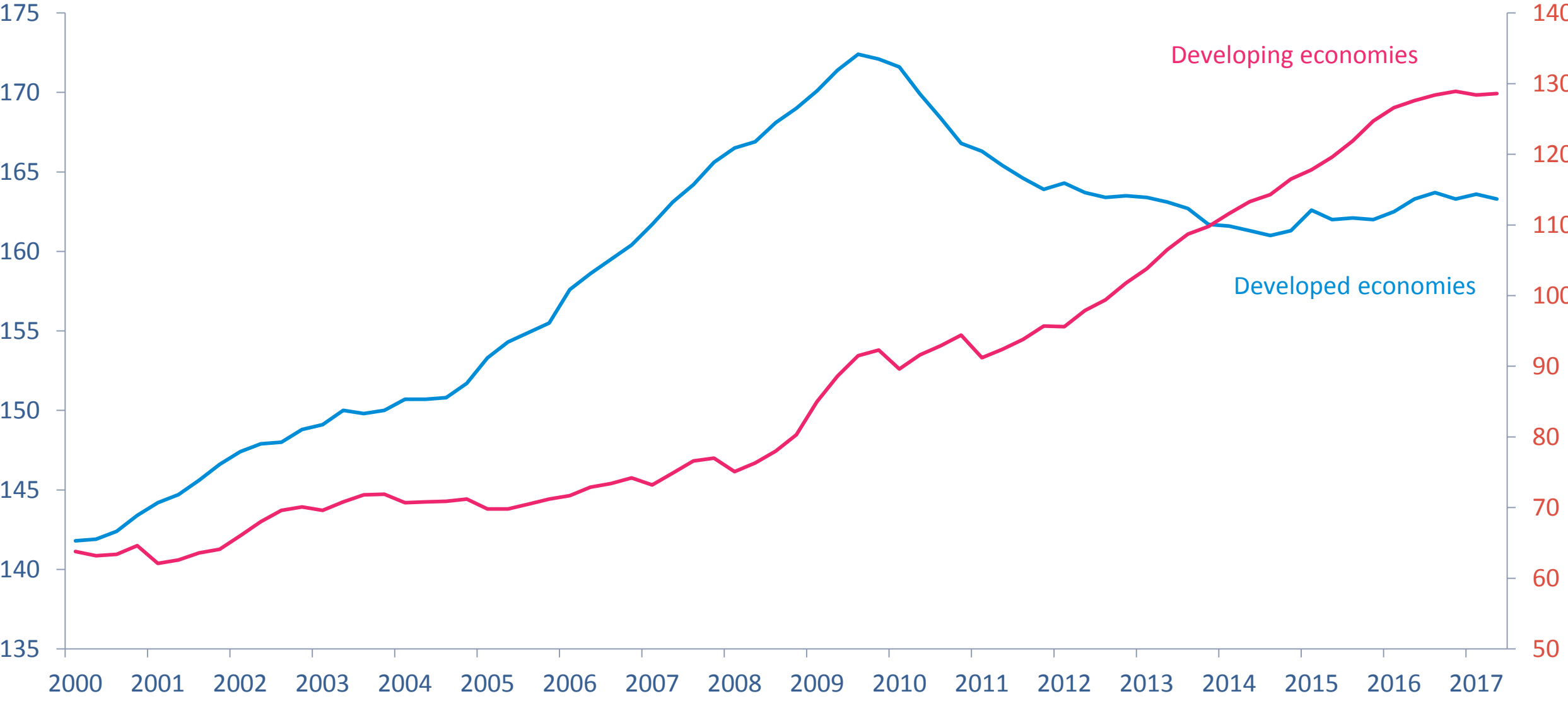
Asset prices near all time highs – bubbles about to burst?



Source: IATA Economics using data from Datastream, IMF

If so, high debt ratios could be the source of a downward shock

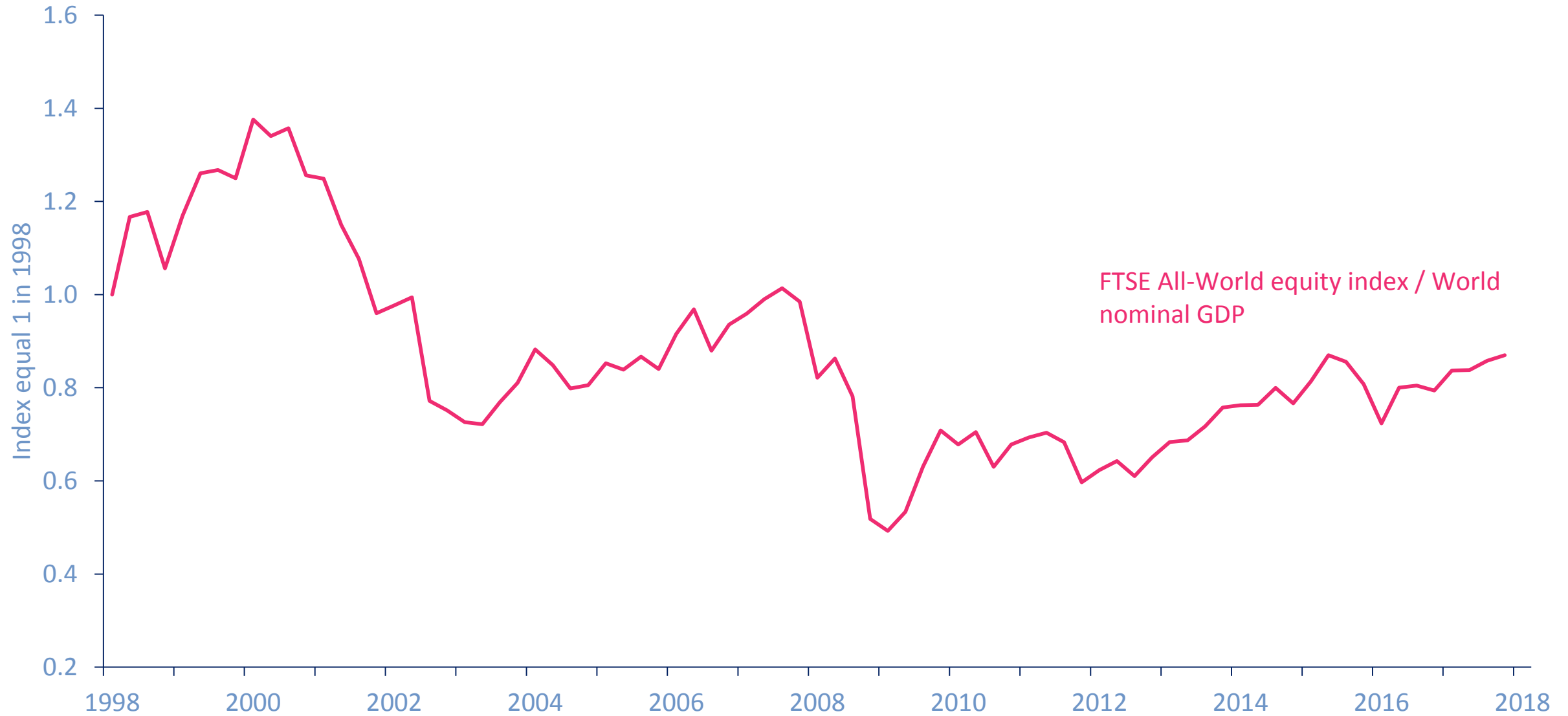
Outstanding debt held by non-financial private sector, % GDP



Source: Datastream

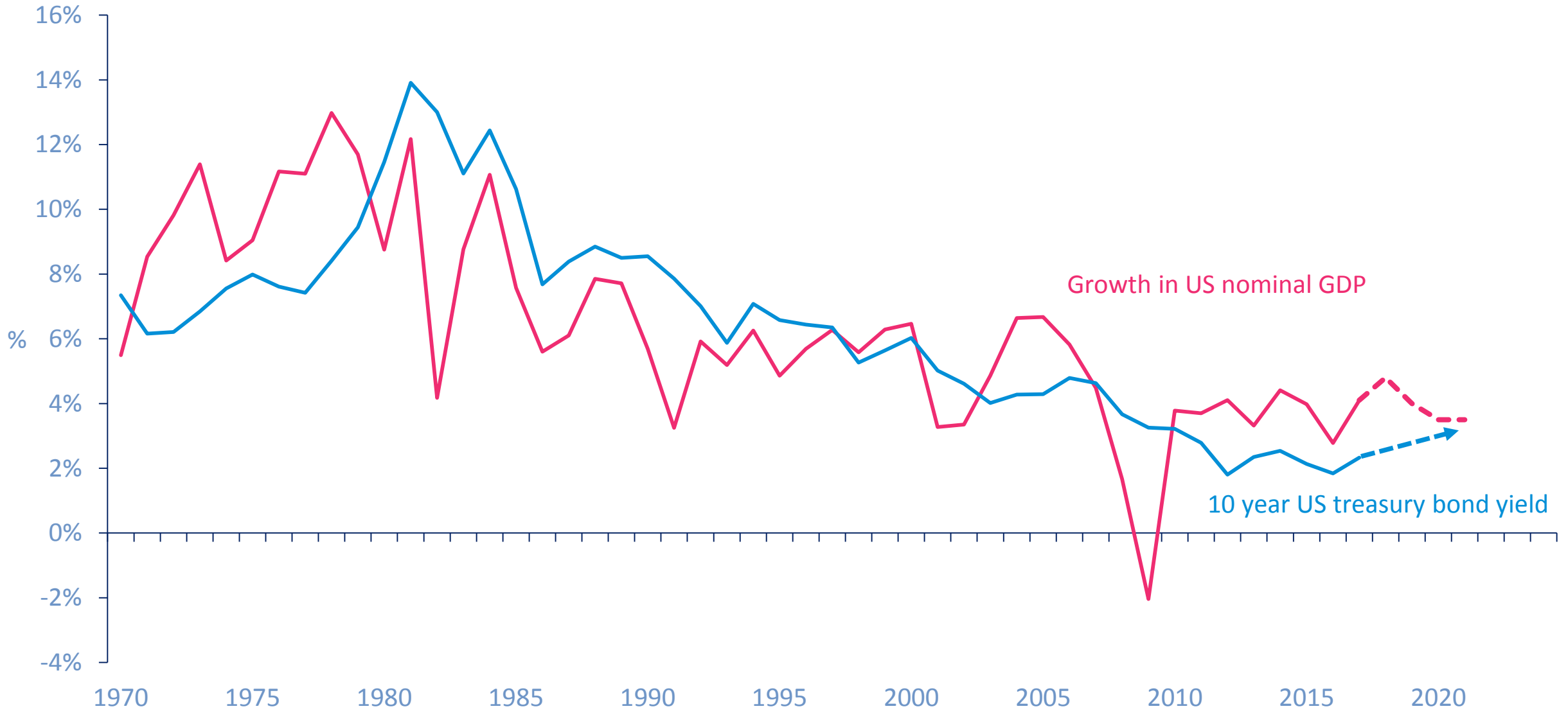
But asset prices don't look exceptionally high compared to nominal GDP

A broader P/E ratio: equity prices as a ratio of nominal GDP



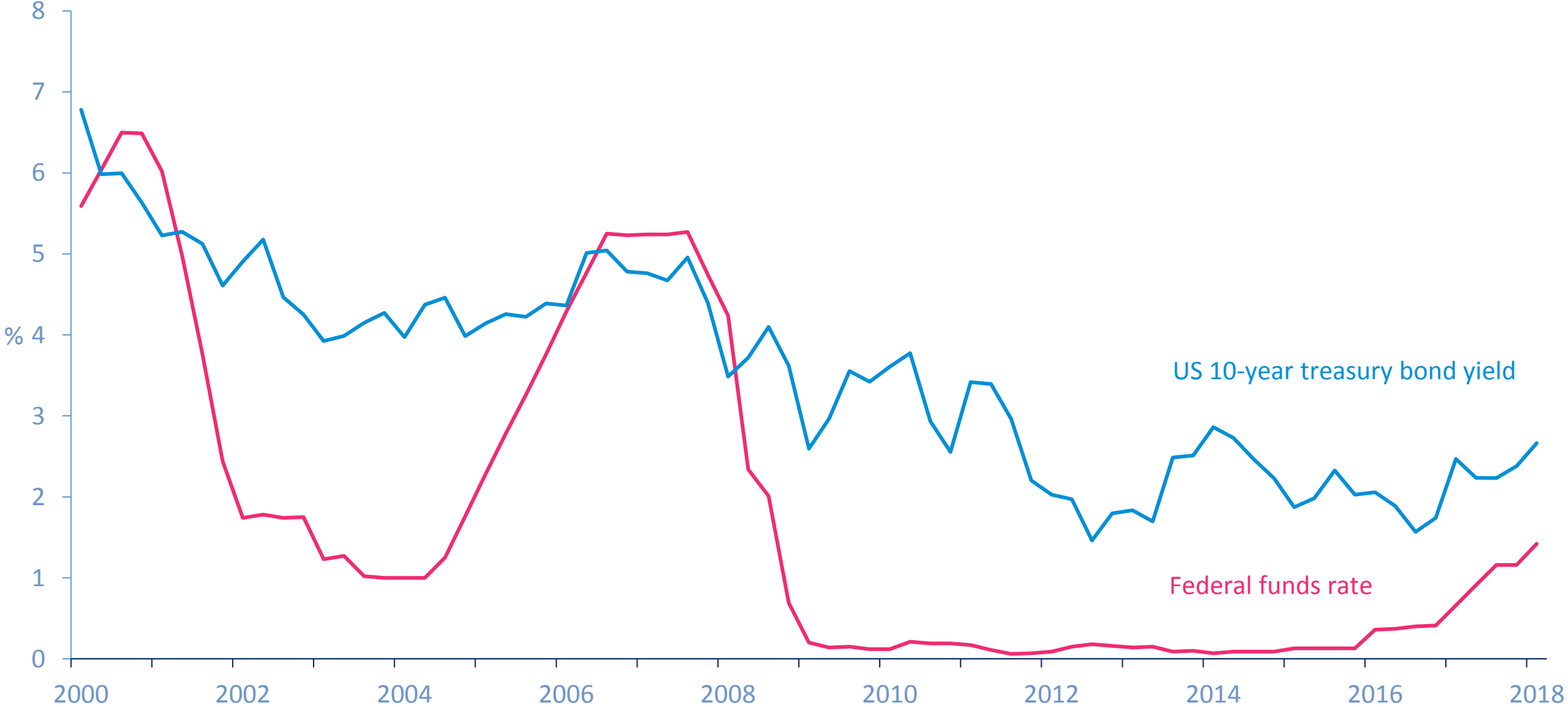
'Normal' bond yields should be closer to trend growth in nominal GDP

US 10-year Treasury bond yield and growth in US nominal GDP



The interest rate cycle is finally turning up

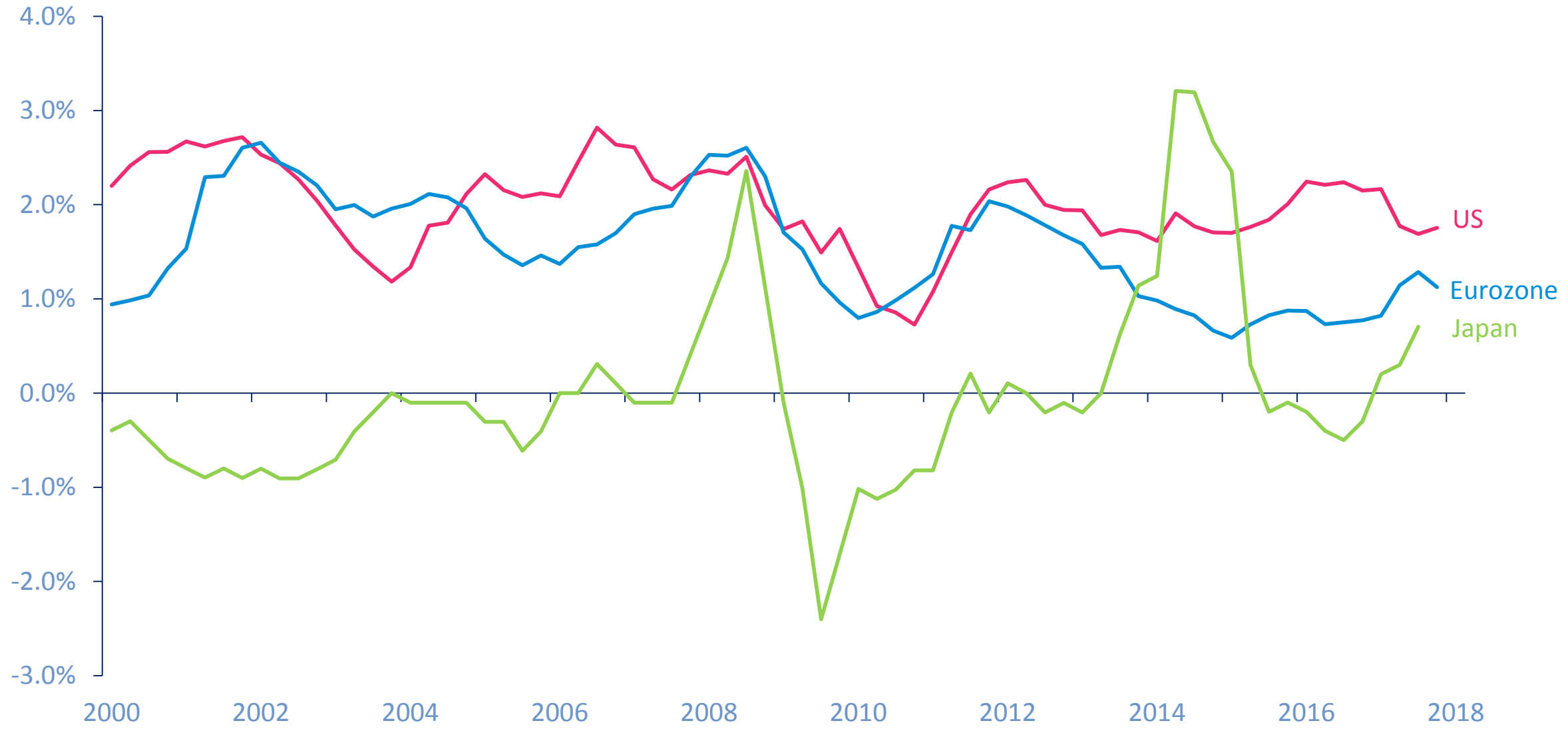
US interest rates



Source: Datastream

So far there is no sign yet of an inflation problem

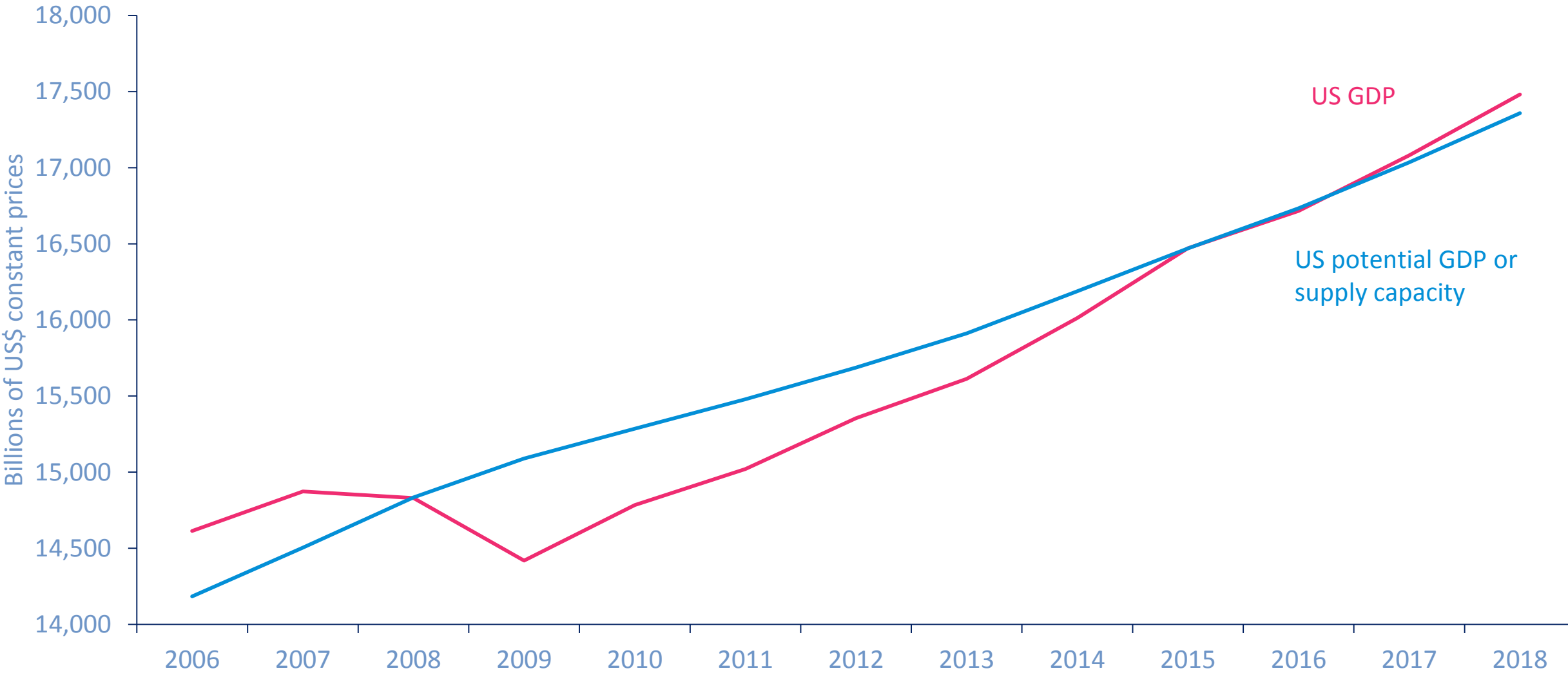
Core consumer price inflation



Source: Datastream

But an inflation shock may come from the US, now out of spare capacity

GDP and potential GDP in the US



Source: Datastream

Hard Brexit looking more likely – damaging not disastrous

The Treasury View: 3-4 years worth of GDP growth lost

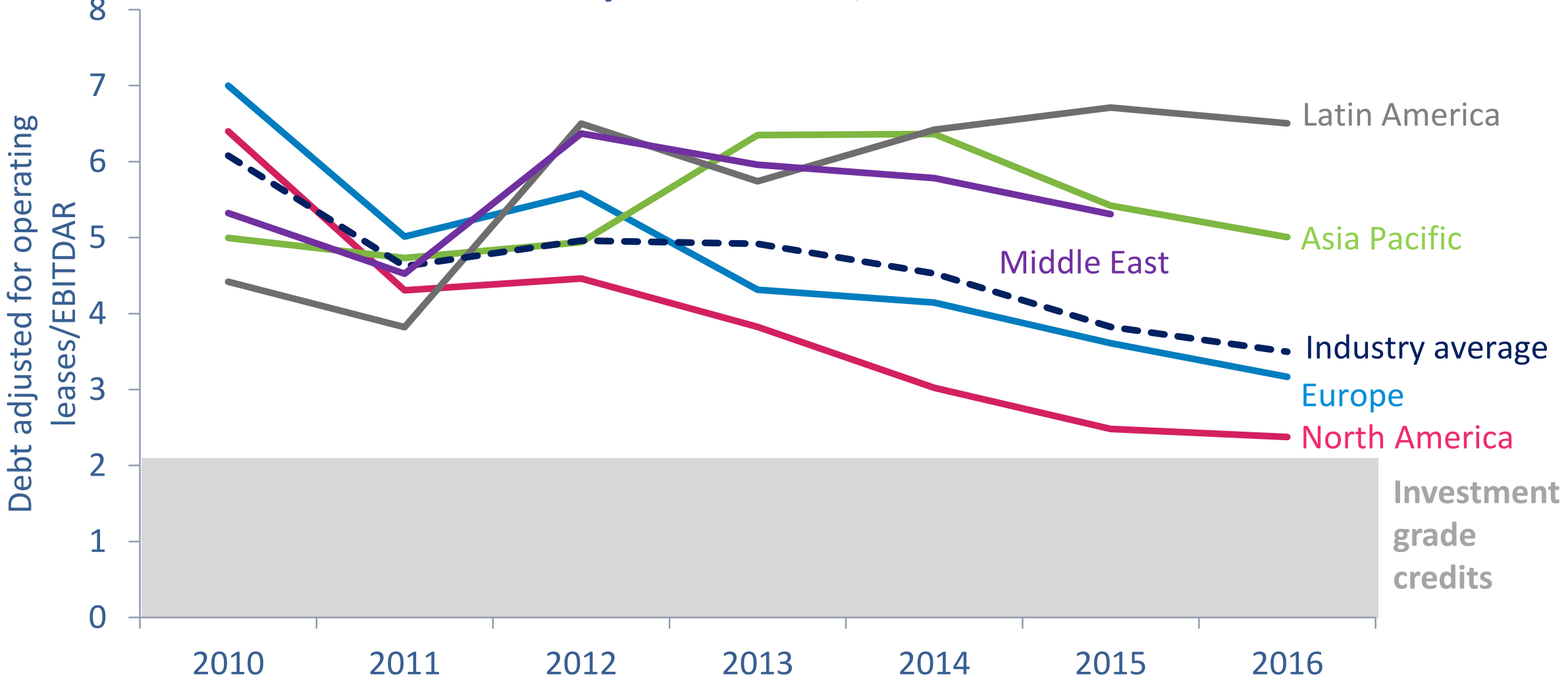
Table 3.D: Annual impact of leaving the EU on the UK (difference from being in the EU after 15 years)

| | EEA | Negotiated bilateral agreement | WTO |
|------------------------------------------|--------------------|--------------------------------|--------------------|
| GDP (%) – central | -3.8 | -6.2 | -7.5 |
| GDP (%) | -3.4 to -4.3 | -4.6 to -7.8 | -5.4 to -9.5 |
| GDP per capita ^a – central | -£1,100 | -£1,800 | -£2,100 |
| GDP per capita ^a | -£1,000 to -£1,200 | -£1,300 to -£2,200 | -£1,500 to -£2,700 |
| GDP per household ^a – central | -£2,600 | -£4,300 | -£5,200 |
| GDP per household ^a | -£2,400 to -£2,900 | -£3,200 to -£5,400 | -£3,700 to -£6,600 |

^a Expressed in terms of 2015 GDP in 2015 prices, rounded to the nearest £100.

Airlines have been using strong cash flows to reduce debt

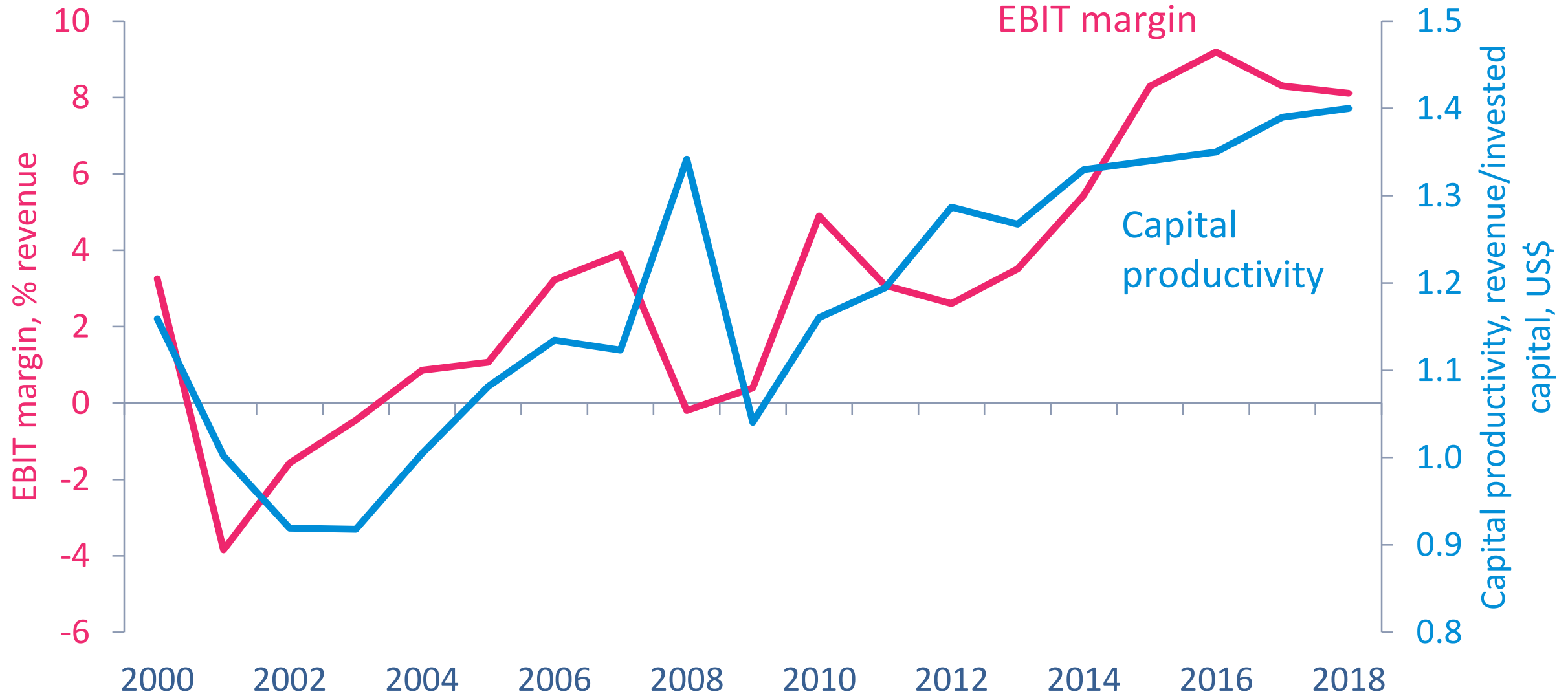
Adjusted net debt/EBITDAR



Source: IATA Economics using data from The Airline Analyst

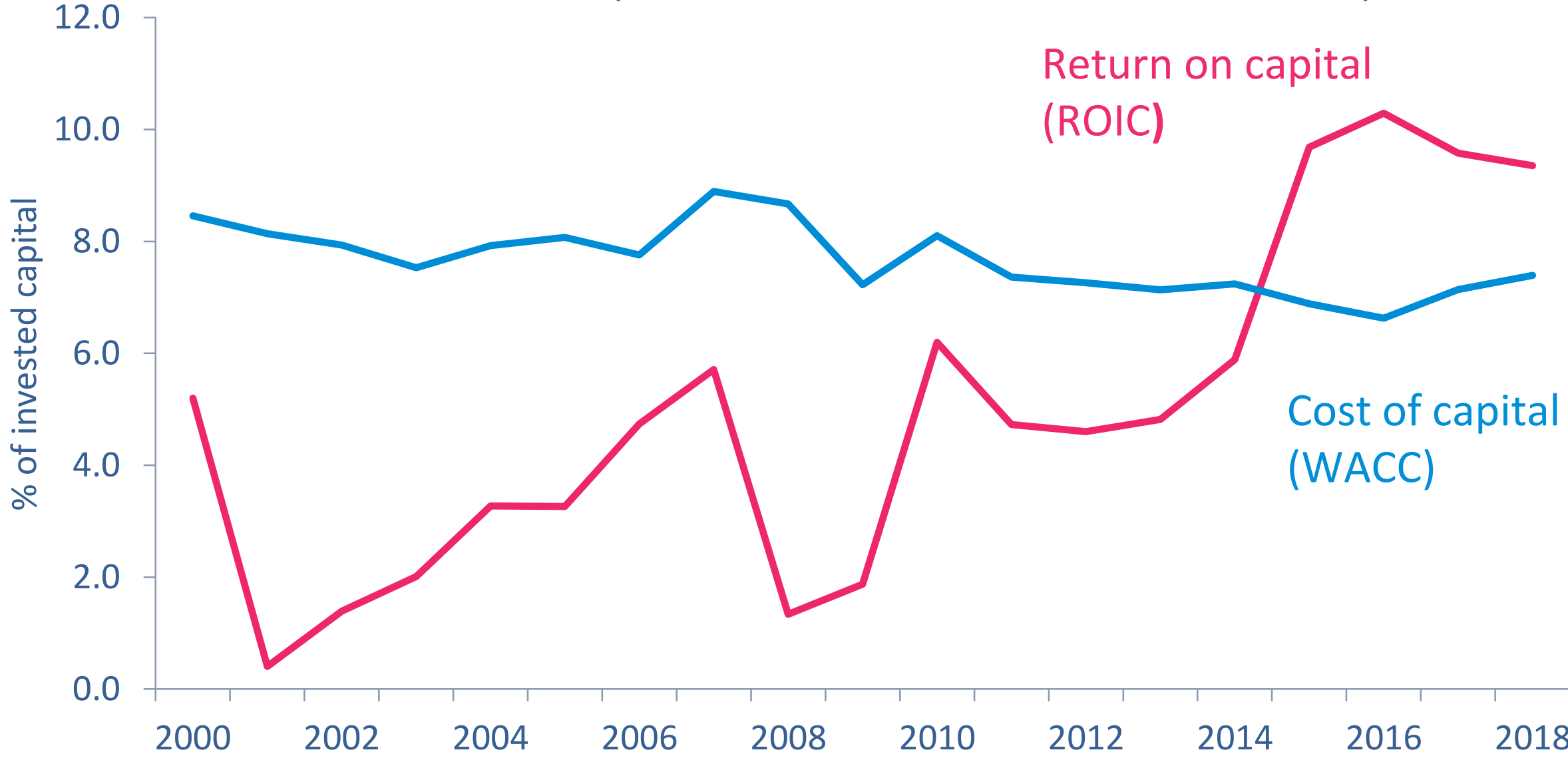
Focus remains on sweating assets as well as protecting margins

Components of return on capital



The evolving trend for 2018 points to a 4th year of good returns

Return on capital invested in airlines and their cost of capital



Source: IATA Economics using data from McKinsey, The Airlines Analyst, IATA forecasts

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