Cargo outlook 2019

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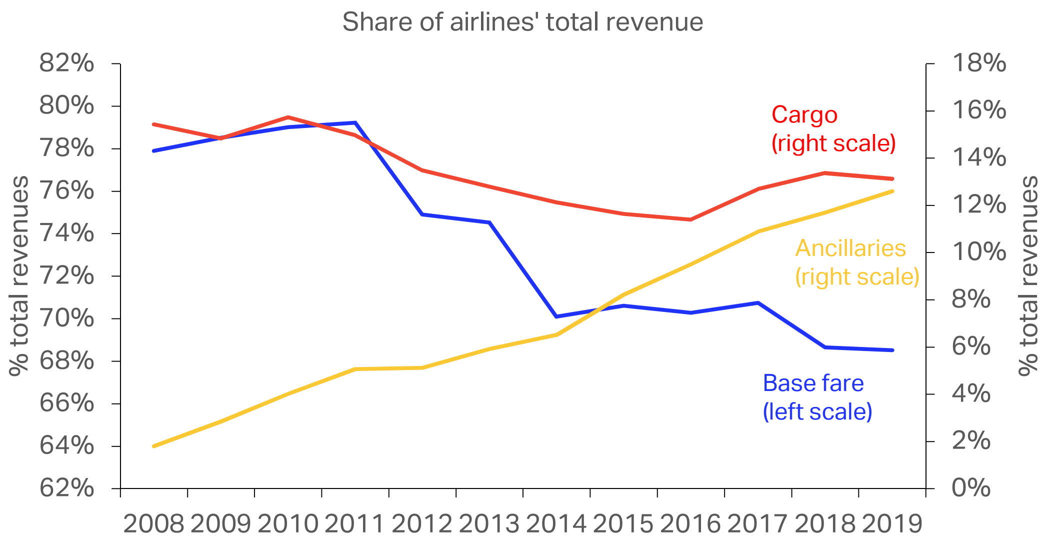
Cargo revenue contribution stabilizing



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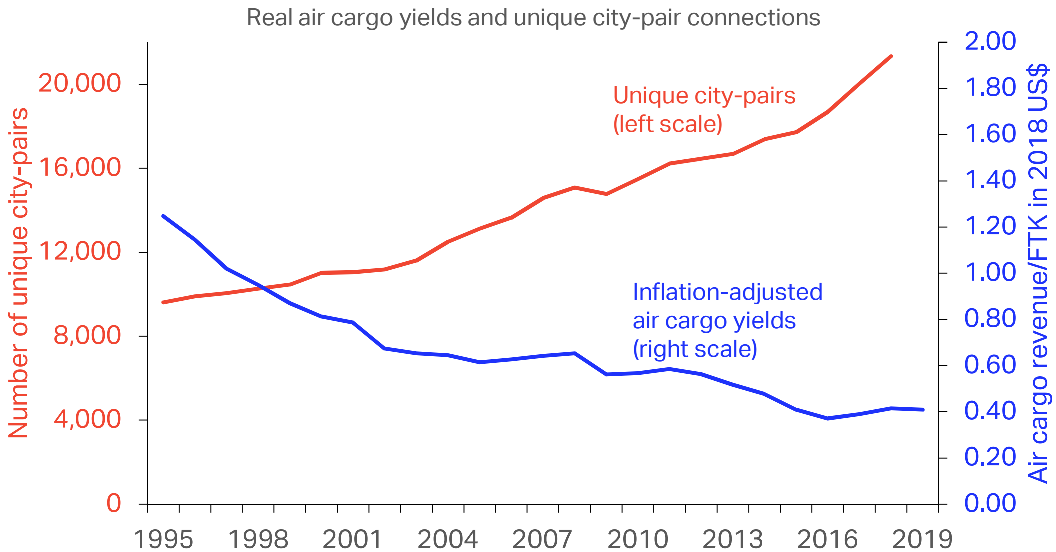
Source: IATA Statistics, IdeaWorks, own forecasts

The cargo business has made a larger contribution to airline revenues in the past 3 years, helping to offset falling base fares

Next year we estimate that cargo revenues of over $116 billion will represent more than 13% of airline revenues.

Economic contribution increasing



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Source: IATA Statistics, CargoIS, SRS Analyser, own forecasts

Air cargo is also making an increasing contribution to economic development around the world.

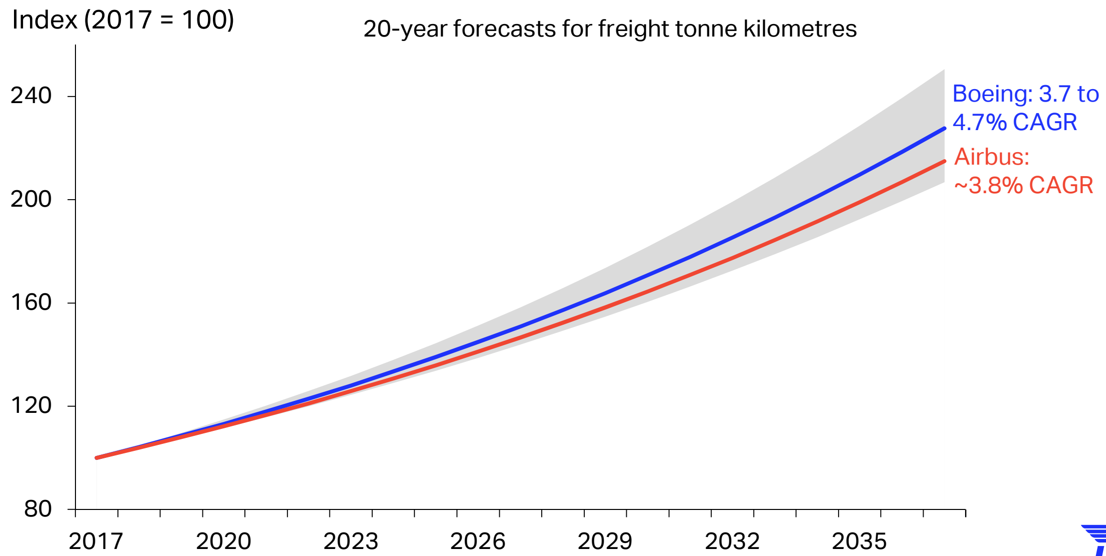
Airlines have been opening up new trade lanes, connecting even more cities

Last year airlines added more than 1300 new city pair connections taking the total in excess of 21,000

These connections – along which trade, global supply chains and air cargo flow – have more than doubled in the past 20 years

Shipping goods by air has also got a lot cheaper in real terms. Per tonne kilometer flown air cargo user costs, compared to other prices in the economy, have fallen around a half in the past 20 years.

Doubling expected within next 20 years



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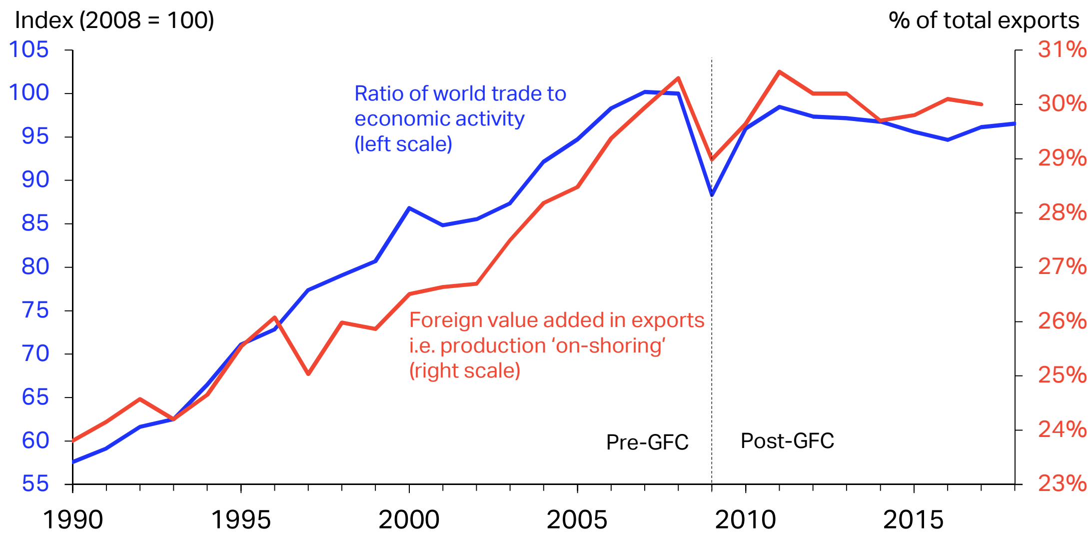
Sources: Airbus, Boeing

That growth and contribution to economic development is expected to more than double within the next 20 years, according to the forecasts of Boeing and Airbus.

But a pause in globalization constrains the outlook



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Source: Netherlands CPB, UNCTAD Eora database, Datastream

But there are challenges to that outlook

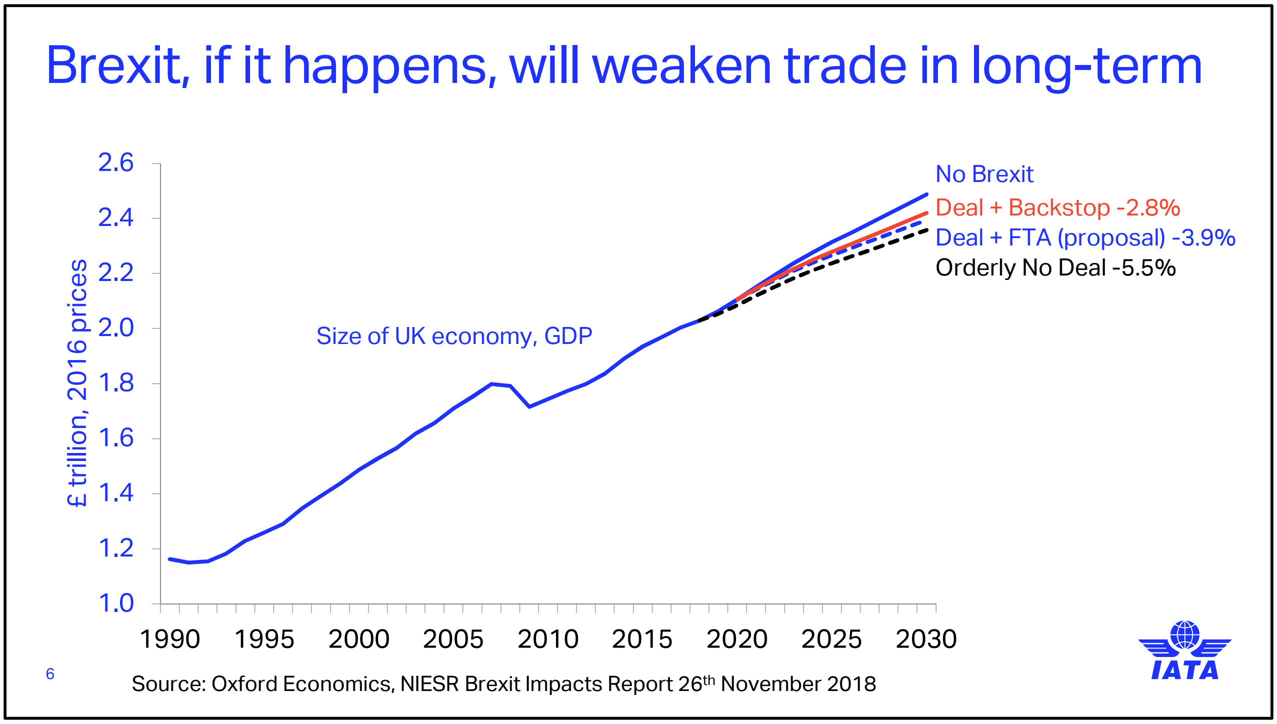
The world, since the GFC, is much less friendly to open and frictionless borders

Globalization, as measured by cross-border trade, has effectively paused ever since the GFC

World trade (exports and imports of goods) grew much faster than GDP (on average 2x) in the decades before the GFC as supply chains extended across borders and trade barriers were progressively removed. The blue line rose sharply as a result.

Since the GFC world trade has slowed to grow no faster than GDP. The blue line is now flat and shows little sign of rising again.

This has been associated with an on-shoring of production and assembly, with businesses moving facilities closer to home markets. This has been driven by a combination of soft protectionism, rising labour costs and technology. This is looking permanent, implying continued relatively slow growth in world trade



Brexit is a reflection of the changes that have taken place in attitudes to open borders since the GFC

We don't know what will happen, when it will happen or if it will happen

If it does there are two types of impact on the UK economy

The first is a confidence impact affecting short term economic developments. This is impossible to model and we don't

The second impact we have more confidence about and that is that trade will become more costly to transact, there will be border frictions.

The UK's National Institute estimate this will reduce the size of the UK economy or GDP by more than 5% in 2030 if there is no deal, and the UK falls back on WTO rules to trade. This is a serious loss, but it does not stop the UK growing.

Tariff wars bigger issue but not a recession cause

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Source: IMF, Citi 'US-China Tariffs-Limbo on the Verge of Trade Wars' 3 December 2018

For the world trade wars are a bigger impact issue

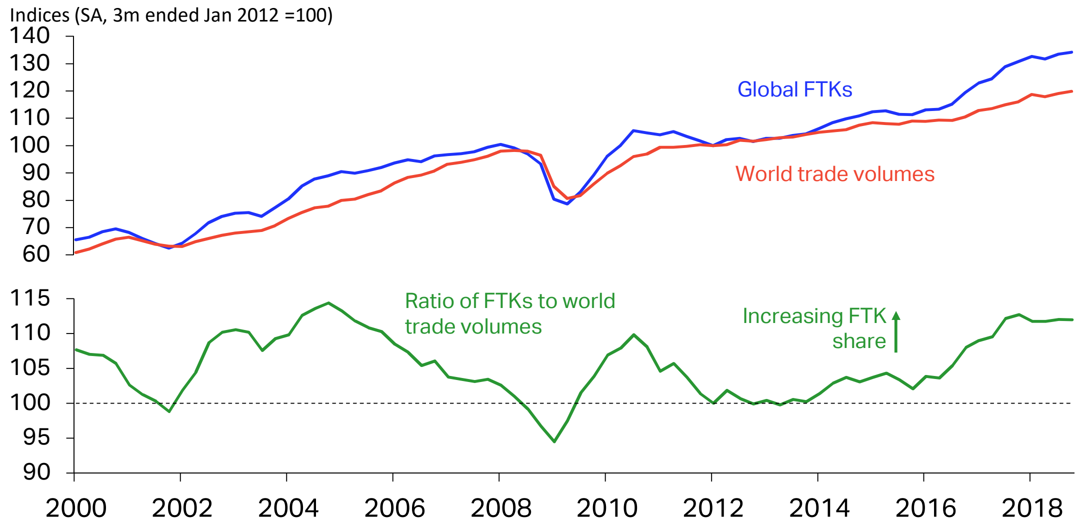
Most of the tariffs imposed so far have had a relatively marginal effect on the goods transported by air

An escalation with the US raising tariffs to 25% would be damaging. But economists at Citi estimate it will reduce global GDP growth by 0.3%

A further deterioration to tariffs on all trade between the US and China is estimated by Cit to reduce global GDP growth by 0.5%.

So these are seriously damaging to GDP and therefore on air cargo but will not on their own stop growth

But air cargo has outperformed sluggish world trade



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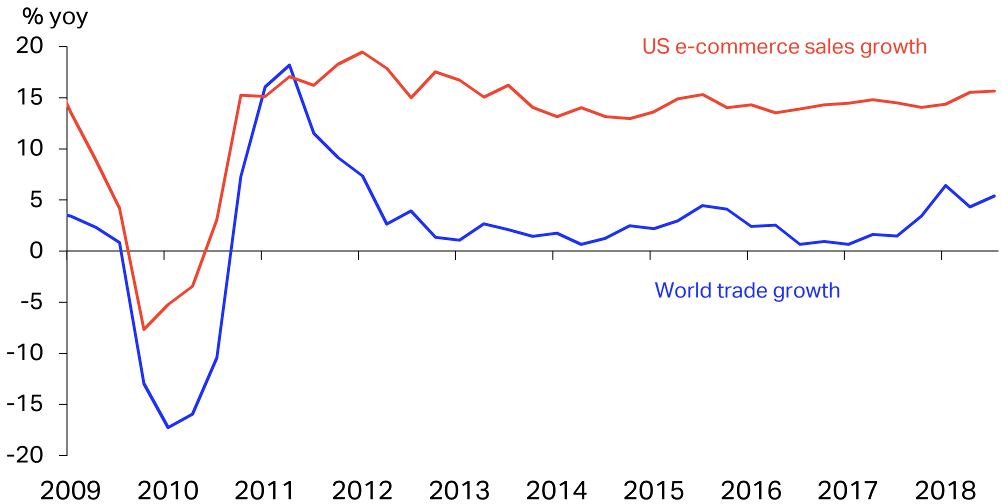
Source: IATA Statistics, Netherlands CPB

Despite the slow growth and the continued uncertainties about world trade, air cargo has increased its share over other transport modes – since early 2014

So air cargo has grown faster than world trade over the past 5 years.

E-commerce is part of the story



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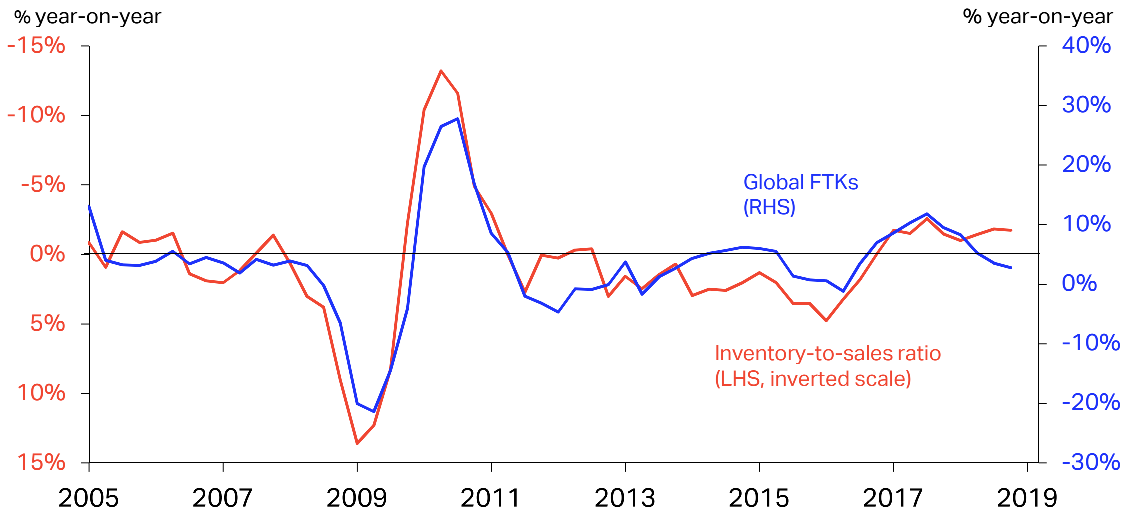
Source: IATA Statistics, Datastream

The structural shift in retailing towards e-commerce is part of the reason for the outperformance of air cargo, in particular on domestic markets.

And the recent business restocking cycle



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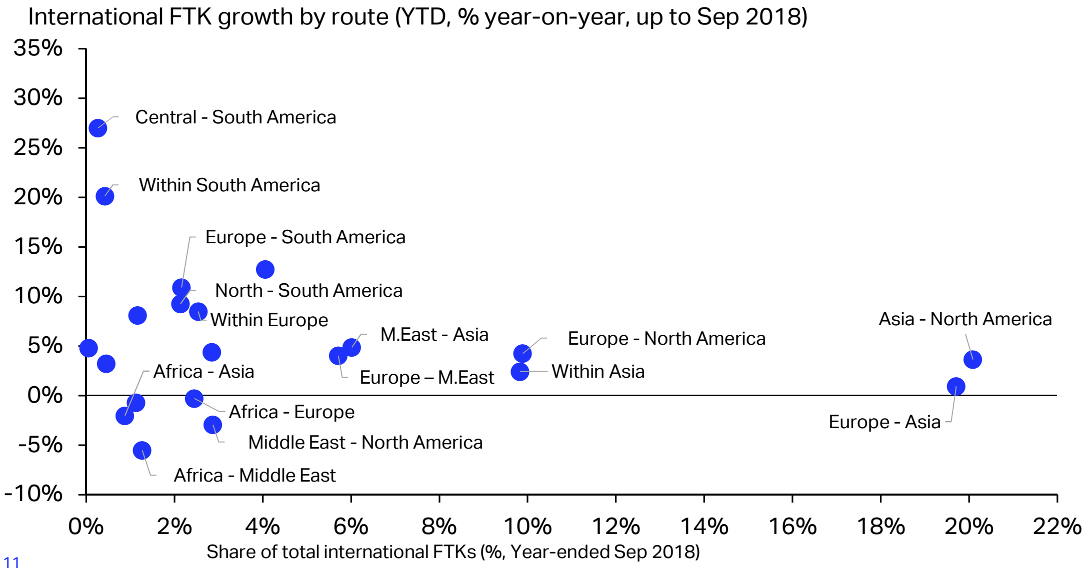
Source: IATA Statistics, Datastream

In the last 3 years the shape of air cargo growth and its outperformance over world trade has been driven by a business restocking cycle.

The acceleration in global economic growth from late 2016 caught business by surprise and inventories fell unexpectedly. They turned to air cargo to restock quickly. That led to a very strong growth year in 2017 for air cargo. Once the inventory-sales ratio (note scale is inverted) had bottomed out shippers turned back to other slower transport modes and air cargo growth fell in 2018.

This year market growth has been very diverse



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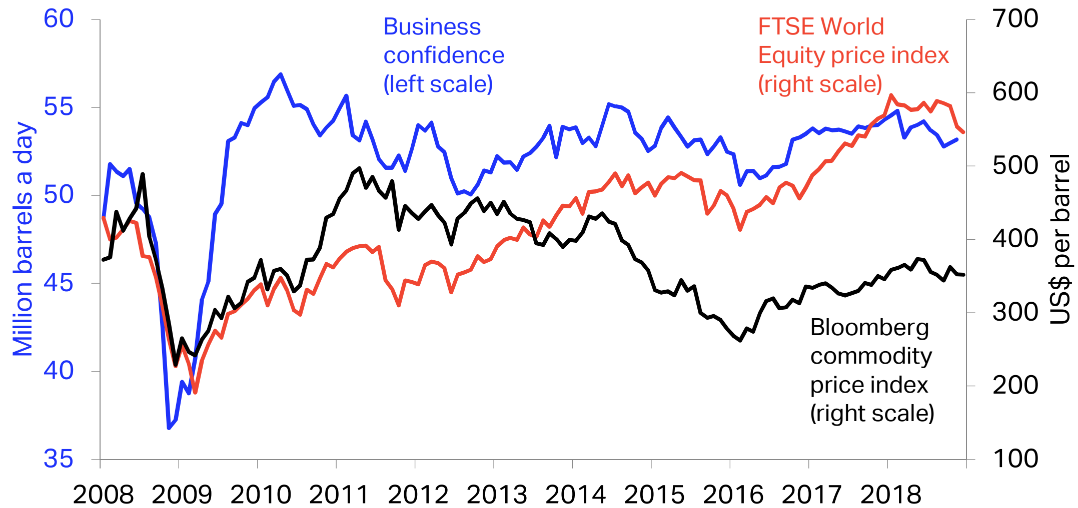
Source: IATA Statistics

Not all markets slowed with the restocking cycle in 2018.

South American markets showed very strong growth, partly due to the economic recovery in Brazil.

By contrast some African markets declined, but this was largely an adjustment following very strong growth the previous year.

But are markets now signalling recession in 2019?



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Source: Datastream, Markit

So what now?

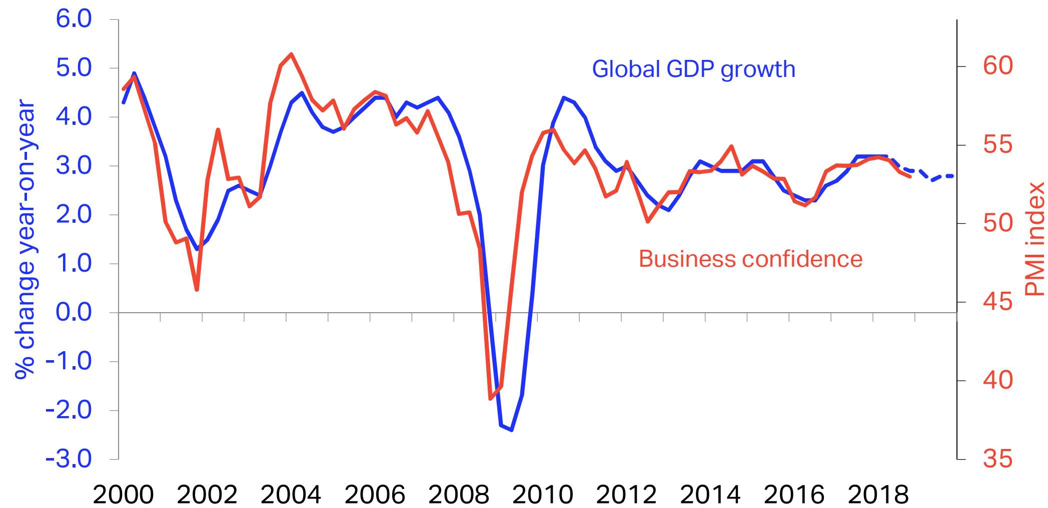
Are financial markets signaling recession with equity market declines and inverted bond yields curves?

We don’t think so.

Equity markets are down 8% on the year but are still 20-30% higher than early 2016

Bond yields are not higher only because of extraordinary central bank bond purchases.

In fact, economic growth is expected to continue



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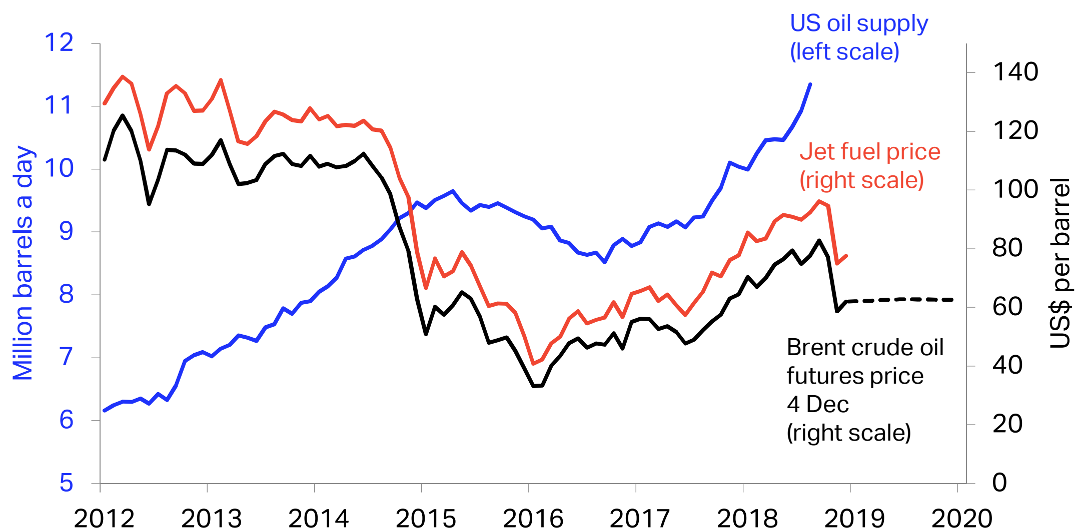
Source: Markit, IMF World Economic Outlook October 2018

In fact the mainstream economic forecasters (IMF, Oxford Economics, Goldman Sachs, Citi etc) are forecasting continued robust, albeit a little slower, growth in 2019.

This is driven by continued business investment, healthy jobs growth in the US and expansionary fiscal policies.

This is a major positive for the outlook

And fuel prices look considerably lower in 2019



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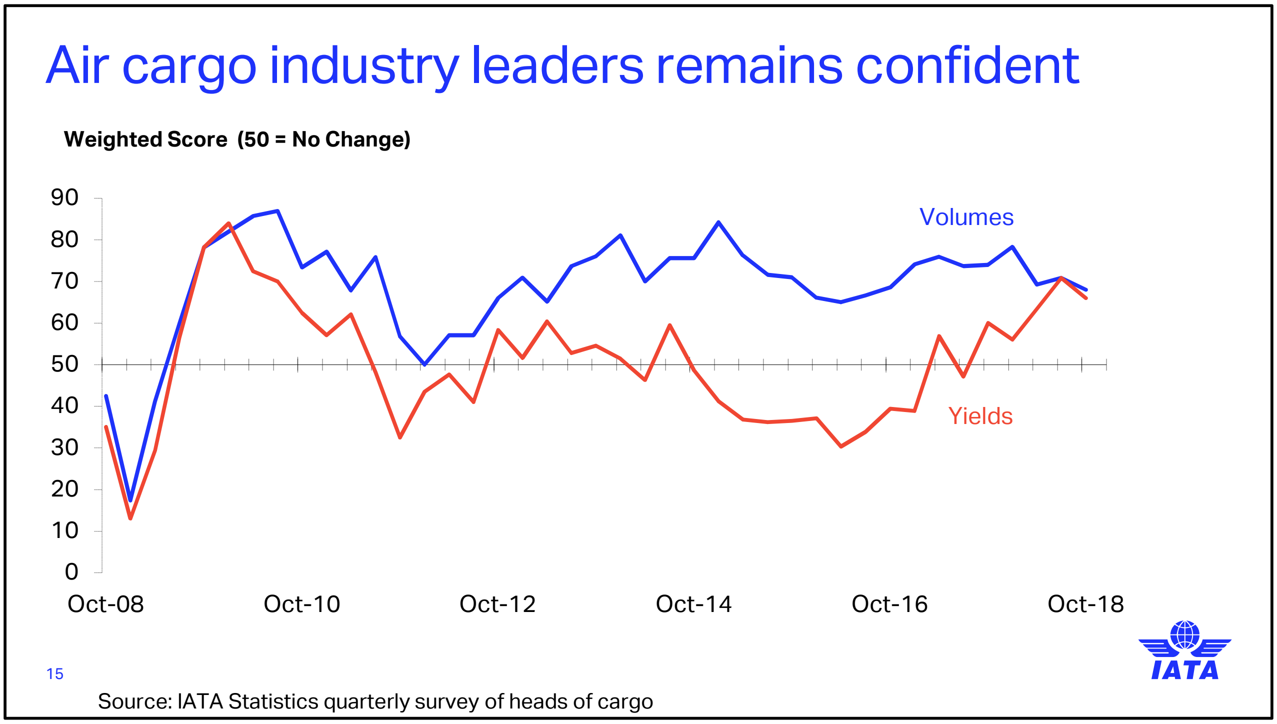
Source: Datastream, Platts

The second positive is the recent substantial fall in oil prices.

This was caused initially by a reassessment of the impact of sanctions on Iran's oil production. But more fundamentally the oil market is seeing increased supplies from the US and elsewhere. OPEC will cut but not by enough to stop inventories rising.

The expectation is that oil prices will be in a $60-70/b range in 2019.

Airlines will not see the full benefit of lower fuel costs in 2019, because of the delaying impact of hedging and because the IMO's 2020 Sulphur regulations will increase diesel demand from shipping.



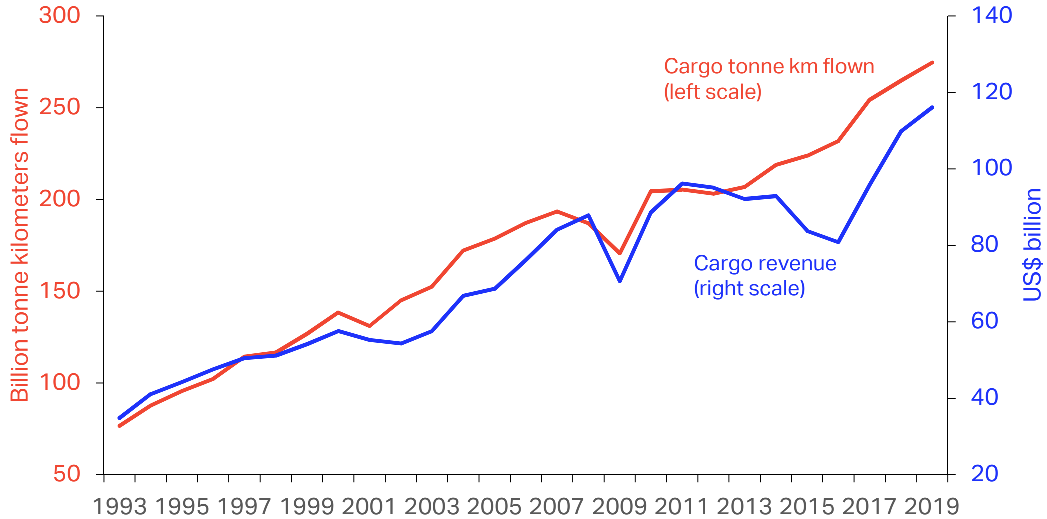
Air cargo industry leaders are confident in prospects for the next twelve months.

When we surveyed them in October they were confident that FTKs would continue to grow, though not at quite as strong a rate as before.

They were also confident that they could recover at least some of the higher fuel costs they had experienced in the year to that point through higher yields.

Revenues & FTKs slow, but grow further in 2019

Cargo revenue and tonne kilometers flown



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Source: IATA Statistics, own forecasts

We expect expansion to continue in 2019

Cargo volumes (FTKs) are forecast to grow 3.7%, a little slower than 2018 as a result of trade pressures but still positive

Cargo revenues are forecast to rise more than 5% to $116 billion in 2019