Economic performance of the airline industry – end-2017 update

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Airlines across the world connected a record number of cities this year, with more than 20,000 city-pair connections*. This is a 1,351 increase over 2016 and a doubling of service since 1996, when there were less than 10,000 city-pair connections, enabled partly by the new longer-range and more fuel-efficient single aisle aircraft replacing airlines’ existing fleet. Over this same period the cost of these airline services has fallen from 86 US cents to fly one tonne one kilometer to 80 cents, a 7% decline over more than 20 years. Since average consumer prices across the world have more than doubled**, this represents a halving in the real or inflation-adjusted cost of air transport***.

* Scheduled services with more than 1 flight per week using aircraft with more than 20 seats. City-pairs with multiple airports connected are counted as one e.g. London-New York. Source: SRS Analyser database.
** World consumer prices rose by 221% between 1996 and 2017. Source: IHS Global Insight.
*** This excludes passenger ticket taxes and passenger airport charges.
We forecast that international tourists travelling by air will spend more than $776 billion in 2018, a rise of over 15% in just two years.

More and cheaper city connections also boosts trade in goods and services, as well as foreign direct investment and other important economic flows. Although more than 99% of world trade by weight goes by surface transport, more than one-third by value is transported by air – and it is value not weight that matters for GDP. In 2017 we estimate that the value of all the goods carried by air was $5.9 trillion. Next year we forecast that this will increase to $6.2 trillion, representing 7.4% of world GDP.
The industry is also an important employer of skilled workers and is now adding a significant number of jobs*. **Next year we forecast that direct employment by airlines will exceed 2.7 million.** Along the supply chain and linked sectors in the wider economy we forecast that total jobs associated with air transport will exceed 70 million in 2018**. Airline jobs are also highly productive for the economies where they are located. On average across the world we forecast that in 2018 each airline employee will generate over $109,000 of gross value added (the firm-level equivalent to GDP), which is considerably higher than the economy-wide average. These jobs, together with the increased city-pair connectivity delivered by airlines to support other business sectors, should help with governments’ current challenge to improve poor productivity growth and living standards in developed economies.


** See p75 in [https://aviationbenefits.org/media/149668/abbb2016_full_a4_web.pdf](https://aviationbenefits.org/media/149668/abbb2016_full_a4_web.pdf)
Connecting cities directly also cuts the cost of air transport by saving time for shippers and travelers. This plus cheaper fares and a strong economy has led us to forecast worldwide air passenger numbers to exceed 4 billion in 2017 for the first time, and grow a further 5.6% to 4.3 billion in 2018. Next year the average world citizen will travel once every 21 months. Back in 1996 the average citizen flew just once every 50 months, and in the year 2000 every 43 months. Airlines count passenger numbers as departing passengers. Airports will count the same passenger both departing and arriving, so airport passenger totals are broadly double those counted by airlines.
Air travel is growing strongly. But in the past twenty-five years three out of four cycles in air travel have lasted around eight years, before ending in a downturn. The last low point in air travel was after the global financial crisis in 2009, so this current cycle is already eight years old.
However, we see no reason for this cycle to end at the moment; after growth of 7.5% in global RPKs this year we are forecasting further above-trend* expansion of 6% in 2018, helped by continued strong global GDP growth next year of 3.1%**.

* Average growth in Revenue Passenger Kilometers (RPKs) from 1996-2016 was 5.6% a year. Source: ICAO.

The cargo business has also benefited from a boom in business over the past year. We estimate that airline revenues from shipping cargo will grow 15% this year and a further 9% in 2018, as a strong cyclical upturn in volumes combines with some recovery in yields. The rise in cargo FTKs has been much stronger than we anticipated in our June forecast; we now expect a 9.3% increase in 2017 which is more than double world trade growth of 4.3%. The cause for this upgrade has been the unexpectedly strong economic upturn, leading shippers to find that their inventories need to be restocked quickly, which has meant they turned to air transport. Restocking cycles do not last very long, but the emerging growth of e-commerce and its use of air transport means that we are forecasting a further above-world-trade-growth expansion of FTKs in 2018 of 4.5%. Freight tonne kilometers.
Unit revenues will be helped by the increase in load factors, raised by above-trend growth in travel and cargo together with the lesser pace of capacity expansion shown in the announced schedules for the summer season next year. The other component of unit revenues is yield and these have been rising in both passenger and cargo markets over the past year, in response both to rising costs and increasing demand. **We anticipate these conditions will persist in 2018 leading to a further 3% increase in passenger yields and an overall rise in unit revenues of 3.5%.**
We now have data on EBIT or operating margins through to the 3rd quarter of 2017. The industry is highly seasonal and the 3rd quarter is always the most profitable quarter. The blue line strips out the seasonal ups and downs. EBIT or operating margins have been squeezed by accelerating unit costs since the high point in the first half of 2016. Nonetheless margins are still high by historical standards, and there were signs that the downward pressure has eased in Q3 of this year.
The biggest profitability challenge to date has come from accelerating costs. Oil prices are taken from market forecasts for 2018 of around $60 a barrel for Brent crude oil. Crack spreads have been widening so we forecast a gallon of jet fuel will cost $1.76 in 2018, a 12.5% increase over this year’s expected average. The impact will vary depending on hedging; US and Chinese airlines have low average hedges and face immediate pressures, but in regions like Europe high hedging ratios are delaying this cost impact. This has already led to some convergence of financial performance between regions. But labor costs are now a larger proportion of a typical airline’s operating costs than fuel, and these have been accelerating strongly in 2017. **Overall unit costs for the industry are forecast to accelerate from 1.8% growth this year to 4.2% in 2018.** Improved profitability in 2018 will depend on keeping unit revenue expansion ahead of this unit cost increase.
Airlines have responded to strong demand in 2017 by adding 1,351 new city-pair connections, taking delivery of 1,683 new jets and turboprop aircraft, increasing utilization of the existing fleet, and raising load factors to record levels; altogether boosting ASKs worldwide by 6.3%. According to the published schedules for 2018 airlines are planning a further significant boost to capacity of around 5.7%, a pace which is likely to come in below the growth of traffic. **Load factors are forecast to rise to a new record of 81.4%** as a result.
Clearly low fuel cost have boosted profitability and return on capital but that took place from 2015. The gap between load factors (cargo + passenger) and breakeven load factors drives profitability and returns, and that gap started to emerge several years before the fall in fuel prices. The shocks of the 2008 fuel price spike and the 2008-9 GFC were key to producing industry restructuring and a change in behavior that led to this emerging gap and better profitability. This suggests there are some structural changes that will keep profitability and returns higher in a lower growth environment than they would have been in the past.
This business environment should be favorable for airlines’ financial performance. The industry typically does well when economies and demand for air transport are strong. The stronger than expected economic upturn has already produced stronger than expected airline profits in the first three quarters of this year. Profits are still down on 2016, but not by as much as we forecast in June. **We now expect post-tax net profits for the industry to be $34.5 billion in 2017 (upgraded from our June forecast of $31.4 billion), after $35.3 billion the previous year.**

**Operating profit margins will slip from 8.3% in 2017 to 8.1% in 2018,** as a result of unit costs outpacing unit revenues. However, this margin compression is less intense than it was in 2017 and 8%+ operating margins are still very good and, apart from the previous three years, have only been seen before in the 1960s.

Lower debt means lower interest costs. As a result we forecast that, despite some reduction in profit margins, the industry will be able to increase profits net of interest costs to a new record $38.4 billion in 2018.
Return on capital for investors depends not just on the margins achieved on revenues, but also the revenues generated from invested capital. Airlines have used their capital more productively in recent years, as well as achieving better margins. Better aircraft utilization and seat densification is one way of sweating assets. But increasingly ancillary revenue streams have been added to the core seat product, partly as a result of unbundling. IATA’s NDC standard has been an important enabler for the indirect sale of ancillaries.
Another important way of measuring profitability is from the perspective of the capital providers to the industry. According to Boeing and Airbus the airline industry will need to attract $5-6 trillion of new capital to buy 35,000-40,000 new aircraft in the next 20 years, so a return on capital acceptable to investors – at least equal to the cost of capital – is critical. Until 2015 the industry as a whole had always failed to achieve this. Since 2015 returns on capital have exceeded the industry’s average cost of capital. We have upgraded our estimate of industry return on capital this year to 9.6% (down from a revised 10.3% in 2016), and we forecast a return of 9.4% in 2018, which is still above an estimated 7.4% cost of capital and so still creating value for the industry’s investors.
Further improvements in balance sheets forecast

Source: IATA Economics using data from IATA and The Airline Analyst
North America: Airlines in this region are forecast to generate net profits of $15.6 billion in 2017, close to our June forecast, and a larger $16.4 billion in 2018. Market conditions are expected to continue to be strong, with announced capacity growth likely to be slightly less than our traffic forecast of 3.5%.

North American airlines have generated more than half of the profits produced by the industry in the past three years, but rising cost pressures have slowed further improvements. Low hedging ratios meant rising fuel prices hit this region first and labor cost pressures have been an issue, though the expectation is that this pressure will diminish in 2018. The region’s share of industry profits slipped in 2018 but it remains the most profitable part of the industry in terms of dollar profits, margins and return on capital for investors.

Asia-Pacific: Airlines in this region are forecast to see profits of $8.3 billion this year, also close to our June forecast, growing to $9 billion in 2018. The strong cyclical rise in cargo markets has been a particular support and we forecast further above-trend growth in the region’s overall traffic of 7% in 2018.

Strong cargo revenues – up over 15% this year - have been a key driver of improved financial performance in this region; its airlines carry more than 37% of air cargo. Passenger markets have been mixed in terms of profitability across the region, but mostly improving to varying degrees; ranging from continuing new entry keeping profitability low.
in ASEAN, to strengthening domestic conditions in China, India and Japan, and a pause in the competitive pressures on long-haul connecting markets from the super-connectors*.

**Europe:** Airlines in this region have performed better than expected this year and we have upgraded our forecast to $9.8 billion (from the June forecast of $8.6 billion), as economic conditions and revenues surprised on the upside. **Next year we forecast further gains leading to net profits of $11.5 billion and stronger operating margins.**

European airlines have benefited from a strong economic recovery in home markets, a rebound from terrorism events the previous year, and some consolidation following the failure of several regional airlines. As a result **passenger load factors at 84.3% so far this year are the highest in the industry,** which helps both reduce unit costs and support unit revenues. The recovery of the Russian economy in the East of the regions has also helped, while the important North Atlantic market in the West continues to help support profitability, though this market is now attracting increasing new entry – as should be expected in an Open Skies market.

**Latin America:** Airlines in this region are forecast to generate $0.7 billion of net profit this year, close to our June forecast. **Next year further gains are expected in operating margins generating net profits of $0.9 billion.**

This region had been hit hard by recession in Brazil and weakness in many of the region’s commodity-based currencies. **The recovery in the Brazilian economy, though moderate, and reasonable growth in Mexico is helping, as is the weakness of the US dollar over the past year.** This has produced stronger market conditions and airlines have expanded at a significantly slower pace than traffic, leading to much improved utilization and load factors.

**Middle East:** Airlines in this region have faced **significant challenges recently** and, in contrast to other regions, we have **downgraded our 2017 forecast to net profits of $0.3 billion.** The situation is slowly improving in part and we forecast a moderate improvement to $0.6 billion net profits in 2018.

Low oil revenues and regional conflict have damaged home markets in the past year or so, while travel restrictions by some governments and competition from new super-connectors restricted growth on international markets. Airlines in the region have substantially scaled back their pace of expansion as a result, and business model changes have led to substantial write-offs in the region. These changes are already producing improvements in financial performance, though challenges remain.

**Africa:** Airlines in this region have faced multiple challenges recently and we forecast aggregates net losses this year of $0.1 billion. **Next year economic growth in the region is expected to be better, but continued low aircraft utilization on average is expected to mean further net losses in the region of $0.1 billion.**

The wider economic situation is only improving slowly in Africa, which is hampering the financial performance of its airlines. The key Nigerian economy is only just out of recession and growth in South Africa remains extremely weak. Traffic is growing but **passenger load factors for African airlines at just over 70% remain over 10 percentage points lower than**
the industry average. With high fixed costs this low utilization makes it very difficult to make a profit. Stronger economic growth will help next year.

* The ‘super-connectors’ is a common label given to the 3 large Gulf airlines and Turkish Airlines.
** In order to give a better picture of underlying profitability we exclude large non-cash items, like asset value write-offs or bankruptcy items, from the industry and regional profit estimates.
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