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RESEARCH NOTE

Commercial Aviation Market Improving, Recovery Time is Uncertain

The COVID-19 pandemic has had a severe impact on the commercial aviation market, with simultaneous government travel restrictions and stay-at-home orders across much of the world effectively grounding the global aircraft fleet. Although the aviation industry has recovered from prior pandemics and exogenous shocks, such as 9/11, SARS (2002–2003) and the Great Financial Crisis (2008–2010), the commercial aviation industry is facing what may be the most challenging period in its history. While the length and depth of this crisis remain uncertain, industry insiders are confident in aviation's resiliency and ability to recover. Nevertheless, the COVID-19 pandemic will reshape the industry for years to come.

There have been some positive developments during the the month of June. In the U.S., domestic flights are gradually recovering, with TSA reporting increasing passenger volumes at approximately 15% of the prior year, compared to 6–8% volumes a month ago. In Europe, domestic flight travel is also improving, with volumes at 40% of the prior year, compared to 20% in May. In China, domestic flights are now at 80% of the prior year, compared to 60% a month ago. In the finance markets, the U.S. capital markets have reopened for stronger airlines, with Southwest Airlines and Delta recently issuing a combined $3 billion of unsecured debt. On the negative side, the resurgence of COVID-19 cases in the southern and western regions of the U.S. and the travel ban imposed by the E.U. on travel from the U.S. may slow the pace of recovery.

Even with the recent positive developments, industry experts believe that a full recovery back to 2019 passenger levels could take several years. This will have many consequences for the commercial aviation sector. Here are several we are tracking:

- The unexpected collapse in air travel has resulted in airlines and aircraft lessors delaying, and in some cases cancelling, aircraft orders. This is bad news for Airbus and especially Boeing, which was already under pressure from the grounding of its 737 MAX. This is a positive, however, for current generation aircraft, such as the narrow-body Airbus A320ceo and Boeing 737NG families, which will remain in service longer, particularly with current low fuel prices.
- Given government restrictions on international travel and the uncertainty of an effective vaccine, international passenger flights will be slower to recover than domestic flights. This will pressure the long-haul markets, particularly wide-body aircraft, whose values will decrease more than narrow-body planes. Airlines focused on international traffic will suffer more than airlines focused on domestic markets.
- Leisure travelers are expected to return sooner than business travelers. This will benefit Low-Cost Carriers (LCCs) in the near term, as they also tend to focus on domestic markets and fly narrow-body aircraft exclusively.
- Government support for airlines has been critical. Governments in North America, Europe and much of Asia have provided loans or taken equity positions in their main airlines. Latin America has been an exception, resulting in bankruptcy filings for Avianca, LATAM and most recently Aeromexico. More government support will be needed if a second wave occurs or if a vaccine is not developed by next year.
- Lessors will likely become even more essential to airlines going forward. Given financial constraints and the need to reduce future Cap Ex, more airlines will turn to aircraft lessors for their aircraft as the industry recovers.

- Freighter aircraft are back in demand, a result of growing e-commerce traffic and the decrease in passenger flights that also carry cargo. Converting passenger aircraft to freighters could prove to be an effective solution for some of the excess aircraft in the market.

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The impact of the COVID-19 pandemic on commercial aviation is unprecedented. Ultimately, the industry will recover, but until then, investors and lenders should be prepared for some more turbulence.

George Stone

Managing Director

George Stone is a member of Barings' Global Private Finance Group. He is responsible for aviation and other transportation assets. George has worked in the industry since 1992. Prior to joining the firm in 2018, he worked for Siemens Financial Services as Head of Transportation Finance, responsible for structured finance transactions globally for aviation, rail, and marine. Prior to Siemens, he was a Managing Director at Babcock & Brown, where he led a team responsible for raising third party equity and debt funds focused on operating leases on rail and transportation infrastructure. George holds a BA degree in Political Science/International Relations from Columbia University.

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