Investec

Aviation Market Snapshot
Q3 2024

Sky high demand

Just the ticket

OUT OF THE ORDINARY

What's inside:

Key market insights

Activity levels improve

In August, the total Revenue Passenger-Kilometre (RPK) for the industry experienced a year-on-year (YoY) increase of 8.6%, surpassing the 6.5% YoY growth observed in Available Seat-Kilometre (ASK). The Passenger Load Factor (PLF) reached a record high of 86.2%, reflecting robust demand for air travel.

Domestic traffic within the industry grew by 5.6% YoY, with China leading the way with a notable 10.7% annual increase. Japan followed closely, recording a 7.6% YoY growth, more than doubling its growth rate from July.

International passenger traffic for the industry in August rose by 10.6% YoY. The Asia Pacific and Latin America regions saw significant growth, with increases of 19.9% and 13.6%, respectively, while other regions experienced growth rates ranging from 4.3% to 10.1%.

Looking ahead, air travel demand shows promising signs of increased appetite compared to the previous year. Ticket sales for both international and domestic travel have accelerated, with an average growth rate of 5.7%.

Source: IATA Sustainability and Economics using data from Information and Data – Monthly Statistics.

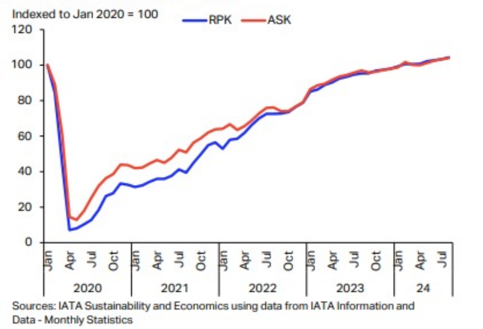
Trends

Commercial air passenger traffic update

In August 2024, commercial air passenger traffic, as measured by RPK, continued its steady growth trajectory, rising from 7.9% YoY in the previous month to 8.6%. Notably, RPK levels were 4.4% higher than those recorded in January 2020, after seasonally adjusting for fluctuations. Month-on-month (MoM), RPK increased by 0.4%, marking the fifth consecutive month of positive growth (see Chart 1).

The supply of seats, indicated by ASK, also remained positive, with global ASK rising by 6.5% YoY. In August, the growth in RPK outpaced that of ASK, leading to a historic high PLF of 86.2% for the industry – 1.7 percentage points higher than the previous year. This trend signals a robust demand for air travel, although ongoing supply chain constraints have also played a role in this dynamic (see Chart 2) Year-to-date, PLF stands at 83.4%.

Chart 1 – Global RPK and ASK, Seasonally Adjusted, Indexed to Jan 2020 = 100



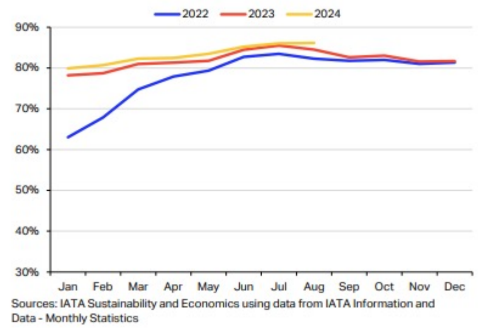
Sources: IATA Sustainability and Economics using data from IATA Information and Data - Monthly Statistics

Domestic and international air traffic update

In August, total domestic RPK for the industry rose by 5.6% YoY, reflecting a one percentage point increase from July, domestic RPK volumes remain higher than in previous Augusts, both for the industry overall and across major markets. Notably, all major markets reported domestic RPK YoY growth exceeding 4.9%, with China leading at an impressive 10.7%.

The domestic market in China has set another benchmark this August, with RPK volumes showing no signs of slowing down, despite economic headwinds. Japan followed with a 7.6% YoY growth, a notable acceleration of 3.1 percentage points from the prior month. For the third consecutive month, Japan's domestic RPK volumes have reached all-time highs, indicating an improving economic landscape.

Chart 2 – Industry PLF, RPK's % share of ASK



Sources: IATA Sustainability and Economics using data from IATA Information and Data - Monthly Statistics

In the US and India, domestic traffic continued its upward trend, achieving annual growth rates of 5.5% and 5.0%, respectively. Both countries also recorded historic monthly highs in RPK volumes for August.

International traffic growth

International passenger traffic, a key driver of overall industry growth, increased by 10.6% YoY in August, adding 0.6 percentage points to July's growth. All international markets reported RPK YoY rates above 4.3%. However, North America and the Middle East experienced slight deceleration compared to July, consistent with typical seasonal trends. Airlines in the Asia Pacific region led the growth with a remarkable 19.9% YoY increase, followed by Latin America and Africa at 13.6% and 10.1%, respectively.

As of August 2024, international air travel demand has reached historic monthly volumes for nearly all regions, with the exception of Asia Pacific, which remains 8.0 percentage points shy of full recovery. The economic challenges faced by China and ongoing geopolitical tensions are likely influencing growth in both its region and the broader industry, given its significant market presence. Despite global political uncertainties, the strong demand for international travel in August indicates a positive outlook.

Regional route performance

In August, routes within Asia experienced double-digit growth, with the exception of the Asia-Middle East route. The Africa-Asia route recorded the highest YoY growth at 28.7%, followed by international traffic within Asia at 25.4% and Europe-Asia at 23.5%. The Asia-Middle East route had the lowest YoY growth at 6.2%. Notably, all route pairs from Asia have experienced positive yearly growth for over 30 consecutive months.

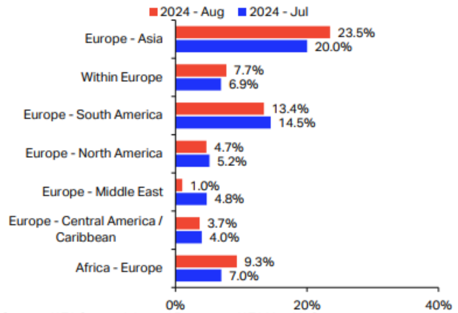
European air travel update

August marked another positive month for international RPK originating from Europe, with YoY growth rates exceeding 1% across all route pairs (see Chart 8 below). While most growth rates now fall within single digits, the Europe-Asia route stands out with a robust 23.5% increase, making it the third most significant route by RPK volumes.

Overall, all route pairs departing from Europe have been on a consistent growth trajectory since early 2021, which is encouraging for the region despite ongoing political instabilities. In August, RPK volumes reached all-time highs for all route pairs, with the exception of the Europe-Asia and Europe-Middle East routes. Notably, the Europe-Asia route remains significantly below its peak value for August 2019.

Source: IATA Sustainability and Economics using data from Information and Data – Monthly Statistics.

Chart 8 – International RPK, YoY% **–** Major route areas from and to Europe



Sources: IATA Sustainability and Economics, IATA Monthly Statistics

Global air cargo performance

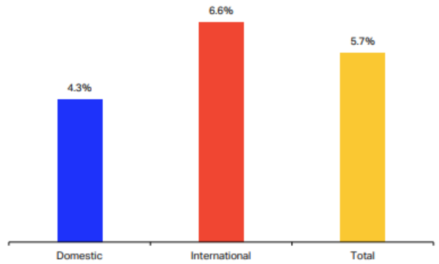
In August, Global Cargo Tonne-Kilometres (CTK) experienced a YoY increase of 11.4%, marking the ninth consecutive month of double-digit demand growth and the second straight month of record year-to-date demand levels. After seasonal adjustments, demand contracted slightly by 0.2% MoM.

International CTK rose by 12.4% compared to the previous year, driven by growth across all regions and major trade lanes. Notably, Asia Pacific carriers reported the largest expansion at 14.8% YoY, while the demand on the Middle East-Europe trade lane surged by an impressive 28.9%.

Global air cargo capacity, measured in Available Cargo Tonne-Kilometres (ACTK), grew by 6.2% YoY in August. Although this represents a slowdown compared to previous months, it still achieved record capacity levels.

Despite the increase in global capacity and declining fuel prices, the global air cargo yield continues to show a moderate upward trend.

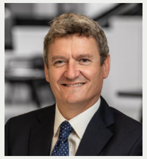
Chart 9 – Ticket sales, made in May – July for travel in August – September, YoY%



Sources: IATA Sustainability and Economics using data from DDS

Information sourced from IATA

A word from the Aviation Finance Team



Paul Da Vall
Aviation Equity Funds

"One consequence of the tight supply of aircraft today is the trend for airline operators to extend leases and keep mature aircraft for significantly longer in operation. This trend creates an interesting play for investors looking for the majority of their return to come from lease receivables, comprising largely of rental, maintenance reserves and end-of-lease compensation paid by the airline.

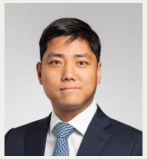
The reliance on residual value is largely removed in these transactions since the 'metal' will represent a low proportion of the overall value. Given the anticipated inflexion point occurring sometime toward the end of this decade, the point at which new technology will finally overtake existing technology, such a structure represents a prudent play to monetise the opportunity created by slow rates of new aircraft manufacture and delivery."

David Louzado
Aviation Technical

"The inability of both primary airframe original equipment manufacturers (OEM)'s to ramp up production rates has been well documented and discussed in previous editions, but more recently Boeing is now dealing with large scale industrial action by approximately 33,000 machinists.

At the time of writing, after a month of strike action, a potential solution has been tabled with the unions which may resolve the dispute, but the strike could not have come at a worse time for Boeing who has faced multiple issues, not just in supply chain and production, but also in certification.

The 777X programme has been put back again, which is further supporting the continuity in service of many widebody aircraft, such as A380s and 777s, beyond previous expectations, and the 737 Max 7 and 10 variants have a new target certification date of the first half of 2025, but industry confidence in target dates supplied by Boeing is very low given the recent setbacks. Current technology aircraft, and more importantly their engines, are holding their values with some appraisers positively revising their previous views and methodology applied to mid to late-life assets."



Derek Wong
Aviation Debt Funds

"As noted in the previous edition of Aviation Market Snapshot, aircraft lease extension rates are at record levels, fuelling strong extension rentals and increased levels of aircraft trading. These have in turn boosted demand for mid-life aircraft refinancing, creating more opportunities for aviation debt investors.

We have also seen increasingly sophisticated ways of structuring lease extension cash flows, particularly in terms of maintenance buyouts and bespoke provisions on mid-lease or end of lease financial compensation. Investec's debt structuring reflects these innovative features to ensure continued alignment with equity while mitigating relevant risks."

Jet fuel market update

The International Energy Agency (IEA) estimates continue to point to an oversupplied market in 2025, in spite of disruptions to Libyan output, a situation that looks set to be exacerbated with the plans of some OPEC+ members to push ahead with plans to increase supply in a phased approach starting in December.

Recently published Chinese GDP data indicate that in the third quarter the economy grew by 4.6% YoY, which is the slowest pace of growth since early 2023 and well below the government's 5% growth target. Meanwhile, the property sector continues to be a drag on the economy, with new home prices falling by 5.8% in September, following a fall of 5.3% in August. All of which adds to the gloomy outlook for the oil market for next year.

However, a resurgence in the geopolitical risk premium associated with the conflict in the Middle East, led to Brent rallying back over $80 per barrel ($/b). This move higher was exacerbated by short positions built up by speculators over the summer. As the market started to rise, those speculators bought back oil to cover their short positions to prevent further losses, thus accelerating the rally. More recently, a measure of stability has returned to the market in the 73 to 75 $/b area, but the market remains very apprehensive about the next developments in the conflict. On the other hand, if the direction of travel in the Middle East leads to increased confidence that supply will not be put at risk, the market could revert to worrying solely about oversupply next year, potentially sending Brent back under 70 $/b. Were that to happen, OPEC+ might be forced to accept that it can no longer delay the downturn in the cycle, leaving the market to balance itself through the price falling to a level that disincentivises output. Because some OPEC+ members, such as Saudi Arabia, have very low production costs, their reaction to low prices can be to increase output to maintain revenues at lower prices, which tends to push prices lower still.

Brent front contract

Sources: Investec, Bloomberg

Interest rate and foreign exchange update

Rate policy outlook

The Bank of England (BoE)'s Monetary Policy Committee cut interest rates for the first time since 2020 by 25 basis points (bps) in its August meeting. It played down the significance of downside surprises in data outturns relative to its August forecasts and indicated that, in the absence of "material developments", it plans to pursue a "gradual approach to removing policy restraint" from there. October's inflation data was lower than market consensus, with headline CPI inflation at 1.7% compared with 1.9% market expectation and core inflation at 3.2% compared with consensus estimates at 3.4%. This keeps the door firmly open to further policy easing by the BoE with the market now pricing in an approximate 25bps rate cut over the next five cycles.

Source: Bloomberg

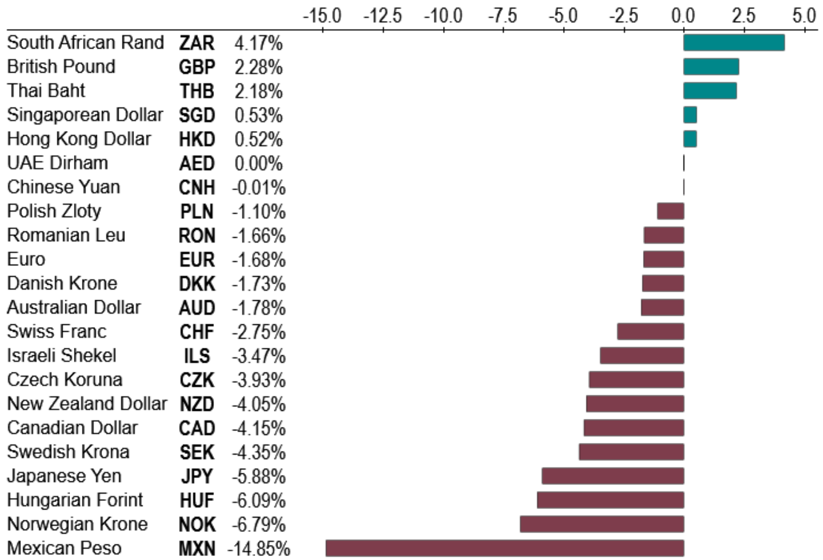
The US Federal Reserve (Fed) has also started its own rate cutting cycle. Although the initial move came later than in the eurozone or the UK, the Federal Open Market Committee (FOMC)'s first rate cut was more aggressive, at 50bps. Crucially, this was not because the latest baseline forecasts by FOMC members looked worrisome, but because the perceived risks of a marked rise in unemployment have shifted up in the past quarter. The larger cut can therefore be seen as an exercise in risk management. The market is pricing in a no more than 25bps rate cut in each of the next six cycles, two of these in 2024 and four in 2025. The European Central Bank has cut the deposit rate three times so far, by 25bps each, to bring it to 3.25%. The market is pricing in a further five rate cuts in each subsequent cycle.

FX market outlook

In the last six months, the US dollar has depreciated against some major currencies. One driver of this is the rebound in global economic momentum, reducing investors' preference towards safer currencies. In addition, there is anticipation that the Fed will lower interest rates at a faster pace than other central banks. The dollar has appreciated against most currencies however on a year-to-date outlook per the below snapshot.

Looking forward, Investec's outlook is a further dollar depreciation. The end-2025 forecast is for $1.37 to the pound, which is a weakening in the US dollar relative to sterling, from the current spot rate of $1.30. Part of that is a US dollar story, as the Fed's easing cycle and the slowing in economic momentum weigh on the currency. But, the strength of sterling also contributes to the forecasts, with the economic backdrop in the UK looking brighter than in 2023. We expect the US dollar to weaken against the euro too, largely due to interest rate dynamics, but also as the euro becomes more attractive as the eurozone economy is expected to improve in 2025.

Spot performance vs USD this year (%)



Source: Bloomberg

One key factor that threatens to alter the US dollar view is the outcome of the US Presidential election on 5 November 2024. Considering that there is no clear front-runner in the race, with polls suggesting a very tight contest, for now Investec's outlook has conditioned the forecast on an unchanged policy stance. There are risks to the dollar, depending on who sits in the White House and the makeup of Congress.

Source: Bloomberg

About Investec

Investec is a leading UK FTSE 250 financial institution with a dedicated alternative investment platform. Our focus is on Cashflow and Asset Backed Strategies including Aviation Finance, Infrastructure Debt, Real Estate Debt, Private Credit and Fund Finance. The group was established in 1974 and currently has approximately 8.200 employees. Investec Aviation offers an alternative approach to commercial airlines and lessors needing innovative financing solutions.