Investec

Airline travel soars

But altitude may be limited

OUT OF THE ORDINARY

What's inside:

Key market insights

Air passenger market analysis

Demand for air travel reached a new all-time high at the end of 2024 driven by a robust performance in the passenger market and an increase in international traffic. Notably, Northeast Asia was the leader in passenger traffic growth, largely due to the recovery of international travel from China and a rise in domestic tourism there.

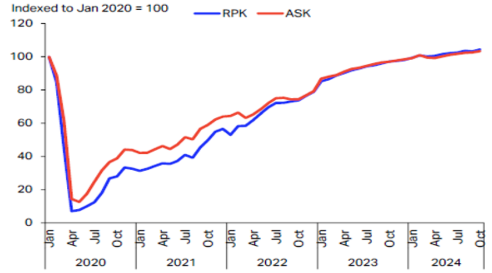
The more established Western European and North American markets also recorded resilient demand, contributing solidly to industry-wide growth. Emerging aviation markets outpaced the industry average, particularly in Northern Africa, Eastern and Central Europe, and Central Asia. The Southwest Pacific region also exceeded global averages, reflecting a revival in travel in the broader Asia Pacific area.

Conversely, despite establishing itself as a vital hub in global air traffic, the Middle East only posted modest growth in international passenger numbers. This can be attributed to a decline in traffic to Israel and its neighbouring countries.

Overall, despite some near-term geopolitical uncertainties, continued demand means the air travel sector is poised for continued growth.

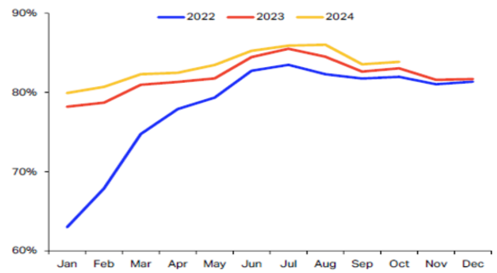
In October 2024, domestic and international passenger load factors (PLF) reached a record high, alongside continued growth in revenue passenger kilometres (RPK). However, there were some regional disparities. Carriers in North America, Latin America, and the Middle East reported lower average load factors compared to the previous year, while other regions set new records. Notably, African airlines demonstrated significant improvement, with October 2024 PLF exceeding 2019 and 2023 levels by 3.8 and 2.8 percentage points, respectively.

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

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



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

In domestic markets, RPK increased by 3.5% year-on-year (yoy) in October, slightly accelerating from the previous month. Domestic passenger traffic has surpassed last year's historical records, maintaining stable levels across key markets. However, the United States experienced a contraction, with RPK declining by 1.2% yoy, as traffic levels remained nearly unchanged from the previous year. Consequently, PLF in the US fell by 1.7 percentage points in October, coinciding with a 0.8% yoy increase in airline seat capacity.

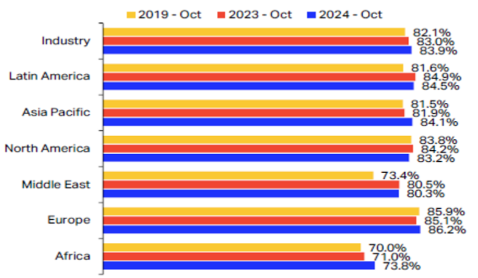
China continued to lead in passenger traffic growth, achieving a remarkable 9.7% yoy increase. The RPK figures for 2023 significantly exceeded the peak levels of 2019, and this year's cumulative traffic levels are nearly 13% higher than those in 2023. Domestic traffic in China is expanding rapidly, while outbound international travel has gradually increased over recent months.

Available Seat Kilometres (ASK) grew by a more modest 2.2% when compared with the robust passenger demand. The previous year saw a substantial increase in airline seat capacity, particularly through the deployment of widebody aircraft on domestic routes, which was previously uncommon. The slower growth in seat capacity this year reflects a small increase from the elevated levels of 2023.

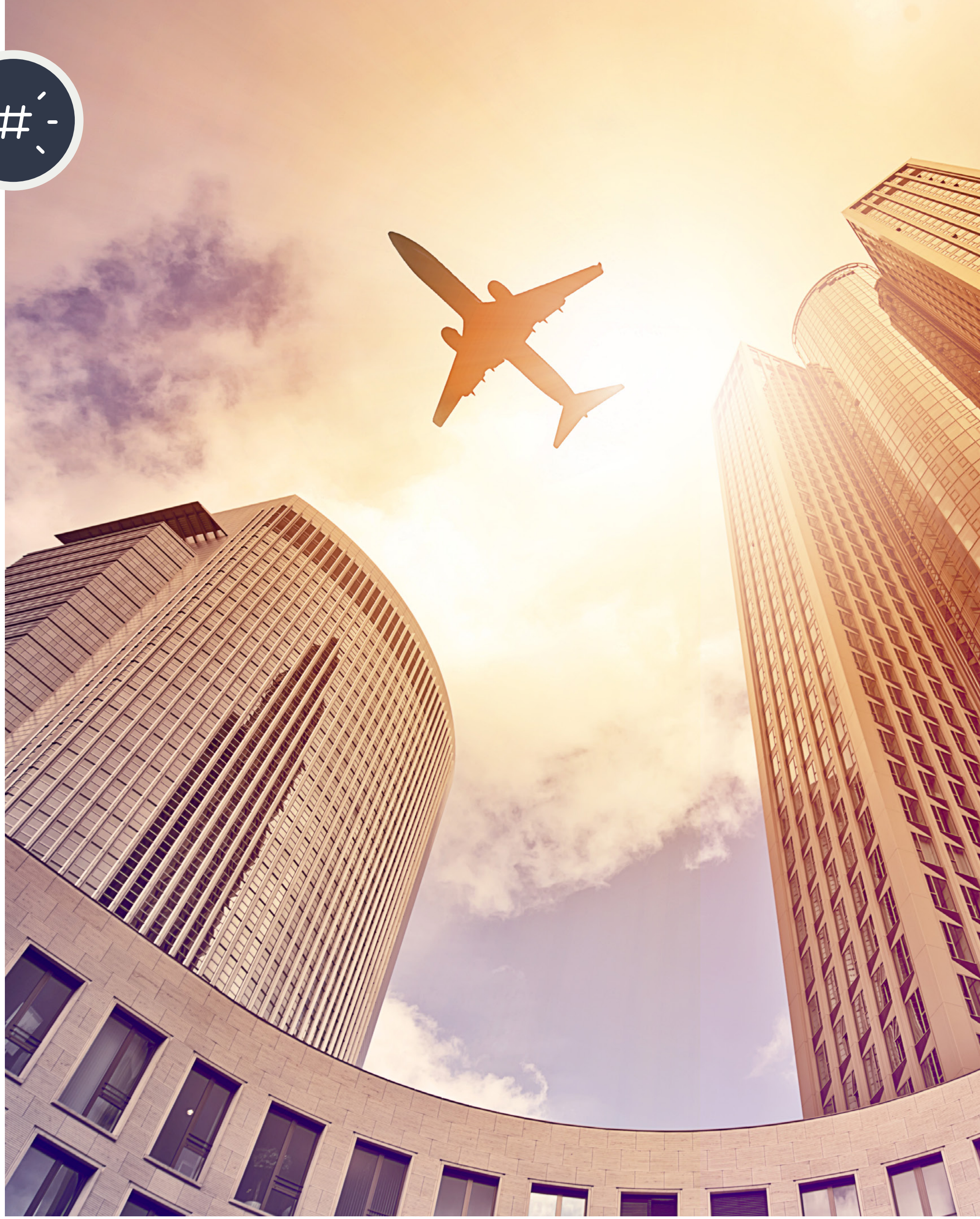
In Japan, passenger traffic grew by 3.3% yoy, while seat capacity decreased by 0.2%, resulting in a 2.9 percentage point rise in PLF. Japan has experienced fluctuations in ASK growth, with seat capacity levels remaining stable, yet demand for air travel surged, pushing load factors to new heights.

There was a 6.1% yoy increase in passenger traffic in India, although the rise in seat capacity outpaced this growth, leading to a 2.7 percentage point decrease in load factor. Brazil's air traffic growth accelerated further in October, reaching 9.5% yoy. In Australia, RPK increased by 2.9% compared to the previous year, with ASK levels stagnating while passenger demand continued to rise.

Chart 3 – Regional and industry passenger load factors, RPK's %share of ASK



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



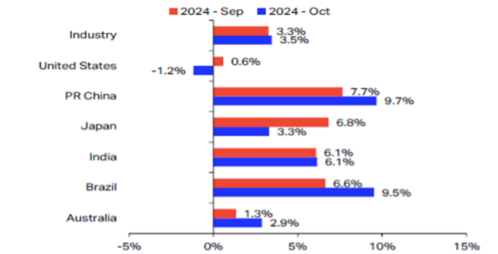
International Revenue Passenger Kilometres (RPK) experienced a yoy increase of 9.5%, maintaining growth momentum similar to the previous month and halting any deceleration. This continued rise in international passenger traffic is a significant driver behind the overall increase in RPK across the industry. On the supply side, ASK growth remains aligned with demand, indicating a balanced market.

The expectation is that RPK growth rates will gradually decline towards pre-pandemic levels. However, this month saw an acceleration in growth in North America and Europe, two of the three largest traffic regions, which substantially contributed to the higher industry figures. Conversely, growth in other regions was lower than previous measures, as expected.

Asia Pacific airlines continue to lead the regions with a remarkable 17.5% yoy increase in RPK, significantly surpassing the industry average, while PLF reached 82.9%. The surge in domestic travel demand in China is a key factor driving this traffic increase.

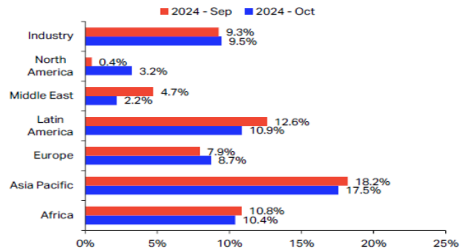
Latin American carriers reported a 10.9% yoy expansion in international traffic, successfully exceeding pre-pandemic levels. Meanwhile, international RPK for Middle Eastern and African carriers rose by 2.2% and 10.4%, respectively.

Chart 4 – Domestic RPK growth by market, YoY%



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

Chart 5 – International RPK growth by airline region of registration, YoY%



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

Intra-European market dynamics

Data indicates that the intra-European international market has experienced slow expansion over the past decade; however, it has witnessed remarkable growth this year, surpassing 2019 levels. The growth drivers appear to be the dynamism of Eastern and Central European passenger markets, alongside robust demand for air travel in Western European countries, despite general pressures on consumer budgets. In October, international RPK within Europe increased by 8.7% yoy, although PLF remains below 2019 levels on certain routes, which previously experienced significant demand surges in 2023.

It is worth noting that the North America – South America route area has recorded three consecutive months of RPK decline. In contrast, traffic between Europe and North America continues to rise steadily, with RPK increasing by 2.8% yoy in October.

Airline financial performance

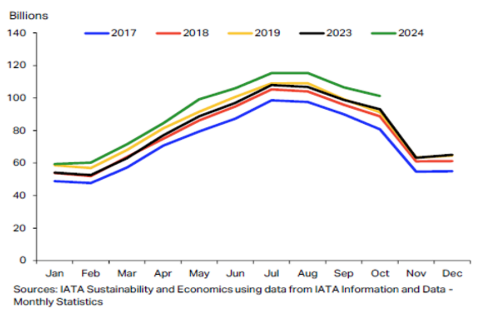
The financial performance of airlines in 2024 has been positively influenced by an upward revision of profitability for 2023, which emerged as an exceptionally strong year—ranking as the fourth best in the last 30 years. Notably, 2023 marked the first year post-pandemic when capacity utilisation and load factors were restored to pre-pandemic levels, resulting in a reduction in unit costs. The estimated operating margin for 2024 stands at 6.4%, which is 3 percentage points above the 20-year median.

However, it is important to note that costs have risen across all non-fuel areas. Following the remarkable recovery in profits during 2023, airlines faced pressure from staff for salary increases, which was compounded by ongoing labour shortages. Additionally, supply chain issues impacted other costs which limited capacity expansion. Maintenance costs, in particular, escalated due to engine-related aircraft groundings and an ageing global fleet. In 2024, the average age of the global commercial aircraft fleet reached 14.8 years, the highest on record. An older fleet means higher maintenance costs, higher fuel consumption, and additional capital expenditure for unplanned retrofits of aircraft that were initially scheduled for retirement.

With replacements currently unavailable, airlines are extending the operational lifetimes of existing aircraft. Furthermore, we have observed a significant rise in aircraft ownership costs, which can be attributed to the delayed effects of previous interest rate increases and a sharp rebound in leasing costs amid delays in new fleet deliveries.

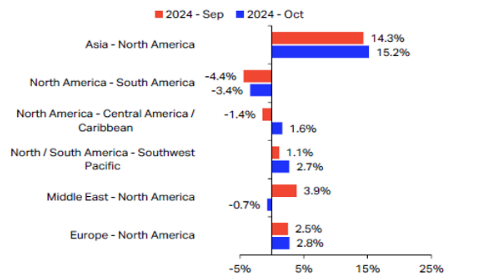
In summary, while the airline industry is benefitting from improved financial performance, rising costs in various areas pose challenges that need to be managed carefully.

Chart 6 – International RPK, Within Europe route area



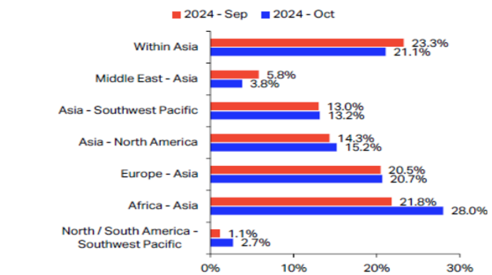
Sources: IATA Sustainability and Economics using data from IATA Information and Data - Monthly Statistics

Chart 7 – International RPK, YoY% – Major route areas from and to North America



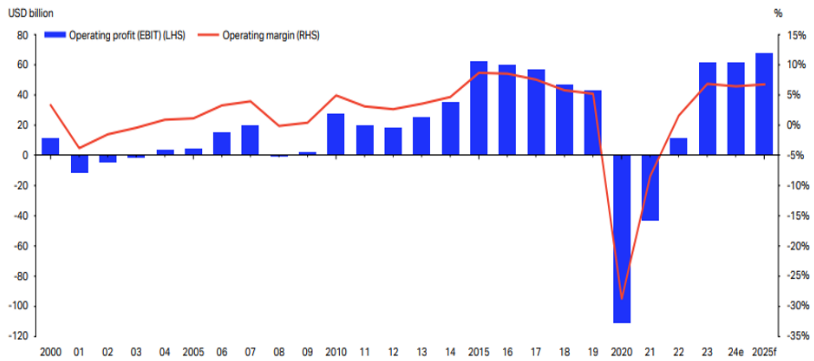
Sources: IATA Sustainability and Economics using data from IATA Information and Data - Monthly Statistics

Chart 8 - International RPK, YoY% – Major route areas from and to Asia Pacific



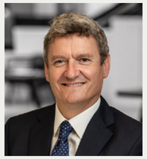
Sources: IATA Sustainability and Economics using data from IATA Information and Data - Monthly Statistics

Global airline operating profit in USD billion and operating margin, as % of revenue



Source: IATA Sustainability and Economics using data from Airfinance Global

A word from the Aviation Finance Team



Paul Da Vall
Aviation Equity Funds

Sentiment was generally positive at the annual aircraft finance and leasing conference in Dublin in early January. The continuing shortage of aircraft due to slow production by Airbus and Boeing means the market expects aircraft values and lease rates to remain strong this year. The larger aircraft lessors set out their growth targets for 2025, generally at or above 2024 rates. It remains unclear what will drive this growth as most lessors will not be able to exceed already modest new aircraft delivery rates from their order books, so growth will have to come from secondary market acquisitions (from other lessors), purchase and lease-backs (from airlines with new deliveries) and M&A (buying other aircraft lessors for their aircraft asset portfolios).

Achieving satisfactory yield will be a particular challenge for shareholders and investors given the strong pricing likely to be required to win any of these deals, which suggests we are in a seller's market until the original equipment manufacturers (OEMs) can raise production rates and begin to rebalance the shortage of aircraft supply.

David Louzado
Aviation Technical

Both Boeing and Airbus fell short of their intended number of deliveries in 2024. Airbus managed a final push, delivering 123 aircraft in December to hit 766 aircraft, just short of the 770 re-planned for the year. Boeing, however, achieved only 340 deliveries, well below its 2023 figure of 528 and lagging Airbus by more than 50%. The issues surrounding Boeing's production woes are well documented, ranging from safety concerns to strikes, but the global supply chain challenges and the shortage of human and material resources continues to restrict production of parts, aircraft assembly and maintenance services. Both OEMs have intentions to ramp up deliveries, but most industry sources are sceptical of their ability to reach these targets, certainly in 2025. Airbus plans to ramp up A320 production from around 55-60 a month to a rate of 75 by 2028, whereas Boeing cannot look to match those figures until the FAA removes the safety related caps imposed on production rates, currently at 38 a month for the 737 Max.

2025 will be another challenging year for all OEM production rates, but Airbus is way ahead in the race and will undoubtedly remain in the lead for some years to come. In the meantime, the used aircraft market continues to enjoy high demand and improved market values because of capacity shortage.

Derek Wong
Aviation Debt Funds

2024 was a busy year with transactions signing and closing right up to the final days of December. There was strong demand for aircraft financing in Q4 which has continued into 2025 amid an increasingly competitive debt market. In Q4, airlines continued to deliver solid results overall and asset values remained robust, as confirmed by appraisers making positive adjustments to market values and lease rates.

Although there is positive momentum as we begin 2025, we are watching for potential headwinds. In the latter half of 2024, the US dollar (USD) strengthened against core emerging market currencies in Brazil, Mexico and India, which further increased costs for local airlines. Air freight carriers will have to adjust to near-shoring trends and uncertainties President Donald Trump's term. In 2025, we will remain disciplined in structuring transactions while taking advantage of the stronger aviation market.

Jet fuel market update

US policy has been an important focus for oil markets so far this year.

At the end of his presidency, President Biden surprised markets by announcing sanctions on Russian and Iranian so-called shadow fleets, which were being used to circumvent sanctions on shipping and insurance. This created significant uncertainties for buyers in India and China.

Middle Eastern crude markets rallied particularly strongly as they form the main alternative source for buyers in Asia. Brent also rallied, exceeding $80 per barrel.

The impact of this was somewhat offset by news of a US backed ceasefire between Israel and Hamas, which prompted the Houthis in Yemen to announce they would stop attacking vessels in the Red Sea.

Therefore, the oil price unwound the conflict risk premium. The prospect of the Red Sea and Suez Canal being reopened to oil and refined product shipments would ease logistical challenges and also help to reduce prices.

Since then, President Trump has been sworn in and lost no time in declaring a “national energy emergency“ in order to boost domestic energy production. This addresses what he considers to be the problem of “hostile state and non-state foreign actors” that have targeted US domestic energy infrastructure, “weaponized” the US’“ reliance on foreign energy and abused their ability to cause dramatic swings in international commodity markets”. Given that increasing production takes time, these measures would seem to be bearish for oil and gas in the longer term, but not have any immediate consequence.

A more pressing concern for oil markets is Trump’s intention to refill the US Strategic Petroleum Reserve “right up to the top” and to impose tariffs of 25% on imports from Mexico and Canada from 1 February. Refilling reserves would be bullish for oil markets, but Trump’s focus on low energy prices suggest that he might be more circumspect than his rhetoric suggests.

His proposal to impose 25% tariffs on Canada and Mexico would presumably include oil. While the US is an overall net exporter, tariffs need to be considered in light of local infrastructure. For example, almost all Canadian production is exported to the US via pipelines to refineries that are geared up to process those grades of crude. It is not possible for Canada to export that crude elsewhere and for the US to substitute that with domestic production, due to infrastructure constraints.

At least Trump seems to have backed away from threats to apply tariffs more broadly and on China. Demand weakness was a key theme for oil markets last year and the outlook is not much more positive this year. A trade war was a potential further headwind.

Brent’s recent rally has broken up through some important technical resistances. This has taken it out of the narrow $71 to $75 per barrel range from Q4 2024, but does not necessarily represent the start of a larger move higher. OPEC+ has ambitions to add more output from April. Also, Russia does have an alternative to its shadow fleet, it can comply with the $60 per barrel price cap and use conventional methods to export its oil, which might mean the effects of the new sanctions are short lived.

Brent front contract

Sources: Investec, Bloomberg

Interest rate and Foreign Exchange update

In Q4 2024, the outlook for interest rates was still somewhat bearish, with cuts expected well into early 2025. This outlook has since changed dramatically given the volatile political and economic landscape. In the US for instance, the market is pricing in a less than 50% chance of a rate cut in each cycle until September 2026! This is mainly driven by the expected economic performance under the Trump administration. Trump's plan to implement tariffs may have an inflationary consequence which might see the US Federal Reserve intervene with rate cuts.

However, the timing of these tariffs, as well as other policies the president is seeking to implement, are uncertain.

In the UK, inflation has been ticking lower over the year with the latest headline inflation release in Q1 2025 in line with the Bank of England's (BOE) forecast. Although inflation is easing, the economy is evidently weaker with lower-than-expected GDP in November 2024. The market is expecting two rate cuts from the BOE in 2025 as inflation trickles lower.

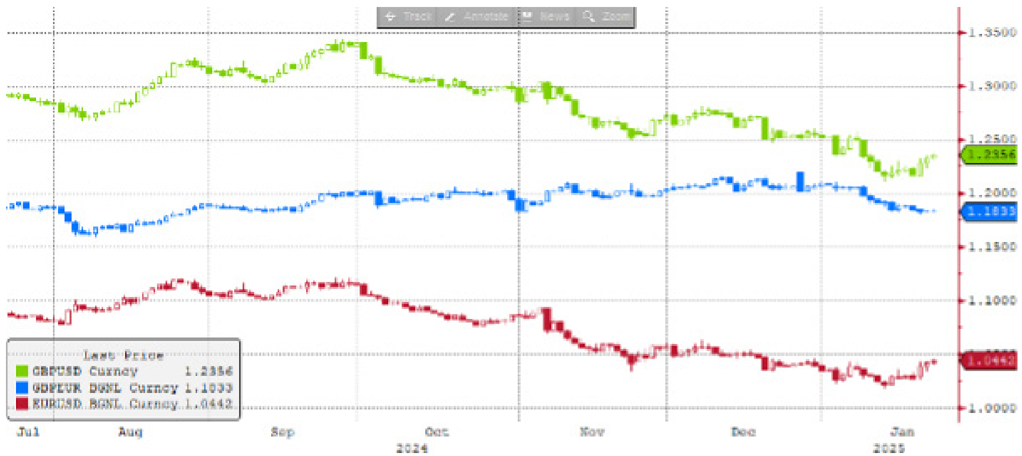
The European Central Bank (ECB) has continued its easing cycle with another rate cut in December, bringing the key deposit rate to 3%. The market has priced in four more rate cuts throughout 2025. Inflation in the Eurozone is still higher than the ECB had anticipated, however, the bank has cited confidence in the easing of inflation in 2025.

In foreign exchange, volatility in GBPUSD remains elevated due to sensitive sentiment towards sterling and potential volatility from a Trump presidency. Since the end of October, implied volatility in sterling has increased more than any other G10 currency. The pair touched a 14-month low of 1.2100 last week, when a vulnerable gilt market saw sterling unusually reacting negatively to higher UK interest rates. Subsequently, a lower UK CPI inflation print and therefore lower prospective BOE interest rate provided some support to sterling, which has traded in and around 1.2200 since touching that low.

5 Year GBP, EUR ad USD Interest rate swaps

Source: Investec Bloomberg

GBPUSD, GBPEUR and EURUSD performance over the last 6 months

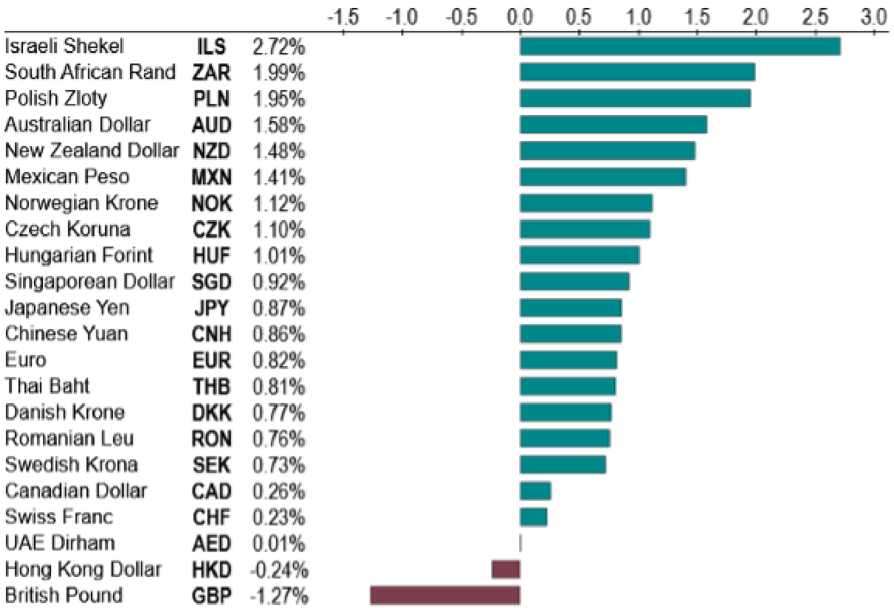


Source: Investec Bloomberg

Sterling has weakened versus the euro since touching its two-year high of 1.2162 on 19 December, and has now fallen below its 200-day moving average for the first time since mid-August, showing the loss of momentum. The pound had outperformed as the political backdrop looked uncertain and ECB interest rates are likely to be cut at a faster pace than the BOE rate. In many ways those two factors remain the case, but investor sentiment towards sterling has turned markedly, and now there's a distinct vulnerability surrounding both the pound and the UK gilt market - GBP is comfortably the underperformer in the G10 so far in 2025. While some may call it speculative trading, the fear around the UK's public finances has driven government borrowing costs higher, hampering HM Treasury's manoeuvrability.

Our economist's forecasts for 2025 are for initial dollar strength, sending EURUSD to parity, as higher tariffs will reduce imports and so the demand for foreign currency. The inflationary impact in the US from Trump's policies compared to disinflationary impact elsewhere will lead to differential monetary policy responses, with others cutting rates while the Fed stands pat. This, and the initial economic growth impulse, will also continue to lead dollar somewhat higher from here.

Spot performance vs USD this year (%)



Source: Investec Bloomberg

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