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From Bad To Worse: Global Air Traffic To Drop 60%-70% In 2020

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Key Takeaways

- We now expect global air passenger traffic to drop by 60%-70% in 2020 compared with 2019, a steeper decline than we estimated previously. We also expect a more gradual recovery to pre-COVID-19 traffic levels by 2024.
- We do not believe that this revision will have a widespread rating impact across the global portfolio of airlines we rate. However, as we continue to review our rated airlines, it may affect some individual companies.
- The more negative air traffic outlook increases pressure on all airlines' credit quality. Cost reductions, fleet right-sizing, and liquidity preservation will be critical measures to partly counterbalance the depressed demand for air travel.

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We have updated our global air passenger traffic forecasts and now expect traffic to fall by as much as 60%-70% in 2020 versus 2019. This is weaker than the 50%-55% drop we forecast at the end of May. We now expect 2021 air passenger traffic to decline 30%-40% compared with the 2019 base, and foresee a more gradual recovery to pre-COVID-19 levels by 2024.

The COVID-19 pandemic is the most severe crisis that the airline industry has ever faced. The International Air Transport Association (IATA, the trade association for the world's airlines) notes that in the six months following the 9/11 attacks, previously considered the most severe aviation crisis, air passenger traffic measured in revenue passenger-kilometers (RPKs) declined by 12%, far less than the 60%-70% drop we forecast for 2020.

Table 1

We Have Revised Downward Our Base-Case Assumptions For Global Passenger Air Traffic*

Year	Current estimates versus 2019 actual	Previous estimate (as of May 28, 2020)§
2020	Negative 60%-70%	Negative 50%-55%
2021	Negative 30%-40%	Negative 25%-30%
2022	Negative 15%-20%	Negative 15%-20%

Table 1

We Have Revised Downward Our Base-Case Assumptions For Global Passenger Air Traffic* (cont.)

Year	Current estimates versus 2019 actual	Previous estimate (as of May 28, 2020)§
2023	Negative 10%-15%	Negative 5%-10%

*Revenue passenger kilometers or revenue passenger miles (one paying passenger flown one kilometre or mile, an industry standard measure of traffic). §Source: "Airports Face A Long Haul To Recovery," published May 28, 2020, on RatingsDirect.

We use these global forecasts as a base for our air passenger traffic assumptions while analyzing individual airlines, but we also incorporate variations around the global estimate, such as regional differences or an individual airline's traffic mix and passenger profile. We follow the same approach when analyzing our portfolio of airports. Previously we made little distinction in our forecasts for global air passenger numbers versus RPKs (although we did make adjustments where appropriate at the individual company level). However, now we expect that the number of passengers flying is likely to show somewhat lesser declines than RPKs. This is because air traffic volumes include the effect of distance traveled, and international travel, particularly long-haul intercontinental travel, is even more depressed than domestic travel. In normal circumstances, international travel overall (both short and long trips) accounts for about two-thirds of the total traffic.

Some Potential For Rating Impact For Global Airlines

We do not believe that the revision of our global air passenger traffic forecasts will have a widespread rating impact across the global portfolio of airlines we rate. However, as we continue to review our rated airlines, it may affect some individual companies.

We have lowered our ratings by multiple notches (between one and eight notches; see table 3) on most airlines since the outbreak of the COVID-19 pandemic. Pre-COVID-19 just over one-third of our global airlines portfolio was rated at 'B+' or lower, and now this has risen to about two-thirds of the total. Only three airlines remain investment grade--Ryanair Holdings PLC, Southwest Airlines Co., and easyJet PLC--all very low or low-cost carriers largely focused on leisure passengers and short-haul flying, and equipped with robust liquidity.

We will continue to review our portfolio to reflect our updated views. Cost reductions, fleet right-sizing, and liquidity preservation will be critical measures to partly counterbalance the depressed demand for air travel. The more negative global traffic outlook increases pressure on all airlines' credit quality, and ratings are likely to remain under pressure until a vaccine or effective treatment is widely available or until airlines find a more widely accepted way to operate under a "new normal". Almost all airlines we rate remain on negative outlook or CreditWatch negative, reflecting the extremely weak and uncertain outlook for the aviation sector.

Many rated airports also remain on negative outlook or CreditWatch negative. We think that any rating actions on airports as a result of our revised air traffic assumptions will be limited to those that already had tight financial, liquidity and/or limited covenant headroom.

Recovery Hindered By International Travel Restrictions

Our 2020 calendar-year forecasts now include actual results, during which global air passenger traffic was largely grounded for almost three months. Industry-wide RPKs fell 94% in April, 91% in

May, and 87% in June year on year as per IATA data (see table 2). Domestic travel has proved more resilient, and we expect it to recover more quickly than international travel, as countries have initially started to ease travel restrictions within their home markets, and due to pent-up demand for visiting friends and relatives. Although we expect some recovery in international travel in July and August, this is limited to particular travel corridors where travel restrictions have been generally lifted (such as the Schengen area). Nevertheless, there are numerous notable exceptions--some countries are adding back restrictions on certain countries with rising infection rates, including quarantine rules or testing for the virus.

Intercontinental traffic is likely to take some time to reopen given more severe border restrictions. The weakening global macroeconomic outlook will also impact both consumer and business spending power on all but essential travel. Furthermore, it has been reported that some countries are set to cut the number of short-haul flights available for environmental reasons (for example, where there is a reasonable alternative rail service), particularly where generous government support packages have been awarded to legacy carriers.

Table 2

Revenue Passenger Kilometers Have Plummeted In 2020 Year on Year

	January	February	March	April	May	June	H1
International	3%	-10%	-56%	-98%	-98%	-97%	-62%
Domestic	2%	-21%	-48%	-87%	-79%	-68%	-52%
Total	2%	-14%	-53%	-94%	-91%	87%	-58%

Source; IATA: Air Passenger Market Analysis.

Corporate travel has not yet shown signs of recovery. More widespread adoption of remote working and virtual meetings, as well as corporate cost-cutting, should ease eventually but could have some lingering impact on business travel. Some may be permanently lost as a result of the adoption of virtual meetings. Unfortunately for many airlines, business travel and intercontinental trips, the two most severely affected, are also the most profitable sources of passenger revenues. Indeed, many legacy airlines use their less profitable (or in some cases unprofitable) short-haul routes primarily to feed into their more profitable long-haul network.

In applying our general assumptions about global air traffic to forecasts for specific airlines, we seek to take into account regional and airline-specific differences. Thus, Chinese airlines, among the first to be affected, have staged a partial recovery in recent months, while those in Europe, North America, and Latin America are at an earlier stage. Notably, the path to recovery may well be uneven as resurgence of the virus prompts renewed travel restrictions and passenger concerns. Individual airlines' normal traffic mix also affects our forecasts of their performance. Thus, for example, airlines that rely heavily on intercontinental business traffic are likely to face greater headwinds than those that mostly serve domestic leisure passengers, which should see earlier and more substantial improvements. A further consideration is the role of seasonality in air travel. In the northern hemisphere, the second and third quarters are normally by far the most profitable, but COVID-19 has submerged this effect, meaning airlines will lose a disproportionate share of their annual revenues.

What matters to airlines' financial performance is ultimately revenues, rather than traffic, so trends in ticket pricing matter as well (the industry measure is "yield", which is passenger revenue per RPK or RPM). In general, we are assuming that yield will be somewhat lower than pre-crisis, both because there may be discounting to lure reluctant passengers on board and, likely more importantly, because there are fewer business travelers, who mostly pay higher fares. However, we note there will be exceptions on certain routes where some tickets are more expensive given fewer seats are offered. Non-passenger revenues, particularly air cargo, have been far less affected, but these do not constitute a large portion of revenues for rated airlines.

Although the revenue outlook is discouraging, there have been some partially offsetting positives for many airlines:

- Ticket refunds for trips cancelled by airlines have so far not caused as much cash outflow as expected, with large portions taking the form of vouchers for future flights (although difficulties of passengers seeking to claim cash refunds has prompted criticism of airlines in some cases). That said, as passengers use these vouchers, airlines will not be receiving more cash in, while they will be incurring costs.
- Many airlines have managed to cut operating costs more extensively than we initially expected from their normal proportion of fixed, variable, and partially variable costs. Mostly this comes from airlines' early recognition that they will need to shrink their operations for years to come, and from willingness of employees to accept temporary furloughs or early retirement.
- Governments in many countries have provided generous aid to airlines in the form of cash grants (mostly to support continued employment), equity injections, and state-backed loans. These have proved crucial in supporting near-term liquidity needs for rated airlines in the U.S. and in some European countries. By contrast, there has so far been little such support in Latin America, where some of the largest airlines in the region have filed for bankruptcy.

Government support for airlines, and more general central bank moves to support capital market liquidity, have bolstered market confidence to support surprisingly large borrowing and even equity increases by large airlines in the U.S. As a result, current cash and borrowing capacity for the four largest U.S. airlines is around $15 billion or higher, more than twice normal levels. These impressive numbers, however, have been achieved mostly by adding debt to the balance sheet, and airlines' continuing (albeit reduced) cash consumption will erode the totals by year-end.

Many European airlines have also been successful in securing necessary liquidity, primarily through state aid in various other forms (including state-backed schemes such as the COVID-19 Corporate Financing Facility from the Bank of England) or through the private loan markets rather than through bond issuance. Deutsche Lufthansa has received a huge €9.0 billion state aid package that will significantly boost the group's liquidity position, but will result in weaker credit metrics because we regard most of the package as debt. In contrast, majority state-owned Air Baltic received a €250 million equity participation from the Latvian government, which we view as akin to common equity.

However, government support may not always prevent a default. For example, Scandinavian Airline SAS has announced a recapitalization plan backed by its two largest shareholders, the Swedish and Danish governments. Capital injections from these governments are conditional on the exchange of SAS' outstanding bonds and hybrid notes into common shares. We will view SAS' exchange offer as distressed and tantamount to default once completed because, in our view, the offer implies that the lenders will receive less value than the promise of the original securities, and is distressed.

High Uncertainty Over Recovery Of Travel Patterns

It is impossible to predict the pace, extent, and timing of recovery in travel patterns with any certainty. We will likely continue to revisit our assumptions as the pandemic continues to evolve.

S&P Global Ratings acknowledges a high degree of uncertainty about the evolution of the coronavirus pandemic. The consensus among health experts is that the pandemic may now be at, or near, its peak in some regions, but will remain a threat until a vaccine or effective treatment is widely available, which may not occur until second-half 2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Table 3

Long-Term Ratings And Outlooks On Airlines*

Company	Region	Feb. 1, 2020	Aug. 12, 2020	Notches downgrade during COVID-19
Ryanair Holdings PLC	EMEA	BBB+/Stable	BBB/Watch Neg	1
Southwest Airlines Co.	North America	BBB+/Stable	BBB/Watch Neg	1
easyJet PLC	EMEA	BBB+/Stable	BBB-/Watch Neg	2
British Airways PLC	EMEA	BBB/Stable	BB/Negative	3
Delta Air Lines Inc.	North America	BBB-/Stable	BB/Negative	2
Deutsche Lufthansa AG	EMEA	BBB/Stable	BB/Negative	3
International Consolidated Airlines Group, S.A.	EMEA	BBB/Stable	BB/Negative	3
Alaska Air Group Inc.	North America	BB+/Stable	BB-/Negative	2
Air Canada	North America	BB+/Stable	BB-/Watch Neg	2
JetBlue Airways Corp.	North America	BB/Stable	B+/Negative	2
United Airlines Holdings, Inc	North America	BB/Positive	B+/Negative	2
Air Baltic Corp AS	EMEA	BB-/Stable	B/Stable	2
Allegiant Travel Co.	North America	BB-/Stable	B/Negative	2
Spirit Airlines Inc.	North America	BB-/Stable	B/Negative	2
Turk Hava Yollari A.O.	EMEA	B+/Stable	B/Negative	1
American Airlines Group Inc.	North America	BB-/Stable	B-/Negative	3
Transportes Aereos Portugueses, SGPS, S.A.	EMEA	BB- prelim/Stable	B-/Watch Neg	3
WestJet Airlines Ltd.	North America	B+/Stable	B-/Watch Neg	2
Hawaiian Holdings Inc.	North America	BB-/Stable	CCC+/Negative	4
Azul S.A.	Latam	B+/Stable	CCC-/Negative	5
Gol Linhas Aereas Inteligentes S.A.	Latam	B/Stable	CCC-/Watch Neg	4
SAS AB	EMEA	B+/Stable	CC/Negative	6
Avianca Holdings S.A.	Latam	B-/Stable	D	5

Table 3

Long-Term Ratings And Outlooks On Airlines* (cont.)

Company	Region	Feb. 1, 2020	Aug. 12, 2020	Notches downgrade during COVID-19
Grupo Aeromexico S.A.B. de C.V.	North America	BB-/Negative	D	8
Latam Airlines Group S.A.	Latam	BB-/Stable	D	8
Virgin Australia Holdings Ltd.	APAC	B+/Stable	D	7

*As of Aug. 12, 2020.

Related Research

- Industry Top Trends Update: North America Transportation, July 16, 2020
- Industry Top Trends Update: EMEA Transportation, July 16, 2020
- Six European Airlines Downgraded As COVID-19 Impact Erodes Credit Metrics; Majority Still On Watch Negative, May 20, 2020
- Airports Face A Long Haul To Recovery, May 28, 2020

This report does not constitute a rating action.

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