The Adolescent Growing Pains and Market Maturity

As part of our latest contribution to a new Market Outlook Report, OAG's John Grant explores a couple of market driven issues that could have an influence on the numbers and types of aircraft that will be in demand.

Firstly, we take critical look at the large number of aircraft deliveries due in China next year and ask whether Chinese infrastructure can support such rapid growth. Secondly, in contrast we explore one of the oldest, most established long-haul markets in the world and ask how the emerging low-cost models are stimulating competition.

It can be difficult to keep up with everything that is happening in the aviation industry; the pace of change, aircraft orders and deliveries, new routes, alliances, legacy and low-cost expansion, and long-haul low-cost are only a few of the daily challenges that we face. Bombarded by so much happening, it's easy to lose sight of the details and as we all know quite frequently, the devil is in that detail.

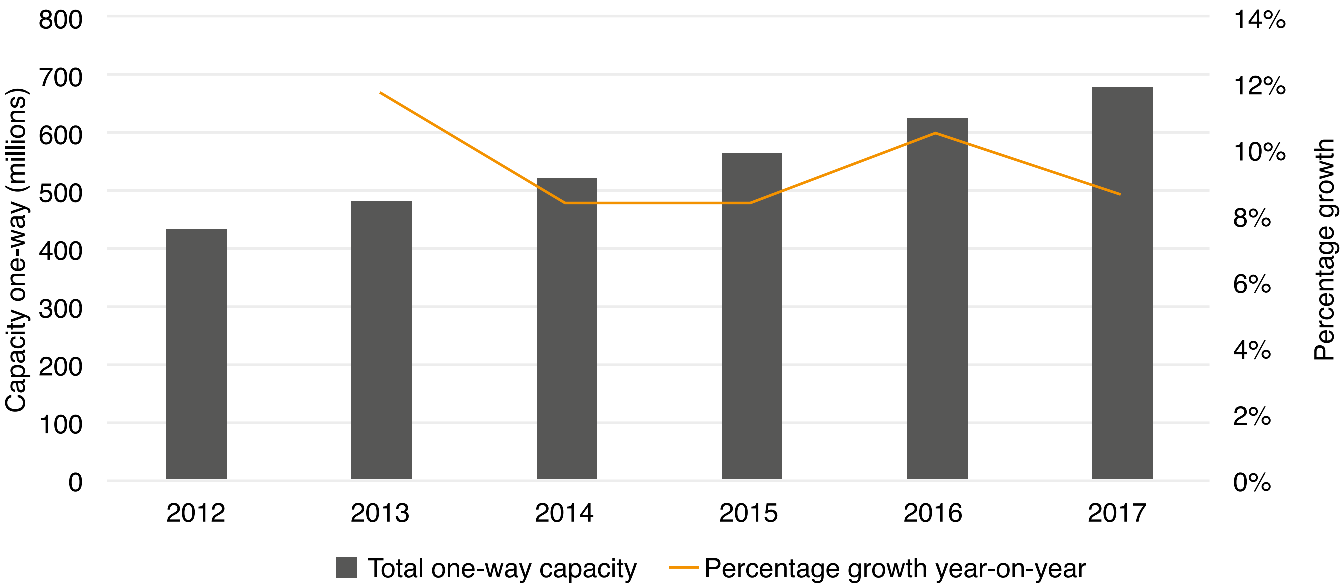
In the last year, nearly 1.4 million new scheduled flights were added to the OAG database; that's the equivalent of some 3,800 flights a day. In capacity terms, that's around 299 million additional seats or 819,000 a day – just over nine completely full Wembley Stadius. There are some 815 scheduled airlines, so keeping up to date on a market changing that quickly probably means you are not doing your day job!

We've picked two interesting areas and dug a bit deeper to see what really is happening, highlighting some things that may not have been spotted and investigating issues that could perhaps impact fleet deliveries and requirements. One is the state of the Chinese market and the second, more surprisingly, is perceived as one of the most mature markets in the world – North America to Europe.

Chinese Growing Pains

Capacity continues to grow in China at similar levels to those of recent years as the chart below illustrates. Scheduled airline capacity from China, including the vast domestic network, is now just under 700 million, reflecting a near 60% increase in capacity in the last five years. Per annum increases of near 9% have been the norm over this period as a mix of new aircraft deliveries, major expansion plans of locally-based airlines and increasing consumer desire to travel have heated the market.

Chart 1 – Scheduled Airline Capacity from China, 2012 - 2017



Source: OAG Schedules Analyser

Analysis of this growth by domestic and international capacity reveals that domestic growth continued to be strong in 2017, whilst international capacity saw a significant reduction from the levels seen in the previous four years. International market capacity accounts for 12% of all seats offered with significant capacity growth in the last year to Malaysia, Indonesia, the Philippines and Russia, whilst South Korea saw capacity fall by 22% as Chinese authorities redirected traffic to other markets as political tensions escalated.

Table 1 – China Capacity Growth by Segment, 2012-2017

China Capacity One-Way (000s)	2013	2014	2015	2016	2017
Domestic	428,139	461,861	497,402	547,921	599,119
Domestic growth %		7.9%	7.7%	10.2%	9.3%
International	56,800	63,721	72,586	82,210	86,221
International growth %		12.2%	13.9%	13.3%	4.9%

Source: OAG Schedules Analyser

Headline analysis would suggest that China will continue to grow at rates consistent with the anticipated aircraft demand, but there are signs of an impending infrastructure issue that may impact that optimism. Deeper analysis of capacity growth at the four largest airports in China, in the table below, highlights that capacity has not grown rapidly in either Beijing or Shanghai in the last year whilst the number of scheduled departures from the four airports has only grown by 1.2% year on year.

Table 2 – Scheduled Capacity from Top Four Chinese Airports 2012 – 2017

Scheduled Capacity One-Way (000s)	2013	2014	2015	2016	2017	% Growth 2017 V's 2016
Beijing Capital International Apt	53,751,796	54,419,026	57,256,237	59,347,776	60,068,922	1.2%
Guangzhou	32,016,196	33,403,378	33,871,375	37,054,021	39,788,247	7.4%
Shanghai Hongqiao International Apt	22,620,293	23,598,943	24,236,017	24,635,601	24,814,561	0.7%
Shanghai Pudong International Apt	31,334,927	34,021,972	38,735,755	41,819,079	42,657,119	2.0%

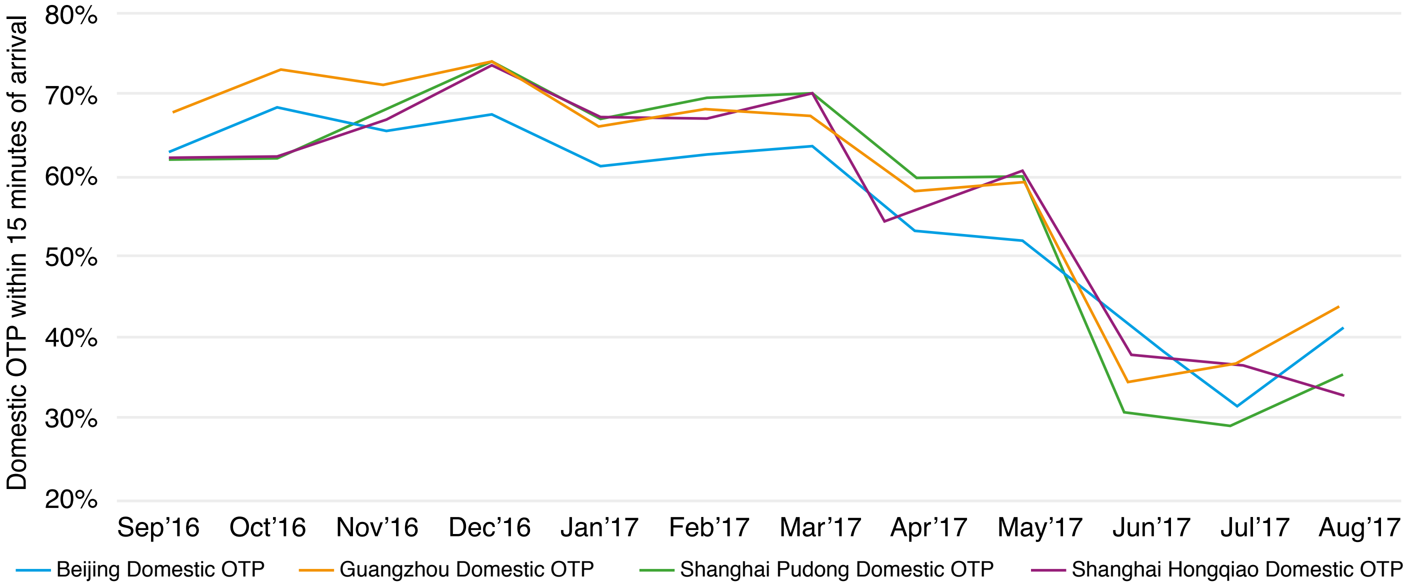
Source: OAG Schedules Analyser

The significant slow-down in capacity growth at the sizeable Chinese airports reflects a major challenge currently facing airports and airlines around on-time performance (OTP). With air-space controlled and protected for military requirements as necessary, airlines have struggled to deliver globally acceptable levels of punctuality for many years in China and the latest twelve months' data gathered by OAG suggest that the issue is far from being resolved.

The chart overleaf details the domestic arrival OTP performance at the four major airports in China for the last year and highlights an alarming deterioration in punctuality from March onwards, with OTP levels falling to below 40% in June. Interestingly, international OTP, whilst also impacted in June appears to have been "protected" to a degree, suggesting a conscious decision to preserve those longer and more prestigious services at the expense of local requirements.

Reduced access to air space and its subsequent impact on OTP can clearly be seen and poses the key question of whether the current infrastructure can accommodate future planned capacity growth. Locally-based airlines are already having to rethink their development plans with instructions from authorities that new services can only be launched if existing services are dropped. The capacity pot is effectively full at the major airports in China.

Chart 2 – Chinese Domestic OTP Performance, September 2016 – August 2017



Source: OAG OTP Database

Whilst capacity growth at the emergent secondary markets in China such as Hangzhou, Chengdu, Jinan and Chongqing continues for many airlines, further access to the 'Big Three" cities and their airports is central to their development and their requirement for additional aircraft in the coming years. The new airport development at Daxing, Beijing will in theory alleviate some of congestion issues at Beijing Capital as both China Southern and China Eastern relocate to the new facility. However, unless dramatic increases and consistent access to air space can be guaranteed, it may be that the slowdown in capacity that has occurred is the first step in a wider slowdown in capacity growth in China that no one expected.

Transatlantic Renaissance

From 2008 through to 2014, capacity between North America and Europe increased by 2%, hardly earth shattering and probably consistent with what we would expect from a market widely regarded as having matured. Since 2014 through to the end of 2017, capacity has increased by 21%; perhaps that mature market has got a new lease of life. The key question is just how sustainable that spurt of growth is and what strategies or changes in operating conditions have led to such giddy growth rates.

Low-cost long haul is clearly a factor: 2.6 million low-cost seats were on sale in 2017 compared to less than 2,000 five years ago; even so, those seats only account for a modest 5% of all capacity on offer. Norwegian accounts for over 1.5 million seats with a low-cost market share of 53% and is followed by WOW air (25%) with it's connecting hub services via Reykjavik and WestJet, with a 10% share of the market. The low-cost operating bases of these airlines, aggressive pricing and network creativity have added momentum to the whole market with Norwegian connecting secondary and new airports together and WOW harnessing the geographic advantages that only an Icelandic stopover can offer.

Of course, if imitation is the sincerest form of flattery then Level (the IAG operated carrier) and Joon (the Air France soon-to-be launched airline) both confirm the 'if you can't beat them, join them' business development theory. What it also confirms is that perhaps some legacy carriers recognise the competitive threat of new long-haul low-cost airlines on the transatlantic market and are seeking to disrupt the disruptors.

The net impact of the increased competition is clearly seen in the number of airport pairs operated in recent years as Table 3 below highlights. Whilst the rapid growth in low-cost activity was probably expected, an increase of some 50 new airport city pairs from established legacy airlines highlights their desire to widen the battleground beyond purely the traditional city pair points.

Table 3 - Western Europe - North America Airport Pair Count

Number of Airport Pairs Operated	2013	2014	2015	2016	2017
Low-Cost Airlines	10	26	32	56	82
Legacy Airlines	353	387	391	435	441
Grand Total	363	413	423	491	523

Source: OAG Schedules Analyser

In the last two years, British Airways has added six new routes, Delta Air Lines, eleven, Aer Lingus, four and Virgin Atlantic, four, aside from the numerous route transfers between Skyteam Alliance members. Both BA (Nashville) and Aer Lingus (Philadelphia) have more new routes already announced for 2018 and a few others will probably be announced in the next few weeks.

For legacy airlines, expanding the battleground to secondary markets in the US with feeds to their respective hub airports makes sense. Connecting traffic to points in Europe can be comfortably moved, although some sharp pricing is required and marketing support from those cities can certainly reduce the risk further. Whereas for the low-cost carriers, operating cost-effective 3 or 4 times weekly low-frequency services to some markets allows them to be sufficiently disruptive to take market share from the established airlines.

Any self-respecting analyst five years ago would have confidently predicted the Transatlantic market to offer limited growth in capacity year on year. Fuel prices were still high, competition was limited and other more attractive market opportunities existed for legacy long-haul network expansion.

In 2017, the world looks very different; fuel remains cheap by recent standards, new aircraft technology has reduced cost, and customer willingness to travel across the Atlantic on a single-aisle aircraft is strong. At either age of the spectrum, the B757 or brand new B737NG provide a market fit that was perhaps discounted a few years ago.

Perhaps surprisingly, one of the oldest, most established long-haul markets in the world has opened our eyes in the last three years and has shown that it is possible to challenge convention, open up new routes and stimulate increased competition. It may require the stars to be aligned or the market conditions to all pull in the same direction but if it’s happened in this market, it begs the question... where next?

This summary is an excerpt from the recently released Ishka Vista: 2018 Aviation Finance Market Forecast produced by Ishka, (an international aviation finance advisory company), which identifies and addresses critical issues impacting the aviation investment landscape over the next 12-18 months.

For more information about Ishka Vista, which includes OAG’s analysis of both the Chinese and Transatlantic capacity trends, please visit https://www.ishkaglobal.com/Advisory/MarketForecast

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