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INDUSTRY OUTLOOK

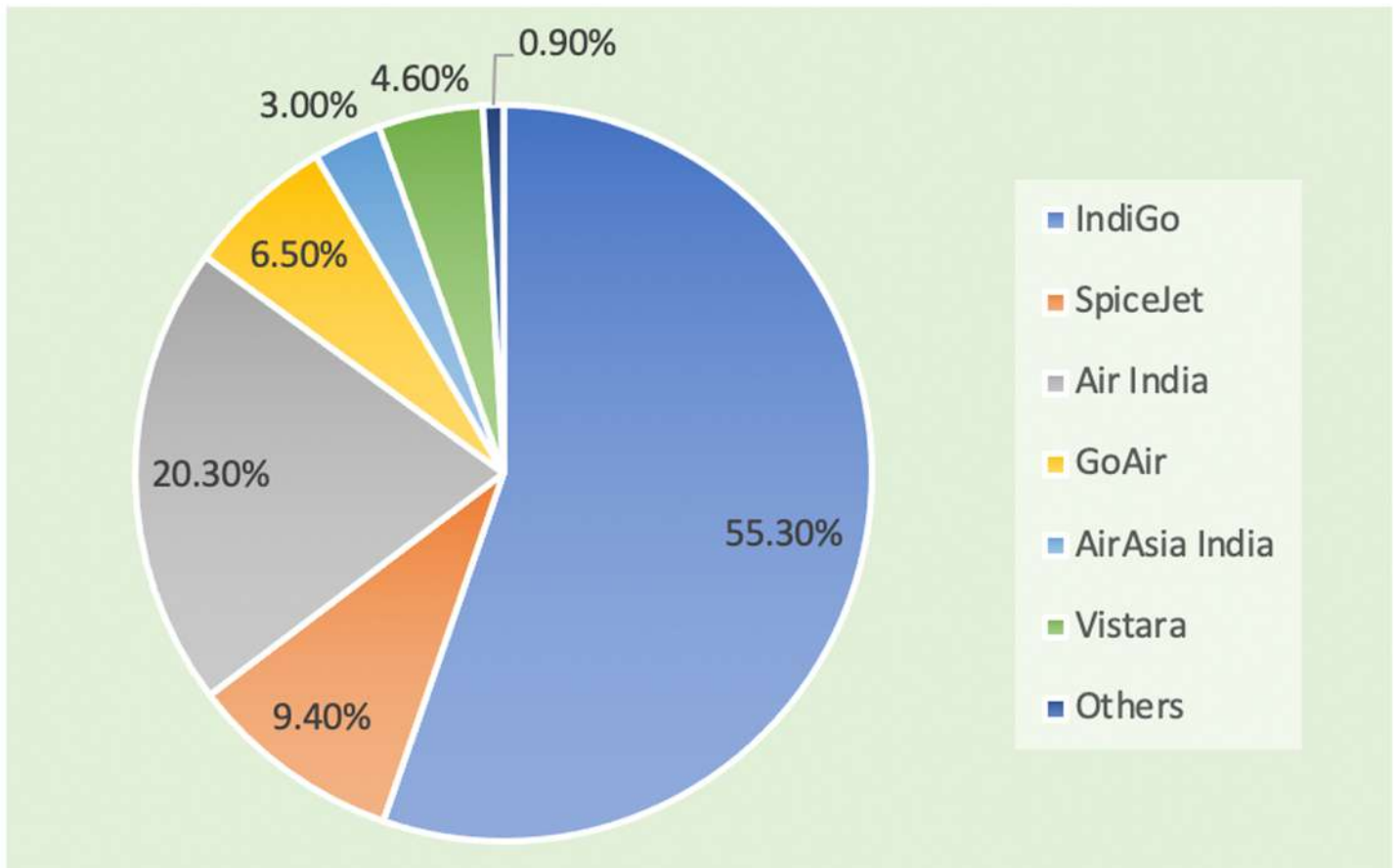
AIRLINE INDUSTRY IN INDIA: OUTLOOK AND CHALLENGES

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Introduction

The Indian aviation industry [1] contributes around USD 72 billion to GDP, according to INVESTINDIA [2]. As per International Air Transport Association (IATA) forecasts, India will become the third-largest aviation market in terms of passengers by 2024.[3] A snapshot of the various market players is given in the figure (Figure 1) below. As can be seen, IndiGo captures the market with a behemoth share of more than 55 per cent.

Figure 1: Market Share (May'21)

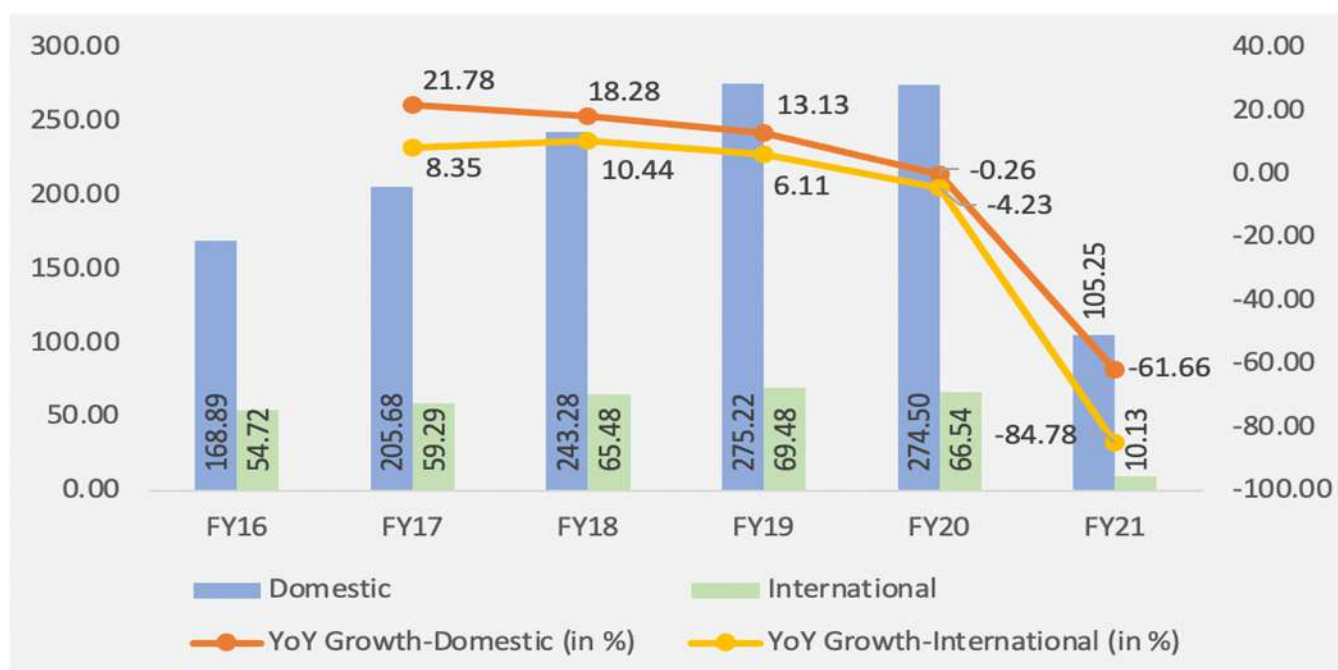


While the airline industry was doing reasonably well till the end of FY20, the industry has been one of the hardest hit after the Covid-19 pandemic took place. In 2020, industry global revenues totaled \$328 billion, around 40 percent of 2019, which was also same as in 2000, in nominal terms. It was expected that the industry will return to its 2019 position not before 2024.[4] It is expected that the Indian airlines will incur a loss of \$4.1 billion loss in the current fiscal (2021-22), with another \$3.9 billion losses reported in the last fiscal.[5]



In FY21, airports in India pegged the domestic passenger traffic to be ~105 million, a 61.66 per cent year-on-year (YoY) decline, and international passenger traffic to be ~10 million, an 84.78 per cent YoY decline, over the fiscal year ended March 31, 2020. [6] The airlines industry has witnessed a huge downfall of more than 60% in domestic passengers in FY21 as compared to FY20 as illustrated in the figure below (Fig 2). The corresponding fall in international passengers has been even greater reaching almost 85%.

Figure 2: International and Domestic Passenger Traffic (in million)



Source: Indian Aviation Industry, Indian Brand Equity Foundation (2021).

The freight carriage has also not been encouraging (Figure 3). The international freight traffic from India reduced by almost 24 per cent in FY21 compared to FY20. The corresponding decline for domestic freight traffic was about 28 per cent for the same years.

Figure 3: International and Domestic Freight Traffic



Source: Indian Aviation Industry, Indian Brand Equity Foundation (2021).

International Travel ⁷

European carriers' May'21 international traffic declined 84.7 per cent versus May'19, improved from the 87.7% decrease in April'21 compared to the same month in 2019. May'21 capacity dropped 75.7 per cent and load factor fell to 52.9 per cent. The Asia-Pacific airlines saw their May'21 international traffic fall of 94.3 per cent compared to May'19, fractionally worse than the 94.2 per cent drop registered in April'21 versus April'19. The region experienced the steepest traffic declines for a tenth consecutive month. May'21 capacity was down 86.4 per cent and the load factor sank to 33.2%, the lowest among regions. Middle Eastern airlines experienced an 81.3 per cent demand drop in May'21 compared to May'19, slightly bettering the 82.9 per cent decrease in April'21, versus the same month in 2019. May'21 capacity declined 63.7 per cent, and load factor fell to 37.7 per cent.

North American carriers' May'21 demand fell 74.4 per cent compared to the May'19 period, an improvement over the 77.6 per cent decline in April'21 versus two years ago. May'21 capacity sagged 58.5 per cent, and load factor dropped to 51.7 per cent. Latin American airlines saw a 75.1 per cent demand drop in May'21, compared to the same month in 2019, notably improved over the 80.9 per cent decline in April'21 compared to April'19. May'21 capacity was down 69.9 per cent and load factor decreased to 69.5 per cent, which was the highest load factor among the regions for the eighth consecutive month. African airlines' traffic fell 71.4 per cent in May'21 versus May'19, a gain from the 75.6 per cent decline in April'21 compared to April'19. May'21 capacity declined 61.8 per cent versus May'19, and load factor dropped to 50.2 per cent. Since July 2020, airlines are operating special international flights under air bubble arrangements formed with around 24 countries. Under a bilateral air bubble arrangement, airlines of the two countries can operate flights between their territories subject to certain restrictions.

Institutional Initiatives

The pandemic has brought about a heightened consciousness of the compelling need for intervention of the government to rescue many industries (e.g., tourism, hotels & hospitality), and airlines industry is no exception. Recently, the Ministry for Civil Aviation formed three committees to get advice on critical issues of the industry. The three advisory committees for airlines, airports and maintenance and repair organisations and flight training institutes, comprise CEOs and promoters.



The group will meet once every month to sort out issues, which can be regulatory or financial.[8] According to the announcement in the Union Budget 2021-22, the government has lowered the custom duty from 2.5 per cent to zero per cent on components or parts, including engines, for manufacturing of aircrafts by public sector units of the Ministry of Defence.[9] Additionally, under Emergency Credit Line Guarantee Scheme (ECLGS) 3.0, current ceiling of ₹500 crore of loan outstanding for eligibility under ECLGS 3.0 to be removed, subject to maximum additional ECLGS assistance to each borrower being limited to 40 per cent or ₹200 crore, whichever is lower. ECLGS 3.0 have been extended up to 30th Sept. 2021 or till guarantees for an amount of ₹3 lakh crore are issued. Last date of disbursement under the scheme has been extended to 31st Dec. 2021.[10]

Buoyed by the rising volume of imports and exports (since 30 per cent of Indian trade is airborne), the National Air Cargo Policy Outline of the Government of India held that the Indian air cargo and logistics could become the most efficient, and the cost and time-effective globally by end 2030. In an attempt to provide an impetus to the aviation industry, the Government of India plans to invest up to \$ 1.83 billion in the development of airport infrastructure along with aviation navigation services by 2026. The country aims to open 100 new airports by 2024, of which 30 airport projects are already in progress across various regions of India.

According to the Ministry of Commerce and Industry data, India has envisaged increasing the number of its airports to a total of 190-200 by 2040. Towards this end, the Airports Authority of India (AAI) has announced a few developments in Indian Airports – construction of a new airport on a green field site in Hollongi, Arunachal Pradesh (November 2022), new integrated passenger terminal building expansion of Tiruchirappalli & Pune Airport (March 2022), Guwahati International Airport (June 2022), Maharaja Bir Bikram Airport (Early 2021, which is about to be complete) and major expansion of Surat Airport (December 2021). [11] However, the targets might be missed due to the pandemic.

Industry Risk



Demand recovery, particularly in international traffic, remains uncertain. The issue of profits and profitability of airlines is fraught with policy and operational difficulties because of a conspicuous absence of a full recovery in higher-yielding segments such as corporate travel. This is why lenders and investors remain cautious and watchful on the airlines industry. This necessitates sector-specific focused policy interventions by the government with a sense of urgency to revive the fortunes of the languishing airlines industry in India.

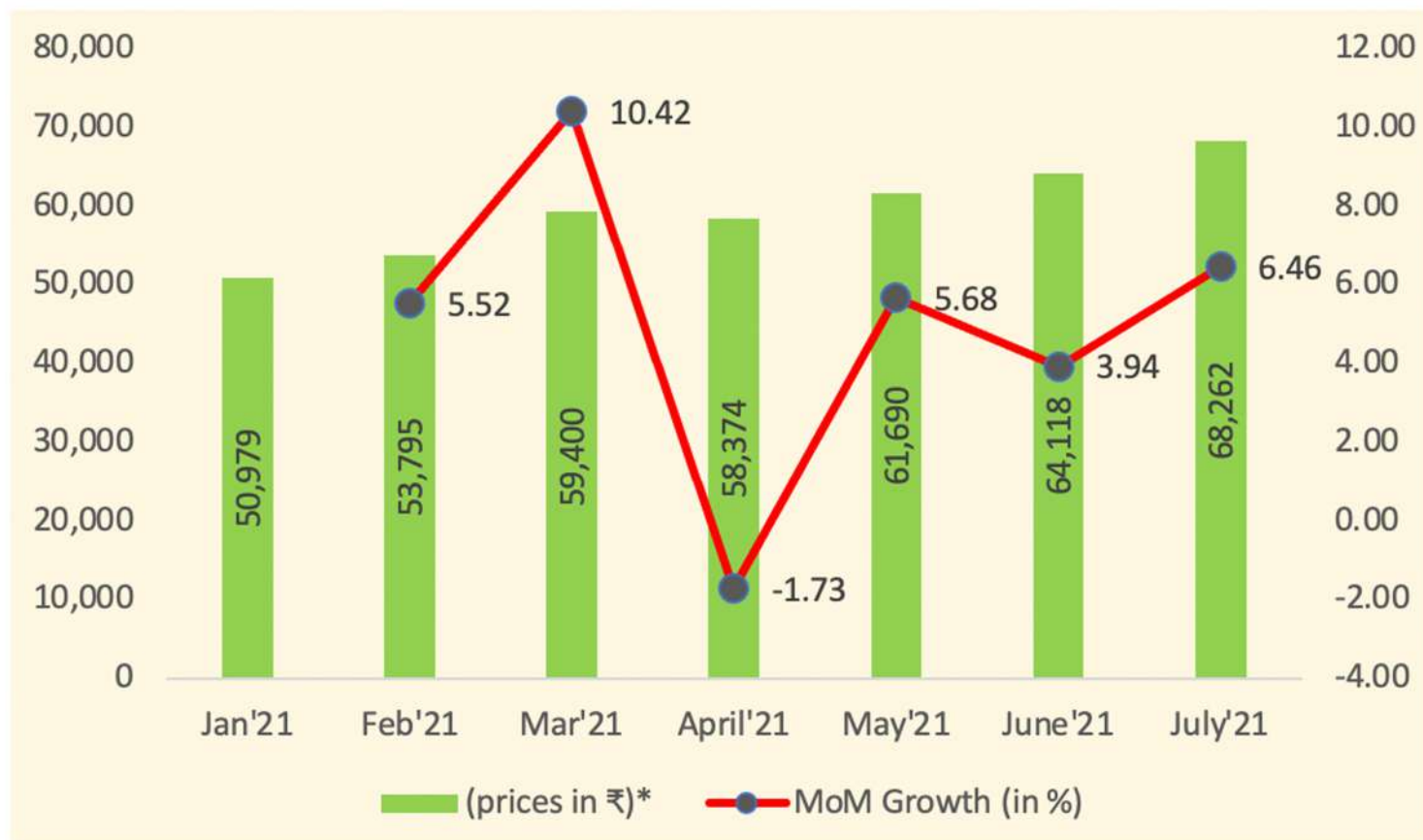


At the present juncture, the biggest industry risk that mars the prospect of the industry is the COVID-19 pandemic and the enormous uncertainty in its wake. What makes matters worse is the fear and uncertainty of the third wave, mutation, delta variant, etc. The new Delta variant, which is marked by joint pain, headache, neck and upper back pain, general weakness, loss of appetite and pneumonia, is more virulent with a higher mortality rate.

Due to various domestic and international restrictions imposed by various local and global authorities, the sector is witnessing huge fluctuations and its financial position is not only grossly unsatisfactory but also clearly unsustainable over the long haul. The Centre for Asia Pacific Aviation (CAPA) forecasts airline losses of \$8 billion for FY2021 and FY2022 combined. CAPA says the “airlines will need \$5 billion to stay aloft but only have access to \$1.1 billion through share offerings and other sources.”[12] Despite the year’s bad start, CAPA reckons passengers will total 80-95 million this year, significantly more than last year’s 52 million passengers. But there is the caveat that if a devastating third wave materializes, the industry will take severe drubbing again. This contrasts starkly with the position a few years ago, when the airline industry was growing at a fast clip. Between 2014 and 2018, the industry almost doubled in size with growth of 20.8 per cent in 2015 and 22.2 per cent in 2016. In 2017, growth stayed high at 18.2 per cent and that was followed by 18.6 per cent in 2018. [13]

Moreover, the demand for greater sanitation facilities and social distancing will force airports to make arrangements for new queues, biometric recognition of passengers, and gathering spaces to ensure contactless travel. Such measures will not only hike operational costs of running the airport, increase turnaround time but also reduce peak hour processing capacity of terminal.[14] Apart from these factors, volatile exchange rate and aviation turbine fuel (ATF), which accounts for roughly half of the total costs has risen continuously (Figure 4).

Figure 4: Aviation Turbine Fuel Prices (per kilolitre in Delhi)



Source: <https://www.livemint.com/news/india/air-travel-likely-to-get-costlier-as-jet-fuel-prices-soar-11625128375296.html>

*Note - as on 1st of every month

Jet fuel soared to ₹68,262 per kiloliter (KL) in Delhi on 1st July 2021. It increased by more than 33 per cent within seven months. The same was priced at ₹50,979 on 1st January 2021. Measures to overcome the same have been long ago taken by the industry. For example, on 27th August 2018, SpiceJet successfully used sustainable aviation fuel (SAF) [15] on a demo flight from Dehradun to Delhi. But since the progress is limited, much more work is needed to bring about a discernible and sustained improvement.

The Way Forward

To be sure, the gloom and doom created by the Covid-19 pandemic, has severely restricted business and leisure travel. But there are some positive aspects. The Indian aviation industry may bounce back to 83 per cent of pre-covid capacity during third quarter and about 90 per cent during the fourth quarter as about 9.2 crore domestic passengers are expected to take to the skies during FY22, Morgan Stanley Research noted.[16] Given the hit on revenue streams, the improved financial position of the airlines would be a function of an austerity drive, cost cutting, maintaining liquidity and the reopening of the skies other nations. In FY22, the metro-metro network (airline network between two metropolitans) is likely to rebound to 53.7 per cent, (while) metro-non metro to 80 per cent and non-metro to non-metro to 70 per cent of pre-covid levels.[17] However, such scenarios are contingent on the belief that a third wave might not materialize or will not cause that much damage as the previous one.

Airlines, recently, are rolling out incentives to passengers who have taken at least one dose of vaccination while some others have fully vaccinated crew to helm flights. Airlines want the mandatory RT-PCR test dispensed with for passengers who have received both shots of a COVID-19 vaccine. However, many governments continue to stress border closure or an arrival quarantine to contain the spread of COVID. However, research from leading medical organizations around the globe confirms that vaccinated travelers pose very little risk to the local population while data show [18] that pre-departure testing largely removes the risk of unvaccinated travelers importing COVID-19.

Consequently, a better alternative could be vaccinating people expeditiously instead of closing borders or imposing stringent restrictions on travel with debilitating impact on the airlines industry, particularly since the risk of transmission of Covid-19 from one passenger to another passenger on board is insignificant because the customers sit facing forward and not toward each other, seat backs provide a barrier, the use of HEPA (high efficiency particulate air) filters and the direction of the air flow on board (from ceiling to floor), and the limited movement onboard aircraft.

The freight traffic grew by more than 5 per cent from 2.70 million tonnes to 3.33 million tonnes in 2016-2020. On the basis of an extrapolation of this trend, cargo traffic in Indian airports could reach 17 million tonnes of freight by 2040. It is expected that by 2023, the total freight traffic will reach 4.1 million tonnes while sharply increasing the compound annual growth rate (CARG) to 7.27 per cent between 2016 and 2023. In comparison, the freight traffic reached 3.32 million tonnes in 2020.

Given the evolving situation, the pace of resumption of international operations by other countries, the spread and virulence of Covid-19 across countries and consumer confidence in airlines, it could take 18-24 months to recover from the current situation to come back to the pre-Covid-19 levels of travel demand. Meanwhile the airlines need to stress better capacity, better fleet, focus on quality and more effective use of their network to reduce unit cost and distribute fixed cost for the airline with improved load factor and yields. With a proper eco-system and enabling policies aimed at quality, cost and passenger interest, the ascendant working group and widening middle-class demography, India could become the third-largest aviation market by 2025.

ENDNOTES

1. Airline industry refers to companies that offer air transport services to paying customers, whereas the aviation industry includes all aviation-related businesses like aircraft manufacturers, companies offering non-commercial flights, aerospace companies, regulation authorities and those involved with research.
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16. For more on SAF refer "Deploying Sustainable Aviation Fuels at Scale in India: A Clean Skies for Tomorrow Publication", World Economic Forum & McKinsey (June 2021). Available at <https://www.weforum.org/reports/deploying-sustainable-aviation-fuels-at-scale-in-india-a-clean-skies-for-tomorrow-publication>
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18. "Domestic air traffic expected to improve by 52% in FY22: CAPA", LiveMint (24th June 2021). Available at <https://www.livemint.com/companies/news/domestic-air-passenger-traffic-expected-to-improve-by-52-in-fy22-cap-a-11624546823513.html>
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