Global Aviation Trends – Soaring into 2023?

By partners James Bradley, Sidanth Rajagopal and Bruce Silvers, and associates Sourabh Bhattacharya and Terry Chang, at global law firm Morgan, Lewis & Bockius.

With tens of billions of dollars being lost by airlines during the pandemic, reports that predictions for 2023 point to the first industry-wide profit since 2019 will be welcomed by those in and connected to the sector. Passenger levels and confidence in travel have seen a resurgence in 2022, showing signs in some regions that they are soaring. Of course, COVID is still not a thing of the past and some markets face a longer road to recovery. With this varied regional outlook, we consider some global trends and look ahead to what 2023 may hold for the industry.

EUROPE

In Europe, strong demand by travellers eager to make up for lost time during the pandemic proved challenging for airlines during the summer of 2022, at a time when they had to cap passenger numbers due to a number of constraints. When Covid-related disruptions finally seemed to taper off, pilot and other staff shortages, delivery and infrastructure limitations became obvious. It appears that at least some of those have been overcome by now, with various airlines announcing that they will add capacity to their 2023 schedule by way of additional flights or new routes. This shows confidence that demand will continue to rise despite increased cost of living, not least due to hybrid work arrangements allowing "workations".

For airlines, this means additions to the fleet are required to meet the demand. In response to the resulting need for financing, similar to developments elsewhere, a number of airlines were able to resort to JOLCOs and it will be interesting to see whether this continues to be the case in 2023. Similarly, sustainable financing projects can be expected to be employed more frequently in line with ESG efforts.

With at least three lessor combinations in the last 12+ months, consolidation is another theme to watch. Though going forward, speculations are more focussed on airlines in this regard, whether some

may follow suit and how they may be able to benefit from such synergies.

All in all, while challenging times are not yet over, it appears that optimism for a continued recovery is appropriate.

MIDDLE EAST

If there is a region that can proudly say that it is now completely recovered from the COVID linked market, it is the Middle East. The aviation industry in the region saw a huge turn around in passenger traffic and consequently big orderbooks. The first FIFA World Cup in the region was a welcome sweetener for the aviation industry tying into the end of the year holiday travel boom.

Most of the major airlines in the region posted record profits with capacity returning to pre-COVID levels. Low-cost airlines showed similar trends with aggressive expansion of routes and fleet. The major airline manufactures have publicly identified the Middle East to be one of their primary customer targets and predict nearly doubling of the demands in both single aisle and wide-bodied assets.

Sustainability continues to be a discussion point in the region with most of the industry players looking at more viable fuel alternatives (this resulted in high purchase volumes of SAF) and further investments in lowering the carbon footprint while equally trying to stay clear of 'green washing'.

Business aviation in the Middle East has also shown significant improvements and the surge of demand from high net worth individuals continues. With a new premium airline soon to be launching from the Kingdom of Saudi Arabia, this region gears up for more and more competition and even higher traffic.

AFRICA

Africa continues to remain the bridesmaid (but still not the bride) to global aviation. With its huge potential for passenger and cargo airlines and its demand growing, the industry is there for the taking and the old guard continue to tag along with the middle eastern airlines who remain the largest beneficiaries of

the demand. The likes of Ibom Air are trying to recalibrate the view on African aviation, but that is a watching brief at the moment. The resurgence of a couple of airlines remains the main focus of the lessor community but carriers such as Bestfly and Fastjet continue to push the boundaries and have started leasing aircraft and reaping the benefits of the passenger demand.

ASIA PACIFIC

The Indian aviation sector remains strong with airlines such as Indigo and Vistara continuing their expansion, new entrant Akasa arriving with a large OEM order, Air India becoming part of the Tata airline portfolio and Jet Airways, possibly getting its second wind with the help of India's new bankruptcy code.

2022 has seen the Tata Group's ongoing investments in Indian aviation with its acquisition of the majority stake in Air India. This acquisition has triggered a further consolidation by the Tata group of its other major investments in the aviation ventures Vistara Airlines and Air Asia India. As publicly announced, Tata group plans to merge Air India with Vistara Airlines and Air India Express (a low-cost division of Air India) with Air Asia India. The year gone by has also seen the arrival of Akasa, a new start up in India, which has placed an order with Boeing for the 737MAX aircraft.

Indian policymakers continue to push for India to be a hub for manufacturing and leasing businesses. With various new and liberalised regulations since 2021, the Indian policy makers are looking to promote aircraft leasing and financing businesses in India though the International Financial Services Centre situated in GIFT City in the state of Gujarat. These changes come together with multiple other regulatory developments in relation to the International Financial Services Centre, each primarily reducing the regulatory clutter and offering key tax incentives to prospective lessors. In late 2021, JetSetGo and Vman Aviation Service became the initial operators to directly import an aircraft through the International Financial Services Centre.

While the trends continue to be positive, India is still plagued by delays in stressed asset recovery by lessors. The timelines have been helped by the revamped Indian Insolvency and Bankruptcy Code of 2016, however its implementation in the aviation sector continues to remain questionable.

The Asia Pacific region overall has seen some early signs of conservative recovery as international mobility improves and airline revenues in the region steadily increase. Reports of significant new fleet purchase orders in the tail end of 2022 from China, Malaysia and Japan are a signal of renewed vibrancy. The strong order books are, however, set against a backdrop of global trade tensions and geopolitical challenges impacting export markets which could influence the ability to clear backlogs and fulfil orders. Airlines in the region are nonetheless likely to follow in the footstep of others in re-fleeting.

2022 saw a gradual return of Japanese operating leases (JOL) and Japanese Operating Leases with Call Option (JOLCO) products, which are essentially used to deploy Japanese equity, bringing back more diverse funding options and the ability for airlines to fund 100% of the asset cost. JOL and JOLCO products were heavily impacted by the Covid-19 pandemic, as there were instances where JOLCO aircraft were rejected by airlines through bankruptcy proceedings and Japanese investors shied away from riskier assets such as aircraft. With reports of further rising interest rates in the US into 2023, there is likely to be a ripple effect on the cost of raising debt, meaning JOL and JOLCO products will become increasingly attractive to airlines. We would, however, expect Japanese investors to return to a more conservative position given the lessons learnt in the last two years.

Several portfolio sales took place throughout 2021 and 2022 involving lessors in the Asia Pacific region. These were, in part, driven by the need to maintain positive cash flow during the peak of the Covid-19 pandemic. For cash-rich lessors, the pandemic was a fantastic opportunity to purchase assets at a discount. We expect that this trend

will continue into 2023, as lessors try to off-load excess assets. In addition, with the uptick in new purchase orders, we expect lessors will seize the opportunity also to replace existing aircraft with newer and more efficient models.

Finally, given its size, it is difficult to downplay the impact of the Chinese market and its re-opening as a significant development. China has recently started to relax its restrictions following a relatively strict lockdown compared with many jurisdictions in the region. Given China's importance as one of the largest aviation markets in the world, the re-opening of China is key to the region's continuing recovery and growth following the Covid-19 pandemic. However, with Covid cases beginning to creep up in China, it is still unclear what 2023 will hold.

Nonetheless, it is expected that the Asia -Pacific region will continue to see a steady recovery year-to-year in 2023.

UNITED STATES

The US has seen high demand and overall, less capacity, keeping it on a steady course. The region's carriers have strong balance sheets and solid liquidity. A range of macroeconomic factors from inflation and fuel prices to name a couple are likely to influence results, but the US market seems reasonably well placed to weather what comes next. Following the re-entry into service of the 737MAX aircraft in most jurisdictions, it seems likely Boeing will ramp up its skyline deliveries for the rest of the decade with a significant number of 737MAX aircraft being delivered in 2023 which should see the necessary new narrowbody aircraft swell the global fleet and will be welcome news for the American manufacturer and the wider aviation community.

THE YEAR AHEAD

It is difficult to paint a picture of the aviation industry that does not continue to be dominated by the global turbulence caused by COVID, the political landscape in Russia and the uncertainty of how China will re-emerge.

The global aviation market, so intrinsically linked to the world's macro-economy, will likely see regional pockets during 2023 as different geographies will have varying economic pressures whether that be through looming concerns of a US recession, high inflation in Europe, the impact of the Ukraine situation, the growth of the Middle East or the inevitable spike in demand following China's re-opening.

Undoubtedly, this highly complicated variety of global socio-economic events will remain at the forefront of the aviation industry's minds as we look to seek the new and exciting opportunities in 2023.

This article is provided as a general informational service and it should not be construed as imparting legal advice on any specific matter.