

Industry Top Trends Update

Transportation

Air traffic booms, shipping strong, but macro risks loom

What's changed?

Air traffic is booming. Europe's airline industry is experiencing a stronger summer than we envisioned now that travel restrictions are all but lifted. Pent-up demand, namely for short-haul leisure trips, is lifting air passenger numbers, and air capacity in third-quarter 2022 is nearing pre-pandemic levels.

Surging oil prices constrain airlines' profitability. Crude oil prices have continued to rise in recent months amid the Russia-Ukraine military conflict and the tightened global supply-and-demand conditions. We assume Brent will average \$100 per barrel (/bbl) for the rest of 2022 and \$85/bbl in 2023.

Port congestion remains severe and containership capacity is tight. We forecast that shipping freight rates might not start moderating (from current all-time highs) until late 2022. From 2023, as the supply chain bottlenecks ease, demand softens, and overall industry capacity increases with the ramp-up of ordered vessel deliveries, rates will decline but remain above 2020 levels.

What to look out for?

High leisure demand may dry up. Although demand for flights is rebounding, increasing headwinds suggest the recovery could decelerate toward end-2022, particularly once pent-up demand is mostly satisfied.

Airlines may charge more. We note markedly higher ticket prices for this summer travel season, with some carriers are reporting higher yields than pre-pandemic levels. Still, the airlines might have trouble raising prices later in the year if inflation causes consumers to cut back on travel. Also, the need to pass-through cost inflation to passengers will build since airlines' hedging contracts rolled into 2023 will likely be at higher prices.

Shipping freight rates could dip amid slowing demand. The intensifying headwinds to trade volumes due to China's stringent COVID-19 policy, the Russia-Ukraine conflict, and rising inflation are rapidly eroding purchasing power, as are potential setbacks from climbing interest rates.

What if there's a recession?

Air traffic recovery would stall. A recession could prevent households from using savings accumulated during the pandemic and might curb discretionary spending, thereby cooling the travel industry's prospects.

Airlines' deleveraging will be slower than expected. Airlines accumulated a lot of debt during the pandemic, and since they face mounting new aircraft investment, their ability to deleverage is limited. Disrupted EBITDA recovery would worsen the already-strained situation.

Supply tightness might ease. The heat from the cargo market and the expected drop in volumes would likely alleviate the supply chain disruptions and capacity shortages.

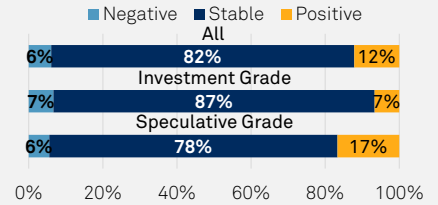
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