



# BUSINESS CONTINUITY – ENSURING A SOLID BUSINESS MODEL THE BUOYANT AIR CARGO MARKET AND ITS IMPLICATIONS FOR AIRLINES AND INVESTORS

by Chris Jackson

## *Takeaways*

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- The pandemic is spurring demand for air freight services
- E-commerce and emerging market economies are contributing to the trend
- The waning of the pandemic may not signal an end to air cargo growth



**W**hile the impact of the COVID-19 pandemic on the air cargo sector can be seen as a bubble, the fundamentals of the air cargo sector need to be viewed in a much broader context – in particular, the evolution of e-commerce and the rapid economic growth of the emerging markets. The air cargo market is, without doubt, a growing sector within the aviation industry and is one that cannot be ignored.

The current growth in demand for freighter capacity is attributable to the following factors.

### Reduced belly cargo capacity

The wide-scale lockdowns, border closures, and travel restrictions brought about by the COVID-19 pandemic have resulted in a dramatic decline in global passenger flights. At the peak of the pandemic in May 2020, the weekly flight frequency for global passenger airlines had fallen by about 70 percent (as compared with data for May 2019).

International passenger traffic remained weak during the first half of 2021, but signs are pointing toward some improvement as more people get vaccinated and international travel restrictions are gradually eased. However, the spread of the COVID-19 Delta variant has weakened consumer travel sentiment and significantly dampened the outlook for long-haul flights.

Domestic passenger traffic is recovering faster than international traffic. Major domestic markets started on a path to recovery in 2020, with the pace accelerating in 2021, especially in the United States, by far the biggest domestic market.

According to Boeing, passenger belly cargo typically accounts for 54 percent of world air cargo capacity. The massive drop in passenger flights resulting from the COVID-19 pandemic has therefore given rise to a corresponding increase in demand for freighter capacity.

As noted above, there is a clear divergence in the pace of recovery between domestic traffic on the one hand and international traffic (particularly long-haul) on the other. Consequently, demand for domestic freighter capacity will reduce faster than international freighter capacity.

According to Boeing's forecast, the aviation industry will recover to 2019 levels of traffic by the end of 2023 or early 2024, with long-haul international routes taking the longest to recover. The air freighter market will therefore see the effects of the COVID-19 pandemic for some time to come.

## **Increase in volume of air cargo**

In addition to the reduction in belly cargo capacity, the COVID-19 pandemic itself has given rise to an increase in the volume of air cargo. The air freight industry has been an essential mode of transport for the pharmaceuticals, medical equipment, and personal protective equipment used in the global fight against COVID-19. This has further stretched the air freight industry but will (hopefully) be a relatively short-lived consequence of the pandemic. We see the following two reasons for this.

### *Economic growth in the emerging markets*

The emerging markets are expected to lead global economic growth during the next 20 years, with South Asia, China, East Asia, and Africa all exceeding the global average GDP growth of around 2.5 percent.

GDP increases when there is a trade surplus (i.e., the total value of goods and services that domestic producers sell abroad exceeds the total value of foreign goods and services that domestic consumers buy). Accordingly, the logistics industry (of which air cargo is a key part) will be vital for those emerging market economies.

### *E-commerce*

Over the last 20 years, there has been significant growth in e-commerce as a consequence of the evolution of internet-based technology. Businesses have endeavored to satisfy customer demand by establishing platforms that facilitate access to goods and rapid delivery times.

The air cargo industry is an essential component in the strategy for businesses looking to capitalize on the e-commerce boom and that need to transport goods between continents. Unlike maritime transport, air transport offers the benefits of speed and reliability.

The boom in e-commerce shows no sign of slowing down and is therefore likely to be a significant driver for the growth of the air cargo market for some time to come. Indeed, it has been cited that the pandemic has accelerated the global transition to e-commerce (by as much as five years, according to IBM) as more people shift to online work and shopping.

## **Is that growth sustainable?**

In the short-to-medium term, we would expect to see a decline in the growth of demand for freighter capacity. The direct impact of the COVID-19 pandemic has created a bubble in demand which will deflate with a reduction in the volume of air cargo needed in the global fight against the pandemic and an increase in passenger flights (and, thereby, belly cargo capacity).

However, that bubble needs to be viewed in the context of other long-term factors (such as the boom in e-commerce and the rapid economic growth of the emerging markets). It will be those factors that drive demand for air freight capacity and, ultimately, the need to increase the global freighter fleet (particularly those serving the emerging markets).

Although growth in air cargo demand would seem inevitable, we would add a small note of caution. The trade conflict between the United States and China and recurring political and financial market instability in some emerging markets are some of the factors that might hamper the growth of air cargo demand, thereby, affecting the freighter aircraft demand.



## Does the supply of new cargo aircraft meet demand?

As compared with other parts of the aviation industry, air cargo operators have performed well during the COVID-19 pandemic and it's therefore no surprise that investors have seen the air cargo sector as an answer to the question of what to do with unwanted or repossessed aircraft.

As things currently stand, there is an insufficient supply of new cargo aircraft to meet demand. Freighter conversion slots are in very high demand, particularly for some aircraft types (such as the Airbus A330). The wait times for the most popular conversion programs are up to four years.

This heightened demand has resulted in the cost of conversion programs increasing significantly. However, this increased cost has been offset, to some degree, by the fall in cost of the feedstock aircraft as a consequence of the COVID-19 pandemic and, specifically, the number of off-lease aircraft available for sale. This reduction in cost has also had the consequence that investors are now looking to convert younger aircraft, which will have a correspondingly longer life in cargo operations.

The use of “freighters” and the increase in passenger-to-freighter conversions, as well as the increase in production of freighter aircraft by the manufacturers, will have provided some easing of air cargo capacity constraints. However, as more passenger aircraft return to the skies and “belly cargo” capacity increases (particularly in relation to wide-body aircraft being operated on long-haul routes), it's expected that the air cargo market should normalize.

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Identified as a leading individual in the aviation finance and leasing market, Chris is recognized for his “in-depth understanding of the aircraft leasing and finance business” (*The Legal 500 UK*, 2017) and his “sensible and commercial” approach to matters (*Chambers & Partners UK*, 2018).