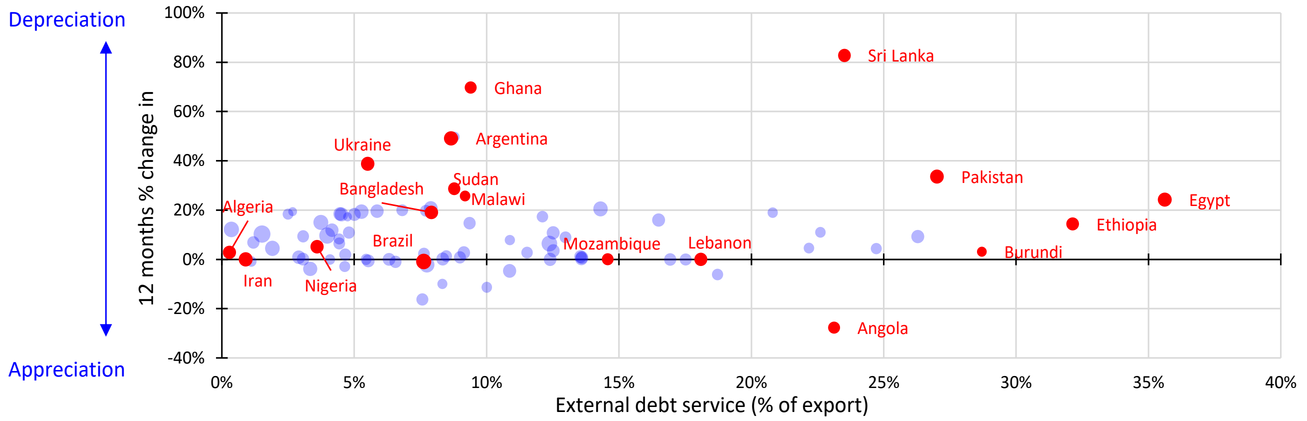
IATA Economics' Chart of the Week

4 November 2022

Airlines' funds blocked in the foreign exchange turmoil



Sources: IATA Economics, IATA Treasury, MacroBond, and World Bank International Debt Statistics.

- The US dollar has seen a sharp appreciation over the past two years, against most of its trading partners, in a move that was accelerated by Russia's invasion of Ukraine in February (see also Chart-of-the-Week). The euro, for example, has depreciated by nearly 14% against the US dollar this year.

- A depreciating currency adds to inflation by making imports more expensive. Any debt held in foreign currency – notably the USD in the current situation – becomes more expensive to pay back and to service, in line with the size of the depreciation. Moreover, higher nominal interest rates add another challenge in this regard. Unless the country in question earns US dollars on their potential exports in sufficient quantities, a central bank can find itself running low on foreign exchange reserves as it strives to honor its external financial obligations. In extremis, this can lead to full-blown balance-of-payments crises and defaults on external debt. Any country facing such challenges can ration access to its limited foreign exchange reserves. Capital controls can be implemented which can, for instance, cap the amount of foreign currency citizens and businesses are allowed to obtain.

- Airlines, and indeed any foreign business making sales in the countries concerned, can find themselves unable to repatriate the funds which they are owed. In 2016, airlines had to completely write off USD 3.7 billion worth of airline funds that were blocked in Venezuela at the time. Currently, IATA puts the industry's blocked funds at USD 1.9 billion globally, as per September, and the risk that this number will rise is elevated. In the chart above we can see in red the countries that have already blocked funds, and in blue a number of countries with varyingly elevated external debt levels and that have suffered sizeable depreciations of their currencies, and where risks might thus be mounting[1].

- The mechanism through which this occurs is that tickets are sold by local travel agents or directly by the airline, which accumulates sales that it then seeks to repatriate. Even the waiting period on such repatriation represents a significant risk to airlines' earnings as the local currency might continue to depreciate.

- The risk here is not only to the airlines' finances but ultimately to the countries' connectivity should airlines decide to reduce service. One national carrier has withdrawn passenger flight services on Nigerian routes over foreign airlines' trapped funds, estimated to have reached over USD 500 million.[2]

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[1] The bubbles chart countries' external financial positions through two dimensions. The y-axis represents the evolution of local currency (LCU) against USD between September 2021 and September 2022, and the x-axis represents expected external debt service (public and publicly guaranteed) for 2023 as a percent of export value in 2019, with a few exceptions due to data availability: data for Iran and Zimbabwe are based on 2020 external debt ratio, and data for Egypt is based on three-year average of quarterly external debt ratio between 2019 and 2021. The size of the bubbles depicts the size of the local air passenger market as of 2019. Red bubbles represent countries blocking funds as per September 2022, and other countries are shown in blue.
[2] The Guardian, 4 November 2022.