

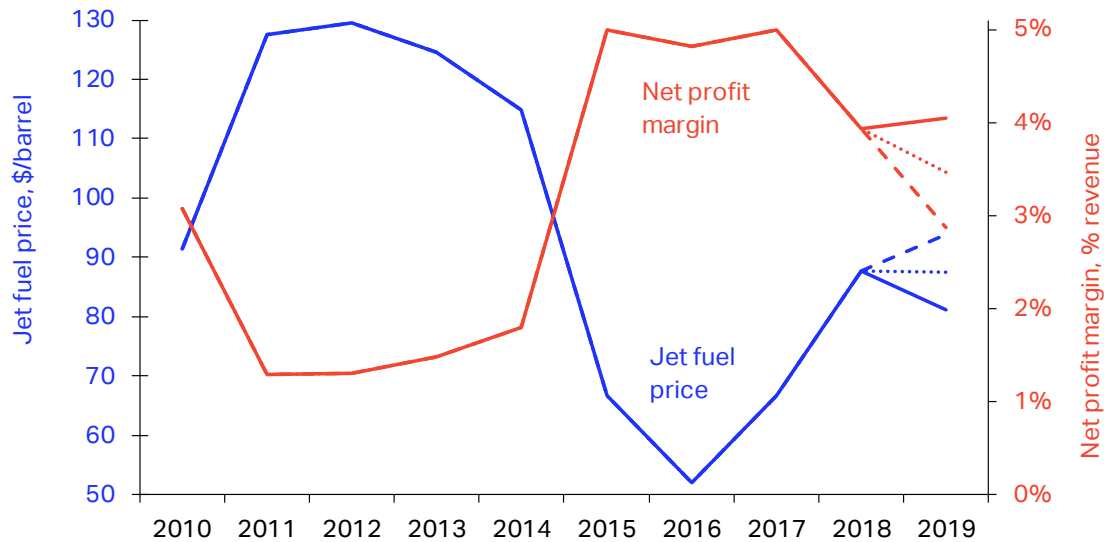


IATA Economics Chart of the Week

3 May 2019

Higher fuel prices hit airline industry profitability outlook

Fuel price vs industry net profit margin



Source: IATA Economics, Airline Analyst, Platts

Oil price=65\$/b
Oil price=70\$/b
Oil price=75\$/b

- Yesterday the US ended the waivers it had granted some countries that enabled them to continue to import crude oil from Iran, despite US sanctions. When that was announced recently, oil prices rose significantly, rising back over 75 \$/b at one point, in response to the prospect of 1.2-1.3 mb/d of oil supply being removed from the market. Saudi Arabia and the UAE have said they will add supply, but only after they see the impact of Iran losses on the market. The consequence is uncertainty, or rather more uncertainty than usual, over the price of jet fuel this year.
- Our December forecast, that industry profitability would stabilize this year close to 2018 levels, was based on Brent crude oil prices averaging 65 \$/b in 2019. Today they are 5 \$/b higher and have been more than 10 \$/b higher recently. The chart above gives some guide to the impact on the industry net profit margin of a higher outturn to oil and jet fuel prices. We compare the impact of our December assumption of 65 \$/b to 70 \$/b and 75 \$/b.
- The impact in 2019 of higher crude oil spot prices will depend on the crack spread, fuel hedging, the extent cost increases can be passed through to consumers and mitigating measures by airlines. We've assumed no change in the crack spread and that 50% of fuel consumption is hedged. With no pass-through to consumers or mitigating measures, each 5 \$/b increase in the price of jet fuel reduces industry net profit margins by around 0.5% points.
- The big question for the profits outlook is how much of this cost increase will be reflected in higher unit revenues. For the decades preceding the Global Financial Crisis the correlation between jet fuel prices and profit margins was close to zero. Costs were almost fully reflected in unit revenues. But since 2010, there has been an almost perfect inverse correlation (correlation coefficient of 0.98), as profit margins were squeezed or expanded by rises and falls in jet fuel prices. That correlation does not mean a 1:1 hit on the bottom line from higher fuel costs. There are other factors. Nevertheless, if fuel prices stay higher than we expected in December (and we await the supply response from other oil producers) there will be a reduction in forecast industry profitability of up to 1% point.

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