

It is clearly still some a considerable time before travel restrictions are lifted and countries become more open and the ability to move freely again is restored. Clearly the timing of what might best be described as of the starting point of the recovery to the “new normal” at a country level will not be the same. Whilst China has begun to recover capacity at the end of June will be some 40% lower than that in the corresponding period in 2019; many other countries are reporting capacity 80-90% below 2019 levels which was broadly similar to the low point in China. The non-coincident re-opening of markets is something that has a particular impact for airlines and airports that are demand aggregators as not only do countries have to be “open” at either side of the hub but where for leisure passengers the accommodation and attractions in the destinations they want to travel to must be available and accessible.

As things currently stand it is likely to take even longer before passengers are confident that their risk of catching the virus associated with travelling is acceptable and when airport and airline managers are also satisfied, and able to demonstrate, that they are not in effect creating infection hot spots as passengers come together, let alone “meeters and greeters”. Against this background it is not surprising that airport and airline managers are calling for testing and also proposing how they might introduce testing. However, in our opinion the missing element at the moment is the need for the intending passenger to be able to demonstrate that they are virus free, and for such information to be known, before they leave for the airport. It is not only the requirement that they are virus-free that is important but also that others know this too as it is this that will provide the necessary confidence.

Applying the the current social distancing requirements with a 2-metre gap at airports would, for example, for each short haul flight at pre crisis loads, imply a queue at both check in and security on departure and immigration on arrival equivalent to almost 350 metres, depending on the number of non-related travellers; beyond this there is of course the issue of what the “compliant” capacity of the terminals and gate areas would be. Whilst this is clearly not manageable the reality would be, given the need also for social distancing to be implemented board an aircraft (which also has significant implications for activities that crews are required to undertake), that the maximum compliant load factor would be between 20 and 25% given current cabin densities and the seat pitch. This would act to regulate the number of passengers per flight and both the airport passenger volumes overall and at the various “pinch points”. Whilst the end of the lock down and removal of restrictions are what might be described as necessary and sufficient conditions for travel to return until there is an ability to demonstrate, and provide the certainty, that intending travellers are virus free and not potential spreaders the recovery will be even slower than it might be as a result of the economic and business dislocation alone.

There should be no doubt that the “new norm” be characterised by a smaller industry and that this change will be structural reduction in size. Even if an economic depression is avoided it would be dangerous to underestimate the depth and pervasive nature of the economic impacts. After the great financial crisis in 2008 it took until 2016 for the number of flights in Europe to return to the levels seen in 2007 where some categories of leisure traffic were not evident after for a considerable period after 2008. In the current situation not only have we seen airlines either stop flying or operate at a “de minimis” level but airports close for flights too; restarting is going to be a significant activity and should not be underestimated. The breadth and depth of the economic impact of Covid19 is far greater than anything seen over the last 70 years and provides the reason and opportunities for airline managements to question what routes they should fly in the future and the shape and size of the business that they will need to be able do this ; we should have seen the end of “have metal will fly” strategies and the replacement by a focus on routes that are profitable or produce a meaningful contribution. There is an opportunity for airline managements to in effect refashion their business and reset the economics.

We have seen from the comments from Carsten Spohr of Lufthansa that even on reasonable assumptions (and without a second, let alone a third, wave of outbreaks of the virus) he would expect to be operating no more than 25% of group capacity by the end of September and 75% by the end of the year. He is of course not the only airline CEO to recognise that the industry will emerge smaller than it went into the crisis. Beyond this there have been a raft of announcements around decommissioning aircraft (Lufthansa 40 aircraft) early retirements of aircraft (IAG 67 aircraft) and also deferrals (easyJet 24 and also prospect of up to 24 lease returns) with many more to come - Avolon has just cancelled an order for 75 Max aircraft, a week after reporting that some 80% of its customers had requested relief from payments.

Given the step change reduction in traffic, the focus by airlines on matching capacity with likely future demand in the new environment and the consequences for both the size of the network and frequencies there is an inevitability that thus structural change will result in significantly fewer flights with a very real prospect, on the most reasonable assumptions that at the end of 2021 will still be materially below the number reported in 2019. Notions that traffic will be back to previous levels by the end of 2021 are a manifestation of unfounded and misplaced optimism - the impact on corporate and household budgets, the sources of the funding for air travel, has been profound and will be long lasting.

Notwithstanding initial/immediate government support for airlines (and airports), which will need to be followed by a significant second round of financing, airlines will fail. For governments the decisions around financing are fraught with a range of issues including moral hazard but where, amongst others, the key ones relate to the economic contribution that would be lost if the airline failed. But even then, open-ended support without the airline's management satisfying a number of conditions would not be appropriate and indeed to date, where support has been offered, conditions have been attached. It will be particularly interesting to see if all governments adopt such an approach. Clearly such support can act to distort competitive markets and we believe that it will in some cases will release managements from making what would be seen as the necessary adjustments to employee levels.

Such outcomes pose a number of questions for regulators across a wide range of areas; for example, how long should the "use it or lose it rules" at airports be suspended given the need to avoid "ghost flights" but where it this will also have implications for rights to slots against a background where retention of unused slots constitutes a barrier to entry. There is clearly a lot of thinking still to be done around this and the issues arising and indeed around all aspects of slot allocation which will inevitably have implications for slot values. Indeed might the industry emerge with new and lower caps on annual airport movements where this would have positive implications for the operational efficiency of airports and airlines and a demonstrable environmental gain.

There has been increasing commentary on the improvement in air quality resulting from the material reductions in all modes of transport where the logical and perhaps inevitable next step is to pose the question "just how much travel in the future do you need?" And where it would be reasonable to conclude that more binding environmental constraints are brought in earlier than previously anticipated- this may become increasingly difficult for governments to ignore and to argue against it.

There should be no doubt that this time it is very different and it both results in a need for managements, across all aviation and related companies, to question everything that their businesses will do in the future and also how they will do. What is also clear is that the dislocation to the preCovid aviation system has yet to fully show through we are still in the initial adjustment phase which will be followed by further adjustment and adaption before the initial steps towards recovery. Against this background whilst it is likely that there will be the need for regulatory modification to reflect the

prevailing circumstances there should also be an awareness that it may also provide “the cover” for more meaningful and binding environmental regulations where compliance will require more than just the accelerated retirement of older aircraft that is already evident. In what are unprecedented times it is even more important than ever to expect the unexpected where the mantra to “plan for the worst but hope for something better” is particularly apposite.