ON TOUR: Chris Tarry talks to the young professionals

The eminent aviation analyst Chris Tarry shared his views on the near, medium and also the longer-term outlook for the aviation industry with the Young Aviation Professionals' Reception held at the RAF Club last week. His comments, here in a precis form, were in a sense out of date as he spoke, and have been updated to reflect the developments up and until 15th March, but do give a view as he sees it.

"The old clichés are still true 'You ain't seen nothing yet'. The crisis comes on top of the MAX debacle, where the fall in the oil price, whilst significant for a number of economies is of limited importance for the airline industry where the issue is one of precipitous falls in revenue and cash.

It is clear that the nature and pervasiveness of Covid-19 and the responses by governments, companies and individuals, have been quite different from any recent "pandemic events".

In terms of reactions by companies, a much more evident "duty of care" in respect of their employees has resulted in almost immediate travel bans with the consequential impact on high value travel and on generally close in forward bookings with the inevitable impact on cash. We have already seen a raft of anecdotal evidence regarding not only of the fall in bookings but also in the number of passengers travelling, even to markets that are still open. However there is no opportunity on this occasion to attempt to either stimulate the near term market or indeed further out with consequences for cash – it will be of particular interest to look at the cash in advance of carriage line when companies next report .

Whilst Italy has become in effect the first closed market in Europe others are following. In terms of the potential impact, taken together the number of passengers flying to and from UK airports to Italy, Portugal and Spain combined is some 70million.

We had also seen airlines announce significant capacity reductions even before President Trump's announcement where US airlines had announced reductions of 7-10% across the Atlantic, had suspended flights to China until the end of October. The broadening of the travel bans to include the UK and Ireland means for a least a month there will in effect be no transatlantic flights.

For many airlines these latest developments have become an almost existential threat – the effective suspension of routes to the US are catastrophic for both British Airways and Virgin Atlantic; Beyond this the closure of other markets not least to date Spain, Italy and India (as well as Poland and the Czech Republic, will inevitably increase. Elsewhere for Finnair with the US, India and the majority of its Asian destinations effectively now closed life has become very difficult very quickly; The challenges facing Norwegian are well-documented . We have seen both ACI and IATA make forecasts of what they expect to be the impact on revenues – whilst these may be directionally correct it remains impossible to predict what the actual outcomes will be. Managements at both a number of airports and airlines in Europe and elsewhere including the US are clear in their view that state aid is essential at the present moment - indeed to sustain the economic and societal benefits from aviation such support may indeed be necessary but it shouldn't be open ended.

We have also seen managements react, as they have in similar situations, by cutting or more appropriately slashing, capacity to reduce costs and also lay-offs and employees taking "voluntary" unpaid leave.

Whilst there is at times a fixation about cost the reality is that this is a business where if the ability to generate revenue and the associated cash becomes compromised, given the significant share of fixed and in the near and medium term generally unavoidable costs, life becomes very difficult very quickly. There is nothing new about this and where what we are seeing now shows how quickly things can change.

Despite the fall in the fuel price this is in operating terms "de minimis" given the fundamental deterioration in the revenue environment, although it has resulted in some potentially significant hedging losses.

Whilst It would not be appropriate to suggest "who's next" in terms of likely to fail, we are not only looking at the challenges but also at the opportunities and for whom and when.

Our view for some time has been that the industry has had too much capacity. Whilst the immediate focus is on cutting capacity on routes where there is now little or no demand it already has begun to focus attention on future requirements both from a position of need as well as affordability; we have already begun to see talk of deferments of deliveries and cancellations, not least as it is reasonable to expect a glut of pre-owned aircraft. This adjustment will provide opportunities for airlines and lessors to acquire aircraft at very attractive prices.

The great unknown is how long not only the virus and its effects will be evident but also the associated behaviours. Indeed when the risk is perceived to have become acceptable, price will overcome fear and there will be a start of a return to normal. Whilst the market for air travel and indeed the stock markets, where "excessive valuations" had been evident for some time and a correction was overdue, will recover the questions are when and how quickly?

In the UK the government has implemented what is described as the delay strategy where the objective is to delay and reduce the peak of the outbreak of the virus. However, the reality is that just as many are likely to succumb to the virus as under the alternative strategy where the peak is higher and earlier.

Whilst on the one hand it is quite reasonable to attempt to match the peak with the resources of the healthcare providers the reality is that this is not a controlled laboratory experiment, on the other hand the duration of infection of the population is also longer which will result in changed behaviours continuing and by definition the economic impact lasting longer with consequences for all industries and not just aviation and hospitality. There is a tendency to choose a letter of the alphabet to describe the shape of the path taken by the economy or stock market indices where selection is usually a "V", sharp decline and recovery, a "U" a sharp fall, a period bumping along the bottom and then a reasonably quick recovery, or a reclining "L" where there is a sharp fall but a slow and prolonged recovery. In the current environment where the stock markets given that they look forward are more likely to reflect a "V" shaped the reality is that for the airline industry the shape is more likely to be that of "a reclining L" and where what emerges will show structural change across a number of areas

Beyond this time, and the recovery to more normal levels, there remains the issue of the environment restrictions, which despite managements setting out their strategies to reach net zero by 2050 has the very real potential to act as a very real constraint to growth over the longer term.

At the simplest level the impact of electric or hybrid aircraft is exceptionally limited and only applicable to small regional aircraft over any reasonable time horizon; Synthetic fuel is clearly an alternative but given the demands to find additional arable land to feed the growing population, plant based feedstocks are a non-starter.

Even allowing for some technological breakthroughs synthetic fuel will cost perhaps 5-8 times that of fossil fuel (before the fall due to the actions taken by Saudi Arabia over the last week or so), something which will have an inevitable effect on demand.

At the present moment the total amount of synthetic fuel available in a year would provide enough for 36 hours flying by Lufthansa.

There is a real risk that not only might offsets become less acceptable, indeed to offset the emissions in 2019 some 180m trees would need to been planted some 20 years ago, but that the policy and regulatory focus is on actual emissions produced. Whilst the airline industry currently accounts for some 2% of global emissions, given what is happening elsewhere, and taking into account current technical developments in the airline industry, the continuing use of fossil fuel, and prevailing growth forecasts, this share could rise to 15% by 2050. Given this and the cost of substitutes it is almost inevitable that beyond the medium term there will be a need to revisit growth forecasts.

In summary the only conclusion is that as we have yet to reach the bottom let alone approach a turning point it will get worse before it gets better and where the short term in particular will be extremely painful and for some overwhelming. The emphasis must be on survival and how to compete and prosper are issues for another day when the shape and size of the remaining industry will be clearer.