

How manufacturer problems deflated my bubble

Adam Pilarski, senior vice-president at Avitas, says the current deviation from the well-accepted relationship of economic and aviation cycles makes the life of forecasters very difficult.

For a long time forecasters and practitioners of aviation developments used a well-documented and universally accepted truth that aviation is highly dependent on economic developments. As people make more money they tend to spend more on luxury goods of which air travel is one. In times of recession people still have to eat but they can curtail holidays. These causal relationships served us well in predicting traffic, demand for aircraft and leasing, profitability and many other variables.

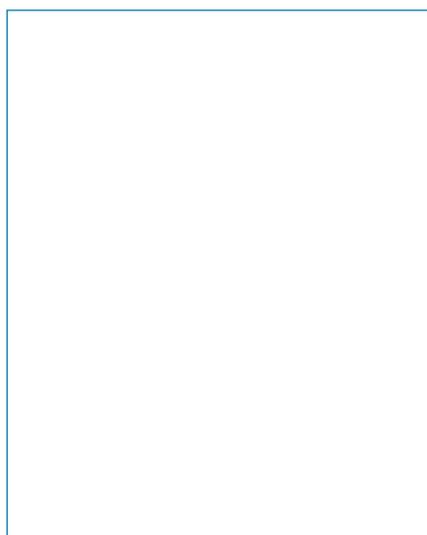
So it is with a heavy heart that I must admit that recently I was wrong. I used the well-proven relationships to assume that with the relentless expansion of orders and deliveries we faced for the last number of years we will reach an imbalance, which will have to lead to a necessary adjustment. I believed that there were simply way too many aircraft in service and plans for too many being further added to allow the situation to continue.

I understood the specific rationale for the unprecedented buildup of orders and deliveries but believed that the market would eventually overheat. This would lead, like it did in the past, to price wars resulting in declines in yield rates for lessors and airline ticket prices. Like in previous times, the result of these price wars to fill too many seats would cause some lessors and airlines to cease operating, grounding fleets until ultimately balance was restored.

But all this has not happened. World traffic did slow down but not because of what some analysts naively called “capacity discipline” to secure solid yields. Rather, capacity did not rise as expected because of supply factors related to manufacturers.

Simply, airlines and lessors did not add extra seats not because they were doing careful macroeconomic forecasts but rather they did not get the aircraft they desperately wanted to utilise which they had bought. They did not get the equipment because of a number of reasons.

First, all engine producers experienced plenty of production problems significantly affecting their output. Second, Airbus had



Our author at the *Airfinance Journal* Dublin 2020 conference.

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its specific production problems, mainly related to the implementation of its Airbus Cabin Flex programme.

This problem will not be resolved for another 18 months, Airbus has revealed.

Finally, the elephant in the room, was the grounding and temporary cessation of the Boeing 737 Max programme. This fact removed at least 800 units from potential supply last year with a continuous reduction of potential (ordered) supply for still some time. This development released a significant amount of the excess pressure of too many seats available in the market. All those manufacturing problems substantially deflated the bubble I had predicted.

So where are we going with all this? Forecasting is made much more difficult. Historically, we used the well-documented and validated relation between economic and aviation cycles. This relationship is temporarily suspended as aviation

experiences a slowdown not related to the economy but to specific aviation structural problems.

Our present circumstances are very different than I had predicted earlier. The explainable and prolonged bubble did not explode. Rather, it was softened by supply considerations totally unrelated to the economic cycle.

With a strong economy we faced not as robust traffic and profit as we should have been expecting. The slowdown in traffic happened not because of, but despite, economic realities. The situation is further complicated by coronavirus, though it works in line with traditional relationships in that it causes both traffic and economy to decline.

The uncertainties related to the current production problems have little to do with the state of the economy but rather consist of a myriad of legal, technical and political issues. Old-fashioned scenario analysis might be the most useful technique to make predictions in today’s world. One very negative such scenario could be the prompt return of Max aircraft, both parked and ready to be produced. Such an increase of supply could come at a time of a forthcoming worldwide economic downturn leading to calamities, losses for airlines and lessors, bankruptcies and financial losses.

A more benign scenario could have a recession-inspired traffic slowdown coinciding with low supply easing the potential ramifications of a downturn. Instead of large fleets being grounded by the imbalance, the industry would not produce the anticipated number of aircraft, sparing owners and purchasers of aircraft possible calamities.

Such a scenario would be most beneficial to many airlines and lessors, though not as positive to aircraft and engine suppliers. It would fit in nicely with my favourite saying: “I’d rather be lucky than good.”

Despite wrong planning, we could be saved temporarily by incompetence leading to reduced supply just in time to avoid overheating, pushing the days of reckoning into the future. ▲