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The coming air cargo reality check: how the industry will evolve through COVID-19

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By Christopher Karp

Nearly six months since the World Health Organization officially declared Covid-19 a pandemic, the world still is in a state of near-emergency. Aviation as a whole is, as is well documented, being hit hard by the ongoing restrictions in travel. The air cargo business has also been affected, but to a lesser extent.

Cargo is a short-term winner for the industry

At the peak of the crisis in April, global cargo capacity was 44% lower than in the same period in 2019. However, the demand decline was not quite as steep, at just 33% against 2019. This, coupled with extraordinarily high demand for personal protective equipment (PPE) and medical goods resulted in air cargo rates skyrocketing by up to 200% on the most important trade-lanes[1].

As a result, cargo has emerged as a lifeline for many airlines. It was the most profitable business segment for Lufthansa Group in Q2 2020, and helped Korean Air and Asiana avoid operating losses for the same period. American Airlines recently completed its 1000th successful belly-cargo-only flight since the start of the pandemic. Clearly, cargo is no longer only a byproduct or afterthought of airline operations. It has become a significant factor in airlines' strategic planning, necessitating a robust view of its development as the industry recovers from the effects of COVID-19.

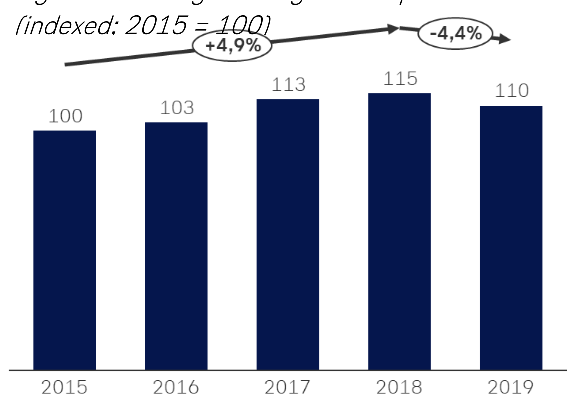
Lufthansa Consulting addresses the outlook for the industry on three dimensions – volume (demand), capacity (supply) and yield levels.

Volume demand will not recover before 2022 at the earliest

Although the cargo industry is seeing booming yields and profitability at the moment, one mustn't lose sight of the fact that volumes have actually fallen – Q2 2020 saw 25-30% lower volumes than the same period in 2019. This, coming after a weak year 2019 that saw a 4.4% fall in volumes from 2018. Lufthansa Consulting estimates that the cargo industry will finish 2020 with demand depressed by 15-20% compared to the previous year.

In the early months of the pandemic, pharmaceutical goods and PPE understandably grew the fastest among all categories. While still strong, this category of goods might decline due to in-shoring as several countries seek to ensure self-sufficiency in the case of a second wave.

Figure 1: Air cargo tonnage development (indexed: 2015 = 100)



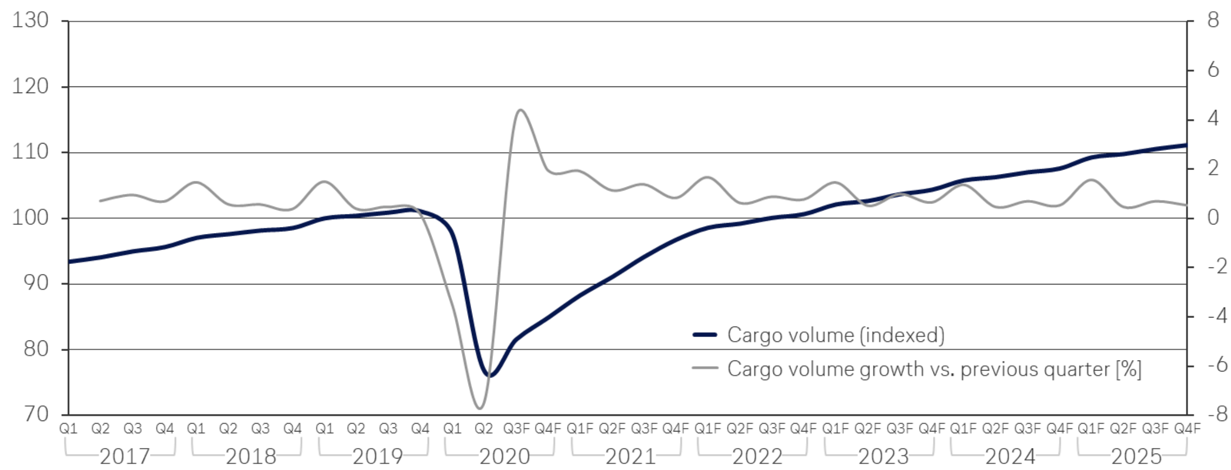
Source: WorldACD, Lufthansa Consulting analysis

[1] *Lufthansa Consulting analysis, IATA AirportIS, WorldACD*

As the industry slowly reverts to normal, the other categories of goods are recovering. E-Commerce, already ascendant pre-COVID, received a significant boost[2] due to worldwide lockdown measures and will continue to be a significant driver of future volumes.

Looking forward, global trade and GDP levels are forecast to reach 2019 levels in 2022 at the earliest. The next 24 months will likely be the proverbial vale of tears for airlines, airport and freight forwarders. After a strong rise in the second half of 2020, Lufthansa Consulting expects demand growth to return to its pre-crisis rates of 3 – 4% per annum. This assumes that a vaccine will not be available in 2020, but also that the world at large does not see a second wave of infections and lockdowns, and avoids a deep and widespread financial crisis. Industry recovery and growth is likely to be driven by developing economies, particularly those in Asia.

Figure 2: Air cargo tonnage development (indexed; Q1/2020 = 100)



Source: WorldACD, IATA Economics, OECD, IHS Markit, Airbus, Lufthansa Consulting analysis

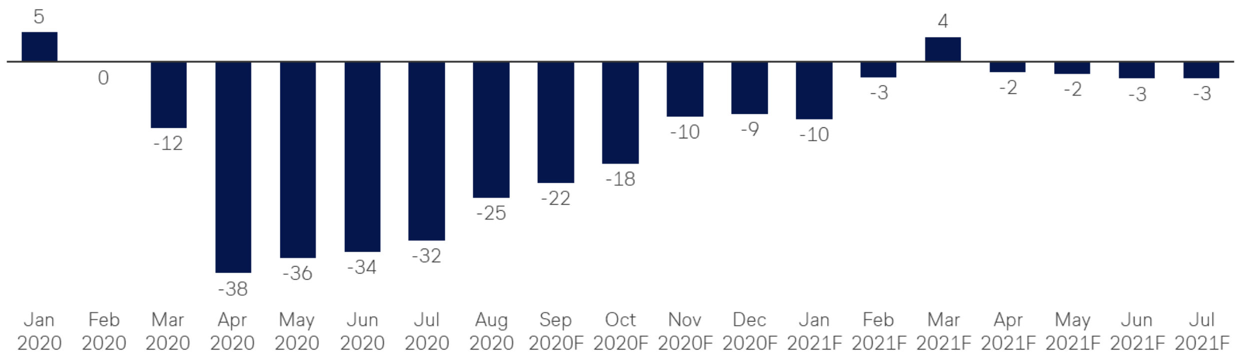
Air cargo capacities will remain suppressed until at least mid-2021, and recovery will be driven by growth in freighter capacity

In recent months, belly capacity fell dramatically as passenger flights were cancelled. Although freighter capacity grew ~25% through conversions or reactivation, this nevertheless represents a significant reduction in global cargo capacity[3].

The recent recovery in passenger capacity to ~50% of 2019 levels is largely on domestic or intra-continental routes that typically offer economical road or rail-based alternatives to air cargo[4]. International wide-body connections will take years to return to pre-crisis levels. With additional freighter operations covering only a small part of the resulting gap in capacity, Lufthansa Consulting expects global availability of capacity to stay well below 2019 levels, returning close to it in the middle of 2021 at the earliest.

[2] Forbes 2020 [3] IATA, July 2020 [4] IATA AirportIS, Lufthansa Consulting analysis

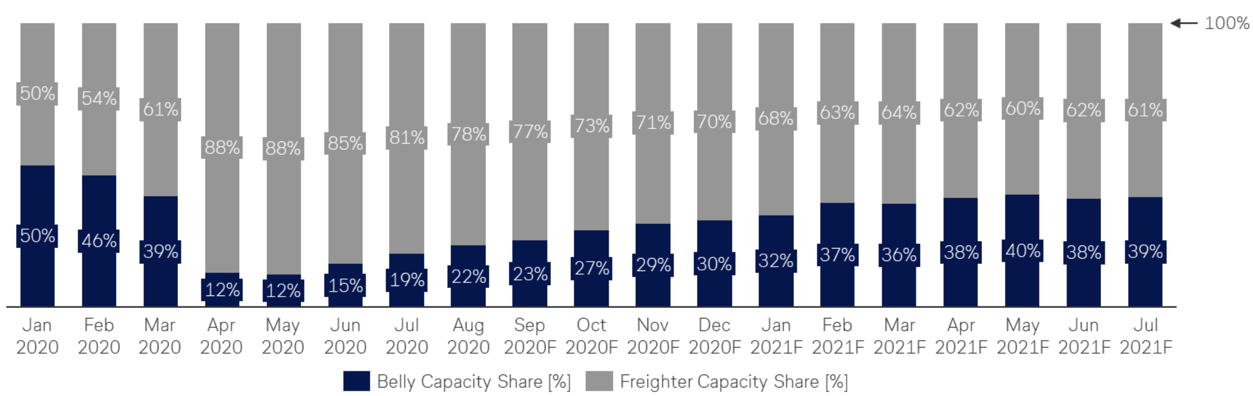
Figure 3: Air cargo capacity compared to the same month in 2019



Source: IATA AirportIS, IATA Air Cargo Market Analysis, Lufthansa Consulting analysis

The oft-cited 50:50 share of belly and freighter capacities pre-pandemic swung to almost 10:90 in April 2020 – a trend that is not expected to fully reverse. For the foreseeable future, airlines will downgrade the size of passenger aircraft deployed and the frequencies. The retirement of large aircraft types, in particular, affects the available belly capacity flying around the world. It is also anticipated that several passenger aircraft will be converted to freighters. Freighter capacity will therefore dominate for some time to come.

Figure 4: Air cargo capacity split by aircraft role



Source: IATA AirportIS, IATA Air Cargo Market Analysis, Lufthansa Consulting analysis

The growth of medium-size freighter aircraft numbers will also lead to more direct point-to-point cargo service, bypassing traditional passenger hubs and reducing transfer costs for airlines and freight forwarders. This is likely to be reflected in a shift of cargo capacities away from legacy cargo providers, because the conversion boom will lead to regional and niche carriers supplying more capacities. This is a business model, which can be particularly relevant for markets in Latin America, Asia and Africa, where trans-continental traffic happens by air to a large extent.

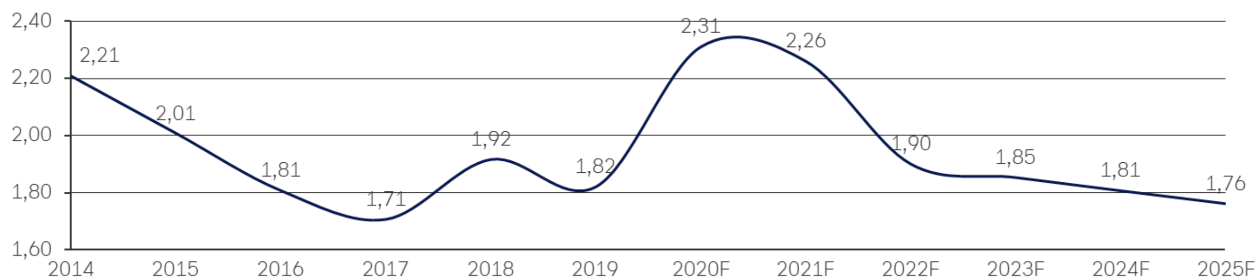
Preighters – passenger aircraft operating as full-cargo flights – were an interesting phenomenon during the peak of the pandemic as demand for cargo capacity soared. However, the return of passenger volumes, growing availability of full-freighter aircraft and the operational complexities of the business model will result in this not being a meaningful contributor to industry volumes in the future.

Yield will revert to normal levels over time as capacity gradually increases

Air cargo yields have been on a steady decline since their peak in April and May 2020, falling from a high of an average of USD 4.29 /kg to a USD 3.12/kg in June 2019. This is, however, still 70% higher than for the comparable period in 2019, largely due to the ongoing capacity shortage.

Cargo capacity is expected to recover in 2021, putting downward pressure on yields. However, the higher share of freighter capacity – which usually trades at a premium to belly capacity – will provide a lift. Further, higher unit costs of operation resulting from lower volumes but high or steady fixed costs and overheads will encourage cargo operators to maintain healthy yields. Air cargo yields will therefore remain significantly above previous years' levels in the medium-term. Once passenger aircraft return to the skies in greater numbers by 2024, it is anticipated that yields will revert to their historical trajectory of falling by 2-3% per annum.

Figure 5: Air cargo yield development [USD / kg]



Source: IATA Industry Economic Performance, Airbus, Lufthansa Consulting analysis

Recent performance notwithstanding, the industry will soon return to regularity

While the last few months have been very profitable for the air cargo industry, the prevailing situation is nevertheless one of concern. Diminished capacities and volume demand are a worry. Competition is increasing as erstwhile passenger-only airlines seek to gain a share of the cargo revenue pool. And yields will soon fall from their historical highs.

The industry remains sensitive to the global economic conditions Resurgence in COVID-19 and the resulting lockdowns continue to be a risk factor. Air cargo is – and will certainly remain – an essential cog in the engine of global transport and logistics. As in the case of the passenger air travel market, though, the air cargo industry will see a "new normal" with shifts in market sizes, types of demand and types of capacity as it navigates the path ahead.

To learn more and discuss how your organization could benefit from Lufthansa Consulting's expertise on Airline Strategy and Crisis Recovery, please get in touch at ALcrisis-solutions@LHConsulting.com.

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