Malaysian Aviation Commission
Suruhanjaya Penerbangan Malaysia
MAVCOM

WAYPOINT

MALAYSIAN AVIATION INDUSTRY OUTLOOK | **MARCH 2020**

KEY HIGHLIGHTS

Contraction in 2020 passenger traffic amidst COVID-19 pandemic

MAVCOM revises its 2020 passenger traffic forecast to -36.2% and -38.1% Year-on-Year (YoY) (previous forecast: growth of between 4.6% and 5.7% YoY), **which translates to 67.7mn – 69.7mn passengers (2019: 109.2mn passengers),** as demand for air travel will be severely impacted by the Coronavirus disease 2019 (COVID-19) pandemic. This forecast considered existing flight cancellations by local and foreign carriers, as well as, an additional 15.0% seat reduction on domestic and 20.0% seat reduction on international routes in 2020, amounting to 31.0mn seats. The passenger traffic forecast and all other estimates in this report are based on the latest available information.[1]

Capacity cuts by Malaysian carriers in 2020 due to COVID-19 pandemic

Malaysian carriers are continuously reducing seat capacity in 2020 in response to low air travel demand and travel restrictions imposed by countries worldwide. 7.3mn seats have already been cancelled (as of 26 March 2020), representing 8.6% of total seat capacity for Malaysian carriers in 2020. **Foreign carriers operating to and from Malaysia have also reduced seat capacity by 6.7mn (24.5% of total seat capacity for foreign carriers) in 2020.**

Bleak outlook in 2020 for the aviation services market

Due to the capacity cuts, **the revenue-at-risk for Malaysian and foreign carriers are estimated to be RM6.8bn and RM5.0bn, respectively (37.9% of estimated total airfare-related revenue, collectively) and RM0.4bn (24.9% of estimated total passenger service charge-related revenue) for aerodrome operators.** The ending of coordinated crude oil production cuts between Saudi Arabia and Russia in March 2020 will lead to an oil supply increase, which will keep oil prices low. A low oil price environment will result in losses for airlines that are highly hedged this year. **The low air travel demand and losses from hedging positions point to a challenging outlook for the industry in 2020.**

Risk of airline insolvency and loss of air connectivity

The International Air Transport Association (IATA) predicted that the airline industry globally stands to lose USD252.0bn in revenue and suffer a liquidity crisis in 2020. Additionally, **the Centre for Aviation (CAPA) predicted that most airlines could be bankrupt by end-May 2020**. The financial strain on airlines' will be exacerbated by lower passenger demand due to fears of air travel, resulting in the reduction of flight frequencies or cancellation of services. This will also lead to **loss of air connectivity to a wide range of destinations as interlining operations are disrupted**. In the case of Malaysia, this would involve several destinations in Australia, China, and India.

[1] As at 26 March 2020. Owing to fast-evolving developments globally and nationally, MAVCOM will continue to monitor the situation and make adjustments to its forecasts, if and when required.

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SECTION 1: INDUSTRY OVERVIEW AND OUTLOOK

Low Gross Domestic Product Growth and Oil Price Likely to Affect the Aviation Services Market

Economic Growth Likely to be Revised Downwards

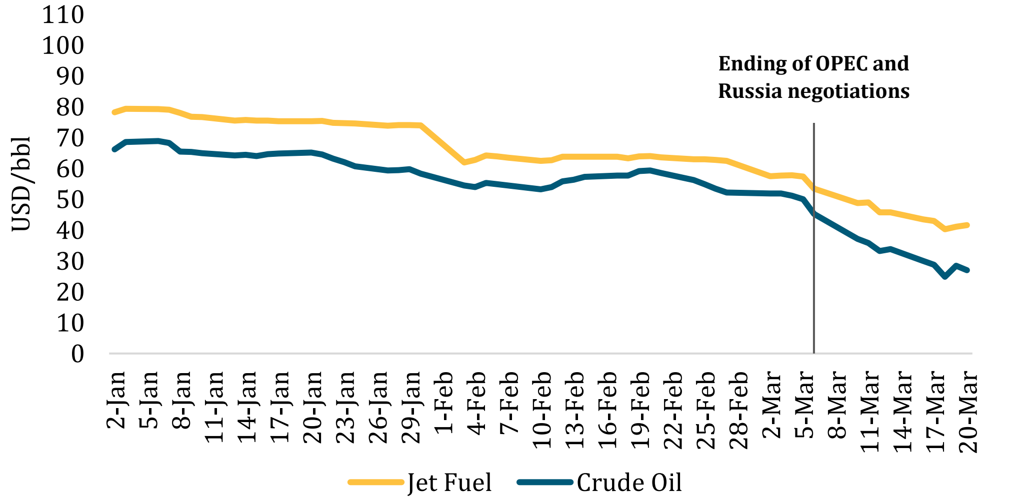
The International Monetary Fund (IMF) had revised its forecast for global economic growth in its World Economic Outlook from 3.3% YoY to 3.2% YoY in February 2020, whilst Bank Negara Malaysia (BNM) had also revised its forecast for the Malaysian economy downwards from 4.8% YoY to between 3.2% YoY and 4.2% YoY in 2020. **Both the global and Malaysian economic growth forecasts are likely to be revised further downwards considering the prolonged COVID-19 pandemic, which has affected global supply chains, consumer demand, and financial markets.**

Low Oil Prices Will Negatively Affect Highly-Hedged Airlines

Brent crude averaged USD64.0/barrel (bbl) while jet fuel averaged USD76.0/bbl in 2019, with an average crack spread[2] of USD12/bbl. However, the ending of negotiations between the Saudi Arabia-led Organization of Petroleum Exporting Countries delegation and Russia on 6 March 2020 is likely to increase the supply of crude oil globally, as the talks failed to extend coordinated production cuts beyond March 2020. This is likely to result in low oil prices.

Against the backdrop of slowing demand due to low economic growth, Brent crude oil prices are expected to remain low. Between 2 January and 20 March 2020, Brent crude oil averaged USD54.0/bbl (see Figure 1) and **the United States (US) Energy Information Administration forecasted that Brent crude oil will now average USD43.0/bbl in 2020**, down from its earlier forecast of USD65/bbl.

Figure 1: Oil and Jet Fuel Trends, January – March 2020



Source: Bloomberg
Note: Data available as at 20 March

[2] The price difference of a barrel of crude oil and jet fuel, also known as the refining margin.

When oil prices are declining, jet fuel hedging becomes unattractive to airlines as they can benefit from falling spot prices. **Airlines that are highly hedged would not be able to take advantage of declining oil prices,** as they had locked in a higher price in their hedging contracts relative to the prevailing spot prices.

Global and Malaysia Passenger Traffic Growth Will be at Risk

Passenger Traffic Growth in the Asia Pacific is Expected to Contract by 8.2% YoY

IATA, in its December 2019 report on Airline Industry Economic Performance, forecasted a growth of 4.1% YoY and 2.0% YoY for global passenger traffic and cargo traffic, respectively, in 2020 (see Table 1). However, IATA is likely to revise both global passenger and cargo traffic forecasts downwards, considering the worsening impact of COVID-19, which will adversely affect the global economy. **In February 2020, IATA revised its passenger traffic growth for the Asia Pacific to -8.2% YoY (previous forecast: 4.8% YoY).**

Table 1: Passenger and Cargo Traffic Forecasts by IATA

Key Figures	2018 YoY Growth (%)	2019 YoY Growth (%)	2020 YoY Growth Forecast (%)
Global Passenger Traffic[3]	7.4	4.2	4.1
Global Cargo Traffic[4]	3.4	-3.3	2.0

Source: IATA

ICAO had called on governments to ensure the continuity of the global air cargo supply chain to facilitate the distribution of aid to countries affected by the COVID-19 pandemic. Despite the reduction of operations by airlines on scheduled passenger services—which is likely to affect belly cargo operations—freight cargo operations will compensate for this shortfall by continuing to deliver vital medicine and medical equipment, among others.

[3] Growth forecasts in terms of Revenue Passenger Kilometre.
[4] Growth forecasts in terms of Freight Tonne Kilometre.

Malaysia's Passenger Traffic is Expected to Contract by 36.2% – 38.1% YoY in 2020

For 2020, the COVID-19 pandemic is expected to severely impact passenger traffic growth in Malaysia. **Low demand for air travel is expected during the Movement Control Order imposed by the Government of Malaysia (GOM) and numerous travel restrictions by countries globally to curtail the pandemic.** MAVCOM lays out three different scenarios for the forecasts to reflect various severities of the potential impact on passenger traffic growth (see Table 2), taking into account existing and additional possible seat cancellations by both local and foreign carriers.

Table 2: Passenger Traffic Forecast, 2020

Assumptions	Worst Case Scenario	Base Case Scenario	Best Case Scenario
Domestic Seats Reduction	25.5% of 2020 seat capacity	20.9% of 2020 seat capacity	16.2% of 2020 seat capacity
International Seats Reduction	35.6% of 2020 seat capacity	31.6% of 2020 seat capacity	27.5% of 2020 seat capacity
Load Factor (%)	63.0 – 65.0	65.0 – 67.0	67.0 – 69.0
Passenger Traffic Forecast (mn)	61.7 – 63.7 (between -41.7% YoY and -43.5% YoY)	67.7 – 69.7 (between -36.2% YoY and -38.1% YoY)	73.8 – 76.1 (between -30.4% YoY and -32.4% YoY)

Source: MAVCOM

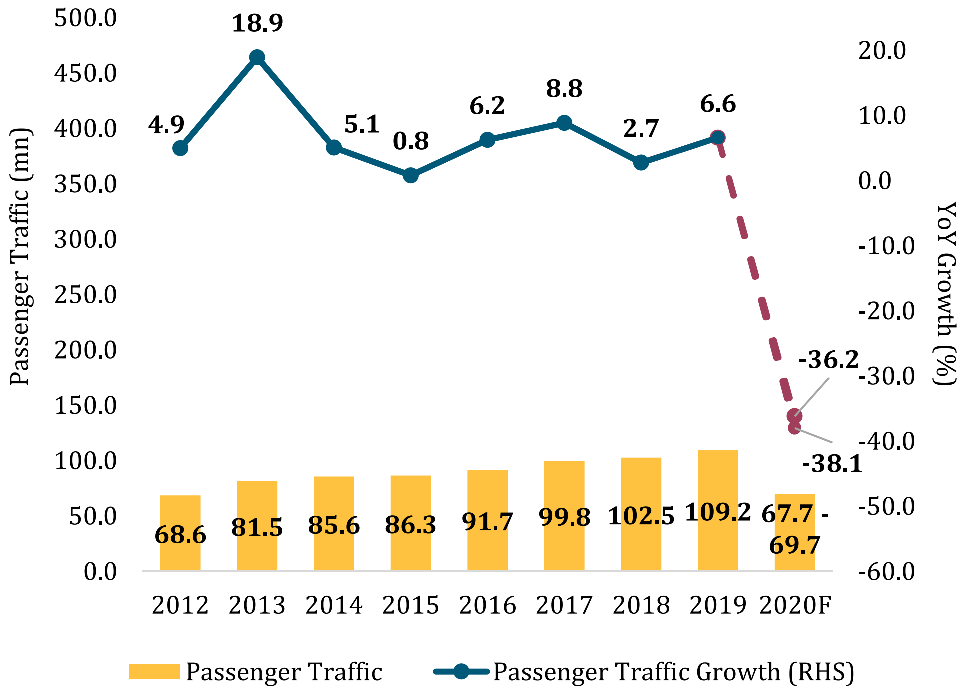
Note: The assumption of seats reduction for domestic and international segments already include a scenario where the magnitude of seats reduction will taper from October 2020.

Given the severity of the COVID-19 pandemic and a possible economic downturn, the recovery of airline seat capacity in 2020 to pre-COVID-19 levels is expected to take a longer time than that of Severe Acute Respiratory Syndrome (SARS) in 2003. In that year, Asia Pacific's carriers took around seven months[5] to recover to pre-outbreak levels.[6] **As such, MAVCOM expects passenger traffic growth in 2020 could only start to recover to pre-COVID-19 pandemic levels in 4Q20, at the earliest**.

[5] In terms of Revenue Passenger Kilometre.
[6] IATA. COVID-19 Initial Impact Assessment, IATA. February 2020.

For the **base case scenario, MAVCOM forecasts for passenger traffic in 2020 to contract by between 36.2% and 38.1% YoY, which translates to 67.7mn – 69.7mn passengers** (see Figure 2). Alongside existing flight cancellations, this forecast assumes a 15.0% and 20.0% seat reduction for domestic and international flights, respectively. This would mean a total of 31.0mn seats lost or 27.9% of total seat capacity in 2020. **The impact of the COVID-19 pandemic on the aviation services market is discussed further in Section 2**.

Figure 2: Passenger Traffic (Base Case Scenario), 2012 – 2020F



Source: MAVCOM, AOL Holders

However, if more stringent travel restrictions are put in place and passenger demand for air travel does not improve, MAVCOM's **worst case scenario** estimates that passenger traffic in 2020 will contract by between 41.7% and 43.5% YoY, translating to 61.7mn – 63.7mn passengers. This assumes a 20.0% and 25.0% seat reduction for domestic and international flights, respectively, alongside existing seat cancellations. Total seat capacity will reduce by 35.7mn seats or 32.2% of total seat capacity in 2020.

On the other hand, if the COVID-19 pandemic slows—thereby improving demand for air travel—and travel restrictions begin to be lifted, MAVCOM's **best case scenario** indicates that passenger traffic in 2020 will contract by between 30.4% and 32.4%, translating to 73.8mn – 76.1mn passengers. This assumes a 10.0% and 15.0% seat reduction for domestic and international flights, respectively, alongside existing seat cancellations. This amounts to 26.3mn seats lost or 23.7% of total seat capacity in 2020.

SECTION 2: THE IMPACT OF COVID-19 ON MALAYSIA'S AVIATION SERVICES MARKET

The COVID-19 pandemic—with Malaysia reporting its first case in January 2020—is severely affecting the aviation services market. As the number of cases grew rapidly worldwide, the outbreak was declared a pandemic by the World Health Organization (WHO) on 11 March 2020. **Since then, travel restrictions have disrupted business value chains, raising concerns that a deep economic downturn will follow, affecting the aviation services market.**

COVID-19 Poses a Significant Threat to the Aviation Services Market in Malaysia

Increasing Travel Restrictions Will Result in Lower Tourist Arrivals and Passenger Traffic

As the COVID-19 spread further around the globe, demand for air travel has been severely reduced as passengers have been postponing or cancelling their journeys. Several countries also responded with measures (see Table 3) to restrict travel—including border closures.

Table 3: Travel Restrictions by Australia, Canada, China, India, Nepal, New Zealand, Oman, Qatar, Saudi Arabia

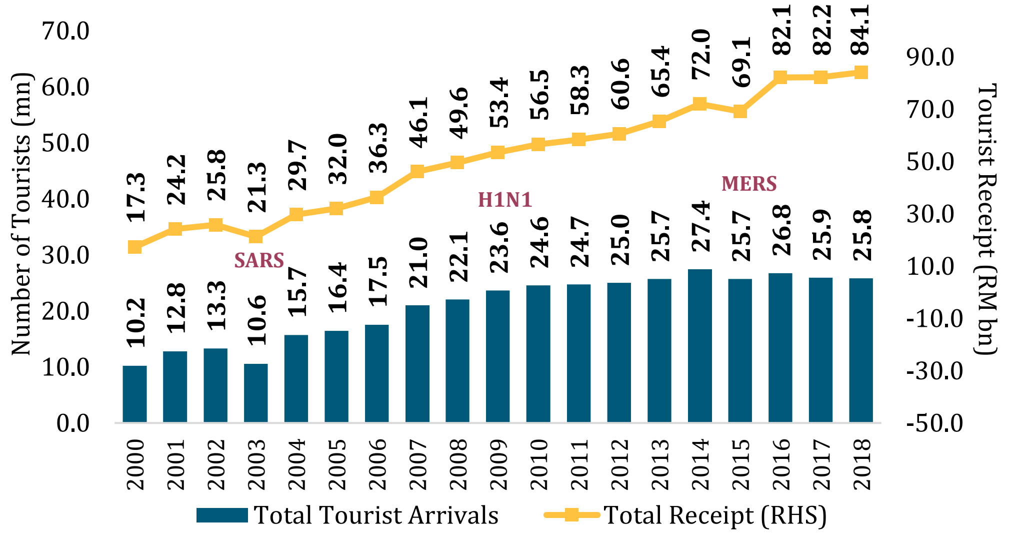
Countries	Travel Restrictions
Australia	Travellers who are not citizens, permanent residents, or their immediate family members, will not be allowed entry
Canada	Travellers who are not citizens, permanent residents, or their immediate family members, will not be allowed entry
China	Entry restrictions (self-quarantine for 14 days) for visitors from various countries, including Malaysia
India	All flights to India (except cargo flights) are suspended
Nepal	All flights to Nepal are suspended
New Zealand	Travellers who are not citizens, permanent residents, or their immediate family members, will not be allowed entry
Oman	Entry ban on all non-citizens
Qatar	Entry ban on all non-citizens
Saudi Arabia	Entry ban on all non-citizens

Source: Bloomberg
Note: As of 26 March 2020.

Malaysia had also announced measures to restrict movements (effective 18 March to 14 April 2020)—banning its citizens from travelling overseas and restricting the arrival of international passengers.

This will likely lead to a decline in tourist arrivals and receipts in 2020. As a comparison, during the SARS outbreak in 2003, total tourist arrivals saw a contraction of 20.6% YoY, from 13.3mn in 2002 to 10.6mn in 2003 (see Figure 3). The WHO estimated that a total of 8,096 cases were recorded then in 29 countries and territories, with 774 deaths. COVID-19, on the other hand, had resulted in 416,686 cases worldwide in 197 countries and territories.[7]

Figure 3: Tourist Arrivals to Malaysia and Receipts, 2000 – 2018

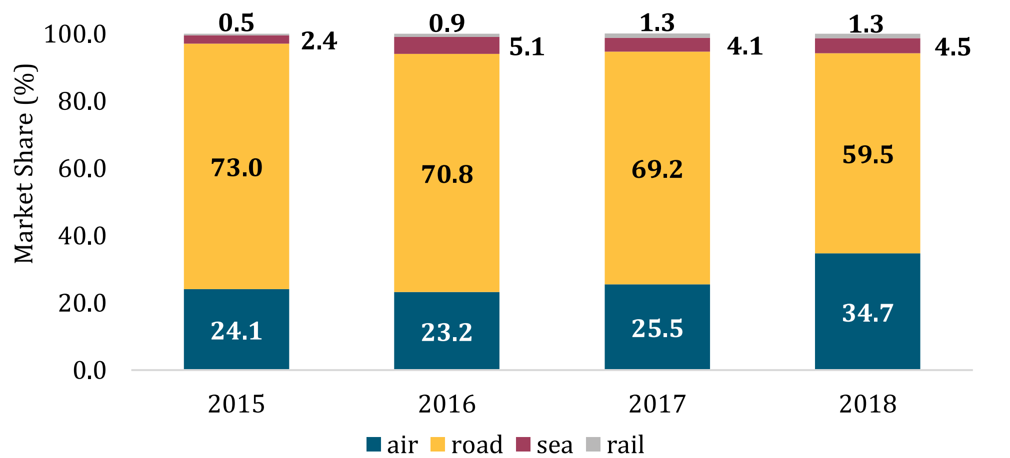


Source: Tourism Malaysia
Note: H1N1 – Influenza A Virus Subtype, MERS – Middle East Respiratory Syndrome

Fewer Tourist Arrivals will Lead to Lower Passenger Traffic Growth

By mode of transport, the share of tourist arrivals by air was the second largest after land transport, making up 34.7% (2017: 25.5%) of total tourist arrivals in 2018 (see Figure 4).

Figure 4: Total Tourist Arrivals to Malaysia by Mode of Transport, 2015 – 2018



Source: Tourism Malaysia

[7] As of 26 March 2020.

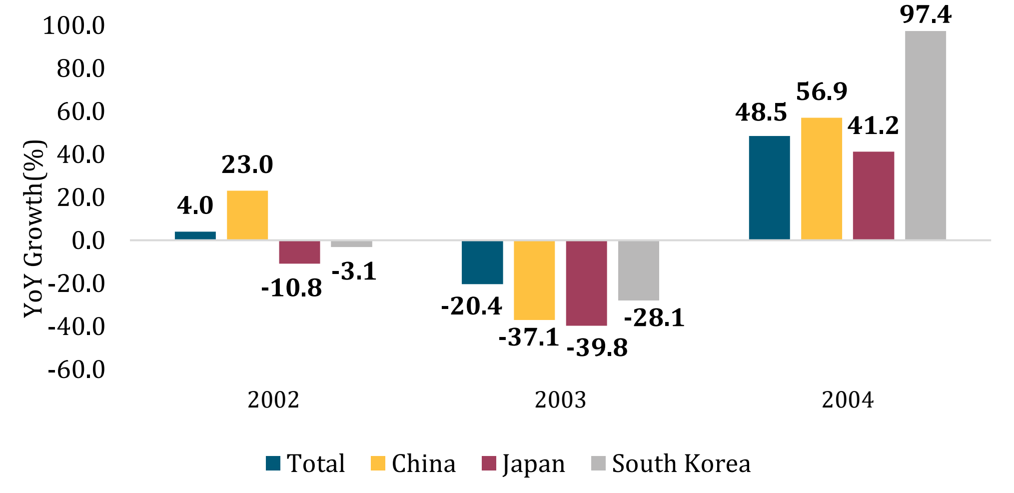
Air transport has become increasingly important in contributing to the total tourist arrivals to Malaysia, witnessed by the increase in the share of tourist arrivals by air between 2015 and 2018. **However, tourist arrivals by air are expected to decline in 2020 due to low travel demand.** This will subsequently affect passenger traffic growth, as airlines aggressively undertake seat capacity reductions in 2020 in response to low air travel demand.

For Malaysian carriers, a total of 7.3mn seats have already been cut, representing 8.6% of their total seat capacity.[8] **Seat capacity reductions involving major air passenger markets, such as China and South Korea, are expected to significantly reduce passenger traffic growth in Malaysia in 2020**. China and South Korea are among the top three countries in Asia in terms of the number of COVID-19 cases, according to the WHO (as of 26 March 2020).

The Revenue-at-Risk for Malaysian Air Service Licence and Aerodrome Operating Licence Holders is Estimated at RM7.2bn

Due to the increased importance of China in Malaysia's aviation industry, **the COVID-19 pandemic poses a bigger threat to Malaysia now compared to during the SARS outbreak in 2003.** China is now a larger market for Malaysia in terms of tourist arrivals and seat capacity compared to 2003. In 2018, China constituted 11.4% of total tourist arrivals and 8.3% of total seat capacity. In comparison, tourist arrivals from China in 2003 was only 3.3% of total tourist arrivals. Collectively, tourist arrivals to Malaysia from China, South Korea, and Japan in 2003 dropped by 20.4% YoY (see Figure 5). These countries are now among the top countries in terms of tourist arrivals in 2018.

Figure 5: Growth of Tourist Arrivals to Malaysia for Selected Markets, 2002 – 2004



Source: MAVCOM, Bloomberg Tourism Malaysia

[8] As of 26 March 2020.

Accordingly, MAVCOM's passenger traffic forecast in 2020 has factored in the evolving severity of the COVID-19 pandemic by including all reductions in seat capacity notified as and when by both Malaysian and foreign carriers, as well as, travel restrictions imposed by various countries globally. Based on MAVCOM's revised passenger traffic forecast in 2020, the **revenue-at-risk for Malaysian and foreign carriers is estimated at RM6.8bn and RM5.0bn, respectively (37.9% of estimated total airfare-related revenue), whilst for aerodrome operators, the revenue-at-risk is estimated at RM0.4bn (24.9% of estimated total passenger service charge-related revenue).**

Financial Strain Puts Industry Players at Risk of Insolvency

IATA had estimated that airlines globally had less than three months of cash at the start of 2020 to cover their fixed costs and predicted that they would lose a total of USD252.0bn in revenue due to the COVID-19 pandemic. The decline in passenger traffic, subsequent loss in revenue, and low liquidity have put a financial strain on industry players, with many airlines being forced to take radical cost-cutting measures. These include cancelling flights, grounding fleet, as well as, imposing unpaid leave, cutting salaries, and retrenching staff. Additionally, the strained financial position of airlines will be exacerbated as existing flights would likely experience lower passenger demand due to fears of air travel. As a result, airlines are likely to reduce flight frequencies or stop services altogether for certain routes. Passengers who continue to fly are likely to lose out both as a result of reduced frequency of services, and loss of connectivity to a wide range of destinations as interlining operations might get disrupted.

CAPA predicted that without government support, most airlines globally could be bankrupt by end-May 2020. Delta Air Lines estimated that it would lose USD2.0bn in March 2020, which is expected to increase further by April 2020.[9] Many airlines and airline associations worldwide have requested for financial assistance from their respective governments, including the US airlines' association—Airlines for America—which requested for USD50.0bn.[10] The United Kingdom's (UK) airlines' association, Airlines UK, had also requested for financial assistance worth between GBP5.0bn to GBP7.5bn.[11] It was also reported that Malaysian carriers had sought support in terms of financial aid for retrenched staff and tax relief from the GOM.[12] Without such financial assistance, airlines may be forced to consolidate in order to stay afloat or exit the market altogether.

The exit of an airline from the market would also result in a loss of air connectivity. For example, the exit of a major local carrier in Malaysia could potentially lead to a loss of air connectivity to several destinations in Australia, China, and India. An exit of any major Malaysian carrier could lead to a loss of seat capacity of between 4.6% and 21.9% for the rest of 2020.

[9] Delta Air Lines memo, March 18, 2020.
[10] Airlines for America statement, March 16, 2020.
[11] Jones, R. (2020, March 15). UK airlines call for multibillion bailout to survive Covid-19 crisis. *The Guardian.*
[12] Leong, D. & Samarathisa, E. (2020, March 19). AirAsia, MAB, Malindo, Firefly seek financial aid from MoF, say sources. *Focus Malaysia.*

Stimulus Package will Help Soften Impact on the Aviation Services Market

On 27 February, an RM20.0bn economic stimulus package was announced in Malaysia, which includes initiatives to assist the aviation services market. Such measures include a 15.0% discount on monthly electricity bills to airlines, rebates on rental for premises at the airport, and rebates on landing and parking charges. Digital vouchers for domestic tourism of up to RM100 per person for domestic flights were also included in the package. At the time of writing, the government has announced its intention to pursue further stimulus measures, which could include measures to aid the aviation services market. However, there are several considerations when extending financial assistance to industry players. **MAVCOM's Commentary on Government Assistance To The Aviation Industry Amidst the COVID-19 Pandemic discusses this**.

Globally, stimulus packages have been announced by the governments of Singapore, China, Australia, Denmark, and Sweden, among others, to reduce operating costs and provide financial support to airlines. The Singaporean government, the Civil Aviation Authority of Singapore (CAAS), and Changi Airport Group had co-funded an SGD112.0mn package for six months which includes measures such as a 100.0% parking charge rebate, 10.0% landing charge rebate, and 50.0% rebate on CAAS' regulatory fees. Further measures were then announced on 26 March to support industry workers and provide more funding for discounts on landing and parking charges, and rental relief for airlines, ground handlers, and cargo agents. Australia's Ministry for Infrastructure, Transport and Regional Development announced an AUD715.0mn relief package that includes a waiver on aviation fuel excise and air traffic control charges.

Bleak Outlook in 2020 for the Aviation Services Market in Malaysia

The COVID-19 pandemic will have a large impact on the Malaysian aviation services market, as it will likely lead to a significant decline in tourist arrivals and receipts, passenger traffic, as well as, revenue due to lower air travel demand. **These effects could be made worse if the pandemic proves hard to contain, leading to prolonged travel restrictions.** As such, **the revenue-at-risk for Malaysian carriers and aerodrome operators is estimated at RM7.2bn in 2020.**

Aggressive measures to aid the aviation industry are being proposed and rolled out in countries worldwide. The measures already announced by the GOM will alleviate the airlines' financial burden. In other countries, further measures have been introduced to reduce operating costs and provide financial assistance to industry players and employees. If the pandemic is prolonged, airlines may require further government support to stay afloat.

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