



Executive Insights

Ready for Take-Off — Opening Our International Borders

The reopening of international travel from November 2021 has been welcome news for the aviation industry. For the first time since the pandemic began and Australian international borders were closed, we can speculate with a heightened degree of confidence on the Australian international aviation recovery.

We now have clarity on the international travel opportunities available to double-vaccinated Australians. Bookings are being taken to a number of “COVID-safe” countries, including the United Kingdom, the United States, Japan, Singapore, Canada and Fiji. Numerous reports have highlighted the strength of demand by Australians eager to fly internationally over the Australian summer. This is entirely consistent with consumer research, including L.E.K. Consulting market surveys, that has highlighted a high degree of pent-up demand for international travel.

Moving beyond the Australian summer, we foresee a number of medium-term (2022-25) “tailwinds” and “headwinds” to international growth.

Tailwinds and headwinds to recovery over the medium term (2022-25)

Demand for air travel

There is evidence of significant pent-up demand for international air travel to and from Australia, particularly for visiting friends and relatives (VFR) and leisure travel. Consumer research indicates the outbound traveller segment will be first to return

as the Commonwealth and state/territory governments relax restrictions on Australians travelling overseas.

A recent L.E.K. consumer survey indicated that most Australians, particularly VFR travellers and younger cohorts, plan to take more international trips post-COVID-19 than they did pre-COVID-19, in part to “make up for lost time”. However, in the near term some traveller segments (e.g. older travellers) may delay a return to international travel due to health concerns and the greater complexity/cost of travel.

Inbound visitation to Australia will be slower to return, but the key underlying macro demand drivers (e.g. GDP, population growth, VFR travel to Australia, interest in Australian holidays) are expected to remain supportive of growth. Traveller surveys continue to indicate strong interest in visiting Australia as a unique location that has developed a reputation as a “safe” — albeit restrictive — destination during the pandemic.

The speed of recovery for international inbound visitor traffic will be dependent on government restrictions on entry and quarantine, and we assume that full vaccination will be an entry requirement for non-Australian citizens/residents.

VFR will be the first inbound market to return, followed by inbound leisure/holiday travel. Amongst Australia’s largest VFR and leisure markets, New Zealand, the UK, the US, China, Singapore and Japan have made good progress with their vaccination programs, with between 50% and 80% of their populations vaccinated. However, the likes of India, Vietnam and the Philippines have lagged behind, suggesting that reopening to these markets will take longer.

Ready for Take-Off — Opening Our International Borders was produced by **Mark Streeting**, partner in L.E.K.’s Transport and Travel practice in Australia, **George Woods**, partner in L.E.K.’s Industrials Practice in Australia and leads L.E.K.’s Asia-Pacific Airports practice and **Ian Kershaw**, principal in L.E.K.’s Travel & Transport practice.

For more information, please contact strategy@lek.com.



L.E.K.

Executive Insights

International business travel will be slower to return and will be dependent on corporate/business decisions on budget, employee health and safety, and on the risk of being caught out by changing government travel restrictions. It will also be driven by the return of conventions and other large-format gatherings.

Business surveys suggest that there could be a medium-term structural impact on international business travel as a result of changed ways of working (i.e. videoconferencing), as well as a near-term impact based on business risk assessments related to health and changing border restrictions.

There is also a potential medium-term structural impact related to Australia's political relationship with China, with broad implications for the VFR, leisure, business and education traveller segments.

Supply of aviation capacity

From a supply-side perspective, the international capacity of Australian carriers was materially reduced during the pandemic. Virgin removed all 11 wide-body aircraft from its fleet (B777s and A330s), although the airline can continue to operate short-haul international flights to New Zealand and parts of Asia with its fleet of 737-800s. Qantas currently has c.11% fewer wide-body aircraft in its fleet versus in January 2020, driven by early retirement of six B747s. At present, Qantas has announced plans to reactivate only five of its 12 A380s in 2022, with two of the 12 to be retired and the remaining five to remain in storage. Like

Virgin, the Qantas Group (inclusive of Jetstar), has narrow-body aircraft (B737s and A320s) that can serve New Zealand and parts of Asia.

The bigger supply risk to the Australian international market is the potential loss of frequency, capacity and destinations provided pre-COVID-19 by international carriers, which account for the majority of international capacity to and from Australia. International airlines will return services to Australia as travel restrictions ease, but they will likely operate with lower frequencies and capacities in the near term across all Australian destinations.

There is also a risk of reduced services to Australia from "tier 2" and "tier 3" Chinese cities facilitated by Chinese airlines due to political uncertainty and reduction in subsidies.

Constrained aviation capacity in the short- to medium-term will likely lead to higher real airfares, which could act as a drag on demand for international air travel.

However, in a positive sign for aviation capacity, airlines — both international carriers and the Qantas Group — should see a resumption of new wide-body aircraft deliveries in 2022, which will begin the process of returning fleets to their pre-COVID-19 sizes.

The figure below summarises these impacts:

Figure 1
Summary of supply and demand drivers over the medium term

L.E.K.	Historical (2020-21)		Medium-term outlook (2022-25)	
			Tailwinds to growth	Headwinds to growth
Supply	<ul style="list-style-type: none"> Airlines reduced international networks and frequencies, and delayed/cancelled aircraft deliveries Aircraft makers reduced production A number of airlines ceased operating 	<ul style="list-style-type: none"> Resumption of new aircraft deliveries (broadly from 2022 onwards) 	<ul style="list-style-type: none"> Lower international wide-body aircraft capacity (due to aircraft retirements and delivery delays) Reduced international route networks and frequencies Higher real airfares due to constrained supply 	
Demand	<ul style="list-style-type: none"> Government restrictions on international travel resulted in a near-complete drop-off of international air travel Consumers have been wary of travel due to health concerns 	<ul style="list-style-type: none"> Strong pent-up demand for VFR and leisure travel Australia expected to benefit from its unique tourism proposition and international perception of Australia as a "safe" destination in terms of public health 	<ul style="list-style-type: none"> Lingering consumer concerns over health (COVID-19 risks) Slow return of international business travel Structural/permanent loss of some international business travel due to changed ways of working Lower demand from China due to geopolitical tensions, particularly impacting tourism and education-related travel Reduced services to Australia from "Tier 2" & "Tier 3" cities and airlines in China due to political uncertainty and reduction in subsidies Environmental concerns over the impact of air travel 	

Executive Insights

Growth expectations and recovery scenarios

Previous shocks to the aviation industry (e.g. SARS, 9/11, the Ansett collapse) had relatively rapid recoveries to a growth trend and little or no impact on long-run growth.

We believe COVID-19 has been different. This shock has been far deeper and lasted far longer; has accelerated trends towards remote working and virtual meetings; and has coincided with a rise in both geopolitical tensions and sensitivity to the environmental impact of air travel.

As a result, we believe there could be a structural reduction in air travel demand that leaves the industry approximately one to two years behind its long-term growth trajectory rather than returning to trend.

Pre-COVID-19, international air travel to/from Australia was forecast to grow at c.4%-5% p.a. to 2025. We still believe that to be a reasonable rate of growth once the industry recovers, as the traditional underlying macro drivers of international air travel appear fundamentally unchanged as a result of COVID-19.

However, several structural impacts may mean that international air travel sits below the pre-COVID-19 trend:

- Lower international business travel to/from Australia
- Lower inbound travel from China, particularly related to education and tourism
- Slightly lower inbound leisure and VFR travel, due to constrained aviation capacity, higher real airfares and double-vaccination requirements for arriving visitors

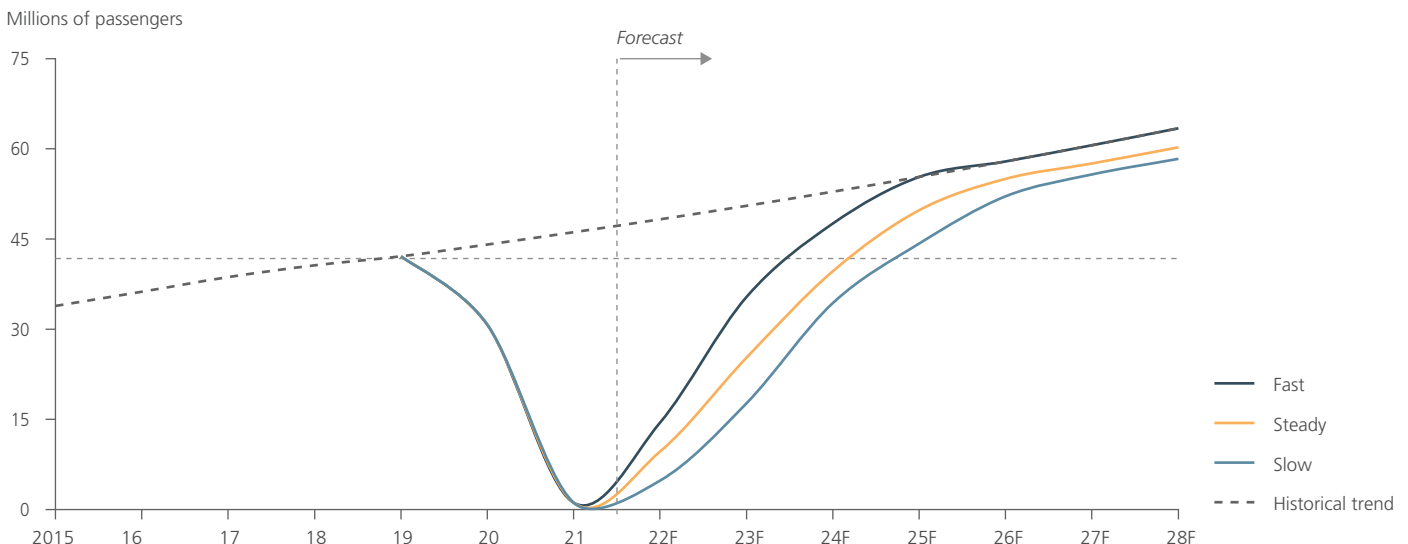
L.E.K. has prepared a set of scenarios to illustrate potential international air travel recovery profiles over the medium term

relative to pre-COVID-19 growth projections. Each scenario reflects a different set of assumptions about supply constraints and demand drivers. The three recovery profiles leverage data on market drivers, our views on market trends, and L.E.K. experience from recent travel and tourism projects.

- **Steady resumption (base case):** Following a successful domestic Australian vaccination program and the staged reopening of borders, Australians begin to return to outbound international travel, particularly for VFR. International inbound travel begins to resume in 2022, but is dependent on government vaccination requirements and restrictions on travel to/from certain countries. There is a degree of structural loss (5%) due to lower business, China and inbound leisure/VFR travel.
- **Slow resumption:** A slower roll-out (or stalling) of overseas vaccination programs results in slower and longer reopening of Australia to the world, delaying the ability of Australians to travel to certain countries and of overseas visitors to come to Australia. There is a higher degree of structural loss (8%) due to lower business, China and inbound leisure/VFR travel.
- **Fast resumption:** A rapid roll-out of global vaccination programs and limited restrictions on inbound visitors result in a faster reopening of Australia to the world. Australia is seen as a desirable destination to visit due to its uniqueness as a holiday destination and its success in handling public health and safety during the COVID-19 pandemic. There is no structural loss related to business travel, Australia's relationship with China or visitor vaccination/quarantine requirements.

As Figure 2 shows, international air travel would return to pre-COVID-19 levels by c. 2023-25 under the steady resumption base case, but would sit below the long-term pre-pandemic growth trend.

Figure 2
International passengers (FY2015-28F)



Source: BITRE, TRA, L.E.K. research and analysis

Executive Insights

Under the slow resumption case, international travel would return to pre-COVID-19 levels by c. 2024-25 and also would sit below the long-term pre-pandemic growth trend.

Under the fast resumption case, international travel would return to pre-COVID-19 levels by c. 2023 and would resume the pre-COVID-19 growth trend by c. 2025. However, this would be dependent on an expansion of aviation capacity above pre-COVID-19 levels, affordable airfares, the rebuilding of route

networks, few or no travel restrictions, and a benign political relationship with China.

Notwithstanding potential structural losses in coming years, we remain optimistic about the recovery of international air travel on the back of significant pent-up traveller demand. We hope that COVID-19 has been a once-in-a-generation shock, and we look forward to getting back in the air ourselves.

About the Authors



Mark Streeting is a partner in L.E.K. Consulting's Sydney office. He regularly advises major private and public sector clients across Australia, New Zealand, Asia and the Middle East on all forms of transport. Over the past 20 years, he has regularly produced long-term traffic forecasts for Government, airports and airport investors across Australia, New Zealand, Asia and the Middle East.



George Woods is a partner in L.E.K. Consulting's Sydney office. George is Regional Head of L.E.K.'s Industrials practice and leads L.E.K.'s Asia-Pacific Airports practice. George has advised airport clients for over 20 years on aeronautical and commercial matters, including runway timing, terminal strategy, retail and ground transport. He has helped Australian airports deliver ground transport EBITDA uplift of over \$50 million per annum, and helped one airport reduce its delays and improve on-time performance by 4 percent.



Ian Kershaw is a principal in L.E.K. Consulting's Sydney Office specialising in aviation, travel and transport, covering airports, airlines, surface transport, tourism and hospitality. Ian has significant experience providing commercial advice to aviation sector clients, including Australian and New Zealand airports, airlines, investors and government. Ian has previously worked for L.E.K. in Europe, Asia, Africa and the US.

About L.E.K. Consulting

We're L.E.K. Consulting, a global strategy consultancy working with business leaders to seize competitive advantage and amplify growth. Our insights are catalysts that reshape the trajectory of our clients' businesses, uncovering opportunities and empowering them to master their moments of truth. Since 1983, our worldwide practice — spanning the Americas, Asia-Pacific and Europe — has guided leaders across all industries from global corporations to emerging entrepreneurial businesses and private equity investors.

Looking for more? Visit www.lek.com.