FITCH: COMMERCIAL AIRCRAFT DELIVERY OUTLOOK INTACT DESPITE ORDER SLOWDOWN

News / Finance, Manufacturer

Fitch Rating's large commercial aircraft (LCA) delivery outlook for 2016 and 2017 is intact despite some weakness in parts of the widebody aircraft market, delivery deferrals across most regions of the airline industry, and a likely decline in new orders in 2016 compared to 2015.

While Fitch is more cautious than at the beginning of the year, the record order backlog combined with other solid indicators of aircraft demand support the firm's delivery expectations for the next two years. There could be some changes to forecasts beyond 2017, particularly for some widebody models, but Fitch expects total deliveries would still rise, as production changes would likely be adjustments to planned increases rather than cuts from existing production levels.

Fitch expects LCA deliveries from Airbus Group NV (Airbus; rated 'A-'/Stable Outlook) and The Boeing Company (Boeing; 'A'/Stable Outlook) to rise to approximately 1,420 (up 2%) and 1,545

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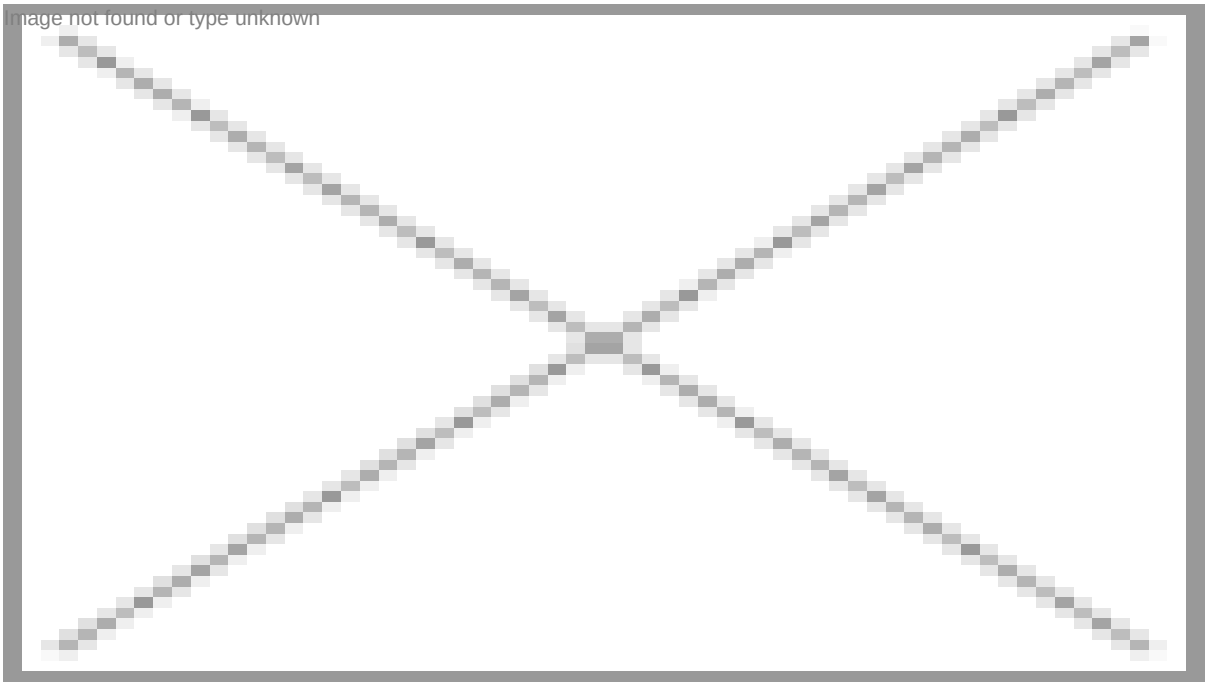
(up 9%) aircraft in 2016 and 2017, respectively. Production will exceed deliveries in 2016 as Boeing builds inventory for the 737 MAX and the 767 Tanker programs ahead of certification and delivery in 2017.

Fitch does not believe current delivery forecasts are excessive, as they fall within a reasonable range of replacement and growth needs for the global airline sector. Barring a demand shock such as an economic downturn, war, or disease pandemic, Fitch sees rising deliveries beyond 2017 for several years before delivery rates peak.

The foundation of Fitch's delivery forecast remains the record order backlog at Airbus and Boeing, which totalled 12,512 aircraft at the end of July, equivalent to eight years of deliveries at projected 2017 rates. Simply put, the manufacturers do not need new orders – they need to focus on delivering the existing backlog, executing on production rate increases, and finishing the development of new aircraft models.



The record backlog serves as a significant cushion to downside scenarios, as delivery slots freed up by deferral requests can be filled by other customers seeking earlier delivery. Both Airbus and Boeing report overbooked delivery slots even at higher planned production rates. Importantly, the backlog is more geographically diverse than in the past. Fitch estimates its value at $875 – $900 billion.

A decade of substantial order activity exceeding deliveries built the current order backlog. Fitch has been expecting new orders to decline, and this will likely happen in 2016 compared to the 1,848 orders Airbus and Boeing received in 2015. Despite the likely decline, Fitch believes that order activity is still relatively healthy, and there is the possibility that orders could match or exceed deliveries in 2016. Net orders through July totalled 657 aircraft versus 771 aircraft deliveries. Adding numbers from Bombardier and Embraer, the net order amount would be near the delivery total.

There is no shortage of other concerns in addition to slowing orders and higher deferrals. Airline revenues are declining this year, partly the result of carriers passing on part of their fuel savings to customers. Capacity has grown slightly faster than traffic in the first half, also contributing to the revenue pressures, as well as to rising order deferrals. The economic environment has also

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pressured airline results, especially in Latin America, where Fitch has downgraded several airlines' credit ratings, including one to Restricted Default. Brexit, labor strikes, and the Zika virus also breed aviation concerns.

Perhaps most concerning in the longer term is the potential impact on travel from terrorist actions aimed at aviation assets such as flights and airports. Other longer-term concerns include the impact on traffic or airline profits if fuel prices normalize from current lows, and some growing imbalances in airline profits and order books across geographic regions.

Despite these headwinds, most key commercial aerospace indicators paint a broader picture which continues to support Fitch's aircraft delivery outlook. Global airline passenger traffic grew 6% through June per the International Air Transport Association (IATA), and this number may understate total growth because it does not include traffic from some large low-cost carriers. IATA also forecasts global airline profits will rise from $35.3 billion in 2015 to a record $39.4 billion in 2016, largely driven by continued low fuel costs.

Delivery deferrals, cancellations and other change requests from airlines are at low levels, with Boeing stating that these change requests are running around 1% of its backlog, well below the approximate 6% average over the past 15 years. The number of parked aircraft has declined year-to-date according to the Ascend database. Despite some export credit agency challenges, the overall aircraft finance market remains supportive of the delivery outlook, and Fitch continues to see a regular flow of ratings enquiries for aircraft-backed capital markets transactions. Finally, the credit ratings for the largest airlines and aircraft lessors generally have improved, with Fitch upgrading several key credits such as Delta Air Lines ('BBB-'/Stable Outlook) and Aercap ('BBB-'/Stable Outlook) to investment grade this year.

The supply and demand imbalance for new and used widebody aircraft is getting attention in the industry, but Fitch believes the situation will not be a broad driver of credit risk. There have been some production rate reductions announced for the 747, A380 and 777 models, and prices have declined beyond Fitch's expectations for some older 777's and A330's. However, Fitch believes the rate cuts for the 747 and A380 are unsurprising, and the firm thinks the 777 reductions are temporary as the program transitions to the new 777X. Some of the pressure on older widebodies is driven by newer aircraft types entering the market.

Other widebody delivery rates have positive trends. The 787 continues to ramp up, as does the A350. Airbus also announced it would increase A330 production rates in 2017, reversing the downward trend that started in 2015.

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