

# Aviation In 2023: Clearer Skies Ahead

By **Bart Biggers and Kevin Lewis** (February 9, 2023)

After continued turbulence early in 2022, commercial aviation stabilized over the course of the year, soaring closer to pre-COVID-19 levels and becoming bullish by the end of the year.

U.S. airlines led the comeback. Keys to that dramatic recovery included:

- Acceptance of COVID-19 as endemic, leading to loosening of travel restrictions;
- "Metal shortage" created reduced capacity, and, in turn, increased revenue from strong demand and higher prices;
- U.S. domestic travel continued to lead recovery;
- International travel increased by approximately 100% year over year, as foreign destinations reopened; and
- Large aircraft orders showed confidence in the future of the industry.



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But turbulence continues due to a number of factors:

- Macroeconomic headwinds include the Russia-Ukraine conflict, inflation and elevated fuel prices;
- Business travel still lags, in part stemming from expense clampdowns due to recession concerns, and may not reach pre-COVID-19 levels;
- Cargo segment revenues remain relatively high, but appear to be on the decline; and
- Supply chain and staffing challenges stubbornly remain major impediments for full recovery.

The 2022 recovery sets up 2023 to be an even stronger year, as the industry appears to be finally moving past COVID-19. 2023's headwinds are challenging, but are nothing like flying less than 10% of the previously expected schedule in 2020.

## 2022 Prediction Report Card

Let's take a look at our grades on some of our 2022 predictions:

Prediction	Result
Omicron variant affects travel in early 2022	Correct: Omicron wave that hit early in Q1 had major impact, but was the last variant to significantly affect travel.
Business travel to recover in earnest in Q2 of 2022	Partially correct: Initial recovery began in Q2, but strength of recovery has flattened at between 50% and 75% of pre-COVID-19 levels, at least due in part to fears of impending recession.
Leisure travel stays strong through summer	Correct: Domestic leisure travel remained the strongest segment of recovery and sales.
Beginning of recovery in international travel in second half of 2022	Correct: 2022 International travel increased to approximately 70% of 2019 levels, up approximately 100% year over year, following loosening of restrictions and quarantine periods in popular foreign destinations.
Strong financial performance of airlines Q2 and beyond	Correct: Major U.S. carriers returned to profitability in 2022, with some setting revenue records.
Supply chain and staffing problems continue to plague the industry	Correct: While some effects of COVID-19 have subsided, supply chain issues and staffing shortages continue to significantly affect carriers.
Airlines comfortable refinancing debt, and high cash levels are less necessary	Partially correct: Airlines still carry relatively high debt levels into the predicted recession, but have aggressively retired debt.
Sustainability investments will be a major trend in 2022	Correct: Investments in newer and more fuel-efficient aircraft, sustainable aviation fuel and developmental aircraft received significant headlines.
Focus on privacy, data and cybersecurity increases	Correct: Cyberattacks on airlines are a continued focus with more regulation on the way.

We will let you grade our prediction performance, but we don't think we were too far off.

## Trends for 2023 and Beyond

Now let's unveil our predictions for 2023.

### ***Profitability***

Global airline profitability will return in 2023. North American, European and Middle Eastern carriers should operate in the black. Latin America, the Asia-Pacific region and Africa will be laggards, likely remaining in the red.

U.S. passengers' demand will return to near pre-COVID-19 levels in 2023. Global passenger traffic won't return to those levels until 2024.

While there is global economic uncertainty, airline revenue and profitability should not be materially affected. This is due in part to reduced capacity from the metal and staffing shortages.

Even so, operators and suppliers in some parts of the world may continue to struggle with high debt loads and high interest rates — meaning that slow recovery, or a decrease in demand, could result in restructuring.

### ***Economic and Geopolitical Risk***

One of the biggest threats to the economic recovery of the industry is economic uncertainty, due to predictions of an impending recession in 2023. This could affect business travel most immediately, and perhaps leisure travel as well.

In addition, geopolitical risks around the world are as high as has been seen in recent years, due to the Russia-Ukraine conflict, and North Korean and Chinese activity.

### ***Continuing Supply Chain and Staffing Issues***

The reduction of capacity is due in large part to retirements of aging fleets during COVID-19, a metal shortage caused by supply chain issues, and a general staffing shortage in the industry.

While some supply chains have recovered, the aviation industry's supply chain recovery still has a ways to go. This is causing a domino effect on aircraft deliveries that is expected to last for years.

In addition, the industry's staffing shortage is further reducing capacity — as seen in the U.S., where COVID-19 exacerbated an existing pilot shortage expected to take years to resolve. The shortage of employees has dramatically increased operating costs for suppliers and airlines, prompting airlines to restrain scheduling to avoid system failures at razor-thin staffing levels.

The government is not immune to these shortages either, which have negatively affected the air traffic control system — and in turn, hurt airline performance and customer satisfaction levels. These shortages have been punishing airlines that have not built expensive redundancies into their deployments of metal and personnel.

Finally, these shortages may be causing a trend toward cost convergence, which more negatively affects newer and smaller airlines that would normally enjoy a lower cost per available seat mile than legacy carriers. We expect these supply chain issues and staffing shortages to continue through 2023.

### ***Declining Cargo Demand***

While the passenger sector looks stronger, the cargo sector appears to be set for its first downturn since COVID-19 began.

This comes after cargo carriers saw demand reach new heights during the pandemic. While demand is not expected to fall to below 2019 levels, the risk of recession appears to be reducing demand for the shipment of goods.

### ***Stable Passenger Demand Mix***

The mix of demand between leisure, business and the newly created "bleisure" category should remain fairly stable.

This is somewhat unfortunate, because recovery in the business segment — which has traditionally created the highest yields — may be stalled at around 70% of pre-COVID-19 levels, in anticipation of a possible recession.

### ***Smoother Operations***

Operations should further smooth out in most areas of the world, with the possible exception of Asia.

Thus far, each region of the globe has experienced operational challenges during the first 12 months after demand began to rebound. Fortunately, most areas of the world have already been through this pain, creating smoother global operations.

### ***ESG: Still Smoking Hot***

Investments in sustainability are going to continue to be airline priorities, with the recognition that these investments are long-term plays to achieve the industry's environmental, social and governance pledges.

We don't expect ESG to take a back seat to many trends for the foreseeable future.

### ***Data Privacy and Security and IT: Also Hot***

Data will remain king — data is power. For 2023, data privacy and security will remain hot topics, as we continue to see how airline data breaches can damage reputations and potentially paralyze a country's infrastructure.

Relatedly, information technology infrastructure is as vital as fuel. Improvements to operations and the customer experience require increasing and developing IT capabilities.

As a result, airlines will have no choice but to continue to make investments in IT systems to improve operational performance and customer experience.

### ***Impact on Legal Services***

So what does all this mean for lawyers? We think that lawyers working for global airlines and suppliers will see a level of activity not matched in years, as the industry approaches, and perhaps surpasses, 2019 levels, and returns to broad profitability.

This appears to hold true for lawyers working for operators and suppliers, as well as outside counsel. Remember that anything near this level of activity was previously handled by over 25% more in-house lawyers. Let that sink in while we look at specific areas of law.

Transactional work will likely see some of its highest levels in years, as larger-scale projects previously delayed by COVID-19 are advanced. Mergers have reappeared in the industry for the first time in recent years.

High debt loads, along with high interest rates, may cause bankruptcies and restructurings in pockets of the industry where the negative impacts of rising interest rates and costs overwhelm the positive impacts of improving revenue and passenger loads.

Finance lawyers should see a rebound in work within the sector, as some operators and suppliers struggle globally to keep up with the pressure of these forces.

Litigators will continue to see high demand, as disputes caused by COVID-19 are still ripe. Airlines operating at full capacity will create even more work. Employment and labor lawyers will continue to see the impact of the pandemic, and the resulting tightened labor force, generate high levels of activity.

Regulatory lawyers will continue to help airlines navigate an ever-more-complicated operating environment — especially those in the U.S., as the current administration has been very active in regulating the industry.

Additionally, lawyers in niches such as ESG and data privacy and security will see activity in their areas increase in the years to come, as those areas stay very hot.

### **Clear Skies Are in Sight**

After the depths of 2020, unlike any seen by the industry in its over-100-year history, how great is it that we are talking about global profitability again? While we aren't back to 2019, we are headed in the right direction.

There will be challenges in 2023, but they appear to be challenges for which we have instructions in our operating manuals. Overall, we can't overstate how great it is to see the industry soaring to such heights again!

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