

Viewpoint: Could COVID-19's Effects on the Broader Eurasian Region Boost Turkey into the Aviation Super League?

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As the global airline industry is entering **its most challenging year with a crisis of a magnitude not faced since World War II**, each pillar of the Turkish aviation industry will also suffer its own fate. COVID-19 is bringing two major shockwaves to disturb air travel demand: **the pandemic effect** with the global lockdown imposed from the international community, and the short-term **recession** brought on by the **pandemic's effects on the global economy**.

The last two decades have seen **a rise in virus contaminations** such as SARS, MERS, SARS-COV, originating from the Far East and impacting, to a certain degree, demand for air travel and airlines negatively. This was first due to the smaller share China had during the early 2000s within the global economy, limiting its spread to only some advanced economies due to lower air connectivity. The scenario with COVID-19 is significantly different, as China's share in the world economy is almost 20% and the world is now connected more than ever. As of today, COVID-19 is affecting **213 countries** globally.²

According to IATA, total RPKs³, the demand side of the airline industry, are expected **to fall in the second quarter of 2020, generating a yearly decline of 48%** compared to 2019 and a revenue loss of 314 Billion USD for the whole year, mainly from airlines based in Europe, Asia and the Middle East.⁴ **The global airport industry** is also facing its fate with **an estimate of 4.6 billion passengers loss equal to a \$ 97B USD revenue decline** for the whole industry.⁵ Due to the immediate effects of COVID-19, the **global GDP growth is estimated to fall as much as 3% on an April 2020 report of the IMF**.⁶ With that being said, the main consensus shared by international monetary and financial institutions seems to be that **this shock will not necessitate any major structural changes on the global economy**. Therefore, international statistics show that national GDPs will recover in 2021 **and the air travel demand, characterized for its resiliency, may start to return to its 2019 traffic levels in 2023**.⁷

What would then be the new potential post-COVID landscape in the aviation industry at the Eurasian level? Will this crisis bring some opportunities in the medium term for Turkish carriers? **Is Turkish Airlines (TK)**

¹ This paper solely reflects the author's own opinions and cannot be attributed to the Boeing Company.

² www.worldometers.info/coronavirus

³ Revenue Passenger Kilometers or RPKs represent an operational performance metric for the airline industry. It's the number of passenger on a flight multiplied with the distance flown.

⁴ www.iata.org IATA Covid-19 Assessment – 24 April 2020

⁵ <https://aci.aero/news/2020/05/05/predicted-global-impact-of-covid-19-on-airport-industry-escalates/>

⁶ www.imf.org, New forecast to be published in July 2020 with worsened figures.

⁷ <https://www.iata.org/en/iata-repository/publications/economic-reports/covid-19-outlook-for-air-travel-in-the-next-5-years/>

ready to turn this crisis into an opportunity to become a superpower among the global players? How about for the other components of the Turkish aviation industry?

Key takeaways:

1. Turkish Airlines (TK) will emerge stronger from this crisis as it has an important role in the Turkish economy and is an integral part for the growth of the Istanbul Grand Airport (IGA);
2. TAV Airports' (TAV) expansion in Central Asia may generate new opportunities for the company in the region and for Turkish carriers by stimulating more demand to Turkey and beyond;
3. Istanbul and Antalya will preserve their positions, generating and continuing to attract international traffic;
4. Charter Airlines operating between Turkey and Russia to increase their long-term share in this market;
5. TAI and Kale Aero to increase their capabilities and their share if global supply chain is also disturbed – Baykar Savunma can find a place on the autonomous vehicles segment if COVID-19 accelerates private travel trends.

The Commercial Aviation Industry in Turkey at a Glance

The global air travel demand has quadrupled in the last 40 years, reaching **4.3 billion passengers in 2019** and on average 200 million passengers, **almost 2.5 times the current Turkish population**, are added each year to this trend.⁸ The global economy and consumption continue to stimulate air cargo. Commercial Aviation is considered to be an economic engine generating wealth and employment for the global and local economies. It has a broader impact on the economic spectrum. In 2018, the aviation industry had \$2.7 Trillion USD of global economic impact, supporting 3.5% of the global GDP and generating 62.7 million jobs worldwide.⁹

Air travel demand in Turkey is a reflection of the global trends with high business and leisure travellers all year long from/to/within and via Turkey. **The number of international incoming travellers to Turkey in 2018 were up by 17% compared to 2017 levels.**¹⁰ Today there are **56 airports in Turkey serving the airlines, the tourism and the broader economy**, and six of them currently serve international flights as well.¹¹ **Istanbul and Antalya** represent the two leading gates for both domestic and international flights, **with an aggregate share of 70% over the total 208,4 million passengers in 2019.**¹²

The Turkish aviation industry plays an important role on the global and regional aviation spectrum due to its fleet size, the global network covered from Istanbul that connects global tourism and trade flows both domestically and internationally. **Turkish Airlines (TK)** is a major global network carrier with **Istanbul Grand Airport (IGA)** as its hub. **Pegasus Airlines (PC)** is the leading LCC, using the secondary airport in Istanbul, **Sabiha Gokcen (SAW)** as its home for the operations. **Three Russian-based but majority Turkish-owned airlines, Azur Air, Nordwind Airlines and Royal Flight** are operating charter flights from Russia to Turkey, Southeast Asia

⁸ www.boeing.com/cmo - Boeing Commercial Market Outlook, 2019

⁹ www.boeing.com/cmo - Boeing Commercial Market Outlook, 2018

¹⁰ www.dhmi.gov.tr – 2018 Havayolu Sektor Raporu

¹¹ www.dhmi.gov.tr – 2018 Havayolu Sektor Raporu

¹² www.dhmi.gov.tr/sayfalar/istatistik.aspx - Inbound/Outbound passenger number in 2019

and the Caribbean with **Moscow** and **Antalya** as their main operating bases. Turkish carriers had in total **546 airplanes in 2019**, equivalent to **2% of the global fleet comprised of 25,000 jet airplanes**.¹³

Turkey has set a development plan for increasing capability and production in the strategic military industry. In order to broaden their work packages outside the military world, state-owned Turkish Aerospace Industries (TAI) and privately-owned Kale Aero became the major airplane manufacturing realities in Turkey. They are also looking beyond to cooperate in the commercial aviation and supplying strategic components for the production of commercial airplanes by major OEMs.

Turkish Airlines: The Global Economic Actor of Turkey

TK is considered a strategic company for Turkey and is controlled by the Turkey Wealth Fund. The company is one of the leading global network carriers connecting the East-West and North-South axes via Istanbul thanks to its network coverage.¹⁴ The company offers more connectivity than any other airline in linking Europe, the Middle East and Africa to the world (as measured by number of origin and destination pairs), and is ranked 2nd in supplying connectivity from the Far East to the rest of the world.

TK competes against the Lufthansa Group in Europe and the Big 3, which may soon be the Big 2, Gulf carriers.¹⁵ Thanks to the geographical location of its hub IST, TK has access to 40% of the international wealthy traffic generated from Europe, Russia, Central Asia, the Middle East and Africa within a narrow body airplane range. These regions represent almost 65% of the global GDP. The airline is able to reach 207 out of its 269 international destinations with a narrow body airplane. **Its direct competitors in Europe and the Gulf do not have the same advantage.** This is why almost **60% of TK's total ASKs¹⁶** are between Europe and Asia, both regions **generating 53% of total international revenues worth \$9.9 B during the same period.**¹⁷ Frankfurt, Dubai or Doha are hubs of major global carriers but do not have the same catchment area.

Europe is one of the most affected regions from the pandemic. A new GDP forecast for the European Union (EU) is -7.4%, led by Italy and Greece's drastic negative performances¹⁸, both important markets for TK. **Nationalist propaganda for promoting local tourism will delay air travel in the short run as is the case in Italy or Germany. These limitations will impact the airlines and the broader global tourism industry**, affecting on the short run the traffic for TK and Istanbul or Antalya also, reducing the revenue in foreign currencies as part of the national income. Yet the impact on employment is still unclear. Due to the strategic importance of the company, the state may yet intervene with a rescue package to support the airline if necessary.

Lufthansa and/or the Gulf carriers may suffer commercially and financially from two complementary issues – starting domestic/international short-haul flights, and the delay in lifting the ban for international travel:

1. The European domestic or regional markets are shrinking due to the presence of the LCCs or other competitive means of transport such as high-speed trains. **Lufthansa, the biggest network carrier in**

¹³ <http://web.shgm.gov.tr/tr/kurumsal/4547-istatistikler> Includes cargo aircraft, excludes mentioned charter operators

¹⁴ THY flies to more than 325 destinations as of 2019 with almost 10.000 weekly flights.

¹⁵ Emirates, Qatar and Etihad

¹⁶ Available Seat Kilometers or ASKs represent an operational performance metric for the airline industry. It's the number of total available seats on a flight multiplied with the distance flown. 165B ASK in 2019.

¹⁷ THY Investor Relations – December 2019 Presentation

¹⁸ <https://www.statista.com/statistics/1102546/coronavirus-european-gdp-growth/>

Europe will face a challenge for not being competitive on its domestic market or intra-regional flights within Europe. Additionally, if international travel is banned for a longer period, this may affect the company's financials that are already in trouble due to the first impact of the fleet grounding.

2. There are two important elements to consider when it comes to the Gulf carriers' business model: the long-haul network that comes with wide-body airplanes and a major concentration of their ASKs in the Indian subcontinent. The former implies that they tend not to fly short-haul routes or fly to few with bigger capacity and the latter implies that if any ban is not lifted from these countries, Gulf carriers will not reach their previous Load Factors.

If these scenarios become reality, TK may seriously become a threat; capturing new shares from its competitors and reconfirming its position among the global big network carriers as the carrier with the ability to establish a balanced network and seat capacity deployment between East/West and North/South axes throughout the year.

TAV likely to increase inbound and outbound air traffic from/to Turkey by expanding its footprint into Central Asia and becoming an actor in the New Silk Road

TAV currently manages 9 airports abroad located in Europe, the Maghreb, the Middle East and the Caucasus.¹⁹ **With the recent Almaty Airport deal announced in early May 2020, TAV is now expanding its *savoir-faire* in airport management to the heart of Central Asia.**²⁰ This is a very strategic move from the company that **first strengthens its international positioning and second balances its managed airports' portfolio between the East and the West.**

The epicentre of aviation was located in the Western hemisphere between 1980-2000, representing 60 to 70% of the aviation and economic market at that time. Since the start of the millenium there is a net shift of the epicentre to Asia where emerging economies like China, India are generating continued air travel demand.²¹ Central Asia is by nature well positioned to capture the connecting passenger traffic from these specific markets to mainly Europe and Russia, regions where local airlines have their capacities deployed in the West.

Data shows that local and Turkish carriers have seen their capacities growing immediately on average after TAV was taking over the management of the airports. Georgia, the first foreign country where TAV initiated airport operations, had **the CAGR²² of the weekly seat capacity to domestic and international markets at 6.6% in the first five-year period prior to 2007²³, while the growth reached 16% during 2007 to 2011.²⁴ On a more detailed level, in 2019, both airports in Istanbul were the leading international destinations from Tbilisi, with 17.3% of the total seat capacity deployed abroad.** It is not surprising that the major beneficiaries of this growth that still keeps the same trend in the Georgian market are Turkish carriers. Two of them were positioned among the top ten airlines in 2019. TK has surpassed Georgia Airways in 2011 and kept being the leader in the Georgian market. **In 2019, TK and PC's total share was around 18% of the total seats deployed internationally from Georgia.**²⁵

¹⁹ Ohrid, Riga, Skopje, Zagreb, Enfidah, Monastir, Madinah, Batumi and Tbilisi are the international airports managed by TAV

²⁰ <http://ir.tav.aero/>

²¹ www.boeing.com/cmo - Boeing Commercial Market Outlook, 2019

²² Compound Average Growth Rate

²³ Tbilisi airport became fully operational under TAV in 2007

²⁴ www.diiio.com – Schedule Weekly Summary Report – Directional 2000-2020

²⁵ www.diiio.com – Schedule Weekly Summary Report – Directional 2000-2020. Total weekly seat capacity deployed to international markets from Georgia reached almost 630,000 seats.

Zagreb is also a good example to prove the potential correlation between TAV and the growth of the traffic from/to Turkey and the positioning of Turkish carriers in the specific market they operate. **In 2010, Istanbul was ranked 9th among 33 foreign destinations from Zagreb and TK was ranked 5th. In 2015, one year after TAV entered to this market, Istanbul jumped to the 5th position and TK became the second carrier after Croatian airlines to serve from Zagreb.**

Bearing this in mind, TAV will likely continue to stimulate growth for Turkey and its airlines once the local and regional markets recover from the Covid impact on air travel demand. Almaty Airport has seen a CAGR of 2.5% for international passenger traffic growth and 5.6% for monthly seats increase during the last four years.²⁶ Turkey is the second largest international destination in terms of passenger traffic from Almaty, after Russia, with a total share of 13.2 % in 2019.²⁷ The top three Turkish destination airports are Antalya, Istanbul and Sabiha Gökçen, Antalya leading with 62% of total traffic from Almaty to Turkey.²⁸ Last year, Turkish Airlines was the third largest airline in the market and the leading airline between Almaty and Turkey. Both TK and PC saw their share growing in the market.

Asian countries have for a long time been present in the region investing in Central Asian transportation infrastructures. Japan financed the new Dushanbe Cargo Terminal, China is investing in Kyrgyzstan for modernizing and building new airports and South Korea is the main financial and technical sponsor for the new Tashkent Terminal in Uzbekistan. **Turkey is now showing higher presence through TAV's capabilities in this field, investing in the biggest aviation market in Central Asia.**²⁹

Istanbul and Antalya will continue to attract international traffic, the latter strengthening the role of the Russo-Turkish Charter airlines

Istanbul began to raise its profile as an international airport when TK set the path to become a global carrier endorsing the Hub and Spoke model since the mid-1990s. This successful business model stimulated the demand for Istanbul and Turkey alongside the demographic evolution of Istanbul and its natural catchment area during the last decades. Istanbul joined the league of cities that are home to a secondary airport in a very short period of time, such was the case for its new airport, SAW, on the Asian side of the city during the 2000s. Congestion in both airports led to the decision of having a mega-airport in order to support the expansion plan of the Turkish aviation industry as it set out to be a strategic sector for the country.

Today, Istanbul, with both of its airports, **serves TK and PC as their hubs for connecting traffic on one hand, and as a part of international carriers' expansion strategy on the other.** For instance, since 2019, the new Istanbul airport has stimulated the arrival of new flights from Chinese and Indian carriers that would not have been able to expand into Istanbul due to traffic congestions that the old Ataturk Airport had. These movements represent an opportunity for TK in terms of airline partnership.

Antalya has surpassed SAW airport in the last two years, due to a growing demand between Russia and Turkey. Despite some cyclical political tensions that Ankara and the Kremlin had over the last decade, the market has been worth **\$7.5B in the same period.**³⁰ Russian Federation was ranked first among international

²⁶ www.diio.com – Schedule Monthly Summary Report – Directional2016-2020

²⁷ Sabre Market Intelligence

²⁸ Sabre Market Intelligence

²⁹ Mario Antonio Ebcim – Central Asia: A Great Growth Opportunity, Tashkent September 2018.

³⁰ Sabre Market Intelligence

arrivals to Turkey in 2019 with a 13% share.³¹ Antalya has been the first and fastest growing destination with 53% of the total incoming passengers from Russia between November 2018 and October 2019 and a change of 13% compared to the previous period.³²

This growing traffic between these two countries created employment in Moscow and Antalya by causing the creation of three charter carriers based in Russia but owned by Turkish business people: Azur Air, Nordwind and Royal Flight. Today, these carriers **are ranked among the top 10 airlines operating from/to Russia**³³ and they mainly serve the leisure market between Russia and Turkey with year-round air services but with higher capacity during the summer seasons. The charter carriers had 32% of the total capacity deployed by all airlines in Antalya during August 2019.³⁴ However, in order to mitigate any market fluctuations due to political tensions between Turkey and Russia, they have started to expand their services in exotic destinations such as Southeast Asia or the Caribbean to also serve the seasonal Russian air travel demand.

The current ban on international travel from Russia will likely impact the short-term financial performance of these operators and any changes requested from regulators on the high density cabin layout would imply a change in business model reflected either in new investments or in leaving the market. However, we have several positive signals coming from Russia, such as the results of a recent survey showing that 67% of the flying public is willing to fly again once the ban is lifted.³⁵

The long term effect of the Ruble's appreciation against the Turkish Lira will also increase the demand from Russia to Turkey.³⁶

TAI and Kale Aero to potentially increase their share in the global aerospace supply chain with potential failures worldwide

There is no doubt that for a short period of time airplane manufacturers will need to adjust their production to a new reality impacted by the double effects of COVID-19, and this will reflect on the global aviation supply chain as a disturbance. In the medium and long run, with the necessity of **replacing almost 5,000 aging airplanes during this decade, production will resume at higher rates**, thus enabling TAI and Kale Aero Group to continue or expand their manufacturing capabilities for increased share of workpackages.

Turkish Seat Industries (TSI) is a joint-venture company between TK and Assan Hanil, created to supply airplane seats to the industry since 2011, with a factory located in Turkey and the US. TSI's widebody Economy-class seat model ***Epianka*** is now installed on both **Boeing 787-9 and Airbus A350-900 airplanes produced for Turkish Airlines**. TSI may become a strong supplier for airplane manufacturers and airlines in the Eurasian region in case some global seat manufacturers fail to survive this crisis.

A post-COVID-19 trend that is likely to grow is the propensity to travel alone and faster. Since this would accelerate the development of autonomous vehicles, **Baykar Savunma, which currently has UAV**

³¹www.dhmi.gov.tr

³² Sabre Market Intelligence

³³ Russian Federal Aviation and Transport Authority statistics

³⁴ Flightaware data from Moscow to Antalya in August 2019

³⁵ <https://nafi.ru/en/analytics/koronavirus-ne-pomekha-rossiyskie-turisty-planiruyut-puteshestvovat-letom-2020/>

³⁶ Oxford Economics

capabilities and several research programs on autonomous vehicles, can follow the same path in capturing and/or creating a market in the future.

Final Remarks

Europe, the US and the Middle East are the most affected regions from COVID-19 with a clear reflection of the double negative pandemic and economic effects over the airlines, the airports and the broader tourism industry. Nationalist propaganda such as inviting citizens to spend holidays in domestic markets would become popular during the next couple of years to boost local tourism. However, since air travel demand is resilient, the tendency to travel abroad may come back sooner than expected, gradually stimulating international traffic.

Major hub carriers or LCCs would survive this crisis if they are able to manage their cash flows. Others that suffer from liquidity problems may struggle to survive in this competitive landscape, and this may result in the creation of new opportunities or alliances.

The author does not expect a consolidation opportunity in Turkey. However, a clear shift of power to the local flag carrier is probable as its strategic importance is a major concern for the incumbent authorities. Any capacity opportunity in the region would be considered and filled by Turkish Airlines, and this would strengthen its position in the industry.

Aviation is a key and strategic sector that generates value to an entire country. Turkey has set a target in this sector for 2023, promoting Istanbul as a global aviation city, home to a growing global carrier and a state-of-the-art airport infrastructure that will welcome more than 150 million passengers once fully completed. COVID-19 may have a marginal impact on this target by postponing some near-term investments aligned to the aviation market. However, in the medium run, **Turkey may strengthen its role as a pivot country within the Belt and Road Initiative where two major hubs, Beijing and Istanbul, will become the pillars of a potential air bridge to reach Europe.**