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for better DECISIONS



Two Steps Forward, One Back

Bumps in the road to COVID recovery

- T2RL's Outlook

January 2022

INTRODUCTION

This is the sixth edition of T2RL's analysis of the market recovery for the airline industry during and after the COVID-19 pandemic. T2RL will update this document on a periodic basis as new information and developments become apparent.

Executive Summary

At the end of 2021 a new variant of COVID-19 is spreading rapidly and many countries are reimposing border controls that were gradually being relaxed. This has a knock-on effect on airline bookings and in particular the European market, which has high levels of short-haul international travel, has seen an immediate downturn.

| REGIONS | December 2021 | Dec 2020 - 2021 % Change | Dec 2019 - 2021 % Change | Nov 2021 - Dec 2021 % Change |
|-----------------|---------------|-----------------------------|-----------------------------|---------------------------------|
| China | 28,578,491 | -14.5% | -31.7% | 8.3% |
| Latin A&C | 11,355,732 | 47.4% | -25.5% | 5.7% |
| North America | 62,046,139 | 113.5% | -21.0% | 1.6% |
| Asia Pacific | 14,876,146 | 7.1% | -60.8% | 1.4% |
| Europe | 38,811,298 | 225.1% | -32.9% | -3.8% |
| Middle East | 6,437,277 | 153.5% | -36.8% | 6.6% |
| TOP 50 carriers | 162,105,083 | 64.4% | -32.9% | 1.8% |

Current Passenger Numbers and Projections for Top 50 Airlines as of 13 December 2021¹

Until the emergence of the Omicron variant, 2021 had seen a slow but steady recovery in passenger numbers with North America leading the way and Asia Pacific remaining the most impacted region.

Most of the developed world is moving ahead with effective vaccination programs although there is concern about North America where the politicisation of the pandemic response has led to very patchy level of take-up. The story is very different in the developing world where many African countries have barely begun vaccination. This is

¹ Source: T2RL dedicated Covid tracking pages at www.t2rl.net



probably the biggest single issue in the global response to the virus as new variants are far more likely to emerge in large unvaccinated populations.

From an airline technology perspective the most pressing needs are for solutions to the challenges of rapidly changing certification and testing requirements. Governments have historically devolved onto airlines the responsibility for enforcing complex border controls. It is almost certain that they will continue to do so and that the requirements will be long-lasting. Providers as diverse as Amadeus, Mindtree and IATA may all have a part to play in equipping airlines to meet this challenge as the world gradually opens up.

T2RL's View

In previous editions of this report we have been careful to caveat our forward-looking statements with the proviso that the emergence of new virus variants could change the outlook for airlines and technology providers alike. As if on cue, while we were beginning to compile this report, the Omicron variant was detected in South Africa and rapidly became the object of concern around the world. At the time of writing it is too soon to know exactly how significant this variant will be although preliminary data suggest that it is more transmissible than the dominant Delta strain but possibly causes less serious illness. If this were the case it would constitute a step towards Covid19 becoming an endemic but manageable virus. In the long term it may become one of the many viruses responsible for the common cold but for now it remains a potent hazard around the world.

The response to the new variant by many governments was to increase travel restrictions, initially to a group of countries in southern Africa but soon more generally. These moves were met with dismay from the airline industry and Willie Walsh, the Director General of IATA was particularly outspoken in condemning them.² One of the main thrusts of criticism is that travel restrictions are ineffective in preventing the spread of the virus and this seems to have been borne out by the rapid detection of Omicron in many countries around the world. Nevertheless governments have reacted as they have and in many cases have increased the burden of testing and documentation placed on airlines and their customers.

² <https://www.independent.co.uk/news/uk/willie-walsh-pcr-test-international-air-transport-association-people-covid-b1965909.html>



It is too soon for Omicron to have made a significant impact on passenger numbers so T2RL's current projections primarily reflect the impact of Delta. They show that for the top 50 airlines in the world by passenger numbers, December 2021 is likely to show a 64% increase on the same month in the previous year. While this is encouraging it still reflects a 33% reduction on 2019, so the industry is far from a full recovery. North America is currently the region closest to that state. Passenger boardings there more than doubled between 2020 and 2021 and now stand only 20% below the level of December 2019. The only region that shows a decrease between 2020 and 2021 is mainland China. The Chinese domestic market appeared to have made a full recovery by the end of last year but has subsequently fallen back as a result of emerging new variants and a slowdown in economic activity. Asia Pacific outside China showed the lowest increase between last year and this and it remains the most drastically affected of all regions with 61% fewer passenger boardings than in 2019. Europe saw the biggest increase over the previous year with passenger numbers tripling in the period although that level of growth was very hard to sustain and it is the only region projecting a decrease in numbers between November and December 2021.

T2RL subscribers can follow the development of traffic recovery at our dedicated COVID-19 pages. <https://www.t2rl.net/airline/covid19traffic> For non-subscribers there is a summary version that is open to view at: <https://www.t2rl.net/airline/covid>.

As we have observed in previous editions of this report the pandemic has paradoxically increased activity around airline start-ups. The theory is that well-funded new entrants without historical debt and other liabilities will be well-placed to benefit from the eventual market recovery. This trend has not gone unnoticed by major carriers and British Airways has moved to create a quasi-independent subsidiary to operate out of Gatwick Airport from March 2022.³ A previous BA attempt to create a low-cost subsidiary a generation ago did not prosper but more recently it has been successful with Cityflyer operating out of London City airport. Like Cityflyer the new entity will have to have significant freedom from legacy baggage while remaining within the halo of BA's brand recognition. It will not be an easy balance to establish and maintain but BA is not the only network airline following this path. SAS has also announced the launch of new subsidiaries, SAS Link and SAS Connect⁴ while Lufthansa Group has long had a semi-autonomous subsidiary fulfilling a similar role in Lufthansa Cityline. It is reasonable to suppose that more

³https://www.breakingtravelnews.com/news/article/british-airways-confirms-routes-for-gatwick-subsiidiary/?utm_source=newsletter&utm_medium=email&utm_campaign=newsletter

⁴ <https://www.ch-aviation.com/portal/news/110407-sas-to-launch-connect-link-brands-in-1q22>



traditional airlines will explore this option as part of their responses to changing market conditions.

The further outlook for the airline industry and its technology providers remains highly uncertain. Change and volatility will be the key factors as we move into 2022. Omicron is unlikely to be the final variant of the virus and governments are unlikely to stop reacting to developments with more regard to domestic politics than to evidence-based epidemiology. The complexity surrounding border controls, vaccination certification and quarantine requirements will grow from an already challenging level. Technology providers are offering solutions to help manage this complexity and there are definitely opportunities for those that can deploy effective and widely applicable solutions.

RECOMMENDATIONS

Contracting

News of the emergence of another new variant of the virus reminds us that the end of the pandemic remains a distant goal. Airlines that obtained temporary relief from unsustainable contract terms should now be seeking to establish longer-term changes to supplier relationships. In some cases the process will be made more difficult by the loss of skilled personnel over the last two years.

Vendors need to understand that airlines are not crying wolf. The financial pressures they face are real and if anything have become worse over the last few months as government support to business in general and airlines in particular has been reduced.

We expect there to be more pressure for consolidation among airlines and technology providers alike. Both sides need to understand clearly the impact of mergers, acquisitions and company failures on their contractual commitments.

Distribution

The broad trends observed in the (northern hemisphere) summer have continued as we approach the end of the year. GDS bookings are still very depressed and corporate

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international travel, which constitutes the core of GDS business, remains almost non-existent.

Whether because of the hiatus in other activity due to the pandemic or simply because its time has arrived, we are seeing significant growth in the importance of API-mediated connectivity. All three western GDSs are now pushing hard to get more airlines connected via NDC. In December American Airlines announced that it will add NDC distribution to Amadeus's North American points of sale by early 2022⁵, alongside its existing implementation for European sellers. Travelport has announced a raft of new NDC agreements including with IAG, Air France/KLM and Cathay Pacific. Sabre has announced NDC distribution agreements with Finnair, Emirates and Qatar Airways amongst others.

As well as the moves by the GDSs, pure-play NDC aggregators are anticipating growth in their bookings by between 300% and 1,000% (four-fold to eleven-fold increase), depending on region, over the next five years⁶. It seems clear that when the recovery comes distribution will increasingly be moving towards new technologies.

The motivations for airlines to adopt NDC are broadly split between a desire to save costs in the form of traditional GDS booking fees and a move to improve revenue by adopting tools like dynamic pricing, fare families, product personalisation and bundling. NDC is a necessary but not sufficient condition to enable these things. Airlines also need to invest in the back-end systems that enable them to deploy innovation in distribution. Those that were already well on the path to NDC before the pandemic will have an advantage.

The pandemic has also shaped some of the responses to the European Union's call for comment on proposals to update the CRS code of Conduct. This has been in force in its current form since 2009 and increasingly appears anachronistic in the world as it is now. In general the established GDSs and their allies are calling for aggregators, metasearchers and even airline's own web booking sites to be brought within the scope of regulation in the same way that the GDSs are. Large airlines want exactly the opposite. IATA has attempted find a middle ground with content aggregators brought into the ambit of regulation once they achieve a critical mass of market share. At a time when sheer survival is the primary objective of many industry participants this might seem like a distraction but the direction that the EU takes over the next year or two could shape the distribution landscape for another generation.

⁵ <https://www.travelpulse.com/news/travel-agents/american-airlines-expects-to-implement-amadeus-technology-by-early-2022.html>

⁶ See the T2RL report on [The Airline Aggregator Market](#) published in November 2021



IT Capabilities

The most critical requirement for airlines and their distribution partners as they attempt to recover from the effects of Covid19 is the ability to manage the increasingly complex regulatory environment. Regulations around border controls, vaccination certification and quarantine are hard to manage and likely to become more so. Governments are already placing increased burdens on airlines with penalties for transporting passengers without the requisite documentation.

Companies offering products that assist airlines in managing these requirements include Amadeus with its Safe Travel Ecosystem which adds capability to the existing Traveler ID that can be integrated into airlines' digital channels.

Some large airlines have adopted the VeriFLY app from Daon Inc which takes a different approach. In this case a separate app sits on the customer's mobile device and checks documentation off against destination requirements. Once the app is satisfied that the customer is clear to travel it gives the airline a positive status and the customer may check in. Anecdotal reports suggest that the process has not yet achieved the level of seamless reliability that airlines and their customers would like to see but with support from British Airways, American Airlines, JAL and others it is likely that the rough edges will be smoothed off fairly quickly.

Mindtree offers a Digital Health Passport that can be integrated with an airline's own customer facing systems to address the same requirements.

Finally the most established of all the systems offering management of health and visa requirements is IATA's Timatic. This lacks the ability to work directly with individual customer status but is widely regarded as having definitive information on border controls. Used in conjunction with the Travel Pass that IATA has been trialling with a range of airlines it may allow them to address the problem from both the government and the individual perspective.

Please see previous editions of this report for commentary on the opportunities and threats the pandemic has generated in the areas of demand forecasting, dynamic scheduling, cargo, loyalty and interlining.



VACCINE RELIANT MARKETS

At the start of the pandemic T2RL defined four categories of national approaches to its management. As time has passed the distinctions between these four approaches have become increasingly blurred and to a large extent they are only of historical interest.

Some markets relied predominantly on vaccines where cultural and economic influences meant other strategies fell by the wayside. Examples of these markets include the USA, UAE, Israel, UK and some EU countries.

While this strategy has been successful in most countries in preventing the rise in case numbers due to the Delta variant causing a similar rise in hospitalisations and deaths, one market in particular has proven to be an outlier. In the United States the management of the pandemic has become a highly politicised issue with supporters of former President Trump refusing vaccination and other amelioration strategies such as social distancing and the use of masks. As of December 13th only 60% of the US population was fully vaccinated⁷. As the Omicron variant takes hold the scientific consensus is that the fullest level of protection requires a booster shot in addition to the two doses required in most vaccine regimes. Most developed countries, including the USA, have booster programs well under way but take up remains as patchy as ever especially in predominantly Trump-supporting regions.

At the time of writing most of the vaccine-dependent markets are still in the process of reopening although knee-jerk restrictions were placed on a group of southern African nations at the time that Omicron was identified. It is likely that these restrictions will be lifted as the reality that Omicron is already present on a global scale dawns on the regulators.

For international travel a mixed approach of medical passports with vaccination certificates and testing is set to become the norm. Just as the events of 11 September 2001 drove major changes in the approach to security in airlines and airports, the current pandemic is leading to new requirements being placed on the industry. This in turn will place a burden and subsequent cost on airlines, PSSs, travel agents and GDSs to enable vaccine and testing data to be collected and certified at the time of booking

⁷ All vaccination data is from The Financial Times Covid Tracker pages

<https://ig.ft.com/coronavirus-vaccine-tracker>

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and/or boarding. Even with little traffic airlines are starting to see more resource needed at the airport check-in to deal with manual paper certification checks and the time it takes for boarding.

The standards used by airlines in these markets will no doubt set the bar for other global markets and will be enforced across the industry in due course. Based on experience after 9/11 we expect that some new processes will be put in place due to political pressures regardless of any evidence base for their effectiveness. Once implemented it will be almost impossible to remove them so airlines and airports are likely to have costs imposed for an extended period.

T2RL continues to believe there will be little business travel in the next year, even in markets where travel restrictions have been relaxed. Most corporate travel insurance will not provide cover while the outbreak is still categorised as a pandemic, which according to the WHO could continue until the end of 2022⁸. Companies have a duty of care to their employees and would have significant legal exposure if they were to require them to travel. Additionally, many office staff have been working from home for quite some time and have become accustomed to readily available video conferencing, meaning a lot of travel for meetings is now deemed unessential and costly. Recession, downsizing, new habits and ways of working are now ingrained into society and will consequently suppress demand for business travel.

Airlines operating in these markets in particular will need to focus on leisure demand as a priority in coming months and potentially open new routes and increase capacity for certain segments.

COVID-Free Markets

COVID-free markets are those countries that have opted for a totally COVID-free approach, reliant on closed borders, strict testing on arrival, quarantine and vigorous contact tracing, for example Australia, New Zealand, Pacific islands and certain Caribbean islands. These markets make up around 2% of international travel.

In the earlier stages of the pandemic these countries seemed to have achieved the most in terms of harm reduction to their populations. New Zealand in particular was often singled out for its success in maintaining low rates of cases, hospitalisations and fatalities.

⁸ <https://www.bbc.co.uk/news/world-53870798>

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As the pandemic stretched out and it became clear that it would be a multi-year event the cost of such draconian measures became a matter of controversy. New Zealand has effectively been cut off from the world for over a year with even residents and citizens unable to travel internationally due to the lack of provision of mandatory hotel quarantine on return.

As a result of this isolation the priority placed on vaccination in these markets has now changed as the new variants have broken out even in tightly-sealed New Zealand while Australia has seen multiple waves, albeit smaller than those in other regions. The vaccination programs in these countries were slow to get started but are now in full swing. As of 13 December 75% of the Australian population was fully vaccinated while the corresponding number for New Zealand was 74%. As we noted in the last edition of this report Qantas has now resumed international flights although its network remains limited compared to the pre-pandemic period.

Given the acceleration of vaccination and the increased emphasis on border controls in other markets it now appears to T2RL that it is no longer useful to consider this a separate category of market.

Testing Focused Markets

Testing focused markets for example, China, Korea, Japan and Thailand, have put in place mass testing and contact tracing with isolation and quarantine when outbreaks become apparent. These markets make up around 24% of international travel. They are predominantly in Asia where the rollout of vaccines took a while to get under way but testing was widely available. Despite the success that these countries have had in suppressing the virus, airlines in the Asia Pacific regions are currently showing the biggest falls in traffic of any in the world.

Markets following this strategy are taking cautious measures to ease quarantine and open borders dependant on negative test results. Despite serious misgivings the delayed Olympic Games in Japan did not lead to a substantial increase in infection rates. In fact the opposite has been observed as Japan has combined its testing-oriented approach with a huge acceleration in vaccination such that in December 2021 it has fully vaccinated almost 80% of its population. 1.4% of the Japanese population has contracted Covid19



since the start of the pandemic compared with 11% for the European Union and 15% for the USA.⁹

China has been even more successful in suppressing the virus with case rates almost too low to measure. This is probably because of the authoritarian political system that allows far more stringent containment measures than would be tolerated in the west. There is also a suspicion among many commentators that numbers are being significantly under-reported. Vaccination in China is now leading the way among large economies with 83% of the population fully vaccinated.

China's domestic airline market had bounced back well but the most recent passenger boarding numbers have fallen by around 14.5% from the level reached by the end of 2020. This is likely as much due to the reduction in economic activity as it is to direct impacts of the virus. The most recent month for which we have data shows an uptick in passenger numbers and we expect the market to grow again in line with global economic recovery.

Currently it still looks set to be towards the end of 2022 when borders will fully open to International travel in these markets although there have been some positive signs such as the tentative reopening of Thailand to international tourists¹⁰. For the present, airlines need to be opportunistic. The focus is on domestic travel and they may need to open and market new routes following demand levels closely.

Developing Markets

Developing markets with large populations and where infections are high will find it difficult to vaccinate whole populations quickly due to limited resource. These markets include India and Brazil. Developing markets make up around 18% of the overall international market. They are vulnerable to discrimination by governments in the developed world such as the border closures imposed after the identification of Omicron in South Africa.

Some developing markets are making progress with vaccination. Brazil and India have both more than doubled the number of their people vaccinated since our last report

⁹ Source : Financial Times <https://ig.ft.com/coronavirus-chart>

¹⁰ https://www.bbc.co.uk/news/business-59115395?at_medium=RSS&at_campaign=KARANGA

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although with large populations they both still have some way to go to reach the levels seen in richer countries. The situation is much worse in sub-Saharan Africa where current vaccination rates are running in single digits per 100 residents. To take some random examples, the numbers are 1.7 doses/hundred in Chad, 4.8/hundred in Mali and 9/hundred in the Central African Republic. The international community still has a pressing need to assist these countries.

Inbound travel will take a long time to recover. The rate of infections and the ability to be vaccinated will deter some travellers but there will still be a limited market demand for some segments including family visits.

It is in these markets where we expect the number of active airlines to diminish the most both through bankruptcy and liquidation and through mergers. We also expect to see fewer travel agencies in the market due to bankruptcies and lower demand. Online travel agencies will be under pressure due to the fall in leisure demand and will be competing more than ever with the airline direct channels.



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