Propensity to fly in emerging economies: What do the trends mean for aviation infrastructure investment?

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Executive summary

In markets around the world, changes in propensity to fly affect demand for air travel. And when future demand increases, so does the need for investment in aviation infrastructure. Many investors form their analyses on developed markets and, more recently, the BRICS – Brazil, Russia, India, China and South Africa – when crafting their infrastructure investment strategies. When it comes to emerging markets, the BRICS do call for close consideration. But there are forces at work in several other emerging markets that could present equally attractive opportunities.

Identifying investment opportunities with strong growth prospects requires an understanding of trends in the forces affecting revenue growth – which is driven primarily by passenger growth and therefore propensity to fly. In this article, we aim to build that understanding. Using forecasting and modelling and drawing on our industry and sector knowledge, we analyse how propensity to fly may shift in various emerging markets in the coming decades – and where the most promising investment opportunities may lie in the future.

What influences propensity to fly?

In any given market, propensity to fly (number of air trips per capita) strongly determines future demand for air travel among business and leisure travellers. The faster the future demand growth, the more urgent the need for safe and efficient airports, reliable transportation and communication networks around airports, and other forms of aviation infrastructure. And the more urgent the infrastructure need, the more opportunities investors have. So understanding how propensity to fly might change in various markets can help investors anticipate where the best opportunities may arise in the future.

But propensity to fly is affected by a lot of different, interrelated forces. An economy’s health (and therefore its personal income levels), demographic changes, and the affordability of air travel are just a few examples. To identify the most promising opportunities for aviation infrastructure investing, investors must understand how those forces are changing within particular markets and compare their findings across markets. Many investors are already basing their investment strategies at least in part on their analysis of the aviation markets of the BRICS. But as we’ll see, that same configuration of markets may not necessarily present the best opportunities in the future.

The more urgent the infrastructure need, the more opportunities investors have.
With that in mind, let’s take a look at the forces affecting propensity to fly. We’ll then compare how the most powerful of these forces are changing in several markets. And we’ll consider what our analysis suggests about investment opportunities.

**Our analysis**

We analysed trends in aviation markets around the globe, with an eye toward determining where the best investment opportunities might arise in the near and long term. Our analysis focused on two factors: compound annual growth rates (CAGR) and correlations between per-capita GDP and number of air trips per capita, taking into account the various factors discussed above.

**Growth in number of air passengers**

When it comes to growth in number of air passengers, our analysis of the developed world presented no surprises. Propensity to fly has been increasing rapidly in Europe, owing to deregulation of the airline industry and the increased competition and consumer benefits that have ensued. But it will probably slow in the medium to long term, after the effects of deregulation have worn off and the market has reached a point of saturation. The US has already experienced this pattern.

It’s the rapidly developing markets – particularly newly industrialised economies\(^2\) like Brazil, China, India, Indonesia, the Philippines, and Turkey – that are seeing the biggest jumps in the number of air passengers. (See Figure 1.) These countries enjoyed CAGRs of 5-13% between 2007 and 2012.\(^3\)

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**Factors affecting propensity to fly**

- **Economic health.** Propensity to fly goes up when people have enough personal income to afford vacations and when growth in the overall economy reflects growth in business and therefore the need for business trips. Having enough money for travel requires a strong economy reflected in healthy growth in gross domestic product (GDP).

- **Demographic changes.** A growing population can increase propensity to fly merely by raising the number of people living within a particular economy. An expanding middle class can boost propensity as well, as more and more people have the incomes needed to afford air travel.

- **Market maturity.** As with demographic changes, propensity to fly doesn’t increase indefinitely as an economy grows.\(^1\) In fact, it tapers off as a market matures and approaches saturation.

- **Crisis.** Unexpected crises, such as the 9/11 terrorist attacks and the global financial crisis in Europe, can temporarily decrease propensity to fly. Following the crisis, propensity can revive strongly in a kind of catching-up pattern after several years of suppressed growth.

- **Geographical features.** Propensity to fly is greater within island nations, countries that are relatively isolated with limited land transport and large distances between population centres, and countries with a long, thin shape, which makes even high-speed rail a challenging option for travel.

- **Competition.** The rise of a new business model in a market – such as low-cost carriers (LCCs) – can increase propensity to fly if it makes air travel more affordable or appealing for consumers and businesspeople.

- **Airport hub status.** Countries with air connectivity far out of proportion to their size, because of their airports’ hub status, have a higher propensity to fly owing to the availability of air services. Singapore and the United Arab Emirates are good examples of this.

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\(^1\) There’s still a limit to how many trips a person can reasonably take in a year, given work and personal commitments. So demographic changes can’t raise propensity to fly indefinitely.

\(^2\) As defined by the International Monetary Fund.

\(^3\) IATA 2007–12 – International traffic only.
Correlations between per-capita GDP and number of air trips

In addition to analysing growth in the number of air passengers, we looked at the relationship between per-capita GDP and number of air trips. But we qualified this analysis in several ways. For instance, we based our calculations on the number of one-way passengers with the point of sale in a particular country. This approach takes out the impact of disparity between inbound and outbound passengers. Countries with a lot of inbound tourism and a low local resident population show a much higher number of trips per capita, driven by the economies of the inbound countries. So to keep things simple, we considered only resident travel patterns in our analysis.

For nearly 200 countries, we plotted per-capita GDP against per-capita number of trips. Collectively, the countries we analysed account for 97% of passenger trips captured in Sabre’s airport data intelligence database. Drawing on the data, we developed a relationship between propensity to fly and per-capita GDP. We took into account market saturation, assuming 2–2.5 trips per capita for non-isolated markets (countries where alternative transport modes are available) and more than twice that for isolated markets (for example, small island nations, countries where other travel modes are not available or competitive, or countries with major air hubs creating an inflated air travel market due to connectivity). Figure 2 shows that as GDP increases, propensity to fly increases. It also suggests that propensity to fly reaches saturation as GDP rises.

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4 We excluded countries for which economic data was unavailable as well as nations that have low levels of outbound travel because of political or social restrictions. Likewise, we didn’t include countries that have a disproportionate share of outbound passengers and that have incomplete point-of-sale or point-of-origin data.

5 Though airfares and exchange rates also contribute to the number of trips a person takes, it wasn’t feasible to gather this level of detail for each country. For this reason, our analysis doesn’t reflect these fares and rates.
Resident trips per country

We used the relationships derived for isolated and non-isolated markets from the data in Figure 2 to forecast growth in resident trips for 2020 for each country in our study, given growth in per-capita GDP and population over the coming three decades. We then compared these forecasts to resident trips for each country in 2013 and considered how the top 20 rankings might change by 2020. (See Table 1.)

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6 Based on real GDP per capita and population forecasts from Global Insight (August 2014).
### Table 1: Resident trips, 2013 versus 2020

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<tr>
<td>20</td>
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<td>29</td>
<td>Thailand</td>
<td>38</td>
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Note: These figures represent unconstrained (for example, capacity and regulation) forecasts based on 7-year forecast GDP and population projections from BMI. These figures represent indicative air-traffic growth figures based on assumptions and analysis outlined in this paper. No reliance should be placed on these forecasts.

Source: Sabre Airport Data Intelligence, BMI, PwC analysis

### Potential investment hot spots

The upshot of our analysis is that the ranking within the top 20 countries by air trips will change over the coming decade. Our findings suggest that Indonesia, Australia, the Philippines, and Russia will move up most in the ranks in terms of resident air trips. Indonesia is expected to overtake the UK and become the fifth-largest air travel market globally. On the other hand, a recent slow-down in GDP growth sees India losing ground to countries such as Australia and Indonesia. In the following paragraphs, we discuss a selection of markets that present varying levels of opportunity.

**China**

To capitalise on forecast growth, the Chinese government is making significant investments to upgrade aviation infrastructure. For instance, mainland China currently has 182 commercial airports. According to the ‘Twelfth Five-Year’ Plan on Civil Aviation Development, by 2015 there will be 82 new construction airports and 101 reconstruction and expansion airports. This is likely to affect investment in infrastructure construction, set as an emphasis investment channel, it is predicted that the fixed investment size will reach more than 400 billion Yuan pre-2015, 60% over the ‘Eleventh Five-Year’ period. By 2030, the number of airports in the country is expected to reach 300.

**Indonesia**

Indonesia is currently the world’s largest archipelago and biggest aviation market in the ASEAN group of nations. With a population of over 250 million and the fastest growing economy in Southeast Asia, Indonesia desperately needs additional aviation capacity and infrastructure.

A wide range of opportunities for investment in infrastructure is available. Thirteen airports have been listed for expansion and refurbishment programs, as outlined in the Masterplan for Acceleration and Expansion of Indonesia Economic Development (2011-2025). Additional opportunities lie in the refurbishment of air traffic control assets and ground handling, where the demand for new
Propensity to fly in emerging economies

The operator of Indonesia’s Soekarno-Hatta International Airport in Jakarta, the nation’s capital, is committing the equivalent of US$1.24 billion to bring the airport up to date and on par with other major global airports. Soekarno-Hatta was built in 1985. In 2013, it was the world’s 10th busiest airport. It’s become so overcrowded that it experiences major flight delays at peak travel times, and passengers can expect to wait as long as an hour to claim their luggage after touching down at the airport. The area around the airport even more problems, including telecommunications difficulties and blackouts. The airport upgrade, which kicked off in August 2012, will be carried out in phases and calls for a new terminal and an extra runway to be completed by 2015.

In addition to development of Soekarno-Hatta, other major airports including Ngurah Rai are currently undergoing major expansion programmes. Whilst existing airport improvements are underway, an entirely new site has been constructed in Medan, about 900 miles north of Jakarta. The New Medan International Airport (Kuala Namu), which has a capacity of 8.1 million passengers per year is the second largest after Soekarno-Hatta International, opened this year in late July. It replaces the existing international airport (Polonia). Airside facilities are controlled by the Indonesian government, and landside facilities are owned by a joint venture with PT Angkasa Pura II,7 which is expected to provide US$350 million as an initial investment in return for a 30-year lease. After the lease expires, ownership will revert to PT Angkasa Pura II. The Medan site is to serve as a regional hub at the same level as Singapore’s Changi and Bangkok’s Suvarnabhumi airports.

**Saudi Arabia**

Saudi Arabia has four international and 26 domestic/regional airports. The Kingdom, which is heavily reliant on air travel, is investing significantly in infrastructure projects to accommodate future growth and help to transform Saudi Arabia into an important hub for east-west routes. In 2010, the General Authority of Civil Aviation of Saudi Arabia (GACA) estimated that over the next 20 years, the government will commit at least US$5.3 billion in the development and revamping of airports. The Saudi market is opening up to foreign investors, as evidenced by foreign organisations managing three of the four international airports in the country.

A consortium led by the Turkish group TAV Airports was awarded the build-operate-transfer contract for Prince Mohammad Bin Abdulaziz International Airport in Medina in October 2011, making it the first airport privatisation deal in Saudi Arabia. The agreement was made between the GACA and TAV alongside partners Al Rahji and Saudi Oger. The consortium will construct a new passenger terminal by the first half of 2015, and will operate the airport for 25 years.

There is private sector involvement in Saudi Arabia’s three major international airports in Riyadh, Jeddah, and Dammam. Fraport Saudia Arabia Ltd (a 100% subsidiary of Fraport AG) is responsible for the management, operation, and further development of the King Abdulaziz International Airport in Jeddah and the King Khalid International Airport in Riyadh. Changi Airports Group (a 100% subsidiary of Changi Airports Group) manages King Fahd International Airport in Dammam.

A second tranche of Islamic bonds worth SR15.2 billion (US$4.05 billion) was issued to further finance the expansion projects of King Abdulaziz International Airport (KAIA) in Jeddah and King Khalid International Airport (KKIA) in Riyadh.

**The Philippines**

The Philippines government announced a Php 303 million (US$7.3 million) project to construct, improve, and expand airports in San Vicente, Pagadian City, Butuan City, Dipolog City, Sanga-Sanga, Tawi-Tawi, Cotabato City, and Maasin. In June 2012, the Department of Transportation and Communications (DOTC) invited local and foreign firms to bid for contracts to expand and improve the passenger and airport traffic handling capacity of these eight provincial airports. In 2014 both the US Federal Aviation Administration and the European Union upgraded aviation safety ratings for the Philippines, providing further scope for expansion of international services and further driving the need for expansion in airports and airport infrastructure.

Amongst ongoing projects is the upgrade of Tacloban Airport, for which a budget of Php 2.12 billion (US$49 million) was approved by DOTC (additional budget, however, may be required for its completion). Following the damage caused by Typhoon Yolanda in November 2013, a runway rehabilitation programme was launched at the airport. During the first phase of the programme, major terminal renovations are being undertaken, while during the second phase, the Civil Aviation Authority of the Philippines (CAAP) will oversee interior redevelopment works and amenity repairs.

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7 PT Angkasa Pura II is state enterprise of the Indonesian Department of Transport that is responsible for the management of airports and air traffic services in Indonesia.
Close-to-capacity facilities at Cebu Airport have also called for the government to tender an upgrade plan for the construction of a new passenger terminal building and the expansion of the existing one. This will increase Cebu Airport’s capacity from 4.5 million passengers per year to 8 million per year.

Furthermore, a US$79.41 million design and build contract for the upgrade and expansion of Puerto Princesa Airport (DOTC) was put to tender in August 2014. The cost of the project was supported by the Export-Import Bank of Korea, from which the Philippines government received a US$71.6 million loan.

**India**

Despite the recent slowing of the economy, India remains one of the 10 largest markets globally. The growth in the aviation sector in India requires significant updating of outdated airport infrastructure. There are currently 454 airports and airstrips in India, 16 of them designated as international airports. The Airports Authority of India (AAI) owns and operates 97 airports. India’s government allows for domestic and foreign investors to participate in the development of airport infrastructure at selected airports. In 2013 the limit by which foreign investors can invest in Indian companies was increased to 49% in the aviation market. The government passed a legislative amendment in 2003 allowing the private sector to enter the field of airport development and permitting 100% foreign direct investment for greenfield airports. A number of other airports have been granted approval to be constructed and financed through public-private partnerships (PPPs).

Given the need to enhance connectivity, the government is planning to build 51 airports over the next few years. Of these, 15 are low-cost airports with construction kicking off in 2013. The investment envisaged for the airports sector is US$12.1 billion, of which US$9.3 billion is expected to come from the private sector. These investments will be used for a wide range of infrastructure projects, including the construction of new airports, the expansion and upgrade of existing airports, and the development of low-cost airports. The development of world-class ground handling, cargo, and logistic facilities including high-output distribution centers at major airports, is also expected to require a very significant investment.

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In addition, the greenfield international airports at Bangalore and Hyderabad were constructed with financing through PPPs with significant shares of foreign investment. In fact, PPPs enabled modernisation and expansion of the Delhi and Mumbai airports through a transparent competitive bidding process. Other major airports such as Chennai and Kolkata will likely also be modernised through PPPs.

**Russia**

Strong economic growth is predicted for Russia in the short term. Demand for air travel is set to increase as a result of a growing middle class with willingness to diversify consumption behaviour increasing their propensity to fly.

Russia has 315 airports, of which 64 urgently need upgrades. Most of the airports requiring refurbishment are located in areas where air travel is the only mode of transport available. The government has been injecting cash into regional airports in a bid to attract private investors. However, owing to the size of the airports (often smaller than 1 million passengers per annum), this has been quite difficult.

With Russia hosting the 2018 FIFA World Cup, major development plans are expected for Russian airports, representing an opportunity for investment. One example of such development has been initiated at Moscow’s Sheremetyevo airport, where plans aim to raise passenger capacity to 53 million by 2017 and include significant infrastructure investment in sub-runway inter-terminal passenger and luggage tunnels.
Brazil

Many of Brazil’s major airports are currently capacity constrained and require upgrading and expansion. Future performance of Brazil’s airports is critical, particularly because of the Olympics in 2016 in Rio de Janeiro. In 2011, the government of Brazil decided that private companies would be granted a concession to commercially run some of Infraero’s airports to implement upgrades to airport facilities and infrastructure. Current legislation in Brazil does not allow the sale of airport infrastructure; however, the government can grant concessions or perpetual franchises to the private sector for airport operations. The concessions are taking the form of PPPs in which the concessionaire would own 51% of the shares and Infraero would own 49%, therefore holding veto rights on strategic decisions in the joint ventures. In 2012, the semi-privatisation of three of the largest airports in the country, namely, Viracopos International Airport in Campinas, Guarulhos International Airport, and Brasilia International Airport, started to occur, with these airports being auctioned to a consortium of private firms. In 2013, development programs for Turkey’s busiest airport, Ataturk, has commenced with initial expansion of aircraft standing and parking facilities. Work at Sabiha Gökçen Airport is also underway in a bid to provide for additional aviation capacity.

Turkey

The Turkish economy has grown robustly over the last decade, and its air transport services have developed exceptionally as both its airlines and its infrastructure have modernised successfully. The number of visitors to Turkey increased at an average annual rate of over 10% over the last decade and Turkey saw a huge increase in resident trips due to strong economic growth. New airport infrastructure and Turkish Airlines’ aggressive growth have helped drive this development. There has been increased private-sector involvement in airport development since the government enacted a law on the realisation of certain investments and services in the Build-Operate-Transfer (BOT) model in 1994. Such development has focused primarily on Antalya, Istanbul-Ataturk, Izmir-Adnan Menderes, Dalaman, and Milas-Bodrum airports. Turkish operator TAV holdings is the largest airport operator in Turkey and operates airports abroad.

Construction has commenced at a third airport with a final passenger handling capacity of 150 million per year, the largest in the world, in Istanbul, with the goal of replacing Ataturk Airport. The project was contracted using the BOT model. The 25-year tender was auctioned off for euro 22 billion (US$31 billion) in May to a consortium of five Turkish companies.

Japan

Air traffic growth in Japan is slowing because of Japan’s aging population. The resulting decline in population, coupled with slow real growth in GDP, means that propensity to fly needs to work even harder for Japan’s air travel market to continue to grow and keep up with other markets. LCCs are beginning to have a presence at Japanese airports, potentially leading to stiffer competition and lower fares, which could increase propensity to fly. This is evidenced by market share claimed by domestic Japanese LCCs, which increased from 17% to 24% of domestic capacity carried between Q4 2013 and Q1 2014.

Despite modest growth expectations, Japan still presents an opportunity for investors, as the Japanese government has announced plans to concession up to 27 airports between 2014 and 2019, with New Kansai and Osaka airports opening for concession bidding in 2014. In parallel, the state of Hokkaido has also expressed interest in concessioning its 11 airports. Japanese airports present significant commercial opportunities, as this area has previously been underexploited.

Additional potential is identified in retail expansion. In 2011, non-aeronautical revenue accounted for about 32% of total airport revenue, suggesting potential scope for maximising revenue generated through retail. With traffic volumes expected to increase significantly in Brazil over the next 10 years, Brazilian airports will likely remain attractive to investors.

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8 Infraero is responsible for operating Brazil’s main commercial airports.
Considerations for investors

We have outlined several emerging markets that will see a major increase in propensity to fly by 2020. Each of these markets needs significant infrastructure upgrading. Such investment may unlock significant economic benefits for a city (or country), supporting an increase in air connectivity through better and more efficient infrastructure. In making investment decisions, investors will want to take into account these markets’ unique characteristics, including the regulatory environment and the changing global aviation landscape.

For example, China will see a big jump in air-traffic growth, and (as we noted above) its government plans to invest heavily in beefing up aviation infrastructure. The government is also initiating reforms to raise income levels – including increasing the minimum wage 40% by 2015, expanding the social welfare and health-care system, and promoting labour-intensive service industries. These moves could boost consumption as a percentage of GDP growth. All this suggests that China may represent a good opportunity for investment. But owing to regulations restricting foreign investment, the door isn’t necessarily open for outside investors. By contrast, the Indian government allows foreigners to invest significantly in Indian companies, and prospects look good for foreign direct investment in greenfield airport developments. Thus India’s aviation infrastructure may constitute a much better opportunity, at least in the medium term.

Here’s another consideration: Developed economies’ aviation markets might not look like worthy investment targets because of market maturity and the influx of new competitors from the Middle East, Turkey, and other emerging economies. But that’s a surface-level view of the situation. Our analysis shows that these new competitors won’t necessarily pose a threat to developed economies in terms of taking away market share. They could actually present an opportunity – for mature markets and investors alike. Why? Their presence will create more inter-airport connections and thus increase cross-border networks. Aviation infrastructure will expand as a result, opening up new opportunities for investors in developed and developing markets.

Next steps

By understanding trends in the forces affecting propensity to fly and comparing these trends across aviation markets, investors can gain critical insights into where the most promising opportunities may arise in the future. Our analysis suggests that while the US, Europe, and BRICS still merit consideration, a number of additional markets – notably Indonesia and the Philippines – may offer equally attractive potential in the future and thus bear watching. To be sure, other factors – particularly restrictions on foreign investment and appetite for private-sector participation – also play an important role in decisions about where to focus investment. However, propensity to fly can provide some useful insights into a market’s potential in the longer term.

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