

ALAFCO Aviation Lease and Finance Company K.S.C.P.



Quarterly Aviation Industry Performance

(July– September 2016)

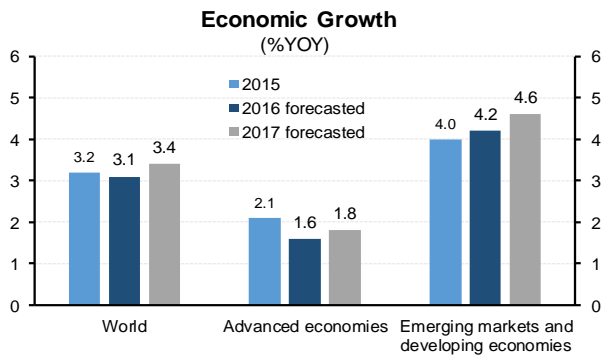
Prepared by: Strategic Planning department

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Growth to remain subdued this year

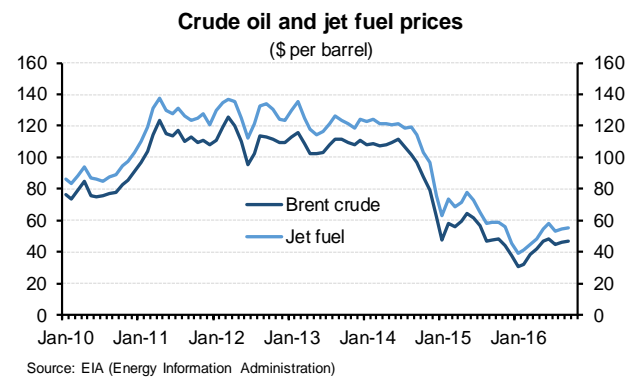


Global economic growth is expected to remain subdued in 2016, due to weaker growth in advanced economies. The IMF (International Monetary Fund) expects world economic growth to slow slightly to 3.1% this year, following a slowdown in the US economy and Britain's vote to leave the EU. Next year, the IMF expects a pick-up to 3.4% on the back of recoveries in major emerging economies.

Growth in advanced economies is expected to slow to 1.6% in 2016 as a result of weaker growth in the US, Euro and UK economies. This has put further downward pressure on global interest rates, as monetary policy is now expected to remain accommodative longer. In 2017, growth in advanced economies is expected to see a slight increase helped by an anticipated pick-up in US growth.

In emerging and developing economies, growth will accelerate for the first time in six years. However, prospects vary sharply across regions and countries. China's economy is expected to expand 6.6% this year, down from 6.9% last year – though concerns about China's growth prospects have been reduced in light of policy support. Growth in emerging Asia continues to be resilient, especially in India which is projected to expand by 7.6% this year and next – the fastest pace among the world's major economies. Meanwhile, economic activity in Latin America is expected to contract – mired by recessions in Brazil and Venezuela – though a recovery is expected to take hold in 2017.

Oil prices pick-up after low start to 2016

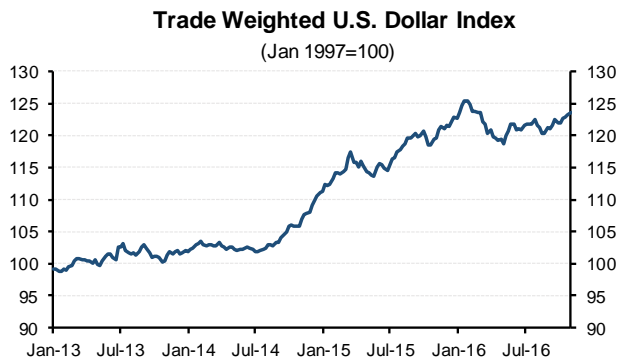


Oil prices continue to strengthen through 2016, after hitting a 12-year low at the start of the year. Brent crude prices, an international benchmark, reached \$47 per barrel by September 2016 – some \$16 higher than its level in January. Nevertheless, oil prices are expected to average just \$43 per barrel for the year, down from \$52 last year.

Oil prices have remained weak as a result of high global oil supplies, supported by strong OPEC production growth. In September 2016, crude output from OPEC (Organization of Petroleum Exporting Countries) climbed to a record high of 33.6 million barrels per day. During the cartel's meeting on 28th September, OPEC agreed to curb production to between 32.5-33 million barrels per day, with the country production limits to be discussed at OPEC's next meeting on 30th November in Vienna. A possible failure of an OPEC deal could result in downward pressure on crude prices, in addition to other downside risks such as a further slowdown in Chinese growth.

Similarly, jet fuel prices also recovered from a low start to the year – though are still below their levels last year. Jet fuel prices averaged some \$50 per barrel in the first 9 months of 2016, compared to \$68 in the same period of 2015. According to IATA (The International Air Transport Association), airlines globally will spend 30% less on fuel this year compared to last year – taking the fuel bill to less than 20% of total operating costs.

US dollar strengthens in recent months

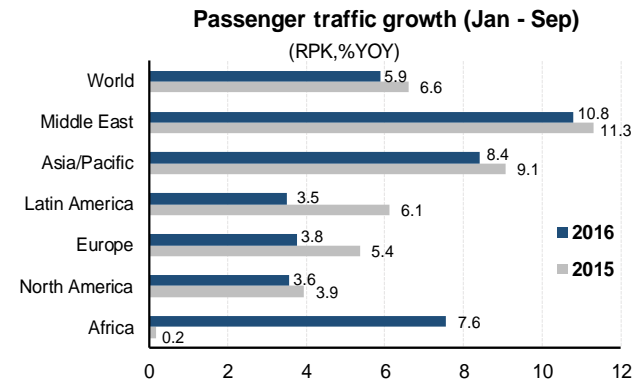


Source: Federal Reserve Bank of St. Louis

The US dollar had risen steadily in past months, supported by continued expectations of interest rate hikes. The Fed last raised interest rates in December 2015, but weaker-than-expected economic growth in the US this year delayed further hikes in the Federal Funds rate, as the economy weathered shocks including a China slowdown, financial market turmoil and fears that Britain's decision to exit the European Union could have negative global consequences. However, expectations of a strengthening in the US economy raised the possibility of an end-2016 Fed rate hike – which reflected in the recent strengthening of the dollar.

Yet, it is expected that the dollar will be impacted by the outcome of the US presidential elections. A Clinton victory was anticipated to clear the Fed for an interest rate hike in December – providing further support for the US dollar. On the other hand, a Trump presidency is expected to create a large amount of uncertainty – which could weigh on the dollar and drive capital into the perceived security of the Japanese yen and the Swiss franc. Trump is also expected to make significant changes to US policy – most notably through his proposed protectionist policies – which could isolate the US from its trading partners and threaten to stall global economic recovery. More importantly, Trump's victory could discourage the Federal Reserve from raising interest rates in December and casts doubt over gradual hikes in coming years.

Air travel moderates, but remains robust



Source: IATA.

Despite the weak global economic backdrop, air travel has continued to grow at a robust pace – albeit at a slower rate than last year. World passenger traffic grew by 5.9% in the first nine months of 2016, compared to the 6.6% seen in the same period of last year. The moderation in traffic growth was experienced across all regions – except Africa.

Air travel has been subject to a number of negative headwinds in 2016, although passenger traffic has still grown broadly in line with the average pace seen over the past decade or so. In addition to the subdued global economic environment, terrorist attacks and political instability in parts of the world during 2016 impacted growth in air travel. Nevertheless, these factors were partially offset by the stimulus from lower fares – resulting from lower oil prices.

IATA's recently released forecast for global air travel predicts that passenger growth is set to double over the next two decades. It expects 7.2 billion passengers to travel in 2035, almost double the 3.8 billion air travelers in 2016. Asia-Pacific will be the biggest driver of demand for air travel – the region is expected to be the source of more than half the new passengers over the next 20 years. IATA also projects that China will displace the US as the world's largest aviation market by 2024, and that India will displace the UK for third place in 2025. □