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Oil price volatility hits European airlines

By Sarah Gordon and Jane Wild in London   Author alerts

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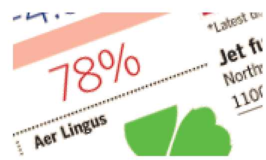
Airline hedging



European airline shares have fallen sharply as growing violence in Iraq marks the end of an unprecedented period of low volatility in oil prices.

Brent crude hit a nine-month high of $115 a barrel on Thursday and has risen more than 5 per cent since militants entered the Iraqi towns of Mosul and Tikrit on June 10. Although jet fuel prices have not risen as much, airline shares have responded by falling sharply. European airline shares are down 13 per cent in the same period, according to MSCI, the index provider.

Fuel costs account for a high proportion of European airlines' costs. Although the region's airlines typically hedge their costs more aggressively than their Asian and US counterparts – with some having hedged as much as 70 per cent of their 2014 fuel needs – several will be caught out by the oil price rise.

HSBC analysts estimate that a $5 a barrel increase in the spot crude price will reduce operating profits for European airlines this year by between 1 and 52 per cent.

Norwegian Air Shuttle, Europe's third-largest low-cost carrier after Ryanair and easyJet, does not hedge any of its fuel requirements. Ryanair dismissed the prospects of a long-term rise in oil prices on Friday.

"This short-term thing happens all the time," said Howard Millar, chief financial officer. "It was Ukraine, now it's Iraq, it will be something else. Every week that goes by in the fuel markets there is an event, this is just one in a long sequence."

Ryanair has hedged 90 per cent of its fuel requirements for this financial year at about $96 a barrel, which it says has generated savings of roughly €70m compared with the previous year.

The Irish low-cost carrier notoriously erred in its fuel hedging policy in 2008, making a series of missteps that cost it €102m, prompting a public admission from chief executive Michael O'Leary that it "screwed up".

For Ryanair, this time the toast has landed butter-side up

- Andrew Lobbenberg, airlines analyst at HSBC

"For Ryanair, this time the toast has landed butter-side up," said Andrew Lobbenberg, airlines analyst at HSBC.

The oil price rise puts an end to a long period of low volatility in the market, with Brent crude trading in a narrow range of about $104 to $110 a barrel over the past year.

An end to low volatility in oil prices would have an impact on all airlines, since it has tended to reduce the cost of hedging as well as create a more stable environment for investment decisions.

"Obviously hedging does have a price, so low volatility tends to lower that price," said Mr Lobbenberg.

Chris Monro, vice-president treasurer at Southwest Airlines in the US, added: "The last several years of relative [oil] price stability has allowed us to plan and execute with more assurance."

Thorsten Luft, head of fuel management at Lufthansa, which typically hedges 85 per cent of its fuel requirement six months in advance, said the recent jump in the oil price had silenced those calling for a review of the airline's hedging policies.

"There were people who were saying the market is flat and we're still paying millions of euros for the premium for the [fuel] hedges, why are we still spending money on this," he said. "But now those voices have gone quiet."

Additional reporting by Robert Wright and Gregory Meyer in New York

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