

Infrastructure

How will COVID-19 reshape key Australian industries?



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Keeping critical infrastructure open for business

In this latest instalment in Westpac IQ's series on the impact of the covid-19 pandemic on major Australian economic sectors, created in partnership with The Economist Intelligence Unit, we have the privilege of discovering how the recent travel restrictions upended the economic fundamentals at one of Australia's busiest transport hubs, Melbourne Airport.

Lyell Strambi, chief executive of Melbourne Airport, explains the challenges of being an 'essential service' at a time when the airport's revenue has plummeted, and reveals how the organisation is planning for the worst, while hoping for better, in terms of the pace of recovery.

Westpac is working with a range of clients responsible for critical infrastructure across various asset classes to find strategic ways to manage their funding. All of them face huge uncertainties in managing an unknown timeframe for an economic recovery.

Our approach is to help clients to see through the cycle and support them in the process. Top of mind for us is how critical these infrastructure assets are, both to the community and to state economies. Underpinning our thinking is the knowledge that a recovery will come, with clear indicators already emerging in some areas.

Our big thanks to Lyell Strambi for sharing his insights with the wider Westpac IQ audience.



Infrastructure: Will the boom resume?

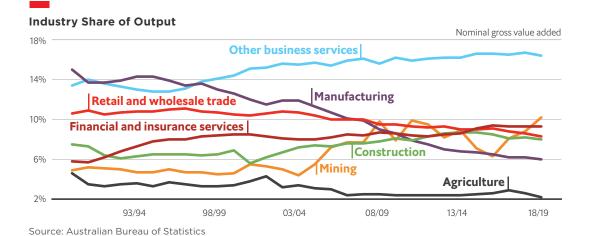
Prior to the covid-19 pandemic, Australia was undergoing an infrastructure boom, with over A\$200bn¹ (US\$139bn) in projects under construction. One of Australia's longstanding challenges was keeping pace with the rate of growth, particularly in transport infrastructure.

Critically, when the pandemic broke out, construction was declared an 'essential service' by the federal government. Work was permitted to continue, with social distancing measures applied. This came as a relief to many in the infrastructure and construction sectors, as site workers cannot work remotely, and many construction projects were being halted globally. New Zealand and Singapore, for example, took a stricter view of 'non-essential' projects, allowing only those that supported critical infrastructure or related to immediate health or life safety risks to continue.

The federal government elected not to issue a shut-down order in recognition of construction and infrastructure's critical contribution to Australia's economy. Construction is the nation's third largest industry and accounted for 8% of Australia's gross value added in 2018-19 for a value of A\$32.9bn (US\$23bn) in the first quarter of 2020.2 It also employs 9% of working age Australians.3

Despite this reprieve, the pandemic has had a significant impact on major infrastructure projects, whether under construction or in operation. Contractors have been affected by restrictions on movement and supply chain disruptions, transport infrastructure has seen patronage plummet and convention centres have cancelled events or been closed to the public. The value of construction work undertaken in Australia fell during the March 2020 quarter as a result, declining by 1.9% from December 2019 to A\$50.78bn (US\$35.4bn) in seasonally-adjusted chain volume terms, a 5.7% decline from a year earlier.4

Of all the types of infrastructure, however, none has been more profoundly affected by covid-19 than airports. In this interview, Lyell Strambi, the chief executive officer of Melbourne Airport, explains how it has upended the most fundamental economic aspects of airport operations, as well as the broader impacts on Australia's transport infrastructure. He also outlines why the inherent agility of the aviation sector makes it uniquely positioned to respond to even the most overwhelming of challenges.



- 1 Record infrastructure spend the new normal, 2019 Australian Infrastructure Audit warns, Infrastructure Australia, The Australian Government. 13th August 2019
- 2 Australian System of National Accounts 2018-2019, Australian Bureau of Statistics
- 3 Australian Government Labour Market Information Portal
- 4 Construction Work Done, Australia, Preliminary, Mar 2020, The Australian Bureau of Statistics





Lyell Strambi, chief executive officer of Melbourne Airport

The Economist Intelligence Unit: How has COVID-19 impacted Melbourne Airport's operations?

Mr Strambi: "The impact has been huge. Travel, tourism and aviation were the first industries to be affected by covid-19 and they will probably be one of the last out to come out. Our passenger volumes fell off a cliff in March and traffic at Melbourne Airport remains down by 98%. We had hoped that domestic may have been higher—before the pandemic we did not understand what 'essential travel' was deemed to be. It has been defined through the crisis.

"In terms of revenue, in April we were down by 85% compared with the same period in 2019. The reason why traffic and revenue figures are different is because we have quite a diversified business, including a big property portfolio. A large amount of that is related to aviation, so that's taken a hit in its own right. We've also got fixed revenue from distribution companies, for example, and they're still performing well. We've given rent relief to some of our customers because we want them to be around after this is all over.

"Our charges are not based on the number of flights, but the number of passengers. For example, if an airline is struggling to fill a plane, we get a lot less money. At the moment we're the meat in the sandwich—we've got this big facility and all the costs associated with it, and we have to stay open because we are an essential service.

"The rationale is that historically airports have been quite prepared to take on the passenger volume risk, because even in a really bad year it is only a 5% to 10% drop. There was a lot of good in the system when things were normal—we provided long-term certainty for airlines that we'd keep the lights on and keep investing in infrastructure. And if any given airline had a lean year, or if the industry suffered an acute shock like a 9/11 or a GFC (global financial crisis), we'd be that buffer for them while they waited for demand to normalise again. Nobody envisaged this situation of almost entirely no flights."

The Economist Intelligence Unit: Are you working on any estimates about when business is expected to pick up and when operations may fully resume?

Mr Strambi: "It's guesswork, to be honest. We're being fairly conservative with our planning. We hope that domestic travel will resume to some extent through July, and that the 'trans-Tasman bubble' might start up reasonably soon thereafter. That will at least be the start of international flying, which will allow us to test some concepts about how to do it safely. This is assuming that Australia and New Zealand keep the pandemic under control, but there is a great deal of confidence in the honesty and integrity of both nations in reporting covid-19 cases.

"Beyond that, we believe that North Asia will probably be next in line because they have also done a good job of controlling the spread of the virus, admittedly with a few outbreaks here and there. Next would likely be Southeast Asia, perhaps by mid-2021, and the rest of the world by the end of next year. We are hoping for better, but we're planning around it not happening."

The Economist Intelligence Unit: How can an asset-intensive industry adapt to something that is so incredibly disruptive?

Mr Strambi: "As an industry, aviation has had a lot of training to deal with an event like covid-19—although I can honestly say that it presently feels like all those previous events rolled into one in terms of the sheer impact of it. However, aviation goes through shocks all the time. So I think as an industry we've had a lot of training that shocks do come, and we do have to adapt to those.

"I've been really proud of the way Melbourne Airport has responded to this particular challenge. As a business, our thinking has always been one step ahead of where things could go. And it was shocking how quickly it did evolve, which might explain our conservative approach. In terms of the rebound, we're

planning for the worst and then making sure we can survive that and deal with it.

"And it's been really interesting to watch our business change. In the space of just three months I think we've built levels of cultural development and agility that would previously have taken us three years. There is no choice here but to do things differently. A number of other industries where this didn't hit so quickly would probably have been in denial for a long period of time and that's the worst place to be. I would hope that agility stays with us as we go forward now and that we don't have 'set and forget' plans—we really think about how we bring variability into the business."

The Economist Intelligence Unit: How has COVID-19 affected Australia's transport infrastructure sector more broadly?

Mr Strambi: "The biggest effect in the near term will be on airport infrastructure building programs. For the past decade, Melbourne Airport's international traffic has been growing by about 8% per annum, which is phenomenal, and it's been a struggle to deliver infrastructure that can keep up. One of the first things that had to be reviewed was what was essential to finish, and determining how to slow down some investment.

"The broader transport infrastructure challenge is that it is based on a crowding model—it's about large mass movements. There are always opportunities in these things though, if you think about it. Car transport will likely be increasing, as people's views on public transport have changed. However, it will be interesting to see whether people forget about the pandemic pretty quickly and go back to their old behaviors. We just don't know yet."

The Economist Intelligence Unit: Was Melbourne Airport already well on its way to becoming contactless prior to covid-19?

Mr Strambi: "Over the years we've invested in technology that minimises contact, rather

than being 'contactless' per se. There will be further investments, but not in a knee-jerk way. We've all got to stand back and be realistic about this: a touchless world is impossible. Think about public transport—it just wouldn't work.

"We all share the goal of being safe, but we must also consider what are realistic and worthwhile investments. At what point do you actually start to waste money for something that's probably not going to deliver any benefits? That is going to be a really interesting call across many industries, including airports.

The Economist Intelligence Unit: Do you believe that covid-19 will have a more profound impact on aviation than the terrorist attacks of 9-11?

Mr Strambi: "I was in the UK after 9-11, which was one of the biggest markets hit in terms of travel confidence. We were lamenting then that demand was down by about 30%—not the 98% it is now.

"The immediate impact of these events has also been different. After 9-11, there was some protective measures put in place to help people feel comfortable travelling again. Whereas with covid-19, governments are telling people they cannot travel, and travel has stopped.

"There are other factors from covid-19 too, such as the global economic shock because we cannot go to work or move around. And there will be enduring psychological scars from this experience, which may permanently change behavior. For example, people may feel nervous about travelling to countries with weak health systems. Of course, some of these factors were present after 9-11, but not to the same extent.

"Another difference is that you can't get a vaccine for terrorism. If we can get a vaccine for covid-19, then we may not have to change very much at all in the future."

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