IATA ECONOMICS BRIEFING
AIRLINE BUSINESS CONFIDENCE INDEX
JANUARY 2009

KEY POINTS

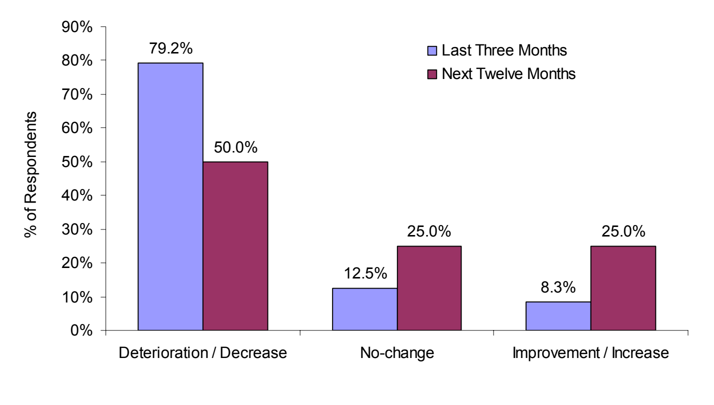
- Airline profitability remained weak as 2008 drew to a close under pressure from falling yields and volumes, according to survey respondents. The impact of financial market turmoil and resulting recessionary forces is beginning to be felt while the full effect of the rapid decline in fuel prices has yet to benefit many airlines given their hedging activity. The outlook for the next 12 months is slightly worse than that reported in the last survey with only a quarter of respondents expecting to see profits rising over the next year, whereas half anticipate a further decline. There is variation in outlook across the regions with Asia the most negative and the Middle East still expecting an improvement in profitability on balance.
- Expectations for growth in traffic volumes continued to deteriorate sharply. Recession-led demand weakness drove the volume declines experienced by half the respondents to the end of 2008, while only a quarter expect passenger demand growth in 2009. Cargo volumes continued to be weak and almost 70 percent of respondents expect a similar trend this year. Expectations on input cost increases have moderated in line with fuel price decreases, but an overwhelming majority also expect corresponding yield decreases going forward.
- Employment levels within the industry are reported to have remained on the increase through the end of 2008 but are set to stabilise or fall slightly as further recession impacts are felt this year.

PROFITABILITY OUTLOOK

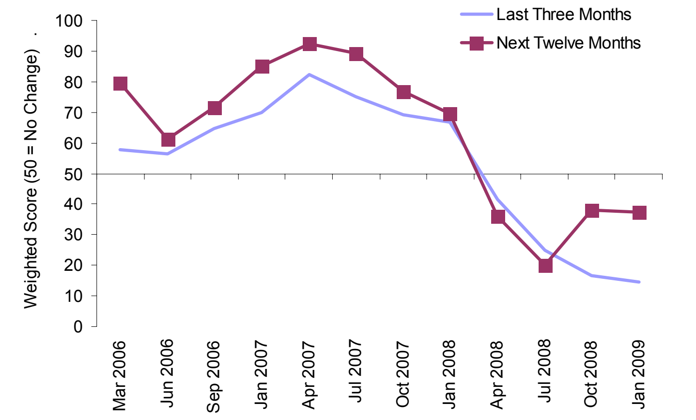
- At the end of 2008 airline expectations for profitability over the next 12 months remained in negative territory making this the fourth successive quarter of such results. The latest responses reflect the delayed benefits of falling spot market fuel costs due to fuel hedging and the significant drop off in demand seen in recent months. Almost 80 percent of respondents reported that profitability had fallen in the three months to the end of 2008. Less than 10 percent saw an increase in profitability. Losses on fuel hedging and softening demand are cited as the main causes of the decline in profitability. On a weighted average basis (with 50 representing no-change, and values below 50 signalling a greater balance of negative views), the score for profitability over the previous three months has fallen from a peak of 82.5 in April 2007 to a new low of 14.6 at the end of 2008.

How has profitability changed? How do you expect it to change over the next twelve months?

a) January 2009 survey



b) Compared to previous surveys



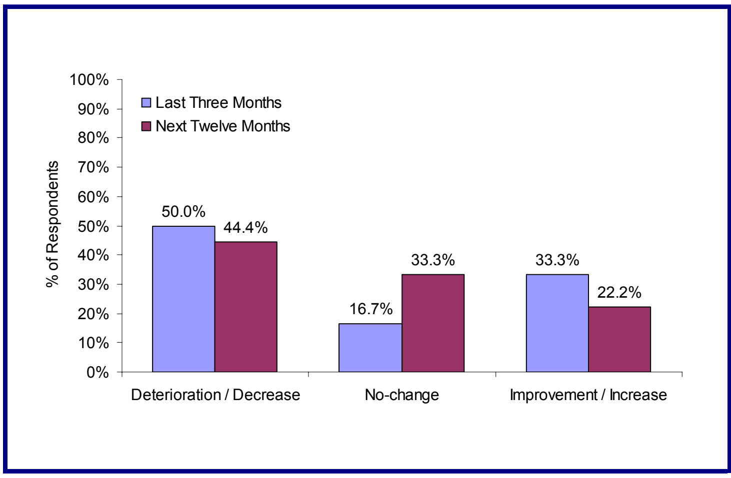
- Airline confidence for the coming 12 months is still weak and has declined slightly since the last survey which was conducted just before the unprecedented turmoil in financial markets in the final quarter of 2008. Half the respondents to the latest survey expect profitability to decrease in the next 12 months while only a quarter expect it to improve. Recession-led demand declines and delayed benefits of fuel price decreases due to hedging losses remain concerns for most respondents. Load factors are also coming under pressure which is not good news for the profits in the period ahead. Airlines in Asia express the most bearish outlook with 80 percent of respondents seeing decrease in profitability over the next 12 months. Around half the respondents from Europe and the Americas concur with this view. Middle Eastern respondents express a more positive outlook with two-thirds expecting improvement in profitability. Globally, on a weighted average basis, the outlook for profitability over the next 12 months is 37.5, well below the 92.5 seen in April 2007.

DEMAND GROWTH

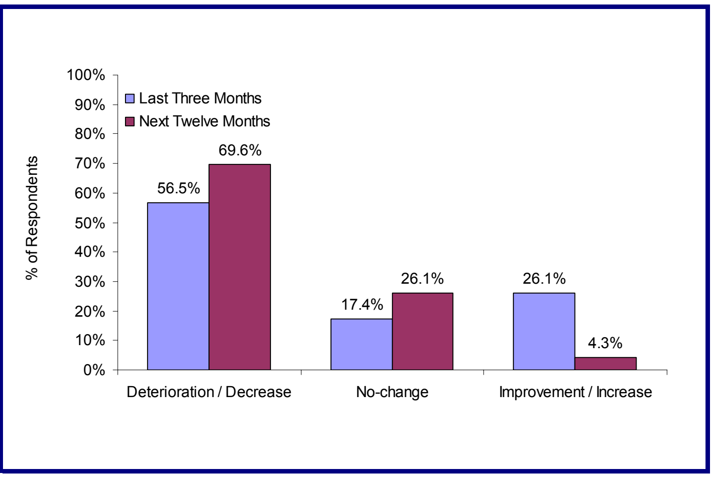
- The picture for passenger demand volumes has deteriorated dramatically since the last survey with a large increase in respondents reporting negative trends in current and future demand. Half the survey respondents now report passenger volume decreases over the last three months – a stark contrast to the 75 percent reporting increases in the previous survey. Economic recession is quoted by many respondents as being a key driver of this change in the demand pattern. Looking forward, almost half the respondents now expect to see lower passenger volumes in the next 12 months with less than a quarter expecting an increase. On a weighted average basis, the outlook for passenger demand for the 12 months ahead is 38.9 – the first time this indicator has slipped below the 50 'no change' line since the first survey was conducted in 2006.
- Air cargo demand has continued its rapid slide as manufacturing activity and trade flows slow. A majority of respondents now say that cargo volumes have decreased over the last three months and only a quarter indicate an increase during that period. Looking forward, the proportion of responses expecting further falls in cargo demand has reached 70%. This is by far the most pessimistic outlook for cargo demand recorded since the survey began. Asian airlines continue to experience the most difficult cargo market conditions with all respondents from the region reporting both declines in the last three months and for future expectations.

The actual and expected change in traffic volumes

a) Passenger



b) Cargo



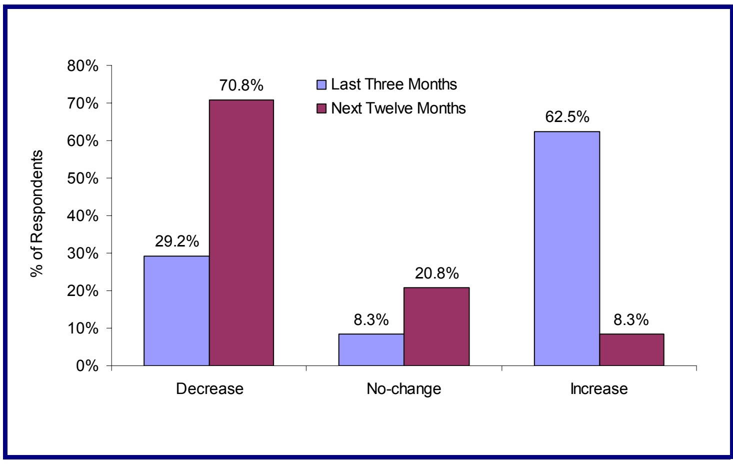
INPUT COSTS

- While jet fuel prices ended the year at roughly a third of their the record highs of over $180 per barrel in July 2008, many airlines have yet to see the full benefit of this price decrease due to having previously entered fuel supply contracts above what is now a lower spot price. Thus 62.5% of respondents still reported higher input costs for the closing months of last year, although this is down significantly from the 81% last survey. On a weighted average basis, the score of 66.7 for unit input cost increases during the quarter shows that costs are moderating, although there is still some way to go before we see levels like the 52.5 reported in April 2007. Some respondents claim that general inflation in areas other than fuel has pushed costs higher over the quarter while others have successfully implemented cost containment and network restructuring initiatives. US dollar appreciation over this period would have also contributed to cost increases for some airlines.

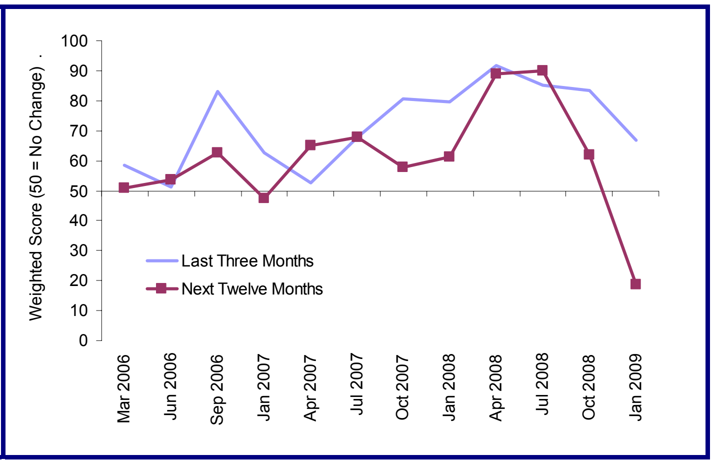
- Expectations over the next 12 months are for significant input cost reductions with more than 70% of respondents expecting relief (up from just 5% in the middle of 2008) while a further 20% expect no significant changes up or down. On a weighted average basis, the score for the outlook in unit input costs has fallen well into negative territory at 18.8 (compared to 61.9 last quarter). Further cost reduction or containment initiatives feature in many respondent plans and this along with the full benefit of fuel price reductions is driving improvement in the input cost outlook.

How have your unit input costs changed? How do you expect them to change over the next twelve months?

a) January 2009 survey



b) Compared to previous surveys

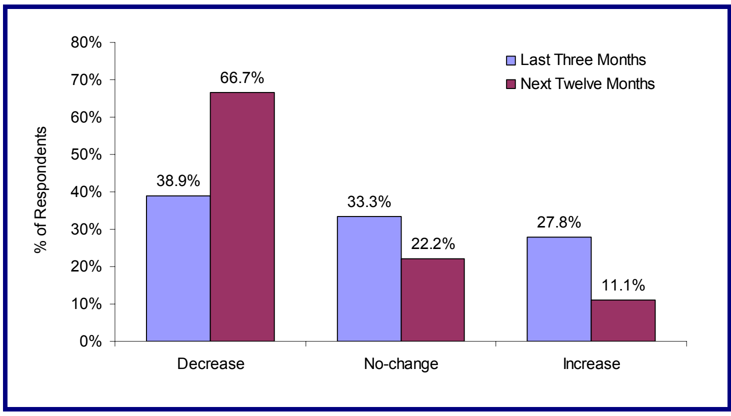


YIELD ENVIRONMENT

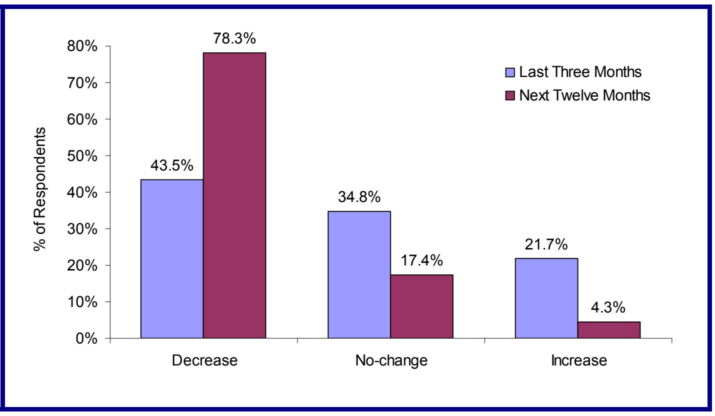
- A combination of factors including falling fuel prices, weakening demand and marketing efforts to hold yields steady has led to a wide range of reported yield impacts in the last three months, although it is very clear that the prospect of any yield increases in the 12 months ahead has weakened sharply. For the passenger business over the last three months, a third of respondents experienced steady yields (some as a result of explicit strategy to hold yields constant) while slightly more (38.9%) had reduced yields driven by falling demand and lower fuel surcharges. This is in stark contrast to the 71.4% of respondents reporting increased yields in Q3 as part of the higher fuel cost was passed on to passengers. The outlook for the next 12 months has weakened significantly with now two thirds holding the view that yields will decrease. This reflects the further reduction in fuel surcharges in the months ahead as well as the deterioration in global economic prospects affecting demand and the likelihood of overcapacity placing further pressures on unit revenues.
- Similar trends are evident in the cargo business with 43.5% of respondents (double the rate of last survey) reporting that cargo yield decreases were recorded over the last three months on the back of weakening demand for air cargo and falling fuel prices. The outlook for cargo yields over the next 12 months is also bleak with almost 80 percent of respondents expecting further declines over that period.

The actual and expected change in yields

a) Passenger



b) Cargo

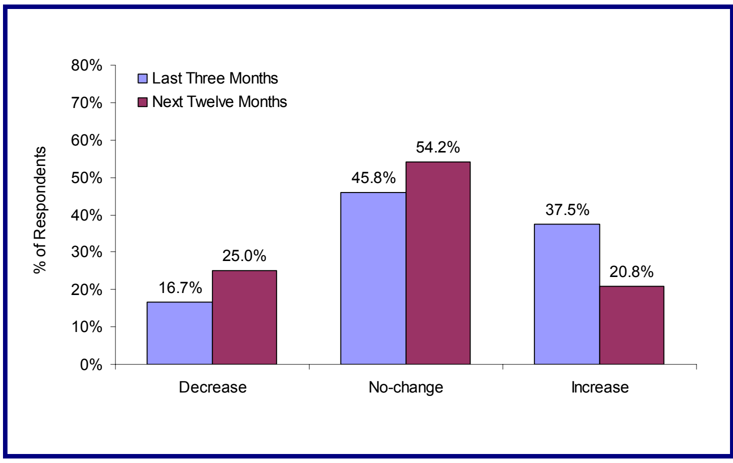


EMPLOYMENT

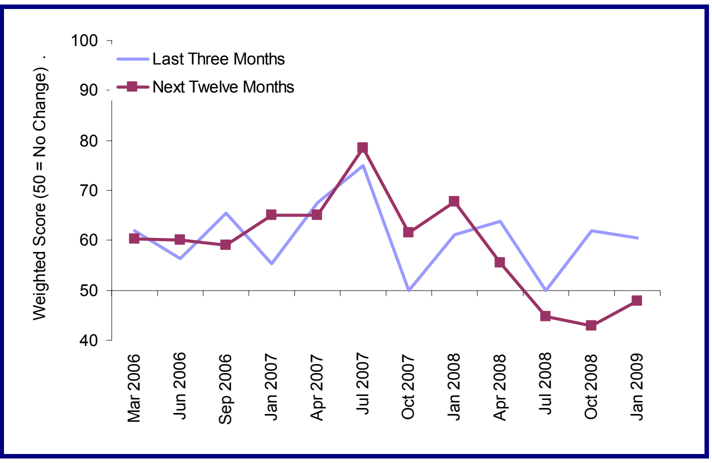
- While still seeking labour productivity increases, many respondents through to the end of 2008 still report increases in employment levels driven by new aircraft deliveries and route/schedule extensions. The pattern of responses to this survey are similar to those in October with slightly less than half keeping staffing levels constant, 37.5% increasing and only 16.7% reducing headcount. Some respondents indicate that in the short term they are reducing staff working hours before looking to reduce overall numbers. Until very recently the industry faced shortages of skilled labour so the absence of a sharp drop off in employment levels to date may reflect a cautious approach by airlines looking to retain skills rather than an absence of the cost pressures normally associated with headcount reduction. On a weighted average basis, the score of 60.4 for the change in employment over the previous three months is a small decrease on last quarter (61.9) but still well below its peak of 75.0 in July 2007.
- The outlook for employment levels continues in the negative territory entered in Q2 of 2008 but latest results show something of a convergence on a steady state. More than 50% of respondents indicate that they aim to keep employment levels constant in the 12 months ahead while only 25% expect to decrease headcount (compared to a third in the previous survey). On a weighted average basis, the outlook for employment remains well below the 78.6 in July 2007 at 47.9 for the end of 2008. The heavy pressure on yields and steep falls in volumes reported elsewhere in the survey may well depress this indicator as 2009 unfolds.

How has your employment level changed? How do you expect it to change over the next twelve months?

a) January 2009 survey



b) Compared to previous surveys



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E-Mail: economics@iata.org