IATA ECONOMICS BRIEFING
AIRLINE BUSINESS CONFIDENCE INDEX
JULY 2009

KEY POINTS

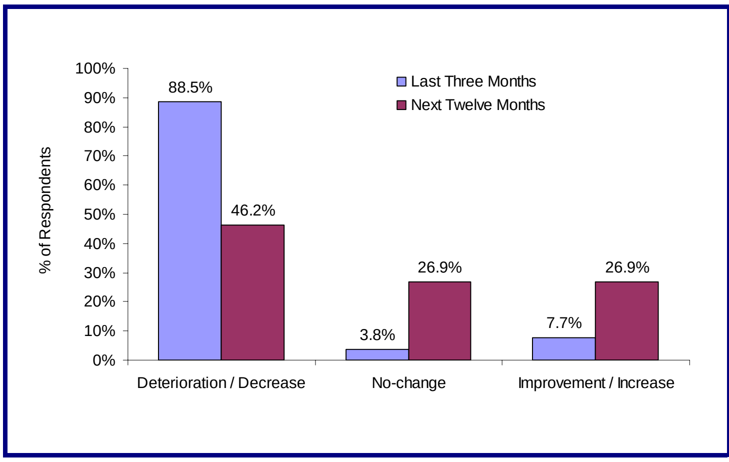
- Airlines continue to report losses during the period through mid-2009 and do not expect conditions to improve until year end, at the earliest. The deep recession has maintained downward pressure on traffic volumes and yields, according to survey respondents. Efforts to resize capacity to better match demand and cut costs have helped but have trailed behind the fall in traffic. The expectations reported for the next 12 months have dipped into pessimism once more. Uncertainty around the timing of recovery and the likely level of fuel prices compound the challenges facing airlines. There is variation in outlook across the regions with Asia on balance now more optimistic than the mood in other parts of the world.
- Both passenger and cargo traffic volumes continued to fall over the last three months, however expectations for the year ahead are for more stability from now on. Expectations for yields remain weak on both the passenger and cargo sides of the business and while input costs continue to fall, the expectation forward is now for rises in the year ahead.
- The bulk of respondents report falls in employment levels and expect this to continue in the 12 months ahead.

PROFITABILITY OUTLOOK

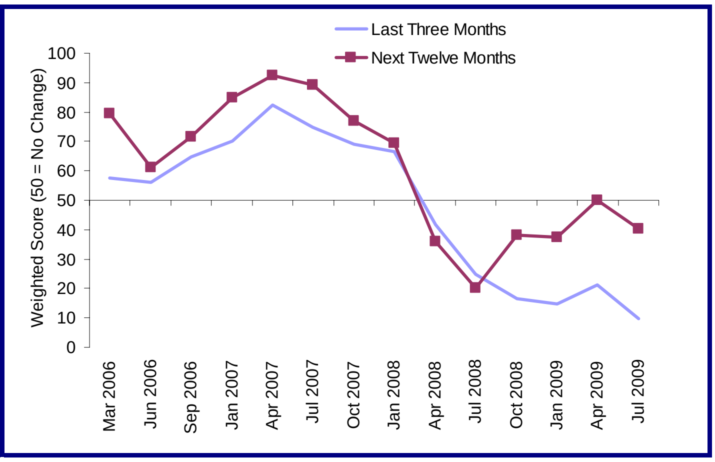
- The environment for airline profitability remained extremely challenging up to mid-2009, and there is renewed pessimism about the outlook ahead. The latest responses reflect the continuing deep economic recession during the second quarter and corresponding traffic and yield weakness. Benefits from lower fuel costs have been outweighed by these and other factors such as passengers trading down to lower priced seats. Following on from estimated industry losses of more than US$3 billion in Q1, over 88 percent of respondents reported that profitability had again fallen over the most recent three month period. 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 is 9.6, still well in negative territory, indicating losses. This is a record low, and emphasises the global scope of the current airline industry downturn.

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

a) July 2009 survey



b) Compared to previous surveys



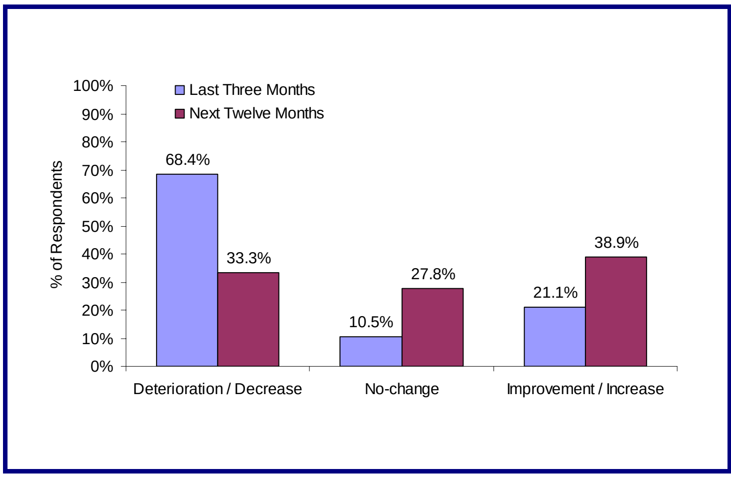
- The glimmer of optimism about financial performance for the coming 12 months seen in April's survey has faded as respondents, on balance, indicate further declines in profitability ahead. The timing of recovery and the longer term level of fuel prices are the main uncertainties affecting the outlook. Even the optimistic respondents don't see significant recovery before Q4 this year and others not until early 2011. While fuel prices are expected to rise as economic growth picks up, the likely level is a matter of considerable debate. In light of the extreme pressure on yields seen over the last three months one could add excess capacity to this list of concerns. In contrast to previous surveys, airlines in Asia on balance expect stabilisation of profitability while European carriers along with those in the Americas are more pessimistic with the balance expecting decreases in profitability. Globally, on a weighted average basis, the outlook for profitability over the next 12 months has dropped below the 50 'no change' line again at 40.4.

DEMAND GROWTH

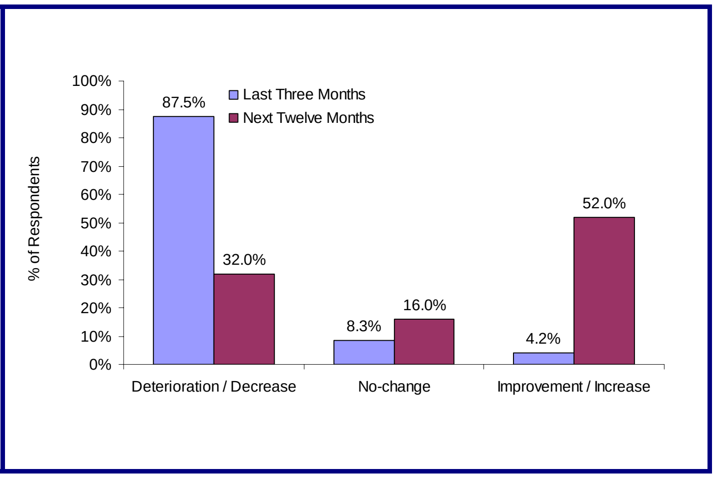
- The picture for passenger demand volumes continued to deteriorate during the last quarter. Over 68% of respondents reported negative trends in demand. Only just over one fifth reported improvement, down from a quarter last survey. Recession remains the main driver of these results as businesses cut travel budgets and leisure travellers make alternative plans, although the effects of Influenza A(H1N1) were also mentioned by a number of respondents. With international traffic down 9.3% in May, there is little to indicate that a sustained recovery is imminent. A third of respondents expect demand over the next 12 months to fall further (up from a quarter last survey) while just under 40% expect an improvement. The net effect is that, on a weighted average basis, the outlook for passenger demand for the 12 months ahead is 52.8 – just above the '50'no change line.
- Air cargo demand continued to suffer during the last quarter with the majority of respondents reporting decreased cargo volumes over the last three months. Recent traffic results indicate that a floor may have been reached during the first half of the year with international FTKs bottoming out at around -20%. Looking forward, the proportion of negative responses moderated further to just under one-third, and now more than half now expect increase in demand over the 12 months ahead. Airlines in Asia, with a heavy exposure to the cargo market, now expect improvement in demand with 86% of respondents from that region in the affirmative.

The actual and expected change in traffic volumes

a) Passenger



b) Cargo



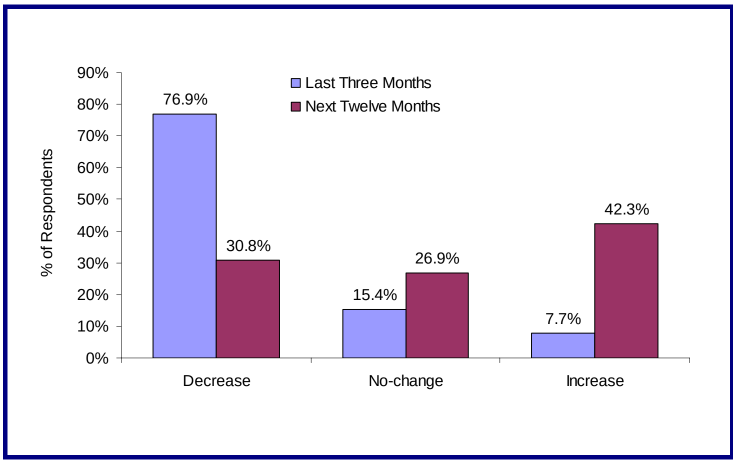
INPUT COSTS

- Costs continued to fall for over three-quarters of respondents during the last three months. While oil is already over 50% more expensive than the low point at the end of 2008 it is still well below the peaks seen 12 months ago. Fuel prices are significantly below their record levels and this has now fed through to the bottom line for most airlines as previous hedges have come off. Many have also realised cost savings associated with capacity reductions or route restructuring. Some respondents report success with labour contract renegotiations and in revised agreements with suppliers. On a weighted average basis, the score of 15.4 for the input cost trend is the lowest seen since the survey began.

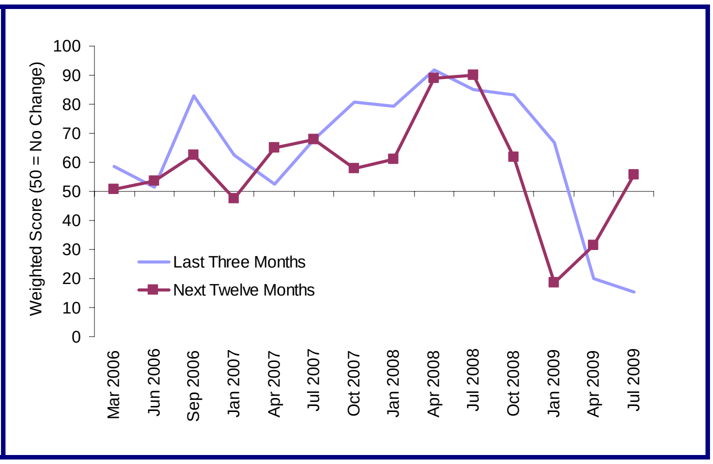
- Expectations for the next 12 months have now shifted back to input cost increases over that period, with 42% of respondents (four times the number from last survey) expecting upward pressure. As such, on a weighted average basis, the score for the outlook in unit input costs has moved above 50 again to 55.8 (compared to 31.6 last quarter). The mixed blessing of potential economic recovery is seen here – recovery may well be good for traffic growth down the line but ahead of that fuel prices are likely to rise on expectation of increased energy demand as economic activity accelerates.

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

a) July 2009 survey



b) Compared to previous surveys

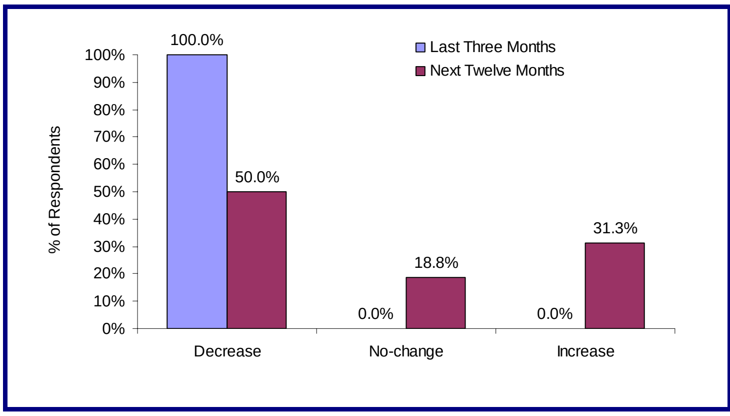


YIELD ENVIRONMENT

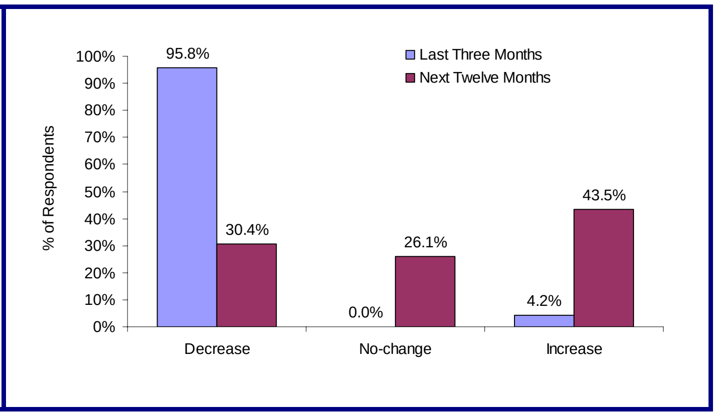
- Respondents were unanimous in reporting declines in yield performance for the passenger business during the last three months and the outlook for the year ahead remains pessimistic. A combination of factors including lowering of fuel surcharges, Influenza A(H1N1) and passengers trading down from premium to economy seats contribute to the decreases in passenger yields over the last three months, however the overriding concern for many is the effect of excess capacity. Airlines have struggled to cut capacity in line with falls in demand; indeed capacity cuts have come at about half the rate of the declining traffic trend. This has put severe pressure on yields as airlines seek to preserve cashflow by cutting fares to fill seats. The expectations of respondents for the next 12 months remain in negative territory with still half expecting further yield declines versus 31% seeing an improvement in performance.
- Cargo yields also suffered heavily over the last three months with more that 95 percent of respondents reporting decreases. As on the passenger side, freight demand has fallen much more rapidly than the reduction in available capacity, putting pressure on yields. The outlook for the next 12 months is for more yield stability which may again see the cargo side of the business lead the upturn – when it arrives.

The actual and expected change in yields

a) Passenger



b) Cargo

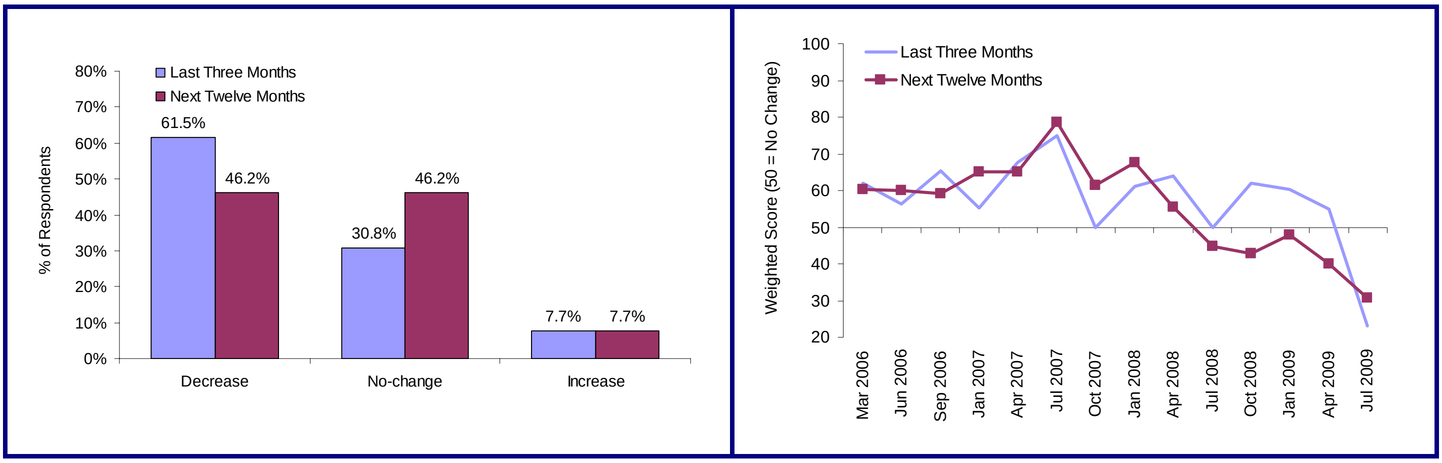


EMPLOYMENT

- There has been a significant shift in employment trends over the latest quarter as more than 60% of respondents reported reduction in employment levels during that period – twice the number reporting this action in the April survey. This has pushed the weighted average employment indicator into negative territory for the first time at 23.1. Many airlines have frozen recruitment leading to headcount reduction from normal staff turnover. Capacity cutbacks have also driven a fall in employment. This latest result had been foreshadowed for the last several surveys in which respondents reported 12-month expectations of a decrease in employment levels.
- The outlook for employment in the year ahead reported this survey continues to fall, reaching a new low of 30.8 on a weighted average basis. Equal numbers of respondents (46%) expect to decrease or hold employment levels steady while less than 8% expect to take on more staff. Last survey there were still 20% of respondents expecting to expand their workforce.
- Airlines are often reluctant to cut employment, especially when it means losing expertise which in recent years has been in short supply. Agreements with unions can also make staff cuts more difficult to implement. The fact that airlines are now reducing staff underlines the severity of the challenges they are facing in the current economic climate. The broader results of this survey indicate that airline managements see a continued period of difficulty ahead before any significant turnaround. Constructive relations between management and labour will be crucial over the coming months if the industry is to ride through this storm and position itself well for brighter times ahead.

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

a) July 2009 survey **b) Compared to previous surveys**



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