

IATA ECONOMICS BRIEFING

AIRLINE BUSINESS CONFIDENCE INDEX

JANUARY 2010 SURVEY

KEY POINTS

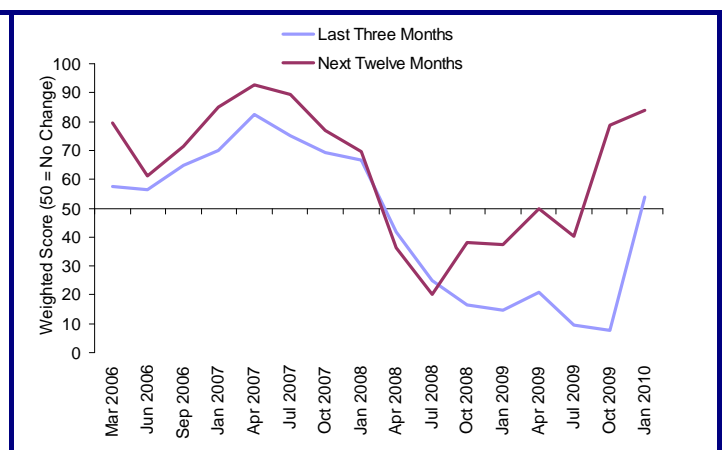
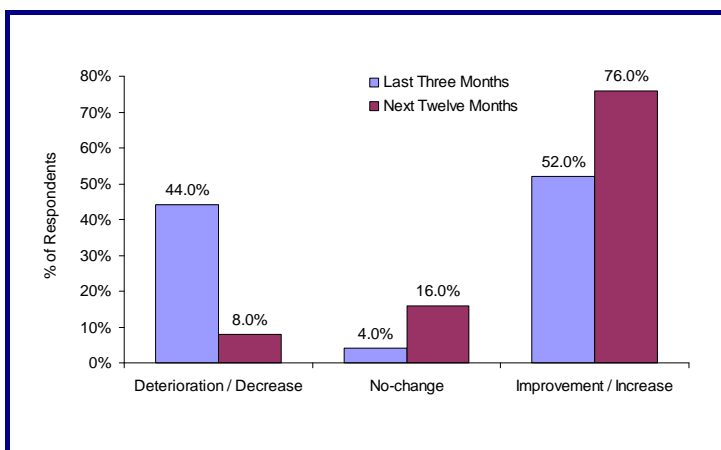
- There was a significant improvement in all the indicators of airline business confidence, measured by IATA's quarterly survey, this January. A divergence was evident between more positive Asian airlines and more pessimism among European airlines but, for the first time since January 2008, a majority said profitability had improved in the previous quarter (2009Q4). 76% expect profitability to improve over the next 12 months. This measures the direction of change not levels so these results are showing that airlines expect a significant narrowing of losses in 2010, but not necessarily a return to profit. IATA's own forecast predicts that airline net losses will halve from US\$11 billion in 2009 to \$5.6 billion in 2010.
- There was a particularly sharp improvement in both cargo and passenger demand during the previous quarter, with the majority of airlines switching from reporting declining demand to rising demand. Expectations for improvements in demand over 2010 have risen back to levels last seen in 2007, with over 82% of airlines expecting further gains in passenger demand and 72% expecting improved cargo demand.
- Of course stronger demand does not always lead to profits, or reduced losses. While airlines reported that unit costs remained relatively low in the previous quarter, a net balance of airlines are now expecting cost pressures to intensify over the next 12 months. However, there is more optimism over yields suggesting that an improvement in margins is expected. There was still a majority of airlines reporting lower yields in the previous quarter. But this was significantly smaller than in October and expectations for the next 12 months are at a high.
- Jobs were still being cut in 2009Q4, as airlines sought to reduce costs but, for the first time since April 2008, a majority of airlines are now expecting to increase or hold employment steady over the next 12 months.
- The results of this quarter's survey mark a sharp improvement in the business environment for airlines. But it should be noted that this is an improvement from a very weak base, so although airlines expect the pace of improvement to be as strong as in 2007, it will still take many quarters before demand, yields and revenues recover to levels seen early in 2008, let alone catching up with the 2-3 years of growth lost due to the recession.

PROFITABILITY OUTLOOK

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

a) January 2010 survey

b) Compared to previous surveys



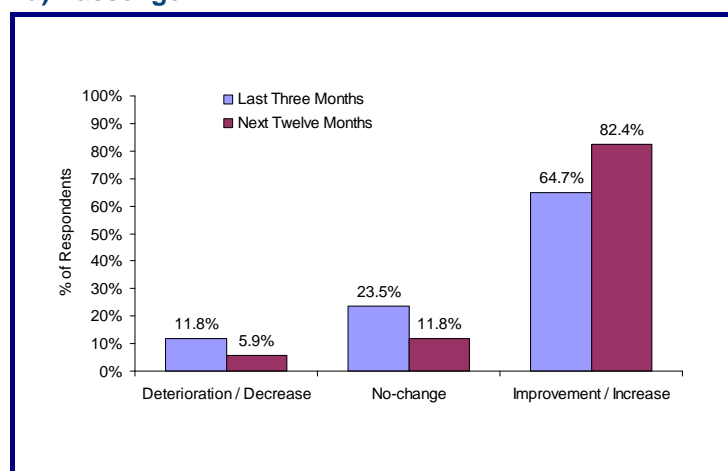
- Airlines, on balance, report improved profitability conditions during the last quarter of 2009 and remain optimistic of further improvement over the year ahead. The rolling off of fuel hedging positions combined with noticeable traffic recovery – particularly in cargo – and rising load factors drove better bottom line performance. Whilst the tail end of the economic recession was still being felt, 52% of respondents reported improved profitability. This is in sharp contrast to the 92% who were still experiencing declines in profitability in the October survey. On a weighted average basis (with 50 representing no-change, and values above 50 signalling a greater balance of positive views), the score for profitability over the previous three months is 54.0. This is the first indication of improving profitability since January 2008.
- Within this overall picture there is significant regional variation. Three-quarters of European airline respondents and 60% of those in the Americas reported further decline in profitability, reflecting the relatively weak economic recovery in these regions. More than three-quarters of respondents from Asia reported improvement, several citing strong traffic recovery within the region.
- An increased majority of respondents now expect profitability to improve over the 12 months ahead. While regional variation remains (Asia the most positive, Europe less so) the balance of responses within all regions point to further improvement. Most indicate that the ‘worst is over’ and that continued recovery in traffic and yields will drive profitability in the right direction. However, several mention that this improvement comes over a low base which may indicate it could take some time for airlines to shift from losses into profits in absolute terms. Concerns remain over increases in fuel prices, cost implications of regulatory changes, and rising airport charges which may temper recovery in profits.

DEMAND GROWTH

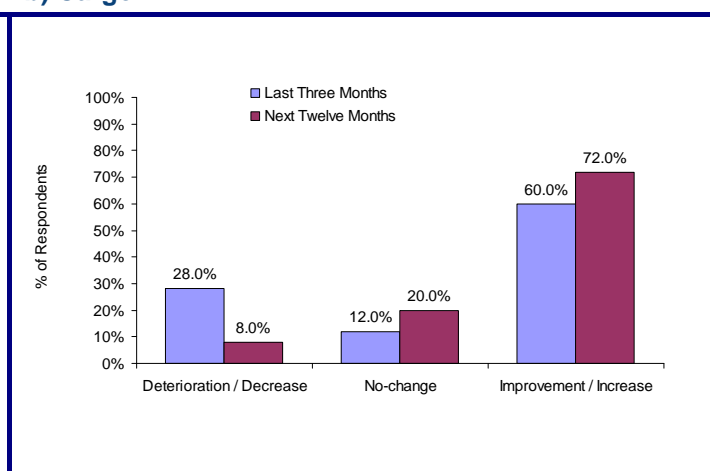
- For the first time in over a year the balance of respondents now report improving traffic volumes on both the passenger and cargo sides of the business during the most recent quarter. Almost two-thirds of respondents report improved passenger volumes over the last three months – twice the proportion from October’s survey. This is consistent with the upturn seen in international passenger kilometer data at the end of 2009. Having said that, four-fifths of European airline respondents recorded traffic falls or ‘no change’ – a further reminder of the uneven recovery around the globe. The outlook for passenger traffic over the 12 months ahead continues to strengthen with over 80% now expecting increases over that period. Respondents point to improving economic outlook as the key driver of further recovery in traffic, although mention is also made of the challenge which may be posed by the ‘low’ season early in 2010. On a weighted average basis, the outlook for passenger demand for the 12 months ahead is 88.2 – back to levels last seen in early 2008.

Recent and expected change in traffic volumes

a) Passenger



b) Cargo

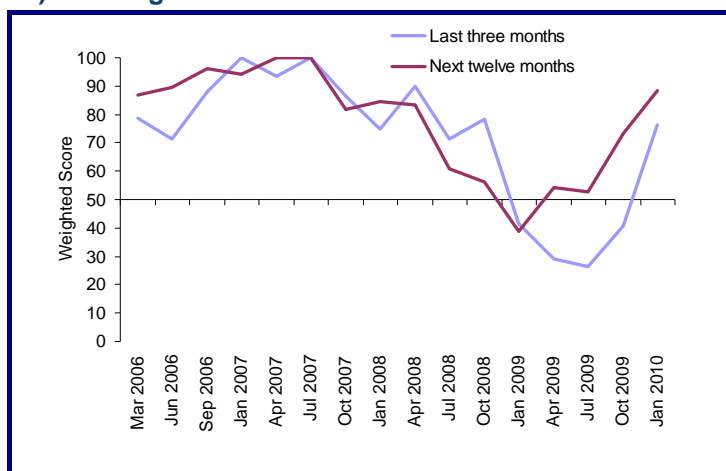


- Fortunes in the air cargo market appear to have improved dramatically since last survey with now 60% of respondents experiencing increased traffic volumes in the last quarter. In October 87% were still reporting falls. This improvement is consistent with the re-stocking activity normally associated with the early stages of

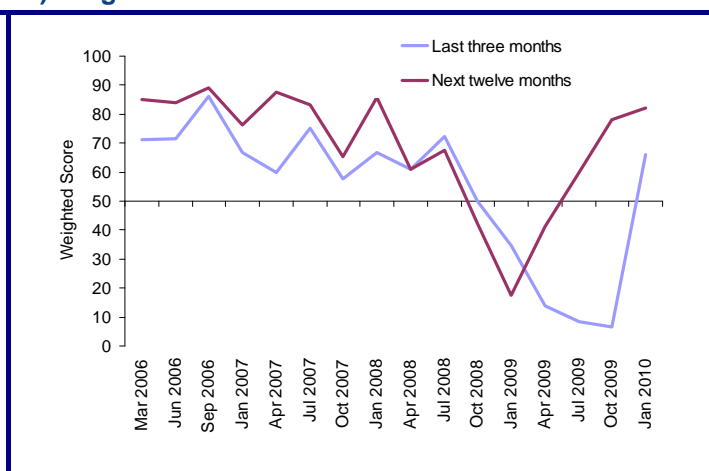
economic recovery and international freight tonne kilometer data to end 2009 shows that levels have risen more than 24% above their lows.

Compared to previous surveys

a) Passenger



b) Cargo



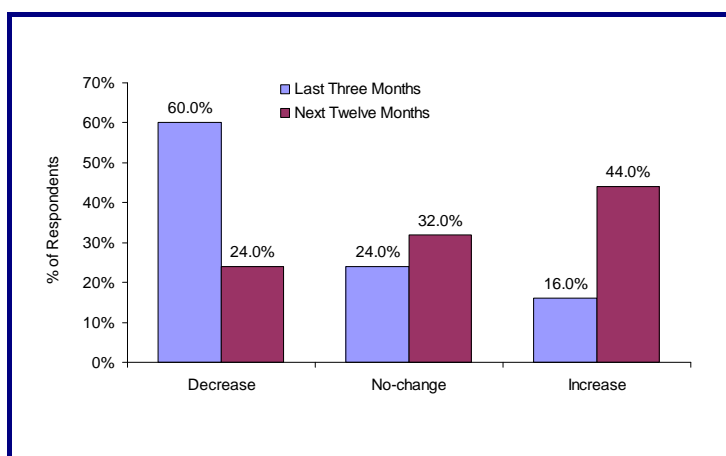
There is still some way to go before cargo traffic returns to levels seen in early 2008, however over 70% of respondents are optimistic about further progress in that direction over the year ahead – a similar proportion to last survey. Less than 10% expect a decline over this period meaning that, on a weighted average basis, respondents have become slightly more optimistic overall with a score of 82.0 – approaching the highs of late 2007 / early 2008. Purchasing manager index data show that buying intentions reached a 44-month high in December which would support further gains in air freight volumes in the months ahead.

INPUT COSTS

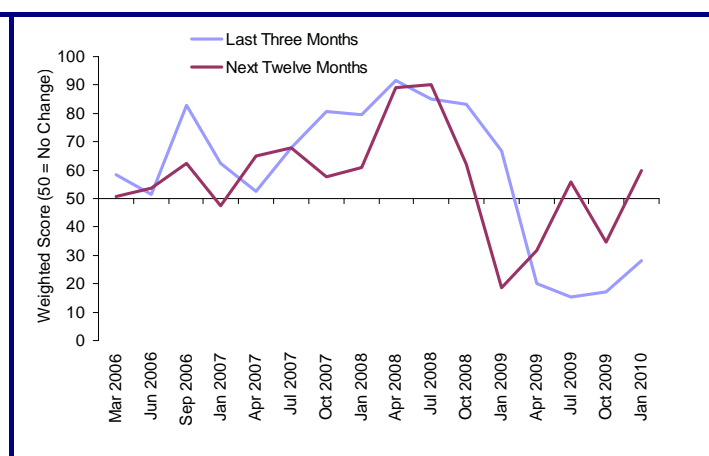
Costs continued to fall for the majority of respondents during the last three months. However almost a quarter reported 'no change'. Many are still benefiting from lower fuel costs and operational cost cutting measures. However factors such as lower aircraft utilization and upward pressure on infrastructure charges are cited as dampening the continued downward trend. On a weighted average basis, the score of 28.0 still indicates overall cost declines but the recent trend looks to have now turned up and is pointing back towards the 50 'no change' mark.

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

a) January 2010 survey



b) Compared to previous surveys



The consensus on the direction for costs over the year ahead has climbed to 60, indicating increases. This indicator has alternated above and below the 50 'no change' mark over the last four surveys reflecting the extent of uncertainty about the profile of costs during the next growth cycle. The persistent concern over rising fuel

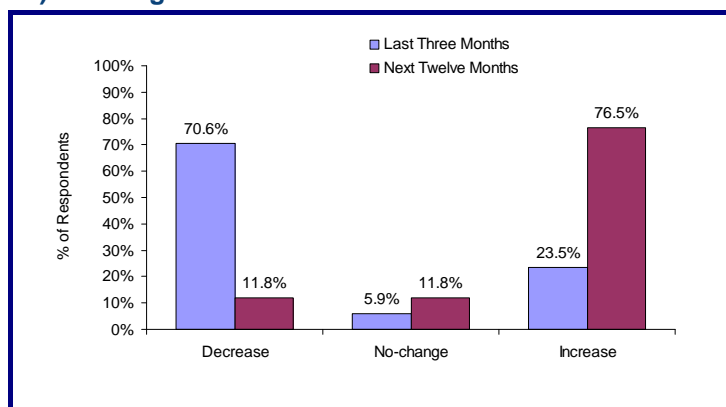
prices continues to shape the cost outlook but higher airport & ANSP charges, maintenance costs and potential tightening of labor markets are added to the list. Controlling and reducing costs will be crucial if the industry is to minimize losses in the current revenue environment.

YIELD ENVIRONMENT

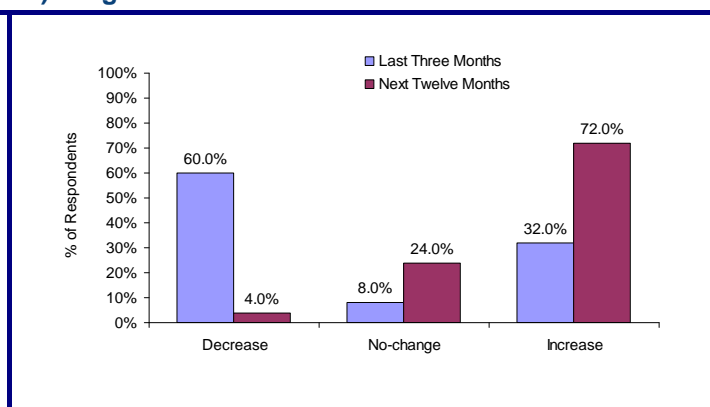
- The majority of respondents continued to experience falls in passenger yields during the last quarter of 2009, compared with levels a year earlier. European airlines in particular appear to be still facing extremely difficult conditions with 80% of respondents from the region still reporting yield falls. In contrast to last survey, however, some airlines are beginning to experience improved yield performance – as indicated by almost one quarter of respondents. Lowering of fuel surcharges is the most often cited rationale for yield decreases. Weak demand is still part of the equation, although several respondents cite higher load factors as helping drive yield improvements where they have been seen so far. Passenger yields may well have turned the corner but further significant improvement will be needed before more normal yield levels are regained.
- The outlook for passenger yields for the year ahead has improved with over three-quarters of respondents indicating that yields should increase. On a weighted average basis, the score for the outlook in yields has moved up to 82.4 – a new high. Further demand recovery combined with capacity restraint could lend support to this pattern of improvement over the year ahead. The risk remains of excess capacity re-entering the market once more and muting yield recovery.

Recent and expected change in yields

a) Passenger

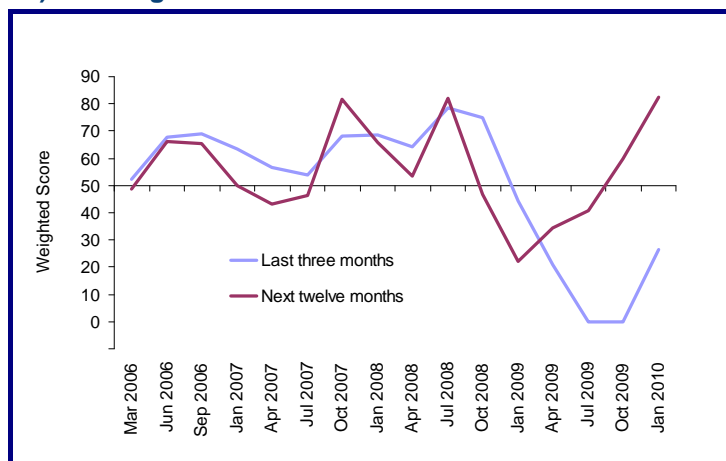


b) Cargo

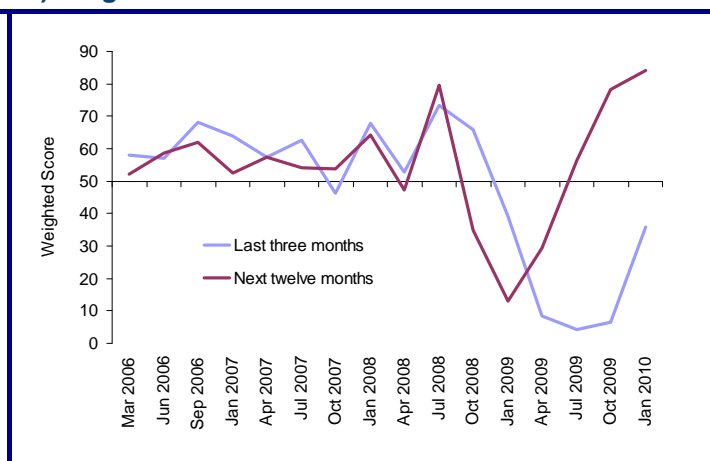


Compared to previous surveys

a) Passenger



b) Cargo



- Cargo yields followed a similar pattern to passenger over the last three months – a majority of respondents still report falls relative to a year ago. However almost one third now report yield increases on the back of

recovering demand and higher freight load factors. Asian airlines – with greater exposure to cargo markets and benefiting from relatively stronger regional economic recovery – report better than average performance with just over half of the respondents from the region reporting cargo yield increases. Expectations for cargo yield improvement over the 12 months ahead reached a new high of 84.0 on a weighted average basis. Freight load factors have risen back to pre-recession levels and, if maintained, this should provide the market conditions for some improvement in yields during the year ahead.

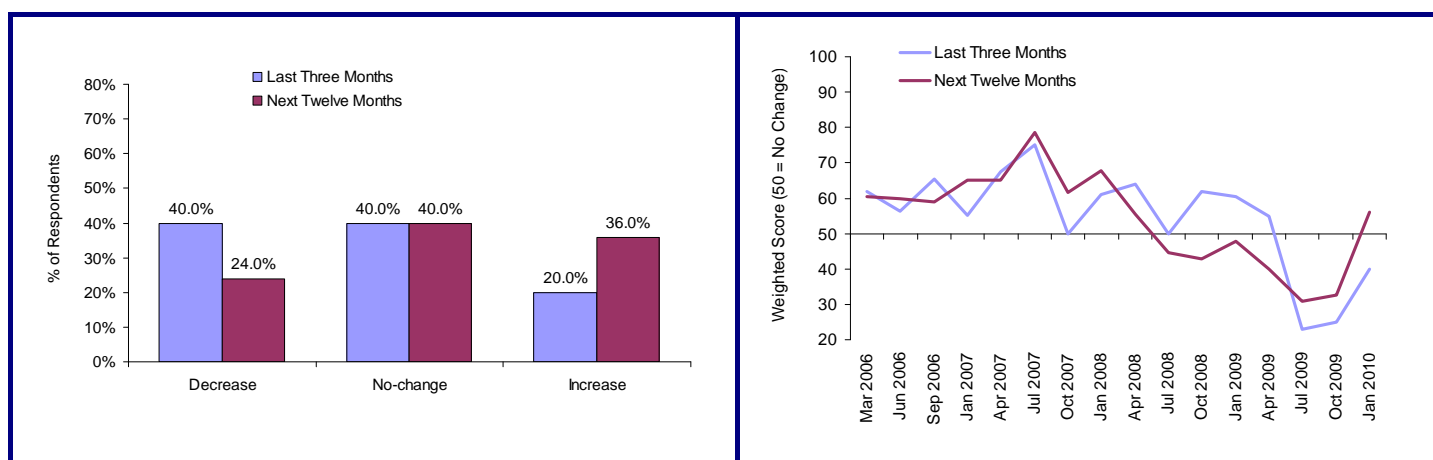
EMPLOYMENT

- The employment situation in the industry may be stabilizing somewhat after several quarters of retrenchment. The balance of responses still indicates that airlines reduced employment levels during the last quarter, however the proportion reporting ‘no change’ has increased to 40%. Some airlines are still cutting headcount in line with network restructuring and cost cutting but others indicate that recruitment or salary freezes are being used to hold employment levels steady.
- Looking ahead over the next 12 months, more respondents now indicate that employment level increases are likely than those foreseeing further cuts. However the more common outlook is for stability. With a weighted average 56.0 the score for change in employment levels over the year ahead has risen above the 50 ‘no change’ line for the first time since April 2008. Time will tell whether this expectation strengthens further as 2010 unfolds. However employment typically lags behind in the recovery cycle – and with several respondents indicating they expect to hold employment levels constant and seek productivity improvements – renewed expansion of airline employment may still be a way off.

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

a) January 2010 survey

b) Compared to previous surveys



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FURTHER ANALYSIS AND DATA

Access video commentary and chart data related to this briefing through the Enhanced Edition: www.iata.org/business-confidence