IATA ECONOMICS BRIEFING
AIRLINE BUSINESS CONFIDENCE INDEX
JANUARY 2008

KEY POINTS

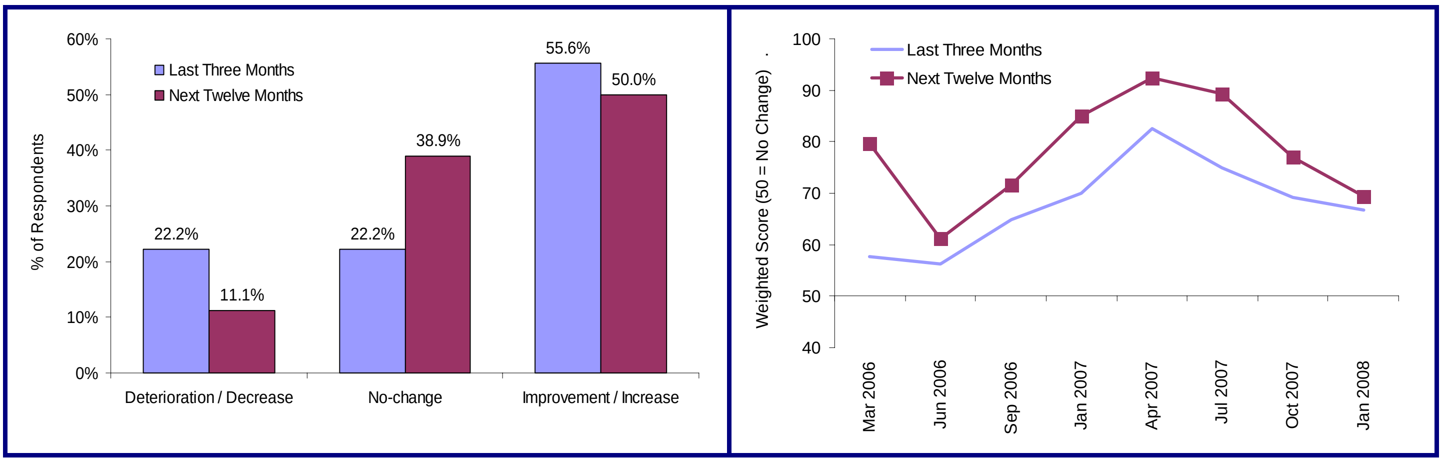
- Airline business confidence has weakened in Q4 2007, but still remains positive overall. Over 55% of respondents saw an improvement in underlying profitability in Q4, with half expecting a further increase in 2008. But there is a clear recognition that challenges for the next 12 months have increased. High fuel prices, economic uncertainty and a pick-up in new aircraft deliveries have contributed to a more cautious airline outlook.
- The rate of improvement in profitability – if not yet the actual level – is likely to have peaked in 2007. Underlying demand-side factors (such as strong GDP growth in developing economies) are still relatively positive, but are set to provide less of a boost in 2008. With fuel prices set to remain relatively high in 2008 and cost pressures emerging in other areas (e.g. labour), further improvements in productivity and efficiency are necessary to maintain profitability levels (for more details see IATA's December 2007 Financial Forecast).
- Revenue management techniques and better product mixes have helped to boost yields while, in some cases, exchange rate movements have provided a positive effect. Over 62% of respondents saw higher passenger yields in Q4, for example through higher fuel surcharges, while over 56% expect to push for further increases in the next 12 months. Nevertheless, many respondents cite a risk of pricing power may weaken, especially if demand growth slows while the rate of new aircraft deliveries increases.

PROFITABILITY OUTLOOK

- Airline profitability increased in 2007, though the rate of increase weakened in the second half of the year. Over 55% of respondents expected profitability to have increased in Q4 2007, though 22% expected no change and a similar proportion expected a fall. Revenue increases and strong growth in developing markets were cited as key factors driving improvements, but the high fuel prices and maturing levels of growth on some routes were highlighted as offsetting factors. As such, the rate of improvement in profitability – if not yet the actual level – is likely to have peaked in 2007. On a weighted average basis (with 50 representing no-change, and higher values signalling a greater balance of positive views), the score for profitability over the previous three months has fallen from a peak of 82.5 in April 2007 (i.e. for Q1 2007) to 66.7 in January 2008 (i.e. for Q4 2007).

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

a) January 2008 survey **b) Compared to previous surveys**



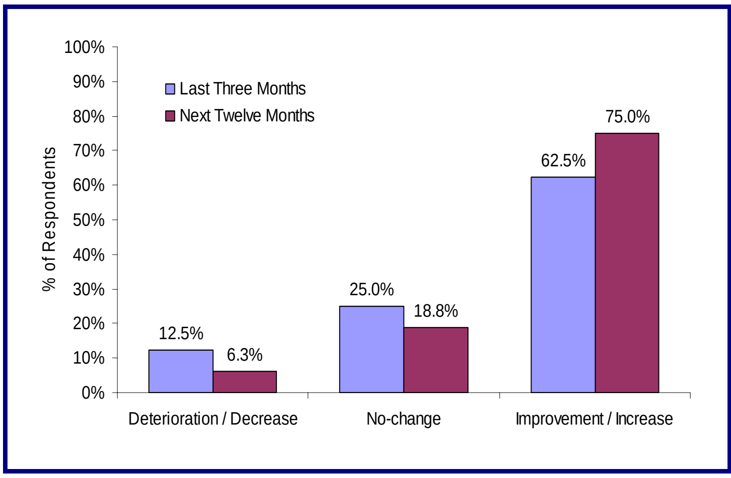
- Looking ahead, half of respondents to the January 2008 survey expect profitability to increase in 2008, while nearly 40% expect it to stay stable and just over 10% expect a fall. Most respondents expect fuel prices to remain high in 2008, but several are still optimistic that this can be offset by higher revenues, operational efficiencies and a positive impact on yields from consolidation. Nevertheless, the credit crunch and high fuel prices have had some impact in terms of lessening the degree of confidence since its peak in April 2007. On a weighted average basis, the outlook for profitability has declined from 92.5 in April 2007 to 69.4 in January 2008.

DEMAND GROWTH

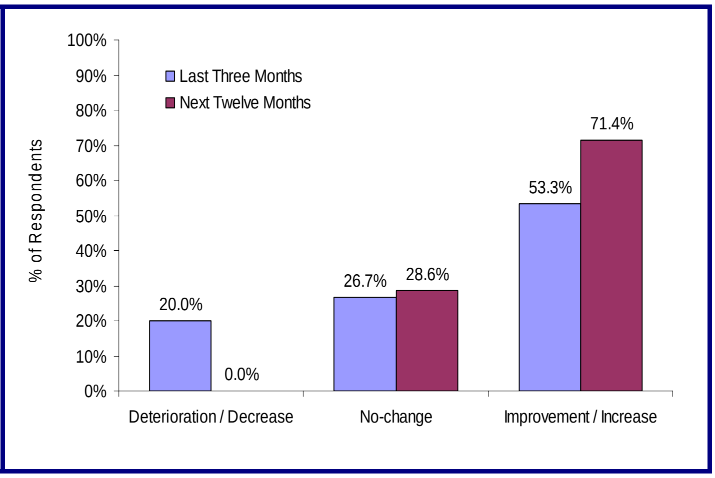
- The demand environment has become tougher in recent months, but airlines are still enjoying an overall increase in volumes and, in several cases, load factors. Over 62% of respondents saw an increase in passenger volumes in Q4 2007, with only 12.5% seeing a fall. New capacity and new routes have helped to meet higher demand in the short run, with passenger demand yet to face any significant impact from financial market and economic uncertainty. Looking forward, there is a recognition that the rate of demand growth may have peaked, but three-quarters of respondents still expect to see higher passenger volumes in 2008. Though the boost from economic growth may weaken, some respondents still expect new capacity and routes to generate higher demand levels.
- Air cargo demand is typically more quickly exposed to an economic slowdown, indeed it is often seen as a leading indicator of wider economic conditions. However, while again there is a recognition that the rate of growth may have weakened, over half of the respondents saw cargo volumes increase in Q4 2007. Even with a weaker global economy and high fuel costs, over 70% expect cargo volumes to increase in 2008, with none expect to see a decline. This reflects positive confidence that there will still be underlying demand growth, especially in developing economies. But it may also reflect an increased confidence that air cargo is regaining its competitiveness against container shipping, as several ports face capacity constraints and higher bunker fuel costs begin to bite.

The actual and expected change in traffic volumes

a) Passenger



b) Cargo



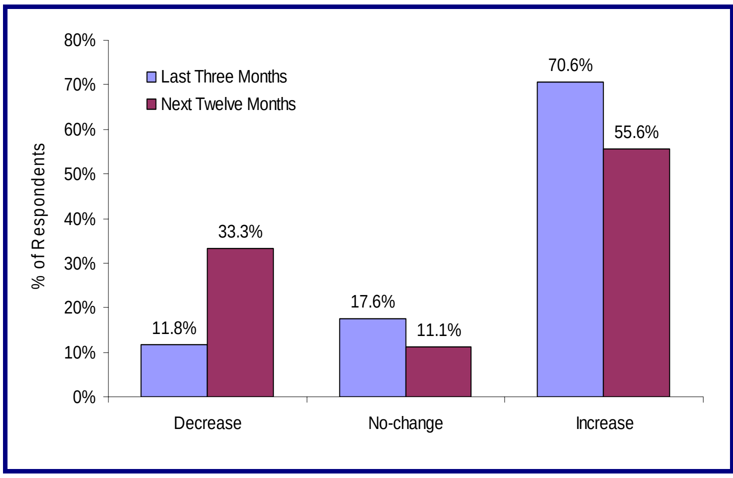
INPUT COSTS

- Oil and fuel prices rose to record highs in Q4 2007, with jet fuel increasing to over $110 per barrel in December. Financial hedging and (for non-US airlines) a depreciation of the US dollar can help to offset (at least temporarily) some of the higher costs, but most of the upward cost pressure is beyond the control of airlines. Over 70% of respondents saw higher input costs in Q4, with less than 12% seeing a decrease. Strong management control and the on-going effects of productivity improvements continue to deliver fuel and non-fuel efficiencies, but in most cases were not sufficient to offset higher fuel costs. On a weighted average basis, the score for unit input costs has risen from 52.5 in April 2007 (i.e. for Q1 2007) to 79.4 in January 2008 (i.e. for Q4 2007), moving in the opposite direction to the weighted average for profitability over the same period.
- With fuel prices already at record levels, there is less of an expectation of further price increases in the next 12 months. However, neither is there any expectation of a sharp fall in fuel prices and the need for further fuel

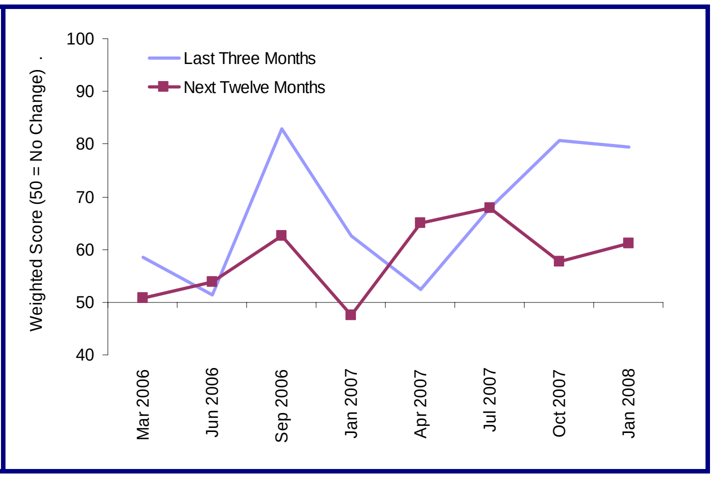
efficiencies remains a key factor for future profitability. Over 55% of respondents still expect unit costs to increase over the next 12 months, though a third of respondents also expect to see a fall. Some respondents cite additional pressures from labour and aircraft maintenance costs, especially with growing shortages in some areas, e.g. labour skills. The focus remains on achieving further fuel and non-fuel cost efficiencies, though they will become increasingly harder to find.

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

a) January 2008 survey



b) Compared to previous surveys

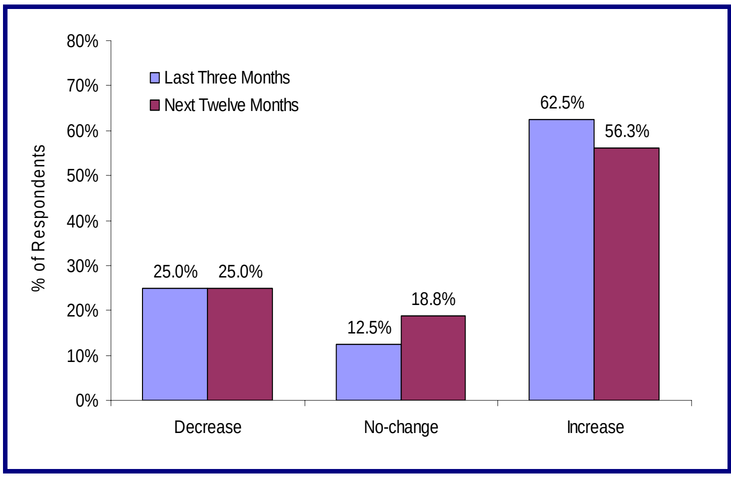


YIELD ENVIRONMENT

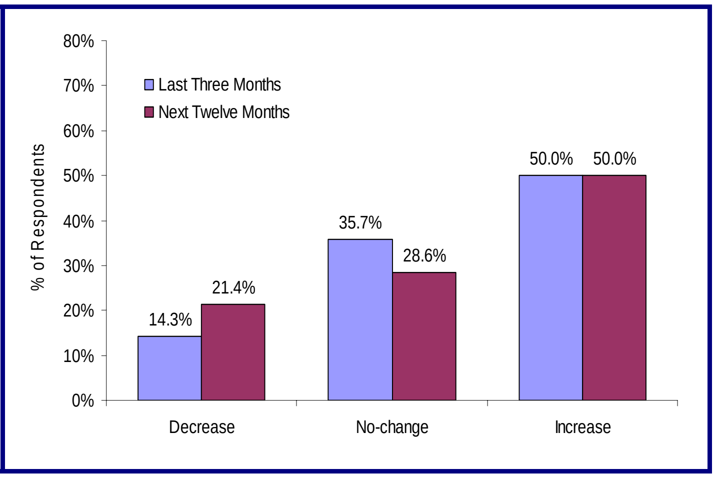
- The overall impact on yields reflects the relative strength of opposing pressures from higher input costs (upward) and increased competition (downward). On the passenger side, a still positive demand environment provides some scope for airlines to pass on part of the higher input costs they face to passengers through higher yields. Over 62% of respondents saw higher yields in Q4, for example through higher fuel surcharges, while over 56% expect to push for further increases in the next 12 months. Revenue management techniques and better product mixes have helped to boost yields while, in some cases, exchange rate movements have provided a positive effect. Nevertheless, many respondents expect pricing power may weaken, especially if demand growth slows while the rate of new aircraft deliveries increases.
- On the cargo side, high fuel costs place an even greater burden on unit costs but the ability to pass on part of the higher costs is constrained by a more uncertain demand environment and by competition from other modes. Half of respondents were able to increase yields in Q4, and a similar amount expect to see further yield improvements in the next 12 months.

The actual and expected change in yields

a) Passenger



b) Cargo

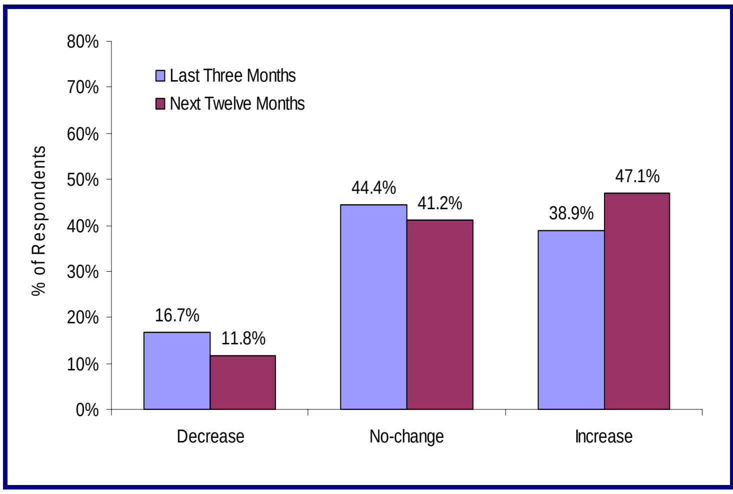


EMPLOYMENT

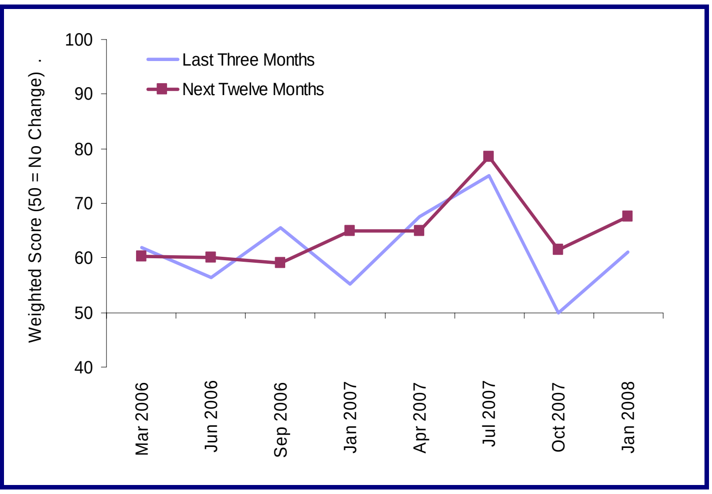
- Airline labour productivity levels have increased significantly since 2001, with labour used more effectively and efficiently and non-core employment being outsourced. Employment levels were restructured post-2001 but have begun to increase again in the last two years as airlines require additional staff to meet higher demand levels. However, with fuel cost pressures increasing and signs that labour costs may also face upward pressure too, the expansion in employment levels has slowed in the second half of 2007. Just under 40% of respondents increased their level of employment in Q4, though only a sixth of respondents actually reduced employment levels. On a weighted average basis, the score of 61.1 for the change in employment over the previous three months has rebounded from a low of 50.0 in October 2007 but remains below its peak of 75.0 in July 2007.
- The outlook for employment levels is affected by the relative strength of two opposing factors; the need for more staff to serve higher demand levels and the need to offset higher fuel and other input costs through further productivity gains or outsourcing on the labour side. Airlines, on balance, expect the former to be more dominant in 2008, with just under half of respondents expecting employment to increase and only around 12% expecting to have to reduce employment levels.

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

a) January 2008 survey



b) Compared to previous surveys



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