IATA ECONOMICS BRIEFING
AIRLINE BUSINESS CONFIDENCE INDEX
JULY 2007

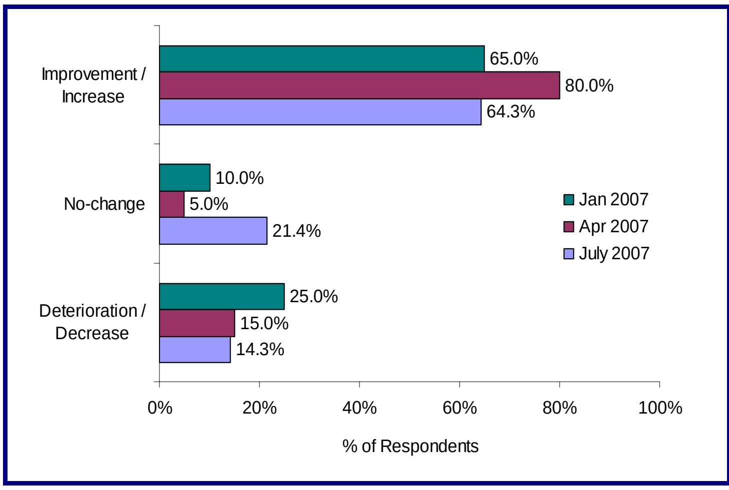
KEY POINTS

- Airline business confidence remains strong, though has weakened slightly in the face of high fuel prices and signs of downward pressure on yields. Nevertheless, with demand continuing to grow and airlines delivering further productivity and efficiency improvements, confidence remains remarkably high. Even with the rise in fuel prices in Q2 2007 nearly 65% of respondents saw profitability increase, while nearly 80% expect profitability to increase over the next 12 months. The strong business confidence is consistent with IATA's latest financial forecast for the industry (see: www.iata.org/economics) that expects net profits of $5.1 billion in 2007.
- Strong competition – both between airlines and, for cargo, with other modes – along with new capacity additions are constraining prices and stabilising or reducing yields. Costs also face upward pressure, for both fuel and for areas (e.g. labour) where some shortages may appear. However, airline respondents remain confident that they can offset this pressure through further productivity improvements and by using higher demand levels to increase and, potentially, broaden their revenue base.

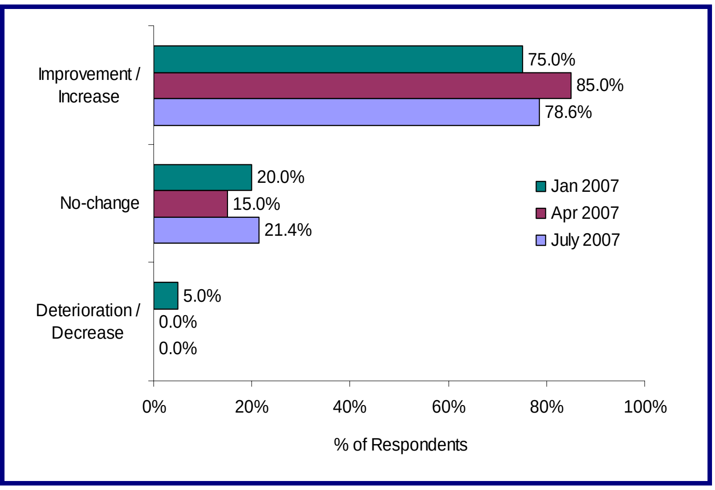
PROFITABILITY OUTLOOK FALLS BACK SLIGHTLY

- The airline industry has, in general, seen significant improvements in underlying profitability in recent years. However, there are signs that additional improvements are becoming increasingly harder to achieve. High fuel prices, pressure on other costs and strong competition meant that less than two-thirds of respondents thought that profitability improved in Q2 2007, compared to 80% who saw it improve in Q1. Nevertheless, less than 15% of respondents reported a fall in profitability in Q2.
- Looking forward, respondents remain relatively confident of higher profitability over the next 12 months. Just under 80% expect to see an improvement, down slightly from 85% in the April survey, but no respondents expect to see a fall. Confidence is linked to further demand growth and an expected weakening in high fuel prices. However, several respondents also recognise the risk posed to profitability by increased capacity as new aircraft are delivered and by the risk of fuel prices being higher than expected.

How has profitability changed in the last three months compared with the same period last year?



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

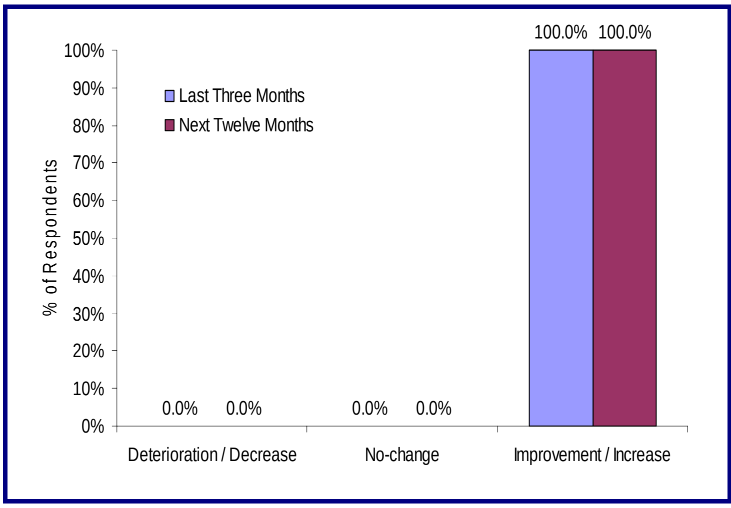


THE DEMAND ENVIRONMENT REMAINS STRONG

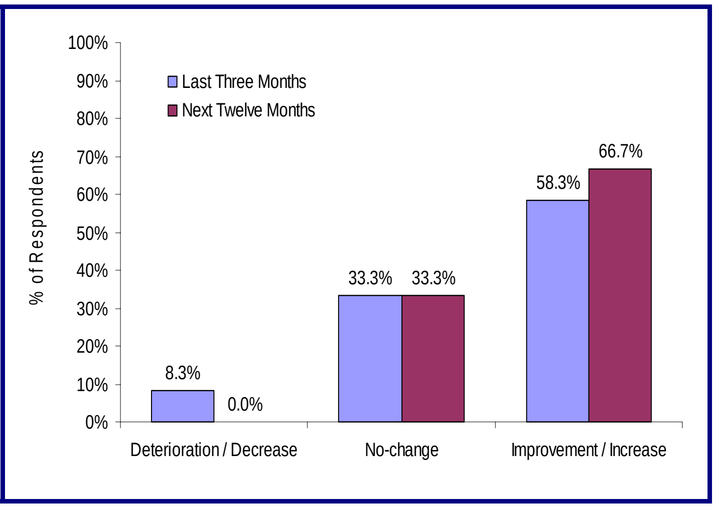
- The airline industry continues to see and expect demand growth across all regions, although there is a recognition that the rate of demand growth has passed its peak for this cycle. Demand growth in 2007 and 2008 is expected to remain strong, supported by robust global GDP growth, but slower than in the last three years. Nevertheless, strong demand growth has been – and is expected to continue to be – a strong factor behind improving profitability. Indeed, all respondents saw some degree of demand growth in passenger traffic in Q2 2007, and all respondents expect a further increase in demand over the next 12 months. Demand on the cargo side is less buoyant, reflecting increased competition from other modes, such as container shipping. Nevertheless, nearly 60% of the respondents saw higher cargo volumes in the first quarter of 2007, while two-thirds expect cargo demand to increase over the next 12 months.

The actual and expected change in traffic volumes

a) Passenger



b) Cargo

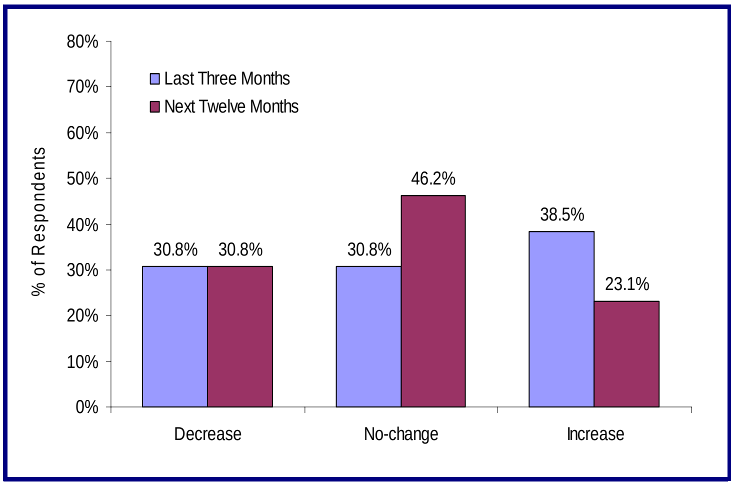


YIELDS FACE INCREASED PRESSURE

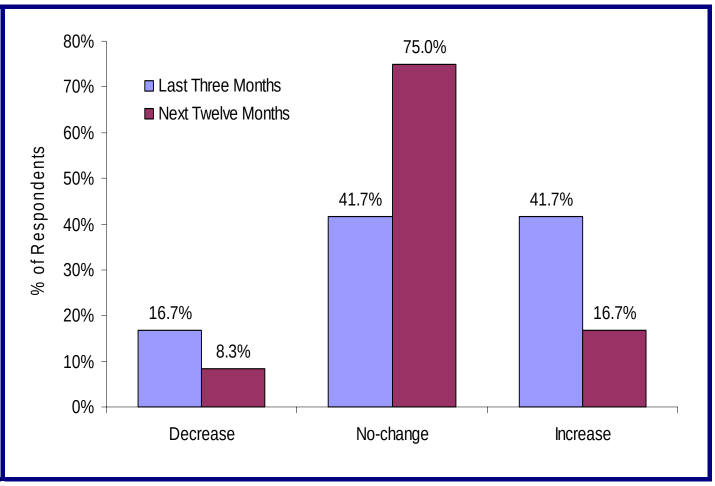
- The ability of airlines to use a strong demand environment to improve yields, as well as to pass on some of the costs of higher fuel prices, has weakened. With significant amounts of new capacity starting to be delivered and strong competition – e.g. from no-frills carriers on the passenger side, from other modes on the cargo side – airlines are increasingly seeing downward pressure on their yields. On the passenger side, less than a quarter of respondents expect yields to increase over the next 12 months, with nearly a third expecting them to fall. On the cargo side, three-quarters of respondents expect yields to not change over the next 12 months, with only a small proportion expecting a further increase.

The actual and expected change in yields

a) Passenger



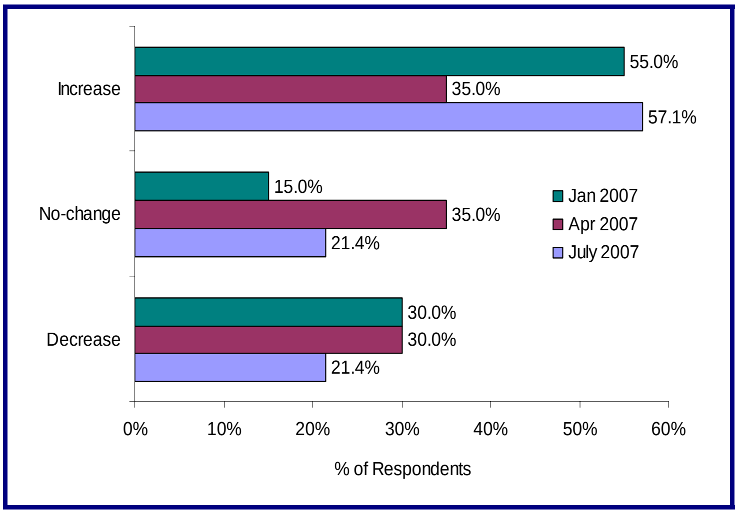
b) Cargo



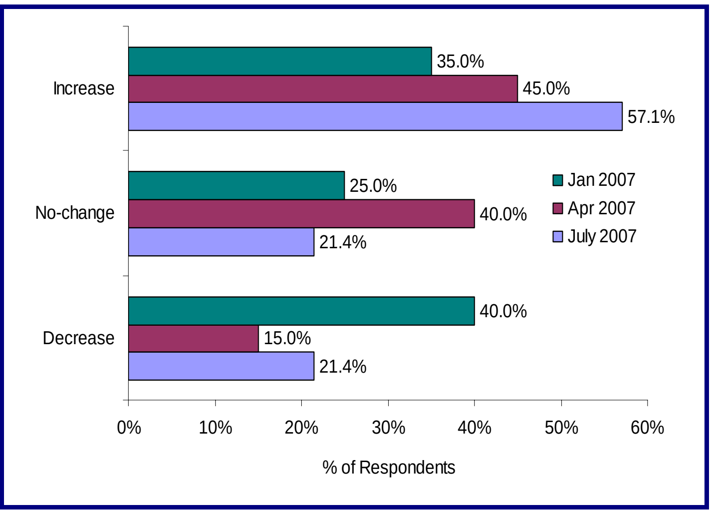
HIGH OIL PRICES INCREASE THE PRESSURE ON COSTS

- The rise in oil and fuel prices in Q2 2007, returning towards the peak levels of mid-2006, has renewed the upward pressure on input costs for airlines. With several airlines expecting fuel prices to remain high over the next 12 months this upward pressure is expected to continue. Achieving further efficiencies in non-fuel costs is essential, but this is also becoming increasingly more difficult as the easier improvements have already been made and as shortages in some areas, e.g. labour skills, can add to cost pressures. Over 57% of respondents saw an increase in input unit costs in Q2 2007, up from 35% in the April survey, compared with just over a fifth of respondents enjoying a fall in unit costs.
- Looking forward, airlines expect to face further cost pressures over the next 12 months, with 57% of respondents expecting unit cost to increase and a further 21% expecting them to remain stable. Key concerns among respondents were the impact of high fuel prices and the potential upward impact on costs as airlines expand capacity to meet higher demand levels. The global airline industry has achieved impressive cost efficiency improvements since 2001. The focus remains on achieving further cost efficiencies, though they will become increasingly harder to find.

How have your input costs changed in the last three months compared with the same period last year?



How do you expect your input costs to change over the next twelve months?



IATA Economics
July 2007
E-Mail: economics@iata.org