

IATA ECONOMICS BRIEFING

AIRLINE BUSINESS CONFIDENCE INDEX

OCTOBER 2008

KEY POINTS

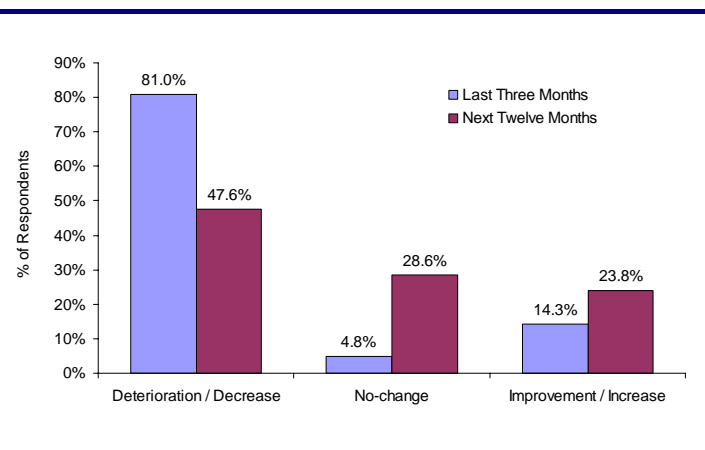
- Airline profitability, according to survey respondents, continued to weaken in Q3 2008 under pressure from the spike in fuel costs. This survey was conducted just before the latest financial crisis and will not reflect intensified concerns about recession. In fact airline CFOs reported a slight improvement in their confidence about prospective profitability over the next 12 months, reflecting the fall in oil prices during September but not the intensified risk of recession that has emerged. Still, less than a quarter of respondents expect to see profits rising over the next year, whereas almost half anticipate a further decline. Our next survey should capture more fully the effects of the unprecedented market turmoil seen in early October.
- Even though this survey does not reflect latest developments in financial markets, expectations for growth in traffic volumes deteriorated sharply. While new and expanded routes helped 75% of respondents report passenger demand growth during Q3, only 43.8% see higher passenger demand over the next 12 months, while a similar proportion expect cargo volumes to decline over that period. Expectations on input costs increases have moderated, but more respondents also expect corresponding yield decreases rather than increases.
- The relief airlines will see from reduced input costs are expected to be offset by weakening demand and yields. Employment levels within the industry will continue to come under pressure as further efficiencies are sought.

PROFITABILITY OUTLOOK

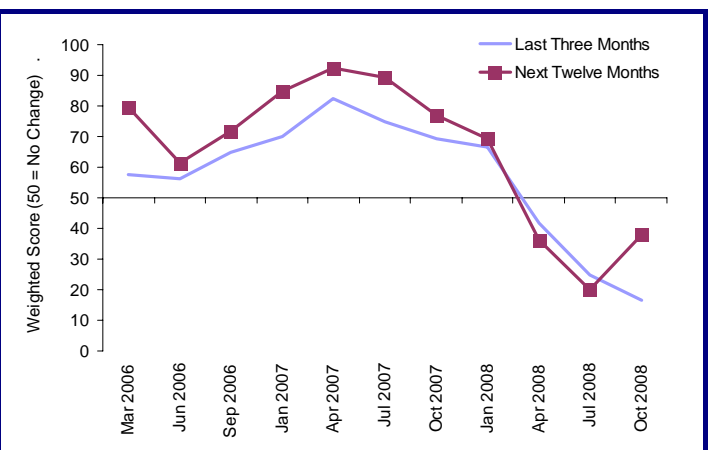
- During the third quarter of this year airline expectations for profitability over the next 12 months improved slightly; although a decline was still expected, for the third successive quarter. As in the previous quarter, the September 2008 responses reflect the impact of higher fuel costs and a deterioration of the demand environment in recent months. Over 80 percent of respondents reported that profitability had fallen in Q3 2008. The high cost of fuel was cited as the main cause of the decline in profitability, along with softening demand. 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 16.7 in September (i.e. Q3) this year.

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

a) September 2008 survey



b) Compared to previous surveys



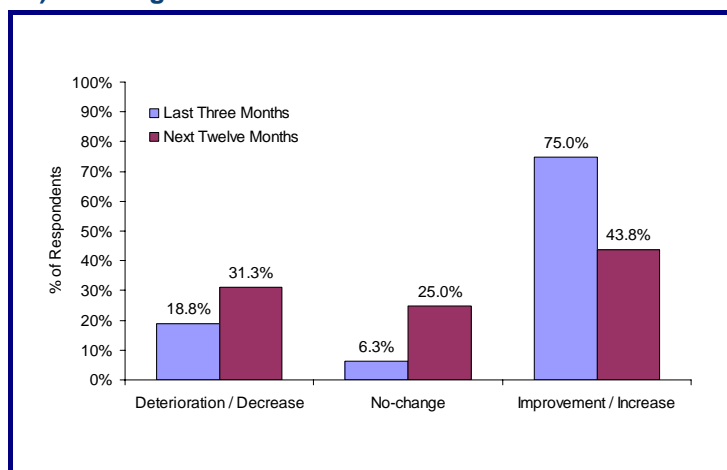
➤ Airline confidence for the coming 12 months is still weak, although has improved slightly since the last survey, but of course this does not reflect the recent financial crisis. Just under half the respondents to the September survey expect profitability to decrease in the next 12 months compared to 70% of respondents in July, while almost a quarter expect it to improve. The fuel price and economic slowdown remain a concerns for most respondents, however some also cite restructuring of capacity and a fall in oil prices as creating the possibility of increased profitability. On a weighted average basis, the outlook for profitability over the next 12 months is 38.1, well below the 92.5 seen in in April 2007. It should be noted that the current survey period closed on October 1st – before the most recent financial market turmoil which has increased the likelihood of a more dramatic economic downturn. A further fall in confidence would not be unexpected in Q4.

DEMAND GROWTH

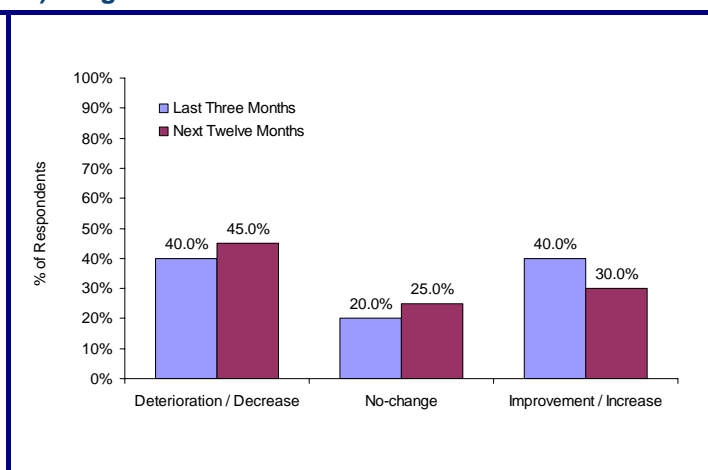
- Although on average airlines see passenger demand volumes continuing to increase, confidence in this trend going forward has declined over the quarter. Three quarters of respondents thought that passenger volumes had increased in Q3 2008, up from two thirds in Q2. In many cases increased capacity has also been accompanied by increased load factors. Further expansion in developing markets, through new capacity and new routes, continue to be key drivers of recent demand growth. Looking forward, less than half the respondents now expect to see higher passenger volumes in the next 12 months. Latin American and European respondents are more positive on growth prospects while those from Asia were almost universally bearish, citing the effects of global economic downturn.
- The picture for air cargo demand has rapidly deteriorated given its higher exposure to the effects of economic slowdown. Only 40% of respondents (down from two thirds last quarter) thought that cargo volumes had increased in Q3 2008 and the same proportion said a decline was experienced. Looking forward, the proportion of responses expecting improvement in cargo demand have halved to 30%. Almost half say there will in fact be a decline in demand over the 12 months ahead. As with the outlook for passenger demand, Asian airlines share a particularly negative view on cargo demand going forward. This reflects the impact of economic downturn on global trade flows, a large proportion of which originate in Asia.

The actual and expected change in traffic volumes

a) Passenger



b) Cargo



INPUT COSTS

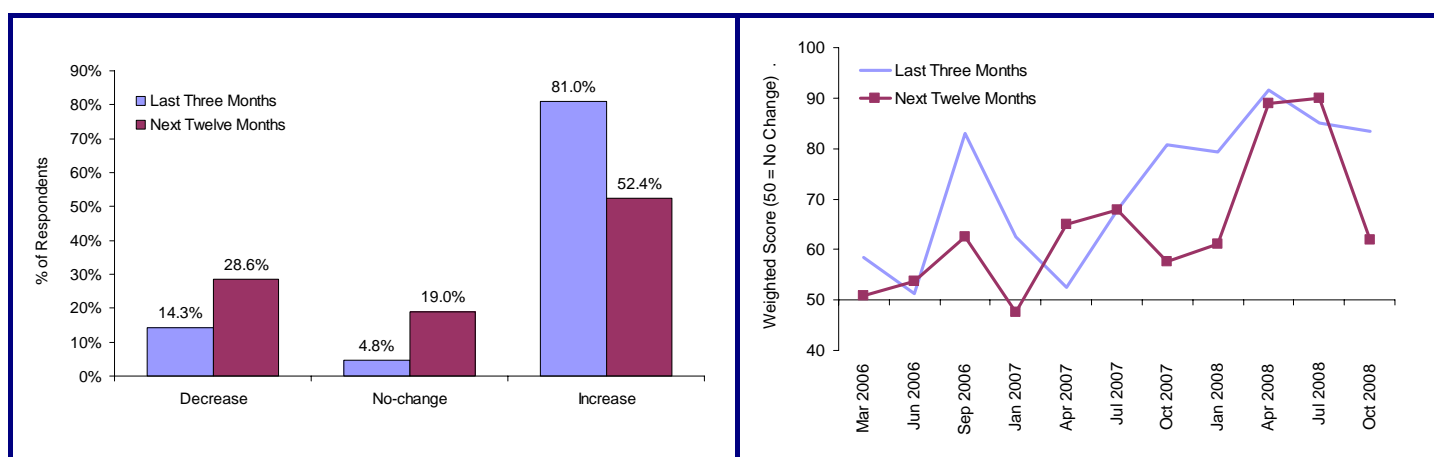
➤ At the end of Q3 oil and fuel prices fell by a third from the record highs of over \$180 per barrel in July 2008. Even so, jet fuel prices in September were still almost 40% higher than during the same period last year. Thus 81% of respondents reported higher input costs in Q3, down only slightly from the 85% last survey. The high price level continued to overwhelm cost-saving fuel and non-fuel productivity gains airlines have driven through. On a weighted average basis, the score of 83.3 for unit input cost increases during the quarter is only very slightly down from Q2 and is much higher than the 52.5 in April 2007 (i.e. for Q1 2007). The decline towards the end of the quarter in the price of key inputs like oil is largely due to the weakening economic outlook which reduces commodity demand, however the outlook for revenues will also be correspondingly weaker.

➤ The recent decline in prices has affected expectations over the next 12 months with more than a quarter of respondents expecting relief (up from 5% last quarter) while just over half expect continued upward cost pressure (down from 85% in Q2). On a weighted average basis, the score for the outlook in unit input costs has fallen sharply back to 61.9 (compared to 90 last quarter), close to the levels last seen at the end of 2007. Many respondents cite continued significant cost cutting initiatives and a stabilisation of fuel prices as rationale for this improvement in input cost outlook.

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

a) September 2008 survey

b) Compared to previous surveys



YIELD ENVIRONMENT

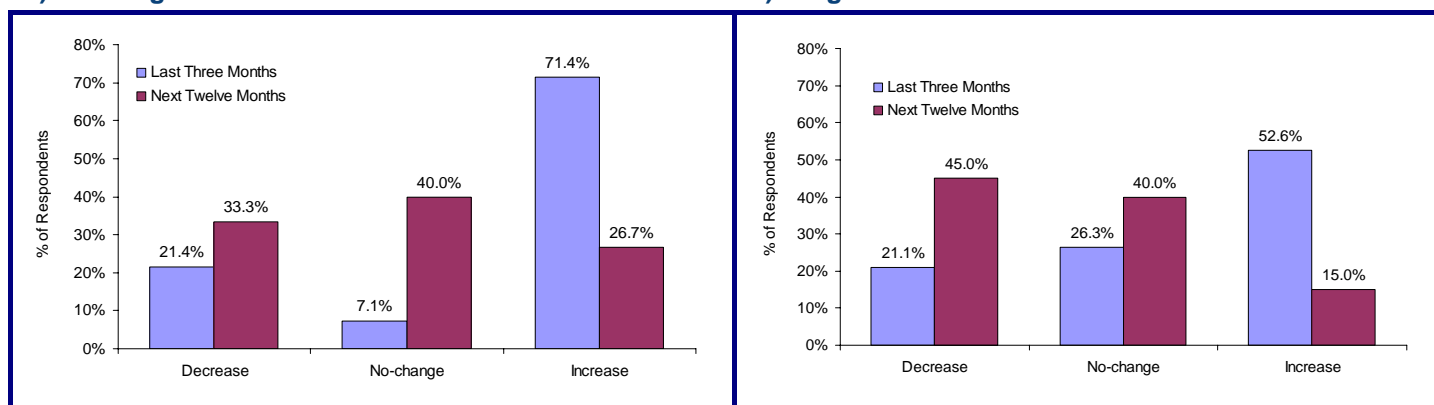
➤ Higher fuel costs continued to drive the impact on yields in Q3, however the prospect of further yield increases has weakened sharply. For the passenger business, over 71.4% of respondents were able to increase yields in Q3 (down slightly from 78.6% in the July survey), as part of the higher fuel costs was passed on to passengers. Capacity reductions and continued use of revenue management techniques have also helped to boost yields. While passenger yields have remained strong during Q3, the outlook for the next 12 months has weakened significantly with now more (33.3%) holding the view that yields will decrease than increase (26.7%). This is a marked shift in pattern from Q2 where over two thirds expected yields to continue to increase over the year ahead, reflecting the deterioration in economic prospects.

➤ In the cargo business, 52.6% of respondents (lower than the 64.7% of Q2) reported that cargo yield increases were possible, helping to offset the high fuel costs which place an even greater burden on unit costs than for passenger operations. However the outlook for cargo yields over the next 12 months has deteriorated significantly. While in Q2 64% expected to be able to raise yields going forward, this has fallen to only 15% of respondents to the Q3 survey. In fact, almost half expect yields to decrease – a much higher proportion than the 5.9% last quarter, reflecting the growing concern about the effects of economic recession on cargo traffic.

The actual and expected change in yields

a) Passenger

b) Cargo



EMPLOYMENT

- Although airline labour productivity levels have increased significantly since 2001, recent growth in traffic has seen overall employment numbers increase. The rate of this growth has moderated since mid-2007, but in the last quarter there were still more respondents reporting an increase in employment levels (38.1%) than those with reductions (14.3%). Roughly half saw employment remain constant over the quarter. On a weighted average basis, the score of 61.9 for the change in employment over the previous three months is an increase on last quarter (50.0) but still well below its peak of 75.0 in July 2007.
- The outlook for employment levels diverges from the activity reported for the last 3 months and picks up on continued concerns about the need to restructure operations in the face of the worsening economic conditions and persistent fuel cost pressures. In Q2, for the first time in the survey, there was a net balance of airlines expecting a decline in employment over the next 12 months and this trend has continued into Q3 with a third anticipating jobs cuts while only 19% of respondents expect to increase employment. On a weighted average basis, the outlook for employment has fallen sharply from 78.6 in July 2007 to 42.9 in September 2008.

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

a) September 2008 survey

b) Compared to previous surveys

