

# IATA ECONOMICS BRIEFING

## AIRLINE BUSINESS CONFIDENCE INDEX

### JULY 2010 SURVEY

#### KEY POINTS

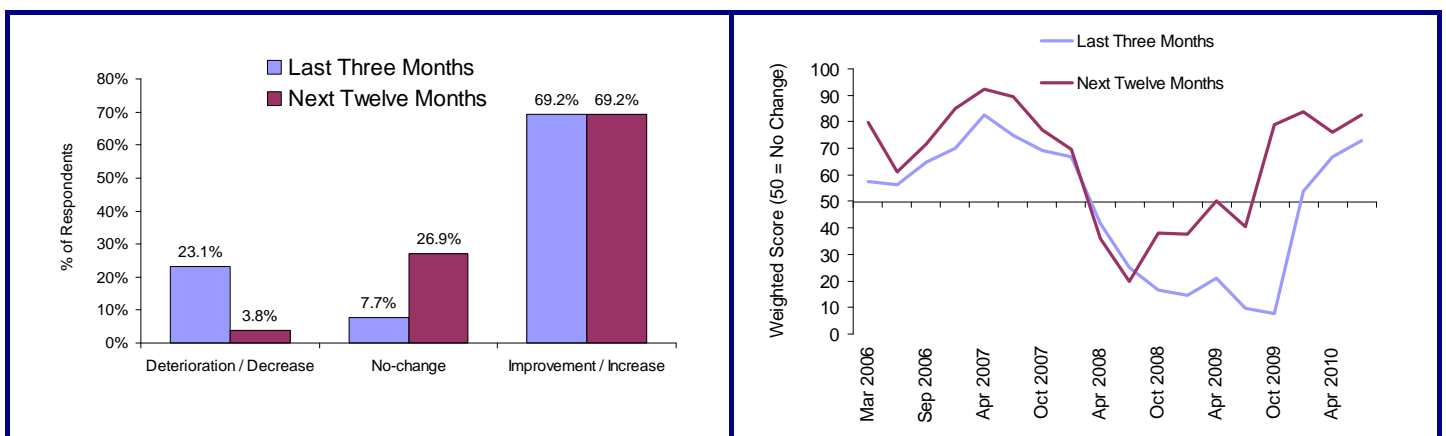
- Results from IATA's quarterly survey conducted in July show a further improvement in airline business confidence. Almost 70% reported improved profitability during the last quarter and a similar proportion expect further improvement over the year ahead. While there is regional variation – largely in line with the strength of economic recovery being experienced – a majority of respondents in all regions report improvements during the last quarter and expect either stability or further improvement over the year ahead. In June IATA revised up its own forecast for 2010 industry financial performance from a loss of \$2.8 billion to profit of \$2.5 billion.
- The sharp improvement in both cargo and passenger demand seen in early 2010 continued during the second quarter of this year. More than 80% of respondents indicated rises in passenger demand. Increases on the cargo side of the business were expressed by a similar proportion. Expectations for further improvements in demand over the 12 months ahead sit at similarly high levels, although just over a quarter of respondents now indicate that cargo traffic growth may moderate – possibly a function of the restocking phase of the inventory cycle coming to a close.
- The picture for yields has improved substantially with now the balance of respondents reporting yield increases on both passenger and cargo markets. Strong demand, returning premium traffic and high load factors are supporting higher yields. The outlook for further yield improvement remains strong – although cargo rates may be starting to stabilize. While there have not been dramatic shifts in the cost base over the last quarter, concern over rising fuel prices remains – meaning reports of higher costs in surveys later this year could be expected.
- Industry employment looks to be growing again in line with increasing output. Regions experiencing faster recovery in traffic have been more active on this front. The outlook for the next 12 months is for further expansion in employment, although this may be slowed by airlines seeking productivity increases from economies of scale.

#### PROFITABILITY OUTLOOK

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

a) April 2010 survey

b) Compared to previous surveys



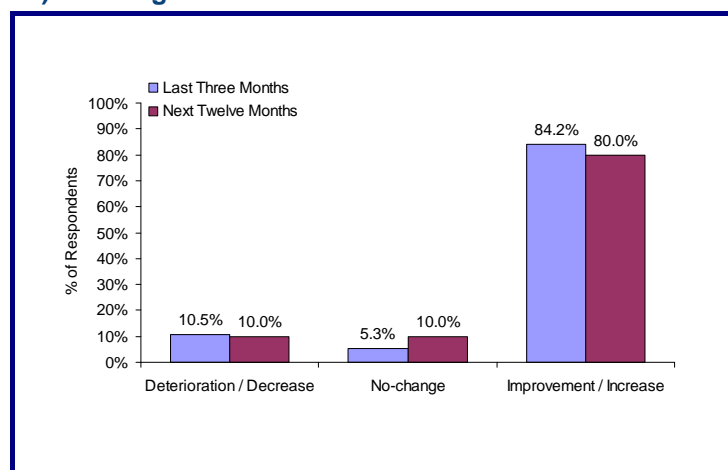
- Airlines remain confident about prospects for profitability. Almost 70% of respondents reported improved profitability during Q2 2010 and a similar high proportion expect further improvement over the 12 months ahead. Stronger demand on the back of improving economic performance in most regions has been the key driver of improved performance. Higher load factors have helped yields, driving revenue growth and improving the bottom line. Some airlines still report softer profitability, driven in some cases by increased competition on key routes, and in other cases by shocks such as the ash cloud airspace closures in Europe during April. Exchange rate shifts (e.g. EUR vs USD) have also hurt some airlines while helping others. On a weighted average basis (with 50 representing no-change, and values above 50 signaling a greater balance of positive views), the score for profitability over the previous three months is 73.1. This a similar level to that reported at the same time in 2007 during a period of improving profitability.
- The regional variation reported in previous surveys still exists, although it may be becoming less pronounced. Recovery in profits for European airlines still appears to lag behind other regions – 30% of respondents from Europe still report declining profitability. However, now a majority 60% of respondents from this region report improved profits in the last quarter, possibly indicating a turning point in prospects. The relatively stronger economic recovery across the other regions continues to drive more positive reports of profitability improvement.
- Confidence about further improvements in profitability over the 12 months ahead remains high. The weighted average measure of expectations for profits sits close to the recent high reached in January this year. Underpinning this confidence is the view that economic growth will continue to recover across the regions and that relatively tight capacity will keep load factors high. A growing proportion – now more than a quarter – see stability ('no-change') in profitability levels, partly due to the offsetting effects of higher fuel costs. Some regional variation remains. Europe is the only region still registering possible profitability decreases over the 12 months ahead – although it should be noted that the overwhelming majority (80%) of European respondents are actually positive on prospects. In the Middle East two thirds of respondents expect 'no-change' in profitability indicating a fairly stable outlook. In the Americas and Asia Pacific two thirds expect further increases in profits.

## DEMAND GROWTH

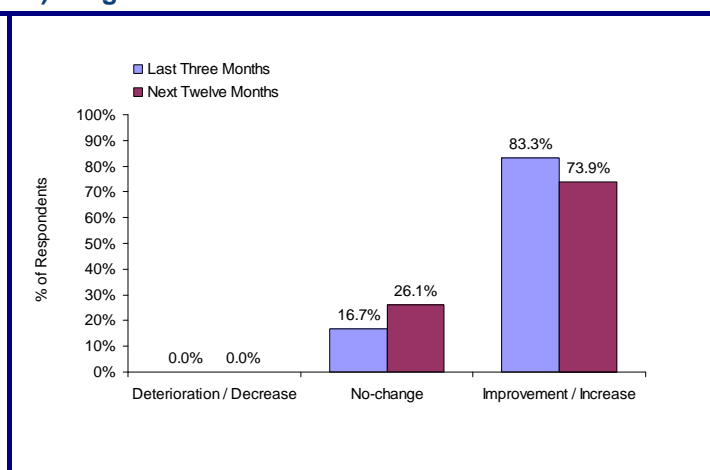
- Strong traffic growth was reported on both the passenger and cargo sides of the business during the last quarter. More than 84% of respondents reported increases in the passenger demand over this period. This picture is consistent with the growth seen in international passenger kilometers of more than 7% over the first five months of the year – above the annual growth trend for the last two decades. The majority of respondents from all regions reported increases, although a third of European respondents reported 'no-change' or deterioration. The outlook for passenger traffic over the 12 months ahead remains strong with 80% expecting increases over that period on the back of an improving economic outlook. Only half of European respondents expect improvement and a third actually expect further decreases – reflecting the relatively slow pace of economic recovery in the region. On a weighted average basis, the outlook for passenger demand for the 12 months ahead is 85.0.

### Recent and expected change in traffic volumes

#### a) Passenger



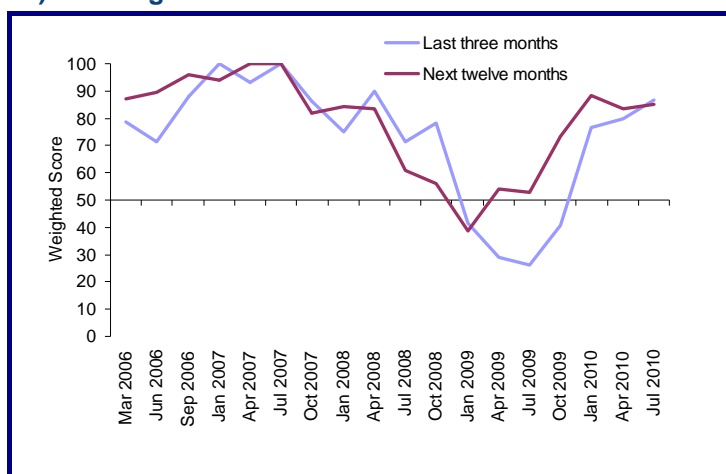
#### b) Cargo



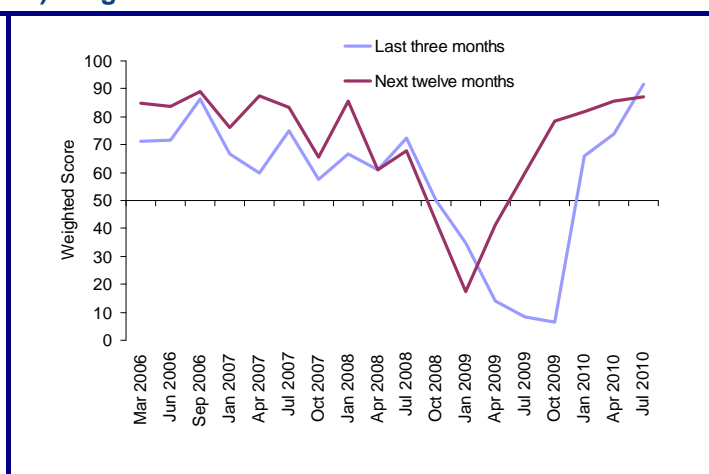
➤ Over 83% of respondents reported stronger cargo traffic in the last quarter. Airlines are seeing the benefits from a sharp recovery in world trade which has led to demand for international air freight rising at year on year rates approaching 30%. The outlook for further cargo volume growth remains positive. More than 70% of respondents expect further improvement. However, a quarter now expect volumes to stabilize – up from 9.5% expressing this view in our April survey. Much of the recent strong recovery in cargo traffic has been driven by re-stocking activity as economies emerge from recession. The growing proportion of respondents in the ‘no-change’ category may indicate that this inventory cycle is coming to a close. Cargo traffic growth rates may moderate somewhat over the year ahead – further growth in freight traffic will be dependent on renewed trade activity beyond re-stocking. Nevertheless, at weighted average level of 87.0, confidence in improving cargo traffic going forward has returned to levels seen prior to the recession.

### Compared to previous surveys

a) Passenger



b) Cargo

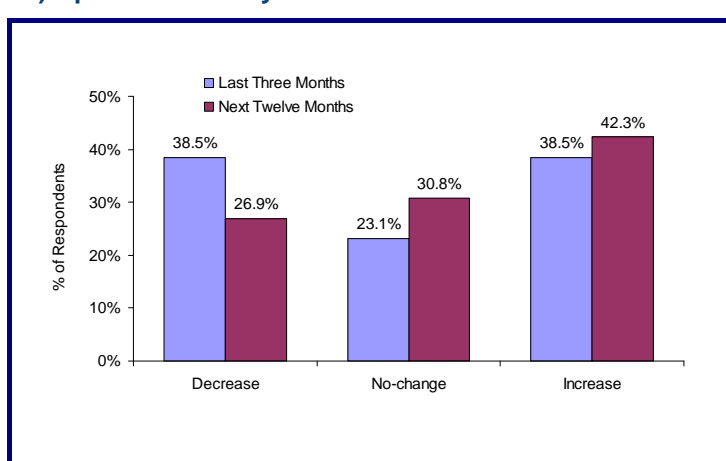


## INPUT COSTS

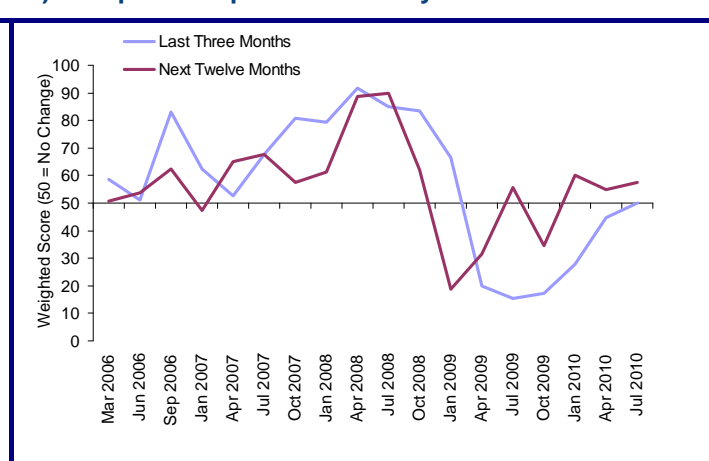
➤ The weighted average score for movement in costs over the last quarter sits right on the 50 ‘no-change’ line in the most recent survey. Equal proportions of respondents reported unit cost increases and decreases. Increased aircraft utilization has reduced costs for some, however rising fuel prices have meant others experienced upward cost pressures. Recent currency exchange movements have also had a polarizing effect – assisting some airlines and hurting others. Cost control remains a major focus for many airlines and several report reaping the benefits now from deep cuts made during the recession period.

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

a) April 2010 survey



b) Compared to previous surveys



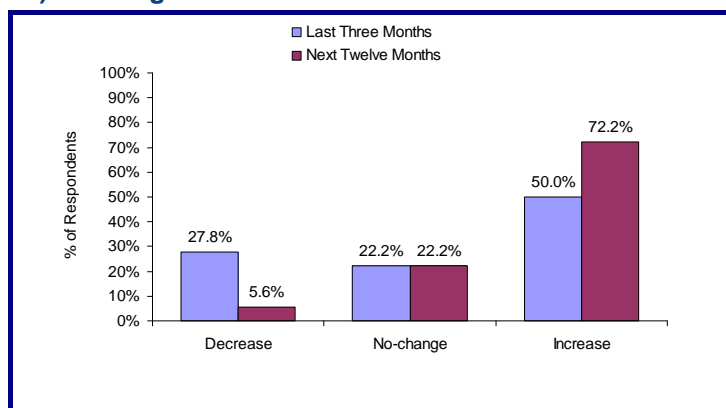
- With over 70% of respondents expecting either cost stability or rises over the year ahead, the forward-looking consensus remains above the 50 'no-change' mark for the third successive quarter. While further utilization increases are expected to help unit costs, the concern over rising fuel prices and other inflationary effects (e.g. labor costs, and eventually even interest rates) from the uptick in economic activity post-recession may now be gaining the upper hand. It would not be unexpected to see the net balance of responses on actual unit cost performance moving above the 50 'no-change' mark in the quarters ahead.

## YIELD ENVIRONMENT

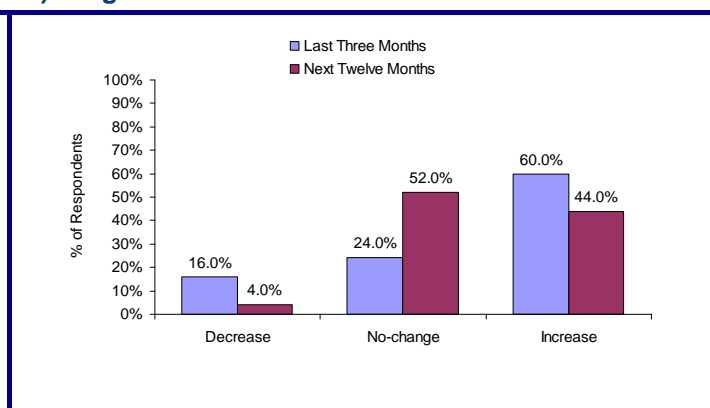
- Half of respondents now report passenger yield increases during the last quarter, up from a third last survey. Airlines are seeing strong demand and higher load factors. An improving share of business class traffic is also supporting higher average yields. However a significant minority (more than a quarter) are still reporting weaker yield performance. Competition is increasing on key routes as capacity is reintroduced. In most regions a majority of respondents are seeing yields rise, although in the Middle East & Africa the bulk of responses indicate yield stability with two-thirds indicating 'no-change' during the previous quarter. Overall, on weighted average basis, the score for yield performance over the last quarter was 61.1, back above the 50 'no-change' mark for the first time since October 2008. This is an encouraging sign, however by April this year average fares on international markets were still 10-15% lower than pre-recession levels, so there is some way yet to go before yields return to more normal levels. Some airlines report holding back on significant fare adjustments in the short term due to uncertainty over whether the market will support rises at this stage.
- The outlook for passenger yields for the year ahead remains positive with over 70% of respondents indicating that yields should increase. On a weighted average basis, the score for the outlook in yields has risen slightly to 83.3. Strengthening demand associated with peak (summer) season travel over the months ahead are helping to support this upbeat view.

### Recent and expected change in yields

#### a) Passenger

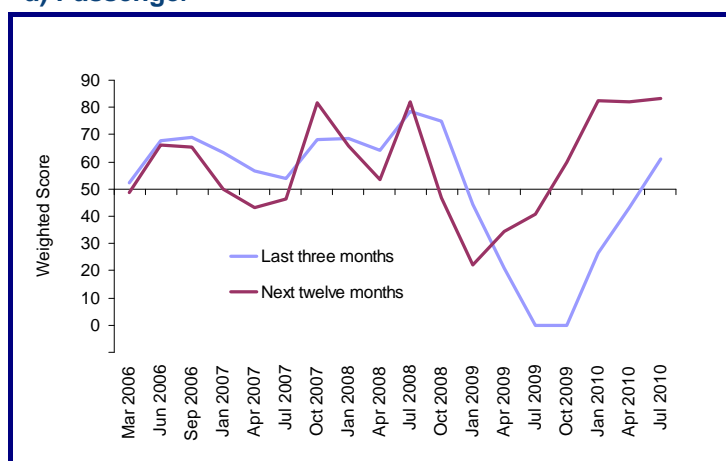


#### b) Cargo

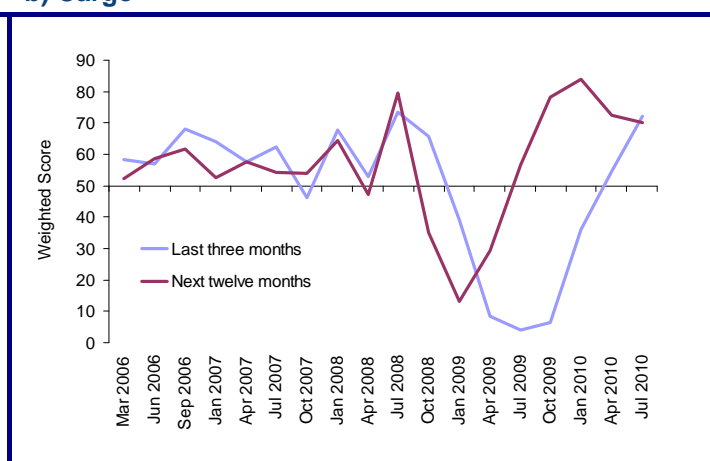


### Compared to previous surveys

#### a) Passenger



#### b) Cargo



➤ A solid majority of respondents reported that cargo yields increased during the last three months. This helps the weighted average balance of responses continue its rise back above the 50 'no-change' line – indicating yield increases. In fact, with a score of 72.0, this indicator has risen back to levels last seen in mid-2008 before the precipitous fall in cargo traffic later that year. With capacity tight on some directional markets and load factors at record highs, cargo yields have been strengthening. Expectations for cargo yield improvement over the 12 months ahead still remains high at 70.0 on a weighted average basis. However this outlook has moderated slightly from the levels seen in recent surveys. The proportion of respondents indicating that 'no-change' in cargo yields is likely over the year ahead has grown from just over a third last survey to more than half in July. In addition to reflecting the effects of increasing cargo capacity, it is possible that pick up concerns over whether the impetus given to yields from restocking activity early in the recovery will continue as this phase of the inventory cycle comes to a close.

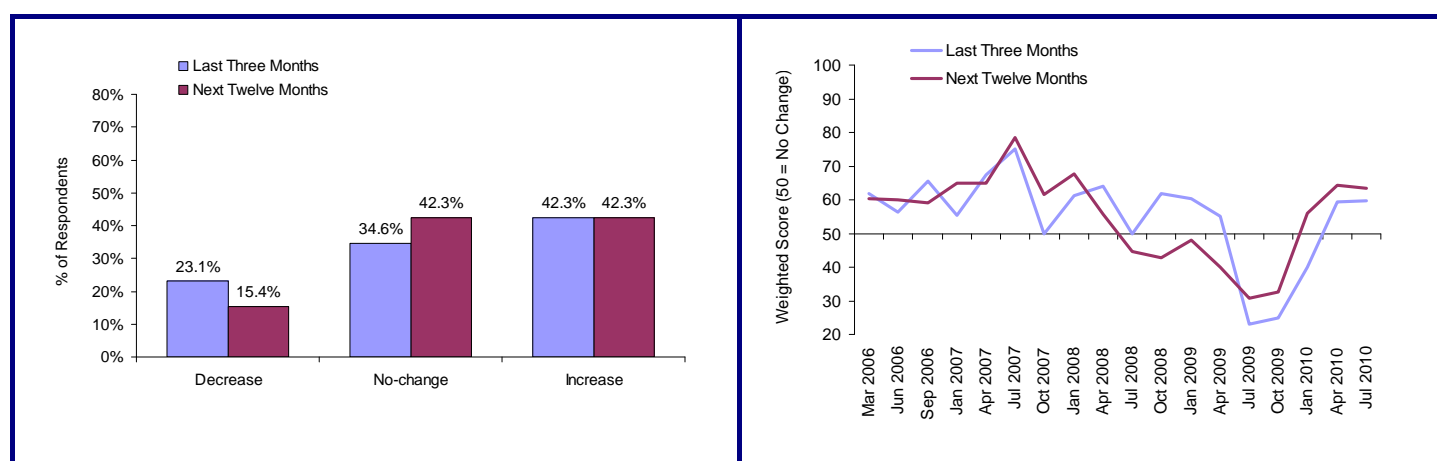
## EMPLOYMENT

- Respondents report that employment levels are, on balance, expanding again. For the second successive survey the weighted average balance of responses sits close to the 60 mark – indicating net hiring. As output increases in response to returning traffic demand, airlines are increasing staffing levels. While some productivity improvements have been gained, extra resources are also required. There is variation across the regions with two-thirds of airlines in the Americas expanding staff levels, while only 30% in Europe are taking this action. This largely reflects the variation in traffic recovery between regions.
- Looking ahead over the next 12 months, the balance of respondents see further increases in employment levels as likely. The weighed average score of 63.5 is similar to last survey and the drivers of this outlook remain the continued recovery of traffic and the return to market expansion through the establishment of new services. There has been a slight increase the proportion of respondents indicating 'no-change' in staffing levels over the year ahead as they seek further productivity increases driven by the economies of scale from expanding operations.

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

a) April 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](http://www.iata.org/business-confidence)