JULY 2019 SURVEY

AIRLINE BUSINESS CONFIDENCE INDEX

KEY POINTS

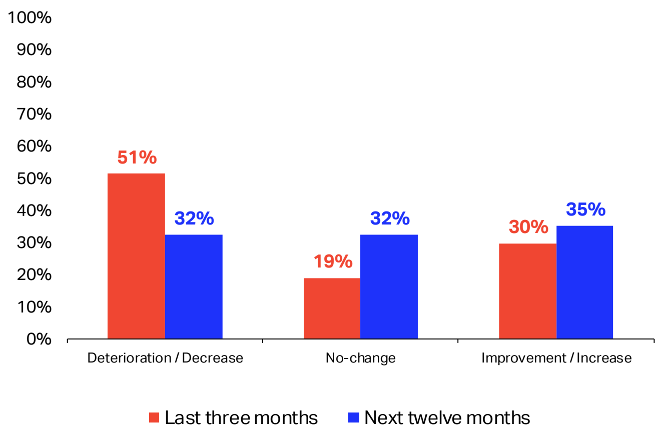
- The July 2019 survey of airline CFOs and Heads of Cargo shows a moderate improvement in the passenger business and a continued deterioration on the cargo side in Q2 2019. For the year ahead, the outlook for passenger volumes is positive, but the cargo business is expected to remain weak. A similar pattern is evident for the year-ahead expectation for yields. Higher costs remain a key concern for the period year-ahead with respondents pointing to fuel price volatility, exchange rate fluctuations and an increase in inflationary pressures as key concerns.
- Despite the improvement in passenger demand and yields, industry-wide profitability remains under pressure with rising input costs and softness on cargo side. Profits in Q2 2019 were weaker compared to the same period last year and the industry is expecting only modest improvement over the coming twelve months; just 35% of respondents are expecting profitability to improve.
- Airline employment continued to expand during Q2 2019 compared to a year ago and the index reached an all-time high. The industry is expecting to increase employment for the year ahead, despite the challenges on profitability.

PROFITABILITY OUTLOOK

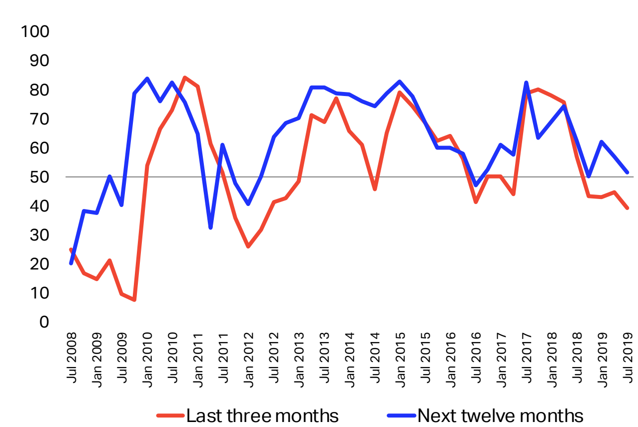
- Our latest survey of airline CFOs and Heads of Cargo, conducted in mid-July, suggests that profitability eased further during Q2 2019 as a result of softer economic conditions, volatility in fuel prices and ongoing US-China trade tensions. The number of respondents reporting improved profitability declined by 10 pp compared to the April survey, while 70% of respondents reported a decline or no change in their profitability in Q2 2019. As a result, the weighted backward-looking score, which was below the 50-mark in the last four quarters, declined further, to its lowest level since July 2012.
- Forward looking profitability expectations worsened as the percentage of respondents expecting improvement dropped to 35% from 46% in April. Almost one third of respondents expect profits to be lower in the year ahead, similar to the results in the past two surveys. Respondents continue to expect economic activity to be soft while fuel price volatility and geopolitical developments are both seen as key risks to the outlook. Overall, despite easing this quarter, the weighted forward-looking score remains slightly above 50, indicating expectations for a modest improvement in profits over the coming year.

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

a) July 2019 survey



b) Compared to previous surveys

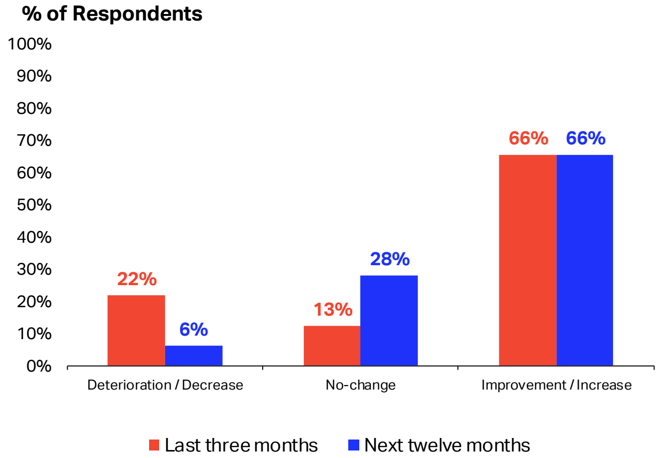


DEMAND GROWTH

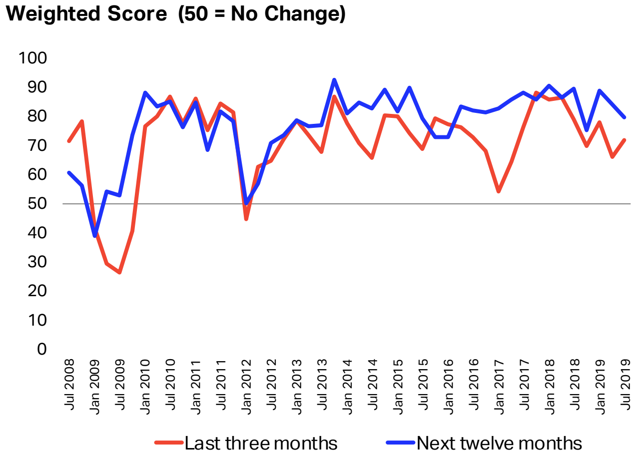
- The July survey shows that passenger demand improved moderately in Q2 2019. 66% of respondents experienced an increase in year-on-year demand, up slightly from 64% in last quarter's survey, reflecting capacity additions and new route openings. In contrast, the ratio of respondents reporting a deterioration in pax volumes declined to 22% from 32% in the previous survey with the B737 Max fleet grounding continuing to affect some airlines. Overall, the weighted backward-looking score improved following a temporary decline in Q1 2019.
- For the next twelve months, while the ratio of respondents expecting improvement in passenger volumes fell sharply to 66% from 77% in April, the ratio expecting a reduction in demand eased to 6% from 9%. Although a number of respondents stated their plans to open new routes and achieve better utilization of the existing operations over the next 12 months, slowing economic activity and geopolitical risks remain as concerns. Overall, the forward-looking weighted-average index declined, but the score remains elevated at 80.

Passenger

a) Recent and expected change in traffic volumes



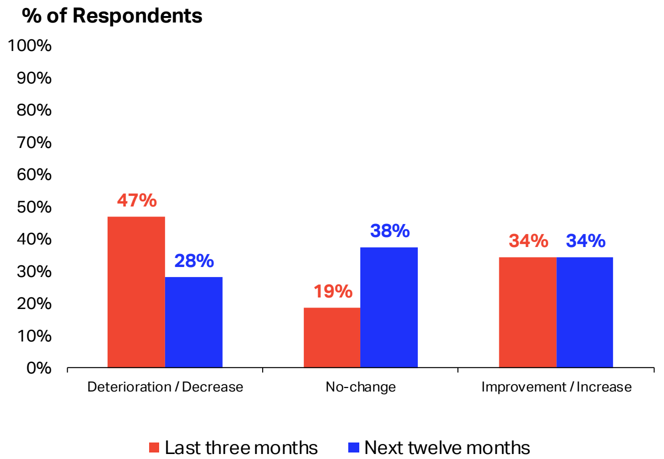
b) Compared to previous surveys



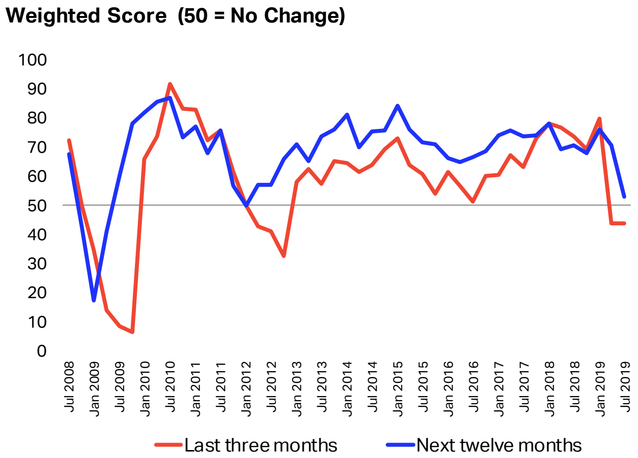
- For freight, 47% of the respondents reported a decrease in cargo volumes in Q2, the largest share since the October 2012 survey. On the other hand, 34% of the respondents saw an improvement in their cargo business compared to 25% in the previous survey. Consequently, the weighted score remined stable at 44 but it is still below the 50-mark, indicating a deterioration in demand.
- More importantly, respondents became less optimistic about the outlook as only 34% expect freight volumes to increase in the coming period compared to 54% in April survey. The expectations of further deterioration more than doubled compared to April survey (13% vs 28%). Consequently, the weighted score fell sharply towards to its lowest level since April 2012 survey, approaching 50 level-mark.

Cargo

a) Recent and expected change in traffic volumes



b) Compared to previous surveys

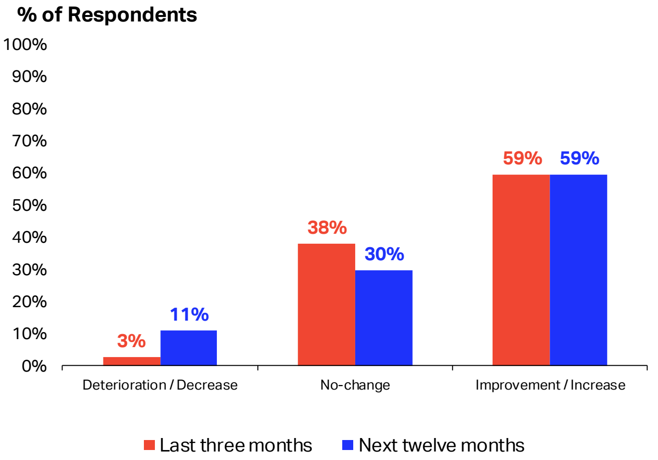


EMPLOYMENT

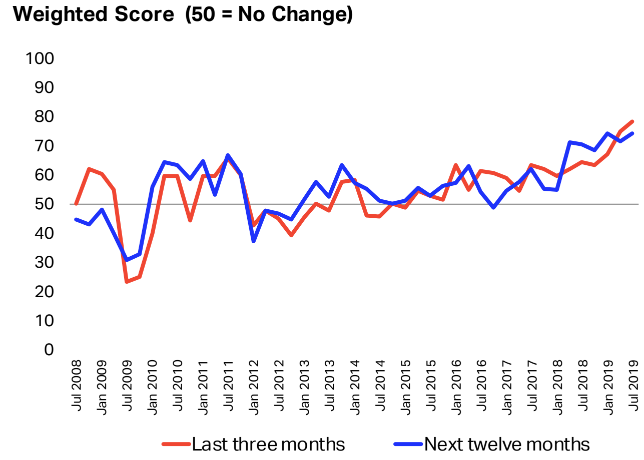
- Almost 60% of respondents indicated that they had increased employment levels in the past three months, which is the highest ratio since the beginning of the survey in September 2006. At the same time, only 7% of the respondents stated a decline in workforce. As a result, the weighted backward-looking score reached all time high of 78.4.
- Looking forward, despite the downbeat expectations for profitability and cargo demand, 60% of respondents expect to increase employment in the next 12 months, up from last quarter's survey (54%). The percentage expecting to cut employment remained stable at 11%. The weighted forward-looking score improved and remains close to historical highs.

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

a) July 2019 survey



b) Compared to previous surveys

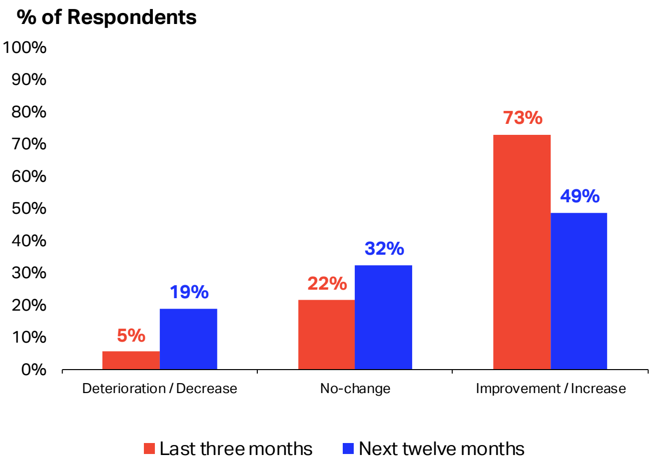


INPUT COSTS

- A higher share of respondents (73% vs 61% in April survey) experienced an increase in input costs over the past three months, while only 5% reported a decline compared to 21% in the previous survey. As a result, the weighted backward-looking score jumped sharply. Respondents pointed to higher fuel prices, weakness in domestic currencies and inflationary pressures as the main sources of rising input costs in Q1.
- A similar pattern is evident in the response for the expectations for the next 12 months. A higher proportion of respondents (49% vs 39% in April 2019 survey) expect input costs to increase and only 19% expect a decline in input costs compared to 29% in the previous survey. Hence, this quarter's survey shows that the key challenge for the industry will be to manage rising inputs costs. Several respondents noted an intention to help manage this challenge via formal cost-reduction initiatives.

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

a) July 2019 survey



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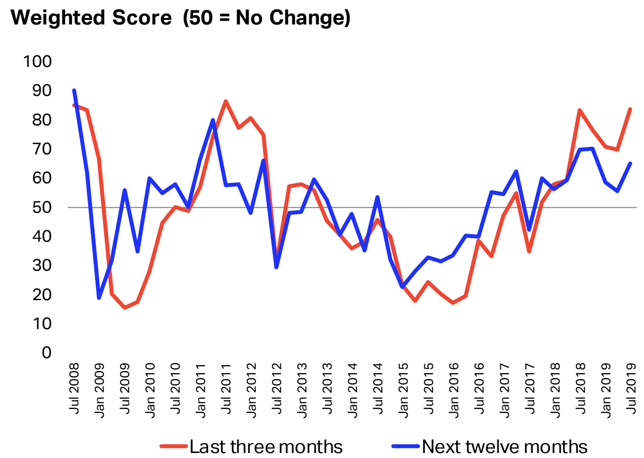
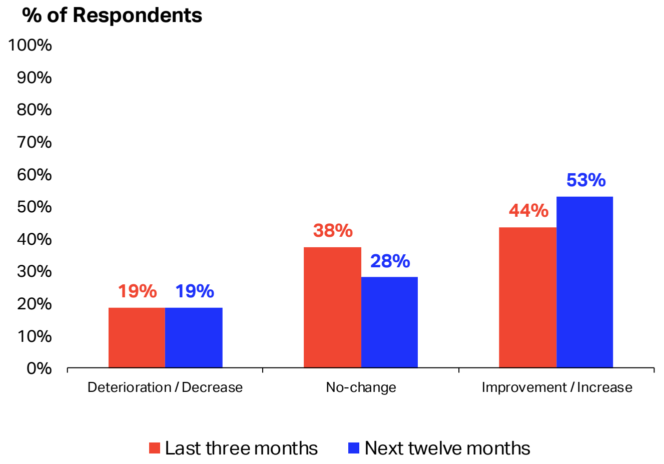


YIELD ENVIRONMENT

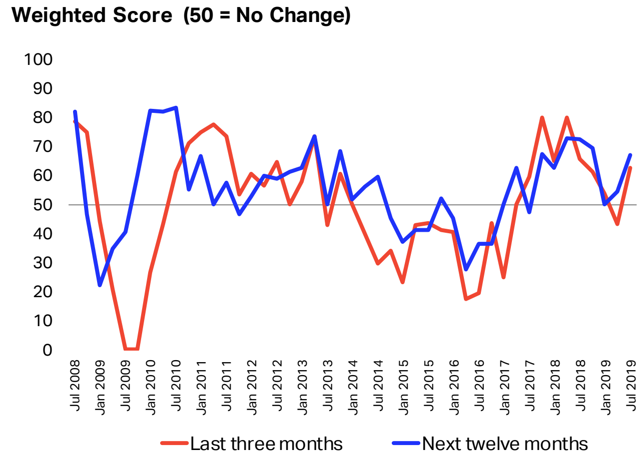
- Following a downward trend in the last four quarters, passenger yields improved in Q2 2019. The weighted score moved once again above the 50-level benchmark. The share of respondents reporting higher yields in the past three months jumped to 44% from 27% amid stronger passenger demand, while the share experiencing a deterioration in yields fell abruptly to 19% from 41% last quarter.
- Looking ahead, 81% of respondents expect yields to remain steady or improve over the year ahead. The share of respondents expecting yields to rise increased by 10 pp to 53%. In contrast, the share expecting a decline eased by 16 pp to 19%. As a result, the weighted average index rebounded solidly this quarter.

Passenger

a) Recent and expected change in yields



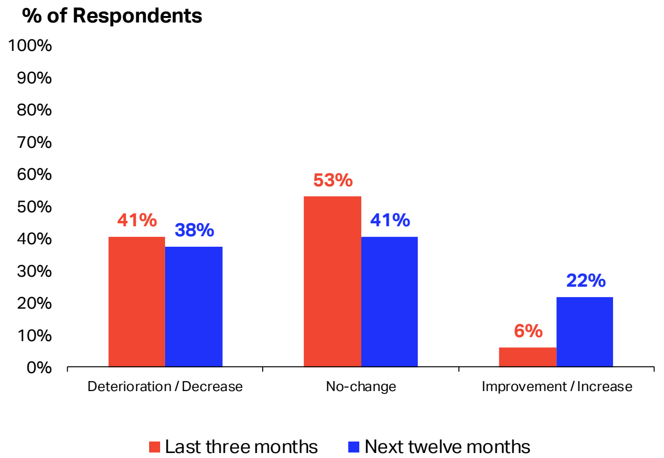
b) Compared to previous surveys



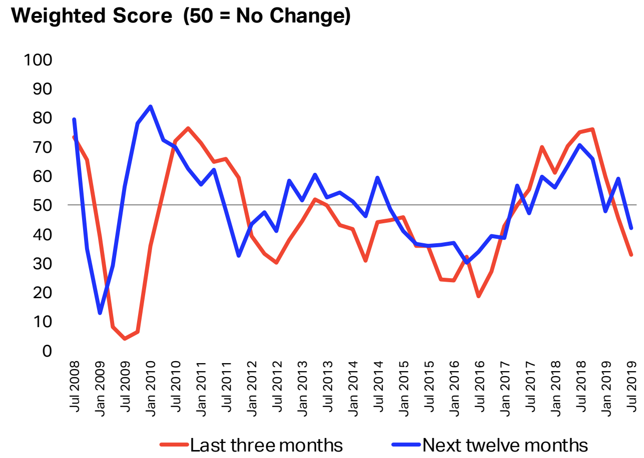
- In contrast to the passenger side, cargo yields continued to deteriorate as the share of respondents reporting higher yields plunged to 6% compared to 23% in the previous survey. Over the same period, the share of respondents indicating deteriorating yields increased by 9 pp to 41%. Overall, the weighted score fell further, remaining below the 50-level.
- Forward expectations also deteriorated as the share of respondents expecting higher yields over the next 12 months declined to 22% from 41% in the April survey. Moreover, 38% of the respondents now expect yields to deteriorate over the year ahead compared to 23% in the previous survey. As a result, the weighted forward-looking weighted score once again moved back below the 50-level.

Cargo

a) Recent and expected change in yields



b) Compared to previous surveys



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