Air travel and freight markets strengthened further in February, taking passenger kilometers flown (RPKs) to a level 9.5% higher than a year ago, and freight tonne kilometers flown (FTKs) to a level 26.5% higher. These are impressive upturns – and stronger than previously expected – but they are comparisons with virtually the lowest point in the travel and freight cycle at this time last year. Compared with market levels in early 2008, the previous high point, air travel volumes are still 1.4% below and air freight volumes are still 3% below. At the current pace of upturn it will be 2-3 months before travel and freight markets recover early 2008 levels. So more than two years of growth has been lost in the recession.

Nevertheless, the current pace of the travel and freight upturn is strong. The annualized pace of growth in the first two months of 2010 has been over 10% for air travel volumes and over 20% for freight, so at present the year-on-year growth rates are not exaggerating the strength of growth. This strong growth is being pushed by an inventory-cycle-driven surge in world trade, with associated business travel, and the return of some pent-up travel demand after the recession. We do expect some slowdown in the second half of 2010, as these transitory factors work through, with travel and freight becoming more dependent on consumer spending growth.

Airlines are still keeping passenger capacity under check. Available seat-kilometers (ASKs) were 1.9% higher than a year ago in February but that represents very little growth at all on average 2009 second half levels. February is one of the seasonally weakest months in the year for air travel but the 75.5% load factor achieved compares very favorably with previous years. Adjusting for seasonality shows February marked a new record high load factor on international markets. However, aircraft utilization is well below its 2008 peak on long-haul markets as airlines have partly achieved capacity cuts by reducing frequencies and kept aircraft on the ground for longer. As a result the recovery of financial performance is lagging the recovery of air transport demand.

Moreover, large geographical differences remain. Economic recovery is strongest in Asia-Pacific, South America and the Middle East. Airlines in these regions are benefiting from local economic strength and are experiencing the strongest growth in air travel and freight volumes. European airlines stand out, particularly for freight, as getting the least benefit from the recent upturn in economic activity. US airlines are also seeing sluggish growth for international air travel, but that is partly because of substantial capacity cuts. African airlines have also benefited from a good regional economic upturn with strong travel and freight carried. However, capacity is also coming back fast so airlines in this region continue to see the weakest load factors on both passengers and freight markets, which will hamper efforts to reduce losses.
COMPARING FEBRUARY TO JANUARY

<table>
<thead>
<tr>
<th>Month on Month Comparison</th>
<th>Feb 2010 vs. Jan 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>RPK</td>
</tr>
<tr>
<td>Africa</td>
<td>-0.6%</td>
</tr>
<tr>
<td>Asia/Pacific</td>
<td>2.7%</td>
</tr>
<tr>
<td>Europe</td>
<td>-0.5%</td>
</tr>
<tr>
<td>Latin America</td>
<td>-1.9%</td>
</tr>
<tr>
<td>Middle East</td>
<td>2.2%</td>
</tr>
<tr>
<td>North America</td>
<td>-0.7%</td>
</tr>
<tr>
<td>Industry</td>
<td>0.6%</td>
</tr>
</tbody>
</table>

Data are seasonally adjusted.

All figures and expressed in % change month on month except, PLF pt and FLF pt which are the percentage point difference between load factors of two consecutive months.

This table compares growth between January and February – after adjusting for seasonality – which is more pronounced in air travel than freight. It helps to show how the pace of the upturn is developing, as it is not as prone to distortion as the year-on-year comparisons. Note however that there can still be considerable month-to-month ‘noise’ in the data so the numbers still need careful interpretation.

The main takeaway is the large geographical variation in the upturn, with the main areas of strength visible with the Asia-Pacific airlines and the Middle East. European airlines are clearly facing weak markets and in fact were cutting capacity significant in February. Only Asia-Pacific and Middle Eastern airlines were adding passenger capacity in February.

STRONG RISE IN INTERNATIONAL PASSENGER TRAFFIC SO FAR IN 2010

The seasonally adjusted data in the chart above shows that international air travel markets have almost recovered early 2008 levels; by February RPKs were 1.4% below the previous peak. February is a seasonally weak month for air travel as the actual RPKs in the chart show, but that hides the underlying trend which has been strongly up since early 2009. Compared to the early 2009 low point, international travel volumes were up 9.2% by February. Looking at both January and February together the annualized pace of growth in air travel has been more than 10%.

So the traditional year-on-year growth rate, of 9.5% in February, usually prone to distortion by fluctuations in the previous year, is currently giving a fairly accurate indication of the underlying pace of air travel expansion. Growth at this pace is much faster than the 7% trend, but 2010 is shaping up to be more like 1992 than the weak years following the 2001 downturn. In 1991 international RPKs fell 3.6% and then rose 14% in 1992, with world GDP expanding by 2%. Part of the post-recession rise is arithmetic – the comparison is with the low point in the cycle. But there is also usually a post-recession surge in business travel and a return of pent-up leisure and VFR travel. Once these temporary influences run their course air travel volume growth will depend more on consumer spending, which in North America and Europe remains weak as households seek to repay debt. But the rebound has not run out of steam yet and this may well cause some upward revisions in forecasts for travel growth in 2010.

The divergent regional picture in the chart above remains stark. US airlines have been cutting capacity sharply on international markets, so the weakness of their passenger growth is not unexpected. Nonetheless, the US
consumer is also paying down debt rather than increasing spending – aside from fiscal stimulus driven car replacement – and so US originating travel growth remains soft. The European airlines are clearly facing tough markets, as many European economies slipped back into economic decline in the fourth quarter of last year, and unemployment continues to rise. This month the numbers were also pushed a little lower by strikes. Many European airlines have networks, alliance relationships or code shares covering the fast growing markets of Asia and South America. However, the restrictions of current ownership and market access rules mean that airlines are still heavily dependent on local conditions. European airlines experienced the weakest regional growth in international RPKs at 4.3% in February.

By contrast strong growth was experienced by Asia-Pacific airlines, after they faced the deepest recession in 2009. February passenger traffic was up 13.5% year-on-year in this region, but compared with the mid-2009 low there has been a 19% rebound – partly boosted by the timing of the Chinese New Year. Middle Eastern airlines are the region that stands out as benefiting from the strongest passenger markets in February, with year-on-year growth of 25.8%. Moreover, airlines in this region experienced no recession in 2009, just a slowdown of growth. This traffic is partly direct O-D leisure travel generated by the large investments in the tourism industry in this region. It also represents the success of Middle Eastern airlines in boosting their market share of long-haul markets e.g. Europe-Asia connecting over their Middle Eastern hubs.

AIR FREIGHT VOLUMES ALMOST RECOVERED EARLY 2008 LEVELS

European airlines also stand out as benefiting least from the strong upturn in air freight volumes, with year-on-year growth of just 7.2% in February, compared to 26.5% on average. Moreover, the level of freight volumes for European airlines is still 16% below the early 2008 market size. All other regions saw that previous peak recovered in February, but European weakness kept the level of air freight volumes in February 3% under its previous peak in early 2008.

By contrast North American airlines have seen an air freight rebound that has been equivalent to those experienced by Asia-Pacific and Latin American airlines, in regions where the economic upturn has been clearly strong. The difference between North American airlines passenger and freight experience seems to be due to the nature of the US economic upturn. GDP did expand at 5.9% in the US during the fourth quarter but consumer spending was up just 1.7% - the bulk of the expansion in GDP being due to businesses restocking. The strong air freight upturn globally, not just for US airlines, has been largely driven by the business inventory cycle. There is a little further for this positive process to go but before long businesses will be happy with inventory levels and will reduce air freight levels. From that point – perhaps in the second half of 2010 – air freight growth will slow and become more dependent on consumer spending and world trade growth.

PASSENGER LOAD FACTORS REACH RECORD HIGH IN FEBRUARY

Airlines are still keeping passenger capacity under check. Available seat-kilometers (ASKs) were 1.9% higher than a year ago in February but that represents very little growth at all on average 2009 second half levels. Schedules suggest that there will be some recovery of frequencies and that passenger capacity will rise in 2010 but so far there is little evidence of any rapid return. As a result load factors reached a new all-time record on
international markets, averaging a seasonally-adjusted 79.3% in February. Unadjusted, as shown in the table on page 1, average load factors were a much lower 75.5% but that is because February is the weakest month of the year purely for seasonal reasons.

The combination of tight capacity control and a strengthening air travel upturn has generated these record load factors. On short-haul markets this is coupled with normal aircraft utilization, however, on long-haul utilization of aircraft is over 8% down on early 2008 levels. Airlines have partly achieved lower ASK capacity by cutting frequencies and effectively leaving aircraft on the ground for longer. Because this raises unit costs this may delay the benefits of stronger travel growth for airlines’ bottom line.

**FREIGHT LOAD FACTORS UP SHARPLY TOO**

Freight capacity is being reintroduced to the market place but with just an additional 5% from its low point, compared with a 29% rise in air freight volumes. Freight capacity remains 8% smaller than in early 2008. As a result freight load factors have risen to relatively high level in February of 54.7% on average.

The two regions that stand out are Africa with the lowest passenger and freight load factors – due to a fairly rapid return of capacity – and Asia-Pacific with the highest load factors – due to the strength of economic recovery in the region. The latter is one reason why we expect Asia-Pacific airlines to move back into profit in 2010, while airlines in Europe and some other regions do not manage to eliminate losses this year.