



AIR TRANSPORT MARKET ANALYSIS

OCTOBER 2009

KEY POINTS

- Demand for air transport, for travel and freight, resumed its upward trend in October after falling back during the previous month. Air travel volumes on international markets, measured by passenger kilometers flown (RPK), rose 0.5% compared with October last year, after a 0.3% growth rate in September. This represents a significant rise in air travel volumes during the month. Air freight volumes rose sharply. Freight tonne kilometers (FTK) flown in October were still 0.5% down on last year, but that is considerably better than the 5.4% decline reported in September.
- The level of international air travel is now just over 6% above the low point reached in the first quarter of this year, but is still 5% below market levels in January 2008. Air travel is on an upwards trend but it is only half way to recovering early 2008 levels.
- Air freight is also half way to recovering early 2008 volumes. Freight tonne kilometers are just over 14% above December 2008 lows but still 15% down on levels in January 2008; such was the severity of the recession and world trade collapse at the end of last year.
- Airlines cut capacity a little further in October. Passenger capacity (ASK) was 3.3% down on the same month last year. Stripping out seasonal fluctuations shows that airlines have kept passenger capacity broadly flat throughout 2009. As a result load factors have risen sharply and, at 78%, are back to pre-recession levels. Freight capacity (AFTK) has been cut even more, with many freighters put into storage or retired, to a level 7.4% lower than a year ago. Freight load factors have also recovered to pre-recession levels at 54.1%.
- However, the recovery to normal load factors exaggerates the progress made to better utilise airlines' key asset. The fleet itself has been expanding through the year, as new deliveries more than offset older aircraft retired and put into storage. In order to cut the seats and freight capacity made available, airlines have flown their aircraft less on average. Average daily hours for both narrow and wide bodied aircraft are around 6% lower than early 2008 levels. Since load factors are just back to early 2008 levels while aircraft utilisation is 6% down it is clear that overall asset utilisation remains low and a negative pressure on operating cash flows.
- There remains considerable regional variation. Of the larger regions, both Asia and Europe have risen most from their low points, though European airlines are still down on levels from last year due to weakness across the Atlantic and within Europe, and their air freight remains very weak. Traffic carried by North American airlines picked up significantly through to the middle of the year, but very significant capacity cuts across both the Atlantic and Pacific have reduced traffic carried in September and October. Airlines in Latin America and the Middle East have seen significant increases in both air travel and freight.

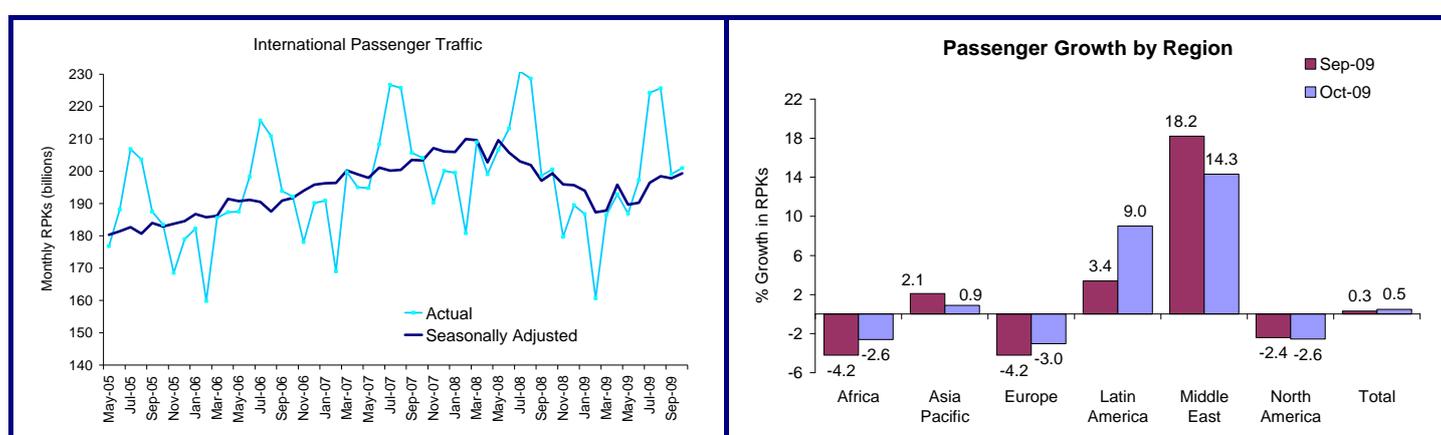
Oct 09 vs. Oct 08

YTD 2009 vs. YTD 2008

	Oct 09 vs. Oct 08						YTD 2009 vs. YTD 2008					
	RPK Growth	ASK Growth	PLF	FTK Growth	AFTK Growth	FLF	RPK Growth	ASK Growth	PLF	FTK Growth	AFTK Growth	FLF
Africa	-2.6%	1.6%	71.1	-3.8%	2.5%	30.4	-8.3%	-4.0%	69.8	-17.5%	-3.9%	26.5
Asia/Pacific	0.9%	-5.6%	76.3	1.9%	-7.5%	65.9	-7.9%	-7.2%	73.3	-15.1%	-13.7%	60.1
Europe	-3.0%	-6.2%	79.9	-11.3%	-12.4%	51.0	-5.5%	-4.5%	76.6	-18.9%	-10.8%	45.7
Latin America	9.0%	3.7%	76.4	6.7%	10.5%	46.0	-1.2%	1.7%	72.5	-10.4%	-1.5%	40.1
Middle East	14.3%	15.3%	73.2	18.4%	11.2%	46.3	9.9%	13.5%	72.9	-0.5%	5.6%	41.4
North America	-2.6%	-6.9%	82.3	0.5%	-12.0%	44.2	-6.3%	-5.3%	79.5	-16.3%	-10.6%	36.0
Industry	0.5%	-3.3%	78.0	-0.5%	-7.4%	54.1	-4.7%	-3.4%	75.3	-14.9%	-9.8%	47.7

INTERNATIONAL PASSENGER TRAFFIC BACK TO GROWTH

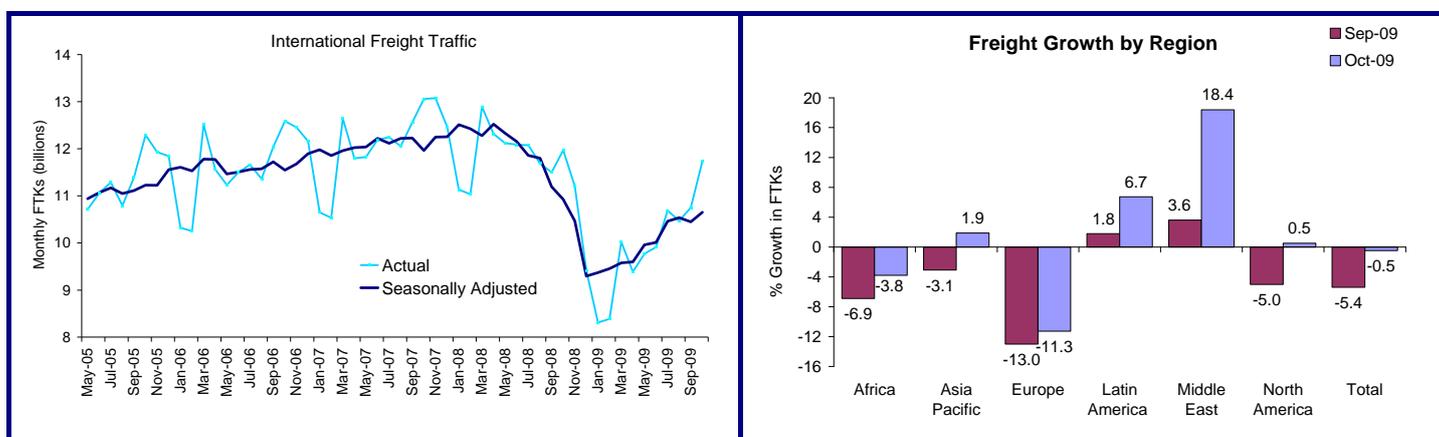
- After a dip in September air travel resumed the upward trend on which it has been since the end of the first quarter. Air travel volumes on international markets, measured by passenger kilometers flown (RPK), rose 0.5% compared with October last year, after a 0.3% growth rate in September. As can be seen in the chart below, the seasonally-adjusted level of RPKs rose, by 0.8%, in October compared with September, more than offsetting that month's decline. The level of international air travel is now just over 6% above the low point reached in the first quarter of this year, but is still 5% below market levels in January 2008. Air travel is on an upwards trend but it is only half way to recovering early 2008 levels.
- The other point to note from the chart below is that the slope of the upturn since Q1 is similar to the pace of growth in 2006 and 2007. No rapid catch up to the 2005-early 2008 trend is happening. Pre-recession growth rates may be resuming but it appears as though the industry has lost 2 years of growth.



- The economic drivers for this recent upturn in air travel are looking reasonably positive but still uncertain. Firstly, although there has been a modest rise in air fares since mid-year it remains around 20% cheaper to fly in real terms today than it was a year ago. Second, consumer confidence has picked up significantly in the major economies since the low point in February this year. Consumer confidence has recovered about half of the ground lost during the recession, as has air travel. This is despite unemployment continuing to rise and jobs being lost. In the US the latest indicators suggest the recent upturn may be running out of steam. In Europe, Latin America and Asia however the renewed economic expansion appears to be continuing through the fourth quarter. Consumer confidence may improve further – boosting air travel – but this is likely to be geographically uneven.
- The data we report here are for IATA member airlines, which carry 93% of the passenger kilometers flown on international markets. The remaining 7% are mostly LCCs. IATA has recently begun compiling a time series of data that represents the complete commercial airline industry, including LCCs and others, which we will start to publish in the next few months. Recently the LCCs have benefited from a shift of passenger demand to the lowest fare providers, due to the recession, however because these airlines still represent a relatively small RPK share they do not change the overall picture of air travel markets described in this note. Including the LCCs raised the growth of international RPKs in October from the 0.5% reported here to 0.9%.
- There remains considerable geographical variation, reflecting differing economic developments and capacity changes. Of the larger regions, both Asia and Europe have risen most from their low points, though European airlines are still down on levels from last year due to weakness across the Atlantic and within Europe, and their air freight remains very weak. Traffic carried by North American airlines picked up significantly through to the middle of the year, but very significant capacity cuts across both the Atlantic and Pacific have reduced traffic carried in September and October. Airlines in Latin America and the Middle East have seen significant increases.

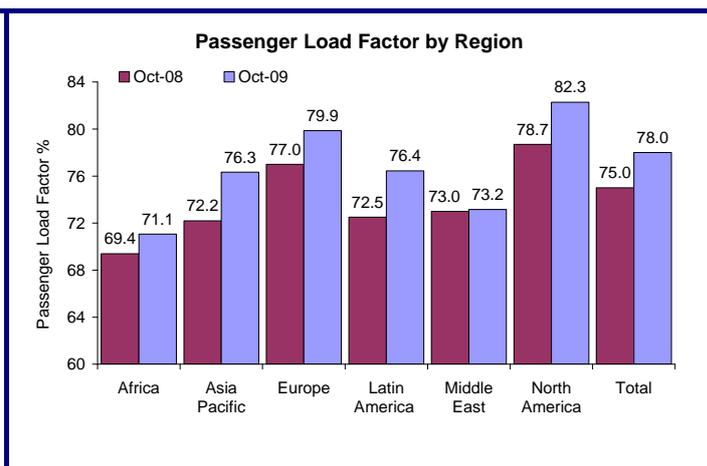
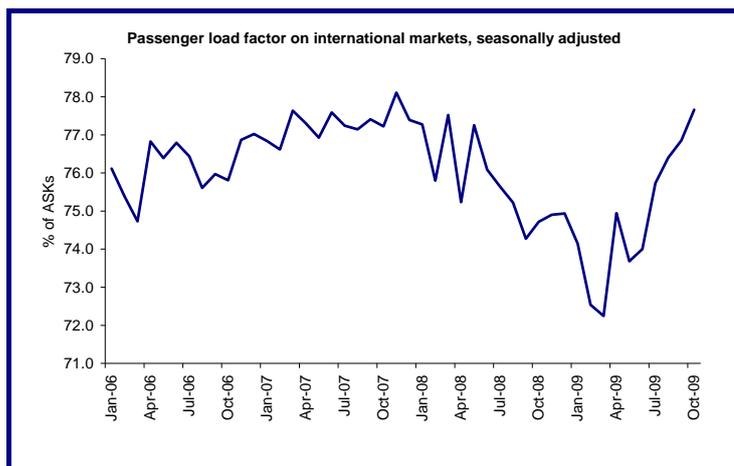
AIR FREIGHT VOLUMES RESUME UPWARD TREND

- Air freight volumes rose sharply. Freight tonne kilometers (FTK) flown in October were still 0.5% down on last year, but that is considerably better than the 5.4% decline reported in September. Air freight is also half way to recovering early 2008 volumes. Freight tonne kilometers are just over 14% above December 2008 lows but still 15% down on levels in January 2008; such was the severity of the recession and world trade collapse at the end of last year.
- The renewed rising trend in air freight was led, by around 2 months, by the rise in the buying intentions of purchasing managers in manufacturing industries of major economies around the world. This leading indicator is pointing to further gains in air freight in the next few months. But so far there has only been a small rise in overall world trade volumes since June. This is normal. As businesses expected a recovery in consumer spending they wanted adequate inventories. Moreover, excess inventories that had built at the end of 2008 had diminished. Since working capital tied up in transit needs to be kept to a minimum business turned to air freight as the transport mode of choice. The 14% rise in air freight volumes has been the result of this change in the inventory cycle.
- The issue looking further ahead is whether the inventory cycle, and government stimulus, is developing into a sustainable recovery in consumer spending and business investment – or will it fizzle out once inventories have been built up to adequate levels.
- Of the larger markets Asia-Pacific airlines have benefited from the air freight generated by the earlier and stronger economic revival in this region. Industrial production is now rising strongly in a number of economies in this region. Air freight was 1.9% up on the previous year in October. The big difference to the pattern in passenger markets was Europe, where air freight volumes remain very weak at a level 11.3% down in last year. By contrast freight was up 6.7% for Latin American airlines and by over 18% for airlines in the Middle East.



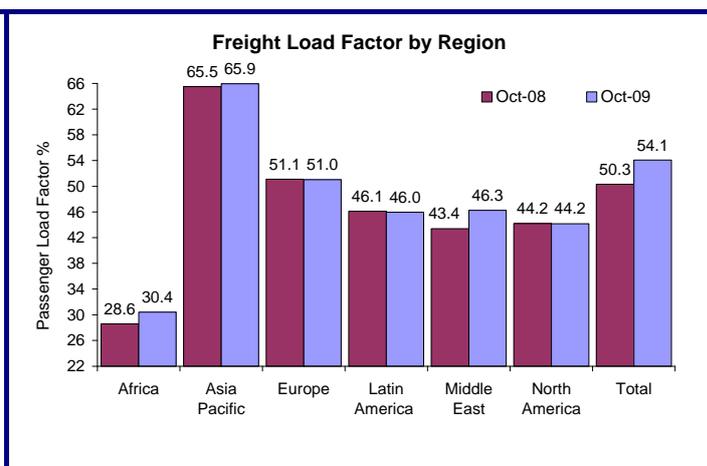
PASSENGER LOAD FACTORS BACK TO LATE 2007 UTILIZATION RATES

- Airlines have managed to keep seat kilometer capacity broadly flat throughout this year, adjusting for seasonal fluctuations, following a cut of around 7% in late 2008. However, there has been quite a bit of geographical variation. In October there were some particularly large further cuts by US airlines on Atlantic and Pacific markets. As a result load factors are up sharply and, seasonally adjusted as in the chart below, are now approaching the highs of late 2007. Fuller aircraft are starting to turn the path of average fares, which are now turning up from their -20% lows. For US airlines there was an improvement of 4-5% points in passenger yields in October, no doubt reflecting sharp capacity cuts and high load factors. Note though that although load factors are back to pre-recession levels, fares and yields are still 15% or more down on last year albeit above recent lows.
- The other negative factor is that airlines have been achieving at least part of the capacity cuts by reducing the average hours flown by their aircraft. Both narrow and wide-body aircraft utilisation is down around 6% since early 2008. So while high loads are starting to turn yields up, low aircraft utilisation is raising unit costs.



FREIGHT LOAD FACTORS BACK TO PRE-RECESSION LEVELS

- Freight capacity has been cut further than passenger capacity as many freighters have been taken out of the fleet and stored or retired. Capacity cuts continued through 2009 and around 10% have been taken out since early 2008. This has pushed load factors back up to pre-recession levels.
- However, that is only just above 50%. At these levels competition will remain intense so this is no guarantee that freight rates will rise from the -20% reached in the second quarter.



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