AIRLINE BUSINESS CONFIDENCE INDEX

OCTOBER 2011 SURVEY

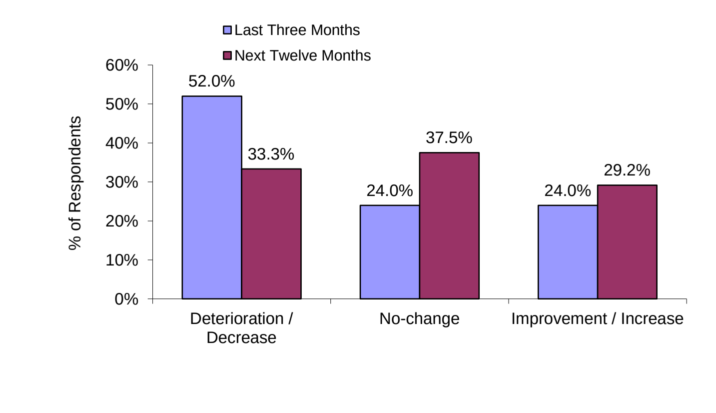
KEY POINTS

- Airline confidence fell in IATA's October survey of CFOs and heads of cargo, with expectations for profitability over the next 12 months down significantly. This low level of confidence has in the past been consistent with the industry doing only a little better than breakeven. A sharp deterioration was also reported for the third quarter.
- The economic outlook has deteriorated since the previous survey in July but airlines expect this to have uneven impacts on their markets. The major deterioration has been in cargo markets, where airlines report a sharp decline in the third quarter and in their expectations for the coming year. Confidence in passenger markets is down but not by much.
- Yield expectations have also declined, particularly in cargo markets where 45% of respondents are now expecting a fall. Even in passenger markets, however, airline confidence in yields over the year ahead is at their lowest level since early 2009.
- The current and expected squeeze on profit margins is apparent in the results for unit costs. Airlines report that unit cost increases were a little lower in Q3 than Q2, but not by much, which is close to 2008 highs. This reflects the relatively modest decline in fuel prices from April peak levels. The outlook for the year ahead is for more subdued increases, but nonetheless increases compared with expected declines in yields. Expected breakeven load factors will have increased as a result.
- Although confidence in the outlook for profitability has fallen back to the levels seen in the first half of 2009, airlines are continuing to hire and expect to do so in the year ahead. Only 12% of respondents expect to cut payrolls over the next 12 months.

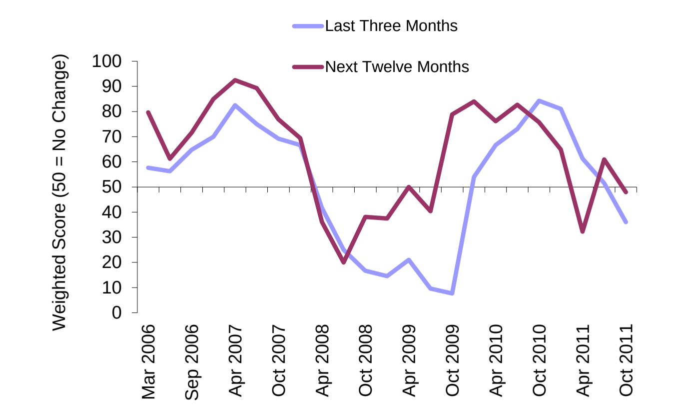
PROFITABILITY OUTLOOK

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

a) October 2011 survey



b) Compared to previous surveys



- Confidence in airline profitability fell back in IATA's October survey of airline CFOs and heads of cargo. Third quarter profits were squeezed, with 52% of respondents reporting a decline in the previous three months, and the weighted score in the second chart above is now well below the neutral 50 level. Looking 12 months ahead only 29% expect an improvement, with the majority expecting deterioration or no change. This compares to the July survey when 47% of CFOs said they expected an increase in profits. The weighted score in the second chart shows that confidence about the year ahead is down to the levels seen in the first half of 2009.

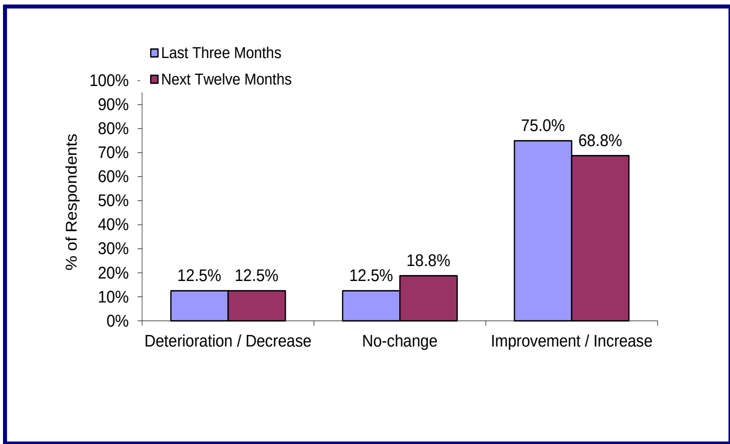
- This loss of confidence has been driven by deterioration in economic conditions recently, particularly in developed markets. Airlines remain confident that passenger markets will continue to expand over the next year but expectations for cargo markets have fallen sharply. The other major change was a fall in expected yields over the next year, particularly in cargo markets. Overall the results suggest that airlines expect breakeven load factors to rise, particularly on cargo markets, as margins get squeezed by lower yields and higher unit costs.

DEMAND GROWTH

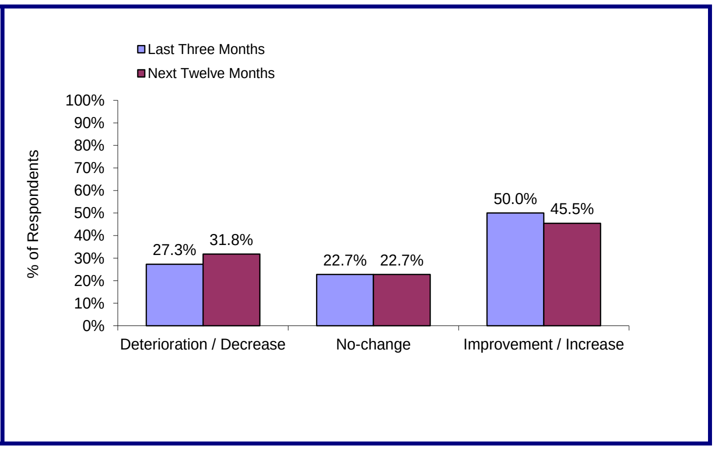
- The major change on airline markets has been a sharp fall in recent and expected cargo volumes. Passenger market volumes appear to be holding up (although end Q3 results look weaker). But in October heads of cargo and CFOs reported that cargo volumes were weak in the past quarter and confidence in future expansion also fell sharply.

Recent and expected change in traffic volumes

a) Passenger



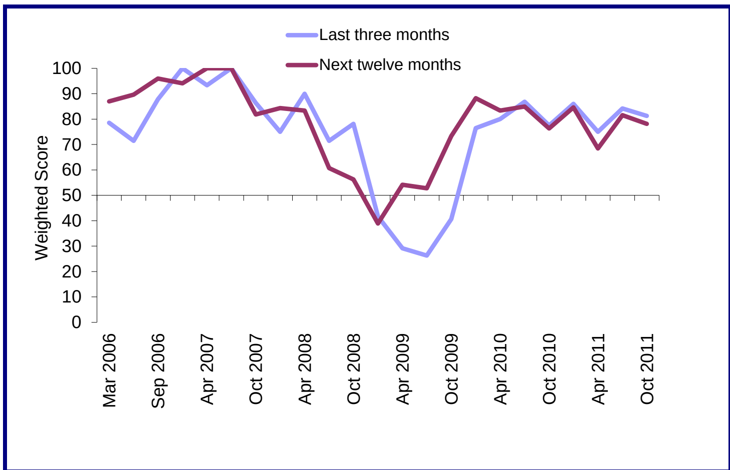
b) Cargo



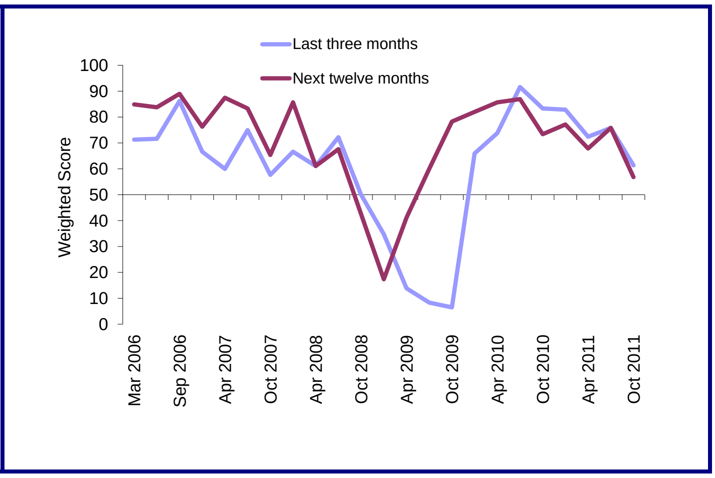
- Although a number of commentators are suggesting the financial situation in major economies, with the Eurozone debt crisis, is similar to that in late 2008, airlines are not expecting a similar fall in demand. The exception is for cargo markets, which appear to have been driven by recent experience. Passenger markets were relatively robust in the third quarter, and most airlines expect that to continue in the year ahead.
- Weaker data at the end of the third quarter, and the weakness of business and consumer confidence in the large developed markets, suggests that this expectation of continued passenger market strength could be at risk of disappointment. If markets are weaker, but capacity and employment decisions are based on expected strength, then profitability could come under further downward pressure.

Compared to previous surveys

a) Passenger



b) Cargo

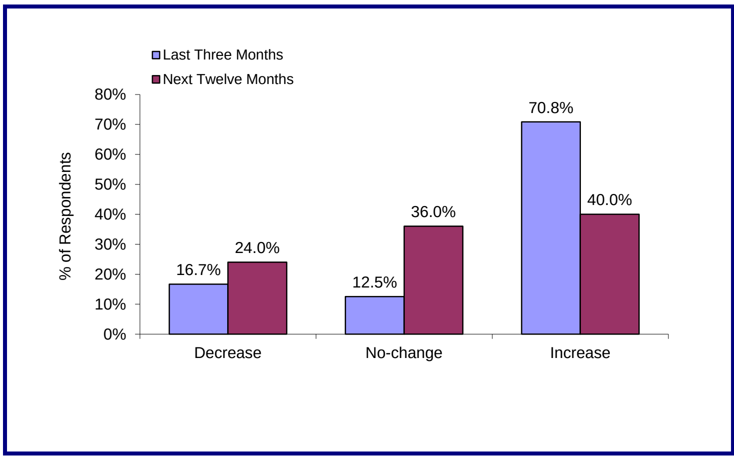


INPUT COSTS

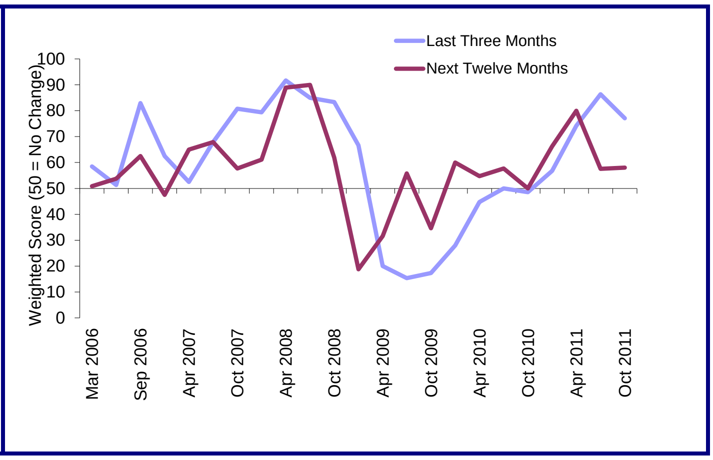
- Unit costs are still putting airline profit margins under pressure. Upward pressure on unit costs moderated in Q3, compared to Q2. Nevertheless, over 70% of respondents reported increasing unit costs in this October survey. Expectations for the year ahead, because of the deteriorating economic environment, continue to be for more moderate cost growth but still an increase. Fuel costs have fallen a little from April peaks but remain over 30% higher than last year, and slippage in asset utilization is also putting upward pressure on unit costs. Expected unit cost increases are significantly higher than yield expectations, which are for a decline in the year ahead.

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

a) October 2011 survey



b) Compared to previous surveys

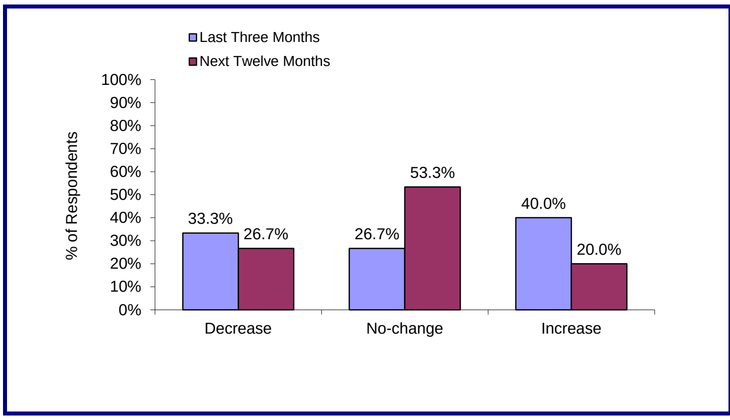


YIELD ENVIRONMENT

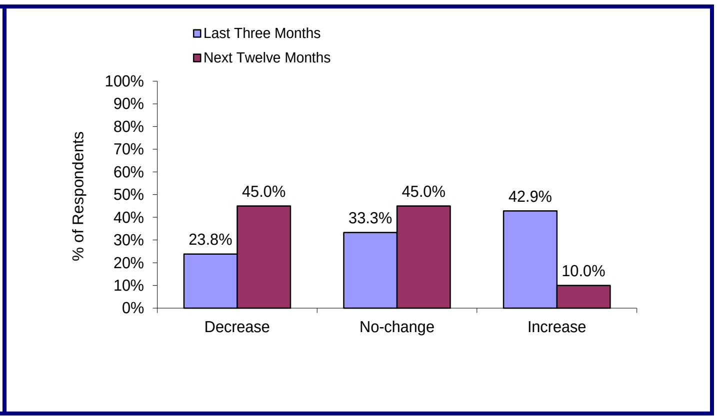
- The yield environment deteriorated significantly during the third quarter, according to responses in this October's survey. This varies considerably by market. For example US airlines are still facing strong passenger yield conditions. Elsewhere the situation is weaker. Yields are still rising, but at a much slower pace in passenger markets. In cargo markets yields are falling as volumes and load factors decline.
- The big deterioration in the outlook for yields was seen for cargo markets in this survey. Now 45% of respondents expect a further decline in the year ahead. Expectations are as low as late 2008/early 2009 when cargo yields fell sharply. A modest decline in the year ahead is expected for yields on passenger markets. Breakeven load factors will be expected to rise significantly as a result. If these are not achieved, and softening demand will make that difficult, then airline profitability will decline, as CFOs reported that they expect.

Recent and expected change in yields

a) Passenger

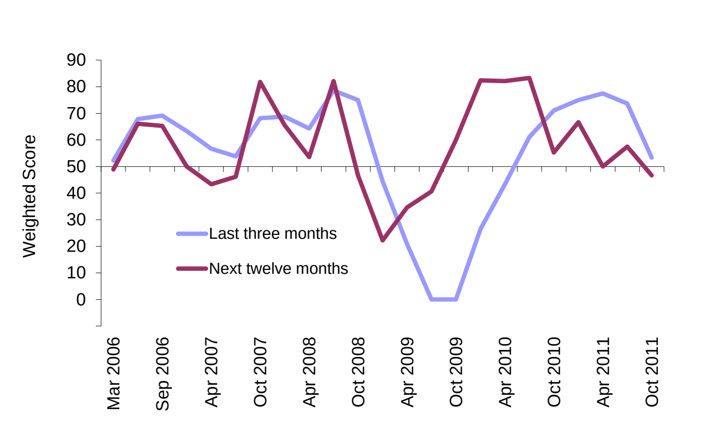


b) Cargo

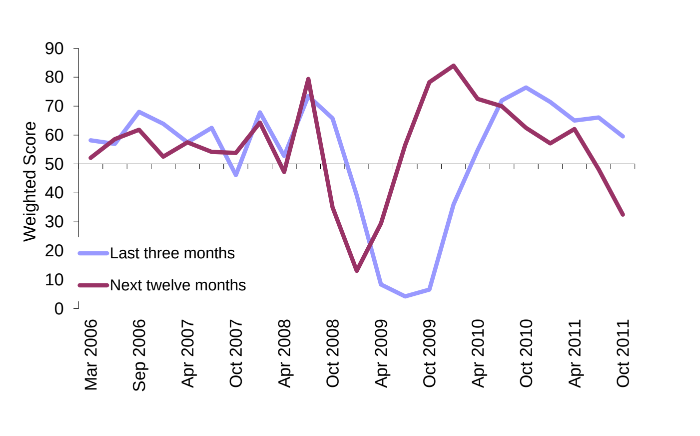


Compared to previous surveys

a) Passenger



b) Cargo

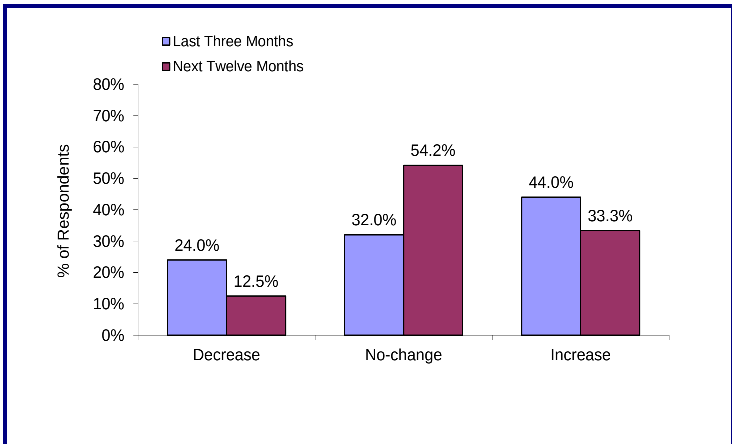


EMPLOYMENT

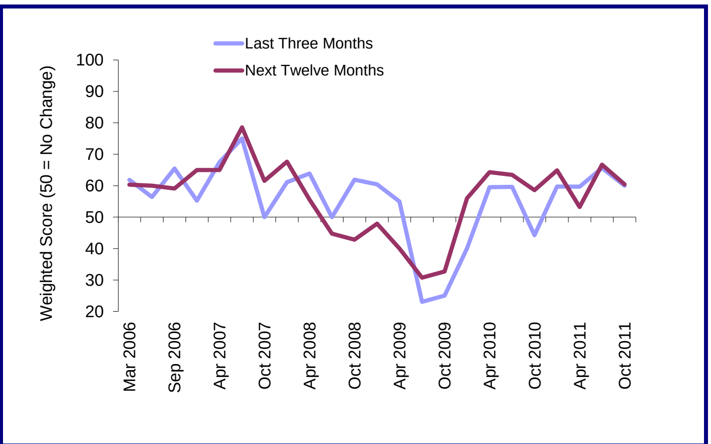
- Employment decisions are being driven more by expected market growth than by expected profitability. Despite the deterioration in financial conditions and expectations of falling profitability, airlines report that they increased employment in Q3 and expect to continue to do so in the year ahead.

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

a) October 2011 survey



b) Compared to previous surveys



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