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The Airline Industry – Surviving the Turbulence Ahead

"Our industry is in survival mode. Whether this crisis is long or short, the world is changing." - Mr. Giovanni Bisignani, Director General and CEO of International Air Transport Association (IATA)

Emerging from an exceptionally challenging 2008, 2009 will prove to be no piece of cake for the airline industry. Following IATA's Annual General Meeting in Kuala Lumpur on the weekend of 6-7 June 2009, it was revealed that in 2008 the industry experienced a net loss of US$10.4 billion and operating profit of US$1.5 billion and IATA now expects that losses for 2009 will amount to US$9 billion (a revision of the March 2009 predicted figure of US$4.7 billion) and an operating loss of US$1.7 billion. This will be the first recorded loss for the industry since 2003.

High oil prices and collapsing demand due to the global recession were the culprits for the losses in 2008. An average oil price of US$99 for the year brought the industry's total fuel bill to US$168 billion. Oil prices have since tempered and it is expected that the industry fuel bill will fall by US$59 billion in 2009, but rising oil prices anticipating economic recovery are still a great risk. The projected lower fuel bill is the only ray of light in the year ahead as continuing recession, protectionist threats, restrictions to restructuring, new government taxes and rising infrastructure costs continue to overshadow the industry. IATA forecasts total industry revenues of US$448 billion in 2009, US$80 billion (15%) less than the US$528 billion recorded in 2008. After September 11, 2001, industry revenues fell by 7% and it took three years to recover lost ground, even on the back of a strong economy. Today they face a 15% drop in world demand in the middle of a world recession. Air cargo demand is expected to decline by 17%, passenger demand is expected to contract by 8% and the revenue impact of falling demand will be further exaggerated by large falls in yields of 11% for cargo and 7% for passenger.

The industry is no stranger to exogenous shocks which could further diminish demand. The increasing severity of the Influenza A H1N1 virus (commonly referred to as swine flu) has grounded many potential passengers at a time when schools close globally and vacations amass. Incidents such as the disappearance of Air France Flight 447 over the Atlantic Ocean on 1 June 2009 with 228 passengers on board do little to encourage the numbers. In addition to reducing consumer demand, it is estimated that the crash could be the most expensive since September 2001. As business habits change and travel budgets cut globally, video conferencing becomes more of a competitor. Many passengers have switched to economy class, causing sales of first- and business-class tickets to slump and depriving many carriers of a major source of revenue unlikely to return any time soon.

So how do they survive this crisis? IATA has identified three top priorities for the year and beyond – further cost cutting, conserving cash and improving safety. Savings are being considered in areas of baggage management, travel processes and e-freight services, in addition to the measures which reduced costs last year such as 100% e-ticketing and the deployment of Common Use Self-Service (CUSS) kiosks. It is hoped that these new measures will provide savings in the arena of US$10 billion. Numerous routes are being flown less frequently, unused planes are being grounded and some carriers have resorted to cutting in-flight services or adding fees for things like luggage or pillows. With regards to labor in the industry, Mr. Bisignani has said that “this is not the time for salary increases” but rather to become more flexible and make use of less resources to preserve jobs. Suppliers and manufacturers must also contribute to the efficiency effort and find ways to reduce costs. However, there exists monopoly suppliers who have been padding the industry’s cost that caused an increase in revenues paid to suppliers by US$1.5 billion for the first six (6) months of 2009. One notable reference is the increase in charges in both Delhi and Mumbai by 10% in early 2009 and the introduction of new airport development fees equivalent to a 137% increase in charges for Delhi and a 278% increase for Mumbai.

The industry’s cash position is estimated to have increased to 13% of current revenues (new cash raised this year includes US$4 billion on the capital market and US$4 billion on aircraft sales and leaseback transactions) but balance sheets are weaker now than they were ahead of the downturn in 2001. It is extremely difficult to raise or pay the cost of new finance given the tightness in credit markets and the industry is in a fragile financial position. Additionally, with a forecasted US$25 billion worth of jet aircraft being delivered to airlines this year based on orders placed in better economic times, cash balances will have to be used to meet payments. Mergers and partnerships will create stronger competitors and increase chances of survival. Delta Air Lines acquired rival Northwest Airlines in October 2008 to create the world's largest airline. European airlines went through a spurt of mergers and acquisitions last year, in which Deutsche Lufthansa agreed to buy Austrian Airlines and Air France-KLM scooped up Alitalia.

Governments are being urged to avoid protectionist policies and move towards progressive liberalization such as the lifting of restrictions on routes and cooperation between airlines to strengthen the global airline industry. Government foreign ownership restrictions that cap foreign investment in airlines to a 25% stake, limit access to global capital which could be detrimental to the industry’s ability to pay its bills. “Liberalizing key routes today would create 24 million jobs and US$490 billion in economic activity” claims Bisignani. Airlines facilitate the international flow of trade, capital, people and ideas that are critical to global economic growth and protectionist measures by government can exacerbate the fall in demand for international goods and services.

Optimists see growth by the end of the year but a more realistic view may be one of an L-shaped recovery. Little evidence exists to support growth this year and it is difficult to imagine profits in such exigent times. Bisignani supports these views as he expects the industry may not recover until 2011. The industry must aim to reshape itself in all areas and interactions and improve efficiency where possible while maintaining high safety standards and reducing carbon emissions. Survival is no easy task and would be made even less feasible if governments and partners do not understand the struggle with this new and harsh reality and assist the industry in whichever ways they can. Those that survive will undeniably be stronger, better companies and business will never be back to usual in the airline industry.

Current Happenings in Local and International Markets:

- Trinidad: Inflation nudges back up
- T&T Minister: Latest audit shows more gas
- S&P maintains Jamaica's B- rating
- Jamaica: Sharp economic downturn led to first decline in personal loans in 5 years

- FirstCaribbean (Jamaica) leads competitors in loans to the productive sector
- Treasuries Gain After Japan Says It's Confident About U.S. Debt
- Europe Industrial Production Declines by Record 21.6%
- Ireland's Debt Rating Cut by One Level to AA by S&P

Table 1: Regional Market Performance (as at 11 June 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
TTSE Composite	780.30	0.28	-2.66	-7.43	-30.92
All Trinidad	1,079.61	0.73	-1.25	-6.51	-27.37
JSE Index	82,626.03	-0.54	3.30	3.09	-24.99
JSE Select	1,848.38	-2.19	7.76	-6.87	-39.22
All Jamaica	68,409.46	-1.21	7.70	-7.55	-38.20
BSE Composite	844.80	0.22	0.49	-8.16	-20.86

Table 2: International Market Performance (as at 11 June 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
S&P 500	944.89	0.26	3.92	4.61	-29.25
Nasdaq Composite	1,862.37	0.67	7.57	18.09	-22.21
Dow Jones Industrial	8,770.92	0.24	4.18	-0.06	-27.42
German Dax	5,107.26	0.84	4.94	6.18	-23.20
FTSE 100	4,461.87	1.71	0.59	0.62	-22.04
Nikkei 225	9,981.33	3.23	5.60	14.11	-29.63
Hang Seng	18,791.03	1.56	9.97	30.61	-19.45
DJ Eurostoxx	2,522.33	1.42	3.65	2.89	-28.13