



03 March 2008

Traffic Trends 2007, Outlook 2008

2007 was another year of growth. AEA airlines have transported more passengers - on average +4.1% - to all major traffic regions. Longhaul activities seem to have reached their market potential ceiling, with Asia tending towards a zero-growth. The expansion on routes within Europe was robust and above expectations. And European services are set to continue to grow in 2008, albeit at a slower rate than in 2007. Adequate capacity planning will be a key issue in the battle for high load factors, sustainable yields and eventually market leadership. Further growth has to translate into financial success or at least help improve competitive positioning. If not, it becomes a risk factor, especially in times of weakening demand.

Total scheduled traffic growth, measured in RPK (passenger kilometre, the usual industry standard) reached +5.1% in 2007, very much in-line with 5.3% of the year before. The airline industry's expansion rate of about 2.0 times global GDP growth is the widely applied rule of thumb that is followed by European airline planners. Asian as well as American competitors also expand their international operations at that speed. (see Fig.1) The international growth of US carriers (+6.4%) follows the apparent return to financial health after several difficult years marred by Chapter 11 filings. It is also a sign that US carriers have sought opportunities beyond the US, as the US domestic market lost its attraction for the local network airlines. Southwest Airlines, the originators of the 'low cost' concept is now the largest US carrier in number of passengers transported. Asian carriers (members of AAPA, the Association of Asia Pacific Airlines) show a similar picture. Their international traffic growth averaged 4.7% in 2007 up from 4.0% in 2006. In the three regions - Europe, America and Asia - the pattern is the same: network carriers seek their luck in the international or longhaul markets. North America and Asia on different tracks.



"Fasten your Seat belts" - for the year ahead

Despite strong growth in the Middle East and South Atlantic, North America and Far East remained the by far the most important longhaul regions for AEA carriers in 2007. But their respective development could not have been more different. Contrary to expectation, the North Atlantic market outperformed the Asian market. Whereas in 2006 barely any growth (+0.6%) was recorded to the region which includes USA and Canada, AEA carriers boosted RPK to a growth of +4.4% in 2007 with a distinct upward trend towards the end of the year. And this, months before the launch of 'Open Skies' between Europe and the US in March 2008. The expansion did not result in a decline in load factors. They remained almost unchanged at over 81%, despite a similar expansion by American



carriers to Europe. Transatlantic traffic reported by the ATA (Air Transport Association) saw an increase of +9.7% in 2007. Delta Airlines which, following its emergence from bankruptcy in 2006, announced its aim to transform into a 'globally balanced' business, proved its intentions and expanded its transatlantic operations by 15.6%. All large US carriers recorded growth at or above 7% to Europe. Analysis shows that European and American carriers share capacity between the two regions equally. Recent growth by AEA carriers was a means of maintaining this equilibrium, in the face of American expansion. So far the market has absorbed the additional offer, but yields have increasingly come under pressure. Latest figures from 2008 also suggest that this erosion is continuing as load factors move away from record highs of recent years.

Fig. 1:

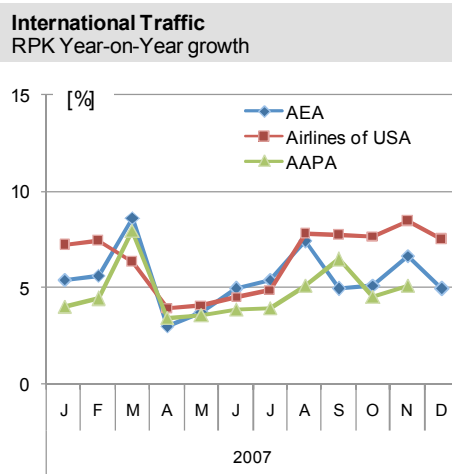


Fig. 2:

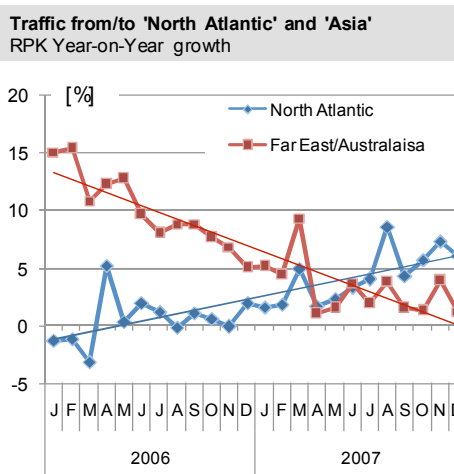
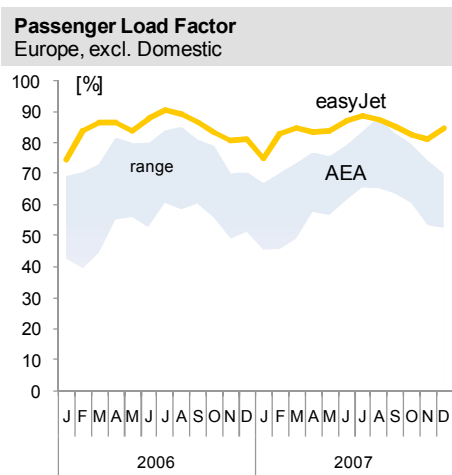


Fig. 3:



Far Eastern routes moved from vibrant growth in 2006 (average rate +9.9%) to almost zero towards the end of 2007. For AEA carriers individual Asian markets differed greatly in their traffic development, with expanding economies such as India registering a strong increase in the number of passengers travelling to/from Europe, of +16.6%. Whilst for China the buoyant economy is not necessarily translating into buoyant traffic, with a surprisingly slow growth of +5.1%. Japan, generally a more mature market, managed a +4.4% increase in traffic in 2007; Singapore even registered a traffic loss (-6.8%). In fact whilst some AEA carriers have greatly reduced capacity to Asia (Austrian, SAS) others have opted for a slower rate of expansion. High fuel cost are noted as one of the reasons for this slower pace. The overall figures certainly reflect a more cautious approach. The assumption that certain AEA traffic to Asia has been lost to Middle Eastern carriers is likely but is not quantified.

Asia's reputation as the world's most booming aviation market stems principally from growth that takes place within the region or on domestic routes. Boeing predicts an an-



Fig. 4:

Passengers boarded in 2007, by region and Year-on-Year growth

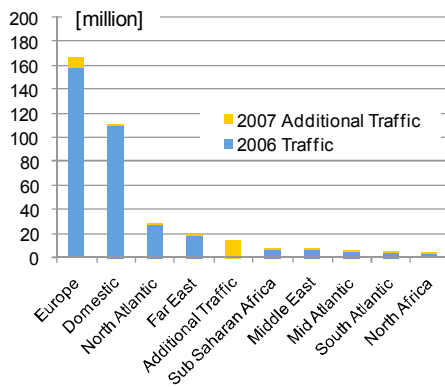


Fig. 5:

RPK growth, SLF growth; per region Q1* 2008

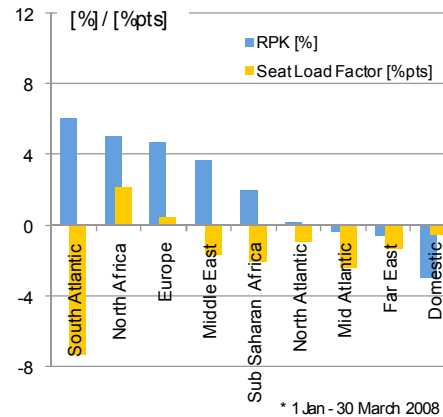


Fig. 6:

AEA 2008 Traffic Forecast [% ASK, RPK growth 2008 over 2007]

	Traffic RPK	Capacity ASK	Load Factor
	%	%	%-pts change
Total Europe	+2.8	+4.0	-0.8
Europe to/from:			
North Africa	+3.4	+1.9	+1.0
Middle East	+7.0	+10.0	-2.0
North Atlantic	+1.7	+3.0	-1.0
Mid Atlantic	+2.7	+4.0	-1.0
South Atlantic	+8.3	+18.0	-7.0
Sub-Saharan Africa	+2.3	+5.0	-2.0
Far East/Australasia	+3.7	+5.0	-1.0
Total Scheduled	+3.1	+5.0	-1.3

nual Chinese domestic growth of +8.8% per year for the next 20 years and that Asia will be the world's highest growth region during that period.

The cautious capacity planning on Asian routes also had positive effects. AEA airlines succeeded in improving the occupancy level from 80.7% to 82.6%, exceeding that achieved on the North Atlantic (81.3%). Yields too improved by +3.8%, a considerable achievement considering the -0.2% decline recorded on the North Atlantic. The Asian region has chronically been suffering from low or negative profitability in recent years. Airlines struggled to translate growth opportunities into sound financial results. The 2007 load and yield improvements could mean that AEA carriers' second most important long-haul region eventually becomes profitable and airlines can harvest the fruits of year-long investment.



Europe strong

European and Domestic routes account for the gross of passengers transported by the European carriers, member of AEA, namely 76%. Domestic transportation by air remains an important business for many airlines. Overall it represents 40% of all passengers travelling within Europe. 2007 did not bring capacity growth on Domestic routes, but this might change soon. Ryanair has recently announced to launch of Domestic operations in France and Germany linking the cities of Paris and Marseille and Frankfurt and Berlin. This is a unicum and has the potential to shake up an as yet (by LCC) untouched

ANNUAL 2007 Traffic Results of AEA Airlines

REGION	PASSENGER DATA								FREIGHT DATA	
	Passengers boarded (000)	Traffic RPK (mill)	Capacity ASK (mill)	Load Factor %	Change to Previous Year				Traffic TFK (mill)	TFK %
					Pax %	Traffic %	Capacity %	PLF Pts		
Domestic (1)	110 633.2	60 955.8	89 485.0	68.1	0.8	1.1	-0.2	0.9	117.3	-7.8
Cross-border Europe (2)	167 910.1	178 872.9	257 032.2	69.6	5.7	7.0	6.6	0.3	737.1	-3.7
Total Europe (1+2)	278 610.5	239 892.4	346 559.2	69.2	3.7	5.4	4.7	0.5	856.4	-4.1
Europe - North Africa (3)	4 490.6	8 665.1	12 465.6	69.5	6.9	8.2	6.7	0.9	190.4	11.2
Europe - Middle East (4)	7 563.8	25 988.6	35 028.6	74.2	10.3	9.7	4.8	3.3	988.2	-0.7
Intl Short/Medium Haul (2+3+4)	180 035.1	213 603.6	304 544.8	70.1	5.9	7.4	6.4	0.7	1 919.9	-0.7
North Atlantic (5)	28 729.6	196 104.1	241 412.7	81.2	4.5	4.4	4.8	-0.3	10 636.1	3.5
Mid Atlantic (6)	6 752.8	51 792.6	61 563.5	84.1	4.9	3.8	1.3	2.1	1 590.6	2.1
South Atlantic (7)	5 333.1	46 370.4	54 591.7	84.9	10.4	11.8	13.7	-1.4	2 551.9	12.8
Europe - Sub Saharan Africa (8)	8 072.3	53 780.2	68 488.4	78.5	5.0	4.6	3.8	0.5	3 395.8	10.3
Europe - Far East/Australasia (9)	18 536.2	152 140.3	184 222.1	82.6	4.3	3.1	0.8	1.9	17 309.0	0.0
Total Longhaul (5 to 9 ^{*)})	67 583.5	500 347.6	610 594.4	81.9	5.0	4.6	3.8	0.6	35 500.6	2.9
Total International (2 to 9 ^{*)})	247 618.6	713 951.1	915 139.2	78.0	5.7	5.4	4.7	0.6	37 446.4	2.7
Total Scheduled (1 to 9 ^{*)})	358 252.0	774 906.9	1 004 623.9	77.1	4.1	5.1	4.2	0.7	37 563.7	2.7

market. Ryanair expects to welcome 60,000 passengers a year on services between Paris and Marseille. At the same time, both the incumbent airline and Ryanair will face competition from an ever expanding high-speed rail network (see more on the topic in this issue of 'Source').

Currently, growth in Europe comes from cross-border routes – and this at a rate that seems little phased by growing macroeconomic concerns. AEA carriers transported an additional 14 million passengers in 2007; 9 million of them within Europe. The remaining 5 million travel on services beyond the borders of the European continent. Traffic to the Middle East, mainly the Gulf region, grew strongest in 2007, by 10.3%, but in absolute terms the number of passengers is still low. Even if growth continues at the current high level, the region will not see passenger numbers comparable to the North Atlantic region until the year 2020. (See Fig. 4).

Cross-boarder European growth has not only been strong for a long time, it has been achieved without compromising on load factors. AEA carriers have constantly improved their efficiency whereas easyJet and Ryanair, the benchmarks for high loads, have lost out in recent months. A comparison with easyJet for example shows that seasonally the best AEA airlines can perform on par (see Fig. 3). The overall AEA load factor reached a record high of 69.5% in Europe, with some individual AEA members topping 76% (easyJet above 83%). Seasonality of demand however seems to be a case where AEA carriers are less able to respond flexibly. The seat load factor gap with the leading low cost airlines frequently widens during periods of lower demand (Winter). On the other hand, any signs on the horizon of a possible decline in consumer confidence towards the end of 2007 did not show an impact on the traffic development within Europe. It might well be, that this is going to change in 2008.



2008 outlook

In fact, 2008 figures up to Week 16 suggest we should expect lower figures for the year. Overall RPK growth is at 1.2% with a continued growth in capacity of 3.3% leading to a overall load factor decline of 1.5 %-pts. Cross-border European load factors are at 63.9% which is 0.5 %-pts lower than in the same period a year before. In fact all regions are now showing a drop in load factor, except North Africa which is only just managing stability. The decline of concern happens on the longhaul routes. The two most important regions North Atlantic and Far East show a reduction in load factors of respectively 1.7 and 0.9 %-pts. (See Fig. 5) Capacity growth has yet to adapt to the change in demand. South Atlantic for example posts a 'healthy' 17.6% ASK growth, obviously at the expense of the seat occupancy that falls by 10.0 %-pts.

Airlines will be forced to review the planning for 2008 and adapt capacity according to the new situation. A long term mismatch between the capacity offer and the demand will bring yields down further, negatively influencing operating costs and consequently undermining profitability for 2008. This profitability is not expected to turn into a loss but any profit achieved will not be as good as in 2007 which was one of the best years on record. Our forecast dated last October predicted 2008 to be as good as 2006. In the light of an oil price set to average close to 100 USD per barrel in 2008, the latest news about a recession in the US, and uncertain consequences for Europe, this forecast is likely to be revised downwards. [SB]

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