

With oil crisis behind it, airlines face falling traffic

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In the airline world one crisis soon replaces another. The sharp decline in fuel prices is bringing some relief to the world's hard-pressed carriers, many of which were fighting for survival in the summer because of the record oil prices.

But the gains on the fuel front are being offset by falling traffic volumes, as recession looms in some of the biggest air travel markets.

The global aviation map is changing and consolidation accelerating as weaker airlines collapse. More than 30 have gone this year, says IATA, the airline industry trade association; 20 more are on the watchlist. Airlines managers are grounding aircraft to cut capacity.

Germany's Lufthansa, the main predator in Europe, yesterday announced its long-awaited takeover of BMI British Midland, only hours after Danish low cost carrier Sterling Airlines said it was filing for bankruptcy.

Financial turmoil and the job losses in the banking sector are taking their toll, especially on business travel, the key profit generator for many of the world's traditional network carriers. The credit squeeze is forcing up the price of financing new aircraft, where funds are still available. The strengthening of the dollar against the euro and the pound is eroding some of the gains from the falling dollar price of fuel, especially for European carriers.

Some countries that were performing most strongly are leading the way down. Airline traffic in India fell 19 per cent in September. Air China reported September passenger traffic volumes down by 7.9 per cent.

Indian carriers, hurt by some of the world's highest jet fuel taxes, face such high losses that they are scrambling to consolidate after the wild years of expansion and have been forced to seek a deal with the government to delay paying overdue fuel bills. Rivals Jet Airways and Kingfisher have been forced into an alliance.

In Europe, even airlines with contrasting business models such as British Airways and Ryanair have, in a matter of months, gone from record profits to barely breaking even. Air France-KLM, the world's largest airline by revenues, and Lufthansa, the number two European player, are the latest to issue profit warnings.

The squeeze is forcing the pace of regional consolidation. Lufthansa is busiest with Brussels Airlines and BMI in the bag and stakes in Austrian Airlines, Alitalia and possibly SAS in its sights. BA is negotiating a merger with Spain's Iberia, although the plunge in the UK carrier's share price and worries about the size of its pension deficit could torpedo the deal. Air France-KLM is bidding against Lufthansa for a minority stake in a restructured Alitalia.

Consolidation is a particular feature in the US. Delta Air Lines says it is on track to complete its takeover of Northwest Airlines by the end of this year to create the biggest North American carrier.

US carriers have led the way in reducing capacity drastically for the coming winter. The cuts were forced originally by the surge in oil prices in the first half of the year; US carriers have on average the oldest fleets among airlines in the developed economies. The oil price has fallen from a July peak of \$147 to about \$60 a barrel but the capacity reductions remain timely given the falling demand for air travel.

As the crisis deepens, the lines of older aircraft parked in the US deserts are growing for the first time since 2005.

Since June, the world's airlines have announced, and begun to implement, a fleet reduction programme that already accounts for 1,083 aircraft, or 5 per cent of the global fleet, according to Ascend, the aviation consultancy.

About 75 per cent of fleet reductions are occurring in North America, where the airlines are cutting 10 per cent of their capacity, according to Eddy Pieniazek, Ascend director. Europe is cutting under 3 per cent of its capacity to date and Asia 2 per cent.

Airlines are inevitably uncertain as to the depth and the length of the coming recession. But Giovanni Bisignani, director general of IATA, says the sharp decline in passenger and cargo traffic in September is "alarming" and for the time being it is outpacing industry actions to cut capacity.

Aircraft values and lease rates are also falling, a sure sign of the mounting troubles. "We are only just beginning to see the impact of the economic slowdown and the financial crisis on aircraft values and lease rates," says Mr Pieniazek.

According to Ascend, lease rates for out of production narrow body jets have fallen by 20 per cent since the middle of the year, while rates for short-haul jets in production are down by 10 per cent. Overall aircraft values have fallen by 5 to 10 per cent.

Airbus and Boeing are preparing to step in as lenders of last resort to support selected sales during the coming year, as airlines find access difficult to some traditional sources of finance for buying new jets. Export credit agencies in the US and Europe are under pressure to fill more of the funding gap.

A leading European aviation banker says the number of institutions offering finance for new commercial jet deliveries has fallen by more than half to no more than 25.

Despite the rapid fall in fuel prices since July, IATA is maintaining its forecast for the global industry to fall to a net loss of \$5.2bn this year. Mr Bisignani says the drop in the oil price is not enough to offset the impact of the drop in demand. "At this rate, losses may be even deeper than our forecast \$5.2bn for this year."

In the six years to 2006, the global airline industry suffered net losses of \$42bn and only returned to a \$5.6bn profit in 2007.

According to IATA, passenger traffic declined by 2.9 per cent year-on-year in September, while cargo traffic, a key early indicator of the state of the world economy, fell by 7.7 per cent.

"The deterioration in traffic is alarmingly fast-paced and widespread," says Mr Bisignani. The decline in passenger volumes was the worst since 2003, when the industry was hit by the Sars epidemic.

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