

**WORLDWIDE AIR TRANSPORT CONFERENCE: CHALLENGES AND
OPPORTUNITIES OF LIBERALIZATION**

Montreal, 24 to 29 March 2003

Agenda Item 1: Preview

1.1: Background to and experience of liberalization

INDUSTRY SITUATION AND AIRLINE TRAFFIC OUTLOOK

(Presented by the Secretariat)

INFORMATION PAPER

SUMMARY

This paper describes the linkage between the economy and air transport, discusses the present state of the air transport industry and presents an airline traffic outlook.

1. INTRODUCTION

1.1 Air transport has experienced rapid expansion since the Second World War as the global economy has grown and the technology of air transport has developed to its present state. The result has been a steady decline in airline operating costs and fares, which, combined with the world economic growth, has stimulated traffic growth. Consequently, scheduled domestic and international air traffic has increased from some 9 million passengers in 1945 to over 1.6 billion in 2002. On average, passenger traffic has grown at about 10 per cent annually, although the growth rates varied significantly from very high, exceeding 20 per cent a year in the first post-war decade, to quite moderate in recent decades as the air transport market has become more mature. There were only two exceptions when world air traffic recorded declines: in 1991 following the 1990 Gulf War and in 2001 in the aftermath of the events of 11 September in that year.

2. AIR TRANSPORT AND THE ECONOMY

2.1 Air transport has traditionally experienced greater growth than most other economic sectors. At the same time, air transport is a driver of economic development. The output of air transport (measured in terms of tonne-kilometres performed) has increased by a factor of 31 since 1960. Gross Domestic Product (GDP), which is the broadest available measure of world output, increased by a factor of 4.2 over the same period. Although growth in world air traffic has been much greater than world economic growth, there is a high correlation between the two. Statistical analyses have shown that growth in GDP now explains about two-thirds of air travel growth, reflecting increasing commercial and business activity and increasing personal income and propensity to travel. Demand for air freight service is also primarily a function of economic growth and international trade. Air travel growth is also explained by other economic and structural factors which, apart from changes in disposable income and stimulation from reductions in airline fares as costs decline, include, *inter alia*: air transport regulatory developments; improvement in service offerings such as routes, frequencies and infrastructure; increasing trade and the globalization of business; population and income distribution; tourism; and propensity to travel.

2.2 As regards the converse relationship, that of air transport driving economic development:

- a) air transport services deliver the final product of aviation industries to customers. In order to facilitate air transport operations, the world's air carriers purchase a wide range of inputs from aviation-specific and other industries in manufacturing and services, which rely on numerous suppliers themselves;
- b) air transport has catalytic demand effects through business, trade and, particularly, tourism; and
- c) air transport has consequential induced demand effects through consumer spending.

2.3 The economic stimuli of airlines, airports and their direct affiliates beyond their direct impact, can be expressed using output and employment multipliers. Every \$100 of output produced and every 100 jobs generated by air transport trigger additional demand of \$325 and 610 jobs in other industries throughout the global economy. More than four and a half per cent of world economic output may be attributed to civil aviation.

3. ECONOMIC ENVIRONMENT

3.1 The events of 11 September 2001 exacerbated an already difficult situation in the global economy. In the aftermath, consumer and business confidence weakened further across the globe. A decline in demand and activity in developed countries was immediately noticeable. Developing countries and, in particular, the poorest countries are being hurt by weaker external demand and falling commodity prices.

3.2 In 2002, the world economy began to recover from the sharp slowdown in 2001 with trade and industrial production improving across almost all regions. Preliminary estimates indicate that the world gross domestic product (GDP) grew approximately 2.8 per cent in real terms. For the industrialized countries, 1.7 per cent GDP growth signalled recovery but on a slow path. Much impulse for the reversed trend came from the North American economy, which grew 2.2 per cent, almost 2 percentage points over the previous year. GDP growth for developing countries consolidated its position at 4.2 per cent, above the world average.

3.3 Global economic growth is projected at about 3.9 per cent and 3.7 per cent in 2003 and 2004, respectively. Over the period to the year 2010 the world economy is anticipated to grow at an average annual rate of some 2.5 per cent.

4. STATE OF THE AIR TRANSPORT INDUSTRY

4.1 The combination of economic slowdown, plummeting demand and increased costs for security and insurance for air travel following the events of 11 September 2001, subsequently exacerbated by fuel price increases, have had an unprecedented impact on the air transport industry at large.

4.2 Many airlines have reacted to contain losses by reducing frequency, capacity and staff. Non-profitable routes have been reduced or eliminated altogether and, in the light of the success of some low-cost “no frills” carriers, experimentation with restructured operations is taking place. Airlines have parked or accelerated the retirement of older aircraft and deferred delivery of new ones. Some airlines have gone into bankruptcy or ceased operations entirely due to accelerated deterioration in their financial situation.

4.3 There have been inevitable ramifications for airports and air navigation services providers, aircraft and engine manufacturers, their suppliers and beyond into business, trade and, particularly, tourism.

4.4 As regards traffic, after declining by 2.9 per cent in 2001, it is estimated that world airline scheduled passenger traffic expressed in terms of passenger-kilometres performed rose by about 1 per cent in 2002. Capacity offered was reduced to the extent that average passenger load factors rose to reach their highest ever annual levels, 71 per cent in total and 73 per cent for international services. In 2002 the number of passengers carried worldwide on scheduled services (domestic and international) remained at just over 1.6 billion.

4.5 Scheduled freight traffic, usually a lead indicator of air traffic and the economy in general, showed a modest increase in 2002 of some 4 per cent both in total and on international services, in terms of tonne-kilometres performed. Freight carried worldwide on scheduled services was about 30 million tonnes.

4.6 Traffic growth varied considerably amongst different regions and route groups. Airlines of Asia/Pacific and the Middle East appeared to be leading traffic recovery, while traffic of European airlines was still down compared with 2001, and, in North America, airlines of the United States were showing substantial traffic reductions.

4.7 In 2001, the world’s scheduled airlines as a whole experienced an operating loss of 3.8 per cent of operating revenues, compared with an operating profit of 3.3 per cent achieved in 2000. The operating revenues for scheduled airlines of ICAO’s Contracting States are estimated at U.S. \$303 400 million in 2001; operating expenses for these airlines are estimated at U.S. \$314 800 million.

4.8 With most airlines in the process of finalizing their 2002 audited results it is too early to estimate with accuracy the financial results of the world’s scheduled airlines for that year. However, on the basis of published interim quarterly results for some airlines some regional trends appear to emerge for 2002: air carriers in North America appear to be headed for significant operating losses, probably even higher than those reported for 2001; airlines of the Asia/Pacific region appear to show continued profitability in 2002; while most major airlines in Europe have reported positive results for the first three quarters of 2002 and the region as a whole is expected to be profitable in 2002.

4.9 The extent to which traffic stabilization or recovery will be translated into airline financial health is uncertain. Sample data and reports suggest that many passengers are trading down to lower fares

with a negative effect on unit revenues and at the same time airlines are having to deal with increased input costs. Political and economic uncertainty have the potential both to place restraints on demand and to provoke further increases in input costs, notably as regards fuel, security and insurance.

4.10 As discussed in ATConf/5-WP/4 (Background and overview of Conference task), the evolution of the industry and the liberalization experience over the last decade, as well as the recent downturn in air transport, are leading to changing structures and business models which will also impact airline traffic growth and finances. At the same time government intervention following the events of 11 September 2001 has underlined the perception of the air transport sector as a strategic industry and, for many States, their national carriers as strategic investments. Regulatory action by States will no doubt continue to play a part in the economic experience of air carriers.

5. TRAFFIC OUTLOOK

5.1 Given the political and economic uncertainty at the time of writing, air traffic for the short-term cannot be forecast with a reasonable degree of accuracy. However, in a scenario assuming there are no major regional or global negative developments resulting in stalling the restoration of passenger demand and in escalating fuel prices, the growth of the total scheduled passenger traffic (in terms of passenger-kilometres performed) is projected to rebound at up to a 7 per cent growth rate in 2003, supported mainly by an expected overall strengthening of the world economy, followed by some 5 to 6 per cent growth for 2004. Traffic growth would vary significantly by geographic region because of the impact of specific local or regional factors.

5.2 For the longer term air transport traffic is anticipated to demonstrate the robust nature that it has shown in the past by rebounding from externally- induced downturns. The passenger traffic forecasts to the year 2010 published in June 2001 in ICAO Circular 281: "Outlook for Air Transport to the Year 2010" have recently been revised to take into consideration the impact of recent events and the changing environment. The average annual growth rate in passenger-kilometres performed from 2000 to 2010 is now projected to be around 4 per cent compared to 4.5 per cent as previously anticipated. This represents a 1 to 2 year lag in the previously forecast traffic levels. The freight traffic forecasts in Circular 281 have yet to be revised, but indications are that freight traffic growth would continue to run a per cent or more higher per annum than that for passenger traffic.

5.3 For studies of economic aspects of environmental protection in the field of civil aviation, ICAO's Committee on Aviation Environmental Protection, in coordination with the Secretariat, has recently developed passenger traffic forecasts by route group and in total up the year 2020. As illustrated in the attached **Table**, total (international and domestic) traffic is expected to grow at an average annual rate of 4.3 per cent (the apparent higher growth per annum between 2000 and 2020 compared with 2000 and 2010 reflecting the downturn in 2001 and subsequent 1 to 2 year lag in return to trend). International traffic is projected to experience higher growth rate of 4.9 per cent. The route group between Europe and Asia/Pacific is anticipated to grow well above the average (at an annual rate of some 5.9 per cent), followed by Intra-Asia Pacific (5.7 per cent), Transpacific (5.5 per cent) and South Atlantic (5.4 per cent). Overall, domestic traffic is projected to grow at a much lower average growth rate of 3.5 per cent per annum with growth rates for individual regions ranging from a high of 6.0 per cent for Asia/Pacific to a low of 2.4 per cent for North America.

TABLE

PASSENGER TRAFFIC FORECAST TO THE YEAR 2020 BY ROUTE GROUP

Route Group	Passenger-kilometres Performed (billions)		Average Annual Growth Rate (%) 2000-2020
	Actual 2000	Forecast 2020	
International			
North Atlantic	391.5	809.7	3.7
South Atlantic	48.8	139.7	5.4
Mid Atlantic	47.8	115.3	4.5
Transpacific	207.9	606.6	5.5
Between Europe and Asia/Pacific	241.9	761.3	5.9
Between Europe and Africa	99.6	240.2	4.5
Between Europe and Middle East	48.3	105.8	4.0
Between North America and South America	42.5	102.5	4.5
Between North America and Central America and Caribbean	48.1	111.6	4.3
Local Africa	8.3	19.6	4.4
Local Asia/Pacific	241.4	731.5	5.7
Local Europe	192.1	490.6	4.8
Local Latin America	16.8	41.3	4.6
Local Middle East	7.0	15.9	4.2
Local North America	26.3	47.5	3.0
Other Routes	110.3	266.0	4.5
Total International	1 778.6	4 605.3	4.9
Domestic			
Africa	9.4	20.2	3.9
Asia/Pacific	214.5	687.9	6.0
Europe	125.6	286.0	4.2
Latin America/Caribbean	55.3	103.8	3.2
Middle East	12.1	25.5	3.8
North America	822.4	1 321.5	2.4
Total Domestic	1 239.3	2 445.0	3.5
Global (International + Domestic)	3 017.9	7 050.3	4.3

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