

IATA ECONOMICS BRIEFING

AIR FREIGHT 2006 – BRIGHTER SKIES AHEAD

FEBRUARY 2006

KEY POINTS

- Air freight is a significant part of the aviation industry, with estimated total revenues of **\$49.5 billion** in 2005. The total value of goods transported by air in 2005 is estimated to be **US\$3.25 trillion**, equivalent to **35.6%** of the estimated **US\$9.14 trillion** total global exports of goods. This share has reduced slightly, from 40% in previous years, due to recent strong increases in the prices of commodity goods (e.g. oil) transported by surface modes.
- International air freight volume growth slowed significantly in 2005, falling from 13.4% in 2004 to **3.2%** in 2005. The industry was hit by weaker demand in some key sectors (e.g. IT), changing global trade patterns and by fuel surcharges. The latter saw waybill prices increase as freight operators sought to pass on some of the burden of higher fuel costs to customers. The subsequent higher yields mean that global air freight revenues are estimated to have increased by 6.7% in 2005, double the rate of growth in demand volumes.
- Encouragingly, we expect air freight volume growth to recover to its long-term trend rate of around **6%** in 2006, as many of the factors that restrained demand in 2005 begin to ease. Freight traffic has shown signs of recovery in recent months, boosted by improved demand in major Asian and North American markets. A relatively strong global economy – as well as long-awaited signs of stronger demand in large European markets – should maintain this improved growth momentum into 2006.
- An improved freight environment will contribute to improved profitability in the global aviation industry. The industry is still forecast to see net losses of **US\$4.3 billion** in 2006 (an improvement on losses of US\$6 billion in 2005), though high interest costs and restructuring charges disguise significant improvements at the operating level. The industry is forecast to return to profit (of US\$6.2 billion) in 2007. However, there are two major risks to the profit and growth outlook: a significant outbreak of avian flu and a renewed rise in fuel prices.

VOLUME GROWTH SLOWED IN 2005, THOUGH IS BEGINNING TO RECOVER

- Freight volume growth slowed significantly in 2005, in all regions (see Figure 1). The sharp slowdown resulted in little or no demand volume growth in North America, Latin America and Europe in 2005.

Figure 1: Freight Traffic Growth by Region

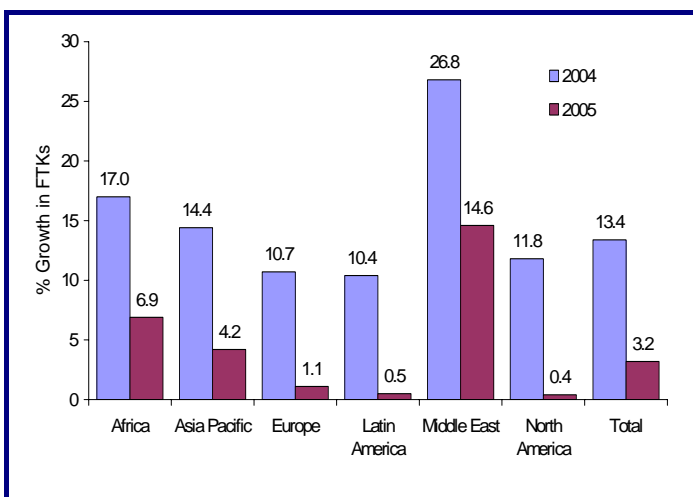
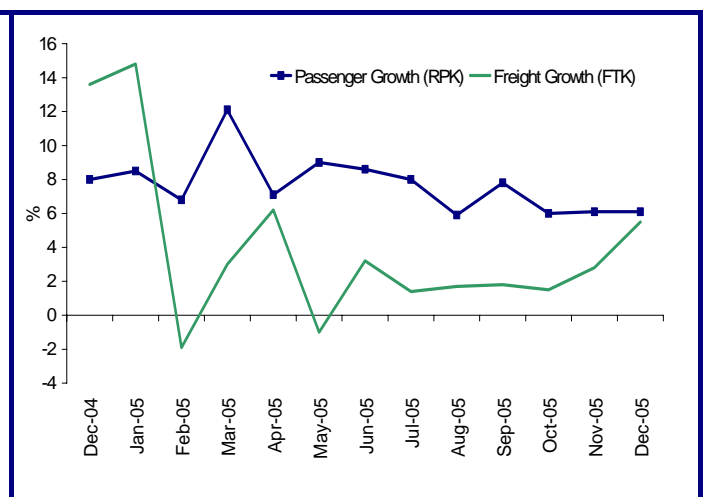


Figure 2: Global Freight Vs Passenger Growth



Source: IATA Monthly Traffic Statistics

- There are significant regional differences in freight growth. The Middle East continues to stand out in terms of freight growth – as the region’s carriers add new capacity and the region’s consumers enjoy higher purchasing power from windfall oil export earnings. Africa also enjoyed an above average growth rate. Yet even within the slower growth regions, some airlines saw an improved operating environment as they increased capacity and captured market share.
- Air freight growth underperformed passenger growth throughout 2005 (see Figure 2). Freight demand slowed sharply in the first quarter of 2005 and remained relatively weak for the next six months. However, there are signs that freight growth is beginning to recover, with a convergence in December’s passenger and freight growth rates around the 6% level.

WHAT CAUSED THE SLOWDOWN, WHAT WILL DRIVE THE RECOVERY?

(i) Macroeconomic Conditions

- The key influence on air freight demand is world economic and trade growth. As economic activity and trade increases, so the demand for the transportation of goods increases. Global economic growth is estimated to have slowed slightly in 2005 to 4.3%, down from a thirty-year high of 5% in 2004. Though several imbalances and risks exist (e.g. higher oil prices and the size of the US trade deficit), the outlook for the global economy remains fairly benign.
- However, while global economic growth remains relatively strong, the growth in trade of goods has been more volatile – with a closer link to the volatility in air freight volume growth (see Figure 3). Global merchandise trade increased by over 10% in 2004 before slowing to an estimated 6% in 2005. Import growth slowed in the two key markets of the US and China in the first half of 2004 – due to a reduction in corporate inventories in the former and a substitution of domestic goods for imports in the latter – before picking-up again in the second half of the year. The expected increase in global trade growth to 7.5% in 2006, driven by strong demand in the emerging markets in China and India, will provide strong support for an increase in air freight growth.

Figure 3: Global GDP and Trade Growth

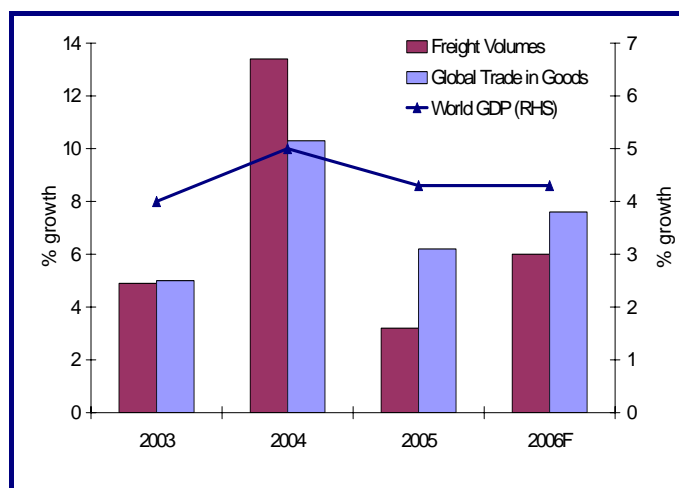
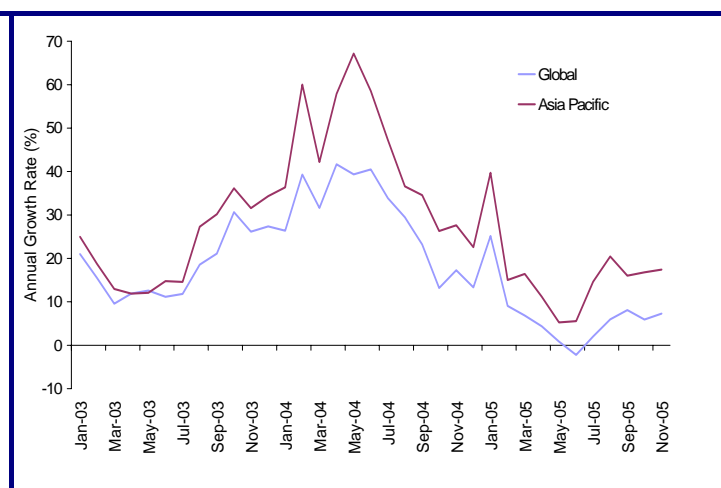


Figure 4: Growth in Semiconductor Shipments



Source: IATA; International Monetary Fund (IMF); Semiconductors Industry Association (SIA)

(ii) Key IT markets

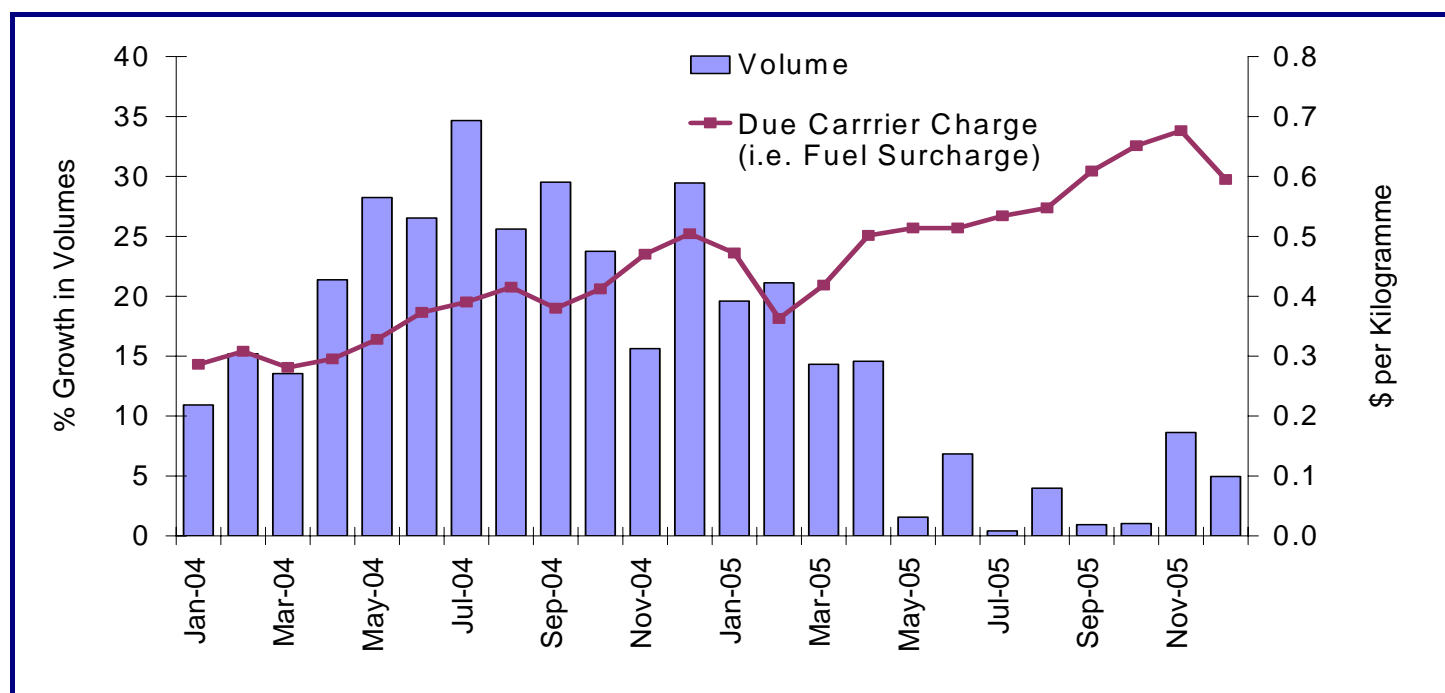
- Air freight demand is also sensitive to industry-specific trends among the high-value, time-critical goods that are transported by air. In particular, the IT sector provides an important source of demand for air freight operators in all regions, and especially in Asia, Europe and North America. For example, high-tech goods are estimated to account for 40% of air freight exports from Asia.
- The IT sector saw weaker growth in 2005, following the strong recovery in 2004. Semi-conductor shipments – a leading indicator for the vitality of the IT sector as a whole – slowed sharply in the first half of 2005 (see Figure 4) as firms sought to adjust excess inventory levels following strong orders in 2004. However, there are

encouraging signs that growth in the IT sector is beginning to pick-up again and will help to support a recovery in air freight growth in 2006.

(iii) Fuel Surcharges

- The average price of a barrel of Brent Crude oil increased from US\$28.80 in 2003 to US\$54.50 in 2005, a 90% rise in just two years. At the same time, constraints in refinery capacity saw jet fuel prices increase even more, with the refinery margin per barrel increasing from US\$5.90 in 2003 to US\$16.50 in 2005¹.
- Faced with significantly higher fuel costs, air freight operators have looked to pass on a share of the burden to customers through the imposition of fuel surcharges. These fuel surcharges have led to regular and, in contrast to the passenger side, highly visible increases in freight charges. Consequently, higher freight charges have acted as a constraint on demand growth and, possibly, a slight loss of competitiveness against surface modes.
- For example, US air freight shipments under the CASS-USA settlements system saw demand growth slow in 2005 while the average due carrier charge (i.e. fuel surcharge) nearly doubled over the year (see Figure 5). At the same time, the weight-related charge for shipments remained relatively constant at \$1 per kilogramme. However, there are signs that fuel surcharges are beginning to stabilise, though not return to pre-2004 levels. IATA forecasts an average price for a barrel of Brent Crude oil of US\$53 in 2006, down slightly from US\$54.5 in 2005. Though fuel prices remain at risk of short-term volatility, we would expect the constraint on air freight demand from higher fuel surcharges to begin to ease in 2006.

Figure 5: US CASS Shipments and Fuel Surcharges



Source: CASS-USA

WHERE ARE THE LARGEST AIR FREIGHT MARKETS?

- Western Europe accounts for the largest share of international air freight movements, followed by Asia and North America (see Table 1). North America has a relatively small share of international movements, but also has a large domestic air freight market in the US.
- Western Europe and Asia are the only two regions where the value of air freight exports is greater than the value of air freight imports. This is a reflection of the relatively higher proportion of high-value, time-sensitive exports (that are more suitable for air freight) from these regions. By contrast, air freight imports in Africa, Australasia

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¹ See www.iata.org for the IATA / Platts Jet Fuel Price Index, a weekly update of jet fuel prices by region.

and Central America are more than twice the value of air freight exports from these regions. This is a reflection of the high proportion of bulk commodity exports from these regions, goods that are more suitable for surface modes of transport.

Table 1: The Value of International Air Freight by Region, 2005.

	By origin		By Destination		Air Freight Exports / Air Freight Imports
	US\$ bn	% Share	US\$ bn	% Share	
Western Europe	1,696.1	52.1%	1,513.8	46.5%	1.12
Asia	973.4	29.9%	856.2	26.3%	1.14
North America	280.0	8.6%	393.9	12.1%	0.71
Eastern Europe	130.2	4.0%	198.6	6.1%	0.66
Middle East	78.1	2.4%	97.7	3.0%	0.80
Africa	35.8	1.1%	78.1	2.4%	0.46
South America	32.6	1.0%	42.3	1.3%	0.77
Australasia	19.5	0.6%	55.3	1.7%	0.35
Central America	9.8	0.3%	19.5	0.6%	0.50

Source: The Colography Group

WHERE ARE THE STRONGEST GROWTH MARKETS?

- IATA's *Freight Forecast 2005* provides a forecast of freight traffic growth to 2009 by region, country and route, based upon a survey of member airlines. International air freight volumes are expected to grow at an average annual rate of 6.3% over the next five years (see Table 2), reflecting a move towards a steady and stable growth path following the volatility of the last few years.
- Asia Pacific is expected to see the fastest freight growth over the next few years, driven by the strong economic growth in China and India. Indeed, China and India are both among the fastest growing markets at an average annual rate of 14.4% and 9.7% respectively. The Middle East is expected to be the second fastest growing market, though at a much slower rate than seen in 2004 and 2005.

Table 2: IATA Freight Forecasts

Region	Freight Volume Growth	
	2006	Average to 2009
Africa	4.8%	4.8%
Asia Pacific	7.6%	7.2%
Europe	5.1%	5.1%
Latin America	5.4%	5.8%
Middle East	6.6%	6.8%
North America	5.9%	5.4%
Total	6.3%	6.3%

Source: IATA

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