Aircraft industry takes off while air transport remains grounded

Industry analysis by credit insurer Euler Hermes

- **Aircraft industry posts robust order books despite the global economic slowdown.**
- **Airline margins badly squeezed by rising fuel costs in 2011.**
- **The air transport sector will continue to deteriorate in 2012, mainly for European airlines.**

Paris, January 31, 2012 – 2011 was a record year for aircraft manufacturers, as much in terms of units produced as in terms of orders, which doubled relative to 2010. Growth in the sector is being driven by the strong expansion of Asian and Middle East airlines, which are developing fast and increasing their capacity in order to gain market share.

In contrast, airlines were faced with rising fuel prices in 2011, which eroded their margins. Moreover, the global economic slowdown will affect air traffic, which is forecast to grow by only 3% in 2012.

Some good years ahead for aircraft manufacturers

In 2011, the aircraft industry for the first time broke through the symbolic 1,000 unit mark, with 1,011 aircraft delivered, corresponding to an annual increase of 4%. At the same time, net orders doubled to 2,224 aircraft. While 2011 was an excellent year at commercial level, the momentum was also due to the arrival on the market of aircraft that consume up to 15% less fuel and produce less CO_2.

"*The aircraft industry is enjoying exceptionally robust growth. It is the first time in thirty years that an economic slowdown has not been accompanied by a fall in production", says* **Ludovic Subran**, Chief Economist at Euler Hermes. *"Thanks to the momentum of Asian, Middle-East and low-cost airlines, aircraft manufacturers saw their order books substantially strengthened in 2011, ensuring solid production for the next seven or eight years."* Euler Hermes forecasts a 12% increase in deliveries of commercial aircraft in 2012.

A more mixed situation for airlines

Passenger transport turnover grew by 10% to nearly USD 500 billion in 2011. The increase was partly due to growth in air traffic (6%) and partly to an increase in prices (4%). The sector's operating profitability, however, was badly hit by **higher fuel bills** (**40% increase** in the average annual cost of fuel) *"Each one dollar increase in the per barrel price adds USD 1 billion to the industry's operating costs"*, explains **Bruno Goutard,** sector analyst with Euler Hermes. *"However, the impact on airlines of the higher fuel costs differs according to region. For example, the traditional* ***U.S. airlines,*** *whose average margin was halved in 2011 to 0.6%, managed to partly offset soaring fuel costs by raising their prices by a substantial 8.4%"*.

In **Europe**, the average margin of the traditional airlines segment (excluding low cost companies) was divided by three in 2011, to just 0.3% despite 8.1% growth in traffic during the year. Faced with ferocious competition from Middle-East players, European airlines were unable to use pricing as a lever and raised their prices by only 1.9% over the period.

In **Asia**, the sector's profitability declined by 30% in 2011 but remained high at 4%, thanks to balanced growth in traffic (+3.3%) and in prices (+6.6%)

Caught up in a frenzy of growth, **Middle East** airlines experienced a substantial margin cut, down by two-thirds to 3%, in 2011. They continue to invest massively in their fleets to increase capacity and gain market share.

European airlines lagging behind

In the wake of a global decline in activity, growth in the air transport market is expected to slow by 25% in 2012. According to **Ludovic Subran**, *"With growth in air traffic of only 3% and no increase in ticket prices, there will naturally be an impact on airlines' balance sheets. The main victim will be the European air transport industry*." European airlines, very dependent on growth in traffic, will be hurt by a combination of factors: weaker demand in Europe - entangled in trying to solve its public debt issues -, less dynamic trade flows, strong competitive pressure on prices, high fuel costs and the coming into effect of European carbon emission quotas. *"Some European companies will make forced landings in 2012, reporting losses. These difficulties will undoubtedly trigger more substantial restructuring than that already planned in the second half of 2012. They could also, however, prompt some airlines to adopt new market strategies to compete with companies that, for their part, are in the process of taking off*", he concludes.

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