



➤ CARRIERS ARE UNDER PRESSURE TO NEGOTIATE RISING OIL PRICES, FALLING DEMAND AND A SLOW ECONOMY. YET NEW SERVICES MUST REMAIN IN DEVELOPMENT.

The heat is on

Future Airport: What is the most influential factor affecting new route development today?

Andrew Herdman: There's no getting away from the fact that oil at \$140 per barrel is worrying airline CEOs, and it's an impediment that is constantly on their minds. The high price is beginning to threaten global economic growth and that's translating into a fall in demand for air travel. It's an unusual situation for the airline industry, which has grown steadily over the years. So in the short-term, the outlook isn't good. Airlines are being forced to make tough decisions when reviewing routes; cutting back on some, reducing frequency or capacity on others, or getting ready to do so in anticipation of weakening demand. The picture in Asia Pacific is a bit more positive than in the US. The Association of Asia Pacific Airlines (AAPA) carriers are actually showing year-on-year traffic growth of 4%.

However, even that's losing pace. The outlook for the rest of the year is overshadowed by concerns about the slowdown of the global economy. In Australia and Japan, carriers are experiencing a gradual weakening in demand, and they're anticipating making reductions after the summer peak.

FA: But there are exceptions – we're seeing new activity around major oil and gas centres.

AH: Certainly – money is flowing into the Middle East and the region is booming. Links to and from the region are growing and there remains potential for significant growth for carriers introducing links into these countries. Russia is another big beneficiary of oil and gas. It's a question of adjustment. In Asia Pacific the drivers are China and India, but even there you can notice a drop-off in demand.

Fuel is by far the biggest single cost for every airline now. A year ago, oil cost would have represented 30% of the ticket price, whereas nowadays it's closer to 45%. You can hedge using futures, which provides some temporary relief, but it's a gamble. Most airlines do a degree of hedging because they can't immediately pass

on their costs to their customers in the form of higher ticket prices. There is a lag between the increase in prices and a carrier's ability to raise fares. It would be a mistake to think that fuel hedging is an easy option or a long-term solution. It's a very high-stakes game.

FA: The high energy cost affects everybody. So to what extent will route development vary between the big carriers, and why?

AH: The impact on airlines does vary. The big differentiator is the age of the fleet. Younger and newer aircraft are much more efficient. This means that the carriers suffering the most at the moment are those that are operating older fleets. The US domestic market in particular is in a weak spot, as it generally has older fleets. That's also why you see a lot of airlines beginning to ground older aircraft. Despite the short-term concerns in the industry, orders for new aircraft are continuing to roll in. There is a curious situation in which Boeing and Airbus are backlogged for five or six years into the future but they are still taking new orders. The benefits of deploying more modern equipment are that strong.

The key is to balance the network and maximise revenue across it. Low-cost carriers tend to favour a point-to-point shorthaul model, which can work if you execute it well. The network model is more powerful for big international network carriers. However, it requires fine-tuning. You have to make adjustments quickly and often.

Despite the clouds, we must remember that this industry has grown more strongly than the global economy for many decades, and I don't see that fundamentally changing. Taking a five to ten-year outlook, there's still a projection of steady growth. It's a cyclical industry and from a strategic point of view, the attractiveness of air travel hasn't changed. Airlines have to weigh today's pressures against a strategic vision of which markets are going to grow. ○

ANDREW HERDMAN

➤ Andrew J Herdman has been director general of the Association of Asia Pacific Airlines (AAPA) since October 2004. Herdman joined the AAPA after 27 years with the Swire Group.