Air transportation

More than a year has passed since the terrorist attacks of September 11, 2001. The airline industry, which had already been suffering from a downturn in the economy, was further affected when these attacks led to an immediate shutdown of U.S. airspace. A staggered resumption of scheduled services followed as new security measures were put in place and airports had to undergo recertification. Reagan National was closed for almost three weeks, causing heavy losses to home-based US Airways. This led to the carrier's recent Chapter 11 filing. Traffic levels plunged some 40% in the aftermath, and in spite of the carrier's efforts to promote activity with deeply discounted fares, year-to-date passenger traffic at this writing is down some 11% from last year, and the near-term airline outlook is not very encouraging.

Another carrier, United Airlines, which earlier had aired concerns about its financial condition, has again raised the specter of a possible bankruptcy filing if it cannot obtain a federal guaranteed loan to meet a large debt payment before the end of this year. American Airlines has also issued warnings, having lost almost $1 billion in the second quarter, and has already taken steps to reduce costs. In fact, with the exception of Southwest Airlines, which managed to post a respectable second-quarter profit, and new entrant Jet Blue, virtually all carriers suffered massive losses.

Airbus has had 97 firm orders placed for its A380.

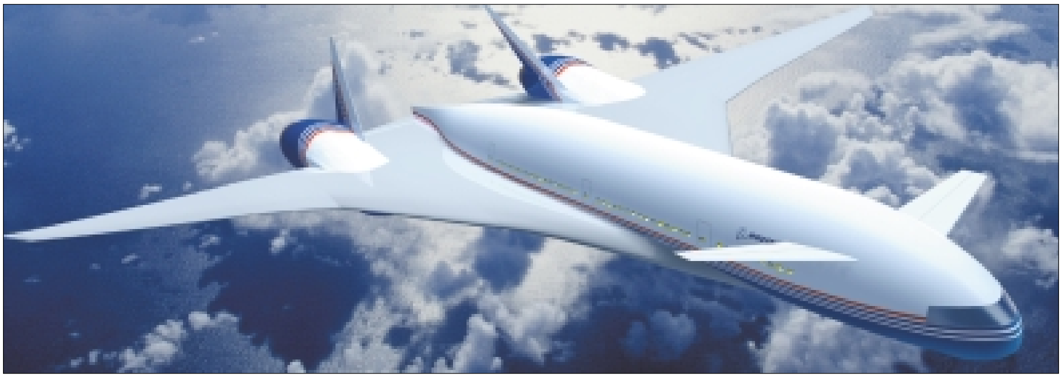
Another major factor in the airlines' current plight is the stock market fall, which was further exacerbated by corporate scandals, most notably at Enron and Arthur Andersen. The ensuing bankruptcies further dampened consumer confidence and did not benefit air travel. The ongoing war on terror and heightened airport security measures have also taken their toll on air travel. While most travelers appreciate increased airport security, there is little doubt that longer check-in times, preboarding inspections, and attendant increases in ticket costs have had a negative impact on traffic.

Near-term forecast

In view of these events, most industry forecasters seem to agree that traffic levels for the next year or two will see little improvement as carriers continue trying to contain costs by reducing flights and personnel and by eliminating meals and other in-flight amenities. Beyond this period, the hope is that traffic will again revert to a more normal growth pattern. Inherent is the assumption that there will be no repeat of a September 11 calamity, although the threat is acknowledged to exist.

After a level-off and turnaround during the next two years, domestic passenger revenue passenger miles (RPMs) are expected to increase about 3.5% over the decade, with passenger load factors rising from the 68% level of the past two years to the 72-73% range. At present, some carriers require a virtually unattainable 90% just to break even in today's operating climate. Domestic passenger yields declined some 3% in the past two years, but are expected to increase in 2003, then grow at an average annual rate of just over 1.0% over the rest of the forecast period. However, a decline in real yields will likely result from competitive pressures from the low-fare carriers, notably Southwest Airlines, which recently announced a new reduced-maximum-fare program to attract business travelers from the other majors, which have added to the already restrictive conditions on their discount fares.

International passenger traffic declined by some 5% in RPMs in 2001, and industry forecasters expect a level-off and slight gain this year followed by a rise of almost 7% in 2003 as global economies recover from the present downturn. Thereafter, growth in international markets is projected to advance at just under 5% annually throughout the forecast period. International carriers, like those in the U.S., curtailed capacity after September 11 to bolster load factors, which had dipped to 72% but are expected to rise again to the 75-76% range next year. Capacity had been cut sharply, by some 17%, following the terrorist attacks, but should return to normal growth in 2004.



Boeing's Sonic Cruiser is still in the discussion stage, and its near-Mach-1 speed may. be replaced by more conventional speeds but enhanced performance.

The aircraft equipment picture is a study in contrasts. First, the current situation is one of contractions, groundings, and retirements, as virtually all carriers have sharply reduced capacity in an attempt to control costs and stem losses. Hundreds of aircraft are parked in the Mojave Desert, some permanently, and many carriers have sought to postpone or cancel orders previously placed for new planes. However, debt service continues for many aircraft, thus minimizing the true cost savings.

New aircraft

In the area of new aircraft, work continues at both Airbus and Boeing on programs begun several years ago. The 550-seat Airbus A380-800 has progressed significantly, with its first flight scheduled for late 2004 and initial air carrier deliveries slated for early or mid-2006. Airbus has 97 firm orders and another 50 options from nine launch airlines. It projects that its customer base will grow to 30 when the aircraft enters service. In the meantime, Boeing has been hard at work on upgrades for its 747-400 series, which will feature increases in range and payload as well as reductions in noise for nighttime operations.

Final assembly work is well under way on the newer 777-300ER. There are 46 orders for the aircraft, which is scheduled for initial delivery in early 2004. The 300ER has a design range of 7,250 n.mi. in a three-class, 365-seat configuration, while a 200LR (long-range) variant has a range of 8,860 n.mi. with 301 passengers. So far only a few orders are in for this model. The other major Boeing project is the high-speed Sonic Cruiser program, which began in early 2001 as a 250-seat design with a speed of Mach 0.95-0.98, a cruise altitude of 41,000-49,000 ft, and an anticipated entry into service in 2008-2010. At this point everything is in the discussion stage, with the possibility of a more conventional Mach-0.85 design with enhanced operating performance also under consideration.

Security and financial health

The industry faces more critical issues today than it has at perhaps any time in its history. Most of these issues fall into the broad categories of security, finance, and traffic/market development, and all point to a common goal: survival.

The security issue is many faceted and includes cockpit safety, which has been partially addressed by the installation of strengthened doors, and by a White House announcement to permit the arming of some 1,400 pilots. It also involves cabin security, which includes sky marshals, now on a limited number of flights. Passenger preboarding screening, although it appears to have improved at many airports, is still suspect—reporters continue to "test" the system with concealed weapons, and the random searches still appear to focus on passengers who are "clean" rather than those who might be selected if profiling were used. A matter of growing concern is cargo screening, or the lack of it, and the whole issue of background checks of ground personnel—two areas seen as loopholes in the system.

The issue of financial condition always seems to return after a few years of good earnings. The industry is now faced with mounting losses, even after the government bailout last year. Traffic has not returned, and the carriers have not been able to lower costs to achieve profitability. The existing and threatened bankruptcies of US Airways and United serve as stark reminders of carriers no longer in existence. Traffic/market development is key to financial health. The fact that existing traffic is still some 10% below pre-September 11 levels, and that over 10% of former air travelers have not flown since that day, is a message to carriers on what must be done to ensure their survival.

by **Joseph J. Windisch**