

## Jet-A At \$3.50. This Is Not A Drill

# Big Changes Arriving At Your Local Airport - Globally

Oil has gone over \$110. And there's every indication that it's still in cruise-climb mode.

For airlines, this means a number of things that are as unambiguous as the \$4-for-regular sign at the local gas station.

- First, the cost of fueling an airplane is going through the roof. (Thank you, Captain Obvious.) That means the raw economic equation is changing for every market operated. Flights that once produced a positive contribution to the bottom line are doing just the opposite, and carriers will move quickly to adjust their revenue systems.
- Second, no airliner flying today was designed with even the concept of \$3 jet fuel anywhere in the manufacturer's mindset. Deal with it, whole parts of airline fleets are now economically obsolete - many of the missions they were designed for are now out of profitable reach, and it's a situation that won't be reversed. That means major shifts in revenue systems and strategies.
- Third, airline planners are fully aware that at \$4 a gallon for gasoline, lots of business and discretionary dollars are being suddenly and inexorably sucked out of the economy. That means, at some point in the near future, traffic and cargo demand could start to fall like a baby grand out of the tenth-floor window.

For air carriers, things have reached the point that it's no longer a case of just jack the fare up, or find another innovative way to charge fees for things nobody ever expected had any value whatsoever. *The cost of fuel has now increased to the point that much of the fleets operated by airlines have reached the end - or shortly will reach the end, of their economic lives.* It's a problem with the metal not matching the cost of operation any longer.

Changes are coming. Pronto.

**Older Jets: It's Going To Rain Aluminum Over The Desert.** American has announced the earlier-than-expected retirement of 25 more MD-80s. American Eagle is a tough challenge - saddled not only with aging 50-seaters, it still has 37-seat and 44-seat ERJs, which at \$3 fuel get real dicey in regard to the bottom line. It's military traffic strategy notwithstanding, market shifts are going to come in some form or another. Plan on Delta and United moving as fast as the agreements will allow to sharply cutting leased-in RJ flying.

**Service Levels: Expect Sudden Reductions.** As fuel costs come over the P&L transom, airlines won't dawdle in making cuts where red ink suddenly appears. As an example, United just announced that they're cutting PIT-LAX from daily to day-of-week flying. Watch for capacity/frequency reductions in hub-to-hub barbell routes such as DFW-ORD, IAH-ORD, and ATL-SLC. Super long-haul intercontinental flying may be cut substantially.

Every feed market - whether it be Shanghai or Shreveport - is going to get tough scrutiny in regard to revenue contribution. And, note to airports: airline planners are going to be buried in near-crisis project mode. So, in regard to any air service meetings, get to the point and close. Eschew any inclination to do irresponsible 60-slide *War & Peace* presentations. They really do annoy the airline.

**Fleet Planning: The C-Series Is Now The Player.** It's no longer a matter of fuel costs being incremental to an airline's bottom line - they are now fundamental. With the specter of \$4 and higher jet-A, an "interest" on the part of airlines like Southwest in more fuel-efficient airliners, moves in to a "demand" mode.

The Bombardier C-Series is the airliner to watch. It's the only entirely new GTF-powered (geared turbo fan) platform that can be stretched to (at least) 150 seats. In addition, the Airbus decision to move on a GTF version of the A-320 has put Boeing in a very difficult competitive position. The CFM-56 core (on the 737) is an incredibly reliable engine, but it's an open question if it can be tweaked along with the current 737 airframe to deliver the type of fuel efficiency promised by the geared turbo fan (GTF) being developed by Pratt & Whitney.

**Surrendering Territory & Circling The 737s Around Fortresses.** The name of the game, as we pointed out last week, is no longer "route systems" but "revenue systems." That means having market share at a given city is less important than using the aircraft to build on core system strengths. American, for example, yanked some transcons out of Boston, preferring to put the capacity where it had system and alliance strengths. Qantas dumped SFO in favor of DFW. It's a new planning dynamic - plan on seeing it more.

**Bottom Line: The Bottom Has Not Been Reached Yet.** Every sector of aviation will be fundamentally changed in the next 12 months. Face it, aviation's been built on cheap oil. Cheap oil is gone.

- For Bombardier, ignore the current order book. Buy a bigger one. Airbus is seeing the A-320NEO get a lot of market traction. Boeing will absolutely have to do something - and fast. Southwest is a Boeing customer, but it has a lot of airplanes coming up for replacement, and it knows where Montreal is, and also how to spell A-I-R-B-U-S.
- Airports - in the US and globally - will see changes in how they access the rest of the world. Alliance power will grow, and that will put pressure on "independents" to find new strategies.
- Suppliers are in for a roller-coaster ride, as engine and airframe strategies shift. Just one area: weight. Airlines are going to scrape to cut every excess kilo of weight off both new and existing airliners. How about IT providers? They'll also be in an opportunity mode. For example high-cost airport IT options like IATA-recommended CUPPS, are now DOA - there are better and less costly options, recommended or not.

**What You Don't Know Can Nuke You.** Most of the ambient, "consensus forecasts" don't address any of this. That's because "the consensus" is nothing more than just groupthink that assumes the future of aviation will be incremental changes. They are glued to their rearview mirrors.

In light of what's evolving in the global economy, putting much credibility in "the consensus" is like the mayor of Hiroshima looking up and telling his staff, "No big deal guys, It's just one B-29."

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