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Assignment 2: Final Report

Example Paper

Strayer University

ECO100

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## Final Report: Airline Industry

### **Introduction**

The US airline industry is on a winning streak following seventeen consecutive productive quarters. Even with its most significant operational costs, labor, and fuel spikes, persistent demand on increasing capacity, the airline industry remains in the black. This paper will focus on critical areas such as the assessment of favorable growth rates up through 2036, government taxation and its impact and trends on the airline industries. All signs point to growing demand for global connectivity. Alexandre de Juniac, Director General, and CEO of the International Air Transport Association (IATA) said, “The world needs to prepare for a doubling of passengers in the next 20 years. It is also a huge challenge for governments and industry to ensure we can successfully meet this essential demand” (1).

### **Size and Growth Rate Assessment**

The IATA, in its latest press release, updates that the airline industry is expected to see roughly 7.8 billion air travelers in 2036, almost double the 4 billion air passengers anticipated to fly this year. This latest update comes from the most recent release of the IATA's 20-Year Air Passenger Forecast, base prediction on a 3.6% average Compound Annual Growth Rate (CAGR) (2). Global air travel is expected to sustain favorable growth rates up to 2030, notwithstanding hurdles faced within the industry. High jet fuel prices and slow economic growth worldwide caused strains within the industry. Although challenging, improvements in passenger totals offset tense economic circumstances which quickly translate into an increased financial performance of the airline industry. Strong representation in passenger patronage supports an impressive GDP growth of 3.5% (the strongest since 2010). Subsequently, the global aviation

industry is predicted to reach up to 33.8 billion US dollars in profits by the close of 2018, up from barely 8.3 billion in 2011. Annual growth report shows that between "2017 and 2036, the number of airline passengers is expected to increase at a combined annual growth rate (CAGR) of 4.7 percent" (2).

### **Key Indicator to Monitor (Inflation) and Importance and Impact to the Airline Industry**

In the airline industry, important macroeconomic indicators are unemployment, inflation, and the business cycle. An important indicator, inflation, influences both the business cycle and unemployment rates, and so it must be monitored closely by the airline industry. For example, the airline industry earnings are reduced at a startling pace due to inflation. Decreased profits affect the economic position of the airline industry, which in turn produces a weak employment environment. Moreover, there is an interchangeable correlation between inflation rates and the rate of unemployment. This relationship includes trade-offs whereas a given high rate of inflation lowers the rate of unemployment to reduce inflation, price regarding a higher percentage of unemployment must be borne (3).

Inflation increases the price of goods and services and decreases the purchasing power of customers. Also, increases to products and services generate higher fuel costs resulting in steep ticket prices and sometimes canceled routes to lower costs for the airlines. Furthermore, inflated fuel prices subsequently increase the overall costs and significantly decreases the demand in the airline industry (IATA, 4). Since 1996 the inflation-adjusted price of air travel to consumers has reduced by half. The IATA reports that "International tourists traveling by air are expected to spend more than \$750 billion in 2018, a rise of 15% in just over 2 years" (4). Furthermore, financial instability within the industry reduces the ability to hire new employees, thus creates an

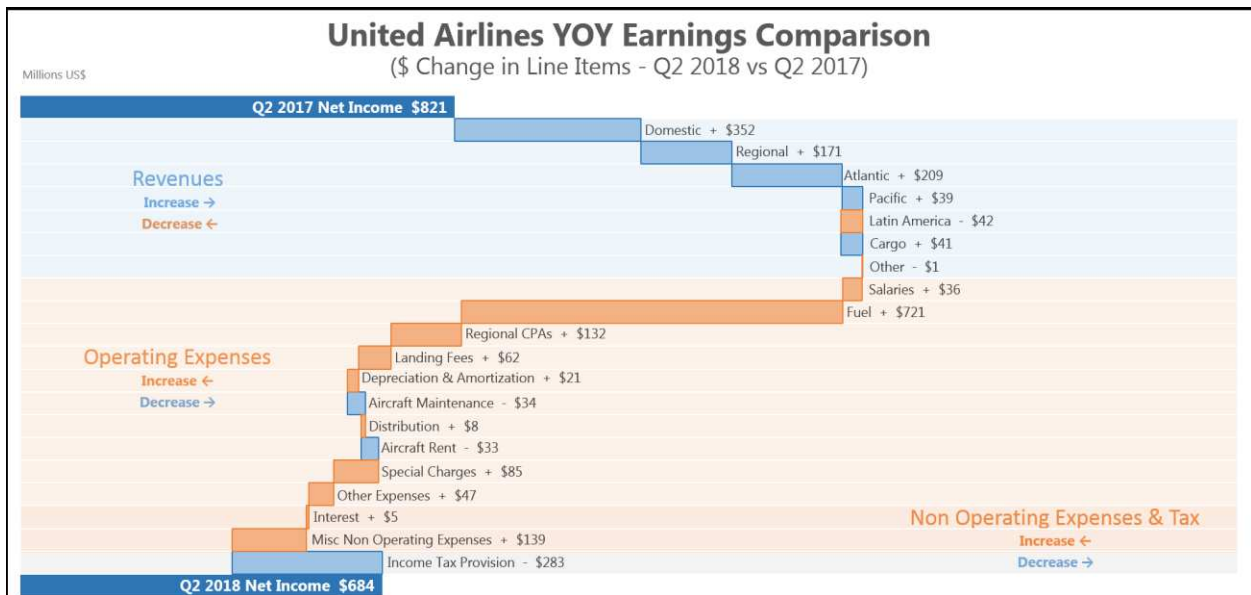
increase in unemployment rates, which in turns is passed on by influencing the quality of the services given to its patrons, which also contributes to lower demand for goods and services.

Moreover, variations in the interest and employment rates further correlate to the airlines business cycle (or economic cycle). A business cycle is a sequence of various periods of economic growth and a declining period, or, "the transition of the economy from peak to trough and trough to peak" (5). Inflation will force the airline industry towards economic decay, and it will create financial uncertainty in the industry. The airline industry has a long-term business cycle, which produces low earnings and yields to its stockholders. In the development and growth cycles of business, both the production and hiring boom until the full employment of resources and production reach their peak

### **Inflation – Recent Trends Within the Airline Industry**

Profits within the global airline industry will drop in 2018 as fuel, labor and interest rates increase. In December, the IATA flagged higher than average spending on labor and fuel, which make up more than half of the operating expenses within the airline industry. Within the last few months, the IATA then lowered its profit prediction for 2018 by 12 percent to \$33.8 billion, down from its December forecast of \$38.4 billion (6). Moreover, airline jet fuel costs are estimated to increase to as much as \$84 a barrel in 2018, while the IATA's December estimates were based on a per barrel price of \$70 (7). Furthermore, on April 26, Douglas Parker, CEO of American Airlines, noted that oil prices have spiked to 60% from last summer, a significant increase over a short period (8).

Meanwhile, the U.S. Bureau of Labor Statistics reports the cost of an airline ticket in 2018 is 10.01% higher versus that of 2000, which is a \$10.01 disparity in value (9). Between 2000 and 2018, airline ticket pricing experienced a median rate of inflation of .53 percent per year. Put differently, a \$100 ticket in 2000 would now cost \$110.01 in 2018 (9). In fact, in June, IATA's Director General and CEO, Alexandre de Juniac, on concerns of increased fuel costs, declared the inevitable, airlines would have to pass some of the fuel burdens onto its passengers (10).



As fuel costs increase, the airline's objectives are still all about their revenues. As seen in the chart above, the Q2 2017 to Q2 2018 income statement for United Airlines show us the impact to net income and the airline's ability to increase the ticket revenue beyond the increased fuel costs.

### Conclusion

In conclusion, we consider inflation a well-known economic indicator within the airline industry, as well as other signs arising as crucial for understanding the actual market demand. While GDP remains as an essential driver for the airline industry, its relationship to aviation's

growth has evolved, this is apparent at a global level, though induced by actions at a locally geographical level. Moreover, inflation is not the only factor that motivates airline growth, elements such as private consumption, international trade, tourism, crude oil prices, airline profits and increase in productivity all contribute to the economic factors (11). The result provides a unique viewpoint on the strategies of the global airline industry, considering fuel costs, which have significantly increased for all airlines. The federal government in its quest to continue its full potential of progression has implemented global standards on security, taxation, and global regulations to build cost-efficient infrastructure and house increasing demand to the detriment of the airline industry.

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