AIR CARGO SPECIAL REPORT:

Is 2012 the turnaround year?

While analysts say this should be a growth year for air cargo, pressing challenges such as increasing EU regulation, the pent-up demand in Asia Pacific, and the cost of global security still weigh heavy on the sector.

By Patrick Burnson, Executive Editor

Industry analysts are predicting that 2012 will be a significant year for air cargo recovery, but not without a new set of challenges that seem to be facing shippers and carriers on all hemispheric fronts.

For example, the troubled European Union (EU) is making life difficult for all airlines by imposing a unilateral carbon-trading scheme. Meanwhile, aircraft manufacturers and shippers agree that bio-fuels must be gradually introduced across the board.

The Asia Pacific, which is still the most vibrant market for U.S. shippers, may be ceding some of its influence to Latin America. Shippers say that fuel and energy costs associated with onerous environmental laws will make "near shoring" more attractive over the next year.

And don't forget the security issue that is ongoing for global shippers and carriers. However, with a more harmonized security system in place, global shippers may finally get a break on compliance expenses.

So, with a slowly improving global economy juxtaposed against this growing list of challenges, is the air cargo industry poised for a comeback? The Boeing Company certainly thinks so. Having ended 2011 with a solid earnings report, the company says it reflects continued strong core performance across its businesses.

"Strong fourth-quarter operating performance, record revenue and backlog, and expanded earnings and cash flow capped a year of substantial progress for Boeing in 2011," said Jim McNerney, Boeing chairman, president, and CEO. "We enter 2012 with renewed momentum, and proven business and product strategies," he says. "With an intense focus on productivity, we're well positioned to deliver growth and increased competitiveness in the air cargo arena"

John Leahy, chief operating officer for Airbus, is equally bullish, saying that the air cargo freighter fleet alone will double in the next 20 years. "Meanwhile shippers moving freight on passenger aircraft will drive even more growth," says Leahy. "Our Global Market Forecast foresees investment in freight-bearing aircraft exceeding $3.5 trillion in that time frame," he says.

Industry analysts support these rosy predictions, noting that more and more commodities are now regarded as

"perishables" and will be moved via air no matter what the cost or challenge. In fact, food, pharmaceuticals, and bio-med products are being joined by fashion and high-tech components in the just-in-time universe of global sourcing and are being packed into aircraft bellies at higher volumes.

Indeed, air transport, while still the most expensive transportation option, is now increasingly used by companies to actually save money, says Luciana Suran, an economist with global real estate consultancy CB Richard Ellis Economic Advisors. "In some cases, companies can save by flying in cargo to meet customer demand rather than spend the money warehousing their goods and distributing them throughout the U.S. and Canada," she said. "Nike is a good example."

So, while analysts say this should be a growth year for air cargo, pressing challenges such as increasing regulation, the pent-up demand in Asia Pacific, and global security improvements still weigh heavy on the sector. Here's a look at those challenges and ways that both shippers and carriers can work to overcome them.

EU's pressure point

As if the EU didn't have enough problems these days, it's also earned a great deal of enmity from its air cargo trading partners as of late.

When the EU Emissions Trading Scheme (ETS) was initially introduced last year, it appeared to be an intra-European solution that would avoid uncoordinated tax measures. But the scope was extended beyond Europe's borders and there was no let-up in taxation.

Departure taxes in the UK, Germany, and Austria—introduced as environmental measures—cost over €4 billion. At current prices for UN issued Certified Emissions Reductions, that would offset aviation's global CO2 emissions about one-and-a-half times.

"And ETS is coming on top of that," says Tony Tyler, director general and CEO of the International Air Transport Association (IATA). In fact, non-European governments, including the U.S., see this extra-territorial tax collection as an attack on their sovereignty. However, they are taking action.

"Aviation can ill afford to be caught in an escalating political or trade conflict over the EU ETS," says Tyler. "The International Civil Aviation Organization (ICAO) is the only way forward. I sense a greater appreciation in Europe that a global solution under ICAO may take time, but it will produce a superior result." It's more important than ever, adds Tyler, for Europe to be a fully engaged participant in discussions at ICAO aimed at delivering a global solution.

"This further isolates

Fuel Impact on Operating Costs

Year	% of Operating Costs	Average Price per Barrel of Crude	Break-even Price per Barrel	Total Fuel Cost
2003	14%	$28.8	$23.4	$44 billion
2004	17%	$38.3	$34.5	$65 billion
2005	22%	$54.5	$51.8	$91 billion
2006	26%	$65.1	$68.3	$117 billion
2007	28%	$73.0	$82.2	$135 billion
2008	33%	$99.0	$88.9	$189 billion
2009	26%	$62.0	$55.4	$125 billion
2010	26%	$79.4	$91.0	$139 billion
2011 F	30%	$112.0	$116.3	$178 billion
2012 F	32%	$99.0	$101.1	$198 billion

Updated: 12/2011 Next Update: 3/2012 Source: Industry Financial Forecast Table (IATA Economics)

the EU from the rest of the world and will keep in place a unilateral scheme that is counterproductive to concerted global action on aviation and climate change," says Charles "Chuck" Clowdis, managing director of global commerce and transport advisory services at IHS Global Insight. "The irony is that all the world's airlines want to address climate change and make a move toward more sustainable energy."

According to IATA, the aviation "value chain" is committed to improving fuel efficiency by an average of 1.5 percent annually to 2020, capping net emissions from 2020 with carbon-neutral growth and cutting its carbon footprint in half by 2050 compared to 2005 levels.

"Improvements in technology, operations, and infrastructure as well as the use of positive economic measures are needed to achieve this," says Tyler.

To underscore this issue, analysts note that Air China, Boeing, and Chinese and U.S. aviation energy partners conducted China's first sustainable bio-fuel flight late last year. The two-hour mainland flight from Beijing Capital International Airport was witnessed by officials from both countries and highlights the viability of using sustainable aviation bio-fuel sourced in China.

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Asia Pacific's pent up demand

The fact that this new fuel demonstration took place in China should certainly not come as a surprise. Airfreight rates for Asia outbound shipments rose 4.6 percent in January over the same month a year ago, the first year-over-year increase in Drewry's Air Freight Price Index in 15 months.

The Drewry index also jumped 8.4 percent from December, signaling that demand remained relatively solid after the late-2011 holidays as airlines kept capacity in check. The measure of 109.6 posted in December 2011 was the highest point since the Drewry index reached its 2011 high of 114 in October.

And on that news, the Year of the Dragon was ushered in with forecasts for continued air cargo growth in the Asia Pacific. Airlines in the region will take delivery of more than 9,370 new aircraft over the next 20 years, according to the latest market forecast by Airbus. Valued at $1.3 trillion, the deliveries will account for 34 percent of all new aircraft with more than 100 seats entering service worldwide over the forecast period, with the region overtaking North America and Europe as the world's largest air transport market.

However, Washington, D.C-based Airfowarders Association (AfA) Executive Director Brandon Fried says that while Asia remains a strong market for his constituents, other options are emerging, too.

"The industry is already seeing some softening in Asian markets where North American buyers are beginning to source products from neighboring countries," says Fried. "This means that as time passes, more opportunities will develop throughout Latin America as well."

Increasing cost of security

Irrespective of regional growth, however, is the ongoing battle waged by the cargo community against global terrorism. Shippers who have been burdened by the cost of security may get little relief in the near future, say analysts.

However, IATA has urged broad cooperation among industry and governments to realize the "Checkpoint of the Future." Given the growing quantity of freight moving in the bellies of passenger aircraft, such a move may be crucial.

"The Checkpoint of the Future envisages using passenger data collected for immigration authorities to differentiate airport screening," says IATA's Tyler. "Secondly, it incorporates technology expected to be available in a 10-year timeframe to enable passengers to walk through checkpoints without stopping or unpacking."

Along with support from Interpol, the European Commission, the U.S. Department of Homeland Security, and the Chinese government, 16 states have endorsed the Checkpoint of the Future concept. The International Air Cargo Association (TIACA) endorses this view too, and is promoting its own agenda for international growth.

"We believe that countries should view air routes as highways in the sky, a competitive public road every bit as important as surface transportation infrastructure," says TIACA's Secretary General Daniel Fernandez. "Under a fully liberalized aviation environment, numerous new international highways in the sky are possible that would markedly improve the speed and accessibility of a nation's businesses to their global suppliers and customers."

In so doing, says Fernandez, the competitiveness of a nation's businesses will increase, more foreign direct investment will be attracted and economic development promoted.

Dr. Walter Kemmsies, Moffatt & Nichol's chief economist concurs with Fernandez, but says any discussion of "highways in the sky" means more investment in existing infrastructure. "Shippers are paying for enough logistical support as it is," says Kemmsies. "It's time for governments to start providing incentives for addressing fuel costs, sustainability, and security. As an American, I say the buck stops here."

—Patrick Burnson is Executive Editor of Logistics Management