

# Growth in Passenger Numbers Forecast to Slow in FY97 Due to Weak Yen

The airline industry showed solid overall air industry demand growth in FY1996. The progressively lower prices of the past few years have sparked demand in the domestic airline industry and total passenger numbers should rise by around 4-5%. However, slight variances in airlines' fare strategies began to appear from the first half of fiscal 1996 and at some airlines prices rose compared to the same period the year before. Expectations are that in future these differences in pricing strategies will possibly produce a growing divergence in individual corporate results.

In spite of a relative depreciation of the yen compared to fiscal 1995, overseas travelers are expected to have reached record numbers on international routes and overseas travel demand could basically be described as strong. Airlines have seen favorable growth in total passenger numbers and an increase of around 7-8% is forecast for FY1996.

As such, because demand has been firm on both domestic and international routes, airlines can look forward to an adequate rise in earnings in the FY1996 settlement. They can also expect to see benefits from cost restructuring undertaken over the past several years. However, with soaring jet fuel prices, the weak yen and other unexpected fac-

tors the outlook for profits is hardly optimistic. Japanese carriers have little foreign currency-based income, so not only can they not expect increased currency conversion income deriving from the lower yen, but since many cost items are dollar denominated, yen conversion results in increased overhead. At more than 10%, jet fuel prices make up a major share of overhead costs and because price fluctuations are linked to dollar rates, the double punch of rising fuel prices and the effect of the yen's depreciation impair corporate earnings. In fiscal 1996, jet fuel prices alone are expected to have had a negative impact of ¥30-40 billion on overall industry profitability. In fiscal 1995, carriers were to some extent able to report profits from sales of aircraft and devise other strategies to boost profitability. But if they fail to come up with some sort of stratagem in FY1996 there is an undeniable fear that they will end up with increased sales and declining profits.

In the area of aviation regulations a more flexible fare system had already been introduced in April 1996 as part of deregulation, and at the end of 1996 clear future intentions to abolish Ministry of Transport regulations governing supply and demand, which had served as the basis of airline industry

regulatory oversight up to now, were also announced. Against this background an unconventional new airline that planned to offer half-price fares proceeded with plans to enter the market on regular domestic routes, and there is an indisputable possibility that this will lead to a future structural shakeup in the airline industry. In the sense that the first step toward those changes will occur this year, fiscal 1997 will be an important year.

As far as the specific outlook for fiscal 1997 is concerned, the strong trend in overseas travel continues and basically stable growth is expected to persist, but the effects of the weak yen should slow growth in total passenger volume. Viewed on the basis of current exchange rates, growth in total overseas passenger volume is expected to remain at around 5%. However, yields are expected to improve because load factors are forecast to rise.

Substantial changes are anticipated on domestic routes. First, after construction of Haneda airport's offshore facilities is completed there will be around 20% more slots. Increased capacity at Haneda, which handles 60% of domestic air travel demand, should be accompanied to a certain extent by a rise in demand and growth in passenger numbers. However, demand is not expected to increase strongly enough to produce increased supply and current, somewhat flat load factors may further worsen. Second, these worsening load factors should inevitably result in declining yields, contributing to an additional drop in prices.

In terms of costs, airlines' fixed costs will probably rise in conjunction with the increased number of slots at Haneda. Jet fuel prices, higher parts costs due to the weak yen, and other factors in declining earnings will also contribute to a cloudy outlook. Expectations are that the fiscal 1997 revenue and expenditure situation of airlines will need to be carefully tended to.

(Hatanaka Hirokazu, senior economist)

