Weekly Briefing

Volume No: 3 Issue No: 29: 8 November 2001

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Bank cuts nominal interest rates to 4%
Aviation in crisis– the first part of a 3-part special report
Falling oil prices– little impact for the UK economy

TUC WELCOMES RATE CUT IN NOVEMBER

'This is a very welcome cut which will help Britain escape the worst of the global downturn.

The Government must now show positive support for industry and jobs. Our priorities are: tax credits to encourage firms to invest in R&D and training; more industrial and regional support and sustaining public investment programmes, with urgent action to tackle underspending.'

John Monks, General Secretary of the TUC

NEW RATE CUTS TO CUSHION THE GLOBAL DOWNTURN

The Bank of England cut nominal rates for the third time since 11 September at their November 2001 meeting. Rates have been reduced to 4.0% - their lowest rate for four decades. The European Central Bank followed suit, allaying fears that ECB inertia might lead to a deeper than expected macroeconomic downturn in the Euro Zone. Wim Duisenberg announced a further 0.5% cut in the Euro Area repo rate.

The rate cuts were welcomed by both sides of industry. Ian Brinkley, Chief Economist at the Trades Union Congress saw this further easing of monetary policy as a vital insurance against a slide in global trade and output. The Confederation of British Industry got their wish of lower rates just days after data showed the worst month for UK manufacturing output for nearly twenty years.

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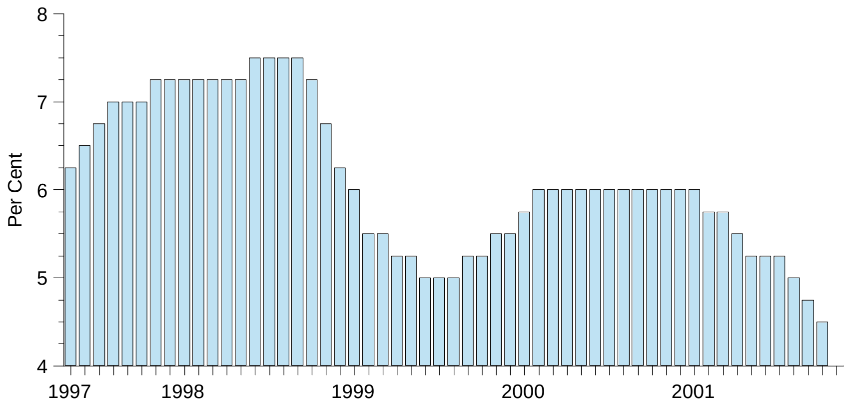
UK BASE INTEREST RATES FALL TO 4% IN NOVEMBER



Special Report: The Aviation Industry After September 11th

No global industry has suffered worse than the aviation market as a direct result of 11 September. That date will probably remain engraved on the minds of all participants in the industry as the darkest day in the history of civil aviation. In the first of a 3-part report, we provide a brief introduction on how 11 September has affected the aviation market. In subsequent articles, we will examine the specific effect on the European aviation market and look at the likely strategies of the major European National, Leisure and Low-Cost Airlines. We will also publish a data summary outlining the long-term historical trends in air traffic demand.

Initial Impact on Aviation Traffic

Airline traffic slowed dramatically in the second half of September 2001. The slowdown was particularly significant for US airlines (or "carriers") who were affected by the initial closure of US airspace, and then by cancellations of domestic and overseas travel by US consumers. US carriers experienced reductions in "Revenue Passenger Kilometers" of some 35% on both international and domestic traffic. The International Air Traffic Association (IATA) indicates that airline traffic in the rest of the world declined by approximately 20-25% in the first week following the Attack, recovering slightly, around 5-10% down in the following weeks.

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Falling Oil Prices Hits BP Profits

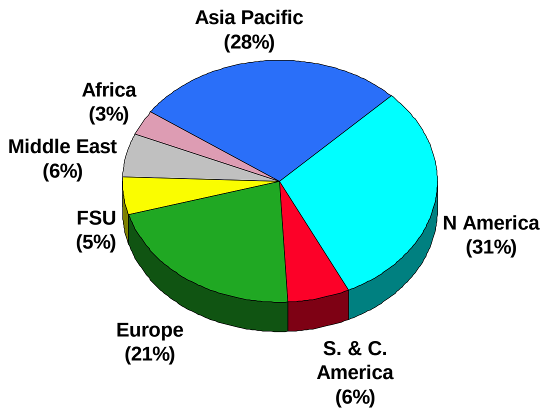
Tumbling oil and gas prices put the skids under BP in the third quarter of this year, leaving profits for the period some 20% lower than a year ago. BP reported a surplus of $3.049bn (£2bn) for the three months to the end of September - down from $3.796bn in the same quarter a year ago - but is still showing record returns of almost $11bn for the year to date

The Guardian

Crude Oil Prices Slump—Can OPEC Respond?

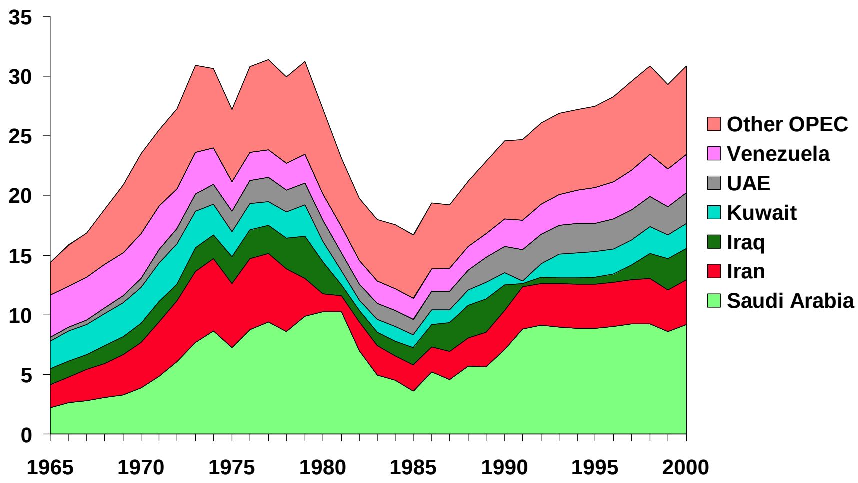
Crude oil prices have fallen by over 30% since the 11th of September. The main reason for this is the collapse in world demand and a rise in world oil stocks. In response to this, OPEC are likely to announce a cut of more than one million barrels of oil per day when they meet on the 14th of November. But will this be a huge mistake? How credible is a strategy of cutting back on output when the oil cartel is already under great strain?

Oil demand dominated by North America and the EU



OPEC is producing well above agreed quotas and is facing up to a non-compliance problem within its organisation. This means that OPEC finds it particularly hard to make agreed output cuts stick when countries leave their monthly meeting. There are huge budget difficulties for several member of the cartel - falling output and prices is leading to a sharp fall in tax revenues for countries such as Nigeria and Saudi Arabia. Indeed the revenue crisis is such that there are rumours that the Nigerian and Saudi governments are finding it increasingly diffucult to pay wages and salaries to their civil servants. Put yourself in the shoes of a leading oil producer. The revenue from crude oil sales account for a large percentage of total exports and government tax revenue. Producers want higher output and higher prices! But this is simply unsustainable.

OPEC production has risen recently—can they make output cuts stick?



Problems in the OPEC Cartel

Even if OPEC manages output cuts on this scale, it is not big enough on its own to dictate the price, and it is finding non-members loth to co-operate

The Economist

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Medium and Longer term impact

It is impossible to predict with any accuracy how severe the medium and longer-term damage could be to the industry. IATA estimates indicate that the major airlines are anticipating reductions in capacity on international scheduled services averaging 10-20% between October and December 2001.

Analysts at Credit Suisse First Boston assume that traffic on Europe/North Atlantic routes will be particularly significantly weak, dropping by 40%. Avis Europe, a car rental business, provides some credibility to these assumptions. Last week, it said that long-haul bookings were down by as much as 35% on last year, including a 15% drop because of the deteriorating economic environment.

The financial implications for the industry are likewise difficult to predict. Al major airlines have taken quick action in the last few weeks to cut costs in response to dwindling revenues. By the end of August 2001, the global industry was already estimated to be suffering a net loss on international services of around $3 billion due to the overcapacity in the market.

Heading

"The early 1990s are a benchmark, but my guess is that this time will be considerably worse than that. We're in totally uncharted waters and it depends on what action the US and its allies take, and whether that provokes more terrorist action.""

Source:

Dr George Williams;

Cranfield University Air Transport Group.

11 September highlights problem of excess capacity

11 September has further worsened the excess capacity issue, making it essential for airlines to close further routes (which itself reduces revenues), ground aircraft and make redundancies. IATA has estimated that, based on a global reduction of 15% in capacity and traffic in the fourth quarter of 2001, global aviation losses will rise to $7 billion for international services and perhaps $10 billion for the industry globally.

Comparison with the 1991 Gulf War

Many commentators have made comparisons between 11 September and the 1991 Gulf War, when passengers also fled air travel and volumes dropped by an average 14.5%. But the Gulf War may be an imperfect guide. In 1991 the world economy was also facing an economic slowdown and airlines were struggling with the (apparently permanent) problems of over-capacity.

But the degree of consumer uncertainty is not comparable. In 1991 there was an identifiable enemy (Saddam Hussein) and despite a relatively long build-up to military action, the conflict was soon resolved. This time, Western Leaders have advised consumers to prepare for a long conflict, both in Afghanistan, but also domestically, where the threat of further terrorist action is significant.

How Can Airlines Respond?

Airlines make severe losses when demand falls because of the high fixed costs. The extent to which airlines can cut costs in the short term is only about 30-35%. The immediate cuts come from flight cancellations (which save on fuel, landing charges and baggage handling). Only over the longer term do costs such as plane leasing and staffing become more controllable, making it imperative to cancel aircraft deliveries and cut the workforce swiftly.

The major North American airlines are a good example of how airlines can respond to an "external" economic shock such as 11 September. Together, American Airlines, United Airlines, Continental, Delta and Air Canada are cutting capacity by almost 20%. American and United are both reducing their workforce by 20,000 jobs, whilst Continental has cut 12,000 employees.

In Europe, Virgin Atlantic quickly announced 1,200 job losses and a 20 per cent capacity reduction and BA announced its intention to shed 7,000 jobs and a tenth of its capacity. More European announcements are inevitable. However, if airlines are to emerge with some kind of business when traffic recovers, there is only so much cost-cutting they can do. Until then, in the absence of government support, they are condemned to make significant losses, and must rely on their reserves or further injections of funding to help them survive.

Tutor2u Weekly Briefing

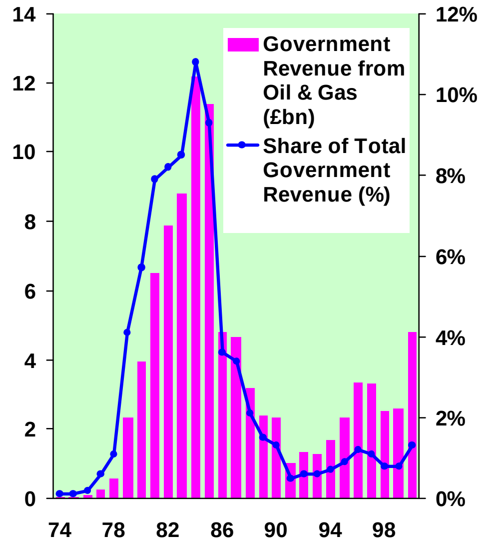
Oil demand dominated by North America and the EU

The fall in world oil prices will help to cushion the collapse in demand for fuel caused by the recession in the United States. Already there are signs that the demand for petroleum in the United States is beginning to pick up again. But demand for jet fuel continues to decline.

What are the current consequences of low oil prices for the UK economy? In the short term, the impact is muted. As the chart opposite shows, the significance of the North Sea Oil sector for our economy has diminished over the years. Petroleum tax receipts as a share of total government tax revenues have declined from their peak in the late 1970s and early 1980s. In 2000, revenue from the oil sector accounted for just four per cent of total tax income– just one third of the scale of tax receipts seen in 1985 when oil production reached a peak.

Importance of Oil for the UK Economy

The share of oil in total merchandise exports has also declined since the early 1980s. Last year, UK exports of oil amounted to only 7% of total exports compared to a peak of 22% in 1985. Nationally, the gyrations in world oil prices have little substantial macroeconomic impact. But clearly there is a strong regional dimension to the issue.



Scotland is more dependent!

The Scottish economy remains relatively more reliant on oil exploration, extraction and refinement. Scotland takes 30% of total employment in the UK oil and gas industry. And the oil sector on its own contributes 7% of total employment in the Scottish economy. Although the relative economic contribution made by oil has been in decline for some time, the health of the UK oil sector remains an issue of great political significance north of the border!

This Week's Best of the Web

You can find all these resources and more at Tutor2u Resources: Find us at www.tutor2u.net/default.asp

Aviation in Crisis

BBC Special Report http://news.bbc.co.uk/hi/english/business/newsid_1578000/1578795.stm

FT UK Economics: http://news.ft.com/home/uk/

Global Oil Market

Opec: http://www.opec.org/