

Aerospace Outlook

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Relative to most other manufacturing industries the recent performance and short-term outlook is very good for manufacturers of aerospace products, including both civilian and military aircraft. That's because of a large backlog of orders for civilian transport aircraft and the fact that the U.S. government defense budget for major aerospace systems is basically set for both FY 2010 and FY 2011. The medium-term outlook for the aerospace industry is less sanguine, however. Due to both new priorities as well as projected budget deficits of unprecedented proportions, the new administration is likely to significantly scale back, or scrap, many major DOD weapons projects. Meanwhile, sharp drops in both passenger and cargo traffic as well as airlines' inability to securing financing on favorable terms are strong headwinds for manufacturers of civilian aircraft. Those headwinds have already led to order postponements and cancellations by air carriers. The recent drought of new orders also suggests that the industry's good times will end as soon as manufacturers have worked their way through the backlog of orders that is on their books. Longer-term, China and Russia will put greater emphasis on developing domestic aerospace manufacturing industries, which increasingly will compete with U.S. manufactures' for sales, especially sales to maturing economies in the developing world.

On the plus side, manufacturers of civilian aircraft stand to gain from airlines' need to update their fleets with more fuel efficient, quieter, and more productive aircraft. Indeed, replacement of existing aircraft to enhance productivity and lower costs rather than growth in the number of aircraft in operation will be an increasingly important driver of the industries overall sales. Another tailwind for manufacturers of civilian aircraft will be rapid growth in air travel throughout China, India, and the Middle East.

Until very recently, the demand for private aircraft had been very strong, reflecting the high value of executive time, increased flexibility, security advantages, the increasing need to travel to airports not served by the big carriers, and the increased hassles involved

in using commercial flights in the wake of 9/11. Both the short-term and medium term outlooks, however, call for sharply lower demand because of the sharp drop in corporate profits, the credit crunch, increased concerns about environmental stewardship, and public outrage over corporate leaders' usage of private planes. Also, the massive destruction of household wealth that has taken place over the last two years has reduced the number of individuals who are wealthy enough to purchase, maintain, and operate private planes.