

**By: Michael Fabey**

Load factors are up, jet fuel prices are down and ancillary revenue is rolling in, but most airlines are still expected to report third-quarter losses.

And the main reason is the airlines' continued fare discounting, according to analysts. The latest government figures, from the first quarter of this year, show declines in base fares of about 9%. But analysts said it could be much worse now: between 14% and 25%.

"Discounting has always been the strategy," said Raphael Bejar, CEO of AirSavings, an airline consultant. "It's not proven to be profitable.

"Yes, load factors are up, but it's with a lower average coupon," he added. "Ancillary revenue helps decrease the impact of keeping fares down, but it hasn't reached a level where the revenue side equals the losses from the slashed fares. It doesn't mean the airlines are making money."

The Transportation Department said airlines collected \$669.6 million in baggage fees in the second quarter, about 18% more than they did in the first quarter and about four times the amount they pocketed for the second quarter of 2008.

Still, analysts anticipate U.S. carriers as a whole will post losses in the third quarter as fares continue to drop, though estimates vary about how far they have fallen and how much lower they can go.

Analyst Darryl Jenkins, founder of the Airline Zone aviation economics website, figured fares have dropped by almost a quarter over the past 12 months.

The average U.S. one-way fare in Q1 2009 was \$175.24, a decline of about 5.8% from same period for 2008, said analyst Darin Lee of the LECG consultancy.

"That's pretty interesting in light of big drop in capacity over the same period," Lee said.

Travelocity reported that summer fares were down 18% compared with summer 2008, and fall fares dropped 14%.

To put that in some context, the average domestic fare has dropped from \$296.95 in 1995 to \$249.58 in 2008, using prices based on 1995 dollar values, according to a Brookings Institution report released this month. The price to fly one mile dropped by 50% between 1978 and 2008, the Brookings report said.

And it looks like much the same in the third quarter of this year, said analyst Vaughn Cordle of the AirlineForecasts consultancy.

Cordle predicted Q3 fares would be down by about 14.2%, and Q4 prices could drop another 2.6%.

But as demand starts to pick up again next year and more people fly on the capacity-gutted airline network, fares should start to rise, Cordle said, starting with an 8.4% jump in the first quarter of 2010.

Fares have already started to rise. FareCompare.com noted a \$16 roundtrip hike last week for many carriers, the fourth bump since the middle of the year.

