

ECONOMIC UPDATE



National Automobile Dealers Association, Industry Analysis Division

Long Awaited Real Estate Legislation May Be Too Late to Avoid Negative Economic Growth.

The U.S. Congress has finally finished the bill to assist the real estate difficulties, but it may come too late to avoid a mild recession for early 2009. The economy has delivered the very modest growth that NADA expected, but in dragging out the rationalization of the real estate market, economic growth may slip into negative territory as early as the fourth quarter of 2007. A few bank failures and some new bad news on structured mortgage based products will contribute to the drag on the economy.

Inadequate underwriting of mortgage loans, and the loss of household wealth that results from the real estate slowdown, are the primary reason for the slow overall outlook for 2009. Consumers have been most affected by this loss of wealth in making decisions to buy new cars. And higher gasoline prices have caused those who are willing to buy to look for mostly midsized to small cars only, resulting in an inventory shortage of what will sell. Mitigation of this problem will come from only two sources: higher production of smaller cars and lower gasoline prices that broadens the range of new vehicles demanded.

Automakers countered sluggish year-to-date new light vehicle sales with significant incentives and subvented interest rates just as gasoline moved over \$4 per gallon nationally, on average. Gasoline prices are currently moderating, which could help used values of pickups, SUVs and Minivans, if it follows the pattern of past years. Will it help this time? Yes, if it persists. Some pundits see the return of \$150 per barrel crude oil, and that would stop the decline of refined gasoline at the pump.

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Inventory Mismatch Cuts Vehicle Sales

NADA continues to believe that the market will support at least 15 million units of sales in 2008. More effective pricing of new vehicles by the Detroit 3 in May and June was offset by higher gasoline prices that caused inventory of new cars to become scarce and truck inventory to sit idly on dealership lots. IRS stimulus checks are distributed, and the impact has been felt mostly at “big box” stores and gas stations.

For Six Months, New Truck Sales were Weak, and July Sales, Announced Tomorrow, will Lag Last July

Light vehicle sales of the Detroit 3 were down 16.3 percent in June and down 17 percent year to date. Year to date, Chrysler Group sales were off by 23 percent, Ford sales were down by 14 percent and GM sales down 16.3 percent. Only two broad categories of new light vehicles saw sales increases during June, small cars (up 20 percent) and midsized cars (up 1.3 percent). Lower priced small cars, including the Honda Fit, Toyota Yaris, Nissan Versa and Chevrolet Aveo were up 32 percent as a class, while the Upper Small Cars subgroup, with traditional favorites Civic, Corolla, Colbalt, Caliber, Focus, Sentra and Elantra were up a still impressive 18.6 percent for the month. Year to date, lower small cars are up 25.5 percent and upper small cars are up 8.5 percent as inventories of both start to run

short.

A major problem in getting new car deals to completion is the weak market prices of the trucks and large cars that many customers want to trade. The only immediate solution for this is falling gasoline prices, a need trend that started in July.

As used SUV prices continue to drop, some customers will simply keep the vehicles and look for an economical new or used car at dealerships to drive to work.

Small and midsize used will continue to be in short supply on the new side, and used cars are bringing better money in the auctions. The manufacturers that will prosper are those who can quickly shift to greater production of small cars to meet the current surge in demand. That will change only if gasoline prices fall, and stay lower for several months.

With concerns about the prospect of \$5 or \$6 per gallon gasoline, consumers in May and June were often looking for cars obtaining 30 miles per gallon or above. In the used market, such cars increased in value, while truck category vehicles fell in value.

This is explained largely by gasoline mileage numbers. Many consumers seem not to even bother to check the EPA ratings for Crossovers, and are looking only at midsize and small sedans. New truck-based SUV sales were down 32.5 percent by volume year to date through June.

Used SUV prices made a recovery in 2006, when gasoline prices came down for six months, starting in July. Hopefully, we will see that pattern with the current moderation in gasoline prices (See attached SUV price graphic).

July sales (released August 1) are too early to expect to see a lot of impact of lower gasoline prices on new or used vehicle prices.

We have \$3.65 per gallon gasoline in parts of the country now. If the average for regular gasoline would stick for a few months, or come down to the \$3.40 range, expect to see some shift of the new and used mix partially back toward truck-category products. Certainly the Crossovers will improve sales. Currently, CUVs are not selling because the trade-in value of some customers SUVs is so low.

At \$3.40 per gallon or below, we think customers with non-SUVs trades will come back to the Crossovers that obtain 25 to 29 on the highway. When consumers start to focus on gasoline prices in the \$3.50 to \$4.50 range over the next year, and not worry that \$5 and \$6 per gallon gas is just ahead. Those lower gasoline prices will help used SUV prices make some recovery.

In 2006, the fear was \$3 per gallon, followed by \$4 and \$5 per gallon. When gasoline started dropping in July, and stayed lower for the next six months, dropping to \$2.40 or below, the values of trucks recovered and the mix of new sales went back to more traditional relative volumes. A repeat of the 2006 experience would be welcome.

That consumer concern about \$5 and \$6 gasoline caused the focus on 30 plus miles per gallon vehicles in May, June and (we expect) July. The economies of Europe and North America are slowing. Moderating gasoline prices for several months should help reduce mismatches in the new and used car market. However, just on geopolitical event or refinery outage can change the current favorable outlook on gasoline.



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Note: Economic Update will appear monthly, after light vehicle sales and other key economic detail become available.