

ECONOMIC UPDATE



National Automobile Dealers Association, Industry Analysis Division

Lower Fuel Prices and Lower Effective Prices Will Help September Light Vehicle Sales. Incentives Arrive Too Late for August

Next week August new light vehicle sales will reflect a month when gasoline prices fell and incentives lowered the effective prices for many customers in the last 10 days of the month. Lower fuel prices and lower effective vehicle prices should help September sales results, but the assist to the August sales results will be modest.

To sum up, the good news is economic: modest, but positive, real economic growth in the economy, lower gasoline prices and vehicle prices will make a real contribution to sales over the next several months. That is the good news for all parts of the country.

The good news for about half the country is that 28 states, mostly in the midsection of the country, are seeing the real estate market stabilize, providing a plateau for residential real estate to begin to recover. The other 22 states will have a falling market well into 2009.

The bad news? Inadequate underwriting of mortgage loans, and the loss of household wealth that results from the real estate slowdown, are the primary reason for a credit crunch that has spilled over into auto lending. Once bankers become timid in loan making, that timidity normally persists for several years, and it appears to be the case this time. Even the 28 states that put in a bottom in the real estate market toward the end of this year will not see a rapid return to robust home price appreciation in the broad real estate market. The end of falling real estate values will be important to those states, and credit availability will improve in 2009. In states with the other half

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of the population, we will see home prices continue to decline, but happily, at a decreasing rate of decent as those regions finally put in a bottom in the real estate market in 2010. Those mostly coastal states include four large ones, California, Florida, New York and New Jersey.

Lower prices for vehicles will not decouple new vehicle sales from the credit crunch. However, for those customers with financing, lower effective new vehicle prices will also be helped by higher average trade in values over the next several quarters. Falling gasoline prices will help bolster the used values of larger sedans and truck based products, and that enormously helps new CUV and midsized sedan sales.

These vehicles, which obtain EPA highway mileage in the 22 to 29 miles per gallon were also caught in the down-draft of used vehicles prices in the second quarter when sales of small and midsized cars boosted overall car sales over flagging truck sales. This happened not just because consumers experienced \$4 per gallon gasoline, but because they feared \$5 and \$6 per gallon gasoline would follow quickly.

Consumers went thought a similar period of fear in the first half of 2006. Then, the immediate threat was \$3 regular, but the fear was \$4 and \$5 gas in the near future. What occurred in July through September 2006 was a fall in regular gasoline to

below \$2.40 per gallon and a resulting recovery of the sales of a broader range of vehicles, including light trucks, during the rest of that year.

The fall of gasoline prices and recovery of truck trade in values will help light vehicle sales for the rest of the year. The summer driving season ends this Labor Day weekend with fewer households on the road, and that should sustain a trend of slightly falling gasoline prices into the fall. Schools go back into session in August, so the die is cast for less long range driving. But make no mistake, gasoline is still about a dollar per gallon higher than it was a year ago, and the prospect is that even with fuel oil and natural gas prices falling, heating costs will be significantly higher than last year, and further regional drain on household budgets in the cooler areas of the country.

The good news on gasoline prices and trade in values will be essential in keeping a slow year from being a more miserable year for new car sales. With some reasonable luck in avoiding hurricane interruptions of gasoline production, lower gasoline price trends should help save both new and used car department revenue drops running at 8 percent through June in the NADA Average Dealership Profile.

The moderation of gasoline prices should also help consumers consider a wider range of vehicles, avoiding what was to be a disastrous trend in May, June and July, when even brands considered small car specialists were out of small and 4 cylinder mid sized cars that were the narrow focus of many new vehicle customers. Drops in used SUV values subdued the multi-year pattern of SUVs traded in on Crossovers that had sustained double digit sales growth of the crossovers for more than ten years. CUVs are among the key new products for newly all brands in the U.S. marketplace. These are key vehicle sales for Detroit 3 dealerships that have too few small car offerings for the current consumer preferences.

The history of 2006 is encouraging for the next four months. Used SUV prices made a recovery in 2006, when gasoline prices came down for six months, starting in July.

We have \$3.45 per gallon gasoline in parts of the country now, and a national average for regular at around \$3.65. If the national average for regular gasoline continues to moderate, and sticks for a few months below \$3.50, the last four months of the year will be much more pleasant. Crossovers and cars getting over 22 miles per gallon on the highway will lead the growth in sales. Used SUV sales at retail will slowly improve.

The critical elements remain lower effective new vehicle prices and receding fears about \$5 and \$6 per gallon gasoline. A key part of this positive part of this improvement is continued modest improvement in used SUV prices. The start of improvement in big truck prices is in the NADA/NAAA Auction Net data for July and early August.

When gasoline started dropping in July 2006, 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. Just partial recovery for truck sales will vastly help sales the last months of 2008, and assist the new vehicle and used vehicle financial results for franchised new dealers for the year.

If Gulf of Mexico storms stay away from U.S. refineries, we can obtain new vehicle sales improvements. Just one refinery outage could interfere with that, but current trends, if they hold, will help sales for the rest of the year, and give us August results somewhat better than what was coming our way a month ago. The improvement in credit availability will be a slower process. It will be more instructive for franchised dealers to check the weather channel than the financial channels over the next two weeks as they contemplate September sales.



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