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inFOCUS
inF 1103 March 21, 2016

Transportation

THE CYCLICAL AND SECULAR OF THE AUTO MARKET, PART ONE: STARING AT A CYCLICAL PEAK

In recent weeks, a flood of data about auto loans has raised questions about the health of the auto industry, in spite of record sales.

• The total dollar amount of car loans outstanding hit $1.1 trillion in the fourth quarter of 2015, a 30 percent increase from pre-financial-crisis levels, while the dollar amount of loans going to subprime borrowers was up more than 150 percent over that time frame. About 12 percent of new-car buyers with loans had subprime credit scores.

• The average maturity of new-car loans climbed since the end of the Great Recession from 59 months to 66 months as of September 2015, suggesting that in spite of an improving economy, buyers have needed smaller monthly payments to be able to afford new cars.

• Nearly 30 percent of new-vehicle loans are now for terms of 73 to 84 months.

"Louie, you apply for a loan while Rocco heads in through this door and files for bankruptcy."

TAKEAWAYS

- The auto industry posted record sales numbers last year, but a closer inspection of leasing terms and delinquency rates suggests those sales figures were partially driven by unsustainable lending practices.
- Recent sales spikes were also driven by a consumer return to SUVs and light trucks during this period of lower gasoline prices, a reality subject to an eventual reversal.
- As noted in ***inFocus* 1102**, American households are facing a consumer squeeze, and even those in upper income brackets are impacted by weak and volatile equity markets. These realities could limit the further growth of car sales.

IMPLICATIONS

- Margins for automakers and auto dealers fall.
- The marked increase in sales volume of passenger vehicles (cars, light trucks and SUVs) over the past year abate.
- Auto-financing companies experience balance-sheet damage from rising delinquencies.
- To drive sales, automakers scramble to excite consumers with new technology in next year's car models.

• In November, about 12 percent of sub-prime auto loans that were packaged into bonds were at least 30 days past due, and a third of those, four percent of the total, were 60 days delinquent. Another 2.6 percent of the loans packaged in bonds were in some state of bankruptcy or repossession of the vehicle.

• The 60-day delinquency rate among subprime car loans that have also been packaged into bonds climbed to over five percent in February, the highest level in nearly two decades.

• Vehicle leasing as a percentage of auto sales hit a monthly record of 32.3 percent in February, up sharply even from the 2015 average of 28 percent.

• At the end of 2015, Ford and other automakers were offering deals of six or more years of no-interest financing.

• According to TrueCar, an auto-pricing website, automakers have been increasing the dollar amount of vehicle incentives by double-digit percentages from a year ago, particularly in midsize and compact-car segments as those vehicles suffered from a consumer preference shift to larger autos.
(*Wall Street Journal*, 3/6/16 and 3/13/16; *Investor's Business Daily*, 3/2/16; *Bloomberg,* 3/11/16; *Automotive News,* 11/2/15)

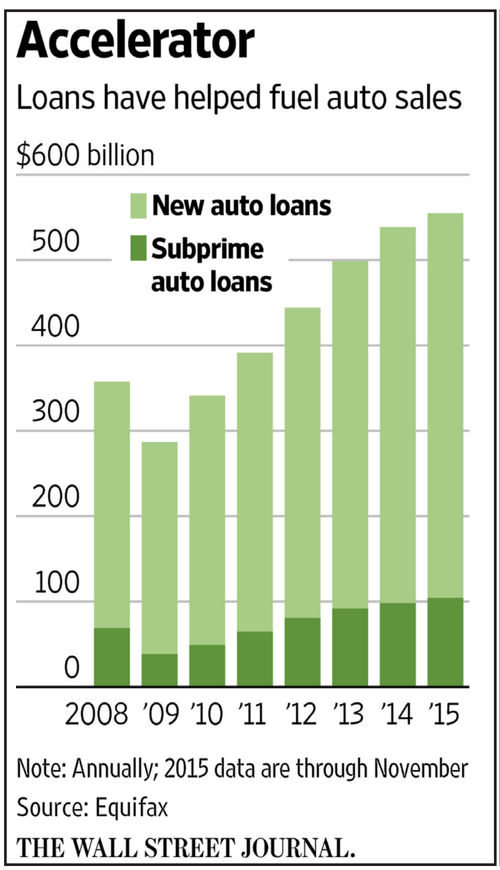
The above facts suggest that in order to get people into new cars and light trucks and to have achieved last year's record sales figure of 17.5 million light vehicles sold, auto companies and dealers have had to offer a broader array of financing options, often with longer terms and often to many borrowers with weaker credit – a rising proportion of whom are already delinquent on those payments.

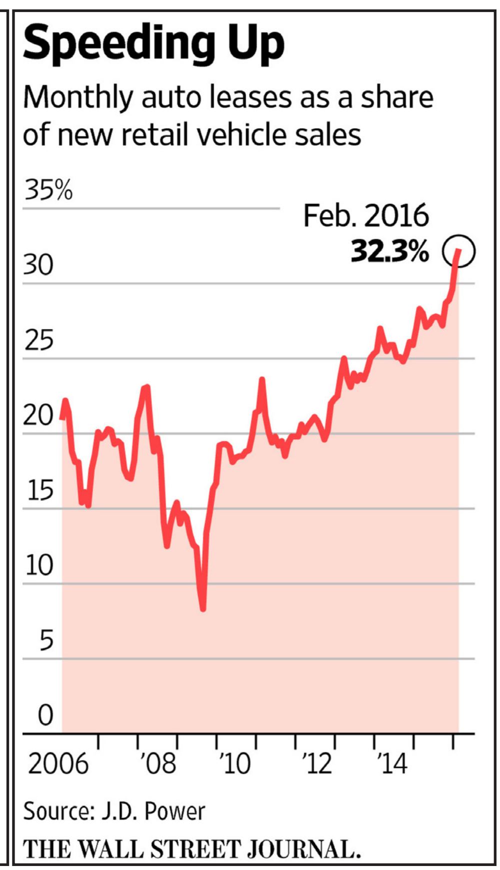
Sales figures also suggest that the jump in light-vehicle sales was in part motivated by the significant fall in gas prices over the past 18 months, a stimulus subject to its own swings. February year-over-year sales were marked by sharp increases in sales of SUVs (29 percent at Ford, 23 percent at Chrysler's Jeep Division). Chrysler also scored a 23 percent year-on-year increase in sales of pickup trucks while Ford saw ten percent growth for sales of its F-series pickups. (*Financial Times,* 3/1/16)

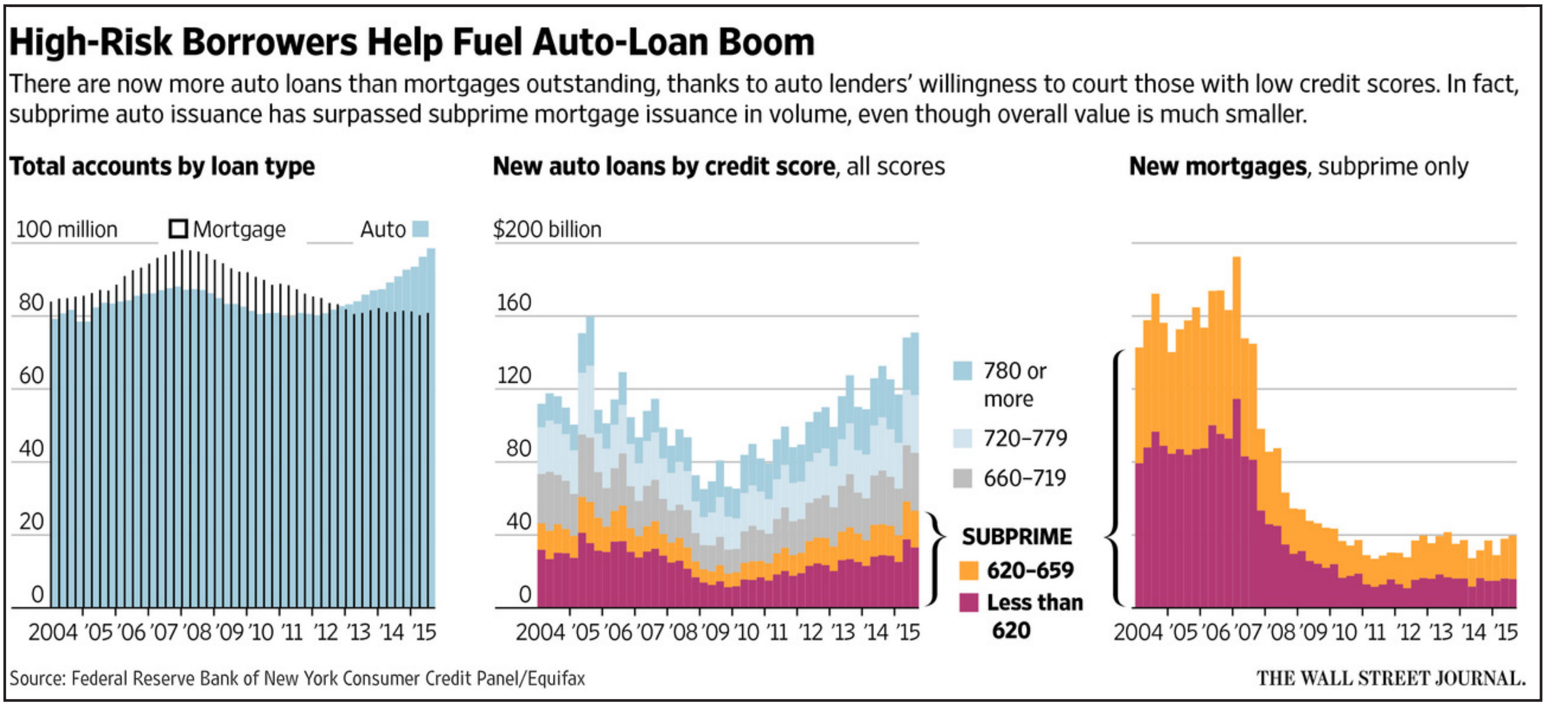
Meanwhile, about 3.1 million vehicles are about to come off leases this year, up 20 percent from last year. That increase has the potential to weaken used-car prices as more supply comes on the market, which can effectively weaken the margins of new-car sales, as dealers and automakers try to compete. (*Wall Street Journal*, 3/6/16)

The Three Squeezes and a Lot Resting on Equities

Evidence suggests that car sales may be reaching a cyclical peak, or at least automaker and auto-dealer profits may be hitting a cyclical peak, as suggested by the more liberal financing and incentives needed to keep car sales growing, juxtaposed against rising delinquencies. Those industry-specific observations are set against the backdrop of a context we recently wrote about in an *inFocus*, where the U.S. consumer is facing the "Three Squeezes": stagnant incomes, rising healthcare costs and rising housing costs, which are limiting spending power. Meanwhile, higher-income consumers, who have driven the bulk of consumer-spending growth since the Great







Recession, may act more conservatively in their spending in light of recent drops in equity markets (see **inF 1102**, "The Three Squeezes Strike: Economic Risks When There's a Lot Resting on Equities," 2/18/16).

The effects of a consumer squeeze are augmented in the "oil bust" states, where declining employment and incomes in the energy industry are accelerating the effect of the Three Squeezes, and are impacting the car industry directly. In Texas and Oklahoma, 14 percent of car payments are delinquent, and Louisiana has an even higher rate of delinquencies. Meanwhile, in North Dakota, delinquencies increased by 42 percent in the fourth quarter of last year, versus 6.4 percent nationwide. (*CNN,* 3/15/16)

These financial pressures on consumers suggest that car sales will not experience as strong a 2016 as 2015. Meanwhile, a variety of secular changes in American's driving habits and vehicle technologies portend many secular changes to the car market, the subject of Part Two of this *inFocus*.