Analyst Note>
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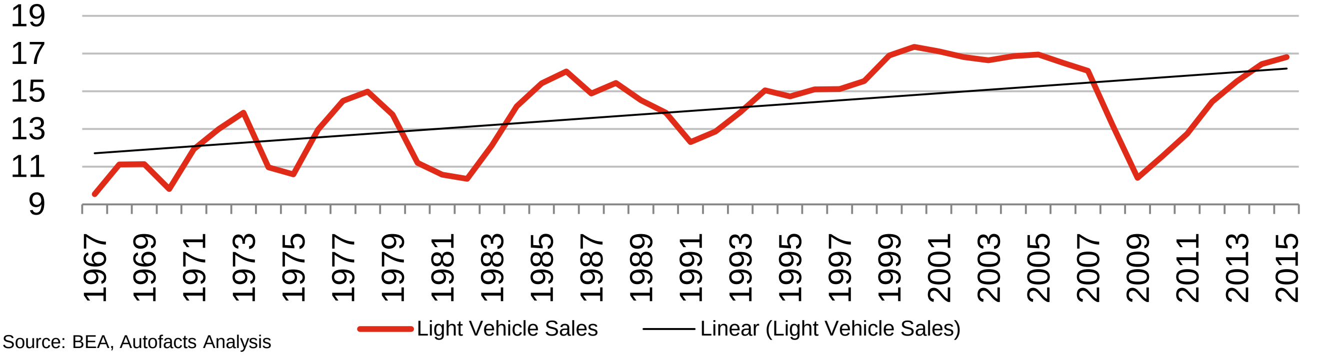
What goes up, must come down?

History may be trying to alert us

After 5 straight years of sales growth most of the industry expects further growth in 2015 and beyond. However, the fifth straight sales gain in 2014 tied a record and expectations of six, seven or even eight straight years of gains represent a significant break from the trend.

US: Light Vehicle Sales

1967 – 2015F (millions)



Source: BEA, Autofacts Analysis

Historical context

The Great Recession was a damaging event for the US auto industry, with new sales plunging over 6.5 million units from peak to trough. The primary question coming out of the recession was: what is the natural rate of demand for auto sales in the US? This number was elusive after the majority of automakers heavily incentivized sales throughout the nineties. Unfortunately the natural rate of demand still remains ambiguous as some forecasts have sales leveling off around 17 million units; while others continue to increase until 20+ million units. Let's look at the cases for and against both arguments.

Case for a new gilded age

Despite a historically weak economic recovery, auto sales have roared back to reach pre-recessionary levels. U-6 unemployment (which includes people without jobs who are not looking for work; people without jobs who would like to work but have not sought employment recently; and part-time workers who would like to be employed full-time) rate remains alarmingly high, and wages have yet to recover; auto sales have outperformed the greater economy ever since the bottom was reached in 2009. With GDP finally expected to go over 3% this year one could expect that a healthy economy could push sales even higher. Additionally US sales have just recovered from the trough they reached in 2009. It could logically be argued that with sales just finally recovering in 2014 that we could be poised for further additional growth in the coming years, due to the overall severity of the last recession. The four year decline in sales recently witnessed was the longest decline in the US since 1982, so a correspondingly long recovery could also be suggested. The average decline for US sales lasts under 2.5 years and the average growth lasts around 3 years, so by that scale a recovery of 5 to 6 years shouldn't be unexpected.

Case for an arrived natural rate of demand

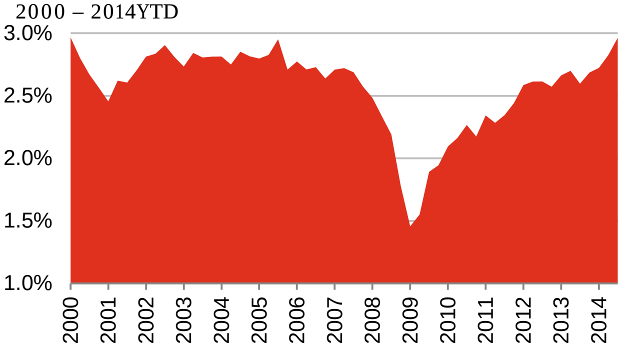
The US population will be undergoing a generational shift in the coming years as the baby-boomers begin to retire, which will curtail their new vehicle purchases; currently 10,000 baby boomers are turning 65 years of age every day. Additionally the millennial generation has so far not shown an ability to take over that level of sales demand either from apathy towards vehicles or the inability to afford them. This fundamental structural change in the population could put downward pressure on sales in the US for the long-term. Another conceivable headwind is the possibility of an interest rate increase in 2015 due to a recovery in the Federal Reserves two primary indicators (inflation and unemployment). Consumers have enjoyed historically low interest rates due to the Fed Funds rate being held from 0 - 0.25bps and a correspondingly low yield curve. With an increase in base interest rates it is expected that consumer rates will increase and buyers who have gotten used to 4% average prime rates might be scared off by an increase. The final headwind against sales deals with used vehicle prices and residual values. With new vehicle prices inching even higher a larger number of people have been exploring 'cheaper' used vehicles which has correspondingly increased used car prices due to a dearth of product after a 4-year decline in new vehicle sales. Now that new sales demand is well above the scrappage rate, used vehicle prices are expected to decline. This will hurt overall residual value calculations which factor heavily into vehicle leasing. Leasing now accounts for nearly 30% of all new vehicle financing, the highest it has ever been. Most consumers go into a dealer with a payment in mind, and with residual values falling it might become harder for consumers and dealers to reach that payment.

Going forward

As Stephen Dedalus aptly said 'History, is a nightmare from which I am trying to awake'; weighing both the pros and cons of market dynamics Autofacts still expects the US market to have a historical sixth straight year of sales gains in 2015 and is forecast to reach a sales total of 16.8 million units. However, as unpleasant as it is to discuss, the prospects of the US continuing to grow on infinitely are unlikely and a decline in US sales will likely happen in the coming years. The industry will need to remain prudent with regards to investment, inventory, and incentives so that when the next downturn hits, the industry remains in a solid position to handle it. In conclusion the industry should enjoy the golden age we're currently basking in, however a storm is coming, and its best to remain ever mindful of it.

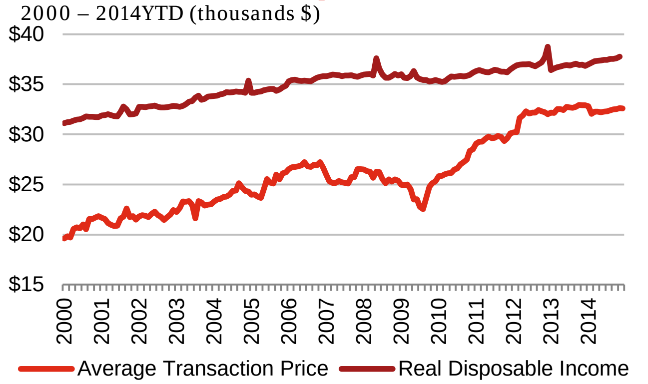
US: Motor Vehicle Output % of GDP

2000 – 2014YTD



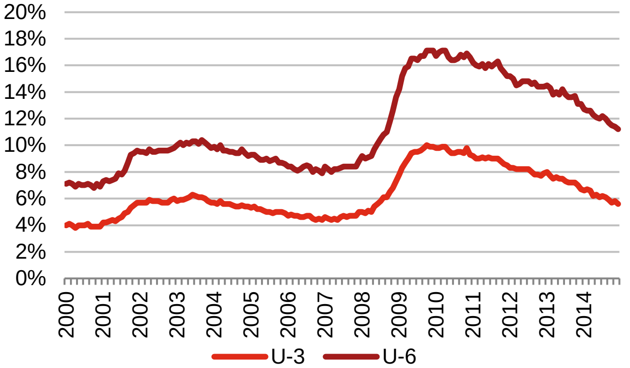
US: Trans. Price & Real Disposable Income

2000 – 2014YTD (thousands $)



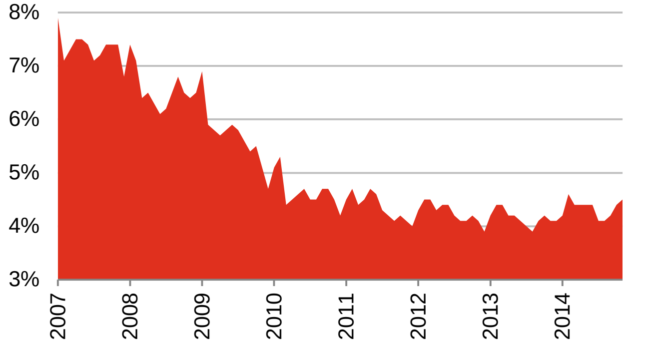
US: U-3 and U-6 Unemployment

2000 – 2014YTD



US: Average Prime Interest Rate

2007 – 2014YTD



Source: BEA, Autofacts Analysis, St Louis Federal Reserve, CNW, Edmunds

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