

How Big Will the Post-Recession US Vehicle Market Be?

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For more than a decade now, easy access to consumer credit and cheap gasoline have fuelled an unprecedented boom in vehicle ownership in the United States that in many respects parallels the boom seen in home ownership. Yet, sales of new vehicles in the 16-17 million a year range are proving to be just as unsustainable as new home housing starts over the two million mark. The residential construction industry is now going through its most dramatic correction since the Great Depression, and the hard reality is that America's auto industry cannot escape a similar fate. The pace of housing sales and starts are half of what they were at their peak, and auto sales and production levels are destined to drop by similar proportions (Chart 1).

After two-and-a-half decades of uninterrupted growth, US automobile ownership metrics are likely to deteriorate markedly over the next five years, with both vehicles per household and vehicles per driver falling back to levels not seen since the late 1980s (Chart 2). As they do, millions of American drivers will have to come off the road, not just because of the weight of the current recession, but the longer-run challenges of tighter consumer credit and renewed strength in energy prices.

25 Million Too Many Cars on the Road Today

Both vehicles per licensed driver and vehicles per household have seen steady, almost uninterrupted

Chart 1
The Shopping Spree Has Ended

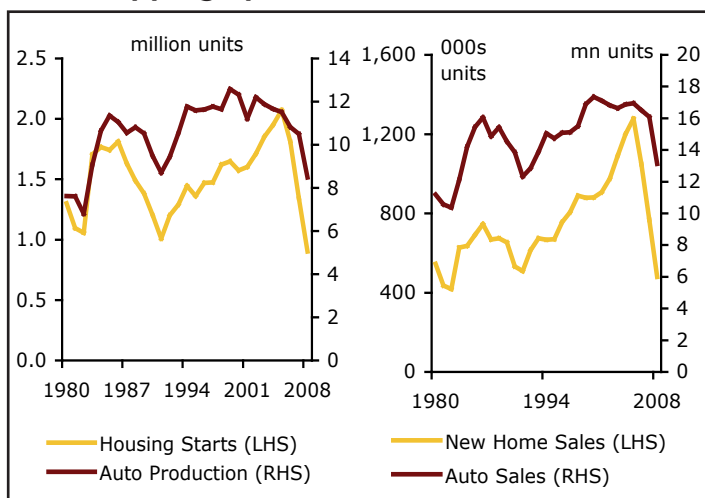
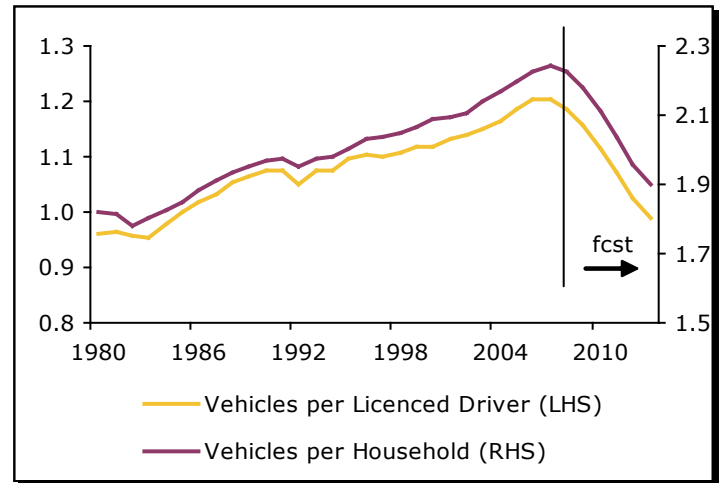


Chart 2
US Vehicle Ownership Rates Will Reverse Course



growth since the last OPEC oil shock nearly thirty years ago. But both are likely to deteriorate markedly over the next five years, reversing the trend growth in vehicle ownership seen over much of the post-OPEC shock period. This fundamental change in the number of vehicles on American roads will be accomplished not only in the short-run by the broad deleveraging of consumer credit, but also by the prospect of consumers paying last Memorial Day weekend gasoline prices (\$4/gal) once economic growth gets back on track.

Over the last decade two-thirds of new vehicle sales were debt financed, with as much as 30% financed from leasing alone. Not only do record household debt levels limit the demand for future financing as Americans struggle to service their outstanding obligations (Chart 3), but leasing and other forms of auto credit are also being rapidly withdrawn from the market. These forces alone will take 15 million Americans off the road over the coming years, as the US consumer shopping spree ends.

That change is already taking place. Over the first three quarters of 2008 transit ridership in the US rose by 5% while Americans drove around 100 billion fewer miles last year. But high energy prices will also do their share as driving habits continue to adjust to rising energy prices. A deep global recession has led to an over-50% drop in this summer's peak pump prices, but that should reverse as global economic fortunes improve. And when it does,

Chart 3

US Consumers Face High Debt Service Burdens

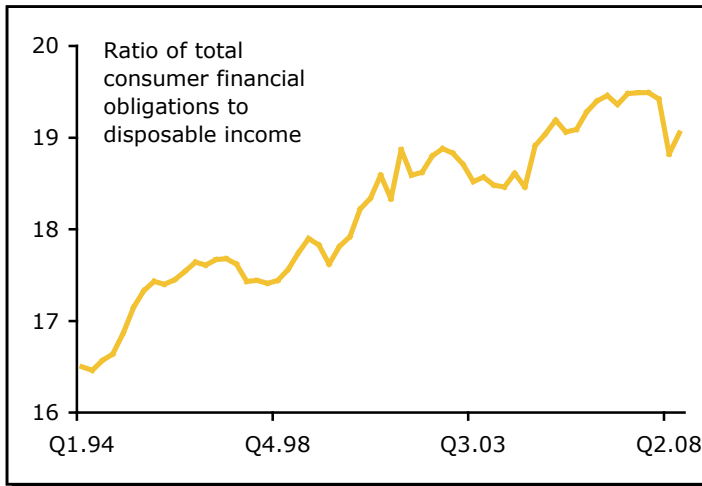
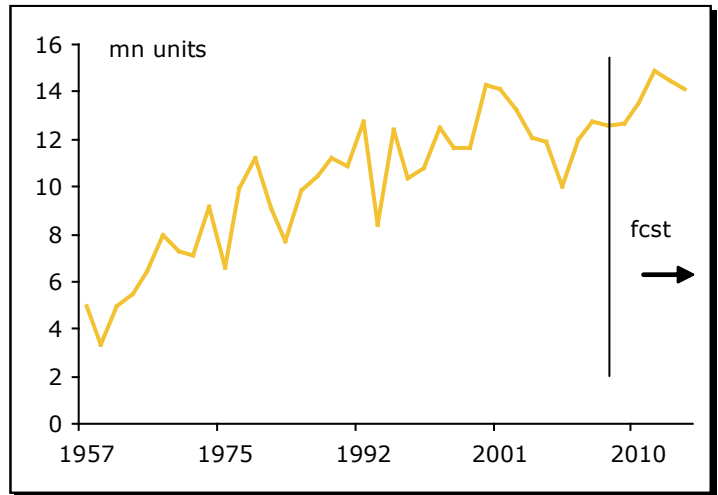


Chart 5

Number of Scrapped US Vehicles



Source: R.L. Polk Co.

rising prices will force many more Americans to adopt European driving habits (Chart 4), which have been conditioned by years of paying much higher (tax-boosted) gasoline prices. The United States is not Europe, and not all Americans will give up their gas-guzzling ways. But applying European ownership rates to the 57 million US households that currently own a vehicle and that have reasonable access to public transit will get an additional 10 million Americans off the road over our forecast horizon. This is on top of the 15 million abandoning their cars for credit reasons, and is a trend that will continue to transform the US public's relationship with the automobile for some time to come.

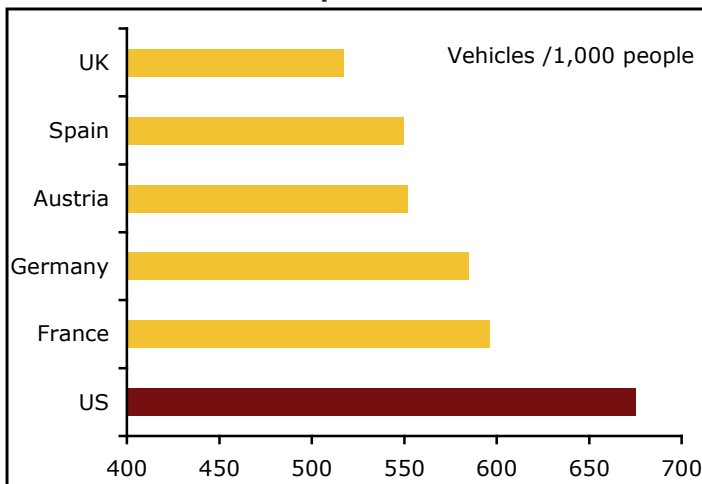
in annual auto sales. Scrappage rates have historically responded to higher gasoline prices and we have allowed for a modest increase over the next five years, in line with our expectation of much higher gasoline prices during the next recovery period. But even if the scrappage rate, which has oscillated between 4-7% over the past eight years, rises modestly (Chart 5), most of the reduction in vehicle ownership should fall squarely on the shoulders of annual vehicle sales. That implies staggering reductions in volumes, almost mimicking the scale of contraction seen in the housing market.

Reductions in vehicle ownership rates can be achieved either by changes in the scrappage rate or changes

Although sales have already plunged to 34-year lows, our analysis suggests that they have considerably more room to contract. In 2008 sales of US vehicles were 24% below their 2000 peak of over 17 million units, and will likely fall by roughly 50% from their peak before sales begin to stabilize. Reducing vehicle ownership rates back to the late 1980s, a level suggested by both consumer deleveraging as well as higher fuel prices, implies future annual vehicle sales of somewhere in the eight to nine million unit range, or a further 30-40% reduction from 2008's already depressed level (Chart 6).

Chart 4

US Vehicle Ownership Out of Line



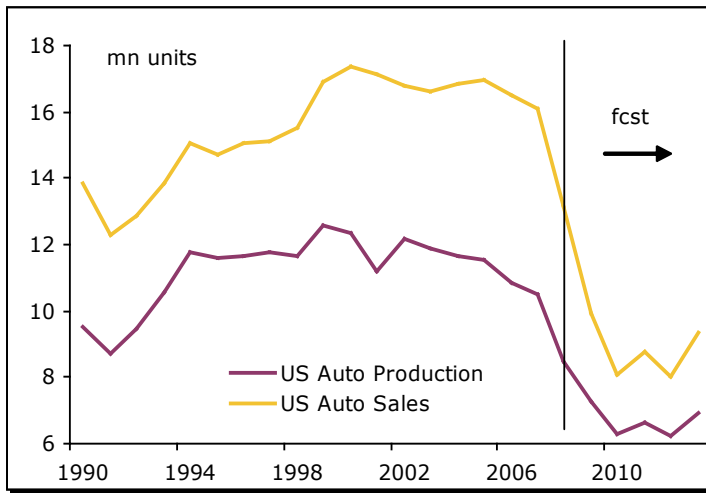
Source: IRF World Road Statistics, 2008

Those sales levels imply that there will be a growing exodus of vehicles from American roadways that will continue well after the current recession is over. While some 2.7 million vehicles are likely to head for the exit lane this year, we expect to see even larger reductions over the next four to five years.

Projected vehicle sales in the eight to nine million range, juxtaposed against a scrappage rate trending to 6%,

Chart 6

Production and Sales



means that roughly 5 million vehicles are likely to come off the road every year over the next five years. Overall, by 2013 we predict that there will be 25 million fewer passenger vehicles travelling on America’s streets and highways compared with 2008 (Chart 7).

Making the Connection from the Showroom Floor to the Factory Floor

A market of eight to nine million in annual vehicle sales is a much smaller market than Detroit is presently built for, particularly when imports continue to account for a growing share of new auto sales every year. Most measures of US auto sales peg imports as making up

no more than a quarter of the market, but that does not include the millions of vehicles sold in the US but produced in Canada and Mexico. Including these units, imports account for roughly 50% of vehicle sales, twice the level of overseas imports alone. Even assuming that this ratio does not continue to rise, but rather stays constant over the coming few years as US-based auto makers begin to hold their own versus foreign rivals, the implications for domestic production levels are significant.

Helping out US production to some extent is the fact that Detroit exports over 2 million cars and light trucks overseas every year. Nevertheless, netted out against total imports, the domestic US auto industry has been running a sustained trade deficit of over 5 million vehicles per year, and any improvement in that gap is likely to have a negligible impact on total US production.

Short-Term Production Cuts Likely To Become Permanent

The prospect of an eight to nine million US vehicle market is a sobering constraint on the size of American auto production, and the number of car plants that will remain economically viable even after economic growth returns to the United States. Netting out the reduction from imports and allowing for exports, US vehicle production is likely to be no more than 6-7 million units a year (Table 1). Compared to the production peak of nearly 13 million units back in 1999, it implies as dramatic a drop in production as the industry experienced around the second OPEC oil shock (Chart 8).

Chart 7

Annual Projected Decline in US Vehicle Stock

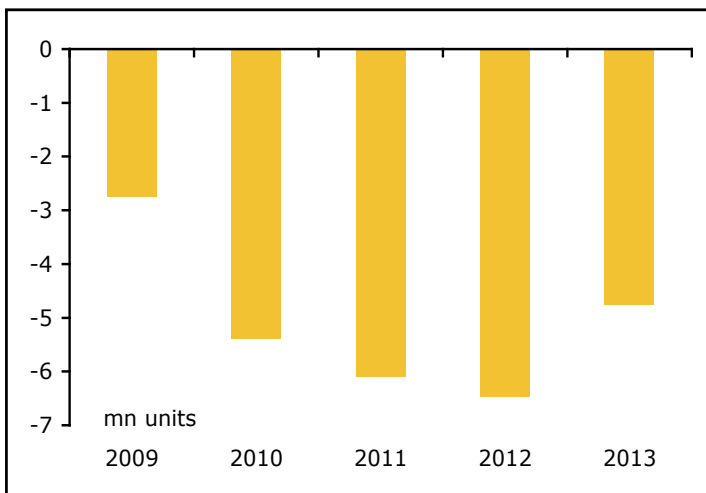


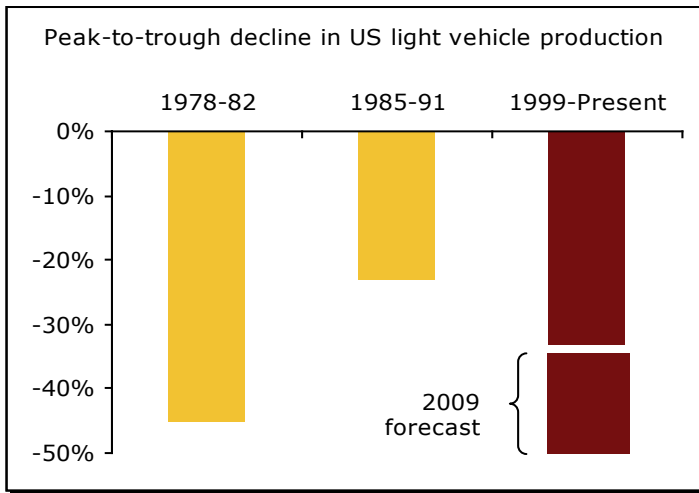
Table 1

Detroit's Shrinking World

US Sales and Production Statistics		
	2008	2009-13 (Annualized)
Vehicle Sales (mn)	13.1	8.0 - 9.0
Scrapped Vehicles (mn)	12.6	12.0 - 15.0
Decline in Total Vehicle Stock (mn)	0.50	3.0 - 6.0
Production (mn)	8.5	6.0 - 7.0

Chart 8

Historical Production Drops



Considering that average annual plant capacity in the US is roughly 250,000 units per year, our production estimate implies that roughly half of the US's 51 light vehicle plants should be permanently shuttered over the coming years as the industry shrinks to fit the contours of a vastly smaller market. And these reductions will, of course, also flow through to the employment picture, where overall job losses in auto manufacturing could add up to another 200K positions. This is on top of the 560K lost jobs in this sector since employment hit a high of 1.3 million in 2000 (Chart 10). All told, just like US housing sales and starts have fallen to levels with no modern precedent, the drop in US vehicle sales and production should be just as dramatic. Except in this case, long-term changes in the way Americans drive will mean that the good times for the auto industry are never coming back.

With the majority of US auto plants either idled or running well below capacity in January, current vehicle production is essentially running at a record low 4 million annualized units a year (Chart 9). While that figure is sure to climb over the next few months, our analysis suggests essentially half of the production that is currently sidelined should be shut down for good. Total US light vehicle production fell to 8.5 million in 2008, but our current sales forecast suggests another decline of roughly 1.6 million units for all of 2009 before production hits a more sustainable level.

Chart 10

Employment Continues to Fall in Auto Sector

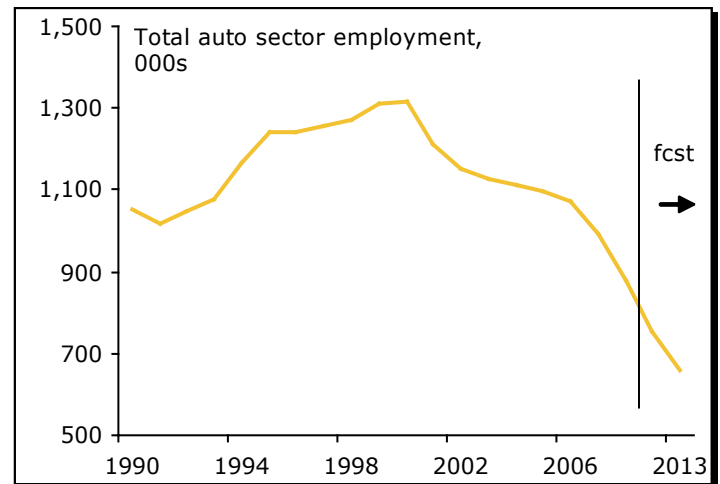
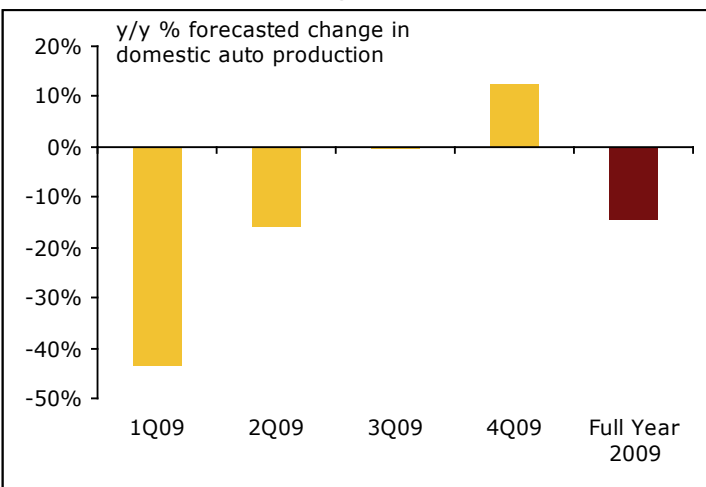


Chart 9

2009 Production Change



Source: Ward's Auto Group