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First Trust

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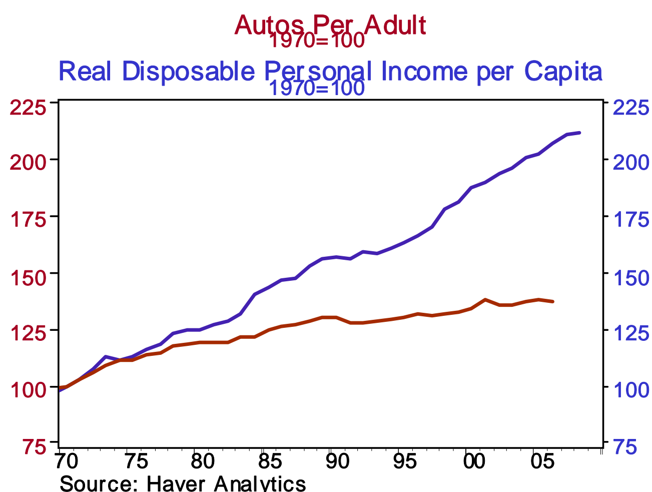
Economic Commentary

Auto Sales Update

We recently made the bullish forecast that auto sales (cars and light trucks) would start recovering from the abysmally low 9.1 million annual rate of February 2009. We expected that a V-shaped recovery could take sales to a 15.9 million rate by the end of 2010. (See, "Bright Prospects for a Steep Auto Sector Recovery," March 23, 2009.) The 15.9 million pace is the long-term underlying sales trend based on "scrappage" (due to old age and accidents) and population growth.

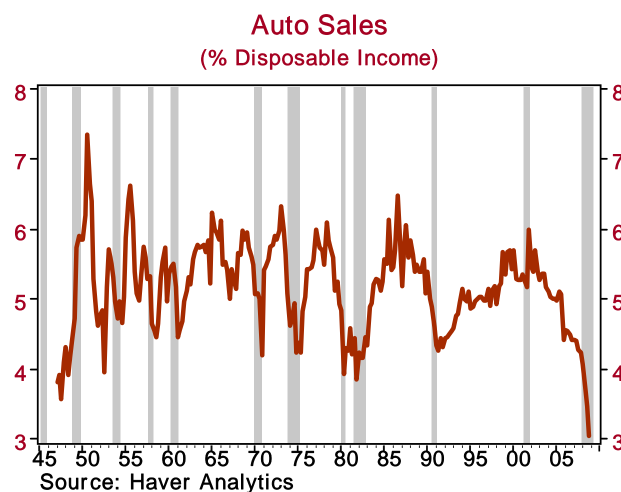
While it's only one month's data, yesterday's reports on March auto sales show the recovery has begun and is even ahead of our forecast. Vehicle sales increased 7.8% in March to a 9.8 million annual rate.

Some analysts have argued that, despite scrappage and population growth, auto sales will lag below a 15.9 million rate well beyond the end of 2010 because there are just too many cars on America's roads, largely due to the artificially easy credit conditions of recent years. They argue that consumers bought beyond their means and the US should not have a car on the road for every person, which is what the ratio averaged between 2001 and 2007.



But that ratio has been falling since early 2008 and, even with our bullish sales forecast, is likely to fall to 0.94 by the end of 2010. At 0.94, the ratio of autos per adult will be the lowest since 1993. So even if easy credit conditions earlier this decade helped keep the auto ownership ratio artificially high, the recent weakness in auto sales will cut the ratio down to levels last seen well before that period of easy credit.

Moreover, as the charts in this piece show, auto sales were never as far above the norm as some analysts suggest. The previous chart shows that since 1970, real disposable income (income after taxes, adjusted for inflation) has increased much faster than the number of autos on the road. Real disposable income per person is up 112% since 1970 while autos per adult are up only 35%.



Of course, part of the rise in income per person has been absorbed by higher automobile *quality* rather than just *quantity*. But, as can be seen in the second chart total consumer spending on motor vehicles and parts peaked at 6% of disposable income in 2001, which is not an unprecedented share. Not only was spending much higher as a share of income in many previous years, the share of income devoted to vehicle purchases and upkeep was already on the down slope before recent economic problems.

The bottom line is that auto sales and, in turn, auto production are set to increase substantially in the US over the next couple of years. Whether this happens fast enough to help the Big Three is still an open question.

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