

Business insights

Big year for cars and trucks

In 1977, as in 1976, rising sales of motor vehicles have been a major factor in the general expansion of business activity. As a result, the economic health of industrial centers specializing in production of components and assembly of finished vehicles, especially in Michigan but also in other Midwestern states, has vastly improved from the low ebb of the 1974-75 recession. Some industry analysts are confident that further gains will occur in 1978.

Barring an unexpected setback in the final months of the year, deliveries of cars and trucks to consumers and businesses will approach 15 million in 1977, slightly exceeding the previous banner year of 1973. Passenger car sales are expected to reach 11.25 million—including over 2 million imports—which would fall short of the 11.45 million record set in 1973. Truck sales, at about 3.6 million, with about 300,000 small imports, are certain to establish a new high by a wide margin.

Crowding the highways

About 100 million passenger cars and about 28 million trucks are in operation currently. This compares with a population 16 years and over of 160 million. Theoretically, four of every five Americans of driving age could be at the wheel of a motor vehicle simultaneously. To the harassed motorist caught in traffic congestion it sometimes appears that they are!

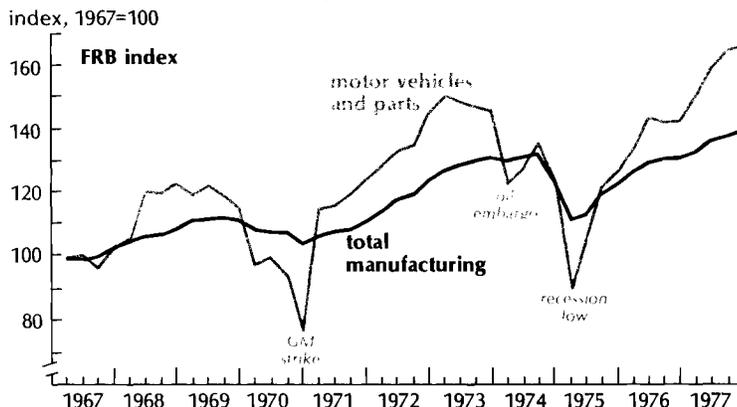
There is no clear evidence that the uptrend in the motor vehicle population will halt in the years ahead. Despite efforts to revive public passenger

transport, Americans use, and often need, personal transportation more than ever before. Moreover, the share of freight moved by truck continues to grow. The steady contraction of the population of the central cities and the sprawling growth of outlying areas encourage these trends. One consequence is the heavy deficit in the balance of payments associated with oil imports, now about 45 percent of our total supply. Motor gasoline and diesel fuel account for about 40 percent of all sales of petroleum products by physical volume.

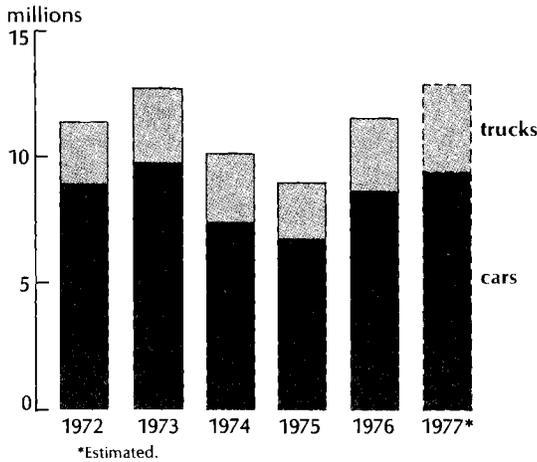
Purchases and prices

In the January-October period retail sales were up 11 percent from last year. Sales of motor vehicle dealers were up 16 percent, while sales of nonautomotive stores were up 9 percent. Not all sales of automotive dealers are to consumers. About a fourth of new passenger cars are purchased by businesses, including auto rental companies. On the other hand, households are increasingly important buyers of trucks. The Department of Commerce estimates that households buy 20

Auto industry has led expansion of total manufacturing



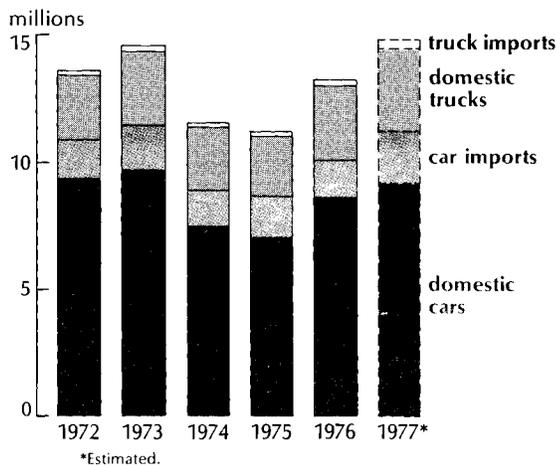
Trucks lead vehicle output growth



percent of all trucks by value and 40 percent by number. These are almost all light trucks, including over a half million vans and many campers and motor homes.

Prices of motor vehicles have increased rapidly in recent years, and most operating costs—fuel, repairs, insurance, etc.—have increased even more rapidly. A recent estimate by the Hertz Corporation places the cost of operating the average 1977 model passenger car, including depreciation, at 30 cents a mile or \$3,000 a year.

Imports take a larger share of the market



At midyear the Consumer Price Index (CPI) showed prices of new cars up 5.4 percent from a year ago, and up 27 percent in five years. The entire index was up 6.9 percent from a year ago, and up 45 percent in five years. Average prices actually paid for new cars have increased much more rapidly than this comparison indicates, however, partly because the CPI compilers assume that safety and pollution controls mandated by government add value to the vehicle and, therefore, these costs should not be counted as price increases. According to data from major auto finance companies, the average sales price of new cars in mid-1977 was \$5,700. This was up 10 percent from a year ago, and up 59 percent in five years, more than the rise in the total CPI.

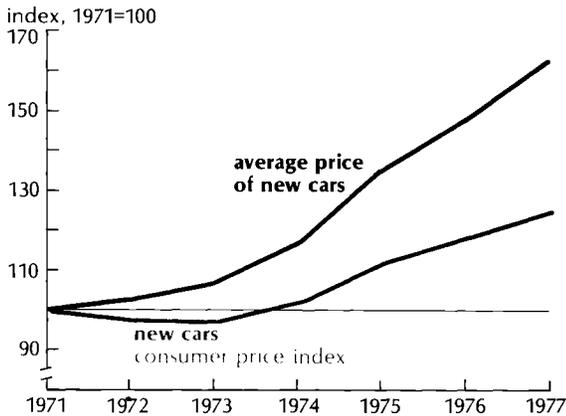
Credit use expands

In 1976 households spent \$142 billion to purchase and operate motor vehicles—13 percent of total consumer expenditures. This outlay was divided about 50-50 between purchases of new or used vehicles and operating costs.

About two-thirds of all new cars are financed through the use of instalment credit contracts with the car serving as collateral. (Other purchases are known to be financed through other types of credit.) Last year \$63 billion was extended on auto loans, including finance charges—one-third of all instalment credit extended. Almost 60 percent of all auto loans are made by commercial banks, the rest mainly by credit unions and the “captive” finance companies operated by the auto companies. In the first eight months of 1977, auto credit extensions were up 15 percent from the same period of 1976. At the end of September, outstanding auto credit was \$77.2 billion, up from \$64.6 billion a year earlier.

For many years the typical new car loan has been equal to the wholesale cost of the car—about 87 to 88 percent of the implied retail price. Delinquencies and write-offs have been relatively low, even in recessions. Delinquency rates are typically under 2 percent, and repossessions under 1 percent of all con-

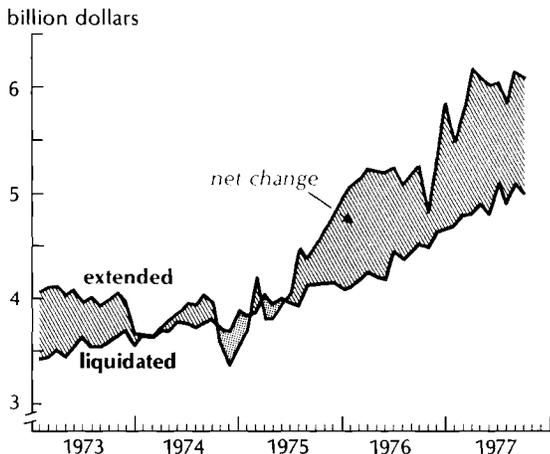
Average price paid for cars has outpaced car price index



tracts, significantly less than on other installment loans. Most families will cut back on other outlays, including food, to maintain payments on a car which, if not a necessity, is a highly prized possession. Monthly payments have been eased, however, by lengthening maturities.

In 1974 and earlier years the average maturity on new car loans by major finance companies averaged 35 months with 36 months typical. Starting in 1974 more loans were made for 42 months and even 48 months. In August 1977 the average maturity on these loans was 41 months, and 30 percent

Rapid rise in instalment credit has financed auto sales boom



of new loans were for over 42 months. Finance company experience with 48-month loans has been excellent, partly because credit standards are higher for longer loans, and partly because used car prices have been strong. However, some lenders have been cautious in joining this trend. Longer-term auto loans probably will be associated with more loans being liquidated before maturity as cars are traded before loans are paid off.

Import share rises

Imports, almost all small cars, may account for over 18 percent of all car sales this calendar year. This would be up from 15 percent in 1976 and about equal to the record proportion reached in 1975. In the five years prior to 1975, imports had accounted for 15 percent of the total, up from 6 percent in the mid-1960s. Imports do not include about 300,000 "domestics" shipped from Canada in excess of cars shipped to Canada under the United States-Canadian Auto Trade Agreement.

In the first nine months of 1977, 68 percent of all imports were from Japan, 21 percent from Germany, and 11 percent from other countries. The Japanese have continued to expand their penetration of the U.S. market in recent years with several popular makes, apparently at the expense of small U.S. and European cars.

Despite new models and heavy promotions, U.S.-made small cars have not been able to stave off imports. Neither have they displaced large domestic cars. According to Ward's Automotive Reports, intermediate and full-sized domestic cars accounted for 52 percent of the total car market in the 1977 model year, up from 50 percent in the 1976 model year. The share of market going to imports rose from 14 percent in the 1976 model year to 18 percent in 1977. The losing group was domestic small cars (compacts and sub-compacts), whose share dropped from 36 to 30 percent.

The consumer rules

The strong market for new cars has not been a boon for all models or all producers.

Successive shutdowns of assembly lines for various domestic small cars have occurred in the past year as inventories bulged. Meanwhile, preferred models, especially larger domestic cars, have been in short supply. On November 1 the 1.6 million inventory of domestic cars represented a manageable 49 days' sales, but the range for particular cars was from 30 to over 100 days. Inventories of imports dropped from over 600,000 in mid-1976 to 300,000 in recent months—probably too low for maximum sales efforts.

U.S. car producers are under government order to improve the average miles per gallon on the average car sold by each company from about 18 on 1978 models to 27.5 in 1985. To some extent this can be accomplished by designing more efficient components, using diesel engines, and including some captive imports in the company mix. For the most part, however, better gas mileage means smaller cars, substitution of lighter materials for steel, and reduced engine size.

The auto industry is engaged in a massive capital expenditure program to "downsize" all classes of cars. While total plant and equipment expenditures by all business is expected to be up 13 percent this year, the auto companies are increasing outlays to \$3.67 billion, up 56 percent from 1976, and up 42 percent from the previous high set in 1974. Most of the money spent by the auto companies will be for machine tools and other equipment, but new buildings also are being constructed and existing buildings are being expanded.

Managing the mix

Auto executives frequently make news with forecasts of the industry's total sales of cars and trucks for the current and/or coming year. They are well aware, however, that both total sales and sales of particular models depend on the sovereign consumer. Production schedules are never firm more than a month or two in advance. A weakening of consumer confidence, or growing disfavor toward particular models, can soon create costly inventory gluts with acres of unsold cars if output is not adjusted promptly.

In early 1974 auto firms took drastic steps to divert the production mix toward small cars. The gas shortage associated with the Arab oil embargo seemed to have created an insatiable market for small cars with high gas mileage. By the late spring, as gasoline supplies returned to normal, demand for domestic small cars collapsed almost as suddenly as it had expanded in the previous winter.

Many American households clearly are not satisfied with small cars. They are ready to pay substantially higher prices for fuel rather than sacrifice carrying capacity, engine power, and, perhaps, prestige. Managing the mix of production and distribution to satisfy consumers on the one hand, and government regulators on the other, presents a challenge unique in the history of the auto industry.

George W. Cloos