When the Wheels Stop Rolling

When it comes to new car sales, most Americans are payment buyers.

We want a good deal, for sure, but we really need a car payment that fits our monthly budgets.

That's a problem, given that we also want premium brands, snazzy features, and, for many of us, hulking big machines that look like they'd be more at home tearing up jungle roads than cruising on asphalt around town or on the interstate.

All of that stuff costs money, which is in short supply with modest wage growth.

But that's OK. For the last several years, automakers, or at least their financing arms, have had an answer to keep the sales humming.

Extend, extend, extend.

Four-year car loans were the norm for many years. Then, as car prices crept higher, the number moved to five years. Now, a full 30% of new car loans stretch to 80 months, or almost seven years!

The average car loan is 68 months. That's just over five and a half years. At this rate, buyers are at risk of their vehicles breaking down before they're paid off.

And longer loans weren't the only extension that financiers made. Lenders also extended or expanded their view of credible borrowers, reaching down to more subprime clients. This goes a long way in explaining how we reached a record pace of 18 million vehicles sold in December 2016.

It appears those days are over.

In March, the sales pace dropped to 16.64 million, missing expectations of 17.3 million, and that followed a dip in February to 17.6 million.

We've been forecasting a drop in new car sales for several years, based on predictable consumer spending patterns. It's telling that dealers had to go to such extremes to keep the steel rolling off the showroom floor.

But the drop in auto sales isn't just a cause for concern in the auto industry. It foreshadows slower consumer spending in general, which will keep a lid on GDP growth.

The problem is that most consumers borrow money to buy cars and it’s unlikely that, if they stop buying cars, they’ll borrow at the same rate to purchase other things.

Almost 85% of new cars are financed, and go out the door with an average transaction cost of $ 32,994. In 2016, the average car loan topped $ 30,000 for the first time, reaching $ 30,032. Through a little math, it’s obvious that the average new car buyer put down a mere $ 2,962, right at 9% of the purchase price.

If we buy one million fewer new cars in the U.S. this year, then, using the figures above, we’ll spend about $ 33 billion less on cars.

Considering that 85% of new vehicles are financed, this means that we’ll spend about $ 7.5 billion less of our savings, and take on $ 25.5 billion less in auto loans.

It’s hard to see how we’ll spend that money elsewhere in the economy.

Where else, beyond cars and housing, can you borrow 90% of the purchase price for many years? And how many people who would have bought cars will instead leverage their money to buy homes? I’m betting the answer is “not many.”

Instead, consumers will spend their money in other areas of their lives, like healthcare, consumables (restaurants, etc.), and might even pay down some debt, or save a bit. But that’s only for those that have a real chunk of cash sitting around.

About half of new car sales involve a trade-in. If consumers aren’t buying a new car, then they aren’t trading in their old ride, so the money tied up in the current vehicle isn’t available to spend elsewhere.

Consumers spent about $ 11.7 trillion last year, so a $ 25 billion to $ 30 billion drop won’t kill the economy by any means. But it does make it harder to grow.

And reducing credit expansion, which is the biggest part of money creation, will definitely leave a mark.

As car sales slow, we’ll all feel like we got thrown under the bus, whether we’re buying (or not buying) a new ride.

Rodney

P.S. Harry wrote about this problem too a few months ago, asking if cars will be the death of us. If you missed that, check it out here. Also, he’s got some important new information coming your way, on how to reel in short-term profits from “hidden” cycles within the supercycles. Click here to make sure you don’t miss it.

The post When the Wheels Stop Rolling appeared first on Economy and Markets.

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