

ECONOMIC UPDATE



National Automobile Dealers Association, Industry Analysis Division

Herding Cats to the Showroom

By Paul Taylor, NADA Chief Economist

An old saying in Economics, used to describe the impact of a low interest rate policy at a time of slow economic activity is: "You can't push a string." That captures the Federal Reserve's dilemma of extremely low interest rate policy, but banks are still reluctant to lend for many purposes. The Federal Reserve System can control short-term interest rates, but does not have any meaningful control over the unwillingness of banks to lend in the current sluggish economic environment.

Car dealers are caught in this dilemma because the subprime borrower is a large portion of borrowers for new and used cars and trucks, currently as much as forty percent of potential customers. The GM acquisition of Americredit was good news for new car dealers and subprime car seekers, and good timing for the New G.M. We need more financial institutions willing to lend to this underserved portion of the marketplace, given the reliable performance of light vehicles as collateral in an elevated used vehicle market.

Are Better-Off Households Conflicted?

Lower concerns about inflation and less concern about Europe's economic challenges has helped create a more bullish sentiment among independent investors in the U.S. According to the American Association of Individual Investors, bullish sentiment among investors increased to 40 percent at the end of July from a much lower 21 percent according to the organization's survey.

It will be difficult to beat the August result of last year, but a good August may still be in store as the end of year bargains start to "kick-start" the marketplace.

However, consumer confidence declined even as confidence in the financial markets, which tend to price on a forward-looking basis, increased. The Conference Board's Index of Consumer Confidence dropped to an index measure of which declined in June, fell further in July to 50.4 as an index reading compared with 54.3 for June.

NADA would prefer that the index be above an index reading of 60. The "Present Situation Index" decreased from 26.8 to 26.1 and the future expectations index measure fell from 72.1 to 66.6. Based on 5,000 households, the survey size, like NADA quarterly survey data, large enough to be reliable for the time period surveyed, which was through July 21. In the past, incentives could offset dips in the outlook of consumers, but those incentives from the manufacturers are in many cases lower this year than last.

What is perplexing is that in the upscale households in the Consumer Confidence Index, there are also the upbeat investors who measure bullish about the market and who drove the Dow and S&P indexes to year-long high readings on the last day of July. Is there spousal division of labor between investing and consumption decisions, and will this lead to happy marriages down the road? That drama will roll out during the rest of the year.

What the Real Economy is Doing?

The real economy is growing slowly. The official initial reading of Real GDP for the U.S. increased at a 2.4 percent annual rate in the second quarter, according to the Department of Commerce's Bureau of Economic Analysis. That was better than many who expected just 2 percent real growth for the second quarter. The three months felt slow, because the base growth rate of the first quarter was just around 3 percent.

New car sales for July will be released next Tuesday, July 3, and will likely outperform sales in July 2009. It will be difficult to outperform August sales for 2009, because that was the peak month for Cash for Clunker sales last week.

So the economy will continue to grow at a pace above 2.4 percent and should improve when we see the Third Quarter Real GDP reading.

What the Next Three Months Suggests for New Light Vehicle Sales

The measures of showroom traffic on the next page track third quarter 2009 sales, with the sharp peak in Cash for Clunkers August 2009 and the sharp drop in "little inventory in September 2009." Therefore, it will be hard to beat the August result of last year, but a good August may still be in store as the end of year bargains start to "kick-start" the marketplace.

September 2010 will be dramatically better than the anemic September of 2009. If the editors are not careful these two months can make for sensational, but inaccurate, headlines in you local paper. Try to educate your local journalists on this point, if you are

talking with them about this improving, and never boring, new and used car market. Sustained used car prices, even if they do not increase as they have in almost all of the past 20 months, will help support your new car and used car sales.

Page 4 demonstrates the dip in Service and Parts profits in 2009 for new car dealers. Bring that to the attention of any independent mechanic demanding free software on repairs for newer cars. You have to pay to play.



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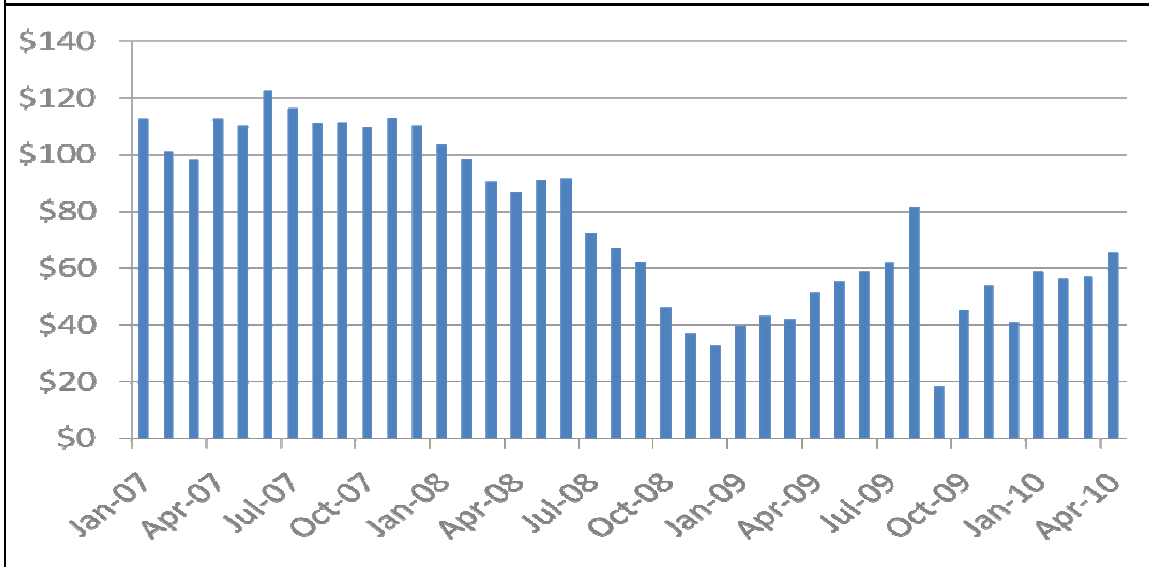
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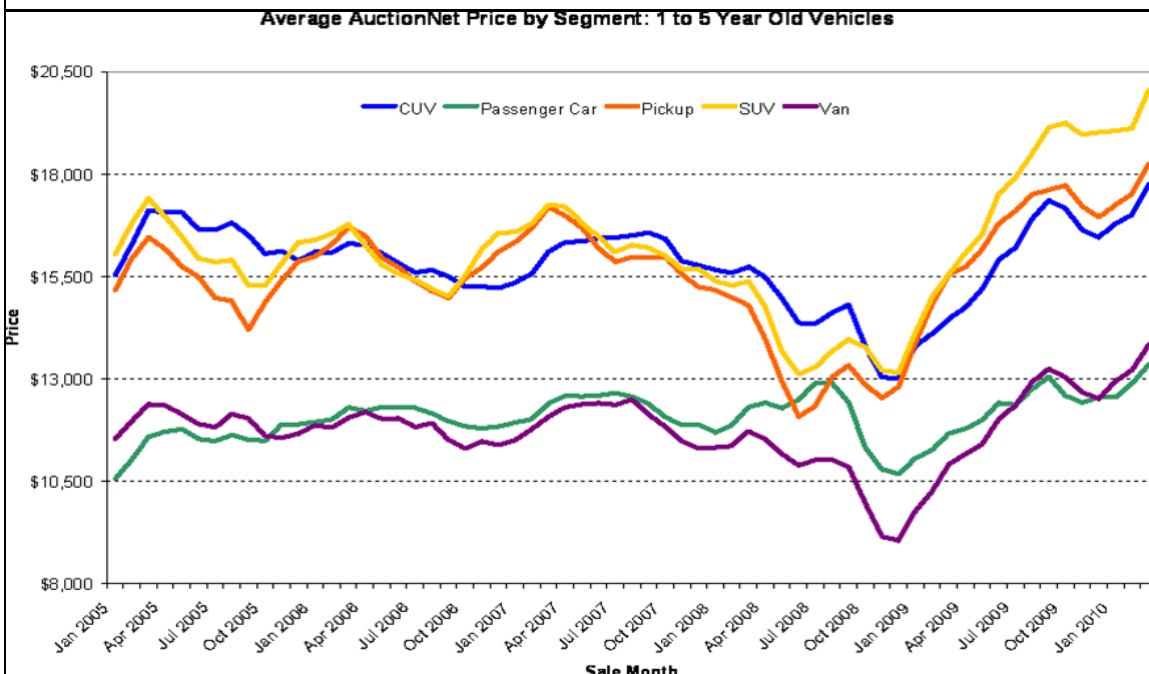
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The Recovery of Floor Traffic at Dealerships is Modest, 2008 – 2010

Cash for Clunkers Spike, August 2009, Inventory is Key to Support the Program's Success



Average AuctionNet Price by Segment for 1- to 5-Year-Old Vehicles, 2005-2010





Dealership Financial Trends

RECESSIONS USUALLY CAUSE negative net profits in the new-vehicle department. After the average dealership's new-vehicle profits increased from 2001 through 2004, 2005 brought the start of a significant decline in new-vehicle profitability. From 2006 through 2009, the new-vehicle department posted increasing net yearly losses, prompting lower new-vehicle inventories and advertising spending to control costs. Lower floor-plan costs, resulting from Federal Reserve policy, and relatively modest energy costs assisted dealership new-vehicle sales in 2009.

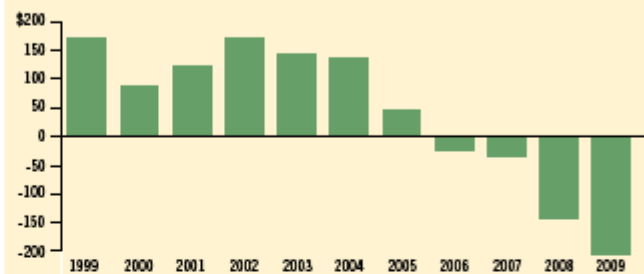
Used-car sales, typically profitable on a net basis, sprang back to net profitability in 2009, after a small net loss in used-car profits in 2008 caused by volatile gasoline prices.

Total service and parts profits moderated as service and parts revenue per-dealer rose by 1.9 percent in 2009. Service and parts gross margins improved slightly, but departmental expenses increased as a portion of departmental sales.

Total typical dealership revenue fell 7.5 percent in 2009, while the net number of dealership closings surpassed 1,500 during the year. The return of future dealership profits in new vehicles remains dependent on growth of revenue in new- and used-vehicle sales. Dealers continue to compete with a large segment of independent service outlets to service older vehicles. Per-dealer service and parts sales grew by a modest 1.9 percent in 2009 as the number of new-car dealerships increased during the year.

New-vehicle department net profit

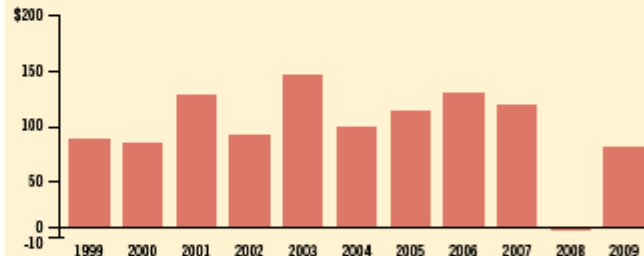
Average dealership, in thousands of dollars, including F&I



Source: NADA Industry Analysis Division

Used-vehicle department net profit

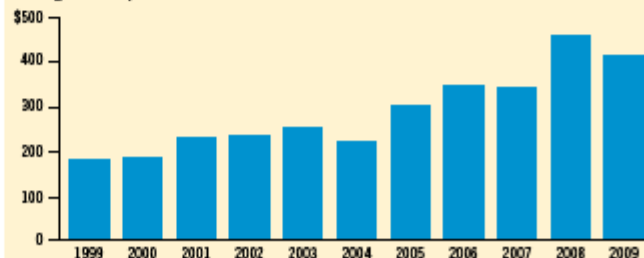
Average dealership, in thousands of dollars, including F&I



Source: NADA Industry Analysis Division

Service and parts department net profit

Average dealership, in thousands of dollars



Source: NADA Industry Analysis Division