First Trust
Monday Morning OUTLOOK
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December 7th, 2015

Respect the Auto Sales Surge

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – Dep. Chief *Economist*
Strider Elass – *Economist*

Cars and light trucks – SUVs, minivans, and pick-ups – have been a key bright spot in the economy the past few years, particularly with tepid growth in overall manufacturing caused by weak foreign economies and a stronger dollar. The pace seen in September, October, and November marks the first time in history that auto sales have exceeded an 18 million annual rate in three consecutive months.

This is in stark contrast to the depths of the last recession, when autos were selling at about a 9 million unit annual rate, the lowest pace since the early 1980s. At the time, many analysts thought auto sales would never recover. Remember the horror stories about how millennials were never going to drive?

Despite these stories, we estimated back in 2009 that, once an economic recovery took hold, driving-age population growth and the scrappage of older vehicles would eventually push sales back up to around 15.5 million per year. By 2013, auto sales were back to that level, and auto sales have been consistently above 15.5 million annualized for the past couple of years. Sales for all of 2015 should hit an all-time record high and go even higher in 2016.

Some analysts have attributed the recent strength in autos to overly loose credit. For example, "subprime" (credit score below 660) auto loan originations totaled $112 billion in the six months ending in September, the most for any six-month period since 2005, back during the housing boom. So, the theory goes, here we go again with cheap credit and an unsustainable boom.

But these scare stories are highly misleading. It's true that subprime auto loans are up, but so are all auto loans. The subprime share of all originations was 36% in the past year, no different than the average over the past decade and much lower than the peak of 44% back in 2005-06.

The median FICO credit score on an auto loan has dropped to 693 in the past year. That's certainly lower than the peak of 715 back in 2010, when it was easier (and more fun) getting a wisdom tooth pulled than getting a loan. But it's higher than the median credit score of 684 back in 2000-05.

And remember that in the era of ride-sharing, some people buying cars to drive for Uber or Lyft may have low credit scores but they're also using their vehicle to generate cash flow. In other words, their credit score underestimates their ability to pay.

In the past year, the balance on seriously delinquent auto loans (90+ days late) is up $6 billion. However, looking at *all* loans (mortgages, home equity, autos, student loans credit cards,…etc.) serious delinquencies are down $50 billion.

Instead of cheap credit, other factors are boosting sales. First, pent-up demand from 2010-12, when consumers did not replace older cars and trucks as rapidly because of fear and continued slow growth in incomes. Second, auto sales are likely up because energy prices are down making them significantly cheaper to operate.

Gas, fuel, and other energy now make up 2.6% of consumer spending, lower than the 20-year average of 3.0%. Meanwhile, auto sales make up 3.7% of consumer spending versus a 20-year average of 4.5%. In other words, auto sales remain below the normal share of consumer spending despite low gas prices.

Eventually, in 2017 and beyond, auto sales should level out as consumers shift spending to other sectors. Gas prices will probably average at higher levels and longer lasting autos should slow the need for future replacements. But, for the time being, the auto sector is clicking on all cylinders.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
12-7 / 2:00 pm	Consumer Credit– Oct	$20.0 Bil	**$20.5 Bil**		$28.9 Bil
12-10 / 7:30 am	Initial Claims – Dec 5	270K	**270K**		269K
7:30 am	Import Prices – Nov	-0.8%	**-0.5%**		-0.5%
7:30 am	Export Prices – Nov	-0.2%	**-0.4%**		-0.2%
12-11 / 7:30 am	Retail Sales – Nov	+0.3%	**+0.4%**		+0.1%
7:30 am	Retail Sales Ex-Auto – Nov	+0.3%	**+0.2%**		+0.2%
7:30 am	PPI – Nov	0.0%	**-0.1%**		-0.4%
7:30 am	"Core" PPI – Nov	+0.1%	**0.0%**		-0.3%
9:00 am	Business Inventories – Oct	+0.1%	**+0.2%**		+0.3%
9:00 am	U. Mich Consumer Sentiment- Dec	92.0	**91.8**		91.3