Collapse in auto sales is not a 'blip'

by Matthew Moriarty

The specter of a prolonged slump in the U.S. auto industry is looming large, according to all but the most slow-witted forecasters in the field. Sales of domestically produced cars and trucks plunged 19% in late June, according to industry figures, and July production is expected to drop to an annual rate of some five million cars, down from the rate of 6.5 million produced in June. The July production rate is in fact the lowest monthly rate since November 1982, according to the usually ebullient *Ward's Automotive Reports*.

Despite the protestations of post-industrialist soothsayers, the auto sector, with $240 billion annual sales, remains the linchpin of the U.S. economy, and directly or indirectly involves 58% of all non-defense capital spending in the United States.

David Healy, an analyst for the Drexel Burnham Lambert investment firm, told *Barron's* in a May 22 interview that he predicts plunging profits for auto next year, especially for General Motors. This, despite the effects of GM's so-called Action Plan, whereby some 40,000 salaried workers have been eliminated along with some "financially costly" plant sites. Healy projects per share profits for GM to plunge from their current $6.80 per share, to $1 per share in 1990. Similarly, he expects Ford's per share profit to drop from $10.96 currently to $3.50 in 1990, while Chrysler's will plunge to $1 in the same time period, down from $5.00. Overall, Healy projects 1990 sales will be in excess of 12.8 million units, compared to the expected 14.7 million for all of 1989 and 15.8 million in 1988.

Incentive schemes fall flat

The dismal state of affairs for the U.S. auto industry follows on the heels of GM's record $11 billion profit in 1988—one of the best years ever, even discounting the estimated $2 billion profit that is due to a change in GM accounting procedures. But the sales nightmare facing auto this year has received at best partially true explanations. The conventional wisdom among many auto analysts is that Americans have simply "overbought" in the auto market and have imprudently over-borrowed with extended 48-month or longer financing terms. As a result, they say, increasingly fewer potential buyers have enough equity in their existing cars to be able to afford financing a new one—incentives or no incentives.

The highly publicized incentive programs are indeed dismal failures, in terms of meeting industry sales targets, and are forcing increasing numbers of new car dealers into Chapter 11 status. "People are catching on," chided one irate dealer. "It used to be we couldn't sell a $14,000 car. But given a $15,000 car and a $1,000 rebate, we could sell it every time." That's over, complained the dealer. "Incentives are like drugs," quipped another dealer. "You start out light, with marijuana. You go to cocaine. You switch to heroin. Finally, you die."

Another ominous influence on the darkening auto picture is the increased competition from imports and so-called transplants (foreign-badged cars) which are built here in the United States. Together these items are expected to garner 40% of the U.S. market share by 1992. Transplants accounted for some 700,000 units in 1988, and are expected to be 1.1 million this year and 2.8 million by 1992. That projection, of course, assumes no disastrous collapse in demand, which is now occurring.

Despite the continuance of incentive plans, overall sales of GM vehicles since January have fallen about 8% below last year's levels, and the company has cut production temporarily at roughly half of its U.S. car plants. Ford has said that it is canceling production at two plants in Atlanta and Chicago for a week in August, because Ford and Lincoln-Mercury dealers were reluctant to order more 1989 model cars. Approximately 4,500 hourly workers will be affected by the shutdown.

Environmentalists drive production abroad

Tighter government fuel economy standards are aggravating industry problems in maintaining market share and profitability. The federal Corporate Average Fuel Economy (CAFE) standard is scheduled to be raised from the current standard of 26.5 miles per gallon (mpg) to 27.5 mpg in 1990. The CAFE rules, in effect since 1975, dictate the average minimum mileage for all new cars an automaker sells in a year. Failure to meet these standards can result in stiff penalties.

The necessity to meet this new standard has caused, in the case of Ford, a stampede to transfer abroad the production of certain of its models unable to meet the 27.5 mpg standard. Already, Ford has announced transferring its Crown Victoria and Grand Marquis from the domestic to the import column by reducing the amount of U.S.-built parts from the current 90% to less than 75%.

Under CAFE rules, domestic cars—those with at least 75% U.S. parts—are counted separately from imports. The Crown Victoria and Grand Marquis get an average of 20 mpg. Shifting those cars from domestic to imports would help the company improve the CAFE ratings of its domestic fleets by nearly one mile per gallon, while reducing the rating of the import fleet by the same amount, but keeping safely within the 27.5 mpg limit.

In a similar manner, GM is threatening to convert some of its big American cars to import status in order to meet CAFE standards.

© 1989 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.