U.S. New Light-Vehicle Demand: More Downside than Upside to 2019 Outlook

Pluses:

• Economic fundamentals still a positive for healthy demand
  ➢ 2019 forecast assumes RGDP growth above 2%
• Robust inventory for trucks (CUVs, SUVs, pickups) – the vehicles consumers want
• Fuel-price levels not an impediment to demand
  ➢ Forecast assumes gasoline prices remain on a par with 2018
• Several high-profile new and redesigned trucks available in 2019, creating market buzz

Potential Downside Risks to Outlook:

• Coming off an unprecedented four straight years of 17-plus million-unit sales; has to balance out at some point
• Higher interest rates, combined with continued probable slowdown in incentive spending, push more consumers out of the market
• Used-vehicle prices, a positive in 2018, might become a negative to new-vehicle demand
• Myriad domestic and global issues directly or indirectly weigh on U.S. economy:
  ➢ Government shutdown, volatile stock markets, tariffs, trade
  ➢ Economic slowdowns in Europe and China
  ➢ Global politics worldwide in general
U.S. Light-Vehicle Sales

Sales in 2018 were stronger than forecast, finishing slightly above 2017, and are expected to remain in the high 16-million range in 2019

- Expect first-half sales to run at a 17.0 million annual rate; 16.8 million in the second half
- Penetration of domestically built vehicles should improve in 2019, which will be a plus for the North America - and U.S. - production outlook
Estimated Annual Average Age of 10-Year-Old Vehicles
(The lower the age, the less replacement, or pent-up, demand)

Excess replacement demand has dried up, and not expected to significantly build up for three to four years from 2018

Gray bars denote recession years or significant slowdown

Aberration in trend caused by 2001-2007 sales “bubble” and severity of 2008-09 recession
Inventory is bordering on excessive but is at a manageable level as long as sales remain at least at a 17-million annual rate

- Dealer inventory entering 2019 was up 2% year/year - light trucks were up 12%; cars down 17%
- Automakers began pulling back on incentives, or price discounting in several forms, in Q3-2018, but production levels for the U.S. market remained strong
- Fleet (commercial, government, rental) demand offset losses in the retail portion, especially in Q4-2018, when incentive spending was in decline

The takeaway: keeping in mind that continued robust light-vehicle inventory totals won’t predict a sharp permanent downturn, as long as inventory remains close to 2018 levels, sales likely continue running close to a 17-million annual rate
Rising fuel prices in 2018 appeared to have no impact on vehicle mix or even hurt total sales volume and, compared with the $3.57 averaged during 2011-2014, can be considered at a positive level – at worst, neutral – for demand in 2019.

- The sharp increase in pump prices last year didn’t even discourage consumers from buying the least fuel-efficient (and high-priced) models – fullsize pickups, SUVs and vans.
2019 Demand: What to Watch for

Basic Expectations: Primarily, demand weakens in second half
- The quarterly sales pattern – based on SAAR – follows 2018
- Volume in the second half roughly equal with the first half - has risen every year since 2013. Why flat this year:
  - Boost from tax reform played out (particularly affecting the cadence for fleet demand)
  - Market saturation after four “17-million” years kicks in harder
  - Interest rates (likely) a little higher, plus 2018 hikes fully filter into economy

Signs and events that could cause demand to deviate from expectations:
- Continued solid employment and wage gains gooses demand
- How long, and how much, automakers continue reducing incentive spending (year/year basis) – and what is the reaction if demand takes hard downward turn
- Used-vehicle pricing remains strong (year/year), lifting trade-in value
- Inventory remains close to year-ago levels entire year, meaning sales (by hook or by crook) probably remain at 17-million or more
  - If inventory in August/September is near year-ago levels, the Q3-to-Q4 change in SAAR probably more similar to past two years
- Increase in moves to reduce inventory, i.e., production slowdowns and short-term plant closures, particularly for CUVs and pickups – indicating market softness
  - Particularly watch market leader General Motors

Projected 2019 Quarterly SAAR (millions) vs. Prior 3 Years

SAAR is seasonally adjusted annual rate and based on factors from the Bureau of Economic Analysis.
Production for the entire year will rise from 2018, largely due to increased capacity for several new vehicles

- Inventory control moves will partly hurt Q1 output
- Increased capacity, especially for several new vehicles, will lift production above year-ago levels in Q2 and Q3
- Production remains nearly flat year/year in Q4 largely because demand is expected to be falling and Q4-2018 output was a little higher than necessary, making for a tougher year-ago comparison

- Production gains in the U.S. will outpace the entire region mainly because more trucks (including CUVs) will be added to the manufacturing footprint, and a lot them will be all-new vehicles
- U.S. share of the North American footprint will be mostly at the expense of Canada
- Mexico continues to record stronger growth, but dampened by demand for pickups and SUVs (which favors U.S. plants)
Wards-LMC Long-Term Sales Outlook

Sales forecasted to decline in 2019 and 2020, resuming growth in 2021

- U.S. volume, which accounts for over 80% of the region’s demand, is forecast to resume growth in 2021 but with no new record highs – mature market
- Canada expected to remain relatively stable throughout forecast period
- Mexico resumes strong growth in 2021; nearly catch Canada by 2025
- Increased North America capacity for new products, especially for trucks, will spur penetration of domestically built vehicles

Forecast assumes no recession-based or other major disrupting force. Even a mild slowdown – a couple consecutive quarters with slightly negative or flat growth – could cut well over one million units from a given 12-month period
Wards-LMC Long-Term Production Outlook

Production rebounds slightly from 2018 and continues with mild growth, boosted by more capacity for trucks (including CUVs) and local sourcing of products previously shipped from overseas.

- U.S. output rises during the forecast period, including taking a bigger share of the North American footprint
- The North American market’s trend from cars to trucks (including CUVs) will lift truck output from 75% of U.S. output in 2018 to 80% in 2025, with a good chance it goes higher
- The U.S. manufacturing footprint for just fullsize CUVs, pickups, SUVS and vans will increase, too

A downside to the U.S. truck footprint: In a recession or oil shock, the vehicles that get hardest hit are the biggest and least fuel-efficient – fullsize pickups, SUVs and vans